Financial Conduct Authority

Consultation Paper CP13/6**

CRD IV for Investment Firms

July 2013

Contents

Abbreviations used in this document		3
1	Overview	6
2	Application to investment firms	14
3	Capital Requirements Directive:	20
4	Capital Requirements Regulation:	30
5	Definition of 'significant institution'	42
6	Prudential requirements for BIPRU	49
7	Treatment of existing FCA rule waivers under the Regulation	53
Annex		
1	Cost benefit analysis	61
2	Compatibility statement	72
3	List of national discretions and FCA's approach to their application	75
4	List of questions	91
Appendix		
1	Draft Handbook text	95

We are asking for comments on this Consultation Paper by 30 September 2013.

You can send them to us using the form on our website at: www.fca.org.uk/your-fca/documents/consultation-papers/cp13-06-response-form.

Or in writing to:

Raul O. Elias
Policy, Risk and Research Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7066 6528
Email: fca-cp13-06@fca.org.uk

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response 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 Rights Tribunal.

You can download this Consultation Paper from our website: www.fca.org.uk. Or contact our order line for paper copies: 0845 608 2372..

Abbreviations used in this document

ABCP	Asset-Backed Commercial Paper
AIFM	Alternative Investment Fund Manager
AIFMD	Directive 2011/61/EU or Alternative Investment Fund Managers Directive
AMA	Advanced Measurement Approach
AT 1	Alternative Tier 1
Bank	Bank of England
Basel Committee	Basel Committee on Banking Supervision
BCD	Directive 2006/48/EC or Banking Consolidation Directive
BIPRU	Prudential Sourcebook for BIPRU firms
CA	Competent Authority
CAD	Directive 2006/49/EC or Capital Adequacy Directive
CB	Combined Buffer Requirement
CCoB	Capital conservation buffer
CCP	Capital Conservation Plans
CCyB	Countercyclical capital buffer
CEBS	Committee of European Banking Supervisors
CET 1	Common Equity Tier 1
Commission	European Commission
COREP	Common Reporting
CP	Consultation Paper
CPB	Capital Planning Buffers
CPMI	Collective portfolio management investment firm
CRD	Current Capital Requirements Directives consisting of BCD and CAD. References in this CP to current or existing CRD include the amendments introduced by the CRD II and CRD III legislative packages
CRD II	CRD as amended by Directives 2009/111/EC, 2009/27/EC and 2009/83/EC

CRD III	CRD as amended by Directive 2010/76/EU
CRD IV	CRR and the Directive
CRR	Regulation (EU) 575/2013 or Capital Requirements Regulation or the Regulation – which forms part of the CRD IV legislative package
CVA	Credit Valuation Adjustment
Directive	Directive 2013/36/EU – which forms part of the CRD IV legislative package
EBA	European Banking Authority
EE	Expected Exposure
ESRB	European Systemic Risk Board
EU	European Union
FCA	Financial Conduct Authority
FINREP	Financial Reporting
FOR	Fixed Overhead Requirement
FPC	Financial Policy Committee of the Bank
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act
G20	The Group of Twenty (G20) is a forum for international cooperation on economic and financial issues
GENPRU	General Prudential Sourcebook
G-SIIB	Global Systemically Important Institution Buffer
IAA	Internal Assessment Approach
ICG	Individual Capital Guidance
IFPRU	Prudential Sourcebook for Investment Firms
IFRS	International Financial Reporting Standards
ILAS	Individual Liquidity Adequacy Standards
IMM	Internal Model Method

IPRU(INV)	Interim Prudential Sourcebook: Investment Business
IRB	Internal Ratings Based
ITS	Implementing Technical Standards
LGD	Loss Given Default
LLP	Limited Liability Partnership
MDA	Maximum Distributable Amount
MIFID	Directive 2004/39/EC or Markets in Financial Instruments Directive
MS	Member State(s)
O-SIIB	Other Systemically Important Institution Buffer
PD	Probability of Default
PRA	Prudential Regulation Authority
PRIN	Principles for Businesses
RWEA	Risk Weight Exposure Amount
SB	Systemic Buffers
SIIB	Systemically Important Institution Buffer
SME	Small and Medium-Sized Enterprise – as defined in the Commission Recommendation 2003/361/EC
SRB	Systemic Risk Buffer
SUP	Supervision sourcebook
T2	Tier 2
Treasury	Her Majesty's Treasury
UCITS	Undertaking for Collective Investment in Transferable Securities
VaR	Value-at-Risk

1. Overview

Introduction

1.1 The Financial Conduct Authority (FCA) is the competent authority (CA) under the Financial Services and Markets Act (FSMA) for the prudential regulation of a large number of investment firms subject to the Capital Requirements Directive (CRD).

1.2 This Consultation Paper (CP) sets out our proposed changes to the FCA Handbook as a result of the transposition of CRD IV – a major package of reforms to the CRD, the EU's prudential requirements regime for credit institutions and investment firms.

1.3 The Prudential Regulation Authority (PRA) is publishing a separate CP on CRD IV as it applies to its authorised firms.

Who does this consultation affect?

1.4 The proposals in this CP apply principally to the following FCA authorised firms:

- investment firms that are currently subject to the CRD including:
  - firms that benefit from the current exemptions on capital requirements and large exposures for specialist commodities derivatives firms; and
  - firms that only execute orders and/or manage portfolios, without holding client money or assets.
- other firms in the investment sector (exempt-CAD firms, management companies – as defined under the UCITS Directive, Alternative Investment Fund Managers (AIFMs) – as defined under the Alternative Investment Fund Managers Directive (AIFMD)), subject to certain CRD IV provisions (e.g. on 'initial capital' in the Directive, etc.).

1.5 The proposals in this CP do not apply to credit institutions (banks and building societies) or investment firms supervised by the PRA.

Is this of interest to consumers?

1.6 The objectives underlying CRD IV and the proposals in our CP are primarily prudential in nature – i.e. they concern the financial risks run by firms themselves. While there are no direct implications for consumers, the enhancements we expect the CRD IV to bring to the prudential framework should make it less likely that banks and investment firms will fail, thereby improving stability in the financial sector in general. This should have positive implications for consumer protection.

1.7 At the same time we would note that, although it was designed with banks in mind, the CRD also applies to investment firms in the EU. The FCA is the prudential regulator for around 2,400 investment firms under the current CRD – covering a wide range of business models (including broker dealers, wealth managers, corporate finance firms etc.), retail and wholesale, and some large as well as many small and medium sized firms.

1.8 The European Commission's CRD IV impact assessment was prepared in relation to credit institutions and yet CRD IV will apply many new prudential requirements to investment firms under a directly binding Regulation. However, there is a requirement for the Commission to review the appropriateness of the whole prudential regime for all investment firms carrying out activities under Directive 2004/39/EC (Markets in Financial Instruments Directive or MIFID) by the end of 2015.

1.9 Meanwhile, our overall approach is to, generally, do the legal minimum and, where possible, not seek to change current policy as well as exercising any national discretions in a proportionate manner. This should help firms to contain any overall increase in costs without reducing the benefit of protection for consumers.

Context

CRD IV and the FCA objectives

1.10 CRD IV sets out quantitative and qualitative enhancement to the capital adequacy and for the first time quantitative liquidity proposals for credit institutions and investment firms. As such, our proposals in this CP are prudential in nature and support the FCA statutory objective of enhancing the integrity of the UK financial system.

1.11 CRD IV is likely to have an impact on competition in the markets through both increasing investment firms' structural costs and the creation of a single rulebook across the EU. It is important to note that our overall approach towards exercising derogations and discretions – outlined below – is likely in our view to be positive insofar as the least burdensome outcomes are generally being sought. More discussion of the effect of CRD IV on competition is included in Annex 1 (Cost benefit analysis).

CRD IV – Background

1.12 The current EU bank capital framework is represented by Directives 2006/48/EC (Banking Consolidating Directive or BCD) and 2006/49/EC (Capital Adequacy Directive or CAD) (both also known as Capital Requirement Directives or CRD); and it reflects the international agreements of the Basel Committee on Banking Supervision (Basel Committee) for international active banks. In the EU, investment firms subject to the MIFID requirements are also subject to the prudential requirements of the CAD.

1.13 The CRD has been amended on a number of occasions since it was originally adopted, most significantly by CRD II (Directives 2009/111/EC, 2009/27/EC and 2009/83/EC) and CRD III (Directive 2010/76/EU). References in this CP to current CRD include the amendments introduced by the CRD II and CRD III legislative packages.

1.14 CRD IV was presented by the Commission in July 2011. Negotiations on a final text between the Commission, the Council and the European Parliament concluded in March 2013. The final rules have been published in the Official Journal of the European Union on 27 June 2013.

1.15 CRD IV transposes into EU law the Basel III agreement concluded by the Basel Committee in November 2010. Basel III – among other items:

- strengthens bank capital requirements;
- introduces a capital conservation buffer and a macro-prudential countercyclical buffer; and
- foresees a framework for new regulatory regimes on liquidity and leverage, as well as additional capital surcharges for systemically important institutions.

1.16 The FCA is now required to consult in transposing into the FCA Handbook those aspects of CRD IV for which it is responsible in time for the CRD IV implementation date of 1 January 2014.

CRD IV – Structure

1.17 CRD IV is divided into two legislative instruments:

- Regulation (EU) 575/2013 (the Capital Requirements Regulation, CRR or the Regulation) – most of which will be directly applicable and take effect in all Member States without any further action; and
- Directive 2013/36/EU (the Directive) – which Member States must transpose into national law.
- CRD IV also represents the Commission's intention to create a single rulebook for banking. This choice of policy instruments (Regulation) is intended to prevent the transposition from producing diverging national requirements, while providing a degree of flexibility via limited areas of national discretions. CRD IV also replaces the current CRD by unifying the prudential requirements from both BCD and CAD and integrating them into the main bodies of the Regulation and the Directive.

1.18 Broadly, the Regulation and the Directive cover the following items:

Table 1

Regulation (Highly prescriptive, applies directly)	Directive (Less prescriptive, application requires transposition into UK law)
• Own funds and capital requirements including transitional provisions	• Access to taking up/pursuit of business
• Credit, operational, market risks	• Prudential supervision
• Large exposures	• Capital buffers
• Liquidity	• Corporate governance
• Leverage	• Remuneration policies
• Disclosures	• Sanctions

Implementation in the UK

1.19 The FCA is the competent authority for nearly all investment firms under CRD whereas the PRA is responsible for credit institutions as well as a number of investment firms 'designated' for prudential supervision by the PRA. Accordingly, CRD IV will need to be transposed in the UK by both the FCA and the PRA for their respective firms. The FCA and the PRA are cooperating closely in this process.

1.20 This CP sets out our proposals for implementing changes brought about by CRD IV which can be done through the FCA Handbook of rules and guidance under existing FSMA powers. Her Majesty's Treasury (Treasury) intends to publish a separate consultation document in due course for those aspects of the Directive and the CRR that require either new, or amendments to existing, legislation in a number of areas to enable the FCA to operate provisions in CRD IV effectively. Where relevant we will take account of the Treasury's developing work on implementation of CRD IV in deciding how to finalise our own rules.

FCA's overall approach to CRD IV transposition

1.21 When formulating our proposals for CRD IV consultation, our approach has been guided by the following principles:

- 'legal minimum': to ensure that our CP delivers the minimum Handbook rules and guidance that FCA must put in place for the UK to discharge its legal duty to transpose CRD IV;
- 'intelligent or even strict copy-out': to avoid placing any additional burdens upon firms;
- 'pragmatic and proportionate': in general and in respect to current standards, using the more favourable, or least unfavourable, treatment for firms available under national discretions and relief under transitional provisions – where allowed by CRD IV and in accordance with the FCA's objectives;
- 'minimise the need for changes' (including systems): and hence minimise the (non-capital) costs for firms[1]; and

1 More details of the impact of our proposals can be found at:(i) for consumers under the section headed 'Is this of interest to consumers' in chapter 1; and (ii) on competition in Annex 1.

- 'forward looking': we are mindful that CRD IV requires the EU Commission to undertake, by the end of 2015, a review of what should be an appropriate prudential regime for investment sector firms. Hence, it provides a suitable opportunity to seek to address any fundamental issues for such firms arising from CRD IV, which was designed more with banks in mind.

Key implications

1.22 This approach has the following key implications:

- this CP includes only the Handbook changes required to transpose the Directive provisions – where it is the responsibility of the FCA – and to exercise certain discretions in the Regulation;
- this CP covers a large number of discretions in the Regulation as well as those parts of the Directive that are allocated, with agreement from HMT, for transposition by the FCA (although policy proposals for the Directive relate to new or changed provisions only);
- the consultation period is two months, to be followed by a Policy Statement and final rules later in 2013 to give firms sight of the final rules before 1 January 2014;
- we carry forward the substance of existing rules as far as possible given the CRD IV and the FCA objectives;
- where possible, we seek ways to reduce the impact of the need for permissions to use certain treatments to be granted by the FCA on a 'case by case' basis, for example by making a general rule allowing a particular treatment or giving guidance on what will be acceptable (to the extent not prevented by the CRR text); and
- the use of rules to exercise national discretions is an approach subject to agreement by the Treasury. Therefore, depending upon the subsequent legal mechanism chosen by the Treasury to achieve transposition, we may need to consult further on some these items later in 2013.

1.23 As a consequence:

Our CP will cover our proposals on Handbook Rules and Guidance on:

- national discretions and derogations in the CRR and the Directive;
- new requirements, and changes to existing requirements, in the Directive; and
- existing requirements in the Directive that are 'carried across'.

However, our CP will not include:

- new, changed and existing requirements now in the CRR (which are directly applicable unless there is a national derogation, choice or action); and
- any other policy changes not essential to meet our legal obligations to transpose CRD IV.

1.24 As a result, the set of rules and guidance applicable to our firms subject to CRD will consist of:

- the Regulation (where most of the rules will now be located);
- supplemented by technical standards and guidelines from the European Banking Authority (EBA); and
- FCA Handbook rules and guidance (with derogations for some types of firms): the FCA will adopt a new Prudential Sourcebook for Investment Firms (IFPRU), make changes to Systems and Controls (SYSC) and consequential amendments[2] to the Handbook to ensure consistency with CRD IV.

Q1: Do you agree with our overall approach to CRD IV transposition outlined in this section pending the Commission's review of the prudential regime for investment sector firms by the end of 2015? If not, please explain why not and what alternative you would suggest.

Pre-consultation with the industry

1.25 We had pre-consultation discussions with industry through conferences, meetings with trade associations, our Industry Standing Group on Prudential Issues for firms that deal on own account and the Smaller Businesses Practitioner Panel. All of them indicated support for our overall approach to CRD IV transposition. In particular, this extends to a consultation period of two months with the aim of providing final rules as early as possible later in 2013 to facilitate implementation by firms.

1.26 For most of the CRR we are not able to make our own rules and so there is no consultation. However, we will continue engaging with the industry to see if it is possible to help firms by producing non-CP communications on specific areas of CRD IV, while being careful not to interpret the CRR legal text.

2 To be consulted later in 2013 (see paragraph 1.35).

Summary of our proposals

1.27 Table 2 sets out the key issues you can find in each chapter of this CP:

Table 2

Chapter	Key content
Chapter 2	• Overall outcome of CRD IV for investment sector firms and how key provisions in the CRR and the Directive apply to each type of firms. • Key implications of the framework for Common Reporting (COREP) and Financial Reporting (FINREP).
Chapter 3	Our proposals and key messages on: • Pillar 2; • capital buffers; • recovery and resolution plans; • stress testing; • key policy changes in the area of remuneration; and • country-by-country disclosure of corporate information.
Chapter 4	Our proposals and key messages on: • Liquidity reporting; • Transitional provisions on capital; • Partnership capital; • Large exposures; • Leverage; • Recognised exchanges; • Discretions in relation to COREP and FINREP; • Simplified credit risk calculation; and • Exposures secured by mortgages on commercial real estate property.
Chapter 5	• Our proposal for a single, consistent definition of 'significant institution' for use in a number of different provisions scattered across CRD IV.
Chapter 6	• Our proposal on prudential requirements for certain firms that only execute orders and/or manage portfolios, without holding client money or assets; and • Changes for certain 'exempt-CAD firms' that might now come back within the definition of investment firm.
Chapter 7	• Our proposals in relation to 'grandfathering' existing Handbook waivers over to the CRR regime.
Annexes	• 1: on Cost benefit analysis; and 4: List of national discretions indicating the FCA's approach.

Approach to cost benefit analysis

1.28 The CBA in Annex 1 analyses the overall incremental impact of CRD IV in terms of its effects on firms and markets. As set out in this CP, our proposals do not cover new or changed requirements now in CRR that apply directly as regulations and thus require no transposition through national rules or guidance. However, the impact of these regulations on firms and markets will in many cases be difficult to differentiate from the impacts of changed requirements arising from transposition. Therefore, the CBA considers the impacts of the overall package of CRD IV when assessing costs and benefits, and thus presents analysis of impacts arising from the mainly non-optional changes to regulations.

1.29 The most significant impacts are likely to arise due to new regulations and transposition of the Directive. Incremental costs and benefits arising from 'optional' exercise of national discretions and derogations are likely to be small relative to these other impacts and we may not be able to differentiate them from the overall impact of the Directive.

1.30 Where they are significant, the impacts of such discretions or individual regulatory changes arising from transposition are analysed briefly in the main body of the CP. We anticipate that many of the discretions will have only marginal impacts.

Equality and diversity considerations

1.31 We have assessed the likely equality and diversity impacts of the proposals and our assessment concluded that they do not give rise to any concerns. But we would welcome your comments.

Next steps

What do you need to do next?

1.32 Please send us your comments and/or responses to the questions on our proposals by 30 September 2013 when the consultation will close.

What will we do?

1.33 We will consider your feedback and publish a Policy Statement later in 2013 so firms have the final rules available before 1 January 2014.

1.34 We may need to consult further on issues linked to the Treasury or following subsequent guidelines and/or technical standards from the EBA (to the extent permitted by EU law). For this purpose, we may include in the Policy Statement some of these items for a short consultation.

1.35 Our proposals in this CP will trigger consequential changes to many parts of the FCA Handbook. Most of these are relatively minor, for example, amending cross references between sourcebooks. Although we intend to include part of the consequential changes in this CP, there may be a need to consult on some of them at a later stage either through a quarterly CP or by other means; we will give further information on timing in due course.

2. Application to investment firms

Introduction

2.1 This chapter:

- explains the overall outcome of CRD IV for investment sector firms;
- provides a summary of key derogations in CRR and the Directive by type of firm;
- explains the impact of CRD IV for AIFM and UCITS management companies; and
- reminds firms of the implications of the new Common Reporting (COREP) and Financial Reporting (FINREP) framework.

Overall outcome of CRD IV for investment sector firms

2.2 This CP concerns changes that have been made by CRD IV. There have not been changes in the initial scope, which is determined by MIFID. However, the definition of 'investment firms' in the CRR has been amended, so that there will be specific prudential requirements for different types of investment firms that carry out MIFID investment activities.

2.3 At the same time, it is important to note that CRD IV was designed for banks yet it is also applied to investment firms in the EU. This means that the overall outcome of CRD IV for investment firms results in placing more requirements on investment firms.

2.4 However, this is mitigated through a combination of provisions – either derogations or national discretions – that effectively dis-apply certain requirements in the CRR and/or in the Directive for different types of investment firms. In line with our overall approach to CRD IV transposition, our proposals have made use of discretions – where allowed – and in accordance with the FCA's own objectives.

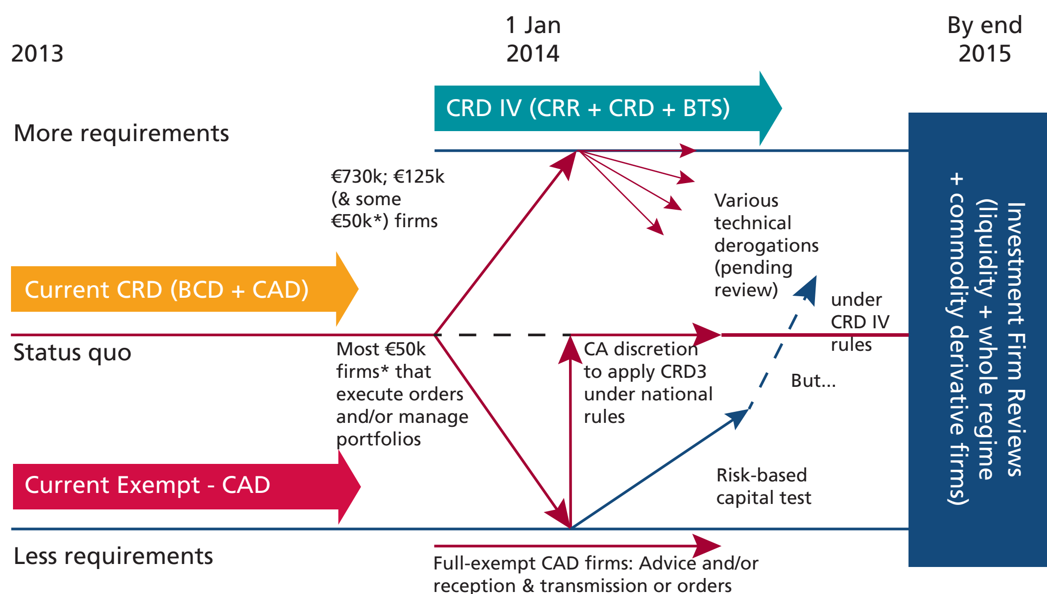
2.5 The Commission is required to review the appropriateness of the whole prudential regime for all firms[3] carrying out investment activities under MIFID (including local firms, specialist commodities firms, other firms exempted from the definition of 'investment firm' in article 4.1(2)(c) of the CRR) by the end of 2015. We therefore wish to minimise changes in the meantime and focus policy efforts upon this review to secure an appropriate EU-wide solution that caters for all the different types of investment sector firms.

2.6 The following diagram seeks to illustrate, in a simple way, the overall outcome of CRD IV for our population of investment sector firms:

3 Other than credit institutions.

Figure 1: CRD IV – Overall outcome for investment firms

(Illustrative only - simplified and not intended to show relative impacts; EU text and FCA consultation proposals must be read for actual requirements that may apply)



*Note: actual situation will depend upon precise investment services and activities consucted under MiFID
Full implementation of all of CRD IV (& expiry of transitional provisions) by January 2019

Summary of key derogations in the CRR and in the Directive by type of firm

2.7 This section provides details of key derogations in the CRR and in the Directive by type of firms.

2.8 At present, the different categories of firms subject to CRD are set out in BIPRU 1.1 with further guidance on the categorisation of investment firms in Chapter 13 of the Perimeter Guidance. In this section, the relevant firms are: 'full scope BIPRU investment firm', 'BIPRU limited activity firm', and 'BIPRU limited licence firm'.

2.9 As outlined in Chapter 1, under CRD IV we are creating a new 'Prudential Sourcebook for Investment Firms' (IFPRU), but we have minimised as much as possible changes to the names of the prudential categories (e.g. we have kept the structure replacing 'BIPRU' with 'IFPRU') in line with our overall approach. We have also created a new prudential category called 'BIPRU firms' for certain firms that only execute orders and/or manage portfolios, without holding client money or assets (see Chapter 6).

2.10 Table 3 shows:

- the prudential categories for:
  - investment firms subject to CRD IV (using the newly proposed term 'IFPRU investment firm'); and
  - firms subject to existing transposition of CRD (using the revised proposed term 'BIPRU firm')

  (for the definitions of the new prudential categories, please see the Glossary in Appendix 1); and

- under each category, the key derogations in the Regulation and the Directive that apply / dis-apply requirements on specific types of investment firms – it does not include general provisions that apply to all types of investment firms.

Table 3: Key derogations in the CRR and in the Directive by type of firm

Prudential			
Category	**Sub-category**	**CRR/Directive key derogations**	**Proposed FCA Handbook 1 January 2014**
IFPRU investment firm	Full scope IFPRU investment firm	• CRR article 6(4) – firm must comply with liquidity regime, but CA may exempt it pending the outcome of the Commission's review by the end of 2015, subject to the restricted scope proposed in Chapter 4 of this CP. • CRR article 11(3-4) – pending the Commission's review and if the group comprises only investment firms, CAs may exempt them from compliance with the obligations laid down in Part Six on liquidity on a consolidated basis, taking into account the nature, scale and complexity of the investment firm's activities. • Directive articles 130(2) and 129(2): Member States may exempt small and medium sized (SME) investment firms from the Capital Conservation buffer (CCoB) and the Countercyclical capital buffer (CCyB).	IFPRU
IFPRU investment firm	IFPRU limited activity firm	• As Full scope IFPRU investment firm and in addition: • CRR article 6(5) excludes this category from the leverage requirements on an individual basis. • CRR article 15 – CA may waive application of own funds requirements on a consolidated basis. • CRR article 16 – if all entities in a group of investment firms are exempt from leverage ratio on an individual basis (6(5)), the parent investment firm may choose not to apply leverage provisions on a consolidated basis. • CRR article 388 states that large exposures do not apply to limited activity firms.	IFPRU

Table 3: Key derogations in the CRR and in the Directive by type of firm

Prudential			
Category	**Sub-category**	**CRR/Directive key derogations**	**Proposed FCA Handbook 1 January 2014**
IFPRU investment firm	IFPRU limited licence firm	• As IFPRU limited activity firm and in addition: • CRR article 6(4) excludes these firms from the liquidity provisions. • Directive article 128 exempts these firms from the capital buffers. • Directive article 51(1)(1) excludes these firms from the regime for designation of significant branches.	IFPRU
Exempt IFPRU commodities firm		• CRR article 498 excludes from the provisions on own funds requirements those firms whose main business consists exclusively of providing investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9 and 10 [commodities derivatives] of Section C of Annex I to Directive 2004/39/EC and to whom Directive 93/22/EEC did not apply on 31 December 2006. This exemption shall apply until 31 December 2017 or the date of entry into force of any modifications, as a result of the Commission's review by the end of 2015. • CRR 493 exempts the large exposure provisions in the CRR to these firms. This exemption is available until 31 December 2017 or the date of entry into force of any modifications as a result of the Commission's review.	IFPRU; IPRU(INV) – (firms need to check the relevant application provisions in the relevant sourcebooks)
BIPRU firm		• CRD IV requires them to apply the 'higher of' requirements in the CRR article 92(3) except for operational risk or the Fixed Overhead Requirement (FOR) and to meet the requirements in the CRR articles 92(1) on own funds and (2) on calculation of capital ratios. • However, CRR article 95(2) allows CA to keep such firms on the current CRD, as it stood under national law (i.e. BIPRU and GENPRU) on 31 December 2013. This would include the current (less onerous) definition of own funds, our simplified approach to calculating credit risk and reporting under GABRIEL (not COREP). • More details on BIPRU firms in Chapter 6 of this CP.	Amended GENPRU / BIPRU / SYSC as of 31 December 2013
Exempt-CAD firm		• Exempt-CAD firms should refer to paragraphs 6.17 and 6.18 in Chapter 6 of this CP.	IPRU(INV) / IFPRU

Collective portfolio management investment firms (CPMI)

2.11 Management companies (as defined under the UCITS Directive) and AIFMs (as defined under the AIFMD) (together CPMI) must meet requirements on initial capital, own funds and fixed overheads. These terms are currently defined by reference to CAD.

2.12 However, CAD will be replaced by CRD IV, therefore the new definitions from CRD IV will apply from 1 January 2014. These can be found at:

- 'initial capital' in article 4(51) of the Regulation;
- 'own funds' in article 4(118) of the Regulation (supplemented by an EBA technical standard); and
- 'fixed overheads' requirement in article 97 of the Regulation (supplemented by an EBA technical standard).

2.13 It is important to note that the draft legal instruments in the Appendix to this CP only contains provisions as a result of the CRD IV, therefore other changes driven by the AIFMD – e.g. the above consequential changes to the FCA Handbook – will be consulted on separately.

Implications of the new framework on Common Reporting (COREP) and Financial Reporting (FINREP)

2.14 Article 99 of the CRR brings in a new EU-wide supervisory reporting framework for Financial Reporting (FINREP) and Common Reporting (COREP) that applies to IFPRU investment firms. COREP covers capital requirements, own funds and liquidity reporting whereas FINREP covers consolidated financial reporting for supervisory purposes based on International Financial Reporting Standards. The introduction of COREP and FINREP will change how IFPRU investment firms report prudential supervisory information to the FCA. COREP will apply from 1 January 2014, whereas FINREP will apply from 1 July 2014.

2.15 Article 99(5) of the CRR requires the European Banking Authority to devise Implementing Technical Standards (ITS) on supervisory reporting. These Standards contain the scope and detail on what IFPRU investment firms will have to report under COREP and FINREP including the reporting templates. The final draft ITS on supervisory reporting was published by the EBA on 26 July 2013 and it is available on the EBA website.

2.16 The Regulation and the Directive include, in other articles, further reporting obligations on IFPRU firms. Most of these reporting obligations are captured by COREP templates (for example, CRR article 100 reporting on repurchase agreements and securities lending) but some are not (for example, Pillar 2 reporting). We will request non-COREP/FINREP supervisory information (e.g. Pillar 2) through submission of FSA0xx templates.

2.17 All IFPRU investment firms will have to complete COREP templates but conceivably not all IFPRU investment firms will have to complete FINREP templates for consolidated financial reporting. IFPRU investment firms will need to refer to Article 99 of the CRR and the ITS on reporting to establish whether they are subject to FINREP, and which COREP and FINREP reporting templates apply to them. (See also Chapter 4 under the heading 'Liquidity reporting'). Firms that do not have to complete FINREP templates will have to submit the FSA001 and FSA002 templates. Furthermore, firms that complete FINREP templates for consolidated reporting will also have to complete FSA001 and FSA002 for solo reporting.

2.18 We will cover in the Policy Statement/Consultation paper in the Autumn further detail on non-COREP supervisory information, and how SUP 16.12 of the FCA Handbook on supervisory reporting will be restructured as a result of the introduction of COREP/FINREP and the ITS on reporting.

2.19 It is important to note that:

- reporting for BIPRU firms is covered in Chapter 6; and
- exempt IFPRU commodities firms will continue to report using FSA reporting templates.

3. Capital Requirements Directive: Key proposals

Introduction

3.1 This chapter:

- sets out our proposals in relation to Pillar 2 and capital buffers;
- explains the requirement on recovery and resolution plans;
- describes our proposals on stress testing;
- outlines the key policy changes in the area of remuneration;
- explains the country-by-country disclosure of corporate information requirement; and
- explains our approach to other technical amendments in the Directive.

3.2 The Directive also contains a small number of areas of national discretions which are listed in Annex 3 including the FCA's approach towards their application.

Approach to Pillar 2

3.3 The Directive requires a firm to assess and to maintain on an on-going basis the amounts, types and distribution of internal capital that it considers adequate to cover the nature and level of the risks to which it is or might be exposed. The FCA is then required to review and evaluate this assessment by the firm. If necessary, additional own funds may be needed on top of the minimum level of own funds set by the CRR. Together, these are known as 'Pillar 2'.

3.4 The following mapping of the key provisions shows that Pillar 2 has remained largely the same as the current CRD:

Table 4

Implementation of current CRD in the FCA Handbook	The Directive
Adequacy of financial resources requirement (GENPRU 1.2)	Internal capital (Articles 73, 79 - 87)
Internal capital adequacy standards (BIPRU 2.2)	Level of application of internal capital adequacy assessment process (Article 108)
Internal capital adequacy standards (BIPRU 2.2)	Supervisory review and evaluation (Article 97)

3.5 We propose that the current GENPRU material on adequacy of financial resources and the current BIPRU material on internal capital adequacy standards will be retained and copied across to IFPRU with some adjustments to improve clarity and to remove possible duplications. No substantive changes are proposed to this longstanding policy, which is mostly written as guidance. We will, however, consider alternative approaches to Pillar 2 as part of our overall preparations for the review of an appropriate prudential regime for the investment firm sector, which the EU Commission is required to undertake by end 2015.

3.6 Any Individual Capital Guidance (ICG) given to firms will therefore continue to be the sum of the minimum own funds requirements (‘Pillar 1’) and the additional own funds requirement under Pillar 2 (previously named ‘Pillar 2A’).

> **Q2: Given there are no proposed substantive changes to the existing Pillar 2 regime do you agree that existing GENPRU and BIPRU Pillar 2 guidance should be copied across to IFPRU? If not, please explain why not, including alternative approaches and the rationale for those approaches.**

Capital buffers

Capital Conservation and Countercyclical Buffers

3.7 The Directive introduces capital buffers as a response to the financial crisis, both to provide a greater ‘cushion’ to absorb losses and to help address the pro-cyclical mechanisms that contributed to its origins and aggravated its effect. There are up to five possible different capital buffers, which together make up the Combined Buffer (CB) requirement; this must then be met by holding Common Equity Tier 1 (CET 1) capital.

3.8 Two of these buffers are: (i) the Capital Conservation Buffer (CCoB), which is a fixed amount to provide a ‘cushion’, and (ii) the Countercyclical Buffer (CCyB), which is variable (and can be zero where no specific amount is set). This aims to ensure that firms accumulate capital during periods of economic growth that can then be released during less favourable conditions. These two buffers apply – on an institution, sub-consolidated and consolidated level – to all investment firms that have permission to deal on their own account, and/or underwrite financial instruments and/or placing of financial instruments on a firm commitment basis.[4] There is an exemption from both the CCoB and CCyB for limited licence firms caught by the CRD IV.[5]

4 MIFID – Directive 2004/39/EC Annex 1 Section A points 3 and 6.

5 Directive, article 128.

3.9 There are also two national discretions whereby a designated UK authority may grant an exemption to (some or all) Small and Medium Sized Enterprises (SMEs) from the CCoB and/or the CCyB, on the basis that the firms concerned do not pose a risk to the financial stability of the UK. The Treasury has not yet proposed which UK authority or authorities would be designated with the power to determine these two exemptions. However, if the FCA was to be made the designated authority then based on our analysis on the definition of significance (see Chapter 5), we would be minded to propose that we exercise these discretions. Whereas, if the FCA is not the designated authority for these two discretions, then we would propose to make our views known to the relevant body that is.

3.10 The CCoB rate is fixed. It will eventually be 2.5% multiplied by total risk exposures (see CRR article 92(3)), subject to a five year transition period shown below:

Table 5: Minimum CCoB rate during five year transition timetable

Year	2014	2015	2016	2017	2018	2019
Rate	0%	0%	0.625%	1.25%	1.875%	2.5%

3.11 There is a further national discretion that provides the Member State with the ability to accelerate the five year transitional timetable. The Treasury has yet to determine who will make the decision on this discretion. If the FCA is able to make the decision for the investment firms it prudentially regulates, then we would be minded not to propose accelerating the five year transition timetable (especially in light of the requirement on the EU Commission to review what is an appropriate prudential regime for all investment sector firms by end 2015).

3.12 The CCyB is set by a UK designated authority to be determined by the Treasury; this is likely to be the macro-prudential authority (i.e. the Bank of England (Bank) or the Financial Policy Committee of the Bank (FPC)). The CCyB captures excess credit growth and is calibrated using measures such as the deviation from long term trends in the ratio of credit to GDP and other relevant factors for addressing cyclical systemic risk.

3.13 The CCyB rate may be set up to 2.5%, in 0.25% increments, with the right in certain circumstances to exceed 2.5%. The European Systemic Risk Board (ESRB) may issue further guidance on the setting of countercyclical buffers. Only once the Treasury has confirmed arrangements for the UK macro-prudential authority designated with the responsibility for setting a CCyB rate for the UK will requirements for this buffer be clearer, including the national discretion to allow the maximum rate (see table 6 below) to be exceeded during the transitional period to 2019:

Table 6: Maximum CCyB rate during five year transition timetable

Year	2014	2015	2016	2017	2018	2019
Rate	0%	0%	0.625%	1.25%	1.875%	2.5%

Q3: Do you agree with our initial view that, if possible and depending upon the decisions of the Treasury regarding the designated authorities, the discretions to exempt SME investment firms from the capital conservation buffer and the countercyclical buffer should be exercised? If not, please explain why not.

Q4: Do you agree with our initial view that, in light of the review by the EU Commission on the prudential regime for all investment sector firms required by end 2015, that the discretion to accelerate the five year transition timetables for the capital conservation buffer and the countercyclical buffer should not be exercised by whoever is the designated responsible authority? If not, please explain why not including alternative transition approaches and the rationale for those approaches.

Systemic buffers

3.14 The other three buffers that make up the Combined Buffer (CB) are designed to address systemic risks. These are:

- the Globally Systemically Important Institutions Buffer (G-SIIB);
- the Other Systemically Important Institutions Buffer (O-SIIB); and
- the Systemic Risk Buffer (SRB).

3.15 These three buffers also only apply to investment firms that have permission to deal on their own account, and/or underwrite financial instruments and/or placing of financial instruments on a firm commitment basis.

3.16 The G-SIIB and the O-SIIB (Article 131 of the Directive) are institution specific buffers. Unlike with the CCoB and CCyB, there is no explicit discretion to exempt investment firms that are SMEs, but this should not be necessary in practice. Indeed given the very nature of these buffers, we would expect only PRA regulated firms or groups to be deemed systemic on a global basis and hence subject to the G-SIIB, and probably the same on a domestic level as regards the O-SIIB. However, as noted below, it is not yet possible to provide greater clarity on this.

3.17 The SRB is intended to prevent and to mitigate long term non-cyclical systemic or macro-prudential risks not covered by the CRR. It specifically addresses the risk of disruption to the financial system and the potential for serious negative consequences to the UK real economy. The SRB (Article 133 of the Directive) is not decided on an individual firm basis, but rather is to be applied either to the whole financial sector, or one or more sub-sets of it.

3.18 CRD IV provides some parameters on how the above three systemic buffers interact (e.g. solo, sub-consolidation and consolidation), how the result should be used with the other buffers (i.e. CCoB and CCyB) to determine the total CB, and the quality of the capital required to be held against this. However, considerable amounts of detail remain outstanding (e.g. scope, buffer rate and which UK (and EU) authorities will be designated responsibility for setting them). Once this has been decided, we will provide further information on how we believe the buffers will work, including consultation on any rules that the FCA may be required to make to fulfil its legal responsibilities in this area.

Capital Conservation Plans (CCP) and Maximum Distributable Amount (MDA)

3.19 Where a firm fails to meet its CB (i.e. when the level of CET 1 capital maintained by the firm that is not used to meet Pillar 1 and any Pillar 2A is insufficient), there are restrictions on the amount of distributions (i.e. dividends, repayment of capital etc.) it will be able to make. These restrictions are set out in the Directive, including the calculation of the Maximum Distributable Amount (MDA). A firm must notify the FCA of its MDA within five working days and is prohibited from creating certain obligations, and making certain payments and distributions before it has calculated its MDA. Firms intending to create such obligations or make such payments or distributions will be required to provide the relevant information and three months' notice to the FCA. This notice period is deemed reasonable given the type of obligations, payment and distributions being constrained as they are typically subject to several months' consideration as strategic rather than tactical business decisions. This notice period is intended to give the FCA sufficient time to give due consideration to whether the proposed payment or distribution pose risks to one of more of its operational objectives. The FCA may in certain circumstances agree to a shorter notice period.

3.20 If the CB is, or is expected, not to be met, firms will be required to agree a Capital Conservation Plan (CCP) with the FCA, which shall include restrictions on distributions (within the MDA) based on the extent of the CB shortfall. Firms that fail to meet the CB must submit a CCP to the FCA within five working days, unless the FCA extends this to up to ten working days.

3.21 The MDA calculation methodology will be copied out from the Directive into IFPRU. If the CCP does not advance one or more of the FCA's operational objectives, the FCA may require the firm to increase its own funds to specified levels within specified periods and/or to further limit distributions than those contemplated under the MDA where necessary.

3.22 The CCP submission timetable is set by the Directive. The five working day MDA notification and three month notification for creating certain obligations or making certain payments or distributions are policy proposals by the FCA.

> **Q5: Do you agree that the calculation of the Maximum Distributable Amount (MDA) should be submitted to the FCA within five working days? If not, please explain why not and propose alternative notice periods and the rationale for those notice periods.**

> **Q6: Do you agree that where the firm fails to meet the Combined Buffer (CB) and has a Maximum Distributable Amount (MDA) in place, that firms must give a minimum of three months' notice to create obligations or make payments or distributions that would otherwise be prohibited because of the requirement to have an MDA? If not, please explain why not and propose alternative approaches and the rationale for those approaches.**

Planning buffers

3.23 Our current 'capital buffer' regime under BIPRU is the Capital Planning Buffer (CPB). The CPB is currently added to a firm's Individual Capital Guidance (ICG), which is the sum of the Pillar 1 and Pillar 2A requirements.

3.24 At this stage it is still unclear how the various component buffers in the Directive will form part of a firm's CB that will be implemented by the designated authority. This means that it is not yet possible to accurately map the CPB to the new capital buffer regime. Until the mapping can be completed, the current CPB will be added to the Pillar 2A charge.

3.25 Therefore, firms should maintain their existing CPB, which (to the extent it is held in CET 1) can be used to meet the CCoB or CCyB. It would not be prudent to 'release' CPB amounts until the precise details and impact of the new capital buffers regime is known (especially if firms were then required to re-capitalise such amounts once CRD IV is fully implemented). Firms should plan both for any absolute increases in own funds as a consequence of the new capital buffer regime as well as changes in the mix of own funds in particular where the quality of capital is being increased (i.e. capital buffers must be held in CET 1).

3.26 In due course we will provide further details, and consult as necessary, on our future policy for the current CPB in the light of the new buffer regime in the Directive. We are mindful of the potential risk of double counting should the CPB and the new capital buffers cover the same risk with the same quality of capital. This will be given due consideration as part of our further work including during the transitional period.

> **Q7: Until such point as we are able to consult further on our future policy, do you agree that the CPB should be maintained and added to the Pillar 2A charge to the extent that there is no identifiable double counting? If not, please explain why not including alternative transition approaches and the rationale for those approaches.**

Recovery and resolution plans

3.27 Article 74(4) of the Directive sets out the requirements in relation to recovery and resolution plans as follows:

- Firms must prepare, maintain and update recovery plans for the restoration of their financial situation following a significant deterioration; and
- Firms must cooperate closely with the resolution authorities providing them with all the necessary information, so the resolution authorities can prepare and draft the resolution plans setting out options for the orderly resolution of the firms in the case of failure.

3.28 The extent of the requirements may be reduced by the CA if, after consulting the national macro-prudential authority, it considers that the failure of a specific institution 'due to its size, to its business model, to its interconnectedness to other institutions, or to the financial system in general, will not have a negative effect on financial markets, on other institutions or on funding conditions'. We are minded to apply this discretion based on proportionality, but we are not consulting on this item at this stage since we need to work further with the macro-prudential authority on a suitable and consistent approach.

Stress testing

3.29 Article 100 of the Directive includes a requirement to carry out stress tests at least annually to facilitate the review and evaluation process under Article 97. It is expected that the EBA will issue guidelines in this area setting up common methodologies to be used when conducting annual supervisory stress tests.

3.30 Until such EBA guidelines are in place and in line with our overall approach to CRD IV transposition, we propose that all FCA investment firms subject to CRD IV should carry out – at least annually – stress tests that are appropriate to the nature, size and complexity of the firm's business and of the risks it bears. In particular, we propose that:

- Firms that are 'significant' (see Chapter 5 on the definition of 'significant' institution) should carry out a comprehensive stress and scenario analyses (as in current GENPRU 1.2.42R) and reverse stress testing (as in current SYSC 20.2). These firms should report the results of the stress tests to the FCA annually;

- Other firms (those that are not 'significant' as per the definition) should only carry out reverse stress testing. These firms do not need to report the stress tests results unless required by the FCA.

3.31 A common feature of these proposals is the requirement to produce 'reverse stress testing'. In our view, this would allow a firm to focus on what can put an investment firm out of business, how quickly this can happen and how an exit from the market can be achieved in an orderly manner. We would expect a firm's senior management to routinely assess such threats to its business. Implementing the reverse stress testing requirement would also assist firms with the requirement under article 74(4) in the Directive on recovery and resolution plans (see heading 'Recovery and Resolution plans' in this chapter).

3.32 In our view, this represents a proportionate approach by carrying forward a suitable type of stress test (i.e. 'reverse stress testing') and by requiring annual reports on results from 'significant' firms.

Q8: Do you agree with our proposed approach on stress testing and to report results annually in the case of those firms that are 'significant' pending the EBA guidelines on this matter? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

Remuneration

Introduction

3.33 CRD IV reproduces to a large extent the remuneration provisions introduced by CRD III. The relevant provisions can be found in articles 74, 92 – 95 and 161 (in addition to recitals 62–69 and 83) in the Directive; and in article 450 on disclosure in the Regulation.

3.34 It is important to note that the remuneration rules under CRD III were already subject to the principle of proportionality that is currently being applied through our framework for investment firms and in particular in relation to rules regarding retained shares, deferral and performance adjustment (reflecting current BCD and previous CEBS Guidelines). The principle of proportionality continues to be an important part of the remuneration framework in the Directive which means the application of certain remuneration requirements may vary in relation to certain types of investment firms based on 'their size, internal organisation and the nature, the scope and the complexity of their activities' (Directive article 92(2)).

Proposals on remuneration provisions carried across from CRD III

3.35 We intend to transpose the Directive articles that carry across provisions on remuneration from CRD III into SYSC 19: The Remuneration Code and the General Guidance on Proportionality – where appropriate.

New CRD IV requirements on remuneration

3.36 CRD IV also contains a small number of new requirements and policy changes for remuneration, notably:

- the limits on bonuses ('bonus caps');
- areas of national discretion related to bonus caps; and
- the possible use of the principle of proportionality in relation to bonus caps.

3.37 The CRD IV regime will be supplemented by the guidelines and technical standards to be issued by the EBA. These would cover:

- guidelines on sound remuneration policies;
- regulatory technical standards (by 31 March 2014) setting out criteria to identify categories of staff whose professional activities have a material impact on the institutions risk profile and therefore are subject to the remuneration provisions[6]; and
- further guidelines and technical standards referred to under each subject below.

3.38 We set out below the key features of these CRD IV policy changes.

Limits on bonuses

3.39 The most significant policy changes on remuneration in CRD IV are the 'hard' limits to the variable component (bonus caps) in article 94(1)(g) of the Directive. These are:

- A basic ratio of 1:1 which can only be increased to 1:2 with shareholder approval (with a quorum of 50% of shareholders, 66% of votes in favour would be required; and, if that quorum is not reached, 75% of votes in favour) guidelines on sound remuneration policies; and
- A maximum of 25% of the total variable remuneration (where it consists of long term financial instruments) may be discounted with reference to factors reflecting risk inherent in the instruments. The EBA is tasked to issue guidelines by 31 March 2014 on the applicable notional discount rate taking into account all relevant factors such as inflation rate and risk, which includes length of deferral. The EBA guidelines will also need to consider how to incentivise the use of instruments which are deferred for a period of not less than 5 years.

Areas of national discretion

3.40 However, the Directive also includes the following areas of national discretion where Member States (and the CA in the case of the last discretion) may:

- lower the upper limit set for bonuses;

6 EBA issued a 'Consultation on draft Technical Standards for the definition of material risk takers for remuneration purposes' on 21 May 2013 (available at the EBA website: www.eba.europa.eu/-/consultation-on-draft-technical-standards-for-the-definition-of-material-risk-takers-for-remuneration-purposes).

- allow firms to apply the discount rate referred to in article 94(1)(g)(iii) to a maximum of 25% of total variable remuneration provided it is paid in instruments deferred for a period of not less than five years; and lower the maximum percentage; and
- place restrictions or prohibit certain types of deferred instruments. The EBA is expected to issue regulatory technical standards by 31 March 2014 regarding specifying the types of instruments appropriate to be used for paying variable remuneration.

Our approach to CRD IV policy changes on remuneration

3.41 This CP does not consult on the new policy changes on remuneration incorporated by CRD IV in the Directive – i.e. limits on bonuses, national discretions and the possible use of proportionality in connection with bonus caps. We are considering with the Treasury how to take these issues forward, including in the context of responding to the Final Report of the Parliamentary Commission on Banking Standards[7]. Therefore, we may need to consult on these items later in 2013.

Country-by-country disclosure of corporate information

3.42 Article 89 of the Directive states that Member States shall require that firms disclose annually, on a consolidated basis, information broadly about their corporate identity, turnover and numbers of employees. This information is to be disclosed from 1 July 2014.

3.43 This CP does not consult on this disclosure requirement because it is expected to be transposed by the Treasury as part of their consultation later in 2013.

Technical amendments

3.44 The Directive also contains a number of provisions that

- recast existing EU requirements (which are currently transposed in the FCA Handbook) with no or limited change of substance; and
- contain new requirements with limited policy change.

We intend to transpose them into our Handbook in line with our overall approach to CRD IV transposition. Since these requirements involve no or limited policy change, we expect them to incur minimal or no costs to firms.

3.45 Table 7 shows these areas:

7 The Parliamentary Commission on Banking Standards' Final Report: 'Changing banking for good' is available at www.parliament.uk/business/committees/committees-a-z/joint-select/professional-standards-in-the-banking-industry/news/changing-banking-for-good-report/.

Table 7: Technical amendments in the Directive

Directive Art.	Area	Impact of the changes
28 to 31	Initial capital for investment firms and other firms that carry out certain MIFID activities	No impact due to no substantive change.
71(3)	A firm must have in place appropriate procedures for its employees to report breaches internally through a specific, independent and autonomous channel. (The transposition of this provision is subject to agreement with the Treasury, so depending upon the subsequent legal mechanism chosen by the Treasury for that purpose, we may need to consult further later in 2013).	No impact due to no substantive change.
74 to 88 / 90 to 96	Changes in governance aimed at increasing the effectiveness of risk oversight by Boards, improving the status of the risk management function and ensuring effective monitoring by supervisors of risk governance. For example: Directive requirements relating to management bodies include: • The management body must commit sufficient time and possess adequate knowledge, skills and experience to be able to understand the business of the firm and its main risk exposures. Limits are placed on the number of directorships and non-executive directorships a member of the management body can hold. • All members of the management body should be of sufficiently good repute, possess sufficient knowledge, skills and experience and commit sufficient time to perform their duties and functions as specified by the Directive. • The roles of chairman and chief executive should not be combined, unless justified by the firm and authorised by the regulator. • Firms that are significant must establish a nomination committee of non-executive directors. The nomination committee will have various duties regarding the composition and functioning of the management body individually and collectively, including selection planning and the qualities, competences and other factors to be taken into account when identifying and recommending candidates; and deciding on a target for the representation of the underrepresented gender on the management body and how to meet it. Directive requirements relating to risk management arrangements include: • The management body has overall responsibility for the firm's overall risk strategy and for the adequacy of the firm's risk management system. • The management body in its supervisory function must establish a separate risk committee to deal specifically with risk issues. The risk committee should assist the management body in its risk oversight role but the management body will remain ultimately accountable for the firm's risk strategy. Firms that are not significant may, with supervisory approval, combine their risk and audit committees, provided members of the combined committee have the relevant knowledge, skills and expertise for both. • Firms must have an independent risk management function, where this is proportionate, depending on the nature, scale and complexity of its business. The function is responsible for assessing all material risks, with direct access to the management body. It is also to be involved in elaborating the firm's risk strategy and in all material risk management decisions.	Most of these items are already covered in SYSC while the proportionate nature of most of them is likely to have minimal impact for firms (see Chapter 5 on definition of 'significant' firm).

4. Capital Requirements Regulation: Key proposals

Introduction

4.1 This chapter highlights some of the key areas of national discretion in the Regulation, and explains the proposed FCA approach to these discretions:

- the implementation of CRD IV liquidity reporting for a small number of firms;
- changes to the definition and structure of capital including the transitional provisions on capital;
- partnership capital;
- internal models;
- large exposures;
- leverage;
- financial reporting;
- simplified credit risk calculation; and
- exposures secured by mortgages on commercial real estate property.

4.2 Particular focus is centred on new national discretions and areas where the FCA proposes to change its approach from the current one.

> We will not be making rules to implement the Regulation, except where permitted as a national discretion, or required as a national implementing measure.
>
> Annex 3 lists the relevant areas of national discretions in the Regulation and the FCA's approach towards their application.

4.3 Please note that the new prudential category of firms created through the use of Article 95(2) of the CRR is discussed in Chapter 6, as it raises issues specific to that category of firms.

Application of liquidity standards and Liquidity reporting

4.4 Article 6(4) of the Regulation requires investment firms which carry out MIFID activities (3) dealing on own account, and (6) underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis, to comply with the liquidity requirements in Part Six of CRR. However, Article 6(4) of the Regulation allows competent authorities to exempt these investment firms from Part Six liquidity requirements, 'taking in to account the nature, scale and complexity of the investment firm's activities.'

4.5 While most solely FCA regulated firms within the UK subject to the CRD IV package are SMEs executing relatively simple investment business, liquidity risk is pertinent in this industry, and the ability to meet liabilities as they fall due is essential in order for a firm to operate as a going concern.

4.6 We perceive the current BIPRU 12 UK liquidity regime (including Individual Liquidity Standards (ILAS)) for a set of large full scope investment firms) to be broadly appropriate and we recognise that firms have invested resources in implementing the UK's liquidity regime within their businesses. Therefore, as permitted under Article 412(5) of the CRR, we intend to maintain the existing domestic liquidity regime until binding minimum standards for liquidity coverage requirements are specified and fully introduced in the CRR in 2015 (when the discretion in Article 412(5) of the Regulation falls away). Accordingly, we intend to include guidance in IFPRU Chapter 7 (Liquidity) referring firms to the BIPRU 12 regime and we do not intend to change the scope of captured FCA firms subject to IFPRU 7.

> **Q9: Do you agree with our proposal to continue the UK's liquidity regime (including ILAS) until binding minimum standards for liquidity coverage requirements are implemented in the CRR in 2015? If not, please explain why not and propose alternative approaches and the rationale for those approaches.**

4.7 However, we note that there are some more complex firms that pose significant prudential risk to financial markets within the solely FCA regulated CRD IV population. Accordingly, we propose to require a small number of firms to be subject to the liquidity standards in the CRR in addition to their compliance with the ILAS regime, taking into account the nature, scale and complexity of the investment firm's activities.

4.8 In keeping with the definition of significant firms outlined in Chapter 5, we intend to apply from 2014 CRD IV liquidity reporting (and from 2015 binding liquidity requirements) to those firms that meet this definition and also exceed the threshold to be an ILAS firm. This is set at having a balance sheet size of equal to or greater than £50m, and being full scope in the investment firm's activities.[8]

4.9 Currently, there are circa 60 full ILAS firms within the solely FCA regulated CRD IV population. We estimate that circa 20 of these exceed the thresholds for the proposed definition of significant discussed in Chapter 5, and so expect that this number of firms would be required to submit CRD IV COREP liquidity reporting templates on an individual basis under our proposals (as well as existing FSA0xx liquidity templates). Firms that meet both the significant definition and £50m net assets balance sheet size criteria will also have to meet CRR binding liquidity requirements on an individual basis from 2015 onwards.

8 It should be noted that whilst CRD IV liquidity templates must be reported from 1 January 2014, the CRD IV binding liquidity requirements do not come into force until 2015 (see CRR Article 460).

4.10 Article 11(3) of the CRR allows competent authorities to exempt investment firms from Part Six liquidity requirements on a consolidated basis, 'taking into account the nature, scale and complexity of the investment firm's activities.' Accordingly, we intend to apply COREP liquidity reporting (and from 2015 binding liquidity requirements) on a consolidated basis to groups that contain a full scope IFPRU investment firm which meets the definition of significant firms outlined in Chapter 5 and also exceeds the threshold to be an ILAS firm.

> **Q10: In your view, is this approach proportional and risk based? If not, which category or categories of firms (within the solely FCA regulated CRD IV population) do you perceive as appropriate to submit CRD IV liquidity reporting forms from 2014 and be subject to binding liquidity requirements from 2015?**

4.11 Article 508(2) of the CRR requires the Commission to report on whether and how the liquidity coverage requirement within the CRR should apply to investment firms by 31 December 2015.

4.12 Data from firms' COREP liquidity submissions will primarily be used to better understand the liquidity risk profile of the affected firms, and to inform the Commission's review of the liquidity regime for investment firms. It would not be used to monitor an enforceable liquidity requirement until CRR binding liquidity requirements are introduced in 2015 for, as proposed above, significant full scope IFPRU investment firms that have balance sheets in excess of £50m net assets.

4.13 In addition, to inform the EU review of the liquidity regime for investment firms, we will approach some firms caught by our definition of a significant institution that do not meet the full ILAS criteria to submit these COREP liquidity returns on a voluntary basis. In asking for this we hope to accumulate liquidity data for a wider range of business models, which can be used to build an appropriate and proportionate European regime for investment firms. We believe that this is in the interest of the industry.

4.14 A summary of how the CRD IV liquidity proposals apply to different types of IFPRU investment firms is outlined in table 8 below:

Table 8

	A Full scope IFPRU investment firm that is identified as significant and is an ILAS firm	**A Full scope IFPRU investment firm that is not covered in the first column**	**An IFPRU limited activity firm**	**An IFPRU limited licence firm**
Does IFPRU Chapter 7 apply?	Yes	Yes	Yes	Yes
Do existing FSA0xx liquidity templates apply?	Yes	Yes	Yes	Yes
Does COREP liquidity reporting apply from 2014?	Yes	No	No	No
Do binding minimum requirements apply from 2015?	Yes	No	No	No

Liquidity reporting: Cost benefit analysis

4.15 We have opted to restrict the scope of CRD IV liquidity requirements (including COREP liquidity reporting) from the circa 250 firms that carry out MIFID activities 3 and 6 to a sub-category of more prudentially significant firms. We estimate that applying this approach to liquidity reporting will result in circa 20 firms being required to submit CRD IV liquidity returns. These firms will already submit other COREP returns, and so, while there will be additional systems costs, they can be incorporated in COREP costs.

4.16 As noted, CRD IV liquidity coverage requirements are not activated until 2015. Accordingly, the initial cost of being required to submit CRD IV liquidity returns is a systems cost rather than a cost of holding higher quality assets within a firm's treasury portfolio.

4.17 As the firms that will be required to submit CRD IV liquidity requirements are already subject to the ILAS regime, they will already have liquidity information to hand, some of which is likely to be able to be moulded to complete the CRD IV return.

4.18 The firms which we propose submit CRD IV liquidity returns are those that are most likely to have similar liquidity risks to credit institutions and investment firms designated for prudential supervision by the PRA. As well as providing the EBA with data about these firms' liquidity position, which in the context of the single market are large participants, this data will be available to formulate the investment firm liquidity regime. Accordingly, by selecting the population in this way, a risk based approach is taken to collecting of liquidity data.

Changes to the definition of capital and transitional provisions on capital

4.19 The CRD IV package significantly changes the definition and structure of capital from the existing framework. Notably, the CRD IV framework removes tier 3 capital (i.e. short term subordinated debt), and increases the loss absorbing capacity threshold for capital instruments to be eligible within the regulatory capital regime.

4.20 CRD IV permits the FCA to determine, within a pre-defined range, various transitional arrangements in order to allow firms reasonable time to raise additional capital required to meet CRD IV own funds requirements.

4.21 The FSA released a statement on 26 October 2012 stating that 'the minimum pace of transition set out in the CRD IV legislation will not be accelerated, except where applying the minimum transitional provisions in CRD IV would have the effect of weakening standards relative to what is in force in the UK prior to the CRD IV implementation date'. In line with the FCA's overall approach to CRD IV transposition (see paragraph 1.21 of this CP) the FCA continues to strive for a transitional provisions approach that is in line with the 26 October 2012 FSA's statement.

4.22 We have taken into account our existing implementation of comparable treatments under current CRD. However, in some cases it has not always been possible to concretely determine how existing FCA own funds standards are affected by CRR transitional provisions, and the knock-on effect on FCA firms' capital levels. This can be for various reasons such as:

- how residual amounts are dealt with during the transitional period compared to existing FCA treatment for those deductions;
- variations in definitions between the CRR and FCA handbook; and
- the types of own funds typically held by FCA firms.

This may mean, therefore, that for some transitional provisions we may not be completely aligned with our 'minimal pace of transition' approach, for example treatment of significant holdings. In those instances we have taken a transitional provision approach that we do not believe will be materially detrimental to firms whilst ensuring that the rules are not overly complex for firms.

4.23 Table 9 outlines the applicable percentages which we propose apply to the capital items which are subject to transitional arrangements at the discretion of the FCA, for each year of the relevant transitional period.

Table 9: section a): transitional provisions with timetable from 2014 to 2017

CRR article	Transitional Provision Issue	Relevant CRR Article for transition percentage rate	From Jan 2014	From Jan 2015	From Jan 2016	From Jan 2017
465 (1)(a)	CET 1 ratio (see Article 92(1)(a))	465(1)(a)	4%	4.5%	-	-
465 (1)(b)	Tier 1 ratio (see Article 92(1)(b)	465(1)(b)	5.5%	6%	-	-
467(1)	Recognition of Unrealised losses measured at fair value (see Article 35)	467(2)	20%	60%	60%	80%
468(1)	Recognition of unrealised gains measured at fair value (see Article 35)	468(2)	100%	60%	40%	20%
468(4)	Unrealised gains and losses measured at fair value from derivative liabilities on own credit risk(see Article 33(1)(c))	478(1)	20%	40%	60%	80%
469 (1)(a)	Deductions from CET1: losses for the current financial year (see Article 36(1)(a))	478(1)	100%	100%	100%	100%
469 (1)(a)	Deductions from CET1: intangible assets (see Article 36(1)(b))	478(1)	20%	40%	60%	80%
469 (1)(a)	Deductions from CET1: IRB losses (see Article 36(1)(d))	478(1)	20%	40%	60%	80%
469(1)(a)	Deductions from CET1: DB pension assets (see Article 36(1)(e))	478(1)	100%	100%	100%	100%

CRR article	Transitional Provision Issue	Relevant CRR Article for transition percentage rate	From Jan 2014	From Jan 2015	From Jan 2016	From Jan 2017
469 (1)(a)	Deductions from CET1: holdings of own shares (see Article 36(1)(f))	478(1)	20%	40%	60%	80%
469(1)(a)	Deductions from CET1: reciprocal cross holdings (see Article 36(1)(g))	478(1)	20%	40%	60%	80%
469 (1)(a)	Deductions from CET1: non-significant holdings (see Article 36(1)(h))	478(1)	20%	40%	60%	80%
469 (1)(c)	Deductions from CET1: DTAs (see Article 36(1)(c))	478(1) for DTAs that did not exist prior to 1 January 2014	20%	40%	60%	80%
469 (1)(c)	Deductions from CET1: significant holdings (see Article 36(1)(i))	478(1)	100%	100%	100%	100%
474(a)	Deductions from Additional Tier 1 items (see Article 56)	478(1)	20%	40%	60%	80%
476(a)	Deductions from Tier 2 items (see Article 66)	478(1)	20%	40%	60%	80%
479(2)	Recognition in consolidated CET 1 capital of instruments that do not qualify as minority interests (see Title II of Part 2)	479(3)	0%	0%	0%	0%
480(1)	Recognition in consolidated own funds of minority interests and qualifying AT1 and T2 (see Articles 84(1)(b), 85(1)(b) and 87(1)(b))	480(2)	0.2	0.4	0.6	0.8
481(1)	Additional filters and deductions	481(3)	0%	0%	0%	0%

Table 9: section b): transitional provisions with timetable from 2014 to 2024

CRR article	Transitional Provision Issue	Relevant CRR Article for transition percentage rate	Timetable – From January of each of the following years	Rate
486	Limit for Grandfathering items	486(3)	2014	80%
			2015	70%
			2016	60%
			2017	50%
			2018	40%
			2019	30%
			2020	20%
			2021	10%
469(1)(c)	Deductions from CET1: DTAs (see Article 36(1)(c))	478(2) for DTAs that existed prior to 1 January 2014	2014	10%
			2015	20%
			2016	30%
			2017	40%
			2018	50%
			2019	50%
			2020	60%
			2021	70%
			2022	80%
			2023	90%
			2024	100%

Note: The following transitional provisions in articles 473 and 481(2) of the CRR are not included in table 9 because we think that they are not applicable.

Q11: Do you agree that these proposals meet our approach of applying the transitional provisions whilst ensuring that we do not materially reduce the standards of the current FCA framework? If not, please indicate why not stating your reasons and your alternative proposal.

Capital transitional provisions: Cost benefit analysis

4.24 The capital arrangements originally proposed under Basel III were formulated for internationally active banks. We estimate that 80% to 90% of the current FCA BIPRU population are SMEs. Accordingly, we do not see it to be proportionate to accelerate the capital arrangements beyond the minimums permitted by the CRD IV package.

4.25 This approach allows the maximum possible time to raise additional capital, rather than requiring an accelerated transitional period that we do not perceive to be proportionate to the risks posed. Of the options available, this approach imposes the lowest costs on investment firms.

Partnership capital

4.26 The CRR does not explicitly address issues around capital instruments for partnerships and limited liability partnerships (LLPs). However, article 26 of CRR the EBA is required to maintain a list of all eligible instruments that qualify as CET 1. Accordingly, we require a list of all instruments that are used by partnerships and LLPs to satisfy the CET 1 criteria outlined in article 28 of the CRR, in order that the FCA can inform the EBA that we intend to accept such instruments as CET1 capital.

> **Q12: If appropriate, please can you provide a list of all capital instruments used by partnerships and LLPs that, in your opinion, satisfy the criteria outlined in article 28 of the CRR?**

Internal models

4.27 The solely FCA-regulated CRD IV population does not include many firms that use internal models to calculate credit, operational or market risk capital requirements. Most of the firms that do have permission to use an internal model do so as part of a consolidated permission through a PRA regulated parent undertaking. In such a case, while the FCA would have input in to the process whereby an internal model is approved or not approved, the process would be led by the PRA.[9]

4.28 The CRR text is more prescriptive than the CAD and BCD in its detail surrounding the granting of permission to use an internal model for calculating regulatory capital.

4.29 Noting the small number of firms within the solely FCA regulated CRD IV population which use models, and the greater degree of detail within the CRR than has existed previously, the FCA proposes to keep guidance and rules regarding the use of internal models for calculating regulatory capital within the FCA Handbook to a minimum, except where we can carry across existing relevant guidance.

4.30 This reflects the limited legal capacity of competent authorities to interpret a European regulation. The processes for our operational implementation will be communicated to firms separately, before the implementation of CRD IV.

4.31 Any firm considering applying to use an internal model should, in the first instance, approach their usual supervisory contact at the FCA. All model applications will be considered against the CRR text, and assessed on the individual merits of the application.

> **Q13: Considering the legal constraints in respect of EU regulation and in the context of internal models, do you agree to our proposal to use guidance where appropriate while explaining the operational implications of the changes via targeted communications? If not, please explain why not and propose alternative approaches and the rationale for those approaches.**

9 Although the FCA would remain responsible for the application of the model at a solo level entity.

Large exposures

4.32 The FCA does not prudentially regulate deposit-takers. We therefore perceive two of the large exposures exemptions inherited from the FSA's implementation of the CRD III that were carried over to the FCA – as no longer being relevant to the solely FCA regulated CRD IV firm population.

4.33 The FCA currently implements three of the exemptions permitted in Article 400(2) of the CRR through BIPRU 10.6. These are:

- Article 400(2)(c) of the CRR concerns intra-group exposures, and we propose to continue to carry forward this exemption.
- Article 400(2)(g) of the CRR concerns reserves held at overseas central banks. As the solely FCA regulated CRD IV firm population does not contain banks, we do not believe that any affected firms would benefit from this exemption, and so we do not propose to carry forward this exemption.
- Article 400(2)(h) of the CRR concerns asset items constituting claims on central governments that are in the form of statutory liquidity requirements held in government securities denominated and funded in their national currencies. We do not believe that this is applicable to the solely FCA regulated CRD IV firm population, and so we do not propose to carry forward this exemption.

4.34 Other than the items mentioned in the preceding paragraph, we propose to continue with our existing framework and we do not intend to exercise the other discretions on the large exposures framework.

> **Q14: Do you agree with our approach to these exemptions? If not, which exemptions under Article 400(2) of the CRR do you believe should be included, or should not be included?**

4.35 In addition, article 400(2)(k) includes a new exposure to assets constituting 'claims on and other exposures to recognised exchanges'. We are not aware of any problems with the size of such exposures being subject to the normal large exposures limit under the current regime. Therefore, we propose not to exercise this exemption, but welcome views from firms on this exposure item.

> **Q15: Do you agree with our proposal not to exercise the exemption in article 400(2)(k) of the Regulation? If not, please explain the reasons why not.**

4.36 The framework will continue to only apply to full scope firms.

4.37 We do not propose lowering the exposure limit from the higher of 25% of eligible capital or €150 million, as permitted by Article 395 of the Regulation.

4.38 As permitted by Article 396 of the CRR, we will consider applications to exceed the €150m limit on a case-by-case basis.

> **Q16: Do you agree with this approach in relation to articles 395 and 396 of the Regulation? If not, please explain why not and propose alternative approaches and the rationale for those approaches.**

Leverage

4.39 A key backstop included in CRD IV is the leverage ratio. There are some national discretions in this area. Article 499(3) of the CRR permits the FCA to allow firms to submit their leverage ratio based on a quarterly point-in-time calculation, as opposed to three monthly calculations averaged over the quarter, until 31 December 2017.

4.40 We propose to allow this time limited concession, as we note that requiring monthly calculations would impose additional cost on firms while providing little additional data around a group of firms which we generally do not deem to have systemic prudential impact. Further, the calculation of the leverage ratio is significantly more complex than an asset to equity ratio. Firms may not have this data readily available, and so this transitional arrangement allows firms to improve their data quality during this time.

Q17: Do you agree with the approach of allowing firms to report a quarterly leverage ratio as opposed to a three monthly ratio averaged for the quarter? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

Recognised exchanges, regulated markets and third-country stock exchanges

Recognised exchanges

4.41 Several provisions in the Regulation refer to a 'recognised exchange' as a condition to grant certain treatments. ESMA is tasked with developing ITSs to specify 'recognised exchanges' regarding those provisions listed in article 197(8)(b) of the CRR by 31 December 2014.

4.42 However, until the ESMA ITSs are in place, we propose to publish an interim list of recognised exchanges that in our view meet the conditions in the definition of 'recognised exchange' in Article 4.1(72) of the CRR. This interim list is based on the current list of UK Recognised Investment Exchanges (UK RIE) which at present includes:

- ICE Futures Europe;
- BATS Trading Limited;
- ICAP Securities & Derivatives Exchange Limited;
- LIFFE Administration and Management;
- London Stock Exchange PLC; and
- The London Metal Exchange Limited.

4.43 Our understanding is that firms in the investment sector prudentially regulated by the FCA trade primarily on UK exchanges. However, if any of these firms were to trade significant volumes on overseas exchanges (i.e. in other Member States and/or third countries), we invite such firms to propose including those exchanges in the FCA list of recognised exchanges. These proposals would have to adequately detail how these exchanges meet the conditions in the definition of recognised exchanges in Article 4.1(72) of the CRR and the business case for such inclusion.

Regulated markets and third country stock exchanges

4.44 Under article 336(4)(a)(iii) of the CRR, certain qualifying items should meet certain conditions one of which is that they should be listed on a Member State regulated market (see Article 4(1)(92) of the Regulation)[10], or on a stock exchange of a third country recognised by the FCA.

4.45 Based on the same approach for recognised exchanges in paragraph 4.43 (and subject to the same conditions), firms are invited to propose to the FCA for recognition those third country stock exchanges where the qualifying items are listed.

> **Q18: Do you agree with our proposal for an interim list of recognised exchanges pending the ESMA ITSs including our approach for third country stock exchanges? If not please propose changes to the list explaining the rationale why.**

Financial reporting: FINREP

4.46 Article 99(6) of the CRR allows the FCA to consider extending the scope of IFPRU investment firms subject to FINREP (beyond those firms mandated to submit FINREP templates under Article 99(2)) if the FCA believes that this is necessary to obtain a comprehensive view of the risk profile of the activities of, and a view of the systemic risks to the financial sector or the real economy posed by these firms.

4.47 The FCA will adopt the discretion in article 99(6) of the Regulation, but in line with our pragmatic and proportionate approach to CRD IV transposition, this does not imply that we intend to automatically implement this discretion. The nature of this CA discretion is such that by adopting it we are retaining an option to determine if we need to extend the scope of FINREP in the future. In practice, for the FCA to introduce this discretion, we would first have to consult with the EBA on extending the scope of IFPRU investment firms subject to FINREP.

> **Q19: Do you agree that this approach in relation to the discretion in article 99 of the Regulation is proportionate and risk based? If not, please explain why not and propose alternative approaches and the rationale for those approaches.**

Simplified credit risk calculation

4.48 The CRR does not permit the simplified method of calculating credit risk weights in relation to credit risk which is currently permitted in BIPRU 3.5. Accordingly, IFPRU firms should note that they will no longer be able to use this method.

10 This corresponds to the list of regulated markets prepared by ESMA that is available at ESMA List of regulated markets.

Exposures secured by mortgages on commercial real estate property

4.49 The Regulation applies a risk weight of 50% for exposures secured by mortgages on commercial immovable property where specific criteria are met (articles 124 and 126 of the CRR). The risk weight increases to 100% where those criteria are not met (article 124(1) of the CRR).

4.50 The CRR provides for the following discretions for competent authorities that allow the FCA to:

- derogate from one of the relevant criteria where the FCA publishes evidence of the long-established and well-developed nature of the UK commercial mortgage market, and data showing loss rates on UK commercial real estate to be within certain limits (Article 126(3)); and
- set a higher risk weight or stricter criteria than those set out in article 126(2) of the CRR – where appropriate – on the basis of financial stability considerations (Article 124(2)).

4.51 Under the current BCD (point 9.2, Part I, Annex VI) there is a similar discretion allowing the competent authority to apply a 50% risk weight to loans fully and completely secured on commercial real estate. The FSA did not exercise that discretion, as it was considered that a risk weight of 50% was not adequate to capture the risk inherent in fully secured commercial property lending in the UK; therefore a risk weight of 100% currently applies to such exposures.

4.52 We propose to exercise these discretions and, therefore, to maintain a risk weight of 100% for exposures to UK commercial real estate. Details regarding the application of this risk weight are included in the relevant rule in the Appendix. As prescribed by article 124(2) of the CRR, the FCA intends to consult the EBA on its proposed approach.

4.53 It is important to note that the FCA may need to revisit this issue when the EBA issue technical standards to specify among other items the conditions the competent authorities shall take into account when determining higher risk weights.

Q20: Do you agree with our proposal to exercise the discretions in articles 124(2) and 126(3) of the Regulation to maintain a risk weight of 100% for exposures to UK commercial real estate, as it is currently the case? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

5.
Definition of 'significant institution'

Background

5.1 Throughout the CRD IV package there are several policies that only apply to institutions which are 'significant *in terms of size, internal organisation and nature, scope and complexity of their activities*'. To clarify which firms these policies apply to, this chapter outlines a proposal for an objective definition with pre-defined thresholds that firms can use to determine whether these policies apply to them.

5.2 For clarity, this proposal would apply to FCA authorised firms that would be subject to CRD IV and has direct impact on the FCA implementation of the following articles:

- Article 76 of the Directive regarding the requirement to establish an independent risk committee;
- Article 88 of the Directive regarding the requirement to establish an independent nominations committee;
- Article 91 of the Directive regarding the requirement to separate the CEO and chairperson role, and limitations on the number of directorships an individual may hold;
- Article 95 of the Directive regarding the requirement to establish an independent remuneration committee;
- Article 100 of the Directive regarding supervisory stress testing to facilitate the review and evaluation process under Article 97 of the Directive;
- Articles 129 and 130 of the Directive on applicability of the capital conservation buffer and the countercyclical capital buffer (but provided that an exemption from the application of these articles does not threaten the stability of the financial system of the Member State);
- Article 6 of the Regulation regarding the scope of liquidity reporting on an individual basis;
- Article 11 of the Regulation regarding the scope of liquidity reporting on a consolidated basis; and
- Article 450 of the Regulation regarding remuneration disclosure.

5.3 We recognise that these articles reflect a broad range of policy areas which are not necessarily directly linked to each other. However, we propose that by defining an objective criteria, tailored where required, producing a definition of 'significant' firms will provide clarity to firms about which policies apply to them. Were each reference to be defined independently, this would create substantial complexity without significantly improving risk mitigation.

We are proposing that only firms captured by this definition of 'significant' must comply with the relevant requirements in the CRD IV provisions. However, other firms may also wish to consider adopting these requirements as a matter of good practice.

5.4 Should a firm exceed a threshold and be caught by this definition, and then drops below the threshold at a later date, we propose that these rules continue to apply for one year from the date at which the firm drops below the relevant threshold. This is to prevent arbitrage, to reduce the incentive to structure a business model to avoid regulatory scrutiny and to provide an element of continuity.

Q21: Do you agree with our proposal to publish an objective criteria identifying which firms these policies refer to? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

The methodology

5.5 The approach is designed to identify 'significant' firms using five pre-defined risk parameters. Collectively, these act as a proxy for a firm's significance in terms of size, internal organisation and nature, scope and/or complexity of their activities. These are:

- total balance sheet assets;
- total balance sheet liabilities;
- annual fees and commission income;
- client money; and
- client assets.

Q22: Do you agree that the combination of these metrics sufficiently capture the size, internal organisation and nature, scope and complexity of an investment firm's activities? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

5.6 A cumulative distribution for each impact factor has been produced based on data currently reported by firms to the FCA and ordered from highest to lowest. This allows the FCA to assess the marginal impact of imposing each requirement on one more firm. For example, the marginal impact analysis of the balance sheet assets impact factor shows that 68% of all balance sheet assets are held by only 39 solely FCA regulated CRD IV firms. The marginal benefit of imposing requirements due to the impact resulting from the amount of assets held on the balance sheet rapidly declines after this point.

5.7 The cut-off point will fall within a marginal impact range. The lower bound of this range is based on the point at which the slope of the curve falls below 100% (i.e. the point at which it could be argued that the marginal cost rate is greater than the marginal benefit rate, where the gradient is 1). The upper bound is based on the point at which the slope of the curve falls below 50% (gradient of 0.5). Within this range the cut-off point is based on the percentage of firms captured; so for steep curves the number will tend to be less than that for shallower curves.

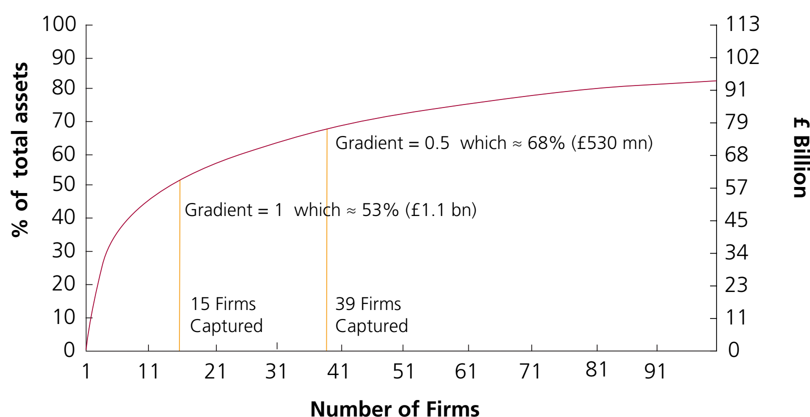
5.8 Broadly, we aim to capture the firms that constitute at least the top two thirds of the total market for each indicator. However, due to the broader distribution of fees and commission income across firms, we have lowered that threshold.

5.9 While this proposal applies at an individual firm basis, the FCA reserves the right to apply the criteria at a consolidated level where deemed appropriate.

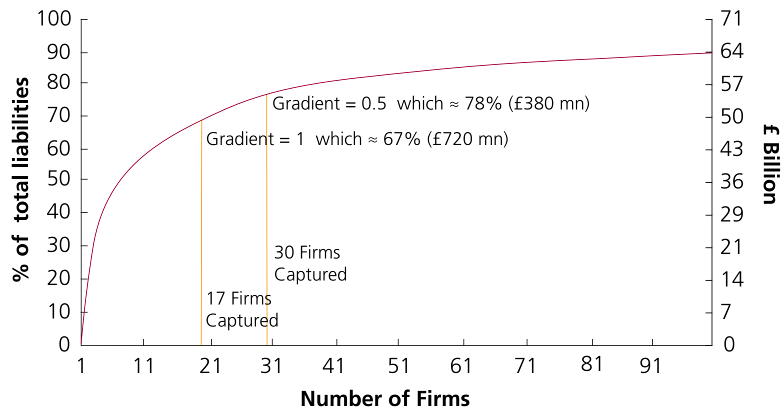
Market analysis

5.10 The graphs below show the cumulative distribution for each of the impact factors, the upper and lower bound and the proposed thresholds:

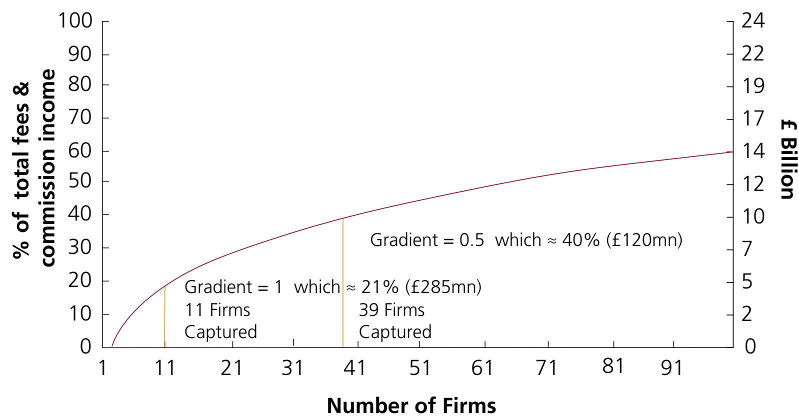
- **Figure 2: Cumulative total assets:** 39 firms account for 68% of the total assets within the market, of which the firm accounting for the lowest value of assets holds approximately £530 million of assets. We therefore propose that the threshold for total balance sheet assets is £530 million.



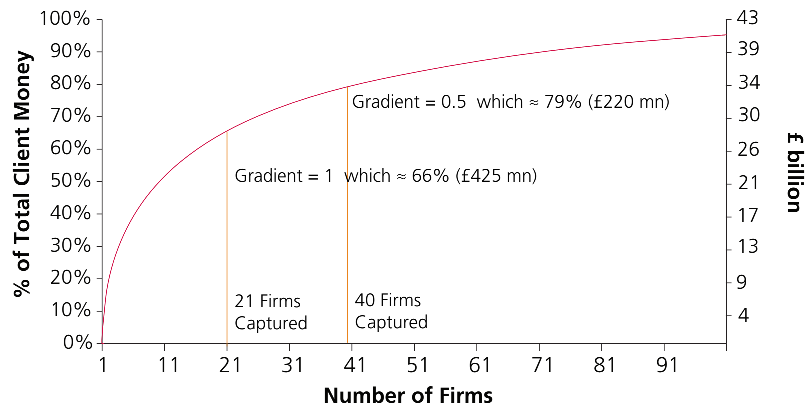
- **Figure 3: Cumulative total liabilities:** 30 firms represent 78% of the total liabilities within the market, of which the firm accounting for the lowest value of liabilities holds approximately £380 million of liabilities. We therefore propose that the threshold for total balance sheet liabilities is £380 million.



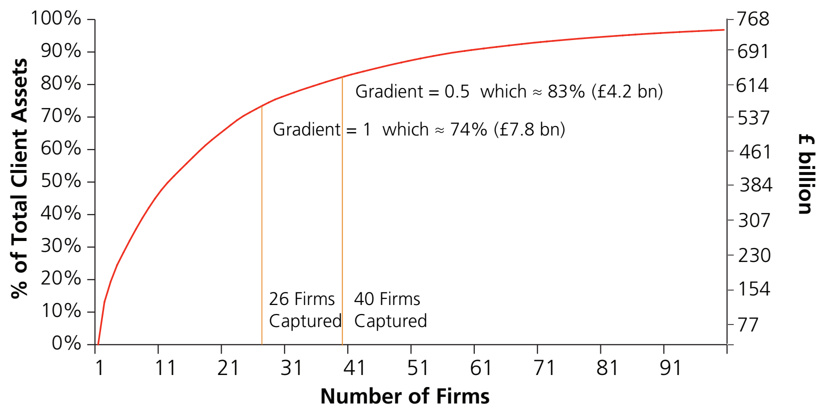
- **Figure 4: Cumulative total fees and commission income:** 39 firms receive 40% of the total fees and commission income within the market, of which the firm receiving the lowest fees and commission income receives approximately £120 million. We therefore propose that the threshold for fees and commission income is £120 million.



- **Figure 5: Cumulative total client money:** 21 firms hold 66% of the total client money within the market, of which the firm holding the lowest amount of client money holds approximately £425 million. We therefore propose that the threshold for total client money is £425 million.



- **Figure 6: Cumulative total client assets:** 26 firms hold 74% of the total client assets within the market, of which the firm holding the lowest amount of client assets holds approximately £7.8 billion. We therefore propose that the threshold for total client assets is £7.8 billion.



5.11 Accordingly, the proposed thresholds are as follows:

Table 10: Thresholds

Indicator	Threshold
Total assets	£530 million
Total liabilities	£380 million
Annual fees and commission income	£120 million
Client money	£425 million
Client assets	£7.8 billion

Q23: Do you agree that these thresholds are appropriate? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

5.12 This analysis highlights that a relatively small number of FCA investment firms account for the majority of the market using these metrics. Accordingly, we propose that should a firm exceed the threshold for one or more of these risk parameters, they are a 'significant' firm, and so the relevant policies apply to that firm.

Q24: Do you agree with our proposal to define a firm as a 'significant' firm if it exceeds at least one of these thresholds? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

5.13 This definition of significant provides a base case. Whilst the expectation is that the base case will apply across the affected FCA prudential regime, where necessary (e.g. in order to be proportionate) it can be modified on a case-by-case basis whilst retaining the advantage of being able to reconcile it back to the base case analysis.

5.14 The proposed definition provides a clear industry-wide quantitative measure of significant. If necessary on a case-by-case basis the FCA may require firms not caught by this definition to comply with the relevant prudential requirements. Equally, it is open to firms caught by the definition of 'significant' that believe the requirements are disproportionate to apply for a waiver.

Cost benefit analysis

5.15 By formulating an objective criteria from which firms can identify which rules within the CRR do and do not apply to them, we provide certainty and allow firms to make any necessary arrangements in the limited time available between now and the implementation date.

5.16 There are numerous alternatives to our approach. For example, all firms with a permission to trade on their own account could be labelled as 'significant' firms. However, we do not believe that this is a risk based approach. There are firms within this population that are SMEs. Within the UK market, it is highly unlikely that the failure of such a firm could cause substantial market dislocation, or could be deemed significant in relation to its peers. Concurrently, there are firms outside of this population, for example in the asset management industry, which could cause greater market dislocation and significant consumer harm.

Population of firms affected

5.17 The proposed approach results in circa 80 firms being classified as 'significant'. These firms comprise significant market participants across a range of business models.

5.18 The firms have been identified using tailored metrics. We are conscious that any metric and threshold may be unlikely to capture all appropriate firms in every situation. Accordingly, we reserve the right to apply these policies to firms that do not meet the criteria.

Costs and benefits

5.19 The effect of applying this definition to the requirement to hold capital buffers (Chapter 3) and liquidity reporting (Chapter 4) is covered in the relative chapters.

5.20 We consider that applying these CRD IV governance requirements to more prudentially significant firms is in the interest of consumers and promotes market integrity. However, by applying these policies additional costs may be imposed. We anticipate that most of these additional requirements will already be met by firms, as the governance requirements are broadly covered by SYSC rules, and so the cost will be minimal.

5.21 It is possible that a small number of firms do not currently meet the requirements to include non-executive directors in the membership of various governance committees in these policies. Where this cannot be met from existing resource, there will be additional on-going costs imposed on these firms. We estimate the cost of hiring a non-executive director for such a firm to be in the region of £50,000 per year. However, due to the more complex nature of these firms, we believe that the benefits from independent challenge that non-executive directors bring to the Board and to internal governance, are sizable.

5.22 We have opted not to apply these policies to those firms that are not caught by the definition of a significant institution, as we do not believe that the additional risk mitigation achieved is proportionate to the risks posed by these firms.

6.
Prudential requirements for BIPRU firms

Purpose

6.1 This chapter sets out our proposals to:

- exercise the discretion in the CRR article 95(2) to retain current CRD rules on own funds requirements (Pillar 1);
- retain current CRD rules on Pillar 2, disclosure (Pillar 3) and systems and control requirements in SYSC (including the Remuneration Code); and
- for the new prudential category of 'BIPRU firms' (using the revised, proposed term included in the Glossary in Appendix 1).

Background

6.2 Certain investment firms subject to current CRD are not subject to the full CRD IV, pending the Commission's review by end 2015.

6.3 These firms are a subset of the category excluded from the definition of 'investment firm' in article 4.1(2)(c) of the Regulation. This exclusion has been amended in relation to the corresponding one in article 3(1)(b)(iii) of the CAD – also referred to as 'exempt CAD firms' in our current Handbook. However, the Regulation changes the scope of this exclusion in the following ways:

- a firm in this category must not be authorised to provide ancillary service (1) referred to in Section B of Annex 1 MIFID (which is safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management); and
- the addition of MIFID activities (2) (execution of orders on behalf of clients) and (4) (portfolio management) have been added.

6.4 Article 95(2) of the Regulation sets out the own funds requirements and the alternative treatment – as part of the discretion for competent authority explained below – in relation to those firms in the exclusion in article 4.1(2)(c) of the CRR where they carry out MIFID activities (2) and/or (4).

In summary, these firms are those that:

- carry out MIFID activities (2) (execution of orders on behalf of clients) and/or (4) (portfolio management);
- may carry out MIFID activities (1) (reception/transmission of order related to financial instruments) and/or (5) (investment advice);
- do not carry out MIFID activities (3) (dealing on own account), (6) (underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis), (7) Placing of financial instruments without a firm commitment basis) and/or (8) operation of Multilateral Trading Facilities);
- do not carry out MIFID ancillary service (1) (safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management); and
- are not permitted to hold money or securities belonging to their client.

6.5 CRD IV requires these firms to apply the 'higher of' (i) the requirements in the CRR article 92(3) except operational risk and (ii) the Fixed Overhead Requirement (FOR). Additionally, these firms have to meet the requirements in the CRR articles 92(1) on own funds and (2) on calculation of capital ratios.

6.6 This is the same Pillar 1 'higher of' capital test as under current CRD for these firms, but using the new, stricter CRR definition of Own Funds (including deductions), requirements calculated under the CRR (i.e. the FCA's current 'simplified' approach to calculating credit risk would not be available) and potentially also subject to reporting via COREP.

6.7 However, no other parts of the CRD IV requirements would apply.

Proposals

6.8 There is an alternative Competent Authority discretion in article 95(2) of the Regulation to keep such firms on the current CRD, as it stood under national law (i.e. BIPRU & GENPRU) on 31 December 2013 before the CRD IV enters into force.

6.9 This would include Pillar 1 requirements i.e. the current (less onerous) definition of own funds, our simplified approach to calculating credit risk and reporting under GABRIEL. We propose to exercise this discretion in relation to what we proposed to call for the purpose of the FCA Handbook: 'BIPRU firms'.

6.10 In addition, we also propose to retain for such firms the current CRD rules in force on Pillar 2, Pillar 3 and systems and control requirements in SYSC (depending on the application provisions) including the Remuneration Code, but without the new CRD IV material such as limits on bonuses.

6.11 These proposals amount to keeping the 'status quo' pending the Commission's review of an appropriate prudential regime for firms in the investment sector by end 2015 which is the proper place to secure a more permanent 'level playing field' across the EU.

Applicable provisions from the FCA Handbook

Table 11: It shows the relevant Sourcebooks and chapters from the FCA Handbook that would be applicable to BIPRU firms as a result of our proposals:

Sourcebook	Applicable Chapters
GENPRU	1, 2 and 3 (and relevant transitionals)
BIPRU	1 to 5, 7 to 9, 11, 13 and 14 (and relevant transitionals). 12 (firms need to check the relevant application provisions)
SYSC	Firms need to check the application provision of the relevant chapter

Existing waivers

6.12 Any existing waivers under GENPRU and BIPRU for these firms would continue to be in effect after 1 January 2014 since the rules would continue to apply.

Reporting

6.13 Under our proposals BIPRU firms would continue using GABRIEL to submit FSA0xx reporting templates because COREP and FINREP are designed to report on CRD IV elements.

Firm impact

6.14 We estimate that approximately 1000 firms could benefit from our proposals in this chapter.

6.15 Applying our proposals mean no overall change in costs or benefits for BIPRU firms since we would be keeping the 'status quo' subject to the outcome of the EU wide review of the whole prudential regime by 2015.

6.16 We believe our pre-consultation discussions indicated initial support for these proposals, as they avoid the cost of changes for all concerned, while maintaining protection for consumers and market integrity, pending the EU-wide review. Under these proposals firms would not need to implement unnecessary changes to systems and capital that otherwise they might have had to undo in a few years time – depending on the outcome of the EU review.

6.17 There is a further consequence of the change to the definition of 'investment firm' in article 4.1(2)(c) outlined above in paragraph 6.3, which may impact some existing firms that currently benefit from being treated as 'exempt CAD firms' in our current Handbook. This is where a firm carries out only MIFID services and activities (1) reception and transmission of orders in relation to one or more financial instruments and/or (5) investment advice (but not (2) execution of orders on behalf of clients and/or (4) portfolio management).

6.18 The CRR now prevents 'exempt CAD firms' from also being authorised to provide the ancillary service (1) referred to in Section B of Annex I to MIFID, which is safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management. To the extent that there are any such firms that would otherwise be 'exempt CAD firms' but for this additional permission, they would now be included back within the definition of 'investment firm' under CRD IV. As a result, such firms would not be eligible for the limited treatment under Article 31 of the Directive – as reflected in the Interim Prudential Sourcebook for Investment Businesses (IPRU (INV)) – but would be subject to the CRR and the Directive, as an IFPRU limited licence firm.

In summary, firms that are authorised to carry out:

- MIFID investment services and activities (1) (reception and transmission of orders) and/or (5) (investment advice); and
- MIFID ancillary service (1) safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management ;

will no longer be exempt from the definition of 'investment firm' and will instead become subject to the CRD IV. Firms in this position should refer to chapter 2 for details on the application of CRD IV to investment firms.

Whereas firms that are authorised only for the purposes of MIFID investment services and activities (1) and (5), but not ancillary service (1), may continue to be treated as 'exempt CAD firms'.

Q25: Do you agree to our proposal to exercise the discretion in article 95(2) of the CRR to retain current CRD rules in force on own funds requirements (Pillar 1) for BIPRU firms keeping the 'status quo' pending the EU-wide review of what is an appropriate prudential regime as a whole for firms in the investment sector in 2015? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

Q26: Do you agree to our proposal to retain current CRD rules in force on Pillar 2, Pillar 3 and systems and control requirements in SYSC (including the Remuneration Code) for BIPRU firms keeping the 'status quo' pending the EU-wide review of what is an appropriate prudential regime as a whole for firms in the investment sector in 2015? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

7.
Treatment of existing FCA rule waivers under the Regulation

Introduction

7.1 This chapter sets out the FCA's proposals in relation to the treatment under the CRR of rule waivers and modifications granted to firms in accordance with section 138A of FSMA. Rule waivers and modifications will be jointly referred to in this Chapter as 'waivers'.

7.2 The PRA is also consulting on similar proposals in relation to waivers that affect their firm population.

Background

7.3 As explained in Chapter 1 of this CP, the FCA will make a new sourcebook IFPRU that transposes the relevant directive provisions and implements the discretions afforded to competent authorities in the CRR. It will apply to the investment firms subject to CRD IV that are presently subject to GENPRU and BIPRU with the effect that GENPRU and BIPRU will no longer apply to these firms.

7.4 As a result, all waivers granted to investment firms subject to CRD under BIPRU and GENPRU rules will cease to have effect by operation of law. However, where those rules are replaced by substantially equivalent requirements in the CRR, the FCA will have the power to grant an equivalent permission when exercising a national discretion given to it as a 'competent authority'.

7.5 It is important to note that the proposals in this chapter do not apply to waivers granted to 'BIPRU firms' (see Chapter 6 of this CP under the heading 'Existing waivers').

Our proposals

7.6 Accordingly, the FCA proposes to grant such CRR-based permissions with effect from 1 January 2014 to those firms which are currently holding an eligible waiver. A waiver will be eligible only if it meets the following conditions:

- first, the relevant waiver must relate to a rule in GENPRU / BIPRU with an equivalent article in the CRR. Waivers with equivalent CRR articles are shown in the second column of tables 12 and 13 below[11];

11 The lists of existing waivers included under each proposal are based on all the waivers that historically the FSA granted under GENPRU and/or BIPRU to the whole CRD firm population and may include some treatments that are no longer available for the current FCA population of firms.

- second, the firm holding a waiver must be fully compliant with the GENPRU/ BIPRU rule, as waived or modified, and with any conditions relevant to the granting of the waiver (as such may be reflected on the direction given to the firm) on and before 31 December 2013. Compliance with the GENPRU / BIPRU rule will tend to show compliance with the equivalent CRR article, although specified requirements and conditions will apply to different types of waivers. This is explained further below.

7.7 Waiver directions that remain in effect as equivalent CRR-based permissions in accordance with this Chapter on 1 January 2014 will continue in full force and effect until the expiry date specified thereto. The Financial Services Register will be updated progressively as waivers directions expire and are replaced CRR-based permissions upon application for renewal.

7.8 Our proposals in this Chapter would also apply to relevant requirements imposed by the FCA on firms under section 55L of FSMA in relation to a rule listed in the second column of table 12, subject to the same conditions and processes – as appropriate – described for waivers in this Chapter.

7.9 The legal instrument underpinning these arrangements may change following consultation with the Treasury, but we expect that the substance of our proposals as described in this chapter will remain the same.

7.10 Our proposals in this area vary depending on the type of waivers:

Eligible waivers not related to an advanced prudential calculation approach

7.11 Where a firm currently holds an eligible waiver specified in table 12, it may rely on the existing direction as the equivalent permission under the CRR with effect from 1 January 2014:

Table 12: Eligible waivers not related to an advanced prudential calculation approach

Permission	FCA Rule (rule waiver or modification)	CRR article
Individual consolidation method	• BIPRU 2.1.7R • (Solo consolidation waivers)	Art. 9
Derogation to the application of own funds requirements on a consolidated basis for groups of investment firms	• BIPRU 8.4 applies to a firm with an investment firm consolidation waiver • Rules waived: a. BIPRU 8.2.1R b. BIPRU 8.2.2R c. BIPRU 8.3.1R d. BIPRU 8.3.2R	Art. 15 Art. 17
Methods of prudential consolidation – Art. 12(1) relationship	• BIPRU 8.5.6(2)R (As required by the Part 4A permission of the firm)	Art. 18.3
Methods of prudential consolidation- Significant influence or single management relationship	• BIPRU 8.5.6(2)R – 'Art. 134 relationship' (as required by the Part 4A permission of the firm)	Art. 18.6
Entities excluded from the scope of prudential consolidation	• BIPRU 8.5.1R • BIPRU 8.5.10R	Art. 19.2

Permission	FCA Rule (rule waiver or modification)	CRR article
Permission to revert to the use of a less sophisticated approach for credit risk	• BIPRU 4.2.23R (as modified in accordance with BIPRU 4.2.25G) • BIPRU 4.2.24R (as modified in accordance with BIPRU 4.2.25G)	Art. 149
Traditional securitisation – recognition of significant risk transfer	• BIPRU 9.4.11R • BIPRU 9.4.12R (subject to conditions in BIPRU 9.4.15D)	Art. 243 par. 2, 3, 4 and 5
Synthetic securitisation – recognition of significant risk transfer	• BIPRU 9.5.1R (6) and(7) • (subject to conditions in BIPRU 9.5.1B D)	Art. 244, par. 2, 3, 4 and 5
Securitisations of revolving exposures with early amortisation provisions – similar transactions	• BIPRU 9.13.11R • BIPRU 9.13.13R • BIPRU 9.13.14R • BIPRU 9.13.15R • BIPRU 9.13.16R • BIPRU 9.13.17R (subject to conditions in BIPRU 9.13.18G)	Art. 256.7
Permission to revert to the use of a less sophisticated approach for operational risk	• BIPRU 6.2.5R (as modified in accordance with BIPRU 6.2.6G) • BIPRU 6.2.7R (as modified in accordance with BIPRU 6.2.8G)	Art. 313
Combined use of different approaches for operational risk – standardised approach and basic indicator approach	• BIPRU 6.2.12R (as modified in accordance with BIPRU 6.2.13G)	Art. 314.4
Waiver of the 3 year average for calculating the own funds requirement under the basic indicator approach for operational risk	• BIPRU 6.3.2R (as modified in accordance with BIPRU 6.3.9G)	Art. 315
Waiver of the 3 year average for calculating the own funds requirement under the standardised approach for operational risk	• BIPRU 6.4.5R (as modified in accordance with BIPRU 6.4.8G)	Art. 317.4
Own funds requirements for position risk for options and warrants on: a. interest rates; a. debt instruments; a. equities; a. equity indices; a. financial futures; a. swaps; and a. foreign currencies	• BIPRU 7.9 applies to a firm with a CAD1 model waiver. • Rules waived or modified: (a) GENPRU 2.1.52R (b) BIPRU 7.6.1R	Art. 329

Permission	FCA Rule (rule waiver or modification)	CRR article
Own funds requirements for commodities risk for options and warrants on: commodities; and commodities derivatives	• BIPRU 7.9 applies to a firm with a CAD1 model waiver. • Rules waived or modified: (a) GENPRU 2.1.52R (b) BIPRU 7.4.1R	Art. 358.3
Interest rate risk on derivative instruments	• CAD1 model waiver for the use of an interest rate pre-processing model in accordance with BIPRU 7.9.44G • Rule waived: GENPRU 2.1.52R	Art. 331 Art. 340
Waiver of large exposure limits in exceptional cases	• BIPRU 10.6.32R – As waived in accordance with BIPRU 10.6.33G	Art. 396 in relation to the 100% large exposure limit set out in Art. 395(1)
Waiver of large exposure limits in relation to intra-group exposures: core UK group waivers	• BIPRU 3.2.25R(2) • BIPRU 10.8A	Art. 113.6 Art. 400.1(f)
Waiver of large exposure limits in relation to intra-group exposures: non-core group waivers	• BIPRU 10.9A	Art. 400.2(c) as implemented by IFPRU 8.2.4R–8.2.7R (Intra-group exposures: non-core large exposures group)

7.12 Firms will not be required to confirm expressly to the FCA that they continue to comply with any relevant rules and conditions applicable to each eligible waiver referred to in Table 12. However, as stated above, firms must be fully compliant with all such rules and conditions on and before 31 December 2013 in order to be able to rely on the current waiver direction as the equivalent permission under the CRR with effect from 1 January 2014. Should a firm cease to comply at any time, they must notify the FCA immediately as per Principle 11 (Relations with Regulators) (PRIN 11) by contacting their FCA supervisory contact.

Eligible waivers related to an advanced prudential calculation approach

7.13 Where a firm holds a waiver that relates to an advanced prudential calculation approach, it must expressly confirm to the FCA that it complies with the relevant requirements that apply to that approach. Table 13 shows the applicable GENPRU / BIPRU rules and the equivalent articles in the CRR for all waivers relating to advanced prudential calculation approaches that will be eligible for the treatment described in this chapter:

Table 13: Eligible waivers related to an advanced prudential calculation approach

Permission – Model waivers	FCA Rule (rule waiver or modification)	CRR article
Internal Ratings Based (IRB) permission for credit risk	• BIPRU 4 applies to a firm with an IRB permission • Rules waived or modified: (a) GENPRU 2.1.51R (b) BIPRU 3.1.1R	• Part Three, Title II, Chapter 3 • Art. 143 • Art. 178.1(b)
Eligibility of physical collateral under the IRB Approach	• BIPRU 4.10.16R (Where authorised by the firm's IRB permission)	Art. 199.6
Master netting agreement internal models approach	• BIPRU 5.6.1R in accordance with BIPRU 5.6.12R	Art. 221
Supervisory formula method for securitisation transactions	• BIPRU 9.12.3R • BIPRU 9.12.5R • BIPRU 9.12.21R (Where authorised by the firm's IRB permission)	Art. 259.1(b) Art. 262
ABCP internal assessment approach	• BIPRU 9.12.20R (Where authorised by the firm's IRB permission)	Art. 259.3
Exceptional treatment for liquidity facilities where pre-securitisation Risk Weight Exposure Amount (RWEA) cannot be calculated	• BIPRU 9.11.10R as modified in accordance with BIPRU 9.12.28G (Where authorised by the firm's IRB permission)	Art. 263.2
Advanced Measurement Approach (AMA) permission	• BIPRU 6.5 applies to a firm with an AMA permission • Rule waived or modified: BIPRU 6.2.1R	• Art. 312.2 • Part Three, Title III, Chapter 4
Combined use of different approaches for operational risk – AMA and standardised approach or basic indicator approach	• BIPRU 6.2.9R (in accordance with BIPRU 6.2.10G and the firm's AMA permission)	Art. 314, par. 2 and 3
Permission to use internal models to calculate own funds requirements for market risk (Value at Risk)	• BIPRU 7.10 applies to a firm with a VaR model permission • Standard market risk PRR rules as specified and waived or modified by the firm's VaR model permission waiver • GENPRU 2.1.52R	• Art. 363 • Part Three; Title IV; Chapter 5; Sections 2, 3 and 4
Permission to use internal models to calculate own fund requirements for the correlation trading portfolio	• BIPRU 7.10.55T R to BIPRU 7.10 55ZA R (Where the firm is authorised to use the all price risk measure in its VaR model permission waiver)	Art. 377

7.14 The FCA has already started contacting firms holding eligible advanced prudential calculation approaches waivers to inform them of the steps that will be followed ahead of the entry into force of the CRR. In short, the process will be as follows:

- first, the affected firms will have to submit to the FCA a confirmation of compliance in relation to each relevant waiver by no later than 31 August 2013, unless they have done so already;
- at the same time, if the FCA has identified any instances of non-compliance, it will require those firms to remediate them before the end of 2013 or to put in place a credible remediation plan where compliance cannot be fully restored within this time period; and
- the FCA expects to review the responses and engage in bilateral discussions with the affected firms during the Autumn. By no later than 30 November 2013, the FCA will notify its decision to the affected firms on whether they may rely on the existing waiver direction as the equivalent permission under the CRR with effect from 1 January 2014 and, if so:
  - whether it will be subject to the same terms; or
  - the permission will be subject to certain modified terms. Among these, the FCA may decide to exclude certain models, exposures or products from the scope due to the firm being unable to restore compliance before the end of 2013. As an alternative, the FCA may add an agreed remediation plan as a condition for the firm to maintain certain models, exposures or products within scope.

BIPRU 12 intra-group modification

7.15 As permitted under Article 412(5) of the Regulation, we intend to maintain the existing domestic liquidity regime until binding minimum standards for liquidity coverage requirements are specified and fully introduced in the CRR in 2015 (see our proposals in Chapter 4).

7.16 Therefore, where a firm holds an 'intra-group liquidity modification' to the overall liquidity adequacy rule in BIPRU 12, it should engage with its FCA supervisory contact on a bilateral basis to determine whether the existing waiver can be extended until the discretion in Article 412(5) of the Regulation falls away in 2015. Any firm requests for liquidity permissions under the CRR will be covered by the process for new CRR permissions.

Existing waivers where there is no equivalent CRR provision

7.17 Any waivers granted to firms under BIPRU or GENPRU rules which are repealed or disapplied on 1 January 2014 and not otherwise listed as eligible waivers in tables 12 and 13 will cease to have effect on that date.

7.18 The FCA will update the Financial Services Register and communicate this to firms in due course.

Processes for new CRR permissions

7.19 We are also working to have in place new processes to grant firms' regulatory 'permission' in those areas under CRD IV where they will be required. For this purpose we have also engaged with the Treasury (and the PRA) to ensure that suitable procedures to be applied to the new CRR permissions are in place.

7.20 We will communicate the new procedures to firms later in 2013.

Q27: Do you agree to our proposal to grant CRR-based permissions with effect from 1 January 2014 to those firms currently holding an eligible waiver related to a GENPRU / BIPRU rule – listed in tables 12 and 13 – provided the conditions in paragraph 7.6 are met? If not please explain why not and propose alternative approaches and the rationale for those approaches.

Annex 1: Cost benefit analysis

Summary

1. On 16 December 2010, the Basel Committee published Basel III, which outlines proposals for a strengthened set of prudential requirements for banks. In the EU these proposals have been implemented through the CRD IV.

2. CRD IV expands the scope of firms subject to this legislative package to investment firms. Approximately 2,400 investment firms are authorised within the UK and are prudentially regulated by the FCA. We estimate that 80-90% of these firms meet the EU definition of SMEs.

3. This CBA analyses the incremental impact of the overall package of CRD IV in terms of its effects on firms and markets within the FCA remit. Where appropriate and feasible, the estimated impacts of individual discretions or regulatory changes have been presented in the relevant CP chapter.

4. The main impacts of CRD IV will be on systemically important institutions which are mostly regulated by the PRA. Both the costs and benefits for FCA regulated firms will not be as significant. However, in relative terms, the cost for small FCA regulated firms could be important. These costs will mainly arise from the new reporting obligations and additional capital requirements. Similarly, the main costs for the FCA will arise from the new reporting framework. Similarly to the cost, we do not expect the benefits of implementing CRD IV to investment firms will be as significant as those arising from the implementation on systemically important firms. However CRD IV will reduce potential market failures by improving transparency, corporate governance and the levels and quality of capital. Finally, we do not expect material macroeconomic impacts due to the effects of CRD IV on investment firms; these will again be mainly driven by systemically important firms and are presented in the PRA's consultation paper.

General approach to the CBA

5. This Annex contains the FCA's cost benefit analysis (CBA) for transposing the Directive provisions – where it is the responsibility of the FCA – and exercising certain discretions in the Regulation in the UK. This CBA focusses on the impacts arising from the implementation of CRD IV on FCA-regulated investment firms. PRA-regulated firms are out of scope and have been considered in the CBA accompanying the PRA's consultation paper on the implementation of CRD IV.

6. When proposing new rules, we are obliged under section 138I of FSMA to publish a CBA, unless we believe there will be no increase in costs or that the increase will be of minimal significance. We are required to publish an estimate of costs and benefits unless they cannot be reasonably estimated or it is not reasonably practicable to produce an estimate.

7. It is important to note that the major economic benefits arising from implementation of CRD IV come from increased financial stability and reduced macro-prudential risk. Such benefits generally arise from regulation of systemically important institutions. Most FCA regulated firms will not fall under the systemically important category. When considering the overall cost-benefit impact of CRD IV, therefore, the analysis contained in this document should be considered alongside the CBA produced by the PRA.

8. The implementation of CRD IV will have a direct impact on the regulatory costs experienced by investment firms. The large majority of such costs arise as a result of new Regulation (in particular COREP/FINREP) and the transposition of the Directive. Such policy changes are not subject to FCA discretion but we need to consider the cost arising from rule changes that result from Directive transposition. In addition, although we would not usually assess the impact of a Regulation as part of a CBA, this CBA presents estimates of costs arising from the Regulation as they represent the bulk of the costs to be incurred by investment firms. It is important that any incremental impact arising from UK optional policy changes should be placed in such context.

9. We have not presented detailed estimates for the costs associated with individual articles since:

- in many cases it is not possible to separate the incremental impact of each element of the overall package; and

- it is difficult to differentiate the impacts from provisions in Regulations from those of changed requirements arising from transposition of Directives.

10. Incremental costs and benefits arising from "optional" exercise of national discretions and derogations are likely to be small relative to those due to the Regulation and transposition of the Directive. As described in Chapter 1, where discretions and derogations have been available, the general approach has been to ensure costs for incumbent investment firms are minimised. Where appropriate and feasible, the estimates of impacts have been presented in the relevant CP chapter.

11. This CBA estimates the overall impact of the Directive and the Regulation against a **baseline** in which the Directive is not transposed and the Regulation is not introduced.

The market affected

12. The implementation of CRD IV will impact FCA-regulated markets including (activity types):

- venture capital/private equity;

- investment management;

- brokerage firms;

- inter-broker dealer;

- other non-capital-intensive business (custody, corporate finance, advice).

13. CRD IV implementation will alter the rules and guidance that apply to around 2,400 investment firms regulated by the FCA. These investment firms are diverse in nature, as shown in Table 14, below.

Table 14: Categorisation of investment firms subject to CRD IV

Firm primary category	Firm status			Total by firm category
	Full-scope	Limited Activity	Limited License	
Discretionary Investment Manager	20	5	1440	1465
Advising and Arranging Intermediary (exc. FA & Stockbroker)	21	3	229	253
Stockbroker	62	11	85	158
Corporate Finance Firm	14	1	118	133
Financial Adviser (FA)	3		102	105
Other	81	23	218	322
Total by firm status	**201**	**43**	**2192**	**2436**

14. We estimate that circa 1,000[11] of these 2,400 firms will not be subject to CRD IV. The FCA is consulting on exercising the discretion under article 95(2) in the Regulation that allows the CA to keep such firms on the current CRD, as it stood under national law (i.e. BIPRU and GENPRU) on 31 December 2013. Details on the type of firms affected – under the revised proposed term of 'BIPRU firms' – and the extent of our proposals can be found in Chapter 6.

15. In general, the application of our proposals means no overall change in costs or benefits for these firms since we would be keeping the 'status quo' subject to the outcome of the EU wide review of the whole prudential regime for investment firms by 31 December 2015.

Proposed regulatory changes

16. In summary the main changes introduced by CRDIV are:

- the improved quantity and quality of capital that firms' are required to hold;
- the introduction of capital buffers;
- governance arrangements;
- new reporting framework (COREP/FINREP);
- liquidity requirements and liquidity reporting.

11 Various proxies have been used to estimate the firms that will fall under the discretion in article 95(2). The number presented here should be treated as an estimate since we do not directly record firm's MIFID activities. We believe that the figure reported here is likely to be a high-end estimate of the exempted population.

17. The most fundamental changes introduced by CRD IV are the improved quantity and quality of capital that firms' are required to hold and the liquidity requirements. The transitional period for the liquidity coverage requirement does not start until 2015, and the Commission is mandated to submit a proposal for a liquidity regime for investment firms by 2016. However, liquidity reporting commences from 1 January 2014. The FCA has proposed to significantly limit the number of firms required to submit CRD IV liquidity returns, and these firms are already subject to the ILAS regime. Therefore, whilst there will be systems costs for the firms affected, it is unlikely that the treasury cost during 2015 imposed by the liquidity coverage requirement would exceed existing ILAS requirements.

18. The most significant system changes arise from the new reporting requirements. The circa 1,400 firms subject to the full CRD IV package will be required to submit regulatory information to the FCA through COREP, as part of the EU project to harmonise reporting of financial and regulatory information by credit institutions and investment firms.

Market failure analysis

19. The Commission in its impact assessment of the Directive and Regulation[12], identified the following problems that needed remedy:

- liquidity risk management practices "shown to be inadequate in fully grasping risks linked to originate-to-distribute securitisation, use of complex financial instruments and reliance on wholesale funding with short term maturity instruments";
- inadequate levels of capital, and in particular, the fact that "the EU banking system entered the crisis with capital of insufficient quality and quantity";
- "shortcomings in current regulatory treatment of counterparty credit risk arising from derivatives, repo and securities financing activities";
- divergent sanctioning regimes for violations of CRD between Member States and "not always appropriate to ensure effective enforcement";
- poor corporate governance leading to instances of excessive risk taking.

20. It should be noted that the Commission's CRD IV impact assessment was prepared largely in relation to credit institutions whilst CRD IV will also apply many new prudential requirements to investment firms under a directly binding Regulation. However, there is a requirement for the Commission to review the appropriateness of the whole prudential regime for all CRD investment firms by the end of 2015.

21. Broadly speaking, the regulatory reforms in CRD IV look to address the market failures revealed by the financial crisis. Information asymmetries and systemic externalities exacerbated the financial crisis and the ensuing economic downturn. The provisions of the Directive and the Regulation seek to address such failures through increasing the level and quality of capital, improving governance of firms, strengthening liquidity standards and expanding disclosure requirements. Such provisions are particularly aimed at the banking sector where these market failures are most acute and significant.

12 http://ec.europa.eu/internal_market/bank/regcapital/new_proposals_en.htm

22. Problems of informational asymmetry (including principal-agent problems) also exist within investment firms, and the provisions of CRD IV will help remedy such problems.

23. Asymmetry of information and poor disclosure practices may currently be leading to a variety of problems in the markets. For example:

- There may be divergences of interests between principals and agents in some of the investment markets considered by this CBA. Such principal-agent problems may be brought about by imperfect information and could lead to instances of consumer detriment. These problems may be particularly acute at times of crisis, when the principals' and agents' interests could become most misaligned as firms seek to minimise adverse impacts potentially at their clients' expense;

- It may be currently difficult to understand firms' risk profiles, making it difficult for investors to accurately value and select firms; and

- A lack of transparency may reduce corporate governance standards as clients and potential investors are unable to hold management to account.

24. The financial crisis demonstrated the complex and interlinked nature of financial markets. Although the new capital standards are aimed primarily at reducing risks from systemically important institutions, these measures will also reduce the risk of failure of an investment firm, thus reducing the negative externalities associated with such occurrences.

Cost analysis

25. The implementation of CRD IV is likely to have a substantial impact on the regulatory costs of systemically important institutions; comparably, the costs for FCA regulated firms will not be as substantial. However the relative cost for small firms could be significant. These costs break down into (1) compliance costs to firms (capital and non-capital compliance costs), (2) indirect costs arising from changes to firms' behaviour and its impact on the markets; (3) wider macroeconomic impacts; and (4) direct costs to the FCA.

Compliance costs to firms

26. The large majority of non-capital compliance costs to firms arise from the new supervisory framework for Common Reporting (COREP) and Financial Reporting (FINREP). These new reporting obligations will allow regulators to better assess the firms' risks and compare them by uniforming formats, frequencies and dates of prudential reporting and increasing the quantity and level of detail of information. COREP costs arise from Regulation which we are obliged to implement. Although we do not have a legal obligation to estimate the impact of such Regulation, we are including our estimates of the costs in this CBA for reference, since they are the most significant (non-capital) costs associated with CRD IV.

27. As discussed, we estimate that circa 1,000[13] of BIPRU firms will not be subject to CRD IV due to the proposed exercise by the FCA of the discretion in article 95(2) of the Regulation. These firms will continue to be subject to existing CRD III capital provisions and will continue submitting their information in the existing forms. On the other hand, at least 1,400 firms will need to comply with the new CRD IV reporting framework. Table 15 shows the approximate distribution of these firms by size[14] and type.[15]

Table 15: Approximate number of firms mandated to comply with the reporting framework[16]

Investment Firm Type	Approximate number of firms			Totals by type
	Small	Mid-Size	Large	
Full-Scope	160	30	10	200
Limited Activity	15	20	5	40
Limited License	1100	50	10	1160
Total by size	**1275**	**100**	**25**	**1400**

28. The incremental compliance costs per firm include one-off and on-going costs. Given the uncertainty of the cost impact on the investment firms affected, the costs are estimated based on the replies of firms responding to a survey conducted by the FSA.[17] Table 16 and Table 17 show the estimated incremental one-off and annual on-going compliance costs per firm respectively. The estimates are based on the median costs by firm type and size category.

Table 16: Estimated incremental one-off compliance costs per firm

	Costs per firm (£ thousands)		
Investment Firm Type	Small	Mid-Size	Large
Full-Scope	20	155	350
Limited Activity	10	21	59
Limited License	11	NA[18]	30

13 See footnote 11.

14 Firms were categorised into small, mid-size and large firms. Small investment firms are those with assets less than £100 million, mid-size are those with assets between £100 million and £1billion and large are those with assets above £1 billion. For asset management firms, assets under management are used instead of total assets but the same thresholds were used.

15 These are approximate figures as we do not record firm's MIFID activities.

16 The approximate number of firms that will need to comply with the reporting framework is the difference between the total number of BIPRU firms (see Table 14) and the number of firms that will not be subject to CRD IV due to the discretion in article 95(2). The approximate figures presented in this table have been rounded up.

17 Approximately 13% of relevant BIPRU investment firms completed a survey conducted by the FSA.

18 Given the small number of firms in this category and the low response rate to this survey, we are unable to estimates the costs for this size and type of firms due to the lack of representativeness of the data.

Table 17: Estimated incremental annual on-going compliance costs per firm

	Costs per firm (£ thousands)		
Investment Firm Type	Small	Mid-Size	Large
Full-Scope	2	12	61
Limited Activity[19]	NA	NA	NA
Limited License	3	4	11

29. We estimate that the total COREP/FINREP compliance costs per firm range from £50 thousand to £2.2 million pounds depending on the size and type of firm. These estimates are based on the assumption of a perpetual stream of on-going costs discounted at 3%. However, as mentioned before, there will be an EU wide review of the whole prudential regime for investment firms by 31 December 2015. Estimating only the costs involved until the review date, the total compliance costs per firm would range from £15 thousand to £500 thousand. These costs are incremental to those the firms already incur in reporting capital and financial information.

30. Extrapolating these costs to the entire estimated population that will need to comply with the new reporting framework, the approximate overall cost until December 2015 will be £35 million. This figure is based on the approximate number of firms affected and the estimated one-off and on-going compliance costs per firm shown in the tables above. The number of firms affected in practice may be slightly larger, marginally increasing this overall cost.

31. These costs will arise from changes in information systems, data requirements, data transmission procedures, staffing and training, senior management reviews, external services, data publication and other areas identified by firms. Firms were also asked to include in their estimates the incremental costs due to changes to the frequencies and timing of reporting required by this regulation.

32. In general, smaller firms expect most of the cost to be associated with IT and external consulting services. Mid-size firms estimate the cost of senior management time to review to be the most important. Data verification, capturing and submission are expected to be the main additional cost for the larger firms.

33. In addition to the costs associated with COREP/FINREP as outlined above, there are likely to be additional administrative burdens arising from a requirement for some firms to develop internal whistle-blowing systems and from corporate governance requirements. However we expect these incremental costs to be small compared to those arising from the reporting requirements. Other changes relate to governance and risk management arrangements, which may drive additional costs. These are likely to be proportionally higher for more complex firms, who have more intricate risk management and regulatory compliance arrangements.

Capital compliance costs

34. CRD IV changes firms' capital requirements by increasing the level and quality of capital. The main impact on firms may come from (1) changes to the composition of capital and risk weighted assets and (2) changes to minimum capital ratios.

19 See footnote 18.

35. The actual capital compliance costs for a firm depend on their levels and composition of capital and will therefore vary on a firm-by-firm basis. Providing an accurate estimate of capital compliance costs is very resource intensive. As we do not have to estimate the costs arising from Regulation, we have provided data on how the costs arise, the different options for firms based on their existing capital structure, as well as some estimates of the potential magnitude of capital costs using some assumptions. We are not providing an exact calculation of the capital compliance costs that CRD IV will entail for the investment firms affected by it and within our remit.

36. Table 18 outlines the change between GENPRU and CRD IV Pillar 1 capital requirements. In order to allow comparisons, it assumes parity between GENPRU and CRD IV capital tiers. However, CRD IV definition of capital is more stringent than GENPRU, so this is a simplifying assumption. These are subject to transitional arrangements until 31 December 2014. Until then we have proposed the minimum requirements available[20]. However, rather than calculating the costs during the transitional period, our calculations compare the increase in the cost of capital between existing BIPRU and the CRD IV end point requirements.

37. Pillar 1 applies to all firms, although as discussed before, some firms will not be subject to CRD IV due to the proposed exercise by the FCA of the discretion in article 95(2) of the Regulation and will continue to be under existing CRD III capital provisions. The capital requirements for Pillar 2 and the capital buffers are firm specific, therefore we are not including them in the cost estimates.

Table 18: Changes to level of capital requirements

Type of capital	GENPRU requirement	CRD IV requirement
Core Tier 1/Common Equity Tier 1	2%	4.5%
Tier 1/Additional Tier 1	2%	1.5%
Tier 2	3%	2%
Tier 3	1%	-

38. Given that total Pillar 1 requirement remains at 8% but the importance of Common Equity Tier 1 increases, many firms that currently exceed the existing Core Tier 1 requirements will already meet CRD IV capital requirements. These firms may not have to raise any additional capital.

39. Firms that currently just meet the existing equity capital requirements will need to raise the additional amount of capital required by CRD IV entirely with equity (see Table 18 for the differences in composition of capital). Given the differences in the population of firms affected, we estimate a reasonable range of cost of equity to be 5 to 15%.[21]

40. There may be cases where firms adapt to CRD IV capital requirements by retiring existing debt and substituting it with equity, changing their capital mix but maintaining the existing total levels of capital. The additional equity to be raised in this scenario is 2.5% of the risk weighted assets (RWAs).[22] In this case, the incremental cost from CRD IV will be the difference between the cost of raising new equity minus the after tax cost of the existing debt that will be retired and replaced by equity. We estimate that a reasonable range for that incremental cost of equity over debt could be 3% to 10%.[23]

20 Transitional arrangements are discussed in Chapter 4.

21 The cost of equity was estimated using the CAPM model. The cost of equity could only be estimated for a small number of firms. However we recognise that these listed firms are not representative of the entire population of firms affected by CRD IV. Therefore we present a range for the estimated cost of equity. However, it is possible that the cost for some of the firms lies outside this range.

22 This 2.5% is the difference between the CRD IV CET 1 requirement (4.5%) and the current GENPRU Core Tier 1 requirement (2%).

23 As for the cost of equity (see footnote 11), the cost of debt could only be estimated for a small number of firms using the yield to maturity of corporate bonds. Therefore we present a range for the estimated incremental cost of equity over debt. However, it is possible that the cost for some of the firms lies outside this range.

41. Whenever possible, firms may have the incentive to fill any remaining total capital requirement by issuing qualifying debt, as this is the cheapest capital raising option in terms of cost. In the scenario where firms hold the minimum required levels of capital, most firms would substitute debt for equity, therefore we calculate the overall cost for the total investment firms affected by CRD IV by estimating the additional RWAs that will need to be financed by equity and apply to that our estimated range of incremental cost of equity. We estimate the overall capital compliance cost for the CRD IV firm population to be between £64 to £215 million (see Table 19).

Table 19: Estimated overall capital compliance cost for the CRD IV firm population

	£ Millions
Total risk weighted assets (RWA)	86,028
Incremental equity to be raised: 2.5% of RWA	2,150
Overall capital compliance cost: [3-10%] x incremental equity to be raised	[64 - 215]

Indirect costs

42. Together capital and non-capital compliance costs will increase the cost structures of the investment firms considered as part of this CBA. These increased costs will have indirect effects since they may alter the structure of some of the markets we are considering in this CBA. For example, the increased costs of financial intermediation may be passed on to clients, possibly resulting in a reduction in client return and that, in turn, could lead to a reduction in demand for such services. Furthermore, such effects could potentially affect consumer behaviour, driving investors to look for higher returns by, warily or unwarily, taking more risk.

43. Additionally, there could be implications for competition in the market as explained in the competition assessment section at the end of this Annex.

Wider macroeconomic impacts

44. We do not expect significant wider macroeconomic costs arising from the impacts of the policies on investment firms. The firms we consider in this CBA do not generally provide credit to SMEs or households in the real economy, so the main indirect economic impacts will be felt only within the markets in which they operate. As noted previously, we expect the major macroeconomic impacts will come from systemically important firms. The PRA has estimated the macroeconomic costs and benefits of the policy package by considering the impact on PRA-regulated firms.

Direct costs to the FCA

45. The FCA will incur incremental costs to implement the CRD IV package. The major costs will arise from implementing COREP/FINREP. The incremental costs to the FCA to collect all the required information will include IT systems and IT development staff. We currently expect the one off cost to be circa £10 million, including the operational costs for 2014 and 2015. We anticipate an on-going operational cost each year after of circa £300 thousand.

46. Additional to the reporting requirements, the FCA will need to implement business and handbook changes. We expect these costs to amount to a one off cost of £5.4 million in addition to the harmonised reporting costs.

47. The FCA will cover any additional supervisory needs arising from the regulatory packages with existing resources.

Benefits analysis

48. The main benefits from CRD IV arise from addressing the market failures described above.

49. Overall, the major economic benefits arising from implementation of CRD IV come from increased financial stability and reduced macro-prudential risk. We expect these benefits to be described and estimated in the PRA's CBA accompanying CRD IV.

50. We do not believe that the investment firms considered as part of this CBA can be considered globally systemic. Just as the costs for investment firms will not be materially significant compared to those of systemically important firms, the benefits are expected to be comparably smaller. We have identified, however, areas where we believe the measures will reduce some of the potential market failures and problems described earlier in this Annex.

51. The changes in capital requirements, i.e. the increase on capital ratios and the improvements on the quality of capital, will increase the firms' resilience to financial shocks and stress. This will reduce potential spillover effects and negative externalities.

52. The new disclosure requirements will improve transparency and allow the effective monitoring and comparison of the risk-taking activities of the regulated firms. Harmonised disclosure and increased transparency will help reduce the information asymmetries that create uncertainty during financial crises.

53. Improved transparency from new disclosure requirements will also support good corporate governance, reducing instances of principal-agent problems. Such improvements may also come about from new corporate governance guidelines. In general, improvements in corporate governance will lead to efficient allocation of resources increasing productivity and reducing the possibility of excessive risk–taking. It also allows senior management to have a clearer view of the risks for decision-taking. This may increase investor confidence, leading to a positive spillover as financial markets work more efficiently. Additionally, improved transparency leads to a more accurate valuation of companies, benefiting investors.

Competition assessment

54. The main competition impacts arising from CRD IV will come from the requirements imposed by the Regulation and new rules resulting from transposition of the Directive. The exercise of discretions aims to keep disproportionate impacts on investment firms to a minimum. This approach generally implies that the impacts from the exercise of discretions on current market structures and hence the effectiveness of competition should also be minimised. The overall impacts on investment firms (in terms of costs and benefits) will be significantly smaller than those on credit institutions. We believe this is also true for the impacts on the effectiveness of competition.

55. We have estimated that non-capital compliance costs will be more significant for small firms, and in particular small limited license firms who are subject to full CRD IV. The compliance costs are to a large extent caused by the COREP/FINREP requirements, which we are required to implement. Such burdensome requirements could in principle lead to market exit by some of the affected smaller firms. They could also act as barriers to entry to markets as potential entrants are deterred. This is potentially costly in terms of the effectiveness of competition in the market.

56. There may be some small beneficial impacts on the effectiveness of competition that arise from increased transparency in firms (and improved governance in some firms where such rules become applicable). These regulatory changes should result in a better approach to risk-taking in investment firms as incentive structures improve and investors become better informed about firm behaviour. In turn, competition in the market may result in products and services that are more beneficial to consumers.

57. The approach outlined in respect of exercising derogations and discretions is likely in our view to be positive for competition insofar as the least burdensome outcomes are generally being sought. The possible exception to this is where options are deliberately chosen to limit the impact on incumbent firms. It may be that such choices benefit incumbents at the expense of potential entrants. However, we consider that such adverse impacts will be small.

58. For many products and services affected by CRD IV there is a good degree of cross-border substitutability. This is evidenced by the fact that many wholesale, and to a lesser extent retail consumers use investment firms which are established in other Member States to their own. Such markets are therefore European in nature. Further, the majority of UK based full CRD IV firms passport outwards through MIFID to at least one other Member State, providing investment services across the EU. Also a large number of EEA firms passport in to the UK.

59. Where the markets are European, there are likely to be competition benefits from the implementation of a single rulebook. This harmonises rules for the industry across the market, ensuring that firms treat the same exposures and products in the same way. In addition, it removes previous competitive distortions due to different Member States having different rules, which could enable market participants to exploit differences in regulatory regimes.

60. There may however be markets affected which are national in nature. In such markets the effect of a single rulebook is not unambiguously good for competition since the benefits from harmonisation described above do not apply.

Q28: Do you have any comments on our cost benefit analysis?

Annex 2: Compatibility statement

Introduction and statement of purpose

1. This Annex sets out our views on how the proposals for transposing the CRD IV in the UK are compatible with our objectives and the principles of good regulation. CRD IV is a set of reforms to the EU's capital requirements regime for credit institutions and investment which consist of Regulation (EU) No 575/2013 and Directive 2013/36/EU.

Compatibility with the FCA's objectives and general duties

2. Our planned transposition of CRD IV, as set out in this CP and the draft Handbook text that accompanies it, aims primarily to meet our integrity objective. However, our consumer protection and competition objectives are also relevant.

Integrity objective

3. This objective requires us to protect and enhance the integrity of the UK financial system.

4. CRD IV represents the EU's implementation of the international standards for banks agreed by the Basel Committee, which materially strengthen the prudential regime. It also applies to investment firms.

5. Our proposals in this CP and the draft Handbook rules and guidance seek to reduce the risk of market disruption arising from financial failure of an authorised firm or group of firms. This is achieved through quantitative and especially qualitative enhancement of the institutions' capital adequacy.

6. As described in the CBA, the regulatory reforms aim to reduce problems associated with informational asymmetries and negative externalities as revealed by the financial crisis. Whilst such problems are particularly associated with the banking sector, the reduction of informational asymmetries for investment firms' may also improve market integrity.

Consumer protection objective

7. This objective requires us to secure an appropriate degree of protection for consumers.

8. The objectives underlying CRD IV are primarily prudential in nature. While there are no direct implications for consumers, the proposed Handbook text seeks 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 and governance arrangements for these firms, as a result of the changes the CRD requires, will make it less likely that they fail in a disorderly manner. This should have positive outcomes for consumers.

9. Although most of the EU requirements are now directly applicable to firms through the Regulation, there are a number of areas where we still need to make rules. Our overall approach to CRD IV transposition - outlined in Chapter 1, should help firms to contain any overall increase in costs while keeping the benefit of prudential soundness. This is pending an EU-wide review of what is an appropriate prudential regime for different types of investment firms that the Commission is required to undertake by the end of 2015.

Competition objective

10. It should be noted that our overall approach towards the exercise of CRD IV derogations and discretions (where the least burdensome outcomes are being sought) will result in the minimum feasible impacts on competition in the market.

11. As described in the CBA, there may be some adverse impacts on competition as firms (and potential entrants to the market) face increased costs. These costs come primarily from the Regulation and transposition of the Directive where the FCA has no ability to promote a more beneficial outcome for competition in the markets.

12. There may be some beneficial impacts on competition from the improvements in transparency arising from CRD IV.

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

13. Under section 1B (5) of 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

14. The publication of this CP with a consultation period over the summer allows the industry time to consider and to implement the relevant changes brought about by CRD IV. Furthermore, the timing enables the FCA to publish, in due course, a Policy Statement in response to comments from industry and other stakeholders on our implementation proposals with the aim of providing the final rules ahead of the CRD IV implementation by 1 January 2014.

15. We outline our overall approach to CRD IV transposition in Chapter 1.

Principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected

16. We have undertaken a cost-benefit analysis of the material areas of the changes in order to help with this CP. Given the diverse nature of the different policy topics covered within the package of changes as a whole, we include references to the CBA in the relevant chapters – where appropriate, and in Annex 1.

Principle that consumers should take responsibility for their own decisions

17. This principle is not directly relevant to this CP since our proposals do not remove consumer's responsibility for their financial decisions.

Desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

18. Our overall approach to, in general, applying the minimum requirements and, where possible, not seeking to change current policy as well as exercising national discretions in a proportionate manner, should help our firms to limit any overall increase in costs pending the Commission's review of their prudential regime by the end of 2015.

Responsibilities of those who manage the affairs of authorised persons

19. In general, our approach to intelligent 'copy-out' of EU law -where possible – is consistent with our implementation of the original requirements of the CRD. This means there will be less prescription and guidance for firms, shifting onto them more responsibility for compliance.

Desirability of exercising our functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons

20. The FCA is currently the prudential regulator of wide range of investment firms under the current CRD – covering a range of business models (including broker dealers, wealth managers, retail and wholesale, and some large through to many very small firms). Our overall approach towards the discretions and derogations in the CRD IV ensures that we recognise differences in the nature and business models of each type of investment sector firms affected by CRD IV.

Desirability of publishing information relating to persons

21. This principle is not relevant to the proposals in this CP.

Principle that we should exercise our functions as transparently as possible

22. We have engaged with trade associations and firms throughout this process in relation to our overall approach to CRD IV transposition including our timeline for this consultation process.

Expected effect on mutual societies

23. Our proposals in this CP refer to firms in the investment sector affected by CRD IV, but they do not refer to mutual societies.

Equality and diversity

24. We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we conduct an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered.

25. Our equality impact assessment suggests that our proposals do not result in direct discrimination for any of the groups with protected characteristics i.e. age, disability, gender, pregnancy and maternity, race, religion and belief, sexual orientation and transgender, nor do we believe that our proposals should give to rise to indirect discrimination against any of these groups. We would nevertheless welcome any comments respondents may have on any equality issues they believe may arise.

Annex 3: List of national discretions and FCA's approach to their application

1. Tables 20 and 21:

- show the areas of national discretions in the Regulation and the Directive; and
- indicate the FCA's proposal to exercise or not the relevant discretion.

Table 20: Capital Requirements Regulation: Areas of national discretion

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
4(2)		FCA may allow shares constituting an equivalent indirect holding of real estate to be treated as a direct holding of real estate, subject to certain conditions.	Yes
6(4)		FCA may exempt investment firms from complying with liquidity rules taking into account the nature, scale and complexity of investment firms' activities.	Yes
7		FCA may give a direction to a firm to exempt it from solo capital requirements in accordance with this article.	No
8(1)	BIPRU 12.8	FCA may waive collection of liquidity data on an individual/solo basis and collect on a sub-consolidated basis for liquidity sub-groups containing only EU firms.	Yes
8(2)	BIPRU 12.8	FCA may waive collection of liquidity data on an individual/solo basis and collect on a sub-consolidated basis for liquidity sub-groups containing only UK authorised firms	Yes
8(5)		In instances where 8(1) or 8(2) have been applied the FCA may apply Article 86 of the Directive, or parts thereof, at the level of the liquidity sub-group as opposed to on an individual basis.	Yes
9	BIPRU 2.1	FCA may issue solo consolidation directions to replace existing waivers.	Yes
11(3)		FCA may exempt groups comprising only investment firms from complying with liquidity rules taking into account the nature, scale and complexity of investment firms' activities.	Yes

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
14(3)		Where subsidiaries which are not subject to CRD IV are affected by Part V of CRR, which concerns securitisation, if the UK regulated firm can demonstrate to the FCA that the application of Part V is unlawful in the third country where the subsidiaries (or multiple thereof) are incorporated, the FCA should waive the application of Part V.	Yes
15, 16 and 17	BIPRU 8.4	FCA may issue investment firm consolidation waivers.	Yes
18(2)		FCA may give a direction to permit proportional consolidation on a case by case basis if the conditions in this article are met.	Yes
18(3) and 18(6)	BIPRU 8.5.6(2)R	FCA to determine how consolidation should occur for organisations related within the meaning of a consolidation Article 12(1) (of Directive 83/349/EC) relationship.	Yes
18(5)	BIPRU 8.5.5R(3) BIPRU 8.5.6R(1	FCA may determine whether and how consolidation is to be carried out in the case of participations or capital ties different from those set out in art. 18(1) and 18(2).	Yes
19	BIPRU 8.5.9 R BIPRU 8.5.10 R BIPRU 8.5.11 G	FCA may permit that a subsidiary need not be included in the consolidated group provided that certain conditions are met.	Yes
26(2)	GENPRU 2.2.102R - 103R	This provision requires the FCA to consent to a firm including interim or year-end profits in CET1 before the firm has taken a formal decision to confirm the year-end profit or loss, provided that the conditions in art. 26(2) are met.	Yes
26(3)		The FCA must evaluate whether CET 1 issuances meet the criteria in art 28 or 29, as appropriate.	Yes

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
28(1) (f)(ii), 77 and 78	GENPRU 2.2.64R GENRU 2.2.80R GENPRU 2.2.83R (4) GENPRU 2.2.83AR GENPRU 2.2.83BR GENPRU 2.2.83CR GENPRU 2.2.83DG GENPRU 2.2.85R (3) and part of 2.2.85R(1) GENPRU 2.2.86R - 101R	FCA may give a direction to a firm to allow it to repurchase CET1 instruments in accordance with art 28 (1)(f)(ii).	Yes
36, 56 and 66	GENPRU 2.2.219R	FCA may set out what it considers to constitute direct, indirect or synthetic holdings which have been designed to inflate the own funds of the institution.	Yes
41(1) (b)		FCA may give a direction to a firm to allow it to reduce the amount of defined benefit pension fund assets that it must deduct from CET1 resources in accordance with art. 41(1)(b).	Yes
49(1)		FCA may give permission to a firm not to deduct holdings in insurance undertakings for the purpose of calculating capital requirements on a standalone basis.	No
49(2)		FCA may require firms to deduct holdings in 'financial sector entities' for the purposes of supervision on a standalone or sub consolidated basis.	No
49(3)		FCA may give a direction to exempt a firm from the obligation to deduct holdings in 'financial sector entities' where the institutions fall within the same institutional protection scheme referred to in art 113(7) and the remaining conditions thereto are met.	No
73	GENPRU 2.2.64R(4) (b)(i)	FCA may allow capital instruments for which an institution has the sole discretion to decide to pay distributions in a form other than cash or an own funds instrument to qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments, providing the conditions of paragraph 2 are met.	Yes
76(1) (d)		A firm may use a short position where this is part of an index, provided that the FCA assesses annually and is satisfied that the firm's internal control mechanisms are adequate in relation to internal hedges.	Yes

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
76(2-3)		FCA may give a direction to a firm to allow it to use a conservative estimate of the underlying exposure of the firm to capital instruments included in indices as an alternative to the firm's calculating its exposure to its own or financial sector entities' CET1, AT1 and T2 instruments included in such indices. FCA may only give this direction where the firm has demonstrated that it is "operationally burdensome" to monitor such underlying exposure.	Yes
79		Where an institution holds regulatory capital instruments and subordinated loans in a financial sector entity temporarily, the FCA may waive on a temporary basis the provisions on deduction that would otherwise apply to those instruments should those holdings be for the purposes of a financial assistance operation designed to reorganise and save that entity.	Yes
83	BIPRU 8.6.11R to BIPRU 8.6.20R	FCA may give a direction to a firm to waive the requirement to include holdings in SPVs in the firm's consolidated own resources provided that the conditions set out in this article are met.	Yes
84(5)	BIPRU 8.6.10R	FCA may waive the application of this article to a 'parent financial holding company' that satisfies a number of conditions thereto.	Yes
89	GENPRU 2.2.202R to GENPRU 2.2.207R	FCA must choose which treatment between paragraphs (a) (1250% RW) or (b) (prohibition) of art. 89(3) must be applied to UK CA-regulated firms.	Yes
93(2-5)	GENPRU 2.2.202R to GENPRU 2.2.207R	This is a grandfathering clause, carried over from the BCD. It is not currently implemented by the FCA, and we do not believe it is relevant to FCA firms.	No
95(2)		FCA may allow firms that carried out a combination of certain MIFID activities to retain current CRD rules on own funds requirements (Pillar 1) as it stood under national law (i.e. BIPRU and GENPRU) on 31 December 2013.	Yes (see Chapter 6 of this CP)
97(2)		FCA may alter the FOR where it is deemed appropriate. The EBA will publish technical standards around this by March 2014.	Yes
99(6)	SUP 16.12	Where the FCA considers that the financial information required by paragraph 2 of this provision is necessary to obtain a comprehensive view of the risk profile of the activities of, and a view of the systemic risks to the financial sector or the real economy posed by, institutions -other than those referred to in paragraphs 2 and 3 that are subject to an accounting framework based on Directive 86/635/EEC, the FCA shall consult EBA on the extension of the reporting requirements of financial information on a consolidated basis to those institutions, provided that they are not already reporting on such a basis	No

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
113(6)	BIPRU 3.2.20 R to BIPRU 3.2.27R	FCA may allow firms to reduce/waive risk weights to intra-group exposures providing that certain conditions are met.	Yes
114(7), 115(4), 116(5), 132(3) and 142	BIPRU 3.4.6R, BIPRU 3.4.15R, 3.4.26R, BIPRU 3.4.122R, GENPRU 3.2	The Commission must produce a list of third country equivalents in relation to these articles by 1 January 2015. Until then the FCA may continue to treat third country equivalents as such with the proviso that no additional third country equivalents can be approved in respect of these articles after 1 January 2014.	Yes
124, 125 and 126	BIPRU 3.4.55 R	FCA may increase the risk weights on residential mortgage (35%) and commercial immovable property (50%) within certain thresholds or set stricter criteria than those in articles 125(2) and 126(2). The EBA should be consulted if this were exercised.	Yes (see chapter 4)
129		The competent authorities may, after consulting the EBA, partly waive the application of point (c) of the first subparagraph and allow credit quality step 2 for up to 10 % of the total exposure of the nominal amount of outstanding covered bonds of the issuing institution.	No
143 and 144	BIPRU 4	These articles permit a firm to use an IRB model provided that the FCA deems the firm to have met the conditions in Part Three, Title II, Chapter 3. The EBA will submit standards around the IRB assessment methodology by 31 December 2014.	Yes
150	BIPRU 4.2.26 R-35G	Further criteria for IRB Permission: Where institutions have received the prior permission of the FCA, institutions permitted to use the IRB Approach in the calculation of risk-weighted exposure amounts and expected loss amounts for one or more exposure classes may apply the Standardised Approach for certain exposures	Yes
157	BIPRU 4.8.21R	Further criteria for IRB Permission: FCA may exempt a firm from the obligation to calculate and recognise RWEA for dilution risk where the firm has demonstrated to the FCA that dilution risk is immaterial for a given exposure.	Yes

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
162	BIPRU 4.4.67R, BIPRU 4.4.81R, BIPRU 4.6.54R	Further criteria for IRB permissions: 162(1) - for Foundation IRB firms, the FCA may give a direction to a firm to use a specified Maturity for each exposure among those set out in art. 162(2) 162(2)(h) - FCA may give a firm using an internal model to calculate credit valuation adjustment (CVA) authorisation to use its own estimate of effective credit duration as maturity (M). 162(2)(i) - A firm, with an IMM Permission and a specific market risk internal model permission for traded debt instruments shall set M to 1 in the formula laid out in Art 153(1), provided that the firm can demonstrate to the FCA that its internal model for specific risk associated with traded debt positions under Art 383 contains effects of rating migrations.	Yes
164 and 199	BIPRU 4.6.54R	164(2) - FCA may decide whether unfunded credit protection is eligible in support of an individual exposure or pool of exposures. 164(5) - FCA must assess periodically and, at least, annually whether the minimum Loss Given Default (LGD) set out in paragraph (4) for exposures secured by residential and commercial real estate are appropriate. The FCA may increase these minima on the basis of financial stability considerations.	Yes (we will publish this data at a later date)
166(8)	BIPRU 4.4.37R - 9(a) first paragraph, (b), (c) and (d), BIPRU 4.6.44R - 9(a) last paragraph, BIPRU 4.8.29R - 9(c) last paragraph, BIPRU 4.4.45R - 9 (e)	Permission to use own estimates of conversion factors (art. 166(8)(e)): an advanced IRB firm may use its own estimates of conversion factors across the different product types listed in subparagraph (a) to (d) of art. 166(8) with the prior consent of the FCA.	Yes
170(4)	BIPRU 4.6.11R	FCA may exempt a firm from the obligation to include 'delinquency' as a risk driver for assigning exposures to grade or pools, provided that delinquency is not material for a given exposure.	Yes
178	BIPRU 4.3.57	Under the IRB approach, this article defines a period of 90 days past due as a default, with the possibility of this period being extended to 180 days for exposures secured by residential or retail SME CRE, as well as exposures to PSEs should the FCA deem appropriate.	Yes

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
179	BIPRU 4.3.9	FCA may allow in a firm's IRB Permission flexibility in the application of the required standards for data in relation to data collected prior to 1 January 2007.	Yes
180, 181 and 182	BIPRU 4.6.29	FCA may allow a firm in its IRB Permission to use data covering 2 years (not 5 years) for LGD and conversion factors estimations in certain circumstances, when the firm implements the IRB approach.	Yes
183	BIPRU 4.10.44R	FCA may allow a firm in its IRB Permission to recognise conditional guarantees as eligible for the purposes of assessing the effect of these guarantees in the firm's calculation of own LGDs.	Yes
199(6)		Where specified conditions are met, the FCA shall permit an institution to use as eligible collateral physical collateral of a type other than those listed in art 119(2-4).	Yes
221	BIPRU 5.6.12-19R	221(1): FCA may give a direction to a firm to allow it to use an Internal Models Approach for master netting agreements. 221(2): FCA may permit a firm to apply an internal models approach permission to margin lending transactions where they are covered by an appropriate bilateral master netting agreement. 221(4): FCA may only grant an internal models approach permission where the applicant meets the conditions set out in this article.	Yes
225	BIPRU 5.4.45-47R	FCA may give a firm a direction to allow it to use its own estimates of volatility adjustments to be applied to collateral and exposures, where the firm complies with the requirements in paragraphs (2) and (3) of this article. This is a separate permission (own estimates of volatility adjustments approach permission).	Yes
237	BIPRU 5.8.1R BIPRU 5.8.2R BIPRU 4.10.50R	The FCA may specify in an IRB firm's permission short term exposures subject to a one-day floor rather than a one-year floor in respect of the maturity value to be calculated in accordance with art. 162 (Maturity).	Yes
243(2)	BIPRU 9.4.11R BIPRU 9.3.7R BIPRU 9.4.1R	FCA can decide whether significant credit risk has been transferred to third parties in a traditional securitisation.	Yes
244(2)	BIPRU 9.5.1R(6); BCD Annex IX part 2, point 2a	FCA can decide whether significant credit risk has been transferred to third parties in a synthetic securitisation.	Yes

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
244(4)	BIPRU 9.5.1BD; BIPRU 9.5.1CG; BIPRU 9.5.1DG; BIPRU 9.4.1EG; BCD Annex IX part 2, point 2c	FCA shall grant permission for firms to use Significant Risk Transfer if certain criteria are met.	Yes
256(7)	BIPRU 9.13.18 G	FCA may give a firm a direction to allow it to apply paragraph 6 to securitisations subject to an early amortisation provision. The firm must comply with the conditions in this paragraph.	Yes
259(1) (b)	BIPRU 9.12.2 RBIPRU 9.12.3 RBIPRU 9.12.6 R	FCA can give non-originator firms permission to use their IRB model to calculate certain inputs (Probability of Default (PD), LGD, exposure value) in the Supervisory Formula where the IRB model meets the criteria to model those inputs.	Yes
259(1) (b)	BIPRU 9.12.5R	FCA may allow a firm to use the Internal Assessment Approach (IAA) in relation to unrated positions in an Asset-Backed Commercial Paper (ABCP) programme.	Yes
259(1) (e)		FCA can allow firms to apply Articles 253 and 254 to an unrated position which is not commercial paper in an ABCP programme, provided that it falls within the scope of the (IAA).	Yes
259(3)	BIPRU 9.12.20 R	The FCA shall grant permission for a firm to use IAA where certain conditions are met.	Yes
259(5)	BIPRU 9.12.20 R	Firms with permission to use IAA can only revert to the use of other methods without the prior permission of the FCA.	Yes
262(2)	BIPRU 9.14.3R BIPRU 9.12.21R to 9.12.23R BIPRU 9.12.24G BIPRU 9.12.25R BIPRU 9.12.27R	For securitisations in which materially all securitised exposures are retail exposures, institutions may, subject to permission by the FCA, use the Supervisory Formula Method using the simplifications h=0 and v=0, provided that the effective number of exposures is not low and that the exposures are not highly concentrated.	Yes
263(2)	BIPRU 9.12.28G	FCA may give a direction to a firm to allow it to apply the treatment in paragraph (3) to an unrated position that is a liquidity facility where this does not qualify for the IAA.	Yes

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
282(6)	BIPRU 13.5.9R BIPRU 13.5.10R	For (i) transactions with a non-linear risk profile or for payment legs and transactions with debt instruments as underlying for which the instrument cannot determine delta or the modified duration and (ii) where the firm has a market risk model permission; the FCA may determine the size of the risk positions and the applicable Counterparty Credit Risk Multiplier or require the institution to use the mark to market method.	Yes
283	BIPRU 13.6.7R; BIPRU 13.6.8R; BIPRU 13.6.9G; BIPRU 13.6.13R; BIPRU 13.6.17 R; BIPRU 13.6.19G; BIPRU 13.6.20R;	Where the FCA is satisfied that the relevant conditions are met, it shall grant permission for a firm to use an internal model for counterparty credit risk capital calculations.	Yes
284(4)	BIPRU 13.6.24R BIPRU 13.6.25R BIPRU 13.6.31R	FCA may require a firm to use a higher alpha (in addition to FCA having the discretion to grant permission for own estimates of alpha in art 284(9).	Yes
284(9)	BIPRU 13.6.33R BIPRU 13.6.34R	FCA may allow a firm to use its own estimates of alpha. This will be specified in the firm's IMM permission.	Yes
285(1)-(2)	BIPRU 13.6.38R BIPRU 13.6.40R	FCA may allow a firm to use its own model of Expected Exposure (EE) in Calculation of effective EE in art. 284(5) only where the model captures the effects of margining. This permission will be specified in the firm's IMM permission.	Yes
292(3)		Express requirement on firms to demonstrate to the satisfaction of the FCA at least quarterly that the stress period used for the calculation under this paragraph coincides with a period of increased credit default swap or other spreads for a representative selection of its counterparties with traded credit spreads.	Yes
292(5)		The FCA may require a firm to adjust the stress calibration for Effective Expected Positive Exposure if the exposures of the firm's benchmarks deviate substantially from each other.	Yes
295	BIPRU 13.7.6R to 13.7.10R	FCA may only recognise as risk reducing those contractual netting agreements meeting the requirements set out in this article.	Yes

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
298(4)		FCA may allow a firm to choose either original or residual maturity for the purpose of calculating the effects of recognition of netting as risk reduction in relation to interest rate contracts.	Yes
312(1)	BIPRU 6.4.1R(1), BIPRU 6.4.16G	FCA may give a direction to a firm to allow it to use the 'alternative relevant indicator' for operational risk for business lines 'retail banking' and 'commercial banking'	No
312(2) and 322	BIPRU 6.5.2G, BIPRU 6.5.3G, BIPRU 6.5.4G, BIPRU 6.5.5R, BIPRU 6.5.6R, BIPRU 6.5.5AG, BIPRU 6.5.8G to 6.5.11G	FCA may give a direction to a firm to allow it to use the AMA for operational risk when certain conditions are met.	Yes
313	BIPRU 6.2.5R, BIRPU 6.2.6G, BIPRU 6.2.7R, BIPRU 6.2.8G	Firms will not be able to revert back to using a less sophisticated approach to calculating their operational risk capital requirement unless they meet prescribed conditions and receive permission from the FCA.	Yes
314(1-5)	BIPRU 6.2.9R, BIPRU 6.2.10G, BIPRU 6.2.11R, BIPRU 6.2.12R, BIPRU 6.2.13G	Institutions are able to use a combination of approaches to calculating their operational risk capital requirement as long as they meet the prescribed conditions and receive prior permission from the FCA.	Yes
315(3)	BIPRU 6.3.4G, BIPRU 6.3.9G(1), BIPRU 6.3.9G(2)	This discretion relates to the calculation of the Basic Indicator Approach for operational risk. A firm may request to adjust their operational risk calculation as due to a merger, an acquisition or a disposal of entities or activities, a simple three year average of the relevant indicator is not an unbiased calculation. The FCA must consider such a request, and if approved, inform the EBA of this decision. Further, the FCA is able to require the firm to modify its calculation in such circumstances.	Yes

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
317(4)	BIPRU 6.4.5R to 6.4.9R BIPRU 6.4.15R	This discretion relates to the calculation of the Standardised Approach for operational risk. A firm may request to adjust their operational risk calculation as due to a merger, an acquisition or a disposal of entities or activities, a simple three year average of the relevant indicator is not an unbiased calculation. The FCA must consider such a request, and if approved, inform the EBA of this decision. Further, the FCA is able to require the firm to modify its calculation in such circumstances.	Yes
323	BIPRU 6.5.26R to BIPRU 6.5.30AG	The FCA shall permit institutions to recognise the impact of insurance (subject to conditions) where the institution can demonstrate that a noticeable risk mitigating effect is achieved.	Yes
325	BIPRU 8.7.25R	Firms may calculate their net market risk requirements on a consolidated basis by offsetting positions between different undertakings within a group, subject to certain conditions being met. FCA shall grant permission if these conditions are met.	Yes
327(2)	BIPRU 7.3.3R, BIPRU 7.3.13R	This provision prohibits netting convertible position and offsetting underlying unless the FCA adopts an approach dealing with likelihood of conversion or requires firms to hold own funds to cover losses which might result from conversion.	Yes
329(1), 352(1) and 358(3) 329(1), 352(1) and 358(3)	BIPRU 7.2.32 BIPRU 7.3.21R BIPRU 7.9	Under these articles firms must use the delta of the position underlying an option in order to calculate market risk own fund requirements for options and warrants. Firms must use the delta determined by the exchange. Where the exchange does not make delta available or in relation to OTC options, the delta shall be that calculated by the firm itself using generally accepted industry standard pricing models, subject to the permission of the FCA.	Yes
331(1)	BIPRU 7.9 G	Firms who wish to use sensitivity models to calculate interest rate sensitivity on derivative instruments must seek explicit permission to do so from the FCA. Firms which do not use models may offset their positions provided that they meet the conditions outlined in the article.	Yes
336		Firms are permitted to calculate estimates of PDs and LGDs used as inputs in to the supervisory formula for securitisation positions. These are to be derived from the Incremental Risk Charge (IRC) model of a firm that has permission to use a model to calculate the specific risk of debt instruments. Firms must notify the FCA that they operate such a model.	Yes
352(2)	BIPRU 7.5.4(1)(c)R	Permission to hedge open currency positions by taking an offsetting position.	Yes

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
354(6)		Transitional discretion until end 2017 where the FCA may allow 0% own funds requirements in relation to pairs of currencies that are demonstrably perfectly positively correlated.	Yes
363(1)	BIPRU 7.10.1R to BIPRU 7.10.17G	The FCA shall grant a VaR permission to a firm that complies with the requirements in sections 2, 3 and 4 of this article.	Yes
366(4)	BIPRU 7.10.106G	Article 366(4) states that the FCA can use its discretion to limit the VaR multiplier add-on resulting from backtesting exceptions under hypothetical changes, where the number of backtesting exceptions under actual changes does not result from deficiencies in a firm's internal model.	Yes
367(1)(b)	BIPRU 7.10.39 R to BIPRU 7.10.45G, BIPRU 7.10.53 R to BIPRU 7.10.55G, BIPRU 7.10.68 G	This Article requires a firm to justify to the FCA the exclusion from its risk management model of a risk factor incorporated into its pricing model.	Yes
373	BIPRU 7.10.55B R	FCA to grant permission before firms are allowed to include listed equity positions in their Incremental Risk Charge (IRC) model.	Yes
377(1)-(4)	BIPRU 7.10.55T R to BIPRU 7.10.55YR	FCA shall grant a firm with a VaR permission an additional authorisation to use an internal model to calculate market risk of positions in the correlation trading portfolio.	Yes
380	BIPRU 14.4.7G	FCA may waive the capital requirements relating to settlement risk if a system wide failure of a settlement or clearing occurs until the situation is rectified.	Yes
382		An institution can include securities financing transactions in the calculation of own funds required if the FCA determines that the institution's CVA risk exposures arising from those transactions are material.	Yes
395(1)	BIPRU 10.5.6R, BIPRR 10.5.7G, BIPRU 10.6.32R	FCA may set a lower limit than €150 million or 25% of an institutions eligible capital.	No
396(1)	BIPRU 10.6.33G	FCA may waive on a case by case basis compliance with the Large Exposures limits. A waiver would be permitted in under certain circumstances and for a 'limited period of time' for the firm to bring itself into compliance with the Large Exposure limit.	Yes

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
400(1)(f)	BIPRU 10.8A	This Article applies to firms who have a Core UK Group Waiver. The Article permits firms who have this permission to assign an exposure defined within the Core UK Group Waiver a 0% risk weight for the purpose of large exposures requirements in Article 395(1).	Yes
400(2)	BIPRU 10.9A, BIPRU 10.6.34R, BIPRU 10.6.35R, BIPRU 10.3.36R (1), BIPRU 10.6.37G, BIPRU 10.6.34R, BIPRU 10.6.35R, BIPRU 10.3.36R (2), BIPRU 10.6.37G	FCA may 'fully or partially' exempt the exposures listed in this article from the Large Exposures limits. Although, the FCA may only use the exemptions provided if certain conditions are met.	Yes, partially. See large exposures section of Chapter 4.
401(2)	BIPRU 10.2.14R, BIPRU 10.2.15G, BIPRU 10.2.19R, BIPRU 10.2.21R	FCA may authorise an advanced IRB firm on a case-by-case basis to estimate the effects of financial collateral in its calculation of large exposure limits by using its own LGD estimates.	Yes
406	BIPRU 9.15.11R, BIPRU 9.15.12R, BIPRU 9.15.13R	Before becoming exposed to securitisation risks, the institution needs to demonstrate to the FCA (for each position) their understanding and use of formal policies.	Yes
414		If an institution fails to meet its liquidity coverage requirement (412) and stable funding requirement (413), they must immediately notify the FCA. Until they become compliant, the institution must report on a daily basis. FCA may allow a lower reporting frequency and a longer reporting delay on a case by case basis. The FCA shall monitor the implementation of the restoration plan referred to in that Article and shall, if appropriate, require a more timely restoration than it is set out in the plan.	Yes
415(2)		Until the full introduction of binding liquidity requirements, FCA may continue to collect monitoring tools for the purpose of monitoring compliance with existing national liquidity standards (i.e. ILAS).	Yes

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
416		FCA may provide general guidance that institutions shall follow in identifying assets of high and extremely high liquidity and credit quality. However, this is pending a uniform definition in accordance with Article 460 (enter into force no later than 31 December 2014).	Yes
422(8)		FCA may grant permission to apply a lower outflow percentage to certain liabilities on a case-by-case basis assuming certain conditions are met.	Yes
425 and 426		An institution cannot categorise any undrawn credit, liquidity facilities or any other commitments received as liquidity inflows, unless granted a permission to do so by the FCA.	Yes
438(b)	BIPRU 11.5.4R, BIPRU 11.5.5R, BIPRU 11.5.6R	Firms shall disclose the result of their internal capital adequacy assessment process if instructed to do so by the FCA.	Yes
465	GENPU 2.1.40 R to GENPRU 2.1.45 R BIPRU 3.1.5 R BIPRU 4.1.16 R	FCA is permitted to allow firms to build their capital position to CRD IV compliance with the end point of compliance by end-December 2014. The discretion allows the FCA to permit firms to: maintain a CET1 ratio of 4%-4.5% during the transitional period, leading to compliance with the 4.5% minimum by end-2014; maintain a Tier 1 ratio of 5.5%-6% during the transitional period, leading to compliance with the 6% minimum by end-2014. The FCA is required to publish its transitional requirements in this area.	Yes
466		FCA shall grant institutions which are required to effect the valuation of assets and off-balance sheet items and the determination of own funds in accordance with International Accounting Standards as applicable under Regulation (EC) No 1606/2002 for the first time a lead time of 24 months for the implementation of the necessary internal processes and technical requirements.	Yes
467	GENPRU 1.3.9R	FCA must determine the applicable percentage of unrealised losses that institutions must include in CET1 for each year up to end 2017. After 31 December 2017 no adjustment to include unrealised losses allowed under Art. 35 (except as per Art. 33).	Yes (see chapter 4)
468	GENPRU 1.3.9R	FCA must determine the applicable percentage of unrealised gains that institutions must remove from CET1 for each year up to end 2017. After 31 December 2017 no adjustment to remove unrealised gains allowed under Art. 35 (except as per Art. 33).	Yes (see chapter 4)

CRR article	FCA Handbook reference – if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
469, 474 and 476	GENPRU 2.2	FCA must determine the applicable percentage of deductions from various items.	Yes (see chapter 4)
479	BIPRU 8.6.10R to BIPRU 8.6.20R	FCA must determine, for each year up to end 2017, the applicable percentage of minority interests that under Art. 81(2) would otherwise not be allowed in consolidated reserves but qualified under the BCD that may be grandfathered.	Yes (see chapter 4)
480		FCA must determine, for each year up to end 2017, the multiple of the percentage of (i) minority interests allowed under Art. 84 in consolidated CET1, (ii) subsidiary Tier 1 capital allowed under Art. 85 in consolidated own funds and (iii) subsidiary own funds allowed under Art. 87 in consolidated own funds.	Yes (see chapter 4)

Table 21: Capital Requirements Directive: Areas of national discretion

CRD article	FCA Handbook reference –if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
29(3-4)	GENPRU 2.1.47R, BIPRU 1.1.20R	This provision allows to reduce a firm's initial capital requirement from € 125,000 to € 50 000 where a firm is not authorised to hold client money or securities, to deal for its own account, or to underwrite issues on a firm commitment basis.	Yes
32		By way of derogation from Articles 28(2), 29(1), 29(3) and 30, Member States may continue an authorisation of investment firms and firms covered by Article 30 which was in existence before 31 December 1995, the own funds of which firms or investment firms are less than the initial capital levels specified for them in Articles 28(2), 29(1), 29(3), and 30.	No
74(4)		In accordance with the principle of proportionality, the requirements for an institution to draw up, maintain and update recovery plans and for the resolution authority, after consulting the CA, to prepare resolution plans, may be reduced if, after consulting the national macro-prudential authority, the FCA consider that the failure of a specific institution due, inter alia, to its size, to its business model, to its interconnectedness to other institutions, or to the financial system in general, will not have a negative effect on financial markets, on other institutions or on funding conditions.	Yes
76(3)		FCA is permitted to allow a firm is not considered 'significant' to merge its risk and audit committees.	Yes

CRD article	FCA Handbook reference –if existing discretion	Area of national discretion	Does the FCA intend to exercise the relevant discretion from 1 January 2014?
88(1) (e)		An individual will not be allowed to simultaneously carry out the CEO and chairperson function within an institution, unless explicitly authorised to do so by the FCA.	Yes
88(2)		Discretion for Member States to allow a firm that is not considered 'significant' not to establish a nominations committee.	Yes (subject to HMT's decision)
91		FCA may authorise members of the management body to hold one additional non-executive directorship. The number of directorships a member of the management body can hold at the same time shall take into account individual circumstances and the nature, scale and complexity of the institution's activities.	Yes
95		FCA may allow a firm that is not considered 'significant' not to establish a remuneration committee.	Yes
127(3)		In the absence of equivalent supervision, the FCA may require the establishment of a financial holding company or mixed financial holding company which has its head office in the EU, and apply the provisions on consolidated supervision to the consolidated position of that financial holding company or the consolidated position of the institutions of that mixed financial holding company.	Yes
129(2)		This allows member states to exempt SMEs from the capital conservation buffer requirement, provided that they do not pose a risk to the financial stability of the respective member state.	Yes (subject to HMT decision, if the FCA were to be made the designated authority, then based on our analysis on the definition of significance (see Chapter 5), we would be minded to propose that we exercise these discretions)
130		This allows member states to exempt SMEs from the capital conservation buffer requirement provided that they do not pose a risk to the financial stability of the respective member state.	

Q29: Do you agree with our proposed approach to the national discretions? If not, please indicate the areas of national discretion where you disagree with the FCA proposal stating your reasons and alternative proposal.

Q30: Do you believe that there are any articles in the Directive or in the Regulation –not covered in Annex 3 – which would require the FCA to exercise its discretion as a CA? If so, what articles would you suggest and why?

Annex 4: List of questions

Q1: **Do you agree with our overall approach to CRD IV transposition outlined in this section pending the Commission's review of the prudential regime for investment sector firms by the end of 2015? If not, please explain why not and what alternative you would suggest.**

Q2: **Given there are no proposed substantive changes to the existing Pillar 2 regime do you agree that existing GENPRU and BIPRU Pillar 2 guidance should be copied across to IFPRU? If not, please explain why not, including alternative approaches and the rationale for those approaches.**

Q3: **Do you agree with our initial view that, if possible and depending upon the decisions of the Treasury regarding the designated authorities, the discretions to exempt investment firms that are SMEs from the capital conservation buffer, and from the countercyclical buffer should be exercised? If not please explain why not.**

Q4: **Do you agree with our initial view that, in light of the review by the EU Commission of the prudential regime for all investment sector firms required by end 2015, that the discretion to accelerate the five year transition timetables for the capital conservation buffer, and for the countercyclical buffer should not be exercised by whoever is the designated responsible authority? If not, please explain why not including alternative transition approaches and the rationale for those approaches.**

Q5: **Do you agree that the calculation of the Maximum Distributable Amount (MDA) should be submitted to the FCA within five working days? If not, please explain why not and propose alternative notice periods and the rationale for those notice periods.**

Q6: **Do you agree that where the firm fails to meet the Combined Buffer (CB) and has a Maximum Distributable Amount (MDA) in place, that firms must give a minimum of three months' notice to create obligations or make payments or distributions that would otherwise be prohibited because of the requirement to have an MDA? If not, please explain why not and propose alternative approaches and the rationale for those approaches.**

Q7: **Until such point as we are able to consult further on our future policy, do you agree that the CPB should be maintained and added to the Pillar 2A charge to the extent that there is no identifiable double counting? If not, please explain why not including alternative transition approaches and the rationale for those approaches.**

Q8: **Do you agree with our proposed approach on stress testing and to report results annually in the case of those firms that are 'significant' pending the EBA guidelines on this matter? If not, please explain why not and propose alternative approaches and the rationale for those approaches.**

Q9: **Do you agree with our proposal to continue the UK's liquidity regime (including ILAS) until binding minimum standards for liquidity coverage requirements are implemented in the CRR in 2015? If not, please explain why not and propose alternative approaches and the rationale for those approaches.**

Q10: **In your view, is this approach proportional and risk based? If not, which category or categories of firms (within the solely FCA regulated CRD IV population) do you perceive as appropriate to submit CRD IV liquidity reporting forms from 2014 and be subject to binding liquidity requirements from 2015?**

Q11: **Do you agree that these proposals meet our approach of applying the transitional provisions whilst ensuring that we do not materially reduce the standards of the current FCA framework? If not, please indicate why not stating your reasons and your alternative proposal.**

Q12: **If appropriate, please can you provide a list of all capital instruments used by partnerships and LLPs that, in your opinion, satisfy the criteria outlined in article 28 of the CRR?**

Q13: **Considering the legal constraints in respect of EU regulation and in the context of internal models, do you agree to our proposal to use guidance where appropriate while explaining the operational implications of the changes via targeted communications? If not, please explain why not and propose alternative approaches and the rationale for those approaches.**

Q14: **Do you agree with our approach to these exemptions? If not, which exemptions under Article 400(2) of the CRR do you believe should be included, or should not be included, which is contrary to the proposed amendments?**

Q15: Do you agree with our proposal not to exercise the exemption in article 400(2)(k) of the Regulation? If not, please explain the reasons why not.

Q16: Do you agree with this approach in relation to articles 395 and 396 of the Regulation? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

Q17: Do you agree with the approach of allowing firms to report a quarterly leverage ratio as opposed to a three monthly ratios averaged for the quarter? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

Q18: Do you agree with our proposal for an interim list of recognised exchanges pending the ESMA ITSs including our approach for third country stock exchanges? If not please propose changes to the list explaining the rationale why.

Q19: Do you agree that this approach in relation to the discretion in article 99 of the Regulation is proportionate and risk based? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

Q20: Do you agree with our proposal to exercise the discretions in articles 124(2) and 126(3) of the Regulation to maintain a risk weight of 100% for exposures to UK commercial real estate, as it is currently the case? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

Q21: Do you agree with our proposal to publish an objective criteria identifying which firms these policies refer to? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

Q22: Do you agree that the combination of these metrics sufficiently capture the size, internal organisation and nature, scope and complexity of an investment firm's activities? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

Q23: Do you agree that these thresholds are appropriate? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

Q24: Do you agree with our proposal to define a firm as a 'significant' firm if it exceeds at least one of these thresholds? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

Q25: Do you agree to our proposal to exercise the discretion in article 95(2) of the CRR to retain current CRD rules in force on own funds requirements (Pillar 1) for BIPRU firms keeping the 'status quo' pending the EU-wide review of what is an appropriate prudential regime as a whole for firms in the investment sector in 2015? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

Q26: Do you agree to our proposal to retain current CRD rules in force on Pillar 2, Pillar 3 and systems and control requirements in SYSC (including the Remuneration Code) for BIPRU firms keeping the 'status quo' pending the EU-wide review of what is an appropriate prudential regime as a whole for firms in the investment sector in 2015? If not, please explain why not and propose alternative approaches and the rationale for those approaches.

Q27: Do you agree to our proposal to grant CRR-based permissions with effect from 1 January 2014 to those firms currently holding an eligible waiver related to a GENPRU / BIPRU rule – listed in tables 12 and 13 – provided the conditions in paragraph 7.6 are met? If not please explain why not and propose alternative approaches and the rationale for those approaches.

Q28: Do you have any comments on our cost benefit analysis?

Q29: Do you agree with our proposed approach to the national discretions? If not, please indicate the areas of national discretion where you disagree with the FCA proposal stating your reasons and alternative proposal.

Q30: Do you believe that there are any articles in the Directive or in the Regulation –not covered in Annex 3 – which would require the FCA to exercise its discretion as a CA? If so, what articles would you suggest and why?

Appendix 1:
Draft Handbook text

This Appendix includes the following draft legal instruments and general guidance:

- CRD IV (Prudential Sourcebook for Investment Firms and SYSC) Instrument 2013 – p.96
- CRD IV (GENPRU and BIPRU amendments) Instrument 2013 – p.292;
- CRD IV (Governance and remuneration) Instrument 2013 – p.349;
- General guidance on proportionality: The Remuneration Code (SYSC 19A) (including a copy with tracked changes showing the proposed amendments in relation to the current guidance) – 390; and
- General guidance on proportionality: The Remuneration Code (SYSC 19C) & Pillar 3 disclosures on remuneration (BIPRU 11) – p.430.

CAPITAL REQUIREMENTS DIRECTIVE IV INSTRUMENT 2013

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137A (The FCA's general rules);
(2) section 137T (General supplementary powers);
(3) section 138D (Actions for damages); and
(4) section 139A (Power of the FCA to give guidance).

B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 1 January 2014, except the provisions in IFPRU 9 (Capital buffers) do not apply until 1 January 2016.

Making the Prudential sourcebook for Investment Firms (IFPRU)

D. The Financial Conduct Authority makes the rules and gives the guidance in Annex A to this instrument.

Amendments to the FCA Handbook

E. The Glossary of definitions is amended in accordance with Annex B to this instrument.

F. The Senior Management, Arrangements, Systems and Controls sourcebook (SYSC) is amended in accordance with Annex C to this instrument.

Citation

F. This instrument may be cited as the Capital Requirements Directive IV Instrument 2013.

H. The sourcebook in Annex A to this instrument may be cited as the Prudential sourcebook for Investment Firms (or IFPRU).

By order of the Board of the Financial Conduct Authority
[*date*]

Annex A

Prudential sourcebook for Investment Firms (IFPRU)

In this Annex, all text is new and is not underlined.

Insert the following new sourcebook, the Prudential sourcebook for Investment Firms (IFPRU), after the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU).

1 Application

1.1 Application and Purpose

Application

1.1.1 G There is no overall application for *IFPRU*. Each chapter or section has its own application statement. However, *IFPRU* broadly applies in the following manner:

(1) only *IFPRU* 7 (Liquidity) and *IFPRU* 10 (Public disclosure) apply to an *exempt IFPRU commodities firm* and *IFPRU* 8.1 (Prudential consolidation) may apply subject to the conditions in that section;

(2) *IFPRU* 9 (Capital buffers) applies to an *IFPRU investment firm*, unless it is an *exempt IFPRU commodities firm* or an *IFPRU limited licence firm*; and

(3) other than in (1) and (2), the whole of *IFPRU* applies to an *IFPRU investment firm*.

1.1.2 R *IFPRU* applies to a *firm* for the whole of its business, except where a particular provision provides for a narrower scope.

1.1.3 G Generally, *IFPRU* only applies to a *collective portfolio management investment firm's designated investment business* (excluding *managing an AIF* and *managing a UCITS*). However*, IFPRU* 2.2 (Internal capital adequacy assessment process) and *IFPRU* 2.3(Supervisory review and evaluation process: Internal capital adequacy standards) apply to the whole of its business.

Purpose

1.1.4 G (1) The purpose of *IFPRU* is to implement, in part, *CRD* and certain national discretions afforded to the *FCA* as *competent authority* under *EU CRR*.

(2) Save as provided in the *Glossary*, any expression in the *Handbook* for the purpose of *IFPRU* which is defined or used in *EU CRR* shall have

the meaning given by, or used in, those Regulations.

Exclusion of certain types of firms

1.1.5 R None of the following is an *IFPRU investment firm*:

(1) an *incoming EEA firm*;

(2) an *incoming Treaty firm*;

(3) any other *overseas firm*;

(4) a *designated investment firm*;

(5) an *insurer*; and

(6) an *ICVC*.

Types of IFPRU investment firm

1.1.6 R An *IFPRU investment firm* includes a *collective portfolio management investment firm* that is not excluded under *IFPRU* 1.1.5R (Exclusion of certain types of firms).

1.1.7 G In accordance with articles 95 and 96 of *EU CRR*, *IFPRU investment firms* are divided into the following categories:

(1) *full-scope IFPRU investment firm*;

(2) *IFPRU limited licence firm*; and

(3) *IFPRU limited activity firm*.

Alternative classification of IFPRU investment firms

1.1.8 R *IFPRU investment firms* are divided into the following classes for the calculation of the *base own funds requirement* and any other provision of the *Handbook* that applies this classification:

(1) an *IFPRU 50K firm*;

(2) an *IFPRU 125K firm*;

(3) an *IFPRU 730K firm*; and

(4) a *collective portfolio management investment firm*.

Types of IFPRU investment firm: IFPRU 125K firm

1.1.9 R An *IFPRU 125K firm* means an *IFPRU investment firm* that satisfies the following conditions:

(1) it does not:

(a) *deal on own account*; or

(b) underwrite issues of *financial instruments* (as referred to in Section A of Annex I of *MiFID*) on a firm commitment basis;

(2) it holds clients' money or *securities* for *investment services* it provides or is authorised to do so;

(3) it offers one or more of the following services (all as referred to in Section A of Annex I of *MiFID*):

(a) reception and transmission of investors' orders for *financial instruments*; or

(b) the execution of investors' orders for *financial instruments*; or

(c) the management of individual portfolios of investments in *financial instruments*;

(4) it is not a *collective portfolio management investment firm*; and

(5) it does not operate a *multilateral trading facility*.

[**Note**: article 29(1) of *CRD*]

Types of IFPRU investment firm: IFPRU 50K firm

1.1.10 R An *IFPRU 50K firm* is a *IFPRU investment firm* that satisfies the following conditions:

(1) the conditions in *IFPRU* 1.1.9R(1) and (3);

(2) it does not hold clients' money or *securities* for *investment services* it provides and is not authorised to do so;

(3) it is not a *collective portfolio management investment firm*; and

(4) it does not operate a *multilateral trading facility*.

[**Note**: article 29(3) of *CRD*]

Types of IFPRU investment firm: IFPRU 730K firm

1.1.11 R (1) An *IFPRU investment* that is not a *collective portfolio management investment firm*, an *IFPRU 125K firm* or an *IFPRU 50K firm* is an *IFPRU 730K firm*.

(2) An *IFPRU investment firm* that operates a *multilateral trading facility* is an *IFPRU 730K firm*.

[**Note**: article 28(2) of *CRD*]

Meaning of dealing on own account

1.1.12 R (1) For the purpose of *IFPRU* and the *EU CRR*, *dealing on own account* means the service of dealing in any *financial instruments* for own account as referred to in point 3 of Section A of Annex I to *MiFID*, subject to (2) and (3).

(2) In accordance with article 29(2) of *CRD* (Definition of dealing on own account), an *investment firm* that executes investors' orders for *financial instruments* and holds such *financial instruments* for its own account does not, for that reason, *deal on own account* if the following conditions are met:

(a) such *position* only arise as a result of the *investment firm's* failure to match investors' orders precisely;

(b) the total market value of all such *positions* is no higher than 15% of the *investment firm's initial capital*;

(c) (for an *investment firm* that is an *IFPRU investment firm* or an *EEA firm*) it complies with the requirements in articles 92 to 95 (Own funds requirements for investment firms with limited authorisation to provide investment services) and Part Four (Large exposures) of the *EU CRR*;

(d) (for any other *investment firm*) it would comply with the requirements in (2)(c) if it had been an *investment firm* on the basis of the assumptions in *IFPRU* 1.1.13R(1)(a) and (b); and

(e) such *positions* are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question.

(3) In accordance with article 29(4) of *CRD*, the holding on *non-trading book positions in financial instruments* in order to invest in *own funds* is not *dealing on own account* for the purposes of *IFPRU* 1.1.9R (Types of IFPRU investment firm: IFPRU 125K firm) and *IFPRU* 1.1.10R (Types of IFPRU investment firm: IFPRU 50K firm).

Interpretation of the definition of types of firm and undertaking

1.1.13 G A *firm* whose head office is not in an *EEA State* is an *investment firm* if it would have been subject to the requirements imposed by *MiFID* (but it is not a *bank*, *building society*, *credit institution*, *local*, *exempt CAD firm* and *BIPRU firm*) if:

(a) its head office had been in an *EEA State*; and

(b) it had carried on all its business in the *EEA* and had obtained whatever authorisations for doing so as are required under *MiFID*.

1.1.14 G A *firm* also falls into one of the categories of an *IFPRU investment firm* listed in *IFPRU* 1.1.7G (Types of IFPRU investment firm) or *IFPRU* 1.1.8G (Alternative classification of IFPRU investment firms) if its *Part 4A permission* contains a *requirement* that it must comply with the *rules* in *IFPRU* applicable to that category of *firm*. If a *firm* is subject to such a *requirement* and it would otherwise also fall into another category of *IFPRU investment firm*, it does not fall into that other category.

1.1.15 G For the purposes of the definitions in *IFPRU* and Part Three, Title I, Chapter 1, Section 2 of the *EU CRR* (Own funds requirements for investment firms with limited authorisation to provide investment services), a *person* does any of the activities referred to in *IFPRU* and the *EU CRR* if:

(1) it does that activity anywhere in the world; or

(2) its *permission* includes that activity; or

(3) (for an *EEA firm*) it is authorised by its *Home State regulator* to do that activity; or

(4) (if the carrying on of that activity is prohibited in a state or territory without an authorisation in that state or territory) that *firm* has such an authorisation.

1.1.16 G For the purposes of the definitions in *IFPRU* and Part Three, Title I, Chapter 1, Section 2 of the *EU CRR* (Own funds requirements for investment firms with limited authorisation to provide investment services), a *person* offers any of the services referred to in articles 95 and 96 of the *EU CRR* (Own funds requirements for investment firms with limited authorisation to provide investment services) if:

(1) it offers that service anywhere in the world; or

(2) any of *IFPRU* 1.1.15G(1) to (4) apply.

1.1.17 G For the purposes of the definitions in *IFPRU* and Part Three, Title I, Chapter 1, Section 2 of the *EU CRR* (Own funds requirements for investment firms with limited authorisation to provide investment services), a *person* has an authorisation to do any of the activities referred to in articles 95 and 96 of the *EU CRR* (Own funds requirements for investment firms with limited authorisation to provide investment services) if any of *IFPRU* 1.1.15G(1) to (4) apply.

Significant IFPRU firm

1.1.18 G Throughout *CRD* and the *EU CRR* there are various policies which have restricted application based on a *firm's* scope, nature, scale, internal organisation and complexity. These policies are provided in the following:

(1) article 76 of *CRD* on the establishment of an independent risk committee;

(2) article 88 of *CRD* on the establishment of an independent nominations committee;

(3) article 91 of *CRD* on the separation of the role of chairman of the *management body* and the *chief executive function*, and limitations on the number of directorships an individual may hold;

(4) article 95 of *CRD* on the establishment of an independent remuneration committee;

(5) article 100 of *CRD* on supervisory stress testing to facilitate the *SREP*;

(6) articles 129 and 130 of *CRD* on applicability of the *capital conservation buffer* and the *countercyclical capital buffer* (provided that an exemption from the application of these articles does not threaten the stability of the financial system of the *EEA State*);

(7) article 6(4) of the *EU CRR* on the scope of liquidity reporting on a solo basis;

(8) article 11(3) of the *EU CRR* on the scope of liquidity reporting on a consolidated basis; and

(9) article 450 of the *EU CRR* on disclosure on *remuneration*.

1.1.19 G The articles in *IFPRU* 1.1.17G do not always carry the same wording in describing what may be significant in terms of a *firm's* scope, nature, scale, internal organisation and complexity, but the articles have a general policy to restrict the application of those requirements to *institutions* which pose higher risks by virtue of broadly their size, types of business and complexity of activities. The *FCA's* policy is to apply an objective definition with pre-defined thresholds to determine which *firms* are considered as significant for the purpose of these articles. In order to clarify which *firms* these policies apply to, *IFPRU* 1.1.20R defines the factors which determine if a *firm* is a *significant IFPRU firm*.

1.1.20 R A *firm* is a *significant IFPRU firm* if it meets, at any time, one or more of the following conditions:

(1) its total assets exceeds £530 million;

(2) its total liabilities exceeds £380 million;

(3) the annual fees and commission income it receives in relation to the *regulated activities* carried on by the *firm* exceeds £120 million in the 12 *month* period immediately preceding the date the *firm* carries out the assessment under this *rule* on a rolling basis;

(4) the *client money* that it receives or holds exceeds £425 million; and

(5) the assets belonging to its *clients* that it holds in the course of, or

connected with, its *regulated activities* exceeds £7.8 billion.

1.1.21 R (1) This *rule* defines some of the terms used in *IFPRU* 1.1.20R.

(2) "Total assets" means the *firm's* total assets:

(a) set out in the most recent relevant report submitted to the *FCA* under *SUP* 16.12 (Integrated regulatory reporting); or

(b) (where the *firm* carries out the assessment under this *rule* at any time after the date of its most recent report in (a)) as the *firm* would report to the *FCA* in accordance with the relevant report, as if the reporting period for that report ends on the date the assessment is carried out.

(3) "Total liabilities" means the *firm's* total liabilities:

(a) set out in the most recent relevant report submitted to the *FCA* under *SUP* 16.12 (Integrated regulatory reporting); or

(b) (where the *firm* carries out the assessment under this *rule* at any time after the date of its most recent report in (a)) as the *firm* would report to the *FCA* in accordance with the relevant report, as if the reporting period for that report ends on the date the assessment is carried out.

(4) The *client money* means the *money* that a *firm* receives or holds in the course of, or in connection with, all of the *regulated activities* defined in paragraphs (1) to (4) of the *Glossary* that it carries on:

(a) as set out in the most recent client money and client asset report submitted to the *FCA* under *SUP*, as applies to the *firm* in *SUP* 16.12 (Integrated regulatory reporting); or

(b) (where the *firm* carries out the assessment under this *rule* at any time after the date of its most recent report in (a)) as the *firm* would report to the *FCA* in accordance with the relevant report, as if the reporting period for that report ends on the date the assessment is carried out.

(5) "Assets belonging to its *clients*" means the assets to which the *custody rules* apply:

(a) as set out in the most recent client money and client asset report submitted to the *FCA* under *SUP*, as applies to the *firm* in *SUP* 16.12 (Integrated regulatory reporting); or

(b) (if the *firm* carries out the assessment under this *rule* at any time after the date of its most recent report in (a)) as the *firm* would report to the *FCA* in accordance with the relevant report, as if the reporting period for that report ends on the date the

assessment is carried out.

1.1.22 R A *firm* must regularly assess whether it, at any time, becomes a *significant IFPRU firm*.

1.1.23 R (1) If a *firm*, at any time, becomes aware that it is likely to become a *significant IFPRU firm*, it must forthwith make arrangements to establish and have in place sound, effective and comprehensive strategies, processes and systems to achieve compliance with the requirements that apply to a *significant IFPRU firm*.

(2) The *firm* in (1) must comply with the requirements that apply to a *significant IFPRU firm* on the expiry of a period of three *months* from the date it meets any one of the conditions in *IFPRU* 1.1.20R.

1.1.24 R If a *firm* that is a *significant IFPRU firm* ceases to meet any of the conditions in *IFPRU* 1.1.20R, it must continue to comply with the *rules* and requirements applicable to a *significant IFPRU firm* until the first anniversary of the date on which the *firm* ceased to be a *significant IFPRU firm*.

1.1.25 G The *FCA* may, on a case-by-case basis, require a *firm* which does not meet any of the conditions in *IFPRU* 1.1.20R to comply with the *rules* and requirements that apply to a *significant IFPRU firm* if the *FCA* considers it appropriate to do so to meet its strategic objective or to advance one or more of its operational objectives under the *Act*.

1.1.26 G A *firm* which is a *significant IFPRU firm* may apply to the *FCA* under section 138A of the *Act* to *waive* any one or more of the conditions in *IFPRU* 1.1.20R if it believes the *rules* that apply to a *significant IFPRU firm* may be disproportionate to it, taking into account the *firm's* size, internal organisation and nature, scope and complexity of its activities.

1.2 Applications for directions and permissions

[Placeholder]

1.3 Actions for damages

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

2 Governance and supervisory review and evaluation process

2.1 Application

2.1.1 R *IFPRU* 2 applies in the following manner:

(1) to an *IFPRU investment firm*, unless it is an *exempt IFPRU commodities firm*; and

(2) the *general stress and scenario testing rule* (and related *rules* and *guidance*) applies only to a *significant IFPRU firm*.

Purpose

2.1.2 G This Chapter implements certain provisions of *CRD* relating to governance and contains *guidance* related to Section III of Chapter 2, Title VII of *CRD* (Supervisory review and evaluation process).

2.1.3 G This section amplifies *Principle* 4, under which a *firm* must maintain adequate financial resources. It is concerned with the adequacy of the financial resources that a *firm* needs to hold in order to meet its liabilities as they fall due. These resources include both capital and liquidity resources.

2.1.4 G This section has *rules* requiring a *firm* to identify and assess risks to its ability to meet its liabilities as they fall due, how it intends to deal with those risks, and the amount and nature of financial resources that the *firm* considers necessary. *IFPRU* 2.2.43R (Documentation of risk assessment) provides that a *firm* should document that assessment. The *FCA* will review that assessment as part of its own assessment of the adequacy of a *firm's* capital under its *supervisory review and evaluation process* (*SREP*). When forming a view of any *individual capital guidance* to be given to the *firm*, the *FCA* will also review the regulator's risk assessment and any other issues arising from day-to-day supervision.

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

2.2 Internal capital adequacy assessment process

Adequacy of financial resources

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

2.2.2 G *BIPRU* 12 contains *rules* and *guidance* relating to the adequacy of a *firm's* liquidity resources. In assessing the adequacy of its liquidity resources, a *firm* should do so by reference to the *overall liquidity adequacy rule*, rather than the *overall financial adequacy rule*.

2.2.3 G The effective management of prudential risk relies on the adequacy of a *firm's* financial resources, systems and controls. These need to be assessed in relation to all the activities of the *firm* and the risks to which they give rise, and so this chapter applies to a *firm* for the whole of its business. For a *collective portfolio management investment firm* this means that this section also applies to its activities in relation to the management of *AIFs* and/or *UCITS*.

2.2.4 G The liabilities referred to in the *overall financial adequacy rule* include a *firm's* contingent and prospective liabilities. They exclude liabilities that might arise from transactions that a *firm* has not entered into and which it could avoid, for example, by taking realistic management actions such as ceasing to transact new business after a suitable period of time has elapsed. They include liabilities or costs that arise in scenarios where the *firm* is a going concern and those where the *firm* ceases to be a going concern. They also include claims that could be made against a *firm*, which ought to be paid in accordance with fair treatment of *customers*, even if such claims could not be legally enforced.

2.2.5 G In the light of *IPRU* 2.2.4G, a *firm* should make its assessment of adequate financial resources on realistic valuation bases for assets and liabilities, taking into account the actual amounts and timing of cash flows under realistic adverse projections.

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

Strategies, processes and systems

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

(1) to assess and maintain, on an ongoing basis, the amounts, types and distribution of financial resources, *own funds* and internal capital that it considers adequate to cover:

(a) the nature and level of the risks to which it is, or might be, exposed;

(b) the risk in the *overall financial adequacy rule*;

(c) the risk that the *firm* might not be able to meet the obligations in Part Three of the *EU CRR* (Capital Requirements) in the future; and

(2) that enable it to identify and manage the major sources of risks referred to in (1), including the major sources of risk in each of the following categories where they are relevant to the *firm* given the nature and scale of its business:

(a) credit and counterparty risk;

(b) *market risk*;

(c) *liquidity risk*;

(d) *operational risk*;

(e) concentration risk;

(f) residual risk;

(g) *securitisation* risk;

(h) business risk;

(i) interest rate risk, including interest-rate risk in the non-*trading book*;

(j) *risk of excessive leverage*;

(k) pension obligation risk; and

(l) group risk.

[**Note**: article 73 first paragraph and article 74(1) of *CRD*]

2.2.8 R (1) This *rule* defines some of the terms used in the *overall Pillar 2 rule*.

(2) Residual risk means the risk that *credit risk mitigation* techniques used by the *firm* prove less effective than expected.

(3) *Securitisation* risk includes the risk that the *own funds* held by a *firm* for assets which it has *securitised* are inadequate having regard to the economic substance of the transaction, including the degree of risk transfer achieved.

(4) Business risk means any risk to a *firm* arising from:

(a) changes in its business, including:

(i) the acute risk to earnings posed by falling or volatile income;

(ii) the broader risk of a *firm's* business model or strategy proving inappropriate due to macro-economic, geopolitical, industry, regulatory or other factors; and

(iii) the risk that a *firm* may not be able to carry out its business plan and desired strategy; and

(b) its remuneration policy (see also the *Remuneration Code* which applies to *IFPRU investment firms* and the detailed application of which is set out in *SYSC* 19A.1).

(5) Pension obligation risk is the risk to a *firm* caused by its contractual or other liabilities to, or with respect to, a pension scheme (whether established for its employees or those of a related *company* or otherwise). It also means the risk that the *firm* will make payments or other contribution to, or with respect to, a pension scheme because of a moral obligation or because the *firm* considers that it needs to do so for some other reason.

(6) Interest-rate risk in the non-*trading book* means:

(a) risks related to the mismatch of re-pricing of assets and liabilities and off balance sheet short- and long-term *positions* ("re-pricing risk");

(b) risks arising from hedging exposure to one interest rate with exposure to a rate which re-prices under slightly different conditions ("basis risk");

(c) risk related to the uncertainties of occurrence of transactions, for example, when expected future transactions do not equal the actual transactions ("pipeline risk"); and

(d) risks arising from consumers redeeming fixed rate products when market rates change ("optionality risk").

(7) Group risk is the risk that the financial position of a *firm* may be adversely affected by its relationships (financial or non-financial) with other entities in the same *group* or by risks which may affect the financial position of the whole *group*, for example reputational contagion.

2.2.9 G (1) This paragraph gives *guidance* on some of the terms used in the *overall Pillar 2 rule*.

(2) In a narrow sense, business risk is the risk to a *firm* that it suffers

losses because its income falls or is volatile relative to its fixed cost base. However, in a broader sense, it is exposure to a wide range of macro-economic, geopolitical, industry, regulatory and other external risks that might deflect a *firm* from its desired strategy and business plan. *IFPRU* 2.3.47G to *IFPRU* 2.3.54G provides further *guidance* on business risk.

(3) Interest-rate risk in the non-*trading book* is explained in *IFPRU* 2.3.39G (Interest rate risk in the non-trading book).

2.2.10 G In the *overall Pillar 2 rule*, internal capital refers to the financial resources of a *firm* which it treats as being held against the risks listed in the *overall Pillar 2 rule*. The obligation in that *rule* to assess the distribution of such capital refers, in relation to a *firm* making an assessment on a solo basis, for example, to the need to take account of circumstances where part of a *firm's* financial resources are held by a *branch* of that *firm* which are subject to restrictions on its ability to transfer that capital. An assessment of internal capital distribution might also take account of such of a *firm's* financial resources as may be ring-fenced in the event of its insolvency.

2.2.11 R As part of its obligations under the *overall Pillar 2 rule*, a *firm* must identify separately the amount of *common equity tier 1 capital*, *additional tier 1 capital* and *tier 2 capital* and each category of capital (if any) that is not eligible to form part of its *own funds* which it considers adequate for the purposes described in the *overall Pillar 2 rule*.

2.2.12 R The processes, strategies and systems required by the *overall Pillar 2 rule* must be comprehensive and proportionate to the nature, scale and complexity of the *firm's* activities.

[**Note**: article 73 second paragraph (part) of *CRD*]

2.2.13 R A *firm* must:

(1) carry out regularly the assessments required by the *overall Pillar 2 rule*; and

(2) carry out regular assessments of the processes, strategies and systems required by the *overall Pillar 2 rule* to ensure that they remain comprehensive and proportionate to the nature, scale and complexity of the *firm's* activities.

[**Note**: article 73 second paragraph (part) of *CRD*]

2.2.14 R As part of its obligations under the *overall Pillar 2 rule*, a *firm* must :

(1) make an assessment of the *firm*-wide impact of the risks identified in line with that *rule*, to which end a *firm* must aggregate the risks across its various business lines and units, taking appropriate account of the correlation between risks;

(2) take into account the stress tests that the *firm* is required to carry out as follows:

(a) (for a *significant IFPRU firm*) under the *general stress and scenario testing rule* (including *SYSC* 20 (Reverse stress testing));

(b) (except a *firm* in (a)) under *SYSC* 20 (Reverse stress testing),

and any stress tests that the *firm* is required to carry out under the *EU CRR*;

(3) have processes and systems that:

(a) include an assessment of how the *firm* intends to deal with each of the major sources of risk identified in line with *IPFRU* 2.2.7R(2); and

(b) take account of the impact of the diversification effects and how such effects are factored into the *firm's* systems for measuring and managing risks.

2.2.15 G Certain risks, such as systems and controls weaknesses, may not be adequately addressed by, for example, holding additional capital and a more appropriate response would be to rectify the weakness. In such circumstances, the amount of financial resources required to address these risks might be zero. However, a *firm* should consider whether holding additional capital might be an appropriate response until the identified weaknesses are rectified. A *firm*, should, in line with *IFPRU* 2.2.43R (Documentation of risk assessments), document the approaches taken to manage these risks.

2.2.16 G A *firm* should carry out assessments of the sort described in the *overall Pillar 2 rule* and *IFPRU* 2.2.13R at least annually, or more frequently if changes in the business, strategy, nature or scale of its activities or operational environment suggest that the current level of financial resources is no longer adequate. The appropriateness of the internal process, and the degree of involvement of *senior management* in the process, will be taken into account by the *FCA* when reviewing a *firm's* assessment as part of the *FCA's* own assessment of the adequacy of a *firm's* financial resources and internal capital. The processes and systems should ensure that the assessment of the adequacy of a *firm's* financial resources and internal capital is reported to its *senior management* as often as is necessary.

Credit and counterparty risk

2.2.17 R A *firm* must base credit-granting on sound and well-defined criteria and clearly establish the process for approving, amending, renewing and re-financing credits.

[**Note**: article 79(a) of *CRD*]

2.2.18 R A *firm* must have internal methodologies that:

(1) enable it to assess the credit risk of exposures to individual obligors, securities or *securitisation positions* and credit risk at the portfolio level;

(2) do not rely solely or mechanistically on external credit ratings;

(3) where its *own funds requirements* under Part Three of the *EU CRR* (Capital Requirements) are based on a rating by an *ECAI* or based on the fact that an exposure is unrated, enable the *firm* to consider other relevant information for assessing its allocation of financial resources and internal capital.

[**Note**: article 79(b) of *CRD*]

2.2.19 R A *firm* must operate through effective systems the ongoing administration and monitoring of its various credit risk-bearing portfolios and exposures, including for identifying and managing problem credits and for making adequate value adjustments and provisions.

[**Note**: article 79(c) of *CRD*]

2.2.20 R A *firm* must adequately diversify credit portfolios given its target market and overall credit strategy.

[**Note**: article 79(d) of *CRD*]

Residual risk

2.2.21 R A *firm* must address and control, by means which include written policies and procedures, residual risk (see *IFPRU* 2.2.8R(2) and *IFPRU* 2.3.41G).

[**Note**: article 80 of *CRD*]

Concentration risk

2.2.22 R A *firm* must address and control, by means which include written policies and procedures, the concentration risk arising from:

(1) exposures to each counterparty, including central counterparties, groups of connected counterparties and counterparties in the same economic sector, geographic region or from the same activity or commodity;

(2) the application of *credit risk mitigation* techniques; and

(3) risks associated with large indirect credit exposures such as a single collateral issuer.

[**Note**: article 81 of *CRD*]

2.2.23 R In *IFPRU* 2.2.22R, the processes, strategies and systems relating to concentration risk must include those necessary to ensure compliance with Part Four of the *EU CRR* (Large exposures).

Securitisation risk

2.2.24 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 risk assessment and management decisions.

[**Note**: article 82(1) of *CRD*]

2.2.25 R A *firm* which is an *originator* of a revolving *securitisation* transaction involving *early amortisation provisions* should have liquidity plans to address the implications of both scheduled and early amortisation.

[**Note**: article 82(2) of *CRD*]

Market risk

2.2.26 R A *firm* must implement policies and processes for the identification measurement and management of all material sources and effects of *market risks*.

[**Note**: article 83(1) of *CRD*]

2.2.27 R A *firm* must take measures against the risk of a shortage of liquidity if the short position falls before due before the long position.

[**Note**: article 83(2) of *CRD*]

2.2.28 R (1) A *firm's* financial resources and internal capital must be adequate for material *market risk* that are not subject to an *own funds requirement* under Part Three of the *EU CRR* (Capital Requirements).

(2) A *firm* which has, in calculating *own funds requirements* for position risk in accordance with Part Three, Title IV, Chapter 2 of the *EU CRR* (Own funds requirements for position risk), netted off its positions in one or more of the equities constituting a stock-index against one or more positions in the stock index future or other stock-index product, must have adequate financial resources and internal capital to cover the basis risk of loss caused by the future's or other product's value not moving fully in line with that of its constituent equities.

(3) A *firm* using the treatment in article 345 of the *EU CRR* (Underwriting: Reduction of net positions) must ensure that it holds sufficient financial resources and internal capital against the risk of loss which exists between the time of the initial commitment and the following working day.

[**Note**: article 83(3) of *CRD*]

2.2.29 R As part of its obligations under the *overall Pillar 2 rule*, a *firm* must consider whether the value adjustments and provisions taken for *positions* and portfolios in the *trading book* enable the *firm* to sell or hedge out its *positions* within a short period without incurring material losses under normal market conditions.

[**Note**: article 98(4) of *CRD*]

Interest risk arising from non-trading book activities

2.2.30 R A *firm* must implement systems to identify, evaluate and manage the risk arising from potential changes in interest rates that affect a *firm's* non-trading activities.

[**Note**: article 84 of *CRD*]

2.2.31 R (1) As part of its obligations under *the overall Pillar 2 rule*, a *firm* must carry out an evaluation of its exposure to the interest-rate risk arising from its non-trading activities.

(2) The evaluation under (1) must cover the effect of a sudden and unexpected parallel change in interest rates of 200 basis points in both directions.

(3) A *firm* must immediately notify the *FCA* if any evaluation under this *rule* suggests that, as a result of the change in interest rates described in (2), the economic value of the *firm* would decline by more than 20% of its *own funds.*

(4) A *firm* must carry out the evaluation under (1) as frequently as necessary for it to be reasonably satisfied that it has at all times a sufficient understanding of the degree to which it is exposed to the risks referred to in (1) and the nature of that exposure. In any case it must carry out those evaluations no less frequently than once a year.

[**Note**: article 98(5) of *CRD*]

Operational risk

2.2.32 R A *firm* must implement policies and processes to evaluate and manage the exposure to operational risk, including model risk and to cover low-frequency high severity events. Without prejudice to the definition of *operational risk*, a *firm* must articulate what constitutes operational risk for the purposes of those policies and procedures.

[**Note**: article 85(1) of *CRD*]

2.2.33 R A *firm* must have in place adequate contingency and business continuity plans aimed at ensuring that in the case of a severe business disruption the *firm* is

able to operate on an ongoing basis and that any losses are limited.

[**Note**: article 85(2) of *CRD*]

Risk of excessive leverage

2.2.34 R (1) A *firm* must have in place policies and procedures for the identification, management and monitoring of the *risk of excessive leverage*.

(2) Those policies and procedures must include as indicators for *the risk of excessive leverage*, the leverage ratio determined in accordance with article 429 of the *EU CRR* (Calculation of the leverage ratio) and mismatches between assets and obligations.

[**Note**: article 87(1) of *CRD*]

2.2.35 R A *firm* must address the risk of excessive leverage in a precautionary manner by taking due account of potential increases in *the risk of excessive leverage* caused by reductions of the *firm's own funds* through expected or realised losses, depending on the applicable accounting rules. To that end, a *firm* must be able to withstand a range of different stress events with respect to the *risk of excessive leverage*.

[**Note**: article 87(2) of *CRD*]

General stress and scenario testing

2.3.36 R The *general stress and scenario testing rule* in *IFPRU* 2.2.37R and related *rules* and *guidance* apply to a *significant IFPRU firm*.

2.2.37 R (1) As part of its obligation under the *overall Pillar 2 rule*, a *firm* that is a *significant IFPRU firm* must:

(a) for the major sources of risk identified in line with *IFPRU* 2.2.7R(2), carry out stress tests and scenario analyses that are appropriate to the nature, scale and complexity of those major sources of risk and to the nature, scale and complexity of the *firm's* business; and

(b) carry out the reverse stress testing under *SYSC* 20 (Reverse stress testing).

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

(a) circumstances and events occurring over a protracted period of time;

(b) sudden and severe events, such as market shocks or other similar events; and

(c) some combination of the circumstances and events described in (a) and (b), which may include a sudden and severe market event followed by an economic recession.

(3) In carrying out the stress tests and scenario analyses in (1), the *firm* must estimate the financial resources that it would need in order to continue to meet the *overall financial adequacy rule* and the *own funds requirements* under the obligations laid down in Part Three of the *EU CRR* (Capital requirements) in the adverse circumstances being considered.

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

(5) A *firm* must carry out the stress tests and scenario analyses at least annually, unless:

(a) it is notified by the *FCA* to carry out more frequent or ad-hoc stress tests and scenario analyses; or

(b) the nature, scale and complexity of the major sources of risk identified by it under the *overall Pillar 2 rule* make it appropriate to carry out more frequent stress tests and scenario analyses.

(6) A *firm* must report to the *FCA* the results of the stress tests and scenario analysis annually and not later than three *months* after its annual reporting date.

[**Note**: article 100 of *CRD*]

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

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

2.2.40 G In carrying out the stress tests and scenario analyses under *IFPRU* 2.2.37R(1), a *firm* should also consider any impact of the adverse circumstances on its *own funds*. In particular, a *firm* should consider the capital ratios in article 92

of the *EU CRR* (Own funds requirements) where its *common equity tier 1capital* and *additional tier 1 capital* is eroded by the event.

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

2.2.42 G For the purpose of *IFPRU* 2.2.37R(5), a *firm* should consider whether the nature of the major sources of risks identified by it, in line with *IFPRU* 2.2.7R(2) (Main requirement relating to risk strategies, processes and systems), and their possible impact on its financial resources suggest that such tests and analyses should be carried out more frequently. For instance, a sudden change in the economic outlook may prompt a *firm* to revise the parameters of some of its stress tests and scenario analyses. Similarly, if a *firm* has recently become exposed to a particular sectoral concentration, it may wish to add some stress tests and scenario analyses to reflect that concentration.

Documentation of risk assessments

2.2.43 R (1) A *firm* must make a written record of the assessments required under this part. These assessments include assessments carried out on a consolidated basis and on an individual basis. In particular, it must make a written record of:

(a) the major sources of risk identified in accordance with the *overall Pillar 2 rule*;

(b) how it intends to deal with those risks; and

(c) details of the stress tests and scenario analyses carried out, including any assumptions made in relation to scenario design and the resulting financial resources estimated to be required in accordance with the *general stress and scenario testing rule*.

(2) A *firm* must maintain the records in (1) for at least three years.

[Recovery and resolution plans

2.2.44 R (1) A *firm* must have in place:

(a) recovery plans for the restoration of its financial situation following a significant deterioration; and

(b) viable resolution plans setting out options for the orderly resolution of the *firm* in the case of failure.

(2) For the purpose of (1), a *firm* must:

(a) cooperate closely with resolution authorities; and

(b) provide the resolution authorities with all information necessary for their preparation and drafting of the resolution plans.

[**Note**: article 74(4) of *CRD*]]

Application of this section on an individual basis, consolidated basis and sub-consolidated basis: ICAAP rules

2.2.45 R The *ICAAP rules* do not apply on an individual basis to a *firm* to which the *ICAAP rules* apply on a *consolidated basis* or *sub-consolidated basis* under this Chapter.

2.2.46 R The *ICAAP rules* apply on an individual basis to a *firm* to which the *ICAAP rules* do not apply on a *consolidated* or *sub-consolidated* basis under this Chapter.

[**Note**: article 108(1) (part) of *CRD*]

2.2.47 R A *firm* which is a *parent institution in a Member State* must comply with the *ICAAP rules* on a *consolidated basis*.

2.2.48 R A *firm* controlled by a *parent financial holding company in a Member State* or a *parent mixed financial holding company in a Member State* must comply with the *ICAAP rules* on the basis of the *consolidated situation* of that holding company, if the *FCA* is responsible for supervision of the *firm* on a *consolidated basis* under [article 111 of CRD].

2.2.49 R If the *ICAAP rules* apply to a *firm* on a *consolidated basis*, the *firm* must carry out consolidation to the extent and in the manner prescribed in Part One, Title II, Chapter 2, section 2 of the *EU CRR* (Methods for prudential consolidation) and *IFPRU* 8.1 (Prudential consolidation).

[**Note**: article 108(2) and (3) of *CRD*]

2.2.50 R A *firm* that is a *subsidiary* must apply the *ICAAP rules* on a *sub-consolidated basis* if the *firm*, or the *parent undertaking* where it is a *financial holding company* or *mixed financial holding company,* have an *institution* or *financial institution* or an *asset management company* as a *subsidiary* in a *third country* or hold a *participation* in such an undertaking as members of a *non-EEA sub-group*.

[**Note**: article 108(4) of *CRD*]

2.2.51 R For the purpose of the *ICAAP rules* as they apply on a *consolidated basis*:

(1) the *firm* must ensure that the *FCA consolidation group* have the processes, strategies and systems required by the *overall Pillar 2 rule*;

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

of the *FCA consolidation group*;

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

(4) other references to resources must be read as being to resources of the members of the *FCA consolidation group*;

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

(6) the reference in the *overall Pillar 2 rule* to the *overall financial adequacy rule* must be read as being to that *rule* as adjusted under *IFPRU* 2.2.63R (Application of the *overall financial adequacy rule* on a consolidated basis).

2.2.52 R (1) This *rule* relates to the assessment of the amounts, types and distribution of financial resources, *own funds* and internal capital (referred to in this *rule* as "resources") under the *overall Pillar 2 rule* as applied on a *consolidated basis* and to the assessment of diversification effects as referred to in *IFPRU* 2.2.14R(3)(b) as applied on a *consolidated basis*.

(2) A *firm* must be able to explain how it has aggregated the risks referred to in the *overall Pillar 2 rule* and the resources required by each member of the *FCA consolidation group* and how it has taken into account any diversification benefits for the group in question.

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

2.2.53 R (1) A *firm* must allocate the total amount of financial resources, *own funds* and internal capital identified as necessary under the *overall Pillar 2 rule* (as applied on a consolidated basis) between different parts of the *FCA consolidation group*. *IFPRU* 2.2.11R (Identifying different tiers of capital) does not apply to this allocation.

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

2.2.54 R A *firm* must also allocate the total amount of financial resources, *own funds* and internal capital (referred to in this *rule* as "resources") identified as necessary under the *overall Pillar 2 rule* as applied on a *consolidated basis*

between each *firm* which is a member of the *FCA consolidation group* on the following basis:

(1) the amount allocated to each *firm* must be decided on the basis of the principles in *IFPRU* 2.2.53R(2); and

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

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

2.2.56 G The purpose of *IFPRU* 2.2.52R to *IFPRU* 2.2.55R is to enable the *FCA* to assess the extent, if any, to which a *firm's* assessment, calculated on a *consolidated basis*, is lower than it would be if each separate legal entity were to assess the amount of capital it would require to mitigate its risks (to the same level of confidence) were it not part of a group subject to consolidated supervision under Part One, Title II, Chapter 2 of the *EU CRR* (Prudential consolidation). The reason the *FCA* wishes to make this assessment is so that *individual capital guidance* which it gives is fair and comparable between different *firms* and groups. Group diversification benefits which a *firm* might assert exist can be a material consideration in a capital adequacy assessment. Understanding the methods used to aggregate the different risks (for example, the correlation assumptions) is crucial to a proper evaluation of such benefits.

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

(1) capital which is held by overseas regulated *firms* may not be capable of being remitted to a *firm* in the *UK* which has suffered a loss;

(2) a *firm* which is, or likely to become, insolvent may be obliged to look to the interests of its creditors first before transferring capital to other group *companies*; and

(3) a parent *company* may have to balance the interests of its shareholders against the protection of the creditors of a *subsidiary* which is, or might become, insolvent and may, rationally, conclude that a *subsidiary* should be allowed to fail rather than provide capital to support it.

Application of this section on an individual basis, consolidated basis and sub-consolidated basis: risk control rules

2.2.58 R The *risk control rules* apply to a *firm* on an individual basis whether or not

they also apply to the *firm* on a *consolidated basis*.

[**Note**: article 109(1) of *CRD*]

2.2.59 R Where a *firm* is a member of a *FCA consolidation group* or a *non-EEA sub-group*, the *firm* must ensure that the risk management processes and internal control mechanisms at those levels comply with the obligations set out in the *risk control rules* on a *consolidated basis* (or a *sub-consolidated basis*).

[**Note**: article 109(2) of *CRD*]

2.2.60 R Compliance with the obligations in *IFPRU* 2.2.59R must enable the *FCA consolidation group* or the *non-EEA sub-group* to have arrangements, processes and mechanisms that are consistent and well integrated and that any data relevant to the purpose of supervision can be produced.

[**Note**: article 109(2) of *CRD*]

Application of this section on an individual basis, consolidated basis and sub-consolidated basis: overall financial adequacy rules

2.2.61 R The *overall financial adequacy rule* applies to a *firm* on an individual basis, whether or not it also applies to the *firm* on a *consolidated basis*.

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

2.2.63 R When the *overall financial adequacy rule* applies on a consolidated basis, the *firm* must ensure that at all times its group maintains overall financial resources and internal capital, including *own funds* and liquidity resources, which are adequate, both as to amount and quality, to ensure that there is no significant risk that the liabilities of any members of its group cannot be met as they fall due.

Additional guidance on stress tests and scenario analyses

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

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

2.2.66 G Scenario analysis typically refers to a wider range of parameters being varied at the same time. Scenario analyses often examine the impact of adverse events on the *firm's* financial position, for example, simultaneous movements

in a number of risk categories affecting all of a *firm's* business operations, such as business volumes, investment values and interest rate movements.

2.2.67 G There are three broad purposes of stress testing and scenario analysis:

(1) it can be used as a means of quantifying how much capital might be absorbed if an adverse event or events occurs. As such it represents a simple 'what if' approach to estimating exposure to risks. This might be a proportionate approach to risk management for an unsophisticated business;

(2) it can be used to provide a check on the outputs and accuracy of risk models, particularly in identifying non-linear effects when aggregating risks; and

(3) it can be used to explore the sensitivities in longer term business plans and how capital needs might change over time

2.2.68 G One of the main purposes of stress tests and scenario analyses under the *general stress and scenario testing rule* is to test the adequacy of overall financial resources. Scenarios need only be identified, and their impact assessed, in so far as this facilitates that purpose. In particular, the nature, depth and detail of the analysis depend, in part, upon the *firm's* capital strength and the robustness of its risk prevention and risk mitigation measures.

2.2.69 G Both stress testing and scenario analyses are forward-looking analysis techniques which seek to anticipate possible losses that might occur if an identified risk crystallises. In applying them, a *firm* should decide how far forward to look. This should depend upon:

(1) how quickly it would be able to identify events or changes in circumstances that might lead to a risk crystallising resulting in a loss; and

(2) after it has identified the event or circumstance, how quickly and effectively it could act to prevent or mitigate any loss resulting from the risk crystallising and to reduce exposure to any further adverse event or change in circumstance.

2.2.70 G Where a *firm* is exposed to *market risk*, the time horizon over which stress tests and scenario analyses should be carried out will depend on, among other things, the maturity and liquidity of the *positions* stressed. For example, for the *market risk* arising from the holding of investments, this will depend upon:

(1) the extent to which there is a regular, open and transparent market in those assets, which would allow fluctuations in the value of the investment to be more readily and quickly identified; and

(2) the extent to which the market in those assets is sufficiently liquid (and would remain liquid in the changed circumstances contemplated in the stress test or scenario analysis) to allow the *firm*, if needed, to sell,

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

(a) the *general stress and scenario testing rule* should include a regular programme of stress testing and scenario analysis of its *trading book positions*, both at the trading desk level and on a *firm*-wide basis, with the results of these tests being reviewed by *senior management* and reflected in the policies and limits the *firm* sets;

(b) the *firm's* stress testing programme should be comprehensive in both risk and *firm* coverage, and appropriate to the size and complexity of *trading book positions* held;

(c) for the purpose *IFPRU* 2.2.37R(5)(b), the frequency of stress testing of *trading book positions* should be determined by the nature of the *positions*;

(d) the stress testing should include shocks which reflect the nature of the portfolio and the time it could take to hedge out or manage risks under severe market conditions;

(e) the *firm* should have procedures in place to assess and respond to the results of the stress testing programme, in particular, stress testing should be used to evaluate the *firm's* capacity to absorb losses or to identify steps to be taken by the *firm* to reduce risk;

(f) as part of its stress testing programme, the *firm* should consider how prudent valuation requirements in article 105 of the *EU CRR* will be met in a stressed scenario.

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

(1) the nature, scale and mix of its future activities; and

(2) the behaviour of *counterparties*, and of the *firm* itself, including the exercise of choices (for example, options embedded in financial instruments or *contracts of insurance*).

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

(1) only include financial resources that could reasonably be relied upon as being available in the circumstances of the identified scenario; and

(2) take account of any legal or other restriction on the use of financial resources.

Capital planning

2.2.73 G (1) In identifying an appropriate range of adverse circumstances and events in accordance with *IFPRU* 2.2.37R(2):

(a) a *firm* will need to consider the cycles it is most exposed to and whether these are general economic cycles or specific to particular markets, sectors or industries;

(b) for the purposes of *IFPRU* 2.2.37R(2)(a), the amplitude and duration of the relevant cycle should include a severe downturn scenario based on forward-looking hypothetical events, calibrated against the most adverse movements in individual risk drivers experienced over a long historical period;

(c) the adverse scenarios considered should in general be acyclical and, accordingly, the scenario should not become more severe during a downturn and less severe during an upturn. However, the *FCA* does expect scenarios to be updated with relevant new economic data on a pragmatic basis to ensure that the scenario continues to be relevant; and

(d) the adverse scenarios considered should reflect a *firm's* risk tolerance of the adverse conditions through which it expects to remain a going concern.

(2) In making the estimate required by *IFPRU* 2.2.37R(3), a *firm* should project both its *capital resources* and its required *capital resources* over a time horizon of three to five years, taking account of its business plan and the impact of relevant adverse scenarios. In making the estimate, the *firm* should consider both the *capital resources* required to meet its *own funds requirements* and the *own funds* needed to meet the *overall financial adequacy rule*. The *firm* should make these projections in a manner consistent with its risk management processes and systems as in *IFPRU* 2.2.7R.

(3) In projecting its financial position over the relevant time horizon, the *firm* should:

(a) reflect how its business plan would "flex" in response to the adverse events being considered, taking into account factors such as changing consumer demand and changes to new business assumptions;

(b) consider the potential impact on its stress testing of dynamic feedback effects and second order effects of the major sources of risk identified in accordance with *IFPRU* 2.2.7R(2);

(c) estimate the effects on the *firm's* financial position of the adverse event without adjusting for management actions;

(d) separately, identify any realistic management actions that the *firm* could, and would, take to mitigate the adverse effects of the stress scenario; and

(e) estimate the effects of the stress scenario on the *firm's* financial position after taking account of realistic management actions.

(4) A *firm* should identify any realistic management actions intended to maintain or restore its capital adequacy. These could include ceasing to transact new business after a suitable period has elapsed, balance sheet shrinkage, restricting distribution of profits or raising additional capital. A *firm* should reflect management actions in its projections only where it could, and would, take such actions, taking account of factors such as market conditions in the stress scenario and its effects upon the *firm's* reputation with its counterparties and investors. The combined effect on capital and retained earnings should be estimated. To assess whether prospective management actions in a stress scenario would be realistic and to determine which actions the *firm* would and could take, the *firm* should take into account any pre-conditions that might affect the value of management actions as risk mitigants and analyse the difference between the estimates in (3)(c) and (3)(e) in sufficient detail to understand the implications of taking different management actions at different times, particularly where they represent a significant divergence from the *firm's* business plan.

(5) The *firm* should document its stress testing and scenario analysis policies and procedures, as well as the results of its tests in accordance with *IFPRU* 2.2.43R (Documentation of risk assessments). These records should be included within the *firm's ICAAP* submission document.

(6) The *FCA* will review the *firm's* records in (5) as part of its *SREP*. The purpose of examining these is to enable the *FCA* to judge whether a *firm* will be able to continue to meet its *own funds requirements* and the *overall financial adequacy rule* throughout the projection period.

(7) If, after taking account of realistic management actions, a *firm's* stress-testing management plan shows that the *firm's* projected *own funds* are less than those required to continue to meet its *EU CRR* or needed to continue to meet the *overall financial adequacy rule* over the projection period, the *FCA* may require the *firm* to set out additional countervailing measures and off-setting actions to reduce such difference or to restore the *firm's* capital adequacy after the stress event.

(8) The *firm's senior management* or *governing body* should be actively involved and engaged in all relevant stages of the *firm's* stress testing and scenario analysis programme. This would include establishing an appropriate stress testing programme, reviewing the programme's implementation (including the design of scenarios) and challenging,

approving and actioning the results of the stress tests.

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

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

2.2.76 G (1) Stress and scenario analyses should, in the first instance, be aligned with the risk appetite of the *firm*, as well as the nature, scale and complexity of its business and of the risks that it bears. The calibration of the stress and scenario analyses should be reconciled to a clear statement setting out the premise upon which the *firm's* internal capital assessment under the *overall Pillar 2 rule* is based.

(2) In identifying adverse circumstances and events in line with *IFPRU* 2.2.37R(2), a *firm* should consider the results of any reverse stress testing conducted under *SYSC* 20. Reverse stress testing may be expected to provide useful information about the *firm's* vulnerabilities and variations around the most likely ruin scenarios for the purpose of meeting the *firm's* obligations under *IFPRU* 2.2.37R. In addition, such comparison may help a *firm* to assess the sensitivity of its financial position to different stress calibrations.

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

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

Pension obligation risk

2.2.79 G This section contains guidance on the assessment required by *IFPRU* 2.2.7R(2)(k) for a *firm* exposed to pension obligation risk as defined in *IFPRU* 2.2.8R(5)

2.2.80 G The focus of the risk assessment is on the *firm's* obligations towards the pension scheme, not of the pension scheme itself (ie, the scheme's assets and liabilities). A *firm* should include in its estimate of financial resources both its

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

2.2.81 G If a *firm* has a current funding obligation in excess of normal contributions or there is a risk that such a funding obligation will arise then, when calculating available capital resources, it should reverse out any accounting deficit and replace this in its capital adequacy assessment with its best estimate, calculated in discussion with the scheme's actuaries or trustees, of the cash that will need to be paid into the scheme in addition to normal contributions over the foreseeable future. This may differ from the approach taken in assessing pension scheme risks for the purposes of calculating *own funds* to meet the *own funds requirements*.

2.2.82 G If a *firm* has a current funding obligation in excess of normal contributions or there is a risk that such a funding obligation will arise then, when calculating available capital resources, it should reverse out any accounting deficit and replace this in its capital adequacy assessment with its best estimate, calculated in discussion with the scheme's actuaries or trustees, of the cash that will need to be paid into the scheme in addition to normal contributions over the foreseeable future. This may differ from the approach taken in assessing pension scheme risks for the purposes of calculating *own funds* to meet the *own funds requirements*.

2.2.83 G A *firm* may wish to consider the following scenarios:

(1) one in which the *firm* gets into difficulties with an effect on its ability to fund the pension scheme; and

(2) one in which the pension scheme position deteriorates (for example, because investment returns fall below expected returns or because of increases in life expectancy) with an effect on the *firm's* funding obligations; taking into account the management actions the *firm* could and would take.

2.2.84 G A *firm* is expected to determine where the scope of any stress test impacts upon its pension obligation risk and estimate how the relevant measure of pension obligation risk will change in that scenario. For example, in carrying out stress tests under *IFPRU* 2.2.37R, a *firm* must consider how a stress scenario, such as an economic recession, would impact on the *firm's* current obligations towards its pension scheme and any potential increase in those obligations. Risks such as interest-rate risk or reduced investment returns may have a direct impact on a *firm's* financial position as well as an indirect impact resulting from an increase in the *firm's* pension scheme obligations. Both effects should be taken into account in a *firm's* estimate of financial resources under *IFPRU* 2.2.7R (Overall Pillar 2 rule).

2.2.85 G A *firm* should consider issues such as:

(1) the extent to which trustees of the pension scheme or a pension regulator (such as the one created under the Pensions Act 2004) can compel a certain level of contributions or a one-off payment in adverse

financial situations or to meet the minimum legal requirements under the scheme's trust deed and rules or applicable laws relating to the pension scheme;

(2) whether the valuation bases used to set pension scheme contribution rates are consistent with the *firm's* current business plans and anticipated changes in the workforce; and

(3) which valuation basis is appropriate, given the expected investment return on scheme assets and actions the *firm* can take if those returns do not materialise.

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

Group risk

2.2.87 G This section contain additional guidance on the assessment required by *IFPRU* 2.2.7R(2)(l) (Group risk).

2.2.88 G A *firm* should include in the written record in *IFPRU* 2.2.43R (Documentation of risk assessments) a description of the broad business strategy of the *FCA consolidation group* or the *non-EEA sub-group* of which it is a member, the group's view of its principal risks and its approach to measuring, managing and controlling the risks. This description should include the role of stress testing, scenario analysis and contingency planning in managing risk on an individual basis and *consolidated basis*.

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

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

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

2.3 Supervisory review and evaluation process: internal capital adequacy standards

Purpose

2.3.1 G (1) *IFPRU* 2.3 sets out *guidance* on *IFPRU* 2.2 (Adequacy of financial resources) so far as it applies to an *IFPRU investment firm*. In particular, *guidance* on how a *firm* should carry out its *ICAAP*, as well as some factors the *FCA* will take into consideration when undertaking a *SREP*. The terms *ICAAP* and *SREP* are explained in *IFPRU* 2.3.3G. *IFPRU* 2.3.48R to *IFPRU* 2.2.52R are *rules* that apply to a *firm* with an IRB permission.

(2) *IFPRU* 2.3 is mainly written on the basis that *IFPRU* 2.2 (Adequacy of financial resources) applies to a *firm* on a solo basis. However it is still relevant when *IFPRU* 2.2 applies on a *consolidated basis*. When *IFPRU* 2.2 applies on a *consolidated basis*, *IFPRU* 2.3 should be read with appropriate adjustments.

Meaning of capital

2.3.2 G For the purpose of *IFPRU* 2.3, "capital" refers to a *firm's* financial resources, *own funds* and internal capital, all as referred to in the *overall Pillar 2 rule*.

The ICAAP and the SREP: introduction

2.3.3 G The adequacy of a *firm's* capital needs to be assessed both by a *firm* and the *FCA*. This process involves:

(1) an *internal capital adequacy assessment process* (*ICAAP*), which a *firm* is obliged to carry out in accordance with the *ICAAP rules*; and

(2) a *supervisory review and evaluation process* (*SREP*), which is conducted by the *FCA*.

The ICAAP and the SREP: the ICAAP

2.3.4 G The obligation to conduct an *ICAAP* includes requirements on a *firm* to:

(1) carry out regularly assessments of the amounts, types and distribution of financial resources, *own funds* and internal capital that it considers adequate to cover the nature and level of the risks to which it is or might be exposed (*IFPRU* 2.2.1 R to *IFPRU* 2.2.6G (the *overall Pillar 2 rule* and related *rules*));

(2) identify the major sources of risk to its ability to meet its liabilities as they fall due (the *overall Pillar 2 rule*);

(3) conduct stress and scenario tests (the *general stress and scenario testing rule* if it is a *significant IFPRU firm* or *SYSC* 20 (Reverse stress testing) if it is not a *significant IFPRU firm*) taking into account, for a *firm* with an IRB permission, the stress test required by the *EU CRR*;

(4) ensure that the processes, strategies and systems required by the *overall Pillar 2 rule* and used in its *ICAAP*, are both comprehensive and proportionate to the nature, scale and complexity of that *firm's*

activities (*IFPRU* 2.2.13R); and

(5) document its *ICAAP* (*IFPRU* 2.2.43R (Documentation of risk assessments)).

2.3.5 G Where a *firm* is a member of a group, it should base its *ICAAP* on the consolidated financial position of the group. The group assessment should include information on diversification benefits and transferability of resources between members of the group and an apportionment of the capital required by the group as a whole to the *firm* (*IFPRU* 2.2.45G to *IFPRU* 2.2.57G (Application of IFPRU 2.2 on a solo and consolidated basis)). A *firm* may, instead of preparing the *ICAAP* itself, adopt as its *ICAAP* an assessment prepared by other group members.

2.3.6 G A *firm* should ensure that its *ICAAP* is:

(1) the responsibility of the *firm's governing body*;

(2) reported to the *firm's governing body*; and

(3) forms an integral part of the *firm's* management process and decision-making culture.

The ICAAP and the SREP: the SREP

2.3.7 G The *FCA* will review a *firm's ICAAP*, including the results of the *firm's* stress tests carried out under *IFPRU* and the *EU CRR*, as part of its *SREP*. Provided that the *FCA* is satisfied with the appropriateness of a *firm's* capital assessment, the *FCA* will take into account that *firm's ICAAP* and stress tests in its *SREP*. More material on stress tests for a *firm* with an IRB permission can be found in *IFPRU* 2.3.48R to *IFPRU* 2.3.52G.

2.3.8 G The *SREP* is a process under which the *FCA*:

(1) reviews the arrangements, strategies, processes and mechanisms implemented by a *firm* to comply with *IFPRU*, *SYSC* and with requirements imposed by or under the *EU CRR* and wider *regulatory system* and evaluates the risks to which the *firm* is, or might be, exposed;

(2) determines whether the arrangements, strategies, processes and mechanisms implemented by the *firm* and the capital held by the *firm* ensures a sound management and coverage of the risks in (1); and

(3) (if necessary) requires the *firm* to take the necessary actions or steps at an early stage to address any failure to meet the requirements in (1).

2.3.9 G As part of its *SREP*, the *FCA* may ask a *firm* to provide it with the results of that *firm's ICAAP*, together with an explanation of the process used. Where appropriate, the *FCA* will ask for additional information on the *ICAAP*.

2.3.10 G As part of its *SREP*, the *FCA* will consider whether the amount and quality of capital which a *firm* should hold to meet its *own funds requirements* in the *EU CRR* is sufficient for that *firm* to comply with the *overall financial adequacy rule*.

2.3.11 G After completing a review as part of the *SREP*, the *FCA* will normally give that *firm* individual *guidance* (*individual capital guidance*), advising it of the amount and quality of capital which it should hold to meet the *overall financial adequacy rule*.

2.3.12 G As part of its *SREP*, the *FCA* will also consider whether a *firm* should hold a *capital planning buffer* and the amount and quality of such *capital planning buffer*. In making these assessments, the *FCA* will have regard to the nature, scale and complexity of a *firm's* business and of the major sources of risks relevant to such business as referred to in the *general stress and scenario testing rule* and *SYSC* 20 (Reverse stress testing), as applicable. Accordingly, a *firm's capital planning buffer* should be of sufficient amount and adequate quality to allow the *firm* to continue to meet the *overall financial adequacy rule* in the face of adverse circumstances, after allowing for realistic management actions.

2.3.13 G After completing a review as part of the *SREP*, the *FCA* may notify the *firm* of the amount and quality of capital which it should hold as a *capital planning buffer* over and above the level of capital recommended as its *ICG*. The *FCA* may set a *firm's capital planning buffer* either as an amount and quality of capital which it should hold now (ie, at the time of the *FCA* notification following the *firm's SREP*) or, in exceptional cases, as a forward-looking target that the *firm* should build up over time.

2.3.14 G Where the amount or quality of capital which the *FCA* considers a *firm* should hold to meet the *overall financial adequacy rule* or as a *capital planning buffer* is not the same as that which results from a *firm's ICAAP*, the *FCA* usually expects to discuss any such difference with the *firm*. Where necessary, the *FCA* may consider the use of its powers under section 166 of the *Act* (Reports by skilled persons) to assist in such circumstances.

2.3.15 G If a *firm* considers that the *individual capital guidance* given to it is inappropriate to its circumstances it should, consistent with *Principle* 11 (Relations with regulators), inform the *FCA* that it disagrees with that *guidance*. The *FCA* may reissue the *individual capital guidance* if, after discussion with the *firm*, the *FCA* concludes that the amount or quality of capital that the *firm* should hold to meet the *overall financial adequacy rule* is different from the amount or quality initially suggested by the *FCA*.

2.3.16 G If a *firm* disagrees with the *FCA's* assessment as to the amount or quality of *capital planning buffer* that it should hold, it should, consistent with *Principle* 11 (Relations with regulators), notify the *FCA* of its disagreement. The *FCA* may reconsider its initial assessment if, after discussion with the *firm*, the *FCA* concludes that the amount or quality of capital that the *firm* should hold as *capital planning buffer* is different from the amount or quality initially

suggested.

2.3.17 G The *FCA* will not give *individual capital guidance* to the effect that the amount of capital advised in that *guidance* is lower than the amount of capital which a *firm* should hold to meet its *own funds requirements*.

2.3.18 G If, after discussion, the *FCA* and a *firm* still do not agree on an adequate level of capital, the *FCA* may consider using its powers under section 55J of the *Act* to vary on its own initiative a *firm's Part 4A permission* to require it to hold capital in line with the *FCA's* view of the capital necessary to comply with the *overall financial adequacy rule*. In deciding whether it should use its powers under section 55J, the *FCA* will take into account the amount and quality of the *capital planning buffer* which the *firm* should hold as referred to in *IFPRU* 2.3.13G and *IFPRU* 2.3.14G. *SUP 7* provides further information about the *FCA's* powers under section 55J.

The drafting of individual capital guidance and capital planning buffer

2.3.19 G If the *FCA* gives *individual capital guidance* to a *firm*, the *FCA* will state what amount and quality of capital the *FCA* considers the *firm* needs to hold in order to comply with the *overall financial adequacy rule*. It will generally do so by saying that the *firm* should hold *own funds* of an amount which is at least equal to a specified percentage of that *firm's own funds requirements* plus one or more static add-ons for specific risks, in line with the *overall Pillar 2 rule*.

2.3.20 G *Individual capital guidance* may refer to two types of *own funds*:

(1) General capital. It refers to total *common equity tier 1 capital* and *additional tier 1 capital resources* after applying deductions and prudential filters under the *EU CRR*.

(2) Total capital. It refers to total *common equity tier 1 capital*, *additional tier 1 capital* and *tier 2 capital* after applying deductions and prudential filters under the *EU CRR*.

2.3.21 G Where the *FCA* notifies a *firm* that it should hold a *capital planning buffer*, the notification will state what amount and quality of capital the *FCA* considers is adequate for the *firm* to hold as such. This will normally be notified to the *firm*, together with its *individual capital guidance* and expressed as a separate amount of *own funds* that the *firm* should hold in excess of the amount of *own funds* indicated as its *individual capital guidance*.

2.3.22 G For the purposes of *IFPRU* 2.3.21G, *IFPRU* 2.3.30G applies as it applies to *individual capital guidance*. References in those provisions to *individual capital guidance* should be read as if they were references to *capital planning buffer*. In relation to *IFPRU* 2.2.62R, where the *general stress and scenario testing rule* or *SYSC* 20 (Reverse stress testing), as part of the *ICAAP rules*, applies to a *firm* on a *consolidated basis*, the *FCA* may notify the *firm* that it should hold a group *capital planning buffer*. In these cases, the *firm* should ensure that the group holds a *capital planning buffer* of sufficient amount and

adequate quality to allow it to continue to meet the *overall financial adequacy rule* in the face of adverse circumstances, after allowing for realistic management actions.

Failure to meet individual capital guidance and monitoring and reporting on the capital planning buffer

2.3.23 G A *firm* continuing to hold capital in accordance with its *individual capital guidance* and its ability to carry on doing so is a fundamental part of the *FCA's* supervision of that *firm*. Therefore, if a *firm's own funds* have fallen, or are expected to fall, below the level advised in *individual capital guidance*, then, consistent with *Principle* 11 (Relations with regulators), a *firm* should inform the *FCA* of this fact as soon as practicable, explaining why this has happened or is expected to happen and:

(1) what action the *firm* intends to take to increase its own funds or to reduce its risks and hence its own funds requirements; or

(2) what modification the *firm* considers should be made to the *individual capital guidance* which it has been given.

2.3.24 G In the circumstance in *IFPRU* 2.3.23G, the *FCA* may ask a *firm* for alternative or more detailed proposals and plans or further assessments and analyses of capital adequacy and risks faced by the *firm*. The *FCA* will seek to agree with the *firm* appropriate timescales and scope for any such additional work, in the light of the circumstances which have arisen.

2.3.25 G If a *firm* has not accepted *individual capital guidance* given by the *FCA* it should, nevertheless, inform the *FCA* as soon as practicable if its *own funds* have fallen, or are expected to fall, below the level suggested by that *individual capital guidance*.

2.3.26 G Monitoring the use of a *firm's capital planning buffer* is also a fundamental part of the *FCA's* supervision of that *firm*. A *firm* should only use its *capital planning buffer* to absorb losses or meet increased own funds requirements if certain adverse circumstances materialise. These should be circumstances beyond the *firm's* normal and direct control, whether relating to a deteriorating external environment or periods of stress, such as macroeconomic downturns or financial/market shocks, or firm-specific circumstances.

2.3.27 G Consistent with *Principle* 11 (Relations with regulators), a *firm* should notify the *FCA* as early as possible in advance where it has identified that it would need to use its *capital planning buffer*. The *firm's* notification should at least state:

(1) what adverse circumstances are likely to force the *firm* to draw down its *capital planning buffer*;

(2) how the *capital planning buffer* will be used up in line with the *firm's* capital planning projections; and

(3) what plan is in place for the eventual restoration of the *capital planning buffer*.

2.3.28 G Following discussions with the *firm* on the items listed in *IFPRU* 2.3.27G, the *FCA* may put in place additional reporting arrangements to monitor the *firm's* use of its *capital planning buffer* in accordance with the plan referred to in *IPRU* 2.3.27G(3). The *FCA* may also identify specific trigger points as the *capital planning buffer* is being used up by the *firm*, which could lead to additional supervisory actions.

2.3.29 G Where a *firm's capital planning buffer* is being drawn down due to circumstances other than those in *IFPRU* 2.3.26G, such as poor planning or mismanagement, the *FCA* may ask the *firm* for more detailed plans for it to restore its *capital planning buffer*. In the light of the relevant circumstances, the *FCA* may consider taking other remedial actions, which may include using its powers under section 55J of the *Act* to vary, on its own initiative, a *firm's Part 4A permission*.

2.3.30 G A *firm* should inform the *FCA* where its *capital planning buffer* is likely to start being drawn down, even if it has not accepted the *FCA's* assessment as to the amount or quality of its *capital planning buffer*.

2.3.31 G Where a *firm* has started to use its *capital planning buffer* in circumstances where it was not possible to notify in advance, it should notify the *FCA* and provide the information referred to in *IFPRU* 2.3.27G as soon as practicable afterwards.

2.3.32 G *IFPRU* 2.3.23G to *IFPRU* 2.3.31G also apply to *individual capital guidance* and to *capital planning buffer* on a *consolidated basis*.

Proportionality of an ICAAP

2.3.33 G *IFPRU* 2.3.34G to *IFPRU* 2.3.36G set out what the *FCA* considers to be a proportional approach to preparing an *ICAAP* as referred to in *IFPRU* 2.2.12R (The processes, strategies and systems required by the *overall Pillar 2 rule* should be comprehensive and proportionate), according to the relative degree of complexity of a *firm's* activities. If a *firm* adopts the appropriate approach, it may enable the *FCA* more easily to review a *firm's ICAAP* when the *FCA* undertakes its *SREP*. The *FCA* is also likely to place more reliance on an *ICAAP* which takes the appropriate form described in *IFPRU* 2.3.34G to *IFPRU* 2.3.36G than would otherwise be the case, although there may also be circumstances in which the *FCA* will be able to rely on an *ICAAP* that is not drawn up in that form.

2.3.34 G (1) This paragraph applies to a *firm* that is not a *significant IFPRU firm* (see *IFPRU* 1.1.20R) whose activities are simple and primarily not credit-related.

(2) In carrying out its *ICAAP* it could:

(a) identify and consider that *firm's* largest losses over the last three to five years and whether those losses are likely to recur;

(b) prepare a short list of the most significant risks to which that *firm* is exposed;

(c) consider how that *firm* would act, and the amount of capital that would be absorbed, in the event that each of the risks identified were to materialise;

(d) consider how that *firm's own funds requirements* might alter under the scenarios in (c) and how its *own funds requirements* might alter in line with its business plans for the next three to five years;

(e) consider whether any of the risks in the *overall Pillar 2 rule* is applicable to the *firm* (it is unlikely that any of those risks not already identified in (a) or (b) will apply to a *firm* whose activities are simple);

(f) document the ranges of capital required in the scenarios identified and form an overall view on the amount and quality of capital which that *firm* should hold, ensuring that its *senior management* is involved in arriving at that view; and

(g) (to determine the amount of capital that would be absorbed in the circumstances in (c)) carry out simple sensitivity tests where the *firm* analyses the impact of a shift in the key risk parameters identified in (b) on the earnings of the *firm*.

(3) A *firm* is also expected to form a view on the consolidated amount of capital it should hold, as well as the capital required to be held for each of the individual risks identified under the *overall Pillar 2 rule*. For that purpose, it may conservatively sum the results of the individual tests performed in (2)(c). However, if the *firm* chooses to reduce that sum on the understanding that not all risks will materialise at the same time, then the *firm* should perform scenario tests that demonstrate that a reduction in capital is legitimate.

(4) A *firm* should conduct stress tests and scenario analyses in accordance with *SYSC* 20 (Reverse stress testing) to assess how that *firm's* capital and *own funds requirements* would alter and what that *firm's* reaction might be to a range of adverse scenarios, including operational and market events. Where relevant, a *firm* should also consider the impact of a severe economic or industry downturn on its future earnings, *own funds* and *own funds requirements*, taking into account its business plans. The downturn scenario should be based on forward-looking hypothetical events calibrated against the most adverse movements in individual risk drivers experienced over a long historical period.

2.3.35 G For a *firm* that is a *significant IFPRU firm* (see *IFPRU* 1.1.20R) and whose activities are moderately complex, in carrying out its *ICAAP*, *IFPRU* 2.3.34G(2) to (4) apply. In addition, it could:

(1) having consulted the management in each major business line, prepare a comprehensive list of the major risks to which the business is exposed;

(2) estimate, with the aid of historical data, where available, the range and distribution of possible losses which might arise from each of those risks and consider using shock stress tests to provide risk estimates;

(3) consider the extent to which that *firm's own funds requirements* adequately captures the risks identified in (1) and (2);

(4) for areas in which the *own funds requirements* is either inadequate or does not address a risk, estimate the additional capital (if any) needed to protect that *firm* and its *customers*, in addition to any other risk mitigation action that *firm* plans to take;

(5) consider the risk that that *firm's* own analyses of capital adequacy may be inaccurate and that it may suffer from management weaknesses, which affect the effectiveness of its risk management and mitigation;

(6) project that *firm's* business activities forward in detail for one year and in less detail for the next three to five years and estimate how that *firm's* capital and *own funds requirements* would alter, assuming that business develops as expected;

(7) assume that business does not develop as expected and consider how that *firm's* capital and *own funds requirements* would alter and what that *firm's* reaction to a range of adverse economic scenarios might be (see *IFPRU* 2.2.7R to *IFPRU* 2.2.43R (the *overall Pillar 2 rule* and related *rules* and *guidance*)). Where appropriate, the adverse scenarios should consider the impact of market events that are instantaneous or occur over an extended period of time but which are nevertheless still co-dependent on movements in economic conditions;

(8) document the results obtained from the analyses in (2), (4), (6) and (7) in a detailed report for that *firm's senior management* and, where relevant, its *governing body*; and

(9) ensure that systems and processes are in place to review against performance the accuracy of the estimates made in (2), (4), (6) and (7).

2.3.36 G (1) This paragraph applies to a proportional *ICAAP* in the case of a *firm* that is a *significant IFPRU firm* (see *IFPRU* 1.1.20R) whose activities are complex.

(2) A proportional approach to that *firm's ICAAP* should cover the matters identified in *IFPRU* 2.3.34G and *IFPRU* 2.3.35G, but is likely also to

involve the use of models, most of which will be integrated into its day-to-day management and operation.

(3) Models of the kind referred to in (2) may be linked so as to generate an overall estimate of the amount of capital that a *firm* considers appropriate to hold for its business needs. For example, a *firm* is likely to use value-at-risk models for market risk (see Part Three, Title IV, Chapter 5 of the *EU CRR* (Use of internal models to calculate own funds requirements for market risk)), advanced modelling approaches for credit risk (see Part Three, Title II, Chapter 3 of the *EU CRR* (Internal Ratings Based Approach)) and, possibly, advanced measurement approaches for *operational risk* (see Part Three, Title III, Chapter 4 of the *EU CRR* (Advanced measurement approaches)). A *firm* might also use economic scenario generators to model stochastically its business forecasts and risks. A *firm* may also link such models to generate information on the economic capital desirable for that *firm*. A model which a *firm* uses to generate its target amount of economic capital is known as an economic capital model (ECM). Economic capital is the target amount of capital which maximises the return for a *firm's* stakeholders for a desired level of risk.

(4) A *firm* is also likely to be part of a *group* and to be operating internationally. There is likely to be centralised control over the models used throughout the *group*, the assumptions made and their overall calibration.

(5) The more a *firm* integrates into its business such economic capital modelling, the more it is likely to focus on managing risks for the benefit of its stakeholders. Consequently, ECMs may produce capital estimates that differ from the amount of capital needed for regulatory purposes. For the *FCA* to rely on the results of a *firm's* models, including ECMs, a *firm* should be able to explain the basis and results of its models and how the amount of capital produced by its models reflects the amount of capital needed for regulatory purposes. Where they are not equal, the *FCA* will expect a *firm* to explain any differences. However, it may prove difficult to reconcile the outcome of a *firm's* modelling with the *FCA's* own assessment of the adequacy of that *firm's* capital. For example, when matters of judgment are involved in arriving at a *firm's* capital assessment or the *FCA* relies on information which cannot be fully disclosed to the *firm* (eg, comparisons with the *firm's* peers). Nevertheless, a *firm* whose ECM produces a different amount of capital to that required for regulatory purposes is still obliged to comply with the *overall Pillar 2 rule*. A *firm* should, therefore, be able to explain to the *FCA* how the outcome of its ECM is adjusted so that it complies with the *overall financial adequacy rule* and the *overall Pillar 2 rule*.

(6) Stress testing carried out under the *general stress and scenario testing rule* should provide *senior management* with a consolidated view of the amount of risk the *firm* is, or might be, exposed to under the chosen stress events. *Senior management* should be presented with information

that considers the possibility of the risks materialising simultaneously in various proportions. For instance, it would be misrepresentative to simulate *market risk* stressed events without considering that, in those circumstances, market *counterparties* may be more likely to default. Accordingly, a *firm* could:

(a) carry out combined stress tests where assets and liabilities are individually subjected to simultaneous changes in two or more risk drivers; for instance, the change in value of each loan made by a *firm* may be estimated using simultaneous changes to both interest rates and stock market or property values;

(b) integrate the results of market and credit risk models, rather than aggregating the results of each model separately; and

(c) consider scenarios which include systemic effects on the *firm* of wider failures in the *firm's* market or systems upon which the *firm* depends and also any possible systemic effects caused by the *firm* itself suffering losses which affect other market participants which, in turn, exacerbate the *firm's* position.

(7) Furthermore, if a complex *firm* uses an ECM it should validate the assumptions of the model through a comprehensive stress testing programme. In particular this validation should:

(a) test correlation assumptions (where risks are aggregated in this way) using combined stresses and scenario analyses;

(b) use stress tests to identify the extent to which the *firm's* risk models omit non-linear effects, for instance the behaviour of derivatives in market risk models; and

(c) consider not just the effect of parallel shifts in interest-rate curves, but also the effect of curves becoming steeper or flatter.

Guidance on risks to be covered in an ICAAP

2.3.37 G *IFPRU* 2.3.37G to *IFPRU* 2.3.47G set out *guidance* on some of the sources of risk identified in the *overall Pillar 2 rule*. *IFPRU* 2.3.48R to *IFPRU* 2.3.52G contain material relating to a *firm* with an IRB permission.

2.3.38 G (1) A *firm* may take into account factors other than those identified in the *overall Pillar 2 rule* when it assesses the level of capital it wishes to hold. These factors might include external rating goals, market reputation and its strategic goals. However, a *firm* should be able to distinguish, for the purpose of its dialogue with the *FCA*, between capital it holds to comply with the *overall financial adequacy rule*, capital it holds as a *capital planning buffer* and capital held for other purposes.

(2) The calibration of the *own funds requirements* assumes that a *firm's*

business is well diversified, well managed with assets matching its liabilities and good controls, and stable with no large, unusual or high risk transactions. A *firm* may find it helpful to assess the extent to which its business in fact differs from these assumptions and, therefore, what adjustments it might be reasonable for it to make to the *own funds requirements* to arrive at an adequate level of *own funds*.

Interest-rate risk arising from non-trading book activities

2.3.39 G A *firm* should assess its exposure to changes in interest rates, particularly risks arising from the effect of interest-rate changes on non-*trading book* activities that are not captured by the *own funds requirements*. In doing so, a *firm* may wish to use stress tests to determine the impact on its balance sheet of a change in market conditions.

Securitisation risk

2.3.40 G A *firm* should assess its exposure to risks transferred through the *securitisation* of assets should those transfers fail for whatever reason. A *firm* should consider the effect on its financial position of a *securitisation* arrangement failing to operate as anticipated or of the values and risks transferred not emerging as expected.

Residual risk

2.3.41 G A *firm* should assess its exposure to residual risks that may result from the partial performance or failure of *credit risk mitigation* techniques for reasons that are unconnected with their intrinsic value. This could result from, for instance, ineffective documentation, a delay in payment or the inability to realise payment from a guarantor in a timely manner. Given that residual risks can always be present, a *firm* should assess the appropriateness of its *own fund requirements* against its assumptions which underlie any risk mitigation measures it may have in place.

Concentration risk

2.3.42 G A *firm* should assess and monitor, in detail, its exposure to sectoral, geographic, liability and asset concentrations. The *FCA* considers that concentrations in these areas increase a *firm's* exposure to credit risk. Where a *firm* identifies such concentrations it should consider the adequacy of its *own funds requirements*.

Liquidity risk

2.3.43 G Under the *overall Pillar 2 rule*, a *firm* should consider its exposure to *liquidity risk* and assess its response should that risk materialise.

2.3.44 G When assessing *liquidity risk*, a *firm* should consider the extent to which there is a mismatch between assets and liabilities.

2.3.45 G A *firm* should also, when assessing *liquidity risk*, consider the amount of assets it holds in highly liquid, marketable forms that are available should

unexpected cash flows lead to a liquidity problem. The price concession of liquidating assets is of prime concern when assessing such liquidity risk and should, therefore, be built into a *firm's ICAAP*.

2.3.46 G Some further areas to consider in developing the *liquidity risk* scenario might include:

(1) any mismatching between expected asset and liability cash flows;

(2) the inability to sell assets quickly;

(3) the extent to which a *firm's* assets have been pledged; and

(4) the possible need to reduce large asset positions at different levels of market liquidity and the related potential costs and timing constraints.

Business risk: general

2.3.47 G A *firm's own funds requirements*, being risk-sensitive, may vary as business cycles and economic conditions fluctuate over time. Deterioration in business or economic conditions could require a *firm* to raise capital or, alternatively, to contract its businesses at a time when market conditions are most unfavourable to raising capital. Such an effect is known as procyclicality.

2.3.48 G To reduce the impact of cyclical effects, a *firm* should aim to maintain an adequate *capital planning buffer* during an upturn in business and economic cycles such that it has sufficient capital available to protect itself in unfavourable market conditions.

2.3.49 G To assess its expected capital requirements over the economic and business cycles, a *firm* may wish to project forward its financial position taking account of its business strategy and expected growth, according to a range of assumptions regarding the economic or business environment which it faces. For example, an *ICAAP* should include an analysis of the impact that the actions of a *firm's* competitors might have on its performance, in order to see what changes in its environment the *firm* could sustain. Projections over a three- to five-year period would be appropriate in most circumstances. A *firm* may then calculate its projected *own funds requirements* and assess whether it could be met from expected financial resources. Additional *guidance* on capital planning over an economic and business cycle can be found in *IFPRU* 2.2.73G (Capital planning).

Business risk: stress tests for firms using the IRB approach

2.3.50 R A *firm* with an IRB permission must ensure that there is no significant risk of it being unable to meet its own funds requirements for credit risk under Part Three, Title II of the *EU CRR* (Capital requirements for credit risk) at all times throughout an economic cycle, including the *own funds requirements* for credit risk indicated by any stress test carried out under article 177 of the *EU CRR* (Stress tests used in assessment of capital adequacy for a *firm* with an IRB permission) as being likely to apply in the scenario tested. To decide

what *own funds* are, or will be, available to meet those credit risk requirements, a *firm* must exclude *own funds* that are likely to be required to meet its other capital requirements under the *EU CRR* at the relevant time. A *firm* must also be able to demonstrate to the *FCA*, at any time, that it is complying with this *rule*.

2.3.51 R *IFPRU* 2.3.50R applies to a *firm* on an individual basis if Part Three, Title II, Chapter 3 of the *EU CRR* (IRB approach) applies to it on an individual basis and applies on a *consolidated basis* if the *CRR* does.

2.3.52 R If *IFPRU* 2.3.50R applies to a *firm* on a *consolidated basis*, the following adjustments are made to *IFPRU* 2.3.50R in accordance with the general principles of Part One, Title II, Chapter 2 of the *EU CRR* (Prudential consolidation):

(1) references to *own funds* are to the consolidated *own funds* of the *firm's FCA consolidation group* or, as the case may be, its *non-EEA sub-group*; and

(2) references to the capital requirements in Part Three of the *EU CRR* (Capital requirements) are to the consolidated capital requirements with respect to the *firm's FCA consolidation group* or, as the case may be, its *non-EEA sub-group* under Part One, Title II, Chapter 2 of the *EU CRR* (Prudential consolidation).

2.3.53 G If a *firm's* current available *own funds* are less than the own funds requirements indicated by the stress test, that does not necessarily mean there is a breach of *IFPRU* 2.3.50R. The *firm* may wish to set out any countervailing effects and off-setting actions that can be demonstrated to the satisfaction of the *FCA* as being likely to reduce the difference referred to in the first sentence. The *FCA* is only likely to consider a demonstration of such actions as credible if those actions are set out in a capital management plan based on the procedures in *IFPRU* 2.2.73G (Capital planning) and including a plan of the type referred to in *IFPRU* 2.2.73G(5) that has been approved by the *firm's senior management* or *governing body*.

2.3.54 G The countervailing factors and off-setting actions that a *firm* may rely on as referred to in *IFPRU* 2.3.53G include, but are not limited to, projected balance sheet shrinkage, growth in *own funds* resulting from retained profits between the date of the stress test and the projected start of the economic downturn, the possibility of raising new capital in a downturn, the ability to reduce dividend payments or other distributions, and the ability to allocate capital from other risks which can be shown to be negatively correlated with the *firm's* credit risk profile.

Systems and controls

2.3.55 G A *firm* may decide to hold additional capital to mitigate any weaknesses in its overall control environment. These weaknesses might be indicated by the following:

(1) a failure by a *firm* to complete an assessment of its systems and controls to establish whether they comply with *SYSC*; or

(2) a failure by a *firm's senior management* to approve its financial results; or

(3) a failure by a *firm* to consider an analysis of relevant internal and external information on its business and control environment.

2.3.56 G In considering if there are any systems and control weaknesses and their effect on the adequacy of the *own funds requirements*, a *firm* should be able to demonstrate to the *FCA* that all the issues identified in *SYSC* have been considered and that appropriate plans and procedures exist to deal adequately with adverse scenarios.

Risks which may be considered according to the nature of the activities of a firm

2.3.57 G (1) *IFPRU* 2.3.58G to *IFPRU* 2.3.67G set out *guidance* for:

(a) an asset management *firm*; and

(b) a securities *firm*;

(2) *IFPRU* 2.3.58G to *IFPRU* 2.3.67 G provide examples of the sorts of risks which such a *firm* might typically face and of stress tests or scenario analyses which it might carry out as part of its *ICAAP*.

(3) The material on securities *firms* is also relevant to a *commodities firm*.

An asset management firm

2.3.58 G An asset manager is primarily exposed to *operational risk* and reputational risk.

2.3.59 G When assessing reputational risk, an asset manager should consider issues such as:

(1) how poor performance can affect its ability to generate profits;

(2) the effect on its financial position should one or more of its key fund managers leave that *firm*;

(3) the effect on its financial position should it lose some of its largest customers; and

(4) how poor customer services can affect its financial position; for example, a *firm* which has outsourced the management of customer accounts may want to consider the impact on its own reputation of the service provider failing to deliver the service.

2.3.60 G As an asset manager's mandates become more complex, the risk of it failing to comply fully with the terms of its contracts increases. In the event of such

failure, a *firm* can be exposed to substantial losses resulting from customers' claims and legal actions. Although the *FCA* would expect an asset manager to have in place adequate controls to mitigate that risk, it may also like to consider the potential cost to it if customers claim that it has not adhered to mandates. Past claims and compensation may provide a useful benchmark for an asset manager to assess its sensitivity to future legal action. In assessing the adequacy of its capital, an asset manager may therefore consider whether it could absorb the highest operational loss it has suffered over the last three to five years.

2.3.61 G In relation to the issues identified in *IFPRU* 2.3.60G , an asset manager should consider, for example:

(1) the direct cost to it resulting from fraud or theft;

(2) the direct cost arising from customers' claims and legal action in the future – an asset manager could consider the impact on its financial position if a legal precedent were to encourage its customers to take legal action against it for failing to advise correctly on a certain type of product, the relevance of which is likely to depend on whether the asset manager is acting on a discretionary basis or solely as advisor; and

(3) where it has obtained professional indemnity insurance, the deductibles and individual or aggregate limits on the sums insured.

2.3.62 G The *FCA* expects an asset manager to consider the impact of economic factors on its ability to meet its liabilities as they fall due. Therefore, an asset manager should develop scenarios which relate to its strategic and business plan. An asset manager might consider:

(1) the effect of a market downturn that affects both transaction volumes and the market values of assets in its funds – in assessing the impact of such a scenario, an asset manager may consider the extent to which it can remain profitable (for example, by rapidly scaling down its activities and reducing its costs);

(2) the impact on current levels of capital if it plans to undertake a significant restructuring; and

(3) the impact on current levels of capital if it plans to enter a new market or launch a new product – it should assess the amount of capital it needs to hold when operating for the first time in a market in which it lacks expertise.

A securities firm

2.3.63 G (1) A securities *firm* may consider the impact of the following situations on its capital levels when assessing its exposure to concentration risk:

(a) the potential loss that could arise from large exposures to a

single *counterparty*;

(b) the potential loss that could arise from exposures to large transactions or to a product type; and

(c) the potential loss resulting from a combination of events such as a sudden increase in volatility leaving a hitherto fully-margined client unable to meet the margin calls due to the large size of the underlying *position* and the subsequent difficulties involved in liquidating its *position*.

(2) An example of (1)(b) relates to a securities *firm* which relies on the income generated by a large, one-off corporate finance transaction. It may want to consider the possibility of legal action arising from that transaction which prevents the payment of its fees. Additionally, an underwriting *firm* may, as a matter of routine, commit to place a large amount of securities. Therefore, it may like to assess the impact of losses arising from a failure to place the securities successfully.

2.3.64 G Where a securities *firm* deals in illiquid securities (for example, unlisted securities or securities listed on illiquid markets) or holds illiquid assets, potentially large losses can arise from trades that have failed to settle or because of large unrealised market losses. Therefore, a securities *firm* may consider the impact of *liquidity risk* on its exposure to:

(1) credit risk; and

(2) *market risk*.

2.3.65 G Counterparty risk requirements only partially capture the risk of settlement failure, as the quantification of risk is only based on mark-to-market values and does not take account of the volatility of the securities over the settlement period. A securities *firm's* assessment of its exposure to counterparty risk should take into account:

(1) whether it acts as arranger only or whether it also executes trades;

(2) the types of execution venues which it uses – for example, the London Stock Exchange or a retail service provider (RSP) have more depth than *multilateral trading facilities*; and

(3) whether it offers extended settlements and free delivery compared to delivery versus payment business.

2.3.66 G A securities *firm* should also consider the impact of external factors on the levels of capital it needs to hold. Scenarios covering such external factors should relate to its strategy and business plan. A securities *firm* might wish to consider the following factors:

(1) Whether it plans to participate in a one-off transaction that might strain temporarily or permanently its capital.

(2) Whether the unevenness of its revenue suggests that it should hold a capital buffer. Such an assessment could be based, for instance, on an analysis of past revenue and the volatility of its capital.

(3) How its income might alter as interest rates fluctuate where it is obliged to pay interest to its clients in excess of interest it earns on client money deposits.

(4) How its capital would be affected by a market downturn. For instance, how sensitive that *firm* is to a sharp reduction of trading volumes.

(6) How political and economic factors will affect that *firm's* business. For instance, a *commodity firm* may wish to consider the impact of a sharp increase in prices on initial margins and, consequently, on its liquidity.

(7) Whether it anticipates expanding its activities (for example, by offering clearing services), and if so, the impact on its capital.

2.3.67 G A securities *firm* may also want to assess the impact of its internal credit limits on its levels of capital. For instance, a *firm* whose internal procedures authorise dealing without cash in the account, or without pre-set dealing limits, might consider more capital is required than if it operated stricter internal credit limits.

Capital models

2.3.68 G A *firm* may approach its assessment of adequate capital by developing a model, including an ECM (see *IFPRU* 2.3.36G), for some or all of its business risks. The assumptions required to aggregate risks modelled and the confidence levels adopted should be considered by a *firm's senior management*. A *firm* should also consider whether any relevant risks, including systems and control risks, are not captured by the model.

2.3.69 G A *firm* should not expect the *FCA* to accept as adequate any particular model that it develops or automatically to reflect the results from the model in any *individual capital guidance* or *capital planning buffer*. However, the *FCA* will take into account the results of a sound and prudent model when giving *individual capital guidance* or when dealing with the *firm* in relation to its *capital planning buffer*.

2.3.70 G There is no prescribed approach as to how a *firm* should develop its internal capital model. However, a *firm* should be able to demonstrate:

(1) the confidence levels set and whether these are linked to its corporate strategy;

(2) the time horizons set for the different types of business that it undertakes;

(3) the extent of historic data used and back-testing carried out;

(4) that it has in place a process to verify the correctness of the model's outputs; and

(5) that it has the skills and resources to operate, maintain and develop the model.

2.3.71 G In relation to the use of an ECM (see *IFPRU* 2.3.36G), the *FCA* is likely to place more reliance on a *firm's ICAAP* if the *firm* provides the following information:

(1) a comparison of the amount of capital that the ECM generates in respect of each of the risks captured in the *own funds requirements* before aggregation with the corresponding components of the *own funds requirements* calculation; and

(2) evidence that the *guidance* in *IFPRU* 2.3.66G to *IFPRU* 2.3.73G has been followed.

2.3.72 G If a *firm* adopts a top-down approach to developing its internal model, it should be able to allocate the outcome of the internal model to risks it has previously identified in relation to each separate legal entity, business unit or business activity, as appropriate. For a *firm* which is a member of a group, *IFPRU* 2.2.54R (Application of IFPRU 2.2 on an individual basis and consolidated basis) sets out how internal capital identified as necessary by that *firm's ICAAP* should be allocated.

2.3.73 G If a *firm's* internal model makes explicit or implicit assumptions in relation to correlations within or between risk types, or in relation to diversification benefits between business types, the *firm* should be able to explain to the *FCA*, with the support of empirical evidence, the basis of those assumptions.

2.3.74 G A *firm's* model should also reflect the past experience of both the *firm* and the sectors in which it operates.

2.3.75 G The values assigned to inputs into a *firm's* model should be derived either stochastically, by assuming the value of an item can follow an appropriate probability distribution and by selecting appropriate values at the tail of the distribution, or deterministically, using appropriate prudent assumptions. For options or guarantees which change in value significantly in certain economic or demographic circumstances, a stochastic approach would normally be appropriate.

[2.4 Reporting of breaches

2.4.1 R (1) A *firm* must have in place appropriate procedures for its employees to report breaches internally through a specific, independent and autonomous channel.

(2) The channel in (1) may be provided through arrangements provided for

by social partners, subject to the Public Interest Disclosure Act 1998 to the extent that it applies.

[**Note**: article 71(3) of *CRD*]]

2.4.2 G *SYSC* 18 (Guidance on Public Interest Disclosure Act: Whistleblowing) contains further *guidance* on the effect of the Public Interest Disclosure Act 1998 in the context of the relationship between *firms* and the *FCA*.]

3. Own funds

3.1 Base own funds requirement

Application

3.1.1 R This section applies to an *IFPRU investment firm*, unless it is an *exempt IFPRU commodities firm*.

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

3.1.3 G The adequacy of a *firm's own funds* needs to be assessed in relation to all the activities of the *firm* and risks to which they give rise.

Purpose

3.1.4 G This section implements EC standards for the *base own funds requirement* to be held by an *IFPRU investment firm*. In particular, it implements articles 28 and 29 of *CRD*.

3.1.5 G *Principle 4* requires a *firm* to maintain adequate financial resources. *IFPRU* 3 sets out provisions that deal specifically with the adequacy of that part of a *firm's* financial resources that consists of *own funds* in addition to Parts Two (Own Funds) and Three (Capital requirements) of the *EU CRR*.

Main requirement

3.1.6 R (1) Subject to (2), an *IFPRU investment firm* must maintain, at all times, *common equity tier 1 capital* equal to, or in excess of, the *base own funds requirement*.

(2) For the purpose of (1), the *common equity tier 1 capital* of an *IFPRU investment firm* must comprise only of one or more of the items referred to in article 26(1)(a) to (e) of the *EU CRR* (Common equity tier 1 items).

[**Note**: article 28(1) of *CRD*]

3.1.7 R At the time that it first becomes an *IFPRU investment firm*, a *firm* must hold *initial capital* of not less than the *base own funds requirement* applicable to

that *firm*.

Calculation of the base own funds requirement

3.1.8 R The amount of an *IFPRU investment firm's base own funds requirement* is set out in the table in *IFPRU* 3.1.9R.

Table: Base own funds requirement

3.1.9 R This table belongs to *IFPRU* 3.1.8R.

Firm category	**Amount: Currency equivalent of**
IFPRU 730K firm	€730,000
IFPRU 125K firm	€125,000
IFPRU 50K firm	€50,000
collective portfolio management investment firm	€125,000

[**Note**: articles 28(2), 29(1) and 29(3) of *CRD*]

3.2 Capital

Application

3.2.1 R *IFPRU* 3 applies to an *IFPRU investment firm*, unless it is an *exempt IFPRU commodities firm*.

Purpose

3.2.2 G This chapter:

(1) contains the *rules* that exercise the discretion afforded to the *FCA* as *competent authority* under article 89 of the *EU CRR*;

(2) contains the guidance in relation to article 4(1)(126)of the *EU CRR*; and

(3) contains the *rules* on notification to the *FCA* of intended issuance, or amendment to, *own funds* instruments and specified terms that meet the conditions for qualification as *own funds*.

Qualifying holding outside the financial sector

3.2.3 R For qualifying holdings, described in article 89(1) and (2) of the *EU CRR*, a *firm* must, in accordance with article 89(3) of the *EU CRR*, comply with the

requirement in article 89(3)(a) of the *EU CRR*.

Indirect or synthetic holdings

3.2.4 G For the purposes of Article 4(1)(126) (Definition of synthetic holding) and Part Two (Own funds) of the *EU CRR*, the *FCA* considers the holdings described in *IFPRU* 3.2.5G to be examples of indirect or synthetic holdings by an *IFPRU investment firm* of own *common equity tier 1 instruments*.

3.2.5 G An indirect or synthetic holding includes a holding of a *firm* of *shares*, any other interest in the capital and subordinated debt, whether in the *trading book* or non-*trading book*, in:

(1) an *institution* ; or

(2) a *financial institution*;

that satisfies the following conditions:

(3) the holding is the subject of an agreement or arrangement between the *firm* and either the issuer of the instrument in question or a member of the *group* to which the issuer belongs;

(4) under the terms of the agreement or arrangement described in (3), the issuer invests in the *firm* or in a member of the *group* to which the *firm* belongs;

(5) the effect of that agreement or arrangement on the capital position of the *firm*, the issuer or any member of a *group* to which either belongs, under any relevant rule is significantly more beneficial than in economic terms, taking into account the agreement or arrangement as a whole.

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

Connected transactions

3.2.6 R In determining whether an item of capital qualifies as *common equity tier 1 capital*, *additional tier 1 capital* or *tier 2 capital*, a *firm* must take into account any connected transaction which, when taken together with the item of capital, would cause it not to display the characteristics of *common equity tier 1 capital*, *additional tier 1 capital* or *tier 2 capital*.

3.2.7 R A *firm* must report to the *FCA* all connected transactions described in *IFPRU* 3.2.6R at least one *month* in advance of entry into the relevant transaction and identify each relevant transaction with sufficient detail to allow the *FCA* to evaluate it.

Instruments issued under third country law

3.2.8 R A *firm* must demonstrate to the *FCA* that any *additional tier 1 instrument* or *tier 2 instrument* issued by it that is governed by the law of a *third country* is by its terms capable, as part of a resolution of the *firm*, of being written down or converted into a *common equity tier 1 instrument* of the *firm* to the same extent as an equivalent *own funds* instrument issued under the law of the *UK*.

3.2.9 R A *firm* must include, in the materials it provides to the *FCA* under *IFPRU* 3.2.8R, a properly reasoned legal opinion from an individual appropriately qualified in the relevant *third country*.

Notification of issuance of own funds instruments

3.2.10 R A *firm* must notify the *FCA* of its intention, or the intention of another member of its *group* that is not a *firm* included in the supervision on a *consolidated basis* of the *firm*, to issue a capital instrument that it believes will qualify under the *EU CRR* as *own funds* other than a *common equity tier 1 capital* at least one *month* before the intended date of issue.

3.2.11 R A *firm* does not have to give notice under *IFPRU* 3.2.10R if the capital instrument is:

(1) an ordinary *share*; or

(2) a debt instrument issued under a debt securities programme under which the *firm* or *group* member has previously issued and the *firm* has notified the *FCA*, in accordance with *IFPRU* 3.2.10R, prior to a previous issuance under the programme.

3.2.12 R When giving notice, the *firm* must provide:

(1) details of the amount and type of *own funds* the *firm* is seeking to raise through the intended issue and whether the capital instrument is intended to be issued to external investors or other members of its *group*;

(2) a copy of the term sheet and details of any features of the capital instrument which are novel, unusual or different from a capital instrument of a similar nature previously issued by the *firm* or widely available in the market;

(3) confirmation from a member of the *firm's senior management* responsible for authorising the intended issue or, in the case of an issue by another *group* member, for the issue's inclusion in the *firm's* consolidated *own funds*, that the capital instrument meets the conditions for qualification as an *own funds* item; and

(4) a properly reasoned legal opinion from an appropriately qualified individual confirming that the capital instrument meets the conditions for qualification as the relevant type of *own funds*.

3.2.13 R A *firm* must notify the *FCA* in writing, no later than the date of issue of its

intention, or the intention of another member of its *group* that is not a *firm* included in the supervision on a *consolidated basis* of the *firm*, to issue a capital instrument described in *IFPRU* 3.2.11R.

3.2.14 R When giving notice under *IFPRU* 3.2.13R, the *firm* must provide:

(1) confirmation that the terms of the capital instrument have not changed since the previous issue by the *firm* of that type of capital instrument; and

(2) the information in *IFPRU* 3.2.12R(1) and (3).

3.2.15 R The *firm* must promptly notify the *FCA* of any change to the intended date of issue, amount of issue, type of investors, type of *own funds* or any other feature of the capital instrument to that previously notified to the *FCA* under *IFPRU* 3.2.10R or *IFPRU* 3.2.13R.

Notification of amendments to own funds instruments

3.2.16 R A *firm* must notify the *FCA* of its intention, or the intention of another member of its *group* that is not a *firm* included in the supervision on a *consolidated basis* of the *firm*, to amend or otherwise vary the terms of any *own funds* instrument included in its *own funds* or the *own funds* of its consolidated *group* at least one *month* before the intended date of such amendment or other variation.

Notification of reduction of own funds

3.2.17 R A *firm* must notify the *FCA* of its intention, or the intention of another member of its *group* included in the supervision on a *consolidated basis* of the *firm*, to carry out any of the actions described in article 77 of the *EU CRR* (Conditions for reducing own funds) for an *own funds* instrument.

4 Credit risk

4.1 Application and purpose

Application

4.1.1 R *IFPRU* 4 applies to an *IFPRU investment firm*, unless it is an *exempt IFPRU commodities firm*.

Purpose

4.1.2 G This chapter:

(1) implements article 78 of *CRD*;

(2) contains the *rules* that exercise the discretion afforded to the *FCA* as *competent authority* under articles 115, 119(5), 124(2), 125(3),

126(2), 178(1)(b), 243(2), 244(2), 286(2), 298(4) and 380 of the *EU CRR*; and

(3) contains the guidance in relation to the IRB approach, *securitisation*, counterparty credit risk and *credit risk mitigation*.

4.2 Standardised approach

Standardised approach

4.2.1 R For the purposes of article 115 of the *EU CRR* (Exposures to regional governments or local authorities), a *firm* may treat *exposures* to the following regional governments as *exposures* to central government:

(a) The Scottish Parliament;

(b) The National Assembly for Wales; and

(c) The Northern Ireland Assembly.

Risk weights

4.2.2 G Where the *FCA* has published evidence showing that a well-developed and long-established residential property market is present in that territory with loss rates which do not exceed the limits in article 125(3) of the *EU CRR* (Exposures fully and completely secured by mortgages on residential property), a *firm* does not need to meet the condition in article 125(2)(b) of the *EU CRR* in order to consider an *exposure*, or any part of an *exposure*, as fully and completely secured for the purposes of article 125(1) of the *EU CRR*.

Criteria for certain exposures secured by mortgages on commercial immovable property

4.2.3 R For the purposes of articles 124(2) and 126(2) of the *EU CRR* and in addition to the conditions in those regulations, a *firm* may only treat *exposures* as fully and completely secured by mortgages on commercial immovable property in line with article 126 where annual average *losses* stemming from lending secured by mortgages on commercial property in the *UK* did not exceed 0.5% of risk-weighted exposure amounts over a representative period. The *loss* level in this *rule* shall be the aggregate market data for commercial property lending published by the *FCA* in line with article 101(3) of the *EU CRR*.

4.2.4 R For the purpose of this *rule*, a representative period shall be a time horizon of sufficient length and which includes a mix of good and bad years.

Exposures to institutions

4.2.5 G The *FCA* confirms that there are no *financial institutions* currently authorised and supervised by it that are subject to prudential requirements that it

considers to be comparable to those applied to institutions in terms of robustness.

[**Note**: article 119(5) of the *EU CRR*]

Retail exposures

4.2.6 G Where an *exposure* is denominated in a currency other than the euro, the *FCA* expects a *firm* to calculate its euro equivalent for determining compliance or otherwise with the aggregate monetary limit of €1 million using any appropriate set of exchange rates where the choice has no obvious bias and is derived on the basis of a consistent approach (see article 123(c) of the *EU CRR*).

Exposures fully and completely secured by mortgages on residential property: Ijara mortgages

4.2.7 G The *FCA* considers an Ijara mortgage to be an example of an *exposure* to a tenant under a property leasing transaction concerning residential property under which the *firm* is the lessor and the tenant has an option to purchase. Accordingly, the *FCA* expects exposures to Ijara mortgages to be subject to all of the requirements that apply to *exposures* secured by mortgages on residential property, including in respect of periodic property revaluation.

Multiple exposures on same residential property

4.2.8 G If a *firm* has more than one *exposure* secured on the same residential property, the *FCA* expects the *firm* to aggregate all such *exposures* and treat them as if they were a single *exposure* secured on the property.

Lifetime mortgages

4.2.9 G If a *firm* has an *exposure* to a *lifetime mortgage* against which the firm intends to hold less capital under the *EU CRR* than it did or would have done under *BIPRU* 3.4.56AR, the *FCA* expects the *firm* to notify it so that it may take account of any relevant risks in its supervisory assessment (see articles 124, 125 and 208 of the *EU CRR*).

Exposures in default

4.2.10 G When determining what portion of a past due item is secured, the *FCA* expects the secured portion of an *exposure* covered by a mortgage indemnity product that is eligible for *credit risk mitigation* purposes under Part Three, Title II, Chapter 4 of the *EU CRR* (Credit risk mitigation) to be an example of an eligible guarantee (see article 127(2) of the *EU CRR*).

Items associated with particular high risk

4.2.11 G When considering which *exposures* in the form of units or shares in a *CIU* are associated with particularly high risk, the *FCA* expects a *firm* to take into account:

(1) whether there is an absence of external credit assessment of such *CIU* from an *ECAI* recognised under article 130 of the *EU CRR* (Items representing securitisation positions) and where such *CIU* has specific features (such as high levels of leverage or lack of transparency) that prevent it from meeting the eligibility criteria in article 128(3) of the *EU CRR* (Items associated with particular high risk); or

(2) whether the units or shares in such *CIU* are illiquid and are being held with a view to their long-term sale or realisation.

4.2.12 G The *FCA* expects a *firm* to consider *exposures* arising out of a venture capital business (whether the *firm* itself carries on the venture capital business or not) to be associated with particularly high risk. For these purposes, the *FCA* defines "venture capital business" as not only investing in venture capital firms but also including the business of carrying on any of:

(1) *advising on investments*, *managing investments*, *arranging (bringing about) deals in investments* in or *making arrangements with a view to transactions in investments* in *venture capital investments*;

(2) *advising on investments* or *managing investments* in relation to portfolios, or *establishing, operating or winding up a collective investment scheme*, where the portfolios or collective investment schemes (apart from funds awaiting investment) invest only in *venture capital investments*;

(3) any *custody* activities provided in connection with the activities in (1) or (2); and

(4) any related *ancillary activities*.

Mapping of ECAIs credit assessments

4.2.13 G Until such time as the European Commission adopts implementing technical standards drafted by the European Supervisory Authorities Joint Committee to specify for all *ECAIs* the relevant credit assessments of the *ECAI* that correspond to credit quality steps, the *FCA* expects a *firm* to continue to have regard to the table mapping the credit assessments of certain *ECAIs* to credit quality steps produced in accordance with regulation 22(3) of the *Capital Requirements Regulations 2006*.

4.3 Internal ratings based approach

Supervisory benchmarking of internal approaches for calculating own funds requirements

4.3.1 R Except for *operational risk,* a *firm* permitted to use *internal approaches* for the calculation of risk weighted exposure amounts or *own fund requirements* must report annually to the *FCA*:

(1) the results of the calculations of its *internal approaches* for its

exposures or positions that are included in the benchmark portfolios; and

(2) an explanation of the methodologies used to produce those calculations in (1).

[**Note**: article 78(1) of *CRD*]

4.3.2 G A *firm* must submit the results of the calculations referred to in *IFPRU* 4.3.1R(1), in line with the template developed by *EBA* in accordance with article 78(8) of *CRD*, to the *FCA* and to *EBA*.

4.3.3 R Where the *FCA* has chosen to develop specific portfolios in accordance with article 78(2) of *CRD*, a *firm* must report the results of the calculations separately from the results of the calculations for *EBA* portfolios.

[**Note**: article 78(2) of *CRD*]

Internal ratings based (IRB) approach: risk quantification

4.3.4 G In article 178(1)(b) of the *EU CRR* (Default of an obligor), the reference to 90 days may be read as a reference to 180 days for:

(1) *exposures* secured by residential or SME commercial real estate in the retail exposure class; and

(2) *exposures* to public sector entities.

4.3.5 G The treatment in *IFPRU* 4.3.4G will be considered as part of the *FCA's* assessment of the *firm's* IRB approach.

4.3.6 R For the purposes of article 178(2)(d) of the *EU CRR*, a credit obligation is material if:

(1) in relation to a retail *exposure*:

(a) where a *firm* applies the definition of default at the level of an individual credit facility, the amount of the credit obligation exceeds £100;

(b) where a *firm* applies the definition of default in relation to the total obligations of a borrower, the amount of the total obligations of the borrower to the *firm* exceed £100; and

(2) in all other cases, the amount of the credit obligation exceeds £1,000.

Guidance on IRB approach

4.3.7 G Responsibility for ensuring that internal models are appropriately conservative and that approaches are compliant with the *EU CRR* rests with the *firm* itself.

4.3.8 G A *significant IFPRU firm* should consider developing internal credit risk assessment capacity and to increase use of the internal ratings based approach for calculating *own funds requirements* for credit risk where its *exposures* are material in absolute terms and where it has at the same time a large number of material counterparties. This provision is without prejudice to the fulfilment of criteria laid down in Part Three, Title I, Chapter 3, Section 1 of the *EU CRR* (IRB approach).

[**Note**: article 77(1) of *CRD*]

4.3.9 G The *FCA* will, taking into account the nature, scale and complexity of a *firm's* activities, monitor that it does not solely or mechanistically rely on external credit ratings for assessing the creditworthiness of an entity or *financial instrument*.

[**Note**: article 77(2) of *CRD*]

Application of requirements to EEA groups applying the IRB approach on a unified basis

4.3.9 G Article 20(6) of the *EU CRR* states that, where the IRB approach is used on a unified basis by those entities which fall within the scope of article 20(6), the *FCA* is required to permit certain IRB requirements to be met on a collective basis by members of that *group*. In particular, the *FCA* considers that, where a *firm* is reliant upon a rating system or data provided by another member of its *group*, it will not meet the condition that it is using the IRB approach on a unified basis unless:

(1) the *firm* only does so to the extent that it is appropriate, given the nature and scale of the *firm's* business and portfolios and the *firm's* position within the *group*;

(2) the integrity of the *firm's* systems and controls is not adversely affected;

(3) the outsourcing of these functions meets the requirements of *SYSC*; and

(4) the ability of the *FCA* and the *consolidating supervisor* of the *group* to carry out their responsibilities under the *EU CRR* are not adversely affected.

4.3.10 G Prior to reliance being placed by a *firm* on a rating system or data provided by another member of the *group*, the *FCA* would expect the proposed arrangements to have been explicitly considered, and found to be appropriate, by the *governing body* of the *firm*.

4.3.11 G If a *firm* uses a rating system or data provided by another group member, the *FCA* would expect the *firm's governing body* to delegate those functions formally to the persons or bodies that are to carry them out.

Materiality of non-compliance

4.3.12 G Where a *firm* seeks to demonstrate to the *FCA* that the effect of its non-compliance with the requirements of Part Three, Title II Chapter 3 of the *EU CRR* (Internal ratings based approach) is immaterial under article 146(b) of the *EU CRR* (Measures to be taken where the requirements cease to be met), the *FCA* will not be satisfied that this is the case unless a *firm* has taken into account all instances it has not complied with the requirements of the IRB approach and demonstrated that the overall effect of non-compliance is immaterial.

Corporate governance

4.3.13 G (1) The *FCA* expects that it would not be satisfied that a committee could be treated as a 'designated committee' for the purposes of article 189 of *EU CRR* (Corporate governance) if it did not contain at least one member of the *firm's management body*.

(2) Where the *firm's* rating systems are used on a unified basis under article 20(6) of the *EU CRR*, the *FCA* considers that the governance requirements in article 189 of the *EU CRR* can only be met if the *subsidiaries* have delegated to the *governing body* or designated committee of the *EEA parent institution*, *EEA parent financial holding company* or *EEA parent mixed financial holding company* responsibility for approval of the *firm's* rating systems.

[**Note**: see articles 189 and 20(6) of the *EU CRR* and article 3(1)(7) of *CRD*]

Permanent partial use: policy for identifying exposures

4.3.14 G In the event that a *firm* wishes to permanently apply the Standardised Approach to certain *exposures*, the *FCA* would expect the *firm* to have a well-documented policy explaining the basis on which *exposures* are to be selected for permanent exemption from the IRB approach. This policy should be provided to the *FCA* when the *firm* applies for permission to use the IRB approach. Where a *firm* also wishes to undertake sequential implementation, the *firm's* roll-out plan should provide for the continuing application of that policy on a consistent basis over time.

Permanent partial use: exposures to sovereigns and institutions

4.3.15 G (1) The *FCA* can only permit the exemption of *exposures* to sovereigns and *institutions* under article 150(1)(a) and (b) of the *EU CRR* if the number of material counterparties is limited and it would be unduly burdensome to implement a rating system for such counterparties.

(2) The *FCA* considers that the 'limited number of material counterparties' test is unlikely to be met if for the *UK group* total outstandings to 'higher risk' sovereigns and institutions exceed either £1bn or 5% of total assets (other than for temporary fluctuations above these levels). For these purposes, 'higher risk' sovereigns and institutions are considered to be those that are unrated or carry ratings of BBB+ (or equivalent) or lower. In determining whether to grant this exemption the *FCA* will also consider whether a *firm* incurs *exposures* to 'higher risk' counterparties which are below the levels

set out but are outside the scope of its core activities.

(3) In respect of the 'unduly burdensome' condition, the *FCA* considers that an adequate, but not perfect, proxy for the likely level of expertise available to a *firm* is whether its *group* has a *trading book*. Accordingly, if a *firm's group* does not have a *trading book*, the *FCA* is likely to accept the argument that it would be unduly burdensome to implement a rating system.

Permanent partial use: non-significant business units and immaterial exposure classes and types

4.3.16 G Where a *firm* wishes permanently to apply the Standardised Approach to certain business units on the grounds that they are non-significant and/or certain *exposure* classes or types of *exposures* on the grounds that they are immaterial in terms of size and perceived risk profile the *FCA* expects to permit a *firm* to make use of this exemption to the extent that:

(1) the risk-weighted exposure amount calculated under article 92(3)(a) and (f) of the *EU CRR* (based on the Standardised Approach), so far as it is attributable to the *exposures* to which the Standardised Approach is permanently applied being no more than 15% of the risk-weighted exposure amount calculated under article 92(3)(a) and (f) of the *EU CRR* (based on whichever of the Standardised Approach and the IRB Approach would apply to the *exposures* at the time when the calculation is being made);

(2) if a *firm* is part of a *group* subject to consolidated supervision in the *EEA* and for which the *FCA* is the *consolidating supervisor*, the calculations in (1) are carried out with respect to the wider *group*;

(3) if a *firm* is part of a *group* subject to consolidated supervision in the *EEA* and for which the *FCA* is not the *consolidating supervisor* the calculation in (1) will not apply but the requirements of the *consolidating supervisor* relating to materiality will need to be met for the wider *group*;

(4) if the *firm* is part of a sub-group subject to consolidated supervision in the *EEA* and part of a wider *third country group* subject to equivalent supervision by a regulatory authority outside of the *EEA*, the calculation in (1) will not apply but the requirements of that *third country* regulator relating to materiality will need to be met for both the sub-group and the wider *group*; and

(5) if the *firm* is part of a sub-group subject to consolidated supervision in the *EEA* and is part of a wider *third country group* that is not subject to equivalent supervision by a regulatory authority outside of the *EEA*, then the calculation in (1) applies for the wider *group* if supervision by analogy applies and for the sub-group if other alternative supervisory techniques apply.

The questions of whether a *third country group* is subject to equivalent supervision, whether it is subject to supervision by analogy or whether other

alternative supervisory techniques apply are decided in accordance with article 127 of *CRD* (Assessment of equivalence of third countries' consolidated supervision). (See article 150(1)(c) of the *EU CRR*.)

Permanent partial use: identification of connected counterparties

4.3.17 G Where a *firm* wishes to permanently apply the Standardised Approach to *exposures* to connected counterparties in accordance with article 150(1)(e) of the *EU CRR*, the *FCA* would normally expect to grant permission to do so only if the *firm* had a policy that provided for the identification of connected counterparties excluded, identified *exposures* that would be permanently exempted from the IRB approach and identified connected counterparty *exposures* (if any) that would not be permanently exempted from the IRB approach. The *FCA* expects a *firm* to use the IRB approach either for all of its intra-group *exposures* or none of them (see article 150(1)(e) of the *EU CRR*).

Sequential implementation following significant acquisition

4.3.18 G In the event that a *firm* with IRB permission acquires a significant new business, the *firm* should discuss with the *FCA* whether sequential roll-out of the *firm's* IRB approach to these *exposures* would be appropriate. In addition, the *FCA* would expect to review any existing time period and conditions for sequential roll-out and determine whether these remain appropriate (see article 148 of the *EU CRR*).

Classification of retail exposures: qualifying revolving retail exposures (QRRE)

4.3.19 G (1) Article 154(4)(d) of the *EU CRR* (Risk weighted exposure amounts for retail exposures) specifies that, for an *exposure* to be treated as a qualifying revolving retail *exposure* (QRRE), it needs to exhibit relatively low volatility of loss rates. A *firm* should assess the volatility of loss rates for the qualifying revolving retail *exposure* portfolio, relative to the volatilities of loss rates of other relevant types of retail *exposures*. Low volatility should be demonstrated by reference to data on the mean and standard deviation of loss rates over a time period that can be regarded as representative of the long-run performance of the portfolios concerned.

(2) Article 154(4)(e) of the *EU CRR* specifies that, for an *exposure* to be treated as a QRRE, this treatment should be consistent with the underlying risk characteristic of the sub-portfolio. The *FCA* considers that a sub-portfolio consisting of credit card or overdraft obligations will usually meet this condition and that it is unlikely that any other type of retail *exposure* will do so. If a *firm* wishes to apply the treatment in article 154 (4) of the *EU CRR* to product types other than credit card or overdraft obligations it should first discuss this with the *FCA*.

High level expectations

4.3.20 G The *FCA* expects to be satisfied that a *firm's* rating systems meet the

requirements in article 144(1) of the *EU CRR* if the high-level expectations set out in this section are met.

4.3.21 G The information that a *firm* produces or uses for the IRB approach should be reliable and take proper account of the different users of the information produced (customers, shareholders, regulators and other market participants).

4.3.22 G A *firm* should establish quantified and documented targets and standards, against which it should test the accuracy of data used in its rating systems. Such tests should cover:

(1) a report and accounts reconciliation, including whether every exposure has a PD, LGD and, if applicable, conversion factor for reporting purposes;

(2) whether the *firm's* risk control environment has key risk indicators for the purpose of monitoring and ensuring data accuracy;

(3) whether the *firm* has an adequate business and information technology infrastructure with fully documented processes;

(4) whether the *firm* has clear and documented standards on ownership of data (including inputs and manipulation) and timeliness of current data (daily, monthly, real time); and

(5) whether the *firm* has a comprehensive quantitative audit programme.

4.3.23 G In respect of data inputs, the testing for accuracy of data, including the reconciliation referred to above, should be sufficiently detailed so that, together with other available evidence, it gives reasonable assurance that data input into the rating system is accurate, complete and appropriate. The *FCA* considers that input data fails to meet the required standard if it gives rise to a serious risk of material misstatement in the capital requirement either immediately or subsequently.

4.3.24 G In respect of data outputs, a *firm*, as part of the reconciliation referred to above, should be able to identify and explain material differences between the outputs produced under accounting standards and those produced under the requirements of the IRB approach, including for areas that address similar concepts in different ways (for example, expected loss on the one hand and accounting provisions on the other).

4.3.25 G A *firm* should have clear and documented standards and policies about the use of data in practice (including information technology standards) which should, in particular, cover the firm's approach to the following:

(1) data access and security;

(2) data integrity, including the accuracy, completeness, appropriateness and testing of data; and

(3) data availability.

[**Note**: article 144(1)(a) of the *EU CRR*)

Rating systems: policies

4.3.26 G For the *FCA* to be satisfied that a *firm* documents its ratings systems appropriately, in accordance with article 144(1)(e) of the *EU CRR*, it would expect a *firm* to be able to demonstrate that it has an appropriate policy for any ratings system in relation to:

(1) any deficiencies caused by its not being sensitive to movements in fundamental risk drivers or for any other reason;

(2) the periodic review and action in the light of such review;

(3) providing appropriate internal guidance to staff to ensure consistency in the use of the rating system, including the assignment of exposures or facilities to pools or grades;

(4) dealing with potential weaknesses of the rating system;

(5) identifying appropriate and inappropriate uses of the rating system and acting on that identification;

(6) novel or narrow rating approaches; and

(7) ensuring the appropriate level of stability over time of the rating system.

[**Note**: article 144(1)(a) and (e) of the *EU CRR*)

Collection of data

4.3.27 G To be satisfied that the requirements in article 179(1) of the *EU CRR* are met, the *FCA* would expect a *firm* to collect data on what it considers to be the main drivers of the risk parameters – probability of default (PD), loss given default (LGD), conversion factors (CFs) and expected loss (EL) for each group of obligors or facilities, to document the identification of the main drivers of risk parameters, and be able to demonstrate that the process of identification is reasonable and appropriate.

4.3.28 G In its processes for identifying the main drivers of risk parameters, the *FCA* expects that a *firm* should set out its reasons for concluding that the data sources chosen provide in themselves sufficient discriminative power and accuracy and why additional potential data sources do not provide relevant and reliable information that would be expected materially to improve the discriminative power and accuracy of its estimates of the risk parameter in question. This process need not necessarily require an intensive analysis of all factors.

[**Note**: article 179(1)(a), (d) and (e) of the *EU CRR*)

Data quality

4.3.29 G To demonstrate that rating systems provide for meaningful assessment, the *FCA* would expect that a *firm's* documentation relating to data should include clear identification of responsibility for data quality. A *firm* should set

standards for data quality, aim to improve them over time and measure its performance against those standards. Furthermore, a *firm* should ensure that its data is of high enough quality to support its risk management processes and the calculation of its capital requirements (see article 175(1) of the *EU CRR*).

Use of models and mechanical methods to produce estimates of parameters

4.3.30 G Further detail of standards that the *FCA* will expect a *firm* to meet when it assesses compliance with article 174 of *EU CRR* are set out in the sections on probability of default (PD), loss given default (LGD) and exposure at default (EAD).

4.3.31 G In assessing whether the external data used by a *firm* to build models is representative of its actual obligors or *exposures*, the *FCA* expects a *firm* to consider whether this data is appropriate to its own experience and whether adjustments are necessary (see article 174 of the *EU CRR*).

Calculation of long averages PD, LGD and EAD

4.3.32 G To estimate PDs that are long run averages of one-year default rates for obligor grades or pools, the *FCA* expects a *firm* to estimate expected default rates for the grade/pool over a representative mix of good and bad economic periods, rather than simply taking the historic average of default rates actually incurred by the *firm* over a period of years. The *FCA* expects that a long run estimate will be changed when there is reason to believe that the existing long run estimate is no longer accurate, but expect that it will not be automatically updated to incorporate the experience of additional years as these may not be representative of the long run average (see article 180 of the *EU CRR*).

4.3.33 G To demonstrate compliance with article 144(1) of the *EU CRR*, the *FCA* expects a firm to take into account the following factors in understanding differences between their historic default rates and their PD estimates, and in adjusting the calibration of their estimates as appropriate:

(1) the rating philosophy of the system and the economic conditions in the period over which the defaults have been observed;

(2) the number of defaults, as a low number is less likely to be representative of a long run average. Moreover, where the number of internal defaults is low, there is likely to be a greater need to base PDs on external default data as opposed to purely internal data;

(3) the potential for under-recording of actual defaults; and

(4) the level of conservatism applied.

4.3.34 G The *FCA* expects a *firm* that is unable to produce a long run estimate, as described above, will need to amend their rating system so that the PD used as an input into the IRB *own funds requirement* is an appropriately conservative estimate of the actual default rate expected over the next year (see article 179(1)(f) of the *EU CRR*).

4.3.35 G In accordance with articles 181(1)(b) and 182(1)(b) of the *EU CRR*, where the estimates appropriate for an economic downturn are more conservative than the long run average, the *FCA* expects the estimate for each of these parameters to represent the LGD or CF expected, weighted by the number of defaults, over the downturn period. Where this is not the case, the *FCA* expect the estimate to be used to be the expected LGD or CF, weighted by the number of defaults, over a representative mix of good and bad economic periods (see articles 179, 181 and 182 of the *EU CRR*).

Assignment to grades or pools

4.3.36 G To demonstrate that a rating system provides for a meaningful differentiation of risk and accurate and consistent quantitative estimates of risk, the *FCA* expects a *firm*, in assigning exposures to grades or pools within a rating system, to have regard to the sensitivity of the rating to movements in fundamental risk drivers (see article 171 of the *EU CRR*).

Definition of default: identification of obligors

4.3.37 G The *FCA* expects that if a *firm* ordinarily assigns *exposures* in the corporate, *institution* or central government and central bank *exposure* classes to a member of a *group*, substantially on the basis of membership of that *group* and a common group rating, and the *firm* does so in the case of a particular obligor group, the *firm* should consider whether members of that *group* should be treated as a single obligor for the purpose of the definition of default in article 178(1) of the *EU CRR*.

4.3.38 G The *FCA* does not expect a *firm* to treat an obligor as part of a single obligor under *IFPRU* 4.3.37G if the *firm* rates its *exposures* on a standalone basis or if its rating is notched. (For these purposes a rating is notched if it takes into account individual risk factors or otherwise reflects risk factors that are not applied on a common group basis.) Accordingly if a *group* has two members which are separately rated, the *FCA* will not expect that the default of one will necessarily imply the default of the other.

Definition of default: days past due

4.3.39 G *IFPRU* 4.3.4G contemplates that the *FCA* expects to exercise its discretion to permit the days past due component of the definition of default at 180 days for *exposures* secured by residential or SME commercial real estate in the retail exposure class, as well as exposures to public sector entities (PSEs).

4.3.40 G In certain circumstances, a *firm* may wish to use a 90-day definition of default, for example, where application of a 180-day definition of default would potentially inhibit a joint decision being reached. The *FCA* will assess the option used by the *firm* as part of its assessment of the IRB approach.

Definition of default: unlikeliness to pay in distressed restructuring

4.3.41 G The *FCA* expects a credit obligation to be considered as a distressed restructuring if an independent third party, with expertise in the relevant area, would not be prepared to provide financing on substantially the same terms and conditions (see article 178(2)(d) of the *EU CRR*).

Definition of default: returning to performing status

4.3.42 G To be satisfied that a *firm* complies with the documentation requirements in article 175(3) of the *EU CRR*, the *FCA* expects a *firm* to have a clear and documented policy for determining whether an exposure that has been in default should subsequently be returned to performing status (see article 175(3) of the *EU CRR*).

Rating system philosophy

4.3.43 G 'Rating philosophy' describes the point at which a rating system sits on the spectrum between the stylised extremes of a point in time (PiT) rating system and a through the cycle (TTC) rating system. To explain these concepts:

(1) PiT: a *firm* seeks to explicitly estimate default risk over a fixed period, typically one year. Under such an approach, the increase in default risk in a downturn results in a general tendency for migration to lower grades. When combined with the fixed estimate of the long-run default rate for the grade, the result is a higher capital requirement. Where data are sufficient, grade level default rates tend to be stable and relatively close to the PD estimates; and

(2) TTC: a *firm* seeks to remove cyclical volatility from the estimation of default risk, by assessing borrowers' performance across the economic cycle. TTC ratings do not react to changes in the cycle, so there is no consequent volatility in capital requirements. Actual default rates in each grade diverge from the PD estimate for the grade, with actual default rates relatively higher at weak points in the cycle and relatively lower at strong points.

4.3.44 G Most rating systems sit between these two extremes. Rating philosophy is determined by the cyclicality of the drivers/criteria used in the rating assessment and should not be confused with the requirement for grade level PDs to be "long run". The calibration of even the most PiT rating system needs to be targeted at the long-run default rates for its grades; the use of long-run default rates does not convert such a system into one producing TTC ratings or PDs

4.3.45 G The choice of rating philosophy is a matter for a *firm*. The consequences of the *firm's* choice should be reflected in its model validation and stress-testing processes. A *firm* should understand where its rating systems lie on the PiT/TTC spectrum to enable it to estimate how changes in economic conditions will affect its IRB *own funds requirements* and it should be able to compare the actual default rates incurred against the default rate expected over the same period given the economic conditions pertaining, as implied by its PD estimate.

Use of variable scalar approaches

4.3.46 G The term "variable scalar" is used to describe approaches in which the outputs of an underlying, relatively PiT, rating system are transformed to produce final PD estimates used for regulatory capital requirements that are relatively non-cyclical. Typically this involves basing the resulting

requirement on the long-run default rate of the portfolio or its segments.

4.3.47 G Article 169(3) of the *EU CRR* allows the use of direct estimates of PDs, although such a measure could be assessed over a variety of different time horizons which it does not specify. The *FCA* considers that it is acceptable in principle to use methodologies of this type in lieu of estimation of long-run averages for the grade/pool/score of the underlying rating system, provided that the following conditions are met. Meeting these conditions requires a *firm* using the variable scalar approach to have a deep understanding of how and why its default rates vary over time:

(1) a *firm* meets the following four principles which address the considerable conceptual and technical challenges to be overcome in order to carry out variable scalar adjustments in an appropriate way:

Principle 1: both the initial calculations of and subsequent changes to the scalar must be able to take account of changes in default risk that are not purely related to the changes in the cycle;

Principle 2: a *firm* must be able accurately to measure the long-run default risk of its portfolio; this must include an assumption that there are no changes in the business written;

Principle 3: a *firm* must use a data series of appropriate length in order to establish the long-run default risk; and

Principle 4: a *firm* must be able to demonstrate the appropriateness of the scaling factor being used across a portfolio.

(2) stress testing includes a stress test covering the downturn scenario outlined in *IFPRU* 2.2 (Internal capital adequacy assessment process)] based on the PDs of the underlying PiT rating system, in addition to the stress test based on the parameters used in the Pillar 1 capital calculation (ie, the portfolio level average long-run default rates); and

(3) a *firm* is able to understand and articulate upfront how the scaling factor would vary over time in order to achieve the intended effect.

4.3.48 G The *FCA* will not permit a *firm* using a variable scalar approach to revert to using a PiT approach during more benign economic conditions.

4.3.49 G Principle 1 (in *IFPRU* 4.3.47G) is the most important and challenging to achieve as it requires an ability to be able to distinguish movements not related to the economic cycle, from changes purely related to the economic cycle, and not to average these away. This is because a variable scalar approach removes the ability of a rating system to take account automatically of changes in risk through migration between its grades.

4.3.50 G A *firm* using a variable scalar approach should adopt a PD that is the long-run default rate expected over a representative mix of good and bad economic periods, assuming that the current lending conditions including borrower mix and attitudes and the *firm's* lending policies remain unchanged. If the relevant lending conditions or policies change, then the *FCA* would expect the long-run default rate to change (see article 180(1)(a), (b) and (2)(a) of the *EU CRR*).

Variable scalar considerations for retail portfolios

4.3.51 G The *FCA* considers that, until more promising account level arrears data is collected to enable *firms* to better explain the movement in their arrears rate over time, the likelihood of *firms* being able to develop a compliant variable scalar approach for non-mortgage retail portfolios is low. This is because of the difficulty that *firms* have in distinguishing between movements in default rates that result from cyclical factors and those that result from non-cyclical reasons for these portfolios. Therefore, in practice, the rest of this section applies to residential mortgage portfolios.

4.3.52 G For the purposes of this subsection 'non-mortgage retail portfolios' refers to non-mortgage lending to individuals (eg, credit cards, unsecured personal loans, auto-finance etc) excluding retail SME portfolios.

4.3.53 G The *FCA* considers that one variable scalar approach, potentially compliant with the four principles in *IFPRU* 4.3.47G, could involve:

(1) segmenting a portfolio by its underlying drivers of default risk; and

(2) estimating separate long-run default rates for each of these segmented pools.

Segmentation

4.3.54 G A *firm* that applied the approach in *IFPRU* 4.3.53G properly could satisfy both Principle 1 and Principle 4 (*IFPRU* 4.3.47G). The choice of the basis of segmentation and the calibration of the estimated long-run default rate for the segments would both be of critical importance.

4.3.55 G Segmentation should be done on the basis of the main drivers of both willingness and ability to pay. In the context of residential mortgages an example of the former is the amount of equity in the property and an example of the latter is the ratio of debt to income. The *FCA* would expect a *firm* to:

(1) incorporate an appropriate number of drivers of risk within the segmentation to maximise the accuracy of the system;

(2) provide detailed explanations supporting its choices of drivers, including an explanation of the drivers it has considered and chosen not to use; and

(3) ensure that the drivers reflect its risk processes and lending policy, and is therefore not chosen using only statistical criteria (ie a judgemental assessment of the drivers chosen must be applied).

[**Note**: article 179(1)(d) of the *EU CRR*]

4.3.56 G To the extent that the basis of segmentation is not sufficient completely to explain movements in non-cyclical default risk, the long-run default rate for that segment will not be stable (eg, a change in the mix of the portfolio within the segment could change the long-run default rate). In such cases, the *FCA* would expect a *firm* to make a conservative compensating adjustment to the calibration of the long-run average PD for the affected segments and be able to demonstrate that the amount of judgement required to make such

adjustments is not excessive. Where judgement is used, considerable conservatism may be required. The *FCA* would expect conservatism applied for this reason not to be removed as the cycle changed.

Long-run default rate

4.3.57 G The *FCA* expects a *firm* to review and amend as necessary the long-run default rate to be applied to each segment on a regular (at least an annual) basis. When reviewing the long-run default rate to be applied to each segment, the *FCA* expects a *firm* to consider the extent to which:

(1) realised default rates are changing due to cyclical factors and the scaling factors needs to be changed;

(2) new information suggests that both the PiT PDs and the long-run PDs should be changed; and

(3) new information suggests that the basis of segmentation should be amended.

4.3.58 G The *FCA* expects that, over time, the actual default rates incurred in each segment would form the basis of PD estimates for the segments. However, at the outset, the key calibration issue is likely to be the setting of the initial long-run default rate for each segment, as this will underpin the PD of the entire portfolio for some years to come. A *firm* should apply conservatism in this area and this is something on which the *FCA* is likely to focus on in model reviews.

Governance

4.3.59 G A *firm* should put in place a governance process to provide a judgemental overlay to assess its choices of segments, PD estimates and scalars, both initially and on a continuing basis. Moreover, where the basis of its estimation is a formulaic approach, the *FCA* considers that the act of either accepting or adjusting the estimate suggested by the formula would represent the exercise of judgement.

4.3.60 G A *firm* should consider what use it can make of industry information, however the *firm* should be seeking to measure the absolute level of and changes to its own default risk, rather than changes in default risk relative to the industry. Given the potential for conditions to change across in the market as a whole, a *firm* should not draw undue comfort from the observation that its default risk is changing in the same way as the industry as a whole. Doing so would not allow it to meet Principle 1 in *IFPRU* 4.3.47G.

4.3.61 G A *firm* should be able to demonstrate that it has adequate information and processes in order to underpin the decisions outlined above on choice of segmentation, source of data, and adequacy of conservatism in the calibration, and that this information is reflected in the reports and information being used to support the variable scalar governance process. Given that, for retail business, these decisions would be likely to affect only the *own funds requirements* of the *firm* and not the day-to-day running of its business, the *FCA* will look for a high level of reassurance and commitment from the *firm's senior management* to maintain an adequate governance process.

Data considerations

4.3.62 G The *FCA* expects a *firm* to consider the following issues when seeking to apply a variable scalar approach for *UK* mortgages:

(1) in respect of Principle 2 (*IFPRU* 4.3.47G), the commonly used Council for Mortgage Lenders database was based on arrears data and not defaults during a period, and the use of these data without further analysis and adjustment can undermine the accuracy of any calculations; and

(2) in respect of Principle 3 (*IFPRU* 4.3.47G), the historical data time period chosen for use in the calculations will vary the long-run PDs, and thus *own funds requirements*, when there is no change in the underlying risk.

4.3.63 G The *FCA* expects a *firm* that is including mortgage arrears data as a proxy for default data to:

(1) carry out sensitivity analysis identifying the circumstances in which the assumption that arrears may be used as a proxy for default would produce inaccuracy in long-run PD estimates;

(2) set a standard for what might constitute a potentially significant level of inaccuracy, and demonstrate why in practice the use of this proxy would not result in any significant inaccuracy;

(3) establish a process for assessing the ongoing potential for inaccuracy, including thresholds beyond which the level of inaccuracy may no longer be insignificant; and

(4) consider the use of conservative adjustments to address the potential inaccuracy

4.3.64 G When using historical mortgage data as a key input into variable scalar models, the *FCA* expects a *firm* to:

(1) carry out sensitivity analysis identifying the implications of using different cut-off dates for the start of the reference data set; and

(2) justify the appropriateness of its choice of cut-off date.

Retail exposures: obligor level definition of default

4.3.65 G Where a *firm* has not chosen to apply the definition of default at the level of an individual credit facility in accordance with article 178(1) of the *EU CRR*, the *FCA* expects it to ensure that the PD associated with unsecured *exposures* is not understated as a result of the presence of any collateralised *exposures*.

4.3.66 G The *FCA* expects the PD of a residential mortgage to typically be lower than the PD of an unsecured loan to the same borrower (see article 178(1) of the *EU CRR*).

Retail exposures: facility level definition of default

4.3.67 G Where a *firm* chooses to apply the definition of default at the level of an individual credit facility, in accordance with article 178(1) of the *EU CRR*, and a customer has defaulted on a facility, then default on that facility is likely to influence the PD assigned to that customer on other facilities. The *FCA* expects a *firm* to take this into account in its estimates of PD (see article 178(1) of the *EU CRR*).

Multi-country mid-market corporate PD models

4.3.68 G To ensure that a rating system provides a meaningful differentiation of risk and accurate and consistent quantitative estimates of risk, the *FCA* expects a *firm* to develop country-specific mid-market PD models. Where a *firm* develops multi-country mid-market PD models, the *FCA* expects the *firm* to be able to demonstrate that the model rank orders risk and predicts default rates for each country where it is to be used for regulatory capital calculation.

4.3.69 G The *FCA* expects a *firm* to have challenging standards in place to meaningfully assess whether a model rank orders risk and accurately predict default rates. These standards should specify the number of defaults that are needed for a meaningful assessment to be done.

4.3.70 G The *FCA* expects a *firm* to assess the model's ability to predict default rates using a time series of data (ie, not only based on one year of default data).

4.3.71 G In the *FCA's* view, a model is not likely to be compliant where the *firm* cannot demonstrate that it rank orders risk and predicts default rates for each country, regardless of any apparent conservatism in the model.

Use of external rating agency grades

4.3.72 G The *FCA* expects a *firm* using a rating agency grades as the primary driver in its IRB models to be able to demonstrate (and document) compliance with the following criteria:

(1) the *firm* has its own internal rating scale;

(2) the *firm* has a system and processes in place that allow it to continuously collect and analyse all relevant information, and the 'other relevant information' considered by the *firm* in accordance with article 171(2) of the *EU CRR* reflects the information collected and analysed by the *firm* when extending credit to new or existing obligors;

(3) the 'other relevant information' considered by the *firm* is included in an IRB model in a transparent and objective way and is subject to challenge. The *FCA* expects the *firm* to be able to demonstrate what information was used and why, and how it was included and, if no additional information is included, to be able to document what information was discarded and why;

(4) the development of final grades consists of the following steps at a minimum:

(a) the *firm* takes into account all available information

(eg, external agency grades and any 'other relevant information') prior to allocating obligors to internal grades and does not automatically assign obligors to grades based on the rating agency grade;

(b) any overrides are applied to these grades;

(c) the *firm* has a system and processes in place that allows it to continuously collect and analyse final rating overrides;

(5) the grades to which obligors are assigned is reassessed at least annually. The firm is able to demonstrate how the grades are reassessed on a more frequent than annual basis when new relevant information becomes available;

(6) firms can demonstrate that a modelling approach is being applied, both in terms of the choice of the rating agency grade as the primary driver and, where information is found to materially and consistently add to the internal rating grade, that they have incorporated this information as an additional driver. This work must be analytical (rather than entirely subjective) and could form part of the annual independent review of the model.

4.3.73 G In the *FCA's* view, if a *firm* does not have any additional information to add to the external ratings for the significant part of its portfolio then it will not be meeting the requirements for using an IRB approach.

Low default portfolios

4.3.74 G If a *firm's* internal experience of *exposures* of a type covered by a model or other rating system is 20 defaults or fewer and reliable estimates of PD cannot be derived from external sources of default data, including the use of market price-related data, for all the *exposures* covered by the rating system, then the *FCA* expects a *firm* to estimate PD for exposures covered by that rating system in accordance with this section to:

(1) use a statistical technique to derive the distribution of defaults implied by the *firm's* experience, estimating PDs (the "statistical PD") from the upper bound of a confidence interval set by the *firm* to produce conservative estimates of PDs in accordance with article 179(f) of the *EU CRR*;

(2) use a statistical techniques to derive the distribution of default which takes account, as a minimum, of the following modelling issues:

(a) the number of defaults and number of obligor years in the sample;

(b) the number of years from which the sample was drawn;

(c) the interdependence between default events for individual obligors;

(d) the interdependence between default rates for different years; and

(e) the choice of the statistical estimators and the associated distributions and confidence intervals.

(3) further adjust the statistical PD to the extent necessary to take account of the following:

(a) any likely differences between the observed default rates over the period covered by the *firm's* default experience and the long-run PD for each grade required by article 180(1)(a) and (2)(a) of the *EU CRR*; and

(b) any other information that indicates (taking into account the robustness and cogency of that information) that the statistical PD is likely to be an inaccurate estimate of PD.

4.3.75 G The *FCA* expects a *firm* to take into account only defaults that occurred during periods that are relevant to the validation under the *EU CRR* of the model or other rating system in question when determining whether there are 20 defaults or fewer.

Supervisory slotting criteria for specialised lending

4.3.76 G Until the regulatory technical standards specified in article 153(9) of the *EU CRR* come into force, we would expect a *firm* to assign exposures to the risk weight category for specialised lending exposures based on the criteria set out in the tables in *IFPRU* 4 Annex 1G (Slotting criteria).

Negative LGDs

4.3.77 G The *FCA* expects a *firm* to ensure that no LGD estimate is less than zero.

Low LGDs

4.3.78 G The *FCA* does not expect a *firm* to be using zero LGD estimates in cases other than where it had cash collateral supporting the *exposures*.

4.3.79 G The *FCA* expects a *firm* to justify any low LGD estimates using analysis on volatility of sources of recovery, notably on collateral, and cures. This includes:

(1) recognising that the impact of collateral volatility on low LGDs is asymmetric as surpluses over amounts owed need to be returned to borrowers and that this effect may be more pronounced when estimating downturn, rather than normal period LGDs; and

(2) recognising the costs and discount rate associated with realisations and the requirements of article 181(1)(e) of the *EU CRR*.

4.3.80 G To ensure that the impact of collateral volatility is taken into account, the *FCA* expects a *firm's* LGD framework to include non-zero LGD floors which are not solely related to administration costs (see article 179(1)(f) of the *EU CRR*).

Treatment of cures

4.3.81 G Where a *firm* wishes to include cures in its LGD estimates, the *FCA* expects it to do this on a cautious basis, with reference to both its current experience and how this is expected to change in downturn conditions. In particular, this involves being able to articulate clearly both the precise course of events that

will allow such cures to take place and any consequences of such actions for other elements of its risk quantification. For example:

(1) where cures are driven by the *firm's* own policies, the *FCA* expects the *firm* to consider whether this is likely to result in longer realisation periods and larger forced sale discounts for those exposures that do not cure, and higher default rates on the book as a whole, relative to those that might be expected to result from a less accommodating attitude. To the extent feasible, the *FCA* expects cure assumptions in a downturn to be supported by relevant historical data;

(2) the *FCA* expects a *firm* to be aware of, and properly account for, the link between cures and subsequent defaults. In particular, an earlier cure definition is, other things being equal, likely to result in a higher level of subsequent defaults.

[**Note**: article 5(2) of the *EU CRR*]

Incomplete workouts

4.3.82 G To ensure that estimates of LGDs take into account the most up-to-date experience, the *FCA* expects a *firm* to take account of data for relevant incomplete workouts (ie, defaulted exposures for which the recovery process is still in progress, with the result that the final realised losses in respect of those exposures are not yet certain) (see article 179(1)(c) of the *EU CRR*).

LGD: sovereign floor

4.3.83 G To ensure that sovereign LGD models are sufficiently conservative, the *FCA* expects a *firm* to apply a 45% LGD floor to each unsecured *exposure* in the sovereign asset class (see article 179(1)(a) of the *EU CRR*).

LGD: UK retail mortgage property sales reference point

4.3.84 G The *FCA* believes that an average reduction in property sales prices of 40% from their peak price, prior to the market downturn, forms an appropriate reference point when assessing downturn LGD for *UK* mortgage portfolios. This reduction captures both a fall in the value of the property due to house price deflation, as well as a distressed forced sale discount.

4.3.85 G Where a *firm* adjusts assumed house price values within its LGD models to take account of current market conditions (for example, appropriate house price indices), the *FCA* recognises that realised falls in market values may be captured automatically. A *firm* adopting such approaches may remove observed house price falls from its downturn house price adjustment so as not to double count. A *firm* wishing to apply such an approach must seek the consent of the *FCA* and be able to demonstrate that the following criteria are met:

(1) the adjustment applied to the market value decline element of a *firm's* LGD model is explicitly derived from the decrease in indexed property prices (ie, the process is formulaic, not judgemental);

(2) the output from the adjusted model has been assessed against the 40% peak-to-trough property sales prices decrease reference point (after

inclusion of a forced sale discount);

(3) a minimum 5% market value decline applies at all times in the LGD model; and

(4) the *firm* has set a level for reassessment of the property market price decline from its peak. For example, if a *firm* had initially assumed a peak-to-trough market decline of 15%, then it will have set a level of market value decline where this assumption will be reassessed (see article 181(1)(b) of the *EU CRR*).

Downturn LGDs

4.3.86 G To ensure that its LGD estimates are oriented towards downturn conditions, the *FCA* expects a *firm* to have a process through which it:

(1) identifies appropriate downturn conditions for each IRB *exposure* class within each jurisdiction;

(2) identifies adverse dependencies, if any, between default rates and recovery rates; and

(3) incorporates adverse dependencies, if identified, between default rates and recovery rates in the *firm's* estimates of LGD in a manner that meets the requirements relating to an economic downturn (see article 181(1)(b) of the *EU CRR*).

Discounting cashflows

4.3.87 G To ensure that its LGD estimates incorporate material discount effects, the *FCA* expects a *firm's* methods for discounting cash flows to take account of the uncertainties associated with the receipt of recoveries for a defaulted exposure, for example by adjusting cash flows to certainty-equivalents or by using a discount rate that embodies an appropriate risk premium; or by a combination of the two.

4.3.88 G If a *firm* intends to use a discount rate that does not take full account of the uncertainty in recoveries, the *FCA* expects it to be able to explain how it has otherwise taken into account that uncertainty for the purposes of calculating LGDs. This can be addressed by adjusting cash flows to certainty-equivalents or by using a discount rate that embodies an appropriate risk premium for defaulted assets, or by a combination of the two (see article 5(2) of the *EU CRR*).

Wholesale LGD

4.3.89 G The *FCA* expects a *firm* using advanced IRB approaches to have done the following in respect of wholesale LGD estimates:

(1) applied LGD estimates at transaction level;

(2) ensured that all LGD estimates (both downturn and non-downturn) are cautious, conservative and justifiable, given the paucity of observations. Under article 179(1)(a) of the *EU CRR*, estimates must be derived using both historical experience and empirical evidence,

and not be based purely on judgemental consideration. The *FCA* expects the justification as to why the *firm* thinks the estimates are conservative to be documented;

(3) clearly documented the process for how estimates were arrived at and reviewed, and who was involved in this process in cases where expert judgement has been used;

(4) demonstrated an understanding of the impact of the economic cycle on collateral values and be able to use that understanding in deriving their downturn LGD estimates;

(5) evidenced that it is aware of any weaknesses in their estimation process and have set standards, for example related to accuracy, that their estimates are designed to meet.

(6) demonstrated that it has sought and utilised relevant and appropriate external data, including through identifying all relevant drivers of LGD and how these will be affected by a downturn;

(7) ensured, in most cases, estimates incorporate effective discrimination on the basis of at least security-type and geography. In cases where these drivers are not incorporated into LGD estimates, the *FCA* expects the *firm* to be able to demonstrate why they are not relevant;

(8) maintained an ongoing data collection framework to collect all relevant internal loss and exposure data required for estimating LGD and a framework to start using these data as soon as any meaningful information becomes available;

(9) articulated what data the *firm* intends to use from any industry-wide data collection exercises that they are participating in, and how the data will be used.

4.3.90 G The *FCA* uses a framework for assessing the conservatism of a *firm's* wholesale LGD models for which there are a low number of defaults. This framework is set out in *IFPRU* 4 Annex 2G (Wholesale LGD and EAD framework) and does not apply to sovereign LGD estimates which are floored at 45% or social housing portfolios where the *FCA* intends to have separate bilateral conversations with the *firm* regarding appropriate capital treatments. This framework is also in the process of being used to assess the calibration of a *firm's* material LGD models for low-default portfolios.

4.3.91 G In the following cases, the *FCA* expects a *firm* to determine the effect of applying the framework in *IFPRU* 4 Annex 2G (Wholesale LGD and EAD framework) to models which include LGD values that are based on fewer than 20 'relevant' data points (as defined in *IFPRU* 4 Annex 2G):

(1) the model is identified for review by the *FCA*; or

(2) the *firm* submits a request for approval for a material change to its LGD model.

Unexpected loss on defaulted assets

4.3.92 G The *FCA* considers that both of the following approaches in relation to calculating unexpected loss of defaulted assets are acceptable in principle:

(1) the independent calculation approach, in which possible losses, additional to the best estimate, over the recovery period are estimated; and

(2) subtracting the best estimate of expected loss from post-default LGD.

4.3.93 G Where an independent calculation approach is adopted for the calculation of unexpected loss on defaulted assets, the *FCA* expects a *firm* to ensure that estimates are at least equal, at a portfolio level, to a 100% risk weight/8% capital requirement on the amount outstanding net of provisions (see article 181(1)(h) of the *EU CRR*).

Unsecured LGDs where the borrowers' assets are substantially collateralised

4.3.94 G The extent to which a borrower's assets are already given as collateral will clearly affect the recoveries available to unsecured creditors. If the degree to which assets are pledged is substantial, this will be a material driver of LGDs on such exposures. Although potentially present in all transactions, the *FCA* expects a firm to be particularly aware of this driver in situations where borrowing on a secured basis is the normal form of financing, leaving relatively few assets available for the unsecured debt. Specialist lending (including property), hedge fund, and some SME/mid-market lending can be considered such cases.

4.3.95 G When estimating unsecured LGDs for borrowers whose assets are substantially used as collateral for other obligations, the *FCA* expects a *firm* to take this effect into account. The *firm* is expected to not use unadjusted data sets that ignore this impact, and is reminded that it is an estimate for downturn conditions that is normally required. In the absence of relevant data to estimate this effect, conservative LGDs — quite possibly 100% — are expected to be used (see articles 171(2) and 179(1)(a) of the *EU CRR*).

Estimation of EAD in place of conversion factors

4.3.96 G The *FCA* considers that a *firm* may provide own estimates of EAD in place of the own estimates of conversion factors (CFs) that it is permitted or required to provide under article 151 of the *EU CRR*.

4.3.97 G For the purpose of this section, references to EAD refer to both direct estimates of EAD and CFs, unless specified otherwise (see article 151 of the *EU CRR*).

General expectations for estimating EAD

4.3.98 G The *FCA* expects that EAD estimates should not be less than current drawings (including interest accrued to date). Consequently, CF estimates should not be less than zero.

4.3.99 G The EAD required for IRB purposes is the *exposure* expected to be outstanding under a borrower's current facilities should it go into default in the next year, but assuming that economic downturn conditions occur in the next year and that, other than any changes resulting from the economic

downturn conditions, a *firm's* policies and practices for controlling exposures remain unchanged from what they are at present.

4.3.100 G To achieve comprehensive coverage of the *exposure* at default, the *FCA* expects *firms* to take into account all facility types that may result in an exposure when an obligor defaults, including uncommitted facilities.

4.3.101 G To the extent that a *firm* makes available multiple facilities, the *FCA* expects the *firm* to be able to demonstrate:

(1) how they deal with the fact that *exposures* on one facility may become *exposures* under another on which the losses are ultimately incurred; and

(2) the impact of its approach on its capital requirements.

4.3.102 G The *FCA* expects *firms* using own estimates of EAD to have done the following in respect of EAD estimates:

(1) applied EAD estimates at the level of the individual facility;

(2) where there is a paucity of observations, ensured that all EAD estimates are cautious, conservative and justifiable. In accordance with article 179(1)(a) of the *EU CRR*, estimates must be derived using both historical experience and empirical evidence, and must not be based purely on judgemental consideration. The *FCA* expects the justification as to why the *firm* thinks the estimates are conservative to be documented;

(3) identified and explained at a granular level how each estimate has been derived. This should include an explanation of how internal data, any external data, expert judgement or a combination of these has been used to produce the estimate;

(4) clearly documented the process for how estimates were arrived at and reviewed, and who was involved in this process in cases where expert judgement has been used;

(5) demonstrated an understanding of the impact of the economic cycle on exposure values and be able to use that understanding in deriving downturn EAD estimates;

(6) demonstrated sufficient understanding of any external benchmarks used and identified the extent of their relevance and suitability to the extent that the *firm* can satisfy itself that they are fit for purpose;

(7) evidenced that they are aware of any weaknesses in their estimation process and have set standards that their estimates are designed to meet (eg, related to accuracy);

(8) ensured, in most cases, that estimates incorporate effective discrimination on the basis of at least product features and customer type. In cases where these drivers are not incorporated into LGD estimates, the *FCA* expects the *firm* to be able to demonstrate why they are not relevant;

(9) maintained an ongoing data collection framework to collect all relevant internal exposure data required for estimating EAD and a framework to start using this data as soon as any meaningful information becomes available;

(10) made use of the data they are collecting to identify all relevant drivers of EAD and to understand how these drivers will be affected by a downturn;

(11) identified dependencies between default rates and conversion factors for various products and markets when estimating downturn EADs. *Firms* are expected to consider how they expect their own policies regarding exposure management to evolve in a downturn.

4.3.103 G The *FCA* uses a framework for assessing the conservatism of *firms'* wholesale EAD models for which there are a low number of defaults. This framework is set out in *IFPRU* 4 Annex 2G (Wholesale LGD and EAD framework) and does not apply to social housing portfolios where the *FCA* intends to have separate bilateral conversations with firms regarding appropriate capital treatments. This framework is in the process of being used to assess the calibration of *firms*' material EAD models for low-default portfolios.

4.3.104 G In the following cases, the *FCA* expects *firms* to determine the effect of applying the framework in *IFPRU* 4 Annex 2G (Wholesale LGD and EAD framework) to models which include EAD values that are based on fewer than 20 'relevant' data points (as defined in *IFPRU* 4 Annex 2G):

(1) the model is identified for review by the *FCA*; or

(2) the *firm* submits a request for approval for a material change to its EAD model.

Time horizon

4.3.105 G The *FCA* expects *firms* to use a time horizon of one year for EAD estimates, unless they can demonstrate that another period would be more conservative.

4.3.106 G EAD estimates can be undertaken on the basis that default occurs at any time during the time horizon (the 'cohort approach') or at the end of the time horizon (the 'fixed-horizon approach'). The *FCA* considers that either approach is acceptable in principle.

4.3.107 G The *FCA* expects the time horizon for additional drawings to be the same as the time horizon for defaults. In effect this means that EAD estimation need cover only additional drawings that might take place in the next year, such that:

(1) no *own funds requirements* need be held against facilities, or proportions of facilities that cannot be drawn down within the next year; and

(2) where facilities can be drawn down within the next year, *firms* may, in principle, reduce their estimates to the extent that they can demonstrate that they are able and willing, based on a combination of

empirical evidence, current policies, and documentary protection to prevent further drawings (see article 182 of the *EU CRR*).

Direct estimates of EAD

4.3.108 G There are a range of approaches that focus on the total amount that will be drawn down at the time of default and directly estimate EAD. Typically, but not in all cases, these will estimate EAD as a percentage of total limit. These approaches can be described collectively as 'momentum' approaches.

4.3.109 G A 'momentum' approach can be used either:

(1) by using the drawings/limit percentage to formulaically derive a conversion factor on the undrawn portion of the limit; or

(2) by using the higher of percentage of the limit and the current balance as the EAD.

4.3.110 G The *FCA* considers that the use of momentum approaches in both of the ways outlined above is acceptable in principle as an alternative to direct estimation of conversion factors (see article 4(56) of the *EU CRR*).

Distortions to conversion factor estimates caused by low undrawn limits

4.3.111 G In cases where *firms* estimate conversion factors (CFs) directly using a reference data set that includes a significant number of high CFs as a result of very low undrawn limits at the observation date, the *FCA* expects *firms* to:

(1) investigate the distribution of realised CFs in the reference data set;

(2) base the estimated CF on an appropriate point along that distribution, that results in the choice of a CF appropriate for the exposures to which it is being applied and consistent with the requirement in article 179 of the *EU CRR* for estimates to include a margin of conservatism related to errors; and

(3) be aware that, while the median of the distribution might be a starting point, they should not assume without analysis that the median represents a reasonable unbiased estimate. The *FCA* expects *firms* to consider whether the pattern of distribution in realised CFs means that some further segmentation is needed (eg treating facilities that are close to full utilisations differently) (see article 182(1)(a) of the *EU CRR*).

Identification of exposures for which an EAD must be estimated

4.3.112 G The *FCA* expects *firms* to treat a facility as an exposure from the earliest date at which a customer is able to make drawings under it.

4.3.113 G Where the facility is of the type that it is customary not to advise the borrower of its availability, the *FCA* expects an EAD/CF to be applied from the time that the existence of the facility is recorded on the *firm's* systems in a way that would allow the borrower to make a drawing.

4.3.114 G If the availability of a facility is subject to a further credit assessment by the firm, this may remove the need to apply an EAD/CF. However, the *FCA*

expects this to be the case only if the subsequent credit assessment was of substantially equivalent rigour to that of the initial credit approval and if this includes a re-rating or a confirmation of the rating of the borrower.

4.3.115 G *Firms* are not expected to include in their EAD/CF estimates the probability of increases in limits between observation and default date. If the reference data set includes the impact of such increases, *firms* may adjust their estimates accordingly with the aim of assessing what the *exposure* would have been at default if the limit had not been increased.

4.3.116 G The *FCA* expects *firms* to investigate the incidence of *exposures* existing at default that arise from products or relationships that are not intended to result in a credit exposure and, consequently, have no credit limit established against them and are not reflected in their estimates of EAD. Unless these are immaterial, *firms* are expected to estimate a Pillar 1 capital charge on a portfolio basis to be applied against such *exposures*.

4.3.117 G The *FCA* expects *firms* to investigate how their EAD estimates are impacted by exposures that are in excess of limits at either the observation date (if in the reference data set) or at the current reporting date (for the existing book to which estimates need to be applied). Unless a momentum approach is being used, exposures in excess of limit should be excluded from the reference data set (as the undrawn limit is negative and nonsensical answers would result from their inclusion). The *FCA* expects *firms* to ensure that their EAD estimation includes the risk of further drawings on accounts that are in excess of their limits (see article 4(56) of the *EU CRR*).

Accrued interest

4.3.118 G *Exposures* include not only principal amounts borrowed under facilities but also interest accrued which will fluctuate between payment dates. To ensure proper coverage of interest, the *FCA* expects *firms* to take the following approach:

(1) accrued interest to date should be included in current *exposure* for performing *exposures*;

(2) *firms* may choose whether estimated increases in accrued interest up to the time of default should be included in LGD or EAD;

(3) in the estimation of EAD, increases in accrued interest may be offset against reductions in other outstandings;

(4) estimation of changes in accrued interest needs to take account of changes in the contractual interest rate over the time horizon up to default and consistent with the scenario envisaged in the calculation of the downturn/default weighted average;

(5) inclusion of estimates of future post-default interest is not necessary in either EAD or LGD; and

(6) *firms'* accounting policies will determine the extent to which interest accrued to date is reflected in current exposure as opposed to LGD for defaulted exposures (see article 166(1) of the *EU CRR*).

Netting

4.3.119 G For current balances, netting may be applied in cases where a *firm* meets the general conditions for on balance sheet netting, as set out in the *EU CRR*.

4.3.120 G For the CF on undrawn limits, this may be applied on the basis of the net limit, provided the conditions in the *EU CRR* for the use of net limits are met. However *firms* are reminded that the purpose of the measure is to estimate the amount that would be outstanding in the event of a default. This implies that their ability, in practice, to constrain the drawdown of credit balances will be particularly tested. Moreover, the *FCA* expects the appropriate conversion factor to be higher as a percentage of a net limit than of a gross limit.

4.3.121 G The lower the net limit as a percentage of gross limits or *exposures*, the greater will be the need on the part of the *firm* to ensure that it is restricting *exposures* below net limits in practice and that it will be able to continue to do so should borrowers encounter difficulties. The application of a zero net limit is acceptable in principle but there is, consequently, a very strong obligation on the *firm* to ensure that breaches are not tolerated (see article 166(3) of the *EU CRR*).

Underwriting commitments

4.3.122 G Estimation of CFs on underwritten facilities in the course of primary market syndication may take account of anticipated sell down to other parties.

4.3.123 G *Firms* are reminded that, since the basis of EAD estimation is that default by the borrower is expected to take place in a one-year time horizon and quite possibly in downturn conditions, the *FCA* expects any reduction in their CF in anticipation of syndication to take account of this scenario (see article 4(56) of the *EU CRR*).

Stress tests used in assessment of capital adequacy

4.3.124 G To be satisfied that the credit risk stress test undertaken by a *firm* under article 177(2) of the *EU CRR* is meaningful and considers the effects of severe, but plausible, recession scenarios, the *FCA* expects the stress test to be based on an economic cycle that is consistent with *IFPRU* 2.2.73G(1)(b) (see article 177(2) of the *EU CRR*).

Validation

4.3.125 G The *FCA* expects a *firm* to have a validation process that includes the following:

(1) establish standards of objectivity, accuracy, stability and conservatism that it designs its ratings systems to meet and processes that establish whether its rating systems meet those standards;

(2) establish standards of accuracy of calibration (ie, whether outcomes are consistent with estimate) and discriminative power (ie, the ability to rank-order risk) that it designs its rating systems to meet and processes that establish whether its rating systems meet those standards;

(3) define policies and standards that specify the actions to be taken when a rating system fails to meet its specified standards of accuracy and discriminative power;

(4) use a mix of developmental evidence, benchmarking and process verification and policies on how this mixture varies between different rating systems;

(5) use of both quantitative and qualitative techniques;

(6) policies on how validation procedures are expected to vary over time; and

(7) ensure independent input into, and review of, its rating systems (see article 188 of the *EU CRR*).

4.3.126 G In *IFPRU* 4.3.125G:

(1) developmental evidence means evidence that substantiates whether the logic and quality of a rating system (including the quantification process) adequately discriminates between different levels of, and delivers accurate estimates of, PD, EL, LGD and conversion factors (as applicable); and

(2) process verification means the process of establishing whether the methods used in a rating system to discriminate between different levels of risk and to quantify PD, EL, LGD and conversion factors are being used, monitored and updated in the way intended in the design of the rating system (see article 188 of the *EU CRR*).

4.3.127 G The *FCA* expects a *firm* to be able to explain the performance of its rating systems against its chosen measure (or measures) of discriminative power. In making this comparison a *firm* should rely primarily on actual historic default experience where this is available. In particular, the *FCA* expects a *firm* to be able to explain the extent of any potential inaccuracy in these measures, caused in particular by small sample size and the potential for divergence in the future, whether caused by changing economic conditions or other factors. *Firms'* assessment of discriminative power should include appropriate use of external benchmarks where available.

4.3.128 G The *FCA* will consider the sophistication of the measure of discrimination chosen when assessing the adequacy of a rating system's performance.

4.3.129 G In the case of a portfolio for which there is insufficient default experience to provide any confidence in statistical measures of discriminative power, the *FCA* expects a *firm* to use other methods. For example, analysis of whether the *firm's* rating systems and an external measurement approach, eg, external ratings, rank common obligors in broadly similar ways. The *FCA* expects a *firm* to be able to explain the methodology it uses and the rationale for its use.

Income-producing real estate portfolios

4.3.130 G The *FCA* considers that income-producing real estate (IPRE) is a particularly difficult asset class for which to build effective rating systems that are compliant with the requirements of the internal ratings based (IRB) approach.

4.3.131 G As with all asset classes, *firms* should assess whether their IPRE model is *EU CRR* compliant and not whether it is the nearest they can get to compliance given the constraints imposed on their model development (eg, lack of data or resource constraints).

4.3.132 G Where material non-compliance is identified and cannot be remediated in a timely fashion *firms* should adopt a compliant approach for calculating *own funds requirements*. In most cases this is likely to be the slotting approach (see article 144(1) of the *EU CRR*).

Drivers of risk

4.3.133 G *Firms* should be able to demonstrate that the model drivers selected offer sufficient discriminatory power and to justify why other potential data sources are not expected to materially improve the discriminatory power and accuracy of estimates.

4.3.134 G The *FCA* expects that an IPRE rating system will only be compliant if a *firm* is able to demonstrate the following in respect of its treatment of cash flows (except where the *firm* can demonstrate that this is not an appropriate risk driver):

(1) the difference in deal ratings when tenant ratings are altered is intuitive;

(2) the transformation of ratings into non-rent payment probability is intuitive. Even where tenants are rated by the *firm* the PD will not usually represent a direct read across to probability of non-payment due to, for example, model philosophy issues. Addressing this is likely to be a key area since many *firms* struggle with defining what divergence is expected between observed default rate and PD in different economic conditions in the mid corporate space;

(3) the selection of parameter values and/or distributions, and their impact on deal ratings, is well supported and intuitive;

(4) the impact on the deal rating is intuitive for features such as type of building, geographical location and building quality; and

(5) where data are missing or unavailable the treatment is conservative.

4.3.135 G The *FCA* expects that an IPRE rating system will only be compliant if a *firm* is able to demonstrate the following in respect of its treatment of interest-rate risk (IRR):

(1) IRR is included as a relevant risk driver (unless the portfolio is exclusively hedged);

(2) the way in which IRR is included in the deal rating is intuitive with respect to model philosophy. For example a 'point in time' rating should consider the current interest rate and likely change over a one-year time horizon, whereas a 'through the cycle' model needs to consider the IRR averaged over an economic cycle; and

(3) the model rates deals where IRR is hedged by the *firm* differently

from deals where IRR is unhedged and the magnitude of the difference in these ratings is intuitive.

4.3.136 G The *FCA* expects that an IPRE rating system will only be compliant if a *firm* is able to demonstrate the following in respect of its treatment of refinance risk:

(1) refinance risk is included as a relevant risk driver (unless the portfolio contains only amortising loans);

(2) the model rates interest only and amortising deals differently in the final year and that the magnitude of the difference in these ratings is intuitive;

(3) given the time horizon associated with IRB estimates (ie 12 months), the refinance risk could have a zero weight until the deal enters its final year for point-in-time models. In these cases, the risk should be captured in stress testing and Pillar 2; and

(4) the *firm* is able to report by borrowers that have previously had a distressed restructuring unlikeliness to pay indicator (even if they are now performing) by number, EAD and risk weighted exposure amounts.

Calibration

4.3.137 G The *FCA* expects that *firms* will not be compliant with the calibration requirements relating to use of a long-run default rate unless it can demonstrate that:

(1) the internal data series is the longest relevant and accurate data series, on a *EU CRR* compliant definition of default, that is available;

(2) the determination of long-run default rate includes reference to an appropriate source of downturn data (this may require the use of external data);

(3) the relevance of any external data used is analysed, and the relationship between internal default data and the external data used is considered over a multi-year period; and

(4) where uncertainty is introduced due to, for example, the quality of internal data or shortcomings in the relevance of external data, a conservative adjustment to the estimates should be made.

4.3.138 G The *FCA* expects that a *firm* will only be compliant with the calibration requirements relating to model philosophy if it can demonstrate that:

(1) the model philosophy is clearly articulated and justified. Justification should include analysis of the performance of assets, and the corresponding ratings assigned, over a change in economic conditions (ie, as long as period as possible); and

(2) in addition to encapsulating this information in a coherent way in the calibration, the impact of capturing risks such as IRR and refinance risk is clearly documented.

Low default portfolios

4.3.139 G Where the rating system is classed as a low default portfolio in accordance with the *guidance* in this section, a *firm* should be able to demonstrate that the framework applied adequately considers:

(1) economic environment of data used;

(2) changes in portfolio composition over time;

(3) parameter choices; and

(4) model philosophy.

Constructed theoretically

4.3.140 G Under article 144(1) of the *EU CRR*, all models, including those constructed from a theoretical basis without reference to any empirical default data (such as Monte-Carlo cash-flow simulation models) must meet the IRB requirements that are set out in Title II Chapter 3 of Part Three of the *EU CRR* (IRB approach).

4.3.141 G The *FCA* considers that, to meet the requirements referred to in *IFPRU* 4.3.140G, it will be necessary for *firms* to demonstrate that a *firm* has a good understanding of PD models that are constructed theoretically and that the parameter estimates reflect a one-year PD. In addition, even if empirical data were not used to determine the PD estimate it should, where available, be used to back-test the estimates.

4.3.142 G The *FCA* expects that, as most models of this type will be able to produce one-year estimates of PD that correspond closely to point-in-time estimates, *firms* should conduct robust back-testing of such estimates by comparing them with realised default rates. *Firms* would need to demonstrate that the results of such back-testing meets pre-defined and stringent standards in order for the *FCA* to be satisfied that the IRB requirements are met.

4.3.143 G Because assumptions in the model build process are likely to materially impact the resulting PDs the *FCA* would expect these choices to be clearly justified in the model documentation and to have been independently reviewed. To be satisfied that a *firm* is complying with article 176(1)(d) of the *EU CRR*, the *FCA* expects a *firm* to support justification for all assumptions with analysis of the sensitivity of the model outputs to changes in the assumptions.

4.3.144 G Where the *firm* has less than 20 defaults in their internal data set, the *FCA* considers that it is necessary for it to perform a statistical low default portfolio calibration, as set out in the *guidance* in this section.

Validation

4.3.145 G The *FCA* expects that a *firm* will not be compliant with the validation requirements unless it can demonstrate in respect of discriminatory power that:

(1) appropriate minimum standards that the rating system is expected to reach are defined, together with reasoning behind the adoption of such standards and that the factors considered when determining the tests are clearly documented;

(2) an objective rank-ordering metric, measured using an appropriate time horizon (eg, using ratings one year prior to default) or cohort approach), such as Gini or Accuracy Ratio of 50% is achieved over time;

(3) where there are sufficient defaults from different time periods the discriminatory power is shown to have reached the appropriate minimum standard over an extended time period (ie, longest period possible, including most recent data); and

(4) any concentrations in ratings from the model are demonstrated to be appropriate.

4.3.146 G The *FCA* expects that a *firm* will not be compliant with the validation requirements unless it can demonstrate in respect of the calibration that:

(1) observed default rate versus PD is considered at grade level and across a range of economic environments (ie, as long as period as possible);

(2) where the PD does not relate to a pure point-in-time estimate, either the PD or the observed default rate is transformed such that comparison between the two is meaningful. This transformation should be consistent with the model philosophy and calibration technique applied; and

(3) pre-defined tolerances for the degree of divergence, and the associated actions for what should happen when they are not met, are set.

4.3.147 G The *FCA* also expects that a *firm* will not be compliant with the validation requirements unless it can demonstrate that:

(1) appropriate stability metrics should be considered across a range of economic environments (ie, longest period possible including most recent data);

(2) the tolerances for the degree of divergence, and associated actions for what should happen when they are not met, is pre-defined; and

(3) subsections of portfolios by characteristics affecting risk profile, and therefore potentially model performance, are investigated. Such subsections could include:

(a) loan type (amortising/interest only);

(b) degree of hedging;

(c) building type; and

(d) other factors such as non-SPV (special purpose vehicle) lending in a predominately SPV lending book or vice versa (see article 188 of the *EU CRR*).

Other requirements

4.3.148 G The *FCA* expects that a *firm* will not be compliant with certain other *EU CRR* requirements unless it can demonstrate that:

(1) where more than one model is used, the rationale, and the associated boundary issues, is clearly articulated and justified and the criteria for assigning an asset to a rating model are objective and clear;

(2) the *firm* has a process in place to ensure valuations of the property are appropriate and up to date;

(3) where relevant, the *firm* makes reference to information available from the Investment Property Databank. Where this data is utilised at a broad level when more granular data is available this is fully justified with appropriate analysis;

(4) the rating histories demonstrate that deals are re-rated every time material information becomes available, for example where the deal enters its final year (and refinance risk becomes relevant) or a tenant defaults, is replaced or has their rating changed;

(5) the relationship between the IRB estimates and those used to run the business is demonstrated and justified. Note that the IRB estimates should be one-year estimates which may not be well aligned to managing the business (eg, the potential for refinance risk or significant interest rate risk over the lifetime of the deal may not be captured);

(6) management information covering all aspects required by the *EU CRR* is produced and reviewed regularly by *senior management*;

(7) the tolerances for the degree of divergence, and associated actions for what should happen when they are not met, are pre-defined;

(8) the impact on PDs and risk-weighted exposure amounts is consistent with model philosophy (although ratings should be affected by events such as tenant defaults even if they are TTC);

(9) impairment projections are justified with reference to past internal data;

(10) all the relevant above points are documented in a comprehensive and clear way;

(11) any changes as a result of independent challenge or review work are clearly documented.

Permission not to apply the Basel 1 floor

4.3.149 G The *FCA* does not expect that it will waive the application of the Basel 1 floor as contemplated in article 500(2) of the *EU CRR*.

4.4 Securitisation

Recognition of significant risk transfer

4.4.1 R (1) A *firm* must notify the *FCA* that it is relying on the deemed transfer of significant credit risk under article 243(2) of the *EU CRR* (Traditional securitisation) or article 244(2) of the *EU CRR* (Synthetic securitisation) within a reasonable period before or after a relevant transfer, not being later than one *month* after the date of the transfer.

(2) The notification in (1) must include sufficient information to allow the *FCA* to assess whether the possible reduction in risk-weighted exposure amounts which would be achieved by the *securitisation* is justified by a commensurate transfer of credit risk to third parties.

Significant risk transfer notifications and permissions

4.4.2 G The *EU CRR* allows an *originator* of *securitisations* to use the *securitisation* risk weights (and not calculate *own funds requirements* on the assets underlying its s*ecuritisation*) if it either:

(1) transfers significant credit risk associated with the *securitised exposures* to third parties, or

(2) deducts from *common equity tier 1 capital* or applies a 1250% risk weight to all *positions* it holds in the *securitisation*.

4.4.3 G The significant risk transfer requirements in articles 243 (Traditional securitisation) or 244 (Synthetic securitisation) of the *EU CRR* provide three options for a *firm* to demonstrate how it transfers significant credit risk for any given transaction:

(1) the *originator* does not retain more than 50% of the risk-weighted exposure amounts of mezzanine *securitisation positions*, where these are:

(a) *positions* to which a risk weight lower than 1250% applies; and

(b) more junior than the most senior *position* in the *securitisation* and more junior than any *position* in the *securitisation* rated credit quality step 1 or 2.

(2) where there is no mezzanine position, the *originator* does not hold more than 20% of the *exposure* values of *securitisation positions* that are subject to a deduction or 1250% risk weight and where the *originator* can demonstrate that the *exposure* value of such *securitisation positions* exceeds a reasoned estimate of the expected loss on the *securitised exposures* by a substantial margin; and

(3) the *competent authority* may grant permission to an *originator* to make its own assessment if it is satisfied that the *originator* can meet certain requirements.

Options 1 and 2

4.4.4 G A *firm* should notify the *FCA* of each transaction on which it is seeking capital relief.

4.4.5 G Where the *FCA* considers that the possible reduction in risk-weighted exposure amounts (RWEA) achieved via the *securitisation* is not justified by a commensurate transfer of credit risk to third parties, significant risk transfer will be considered to not have been achieved. Consequently, a *firm* will not be able to recognise any reduction in RWEA due to the transaction.

Option 3

4.4.6 G The *FCA* intends to grant permission for an *originator* to make its own assessment of significant risk transfer only where it is satisfied that:

(1) in every relevant case, the reduction in *own funds requirements* achieved would be justified by a commensurate transfer of risk to third parties;

(2) the *firm* had appropriately risk-sensitive policies and methodologies in place to assess the transfer of risk; and

(3) such transfer of credit risk to third parties was also recognised for the purposes of the *firm's* internal risk management and internal capital allocation.

4.4.7 G Permission may be granted for multiple transactions, in which case it will cover a defined scope of potential transactions and will enable a *firm* (within certain limits) to carry out these transactions without notifying the *FCA* in each individual instance.

Deduction or 1250% risk weighting

4.4.8 G A *firm* seeking to achieve capital relief by deducting or applying a 1250% risk weight to all retained *positions* does not need to comply with the notification and permissions requirements. However, in such cases a *firm* should consider whether the *FCA* would reasonably expect notice and disclosure under *PRIN* 2.1.1R of any characteristics of the transaction.

Significant risk transfer notifications

4.4.9 G Under *IFPRU* 4.4.1R, within one *month* of a *securitisation* transaction closing, a *firm* must notify the *FCA* of the transaction if it has relied on options 1 or 2 to achieve significant risk transfer.

4.4.10 G A *firm* must provide sufficient information to enable the *FCA* to assess whether the possible reduction in RWEA which would be achieved by the *securitisation* is justified by a commensurate transfer of credit risk to third parties. The *FCA* would expect this to include the following:

(1) details of the *securitisation positions*, including rating, *exposure* value and RWEA broken down by *securitisation positions* sold and retained;

(2) key transaction documentation and any relevant supporting documents (eg, a summary of the transaction);

(3) details of the governance process for the transaction, including details of any committees involved in approving the transaction;

(4) a copy of the significant risk transfer policy applied to the transaction, including details of the methodology and any models used to assess risk transfer;

(5) a statement of how all relevant risks are incorporated into the significant risk transfer assessment and how the full economic substance of the transaction is taken into consideration;

(6) the significant risk transfer calculation, setting out why the *firm* believes the capital relief proposed is commensurate with the credit risk transferred to third parties;

(7) the *EU CRR* requirements the *firm* is relying on;

(8) copies of investor and internal presentations on the transaction;

(9) the rationale for the transaction;

(10) details of the underlying assets (including asset class, geography, tenor, rating, spread, collateral, *exposure* size);

(11) details of the transaction structure;

(12) description of the risks being retained;

(13) the cashflow between parties involved in the transaction;

(14) the ratings and pricing of bonds issued in the transaction;

(15) details of any connected parties involved in the transaction;

(16) details of any termination options (for example, call options); and

(17) details of reliance on *ECAIs* in the significant risk transfer assessment.

4.4.11 G Where the *FCA* judges that the reduction in RWEA not to be justified by a commensurate transfer of credit risk to third parties, it will inform the *firm* that significant risk transfer has not been achieved by this transaction. The *FCA's* review will focus on the proportion of credit risk transferred, compared to the proportion by which RWEA are reduced in the transaction.

4.4.12 G The *FCA* does not intend to pre-approve transactions. The *FCA* will provide a point-in-time view on whether it considers that commensurate risk transfer has been achieved, which may be provided after a transaction has closed. The *FCA* may reassess its judgement of the achievement of commensurate risk transfer if the level of credit risk transfer in a transaction changes materially.

Significant risk transfer permissions

4.4.13 G A *firm* may apply for permissions under articles 243 (Traditional securitisation) or 244 (Synthetic securitisation) of the *EU CRR* to consider

significant risk transfer to have been achieved without needing to rely on options (1) or (2).

Multiple transaction permissions

4.4.14 G Where a *firm* applies for such permission, the *FCA* would expect the scope should be defined according to a range of characteristics, including the type of asset class and the structural features of the transaction. The characteristics the *FCA* would expect a *firm* to consider when scoping a permission application include:

(1) asset class, for example, residential mortgages, commercial mortgages, credit card receivables, leasing, loans to corporates or small and medium-sized enterprises (SMEs), consumer loans, trade receivables, *securitisations*, Private finance initiative (PFI), insurance, other assets, covered bonds);

(2) further asset class distinction, for example, geography (eg, distinguish between US and UK residential mortgage-backed securities (RMBS)) and asset quality (eg, distinguish between commercial mortgage-backed securities (CMBS) of different loan to values (LTVs)); and

(3) structural features, for example, by distinguishing between securitisation and re-securitisation, traditional and synthetic securitisation and non-revolving structures and revolving structures.

4.4.15 G Operationally it is likely for it to be easier for the *FCA* to assess relatively narrowly scoped permissions than those covering a wide range of assets and/or with complex structural features. A firm should present its preferred permission scope to the *FCA*. The *FCA* expects to reject any application the scope of which the *FCA* judge to exceed the competency of the firm.

Areas of review and information to be submitted for permission

4.4.16 G To assess a *firm's* ability to use its own policies and methodologies for assessing significant risk transfer, the *FCA's* permission reviews will focus on:

(1) the *firm's* understanding of the risk of any potential transactions within permission scope, including for potential underlying assets, *securitisation* structures and other relevant factors that affect the economic substance of risk transfer;

(2) the governance around significant risk transfer assessment (including sign-off procedures) and systems and controls relating to risk-transfer assessment and determination of significant risk transfer;

(3) significant risk transfer calculation policies and methodologies, including any models used;

(4) the *firm's* historical experience with relevant *securitisation* origination; and

(5) the use of third-party risk assessments (eg, *ECAI* ratings) and the relationship with internal assessments.

4.4.17 G The information the *FCA* would expect to receive in a permission application includes the following:

(1) details of the *firm's* governance processes for significant risk transfer, including details of any relevant committees and the seniority and expertise of key persons involved in sign-off;

(2) a copy of the *firm's* significant risk transfer policy, including details of the significant risk transfer calculation policies, methodologies and any models used to assess risk transfer, which should set out how the *firm* ensures it only takes capital relief in proportion to the amount of risk transferred on any given transaction;

(3) a statement of how all relevant risks are incorporated in the significant risk transfer calculations and how the full economic substance of transactions is taken into consideration;

(4) details of the *firm's* systems and controls regarding risk transfer in *securitisations*;

(5) a copy of the *firm's* capital allocation strategy;

(6) details of any *securitised* assets that have come back on the *firm's* balance sheet and the reason why; and

(7) details of reliance on *ECAIs* in determining significant risk transfer.

Limits attached to multiple transaction permissions: materiality

4.4.18 G Two materiality limits will be applied to the proportion of risk-weighted exposure amount (RWEA) relief that can be taken under any permission covering multiple transactions:

(1) transaction level limit — any transaction that would, in principle, be within the scope of the permission, but that resulted in an RWEA reduction exceeding 1% of the *firm's* credit risk-related RWEAs (as of the date of the *firm's* most recent regulatory return), will fall outside the scope of a multiple transaction permission and will require a separate permission or require notification (if the transaction would satisfy option 1 or 2); and

(2) aggregate limit — once the aggregate RWEA reduction taken on all significant risk transfer transactions executed within the scope of a permission exceeds 5% of the *firm's* credit risk-related RWEAs (as of the date of the *firm's* most recent regulatory return), no additional transactions may be executed within scope of the permission. In such circumstances, a *firm* should take one of the following actions:

(a) reapply to renew the multiple transaction permission; or

(b) apply for a new permission covering the specific transactions exceeding the RWEA limit; or

(c) notify the *FCA* of the transaction, following the significant

risk transfer notification procedure (if the transactions would satisfy option 1 or 2).

Limits attached to multiple transaction permissions: duration of permission

4.4.19 G Multiple transaction permissions will be granted for a period of one year. The *FCA's* review of permission renewal will focus on any changes to the *firm's* significant risk transfer policies and methodologies since the previous review.

Individual transaction permission

4.4.20 G Unlike multiple transaction permissions, permissions relating to individual transactions do not need to be granted prior to the execution of a transaction. The *FCA* does not intend to specify the timeframe in which a *firm* should submit an individual transaction permission, but note that capital relief from a specific transaction will not be available until a *firm* has obtained permission covering the significant risk transfer assessment and capital treatment (unless the transaction is being notified under option 1 or 2, or falls within scope of a multiple transaction permission).

4.4.21 G The information we would expect to receive in an individual transaction permission includes that in *IFPRU* 4.4.10G(2) and (6) to (17), as well as that in *IFPRU* 4.4.17G (1) to (3).

Limits attached to individual transaction permissions

4.4.22 G Depending on the nature of a transaction, the *FCA* may grant an individual permission for the duration of the transaction, or may impose a time limit on the permission. Where a *firm* sought to take capital relief on a transaction beyond the expiry date of the relevant permission, the *firm* would need to renew the permission prior to its expiry date.

4.4.23 G Given that significant risk transfer should be met on a continuing basis, permissions will typically include a requirement to notify the *FCA* of any change in circumstances from those under which the permission was granted (eg, where the amount of credit risk transfer had changed materially). Any reduction in credit risk transfer subsequent to the permission being granted will require the *firm* to take a commensurate reduction in RWEA relief. If a *firm* does not effect a commensurate reduction in the RWEA relief in such circumstances the *FCA* may revoke the relevant permission.

Use of supervisory formula method

4.4.24 G An *originator* must transfer a significant amount of credit risk associated with *securitised* exposures to third parties to be able to apply the *securitisation* risk weights set out in Part Three, Title II, Chapter 5 of the *EU CRR* (Securitisation). The *FCA* has significant concerns that significant risk transfer is undermined where the reduction in risk-weighted exposure amounts (RWEA) which results from the use of the supervisory formula method (SFM) is disproportionate to the credit risk transferred.

4.4.25 G The SFM currently gives, in many circumstances, much more favourable RWEA than the requirement that would apply if the same tranches were externally rated. To satisfy articles 243 and 244 of the *EU CRR* that

commensurate risk transfer has been achieved the *FCA* will generally expect a *firm* to obtain a public rating on retained tranches and apply the ratings-based method (RBM) instead of the SFM. For synthetic *securitisations* this might require a *firm* to create an instrument relating to the retained tranche in order to obtain a rating on the tranche. However, a *firm* should be aware that the use of RBM might not be sufficient to meet the significant risk transfer test if, notwithstanding the higher RWEA that would apply to the retained position, there is not a significant transfer of risk for the overall transaction. A *firm* should ensure it has regard to articles 268 and 269 of the *EU CRR* (Use of credit assessment by ECAIs) when obtaining public ratings on retained positions.

4.4.26 G A *firm* may still be able to demonstrate significant risk transfer without a rating but the *FCA* believes that this is likely to be exceptional and a *firm* is expected to submit any proposal to do so to the *FCA* before claiming any capital relief. Two examples of 'exceptional' cases are where it is not possible to obtain a rating from an eligible *ECAI* or where the small size of a transaction makes the cost of obtaining a rating disproportionate. In each case the *firm* must provide the *FCA* with sufficient evidence of such 'exceptionality'. In the first example, the *FCA* expects this to include written confirmation that no eligible *ECAIs* were prepared to rate the transaction. In the second example, the *FCA* expects a *firm* to provide an analysis of the costs of obtaining a rating relative to the potential capital reduction available from the transaction. The *FCA* does not expect a *firm* to seek to exploit the boundary of what might constitute 'exceptional' cases (eg, by deliberately structuring many small transactions rather than a single larger transaction).

4.4.27 G A *firm* with IRB permission that invest in unrated *securitisation positions* in the *trading book* or non-*trading book* are not required to obtain external ratings on such *positions*. However, use of SFM by investors in the *trading book* or non-*trading book* requires prior permission from the *FCA*, and it will consider the nature of positions for which use of SFM is being sought as part of its approval decision-making process.

High cost credit protection and other significant risk transfer considerations

4.4.28 G Any reduction in *own funds requirements* achieved through *securitisation* should be matched with a commensurate transfer of risk to third parties. Articles 243 (Traditional securitisation) and 244 (Synthetic securitisation) of the *EU CRR* set out that if the *FCA* decides that the possible reduction in risk-weighted exposure amounts which would be achieved through *securitisation* is not matched by such commensurate transfer of risk, it will determine that significant risk transfer has not been achieved by this transaction.

4.4.29 G This substance-over-form principle also applies to the assessment of the minimum requirements contained in articles 243(5) and 244(5) of the *EU CRR*. In particular, the instruments used to transfer credit risk must not contain any terms or conditions which materially limit the amount of risk transferred. For example, where losses or defaults occur in the pool (ie, deterioration in the credit quality of the underlying pool) the originator's net cost of protection or the yield payable to investors should not increase. Legal counsel's opinion (as required under articles 243(5)(b) and 244(5)(d) of the

EU CRR) should be reviewed as necessary. For example, if a relevant statutory provision is amended or a new decision or judgment of a court might have a bearing on the conclusions reached.

4.4.30 G Some transactions can transfer little or no economic risk from the protection buyer to the protection seller, but may still result in a reduction in *own funds requirements*. A particular example of a transaction-type of concern involves protection being purchased on a junior tranche accompanied by a high premium.

4.4.31 G In typical transactions, the premium paid will not materially affect the assessment of whether significant risk transfer has occurred. This is because either:

(1) the protection payment payable upon default from protection seller to protection buyer will dwarf the overall premium payable to the protection seller; or

(2) the premium is payable upfront and leads to an immediate incurred cost.

4.4.32 G However, there comes a point at which the premium payable for the protection can have a significant detrimental effect on the actual economic risk that is transferred from the protection buyer to protection seller. In the extreme, a premium payable of 100% of the protection amount, or more, can put the protection buyer in no better a position over the life of the transaction than if it had not purchased the protection.

4.4.33 G The *FCA* expects originators seeking to apply the *securitisation* risk weights to synthetic *securitisations* to take into account all relevant factors to assess the amount of risk transferred (if any). As well as the size and timing of amounts payable to the protection seller, the circumstances in which those amounts are payable can undermine the effectiveness of risk transfer. The *FCA* expects a *firm* seeking capital relief through synthetic *securitisations* to incorporate premiums in their assessment of significant risk transfer. In particular, the following examples of transaction features may have a significant impact on the amount of risk transfer:

(1) premium which is guaranteed in all or almost all circumstances, for example, premium which is payable upfront or deferred;

(2) where the amount of premium payable for protection could be significantly greater than the spread income on the assets in the portfolio or similar to the size of the hedged position; or

(3) where the protection buyer retains the expected loss through higher transaction costs to the counterparty, whether in the form of premium or otherwise.

4.4.34 G A further area which a *firm* must assess in analysing significant risk transfer is in article 238 of the *EU CRR* (Maturity of credit protection) which determines the effective maturity of any *credit risk mitigation*, including synthetic *securitisations*, where an option to terminate the protection exists at the discretion of the protection buyer. It states that where 'the terms of the arrangement at origination of the protection contain a positive incentive for

the institution to call the transaction before contractual maturity, an institution shall take the maturity of the protection to be the time to the earliest date at which that option may be exercised'.

4.4.35 G The *FCA* considers the following to be examples of features which generally indicate a positive incentive to call or, at least, to constitute grounds for discussion with the *FCA* prior to the conclusion of the transaction:

(1) the transaction contains terms, such as payments at maturity or payments upon early termination or significant premiums, which may reduce risk transfer;

(2) the transaction includes a requirement for the protection buyer to incur additional costs or obligations if they do not exercise their option to terminate the protection; and

(3) there are pre-agreed mechanisms, for example 'at-market unwinds', where the protection seller and protection buyer agree that the transaction can be terminated in the future at a 'market' value and specifies aspects of how the value is calculated.

4.4.36 G It is important that the *senior management* of a *firm* is appropriately engaged in the execution of transactions that lead to a reduction in required *own funds requirements* (both providers and purchasers of structured trades), and that the *firm* purchasing such products ensure that all factors, including high premiums, are adequately reflected when assessing any transfer of risk. This will ensure that these trades comply with the letter and the spirit of the *EU CRR* framework and will not result in less *own funds requirements* being held against *positions* than is warranted by the economic risk that remains with the protection buyer.

4.4.37 G Although the *FCA* does not operate a pre-approval process for transactions, a *firm* is reminded that, under Principle 11 (*PRIN* 2.1.1R), it should discuss any *securitisations*, or other credit protection arrangements which are material or have complex features with its usual supervisory contacts. A *firm* should approach the *FCA* at an early stage, as this may prevent an unnecessary expenditure of time and resources. If a *firm* chooses not to do so prior to completion, it should not claim any reduction in *own funds requirements* from these transactions in its disclosures to the market without warning of the risk of full or partial re-characterisation, where this risk is material in the light of the stated policy in this section.

4.4.38 G While this section provides clarification on the *FCA's* policy on the capital treatment of synthetic *securitisations*, the policies and principles are also applicable to any *securitisation* transaction subject to the *securitisation* framework, as well as to other similar credit protection arrangements. This is consistent with the policy objective that the *securitisation* framework is not used to undermine or arbitrage other parts of the prudential framework. For other similar credit protection arrangements (for example, those subject *credit risk mitigation* or *trading book* requirements) a *firm* should be aware that the impact of certain features (such as significant premiums or call options) may cast doubt on the extent of risk transferred and the resulting capital assessment. Features which result in inadequate *own funds requirements* compared to the risks a *firm* is running may result in the credit protection not

being recognised or the *firm* being subject to extra capital charges in their *ICG* in Pillar 2 add-ons. Credit protection arrangements are generally subject to the same overarching principles as those in the *securitisation* framework, and a *firm* should not seek to arbitrage standards by deliberating structuring transactions so that they fall into a specific section of the *EU CRR*.

4.4.39 G Where a *firm* does achieve significant risk transfer, the *FCA* expects it to continue to monitor any risks that it may still be exposed to in relation to the transaction. The *firm* should consider capital planning implications where the risks of securitised assets may return. A *firm* should conduct regular stress testing of its *securitisation* activities and off-balance sheet *exposures*. The stress tests should consider the *firm*-wide impact of stressed market conditions on those activities and *exposures* and the implications for other sources of risk, for example, credit risk, concentration risk, counterparty risk, *market risk*, *liquidity risk* and reputational risk. Stress testing of *securitisation* activities should take into account both existing *securitisations* and pipeline transactions, as there is a risk that these would not be completed in a stressed market scenario. A *firm* should have procedures in place to assess and respond to the results produced from the stress testing and these should be taken into account under the *overall Pillar 2 rule*.

Clarification of determining tranche seniority

4.4.40 G For the purposes of determining the most senior tranche under article 261 of the *EU CRR* (Ratings based method) and the mapping of *ECAI* assessments by the *FCA*, a senior liquidity facility need not be taken into account.

4.5 Settlement risk

4.5.1 R Where a system wide failure of a settlement system, a clearing system or a *CCP* occurs, the *own funds requirements* calculated in articles 378 (Settlement/delivery risk) and 379 (Free deliveries) of the *EU CRR* are waived until the situation is rectified. In this case, the failure of a counterparty to settle a trade shall not be deemed a default for purposes of credit risk.

4.6 Counterparty credit risk

Hedging sets

4.6.1 R For the purpose of article 282(6) of the *EU CRR* (Hedging sets), where a *firm* is unable to calculate the delta or the modified duration of *OTC derivative transactions* with a non-linear risk profile, or for payment legs and transactions with debt instruments as underlying, using a model approved by the *FCA* for the purposes of determining *own funds requirements* for market risk, it must apply the CCR Mark-to-market method as set out in Part Three, Title II, Chapter 6, Section 3 (Mark-to-market method) of the *EU CRR*.

Recognition of netting: interest rate derivatives

4.6.2 R For the purpose of article 298(4) of the *EU CRR* (Effects of recognition of netting as risk-reducing), a *firm* must use the original maturity of the *interest-rate contract*.

4.6.3 G A *firm* may apply to the *FCA* under section 138A of the *Act* to *waive IFPRU* 4.6.2R if it wishes to use the residual maturity of the *interest-rate contract*.

Use of internal CVA model for calculation of the maturity factor 'M'

4.6.4 G (1) This *guidance* sets out the *FCA's* expectations for granting permission to a *firm* to use its own one-sided credit valuation adjustment internal models (an "internal CVA model") for the purpose of estimating the maturity factor "M", as proposed under article 162(2)(h) of the *EU CRR* (Maturity).

(2) In the context of counterparty credit risk, the maturity factor "M" is intended to increase the *own funds requirements* to reflect potential higher risks associated with medium and long-term OTC derivative portfolios, more specifically when the exposure profile of these contracts is significant beyond one year. This adjustment is only applicable to a *firm* using the Internal Model Method for the calculation of *exposure* values.

(3) Article 162(2)(h) of the *EU CRR* allows a *firm* to replace the formula for the maturity factor "M", as set out in article 162(2)(g) with the 'effective credit duration' derived by a *firm's* internal CVA model, subject to permission being granted by the *FCA*, as the *competent authority*.

(4) Internal CVA models are complex by nature and modelling practises vary significantly across the industry. The *FCA* considers that the challenges of creating an acceptable model resulting in an appropriate credit duration are high, and would require extensive review. Accordingly, the *FCA* will expect a *firm* to demonstrate a strong case for the granting of such permission.

(5) A *firm* which intends to make an application under article 162(2)(h) should provide a satisfactory justification for the use of an internal CVA model for estimating the maturity factor "M". The purpose of reducing the *own funds requirements* for counterparty credit risk will not, on its own, be considered as a reasonable justification. The *FCA* will also expect highly conservative modelling assumptions within a *firm's* internal CVA model for the purpose of article 162(2)(h).

4.6.5 G (1) This *guidance* sets out the *FCA's* expectations for permitting a *firm* with the permission to use the Internal Model Method set out in Part Three, Title II, Chapter 6, Section 6 (Internal model method) and the permission to use an internal VaR model for specific risk set out in Part Three, Title IV, Chapter 5 (Use of internal models) associated

with traded debt instruments to set to 1 the maturity factor "M" defined in article 162 of the *EU CRR*.

(2) In the context of counterparty credit risk, the maturity factor "M" is intended to increase the *own funds requirements* to reflect the potential higher risks associated with medium and long-term *OTC derivative* portfolios, more specifically when the exposure profile of these contracts is significant beyond one year. This adjustment is only applicable to firms using the Internal Model Method for the calculation of *exposure* values.

(3) Article 162(2)(i) of the *EU CRR* allows a *firm* to set the maturity factor "M" to 1 for a *firm* using the Internal Model Method provided that the *firm's* internal VaR model for specific risk associated with traded debt instruments reflects the effect of rating migration and subject to the permission of the *FCA*, as the *competent authority*.

(4) Internal VaR models for specific risk associated with traded debt instruments are not specifically designed to capture the effects of rating migrations. The risk captured by these models is based on a 10-day time horizon which cannot appropriately reflect the dynamics of rating migrations, which occur on an irregular, infrequent basis. This deficiency was one of the main reasons underlying the introduction of a separate risk measure for the capture of both credit default and rating migration risks, based on a one-year time horizon (the IRC models in article 372 of the *EU CRR* (Internal IRC model)).

(5) Since the challenges of appropriately capturing credit-rating migrations in an internal VaR model are high, the *FCA* expects a *firm* to demonstrate a strong case for the granting of the permission set out in article 162(2)(i) of the *EU CRR*.

(6) A *firm* that intends to make an application under article 162(2)(i) of the *EU CRR* should provide a satisfactory justification for use of their internal VaR model to capture the risks associated with ratings migration. The purpose of reducing the *own funds requirements* for counterparty credit risk will not be considered as a reasonable justification.

(7) The *FCA* expects highly conservative modelling assumptions for the capture of rating migrations within a *firm's* internal VaR models for specific risk associated with traded debt instruments under article 162(2)(i) of the *EU CRR* (Maturity).

4.7 Credit risk mitigation

Conditions for applying 0% volatility adjustment under the Financial Collateral Comprehensive Method

4.7.1 G For purposes of purchase transactions and securities lending or borrowing transactions, the *FCA* does not consider that there are any core market participants apart from those entities listed in article 227(3) of the *EU CRR*.

4 Annex 1G Slotting criteria

Table 1 - Supervisory rating grades for project finance exposures				
	Strong	**Good**	**Satisfactory**	**Weak**
Financial strength				
Market conditions	Few competing suppliers or substantial and durable advantage in location, cost, or technology. Demand is strong and growing	Few competing suppliers or better than average location, cost, or technology but this situation may not last. Demand is strong and stable	Project has no advantage in location, cost, or technology. Demand is adequate and stable	Project has worse than average location, cost, or technology. Demand is weak and declining
Financial ratios (eg, debt service coverage ratio (DSCR), loan life coverage ratio (LLCR), project life coverage ratio (PLCR), and debt-to-equity ratio)	Strong financial ratios considering the level of project risk; very robust economic assumptions	Strong to acceptable financial ratios considering the level of project risk; robust project economic assumptions	Standard financial ratios considering the level of project risk	Aggressive financial ratios considering the level of project risk
Stress analysis	The project can meet its financial obligations under sustained, severely stressed economic or sectoral conditions	The project can meet its financial obligations under normal stressed economic or sectoral conditions. The project is only likely to default under severe economic conditions	The project is vulnerable to stresses that are not uncommon through an economic cycle, and may default in a normal downturn	The project is likely to default unless conditions improve soon
Financial structure				

Duration of the credit compared to the duration of the project	Useful life of the project significantly exceeds tenor of the loan	Useful life of the project exceeds tenor of the loan	Useful life of the project exceeds tenor of the loan	Useful life of the project may not exceed tenor of the loan
Amortisation schedule	Amortising debt	Amortising debt	Amortising debt repayments with limited bullet payment	Bullet repayment or amortising debt repayments with high bullet repayment
Political and legal environment				
Political risk, including transfer risk, considering project type and mitigants	Very low exposure; strong mitigation instruments, if needed	Low exposure; satisfactory mitigation instruments, if needed	Moderate exposure; fair mitigation instruments	High exposure; no or weak mitigation instruments
Force majeure risk (war, civil unrest, etc)	Low exposure	Acceptable exposure	Standard protection	Significant risks, not fully mitigated
Government support and project's importance for the country over the long term	Project of strategic importance for the country (preferably export-oriented). Strong support from Government	Project considered important for the country. Good level of support from Government	Project may not be strategic but brings unquestionable benefits for the country. Support from Government may not be explicit	Project not key to the country. No or weak support from Government
Stability of legal and regulatory environment (risk of change in law)	Favourable and stable regulatory environment over the long term	Favourable and stable regulatory environment over the medium term	Regulatory changes can be predicted with a fair level of certainty	Current or future regulatory issues may affect the project
Acquisition of all necessary supports and approvals for such relief from local content	Strong	Satisfactory	Fair	Weak

laws				
Enforceability of contracts, collateral and security	Contracts, collateral and security are enforceable	Contracts, collateral and security are enforceable	Contracts, collateral and security are considered enforceable even if certain non-key issues may exist	There are unresolved key issues for actual enforcement of contracts, collateral and security
Transaction characteristics				
Design and technology risk	Fully proven technology and design	Fully proven technology and design	Proven technology and design and start-up issues are mitigated by a strong completion package	Unproven technology and design; technology issues exist and/or complex design
Construction risk				
Permitting and siting	All permits have been obtained	Some permits are still outstanding but their receipt is considered very likely	Some permits are still outstanding but the permitting process is well defined and they are considered routine	Key permits still need to be obtained and are not considered routine. Significant conditions may be attached
Type of construction contract	Fixed-price date-certain turnkey construction EPC (engineering and procurement contract)	Fixed-price date-certain turnkey construction EPC	Fixed-price date-certain turnkey construction contract with one or several contractors	No or partial fixed-price turnkey contract and/or interfacing issues with multiple contractors
Completion guarantees	Substantial liquidated damages, supported by financial substance and/or strong completion	Significant liquidated damages, supported by financial substance and/or completion	Adequate liquidated damages, supported by financial substance and/or	Inadequate liquidated damages or not supported by financial substance or weak

	guarantee from sponsors with excellent financial standing	guarantee from sponsors with good financial standing	completion guarantee from sponsors with good financial standing	completion guarantees
Track record and financial strength of contractor in constructing similar projects.	Strong	Good	Satisfactory	Weak
Operating risk				
Scope and nature of operations and maintenance (O & M) contracts	Strong long-term O&M contract, preferably with contractual performance incentives, and/or O&M reserve accounts	Long-term O&M contract, and/or O&M reserve accounts	Limited O&M contract or O&M reserve account	No O&M contract: risk of high operational cost overruns beyond mitigants
Operator's expertise, track record, and financial strength	Very strong, or committed technical assistance of the sponsors	Strong	Acceptable	Limited/weak, or local operator dependent on local authorities
Off-take risk				
(a) If there is a take-or-pay or fixed-price off-take contract:	Excellent creditworthiness of off-taker; strong termination clauses; tenor of contract comfortably exceeds the maturity of the debt	Good creditworthiness of off-taker; strong termination clauses; tenor of contract exceeds the maturity of the debt	Acceptable financial standing of off-taker; normal termination clauses; tenor of contract generally matches the maturity of the debt	Weak off-taker; weak termination clauses; tenor of contract does not exceed the maturity of the debt
(b) If there is no take-or-pay or fixed-price off-take contract:	Project produces essential services or a commodity sold widely on a world market; output can readily be absorbed at	Project produces essential services or a commodity sold widely on a regional market that will absorb it at projected prices	Commodity is sold on a limited market that may absorb it only at lower than projected prices	Project output is demanded by only one or a few buyers or is not generally sold on an organised

	projected prices, even at lower than historic market growth rates	at historical growth rates		market
Supply risk				
Price, volume and transportation risk of feed-stocks; supplier's track record and financial strength	Long-term supply contract with supplier of excellent financial standing	Long-term supply contract with supplier of good financial standing	Long-term supply contract with supplier of good financial standing - a degree of price risk may remain	Short-term supply contract or long-term supply contract with financially weak supplier - a degree of price risk definitely remains
Reserve risks (eg, natural resource development)	Independently audited, proven and developed reserves well in excess of requirements over lifetime of the project	Independently audited, proven and developed reserves in excess of requirements over the lifetime of the project	Proven reserves can supply the project adequately through the maturity of the debt	Project relies to some extent on potential and undeveloped reserves
Strength of sponsor				
Sponsor's track record, financial strength, and country/sector experience	Strong sponsor with excellent track record and high financial standing	Good sponsor with satisfactory track record and good financial standing	Adequate sponsor with adequate track record and good financial standing	Weak sponsor with no or questionable track record and/or financial weaknesses
Sponsor support, as evidenced by equity, ownership clause and incentive to inject additional cash if necessary	Strong. Project is highly strategic for the sponsor (core business - long-term strategy)	Good. Project is strategic for the sponsor (core business - long-term strategy)	Acceptable. Project is considered important for the sponsor (core business)	Limited. Project is not key to sponsor's long-term strategy or core business
Security package				
Assignment of contracts and accounts	Fully comprehensive	Comprehensive	Acceptable	Weak

Pledge of assets, taking into account quality, value and liquidity of assets	First perfected security interest in all project assets, contracts, permits and accounts necessary to run the project	Perfected security interest in all project assets, contracts, permits and accounts necessary to run the project	Acceptable security interest in all project assets, contracts, permits and accounts necessary to run the project	Little security or collateral for lenders; weak negative pledge clause
Lender's control over cash flow (eg, cash sweeps, independent escrow accounts)	Strong	Satisfactory	Fair	Weak
Strength of the covenant package (mandatory prepayments, payment deferrals, payment cascade, dividend restrictions, etc)	Covenant package is strong for this type of project Project may issue no additional debt	Covenant package is satisfactory for this type of project Project may issue extremely limited additional debt	Covenant package is fair for this type of project Project may issue limited additional debt	Covenant package is insufficient for this type of project Project may issue unlimited additional debt
Reserve funds (debt service, O&M, renewal and replacement, unforeseen events, etc)	Longer than average coverage period, all reserve funds fully funded in cash or letters of credit from highly rated bank	Average coverage period, all reserve funds fully funded	Average coverage period, all reserve funds fully funded	Shorter than average coverage period, reserve funds funded from operating cash flows

Table 2 - Supervisory rating grades for income-producing real estate exposures				
	Strong	**Good**	**Satisfactory**	**Weak**
Financial strength				
Market conditions	The supply and demand for the project's type and location are currently in	The supply and demand for the project's type and location are currently in	Market conditions are roughly in equilibrium. Competitive	Market conditions are weak. It is uncertain when conditions will

	equilibrium. The number of competitive properties coming to market is equal or lower than forecasted demand	equilibrium. The number of competitive properties coming to market is roughly equal to forecasted demand	properties are coming on the market and others are in the planning stages. The project's design and capabilities may not be state of the art compared to new projects	improve and return to equilibrium. The project is losing tenants at lease expiration. New lease terms are less favourable compared to those expiring
Financial ratios and advance rate	The property's debt service coverage ratio (DSCR) is considered strong (DSCR is not relevant for the construction phase) and its loan-to-value ratio (LTV) is considered low given its property type. Where a secondary market exists, the transaction is underwritten to market standards	The DSCR (not relevant for development real estate) and LTV are satisfactory. Where a secondary market exists, the transaction is underwritten to market standards	The property's DSCR has deteriorated and its value has fallen, increasing its LTV	The property's DSCR has deteriorated significantly and its LTV is well above underwriting standards for new loans
Stress analysis	The property's resources, contingencies and liability structure allow it to meet its financial obligations during a period of severe financial stress (eg, interest rates, economic growth)	The property can meet its financial obligations under a sustained period of financial stress (eg, interest rates, economic growth). The property is likely to default only under severe economic conditions	During an economic downturn, the property would suffer a decline in revenue that would limit its ability to fund capital expenditures and significantly increase the risk of default	The property's financial condition is strained and is likely to default unless conditions improve in the near term
Cash-flow predictability				
(a) For	The property's	Most of the	Most of the	The property's

complete and stabilised property	leases are long-term with creditworthy tenants and their maturity dates are scattered. The property has a track record of tenant retention upon lease expiration. Its vacancy rate is low. Expenses (maintenance, insurance, security and property taxes) are predictable	property's leases are long term, with tenants that range in creditworthiness. The property experiences a normal level of tenant turnover upon lease expiration. Its vacancy rate is low. Expenses are predictable	property's leases are medium rather than long term, with tenants that range in creditworthiness. The property experiences a moderate level of tenant turnover upon lease expiration. Its vacancy rate is moderate. Expenses are relatively predictable but vary in relation to revenue	leases are of various terms with tenants that range in creditworthiness. The property experiences a very high level of tenant turnover upon lease expiration. Its vacancy rate is high. Significant expenses are incurred preparing space for new tenants
(b) For complete but not stabilised property	Leasing activity meets or exceeds projections. The project should achieve stabilisation in the near future	Leasing activity meets or exceeds projections. The project should achieve stabilisation in the near future	Most leasing activity is within projections; however, stabilisation will not occur for some time	Market rents do not meet expectations. Despite achieving target occupancy rate, cash flow coverage is tight due to disappointing revenue
(c) For construction phase	The property is entirely pre-leased through the tenor of the loan or pre-sold to an investment grade tenant or buyer, or the bank has a binding commitment for take-out financing from an investment grade lender	The property is entirely pre-leased or pre-sold to a creditworthy tenant or buyer, or the bank has a binding commitment for permanent financing from a creditworthy lender	Leasing activity is within projections but the building may not be pre-leased and there may not exist a take-out financing. The bank may be the permanent lender	The property is deteriorating due to cost overruns, market deterioration, tenant cancellations or other factors. There may be a dispute with the party providing the permanent financing
Asset characteristics				

Location	Property is located in highly desirable location that is convenient to services that tenants desire	Property is located in desirable location that is convenient to services that tenants desire	The property location lacks a competitive advantage	The property's location, configuration, design and maintenance have contributed to the property's difficulties
Design and condition	Property is favoured due to its design, configuration, and maintenance, and is highly competitive with new properties	Property is appropriate in terms of its design, configuration and maintenance. The property's design and capabilities are competitive with new properties	Property is adequate in terms of its configuration, design and maintenance	Weaknesses exist in the property's configuration, design or maintenance
Property is under construction	Construction budget is conservative and technical hazards are limited. Contractors are highly qualified	Construction budget is conservative and technical hazards are limited. Contractors are highly qualified	Construction budget is adequate and contractors are ordinarily qualified	Project is over budget or unrealistic given its technical hazards. Contractors may be under qualified
Strength of sponsor/ developer				
Financial capacity and willingness to support the property	The sponsor/ developer made a substantial cash contribution to the construction or purchase of the property. The sponsor/ developer has substantial resources and limited direct and contingent liabilities. The sponsor/ developer's	The sponsor/ developer made a material cash contribution to the construction or purchase of the property. The sponsor/ developer's financial condition allows it to support the property in the event of a cash flow shortfall. The sponsor/	The sponsor/ developer's contribution may be immaterial or non-cash. The sponsor/ developer is average to below-average in financial resources	The sponsor/ developer lacks capacity or willingness to support the property

	properties are diversified geographically and by property type	developer's properties are located in several geographic regions		
Reputation and track record with similar properties	Experienced management and high sponsors quality. Strong reputation and lengthy and successful record with similar properties	Appropriate management and sponsors quality. The sponsor or management has a successful record with similar properties	Moderate management and sponsors quality. Management or sponsor track record does not raise serious concerns	Ineffective management and substandard sponsors quality. Management and sponsor difficulties have contributed to difficulties in managing properties in the past
Relationships with relevant real estate actors	Strong relationships with leading actors, such as leasing agents	Proven relationships with leading actors, such as leasing agents	Adequate relationships with leasing agents and other parties providing important real estate services	Poor relationships with leasing agents and/or other parties providing important real estate services
Security package				
Nature of lien	Perfected first lien (Note 1)	Perfected first lien (Note 1)	Perfected first lien (Note 1)	Ability of lender to foreclose is constrained
Assignment of rents (for projects leased to long-term tenants)	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to remit rents directly to the lender, such as a current rent roll and copies of the project's leases	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to the tenants to remit rents directly to the lender, such as current rent roll and copies of the project's leases	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to the tenants to remit rents directly to the lender, such as current rent roll and copies of the project's leases	The lender has not obtained an assignment of the leases or has not maintained the information necessary to readily provide notice to the building's tenants

Quality of the insurance coverage	Appropriate	Appropriate	Appropriate	Substandard
Note 1: Lenders in some markets extensively use loan structures that include junior liens. Junior liens may be indicative of this level of risk if the total LTV inclusive of all senior positions does not exceed a typical first loan LTV.				

Table 3 - Supervisory rating grades for object finance exposures				
	Strong	**Good**	**Satisfactory**	**Weak**
Financial strength				
Market conditions	Demand is strong and growing, strong entry barriers, low sensitivity to changes in technology and economic outlook	Demand is strong and stable. Some entry barriers, some sensitivity to changes in technology and economic outlook	Demand is adequate and stable, limited entry barriers, significant sensitivity to changes in technology and economic outlook	Demand is weak and declining, vulnerable to changes in technology and economic outlook, highly uncertain environment
Financial ratios (debt service coverage ratio and loan-to-value ratio)	Strong financial ratios considering the type of asset. Very robust economic assumptions	Strong / acceptable financial ratios considering the type of asset. Robust project economic assumptions	Standard financial ratios for the asset type	Aggressive financial ratios considering the type of asset
Stress analysis	Stable long-term revenues, capable of withstanding severely stressed conditions through an economic cycle	Satisfactory short-term revenues. Loan can withstand some financial adversity. Default is only likely under severe economic conditions	Uncertain short-term revenues. Cash flows are vulnerable to stresses that are not uncommon through an economic cycle. The loan may default in a normal downturn	Revenues subject to strong uncertainties; even in normal economic conditions the asset may default, unless conditions improve
Market liquidity	Market is structured on a worldwide basis;	Market is worldwide or regional; assets	Market is regional with limited prospects	Local market and/or poor visibility. Low

	assets are highly liquid	are relatively liquid	in the short term, implying lower liquidity	or no liquidity, particularly on niche markets
Political and legal environment				
Political risk, including transfer risk	Very low; strong mitigation instruments, if needed	Low; satisfactory mitigation instruments, if needed	Moderate; fair mitigation instruments	High; no or weak mitigation instruments
Legal and regulatory risks	Jurisdiction is favourable to repossession and enforcement of contracts	Jurisdiction is favourable to repossession and enforcement of contracts	Jurisdiction is generally favourable to repossession and enforcement of contracts, even if repossession might be long and/or difficult	Poor or unstable legal and regulatory environment. Jurisdiction may make repossession and enforcement of contracts lengthy or impossible
Transaction characteristics				
Financing term compared to the economic life of the asset	Full payout profile/minimum balloon. No grace period	Balloon more significant, but still at satisfactory levels	Important balloon with potentially grace periods	Repayment in fine or high balloon
Operating risk				
Permits / licensing	All permits have been obtained; asset meets current and foreseeable safety regulations	All permits obtained or in the process of being obtained; asset meets current and foreseeable safety regulations	Most permits obtained or in process of being obtained, outstanding ones considered routine, asset meets current safety regulations	Problems in obtaining all required permits, part of the planned configuration and/or planned operations might need to be revised
Scope and nature of O & M contracts	Strong long-term O&M contract, preferably with contractual	Long-term O&M contract, and/or O&M reserve accounts	Limited O&M contract or O&M reserve account (if	No O&M contract: risk of high operational cost

	performance incentives, and/or O&M reserve accounts (if needed)	(if needed)	needed)	overruns beyond mitigants
Operator's financial strength, track record in managing the asset type and capability to re-market asset when it comes off-lease	Excellent track record and strong re-marketing capability	Satisfactory track record and re-marketing capability	Weak or short track record and uncertain re-marketing capability	No or unknown track record and inability to re-market the asset
Asset characteristics				
Configuration, size, design and maintenance (ie, age, size for a plane) compared to other assets on the same market	Strong advantage in design and maintenance. Configuration is standard such that the object meets a liquid market	Above average design and maintenance. Standard configuration, maybe with very limited exceptions - such that the object meets a liquid market	Average design and maintenance. Configuration is somewhat specific, and thus might cause a narrower market for the object	Below average design and maintenance. Asset is near the end of its economic life. Configuration is very specific; the market for the object is very narrow
Resale value	Current resale value is well above debt value	Resale value is moderately above debt value	Resale value is slightly above debt value	Resale value is below debt value
Sensitivity of the asset value and liquidity to economic cycles	Asset value and liquidity are relatively insensitive to economic cycles	Asset value and liquidity are sensitive to economic cycles	Asset value and liquidity are quite sensitive to economic cycles	Asset value and liquidity are highly sensitive to economic cycles
Strength of sponsor				
Operator's financial strength, track record in managing the asset type and capability to re-	Excellent track record and strong re-marketing capability	Satisfactory track record and re-marketing capability	Weak or short track record and uncertain re-marketing capability	No or unknown track record and inability to re-market the asset

market asset when it comes off-lease				
Sponsors' track record and financial strength	Sponsors with excellent track record and high financial standing	Sponsors with good track record and good financial standing	Sponsors with adequate track record and good financial standing	Sponsors with no or questionable track record and/or financial weaknesses
Security package				
Asset control	Legal documentation provides the lender effective control (eg, a first perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	Legal documentation provides the lender effective control (eg, a perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	Legal documentation provides the lender effective control (eg, a perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	The contract provides little security to the lender and leaves room to some risk of losing control on the asset
Rights and means at the lender's disposal to monitor the location and condition of the asset	The lender is able to monitor the location and condition of the asset, at any time and place (regular reports, possibility to lead inspections)	The lender is able to monitor the location and condition of the asset, almost at any time and place	The lender is able to monitor the location and condition of the asset, almost at any time and place	The lender is able to monitor the location and condition of the asset are limited
Insurance against damages	Strong insurance coverage including collateral damages with top quality insurance companies	Satisfactory insurance coverage (not including collateral damages) with good quality insurance companies	Fair insurance coverage (not including collateral damages) with acceptable quality insurance companies	Weak insurance coverage (not including collateral damages) or with weak quality insurance companies

Table 4 - Supervisory rating grades for commodities finance exposures				
	Strong	**Good**	**Satisfactory**	**Weak**

Financial strength				
Degree of over-collateralisation of trade	Strong	Good	Satisfactory	Weak
Political and legal environment				
Country risk	No country risk	Limited exposure to country risk (in particular, offshore location of reserves in an emerging country)	Exposure to country risk (in particular, offshore location of reserves in an emerging country)	Strong exposure to country risk (in particular, inland reserves in an emerging country)
Mitigation of country risks	Very strong mitigation:	Strong mitigation:	Acceptable mitigation:	Only partial mitigation:
	Strong offshore mechanisms	Offshore mechanisms	Offshore mechanisms	No offshore mechanisms
	Strategic commodity	Strategic commodity	Less strategic commodity	Non-strategic commodity
	1st class buyer	Strong buyer	Acceptable buyer	Weak buyer
Asset characteristics				
Liquidity and susceptibility to damage	Commodity is quoted and can be hedged through futures or *OTC* instruments. Commodity is not susceptible to damage	Commodity is quoted and can be hedged through *OTC* instruments. Commodity is not susceptible to damage	Commodity is not quoted but is liquid. There is uncertainty about the possibility of hedging. Commodity is not susceptible to damage	Commodity is not quoted. Liquidity is limited given the size and depth of the market. No appropriate hedging instruments. Commodity is susceptible to damage
Strength of sponsor				

Financial strength of trader	Very strong, relative to trading philosophy and risks	Strong	Adequate	Weak
Track record, including ability to manage the logistic process	Extensive experience with the type of transaction in question. Strong record of operating success and cost efficiency	Sufficient experience with the type of transaction in question. Above average record of operating success and cost efficiency	Limited experience with the type of transaction in question. Average record of operating success and cost efficiency	Limited or uncertain track record in general. Volatile costs and profits
Trading controls and hedging policies	Strong standards for counterparty selection, hedging, and monitoring	Adequate standards for counterparty selection, hedging, and monitoring	Past deals have experienced no or minor problems	Trader has experienced significant losses on past deals
Quality of financial disclosure	Excellent	Good	Satisfactory	Financial disclosure contains some uncertainties or is insufficient
Security package				
Asset control	First perfected security interest provides the lender legal control of the assets at any time if needed	First perfected security interest provides the lender legal control of the assets at any time if needed	At some point in the process, there is a rupture in the control of the assets by the lender. The rupture is mitigated by knowledge of the trade process or a third party undertaking as the case may be	Contract leaves room for some risk of losing control over the assets. Recovery could be jeopardised
Insurance against damages	Strong insurance coverage including collateral damages with top quality insurance companies	Satisfactory insurance coverage (not including collateral damages) with good quality	Fair insurance coverage (not including collateral damages) with acceptable quality insurance	Weak insurance coverage (not including collateral damages) or with weak quality

		insurance companies	companies	insurance companies

4 Annex 2G Wholesale LGD and EAD framework

1.	The following framework should be used to assess wholesale LGD models in the circumstances set out in *IFPRU* 4.3.91G:	
	(a)	For unsecured recoveries if a *firm* has fewer than 20 relevant default observations of recoveries in a specific country for an individual type of *exposure* then the maximum recovery a *firm* can assume should be equivalent to that which would give a 45% LGD for senior unsecured exposures, 75% for subordinated exposures and 11.25% for covered bonds.
	(b)	If a *firm* is taking account of non-financial collateral which is not eligible under the foundation approach where they do not have 20 or more relevant data points of recovery values for that type of collateral or do not have a reliable time series of market price data for the collateral in a specific country, then the LGD for the *exposure* to which the collateral is applied should be floored at 45%.
	(c)	If a *firm* is taking account of non-financial collateral which is eligible under the foundation approach where they do not have 20 or more relevant data points of recovery values for that type of collateral or do not have a reliable time series of market price data for that collateral in a specific country, then the LGD for the exposure to which the collateral is applied should be floored at 35%.
2.	*Firms* should note the following when applying the framework to LGD models:	
	(a)	The 20 or more relevant data points can include internal or external data, however, the *FCA* expects *firms* to ensure that each data point is independent, representative and an accurate record of the recovery for that exposure or collateral type in that specific country.
	(b)	The *FCA* anticipates that *firms* are able to use market price data within the framework where they have less than 20 defaults only in exceptional circumstances. As a minimum, *firms* need to demonstrate that the market price data used is representative of their collateral and that it is over a long enough time period to ensure that an appropriate downturn and forced sale haircut can be estimated.
	(c)	The framework does not affect the use of financial collateral.
	(d)	The framework does not affect the use of unfunded credit protection.
	(e)	Where a model takes account of multiple collateral types, if this only includes collateral that is eligible under the foundation approach then LGDs should be floored at 35%, and if any collateral type is not eligible under the foundation approach then LGDs should be floored at 45%.

	(f)	The effect of this framework is to floor bank and non-bank financial institution (NBFI) *exposures* at foundation values unless sufficient country-specific recovery data is available. This floor should be applied where the *exposures* are to types of banks and NBFIs that are not sufficiently represented in the available historic data (eg, if the historic recovery data only relates to small banks then the floor will affect large banks).
	(g)	When applying the framework, the *FCA* expects *firms* to assess whether the 11.25% LGD floor for covered bonds is sufficient given the quality of the underlying assets.
3.	*Firms* should select the most appropriate of the following three options when using the framework to assess wholesale EAD models in the circumstances set out in *IFPRU* 4.3.104G:	
	(a)	rank-order the off balance sheet product types (separately for lending and trade finance) according to their drawdown risk. The EAD parameter for a product with 20 or more default observations can then be applied to low-default products with a lower drawdown risk; or
	(b)	for product types where the *firm* has the defaults needed to estimate the EAD for committed credit lines (or an estimate derived from the option above) but less than 20 defaults for uncommitted credit lines, use 50% of the committed credit line conversion factor as an estimate of the uncommitted credit line conversion factor; or
	(c)	apply the foundation parameters.
4.	*Firms* should note the following when applying the framework to EAD models:	
	(a)	*Firms* may select more than one option when applying the framework, providing that they can demonstrate that their chosen combination is appropriate, reflecting their particular mix of products and risks, and is not selected to minimise their *own funds requirements*.
	(b)	As the *FCA* believes that the EAD experienced by *firms* is dependent on their own credit management processes it would expect only internal data to be used to estimate EAD. However, where *firms* can convincingly demonstrate to the *FCA's* satisfaction that the credit process are consistent across countries then the *FCA* would accept that data sourced from these countries could be combined to estimate the EAD for each product (ie, the 20 default data points do not have to be country specific for the purposes of estimating EAD).
	(c)	*Firms* using the option in (a), above, should be able to demonstrate that a sufficiently robust approach has been taken to rank-ordering their product types by drawdown risk. This approach must be fully documented and assessed by an independent reviewer.

5 Operational risk

5.1 Application and purpose

5.1.1 R *IFPRU* 5 applies to an *IFPRU investment firm*, unless it is an *exempt IFPRU commodities firm*.

Purpose

5.1.2 G This chapter contains *guidance* to help a *firm* understand the *FCA's* expectations on the extent to which the Advanced Measurement Approach (AMA) should capture its *operational risks* where the *firm* has, or is about to, implement AMA.

Advanced Measurement Approach permission

5.1.3 G This is relevant where the AMA is applied across only part of a *firm's* operations and is used in conjunction with either the Basic Indicator Approach (BIA), or the Standardised Approach (TSA).

5.1.4 G A *firm* may use an AMA in combination with the BIA or TSA, provided it obtains permission from the *FCA*. In granting such permission, the *FCA* is required by article 314(3) of the *EU CRR* (Combined use of different approaches) to impose the following conditions when the AMA is used in combination with BIA or TSA:

(1) on the date of first implementation of the AMA, a 'significant' part of the *institution's operational risk* are captured by that approach; and

(2) the *institution* to commit to apply the AMA across a 'material' part of its operations within a time schedule approved by the *FCA*.

5.1.5 G For the purposes of these conditions, the *FCA* considers that:

(1) a "significant" part of *operational risk* shall be approximately 50% (or more); and

(2) a 'material' part of its operations shall be around 85% (or more) .

6 Market risk

6.1 Application and purpose

6.1.1 R *IFPRU* 6 applies to an *IFPRU investment firm*, unless it is an *exempt IFPRU commodities firm*.

Purpose

6.1.2 G This chapter:

(1) implements article 101 of *CRD*;

(2) contains the *rule* that exercises the discretion afforded to the *FCA* as *competent authority* under article 327(2) of the *EU CRR*; and

(3) contains the *guidance* for market risk.

Instruments for which no treatment specified

6.1.3 R (1) Where a *firm* has a position in a *financial instrument* for which no treatment has been specified in the *EU CRR*, it must calculate its *own funds requirement* by applying the most appropriate requirement relating to positions that are specified in the *EU CRR*, if doing so is prudent and appropriate, and if the position is sufficiently similar to those covered by the relevant requirement.

(2) A *firm* must document its policies and procedures for calculating own funds for such positions in its *trading book policy statement*.

(3) If there are no appropriate treatments, the *firm* must calculate *an own funds requirement* of an appropriate percentage of the current value of the position. An appropriate percentage is either 100%, or a percentage that takes into account the characteristics of the position.

Use of internal models: risk capture

6.1.4 R A *firm* which has a permission to use internal models in accordance with Part Three, Title IV, Chapter 5 of the *EU CRR* (Own funds requirements for market risk):

(1) must identify any material risk(s) that, when considered in aggregate, are material, which are not captured by those models;

(2) must ensure that it holds *own funds* to cover those risk(s) in additional to those required to meet its *own funds requirement* calculated in accordance with Part Three, Title IV, Chapter 5 of the *EU CRR*; and

(3) (where applicable) must ensure that it holds additional *own funds requirements* for VaR and stressed VaR models.

[**Note**: article 101 of *CRD*]

6.1.5 G (1) The methodology for the identification of the risks in *IFPRU* 6.1.4R and the calculation of those additional own funds for *VaR* and *stressed VaR* models is called the “RNIV framework”. A *firm* is responsible for identifying these additional risks, and this should be as an opportunity for risk managers and management to better understand the shortcomings of the *firm's* models. Following this initial assessment, the *FCA* will engage with the *firm* to provide challenge and ensure an appropriate outcome.

(2) The RNIV framework is intended to ensure that *own funds* are held to meet all material risks (and all risks that when considered in aggregate are material) which are not captured, or not captured adequately, by

the *firm's* VaR and stressed VaR models. These include, but are not limited to, missing and/or illiquid risk factors such as cross-risks, basis risks, higher-order risks, and calibration parameters. The RNIV framework is also intended to cover event risks that could adversely affect the relevant business.

(3) A *firm* should systematically identify and measure all non-captured or poorly captured risks that fall within the scope of the RNIV framework. This analysis should be updated at least quarterly, or more frequently at the request of the *FCA*. The measurement of these risks should capture the losses that could arise due to the risk factor(s) of all products that are within the scope of the relevant internal model permission, but are not adequately captured by the relevant internal models.

(4) On a quarterly basis, the *firm* should identify and assess individual risk factors covered by the RNIV framework. The *FCA* will review the results of this exercise and may require that firms identify additional risk factors as being eligible for measurement.

(5) (a) Where sufficient data is available, and it is appropriate to do so, the *FCA* expects a *firm* to calculate a VaR and stressed VaR metric for each risk factor within scope of the framework. The stressed period for the RNIV framework should be consistent with that used for stressed VaR. No offsetting or diversification may be recognised across risk factors included in the RNIV framework. The multipliers used for VaR and stressed VaR should be applied to generate an *own funds requirement*.

(b) If it is not appropriate to calculate a VaR and stressed VaR metric for a risk factor, a *firm* should instead measure the size of the risk based on a stress test. The confidence level and capital horizon of the stress test should be commensurate with the liquidity of the risk, and should be at least as conservative as comparable risk factors under the internal model approach. The capital charge should be at least equal to the losses arising from the stress test.

Minimum standards for own estimates of delta

6.1.6 G The level of sophistication of the pricing models used to calculate own estimates of delta for use in the standardised approach for options should be proportionate to the complexity and risk of each option, and the overall risk of the *firm's* options trading business. In general, it is considered that the risk of sold options will be higher than the risk of the same options when bought.

6.1.7 G Delta should be re-calculated at least daily. A *firm* should also recalculate delta promptly following significant movements in the market parameters used as inputs to calculate delta.

6.1.8 G The pricing model used to calculate delta should be:

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

(2) independently tested, including validation of the mathematics, assumptions, and software implementation; and

(3) developed or approved independently of the trading desk.

6.1.9 G A *firm* should use generally accepted industry standard pricing models for the calculation of own deltas where these are available, such as for relatively simple options.

6.1.10 G The IT systems used to run the calculation of delta should be sufficient to ensure that delta can be reliably calculated accurately and frequently.

6.1.11 G A *firm* should have adequate systems and controls in place when using pricing models to calculate deltas. This should include the following documented policies and procedures:

(1) clearly defined responsibilities of the various areas involved in the calculation;

(2) frequency of independent testing;

(3) month-end and ad-hoc verification procedures; and

(4) guidelines for the use of unobservable inputs, where relevant.

6.1.12 G Reporting lines for the department accountable for calculating delta should be:

(1) clear and independent of the front office; and

(2) ultimately to a main board executive director.

6.1.13 G A *firm* should ensure its risk management functions are aware of weaknesses of the model used to calculate deltas. Where weaknesses are identified, the firm should ensure that estimates of delta result in prudent *own funds requirements* being held. The outcome should be prudent across the whole portfolio of options and underlying positions at a given time.

Netting: convertible

6.1.14 R Under article 327(2) of the *EU CRR* (Netting), the netting of a *convertible* and an offsetting position in the underlying instrument is permitted.

6.1.15 G The *convertible* should be:

(1) treated as a position in the *equity* into which it converts; and

(2) the *firm's own funds requirement* for the general and specific risk in its *equity* instruments should be adjusted by making:

(a) an addition equal to the current value of any loss which the *firm* would make if it did convert to *equity*; or

(b) a deduction equal to the current value of any profit which the *firm* would make if it did convert to *equity* (subject to a maximum deduction equal to the own funds requirements on the notional position underlying the *convertible*).

Use of internal approaches

6.1.16 G A *significant IFPRU firm* should consider developing internal specific risk assessment capacity and to increase use of internal models for calculating *own funds requirements* for specific risk of debt instruments in the *trading book*, together with internal models to calculate *own funds requirements* for default and migration risk where its exposures to specific risk are material in absolute terms and where it holds a large number of material positions in debt instruments of different issuers. This provision is without prejudice to the fulfilment of the criteria laid down in Part Three, Title IV, Chapter 5, Sections 1 to 5, of the *EU CRR* (Market risk).

[**Note**: article 77(3) of *CRD*]

6.2 Guidance on market risk

Offsetting derivative instruments

6.2.1 G Article 331(2) of the *EU CRR* (Interest rate risk in derivative instruments) states conditions that must be met before a *firm* not using interest rate pre-processing models can fully offset interest-rate risk on derivative instruments. One condition is that the reference rate (for floating-rate positions) or coupon (for fixed-rate positions) should be closely matched. The *FCA* will normally consider a difference of less than 15 basis points as indicative of the reference rate or coupon being closely matched for the purposes of this requirement.

Exclusion of backtesting exceptions when determining multiplication factor addends

6.2.2 G The *FCA's* starting assumption is that all overshootings should be taken into account for the purpose of the calculation of addends. If a *firm* believes that an overshooting should not count for that purpose, then it should seek a variation of its *VaR* model permission under article 363 of the *EU CRR* (Permission to use internal models) to exclude that particular backtesting exception. The *FCA* will then decide whether to agree to such a variation. One example of when a *firm's* overshooting might properly be disregarded is when it has arisen as a result of a risk that is not captured in its *VaR* model but against which *own funds* are already held.

Futures, forwards or synthetic futures on a basket or index of debt securities

6.2.3 G Futures, forwards or synthetic futures on a basket or index of debt securities should be converted into forwards on single debt securities as follows:

(1) futures, synthetic futures or forwards on a single currency basket or index of debt securities should be treated as either:

(a) a series of forwards, one for each of the constituent debt securities in the basket or index, of an amount which is a proportionate part of the total underlying the contract, according to the weighting of the relevant debt security in the basket; or

(b) a single forward on a notional debt security; and

(2) futures, synthetic futures or forwards on multiple currency baskets or indices of debt securities should be treated as either

(a) a series of forwards (using the method in (1)(a)); or

(b) a series of forwards, each one on a notional debt security to represent one of the currencies in the basket or index, of an amount which is a proportionate part of the total underlying the contract according to the weighting of the relevant currency in the basket.

6.2.4 G Notional debt securities derived through this treatment should be assigned a specific risk position risk adjustment and a general market risk position risk adjustment equal to the highest that would apply to the debt securities in the basket or index.

6.2.5 G The debt security with the highest specific risk position risk adjustment within the basket might not be the same as the one with the highest general market risk position risk adjustment. A *firm* should select the highest percentages even where they relate to different debt securities in the basket or index, and regardless of the proportion of those debt securities in the basket or index.

Bonds where coupons and principal are paid in different currencies

6.2.6 G Where a debt security pays coupons in one currency, but will be redeemed in a different currency, it should be treated as:

(1) a debt security denominated in the coupon's currency; and

(2) a foreign currency forward to capture the fact that the debt security's principal will be repaid in a different currency from that in which it pays coupons, specifically:

(a) a notional forward sale of the coupon currency and purchase of the redemption currency, in the case of a long position in the debt security; or

(b) a notional forward purchase of the coupon currency and sale of the redemption currency, in the case of a short position in the debt security.

Interest-rate risk on other futures, forwards and swaps

6.2.7 G Other futures, forwards, and swaps where a treatment is not specified in article 328 of the *EU CRR* ((Interest rate futures and forwards) should be treated as positions in zero-specific-risk securities, each of which:

(1) has a zero coupon;

(2) has a maturity equal to that of the relevant contract; and

(3) is long or short according to the table in *IFPRU* 6.2.8G.

6.2.8 G This table belongs to *IFPRU* 6.2.8G.

Instrument	**Notional Positions**		
Foreign currency forward or future	A long position denominated in the currency purchased	and	A short position denominated in the currency sold
Gold forward or future	A long position if the forward or future involves an actual (or notional) sale of gold	or	A short position if the forward or future involves an actual (or notional) purchase of gold
Equity forward or future	A long position if the contract involves an actual (or notional) sale of the underlying equity	or	A short position if the contract involves an actual (or notional) purchase of the underlying equity

Deferred start interest rate swaps or foreign currency swaps

6.2.9 G Interest-rate swaps or foreign currency swaps with a deferred start should be treated as the two notional positions (one long, one short). The paying leg should be treated as a short position in a zero specific risk security with a coupon equal to the fixed rate of the swap. The receiving leg should be treated as a long position in a zero specific risk security, which also has a coupon equal to the fixed rate of the swap.

6.2.10 G The maturities of the notional positions are shown in the table in *IFPRU* 6.2.11G.

6.2.11 G This table belongs to *IFPRU* 6.2.10G.

	Paying leg	**Receiving leg**
Receiving fixed and paying floating	The maturity equals the start date of the swap	The maturity equals the end date of the swap
Paying fixed and receiving floating	The maturity equals the end date of the swap	The maturity equals the start date of the swap

Swaps where only one leg is an interest-rate leg

6.2.12 G For interest-rate risk, a *firm* should treat a swap (such as an equity swap) with only one interest-rate leg as a notional position in a zero specific risk security:

(1) with a coupon equal to that on the interest-rate leg;

(2) with a maturity equal to the date that the interest rate will be reset; and

(3) which is a long position if the *firm* is receiving interest payments and short if making interest payments.

Foreign exchange forwards, futures, CFDs and synthetic futures

6.2.13 G (1) A *firm* should treat a foreign currency forward, future, synthetic future or CFD as two notional currency positions as follows:

(a) a long notional position in the currency which the *firm* has contracted to buy; and

(b) a short notional position in the currency which the *firm* has contracted to sell.

(2) In (1) the notional positions should have a value equal to either:

(a) the contracted amount of each currency to be exchanged in a forward, future, synthetic future or CFD held in the non-*trading book*; or

(b) the present value of the amount of each currency to be exchanged in a forward, future, synthetic future or CFD held in the *trading book*.

Foreign currency swaps

6.2.14 G (1) A *firm* should treat a foreign currency swap as:

(a) a long notional position in the currency in which the *firm* has contracted to receive interest and principal; and

(b) a short notional position in the currency in which the *firm* has contracted to pay interest and principal.

(2) In (1) the notional positions should have a value equal to either:

(a) the nominal amount of each currency underlying the swap if it is held in the non-*trading book*; or

(b) the present value amount of all cash flows in the relevant currency in the case of a swap held in the *trading book*.

Futures, forwards and CFDs on a single commodity

6.2.15 G Where a forward, future, CFD or synthetic future settles according to:

(1) the difference between the price set on trade date and that prevailing at contract expiry, then the notional position should:

(a) equal the total quantity underlying the contract; and

(b) have a maturity equal to the expiry date of the contract; and

(2) the difference between the price set on trade date and the average of prices prevailing over a certain period up to contract expiry, then a notional position should be derived for each of the reference dates used in the averaging period to calculate the average price, which:

(a) equals a fractional share of the total quantity underlying the contract; and

(b) has a maturity equal to the relevant reference date.

Buying or selling a single commodity at an average of spot prices prevailing in the future

6.2.16 G Commitments to buy or sell at the average spot price of the commodity prevailing over some period between trade date and maturity should be treated as a combination of:

(1) a *position* equal to the full amount underlying the contract with a maturity equal to the maturity date of the contract, which should be:

(a) long, where the *firm* will buy at the average price; or

(b) short, where the *firm* will sell at the average price; and

(2) a series of notional positions, one for each of the reference dates where the contract price remains unfixed, each of which should:

(a) be long if the position under (1) is short, or short if the position under (1) is long;

(b) equal to a fractional share of the total quantity underlying the contract; and

(c) have a maturity date of the relevant reference date.

6.3 Expectations relating to internal models

6.3.1 G Article 363 of the *EU CRR* (Permission to use internal models) states that permission for an *institution* to use internal models to calculate *own funds requirements* is subject to *competent authorities* verifying compliance with:

(1) the general requirements;

(2) requirements particular to specific risk modelling; and

(3) requirements for an internal model for incremental default and migration risk.

6.3.2 G This section describes some of the standards that the *FCA* expects to be met for it to consider that a *firm* is compliant with the requirements in *IFPRU* 6.3.1G.

High level standards

6.3.3 G A *firm* should be able to demonstrate that it meets the risk management standards in article 368 of the *EU CRR* (Qualitative requirements) on a legal entity and business-line basis where appropriate. This is particularly important for a *subsidiary* in a *group* subject to matrix management where the business lines cut across legal entity boundaries.

Categories of position

6.3.4 G A VaR model permission will generally set out the broad classes of *position* within each risk category in its scope. It may also specify how individual products within one of those broad classes may be brought into or taken out of scope of the VaR model permission. These broad classes of permission are as follows:

(1) linear products, which comprise securities with linear pay-offs (such as bonds and equities) and derivative products which have linear pay-offs in the underlying risk factor (such as interest-rate swaps, *FRAs*, and total return swaps);

(2) European, American and Bermudan put and call options (including caps, floors, and swaptions) and investments with these features;

(3) Asian options, digital options, single barrier options, double barrier options, look-back options, forward-starting options, compound options and investments with these features; and

(4) all other option-based products (such as basket options, quantos,

outperformance options, timing options, and correlation-based products) and investments with these features.

Data standards

6.3.5 G A *firm* should ensure that the data series used by its VaR model is reliable. Where a reliable data series is not available, proxies or any other reasonable value-at-risk measurement may be used when the *firm* demonstrates that the requirements of article 367(2)(e) of the *EU CRR* (Requirements for risk measurement) are met. A *firm* should demonstrate that the technique is appropriate and does not materially understate the modelled risks.

6.3.6 G Data may be deemed insufficient if, for example, it contains missing data points, or data points which contain stale data. With regard to less liquid risk factors or positions, the *FCA* expects the *firm* to make a conservative assessment of those risks, using a combination of prudent valuation techniques and alternative VaR estimation techniques to ensure there is a sufficient cushion against risk over the close-out period, which takes account of the illiquidity of the risk factor or position.

6.3.7 G A *firm* is expected to update data sets to ensure standards of reliability are maintained in accordance with the frequency set out in its VaR model permission, or more frequently if volatility in market prices or rates necessitates more frequent updating. This is in order to ensure a prudent calculation of the VaR measure.

Aggregating VaR measures

6.3.8 G In determining whether it is appropriate for a *firm* to use empirical correlations within risk categories and across risk categories within a model, the *FCA* expects certain features to be observed in assessing whether such an approach is sound and implemented with integrity. It generally expects a *firm* to determine the aggregate VaR measure by adding the relevant VaR measure for each category, unless the *firm's* permission provides for a different method of aggregating VaR measures which is empirically sound. It does not expect a *firm* to use the square root of the sum of the squares approach in aggregating measures across risk categories or within risk categories unless the assumption of zero correlation between these categories is empirically justified. If correlations between risk categories are not empirically justified, the VaR measures for each category should simply be added to determine its aggregate VaR measure. However, to the extent that a *firm's* VaR model permission provides for a different way of aggregating VaR measures:

(1) that method applies instead; and

(2) if the correlations between risk categories used for that purpose cease to be empirically justified then the *firm* must notify the *FCA* at once.

Testing prior to model validation

6.3.9 G A *firm* is expected to provide evidence of its ability to comply with the requirements for a VaR model permission. In general it will be required to

demonstrate this by having a backtesting programme in place and should provide three months of backtesting history.

6.3.10 G A period of initial monitoring or live testing is required before a VaR model can be recognised. This will be agreed on a *firm*-by-*firm* basis.

6.3.11 G In assessing the *firm's* VaR model and risk management, the results of internal model validation procedures used by the firm to assess the VaR model will be taken into account.

Backtesting

6.3.12 G For clarity, the backtesting requirements of article 366 of the *EU CRR* (Regulatory back testing and multiplication factors) should be implemented in the manner of *IFPRU* 6.3.13G and 6.3.14G.

6.3.13 G The day on which a loss is made is day n. The value-at-risk measure for that day will be calculated on day n-1, or overnight between day n-1 and day n. Profit and loss figures are produced on day n+1, and backtesting also takes place on day n+1. The *firm's* supervisor should be notified of any overshootings by close of business on day n+2.

6.3.14 G Any overshooting initially counts for the purpose of the calculation of the plus factor, even if subsequently the *FCA* agrees to exclude it. Thus, where the *firm* experiences an overshooting and already has four or more overshootings for the previous 250 business days, changes to the multiplication factor arising from changes to the plus factor become effective at day n+3.

6.3.15 G A longer time period generally improves the power of backtesting. However, a longer time period may not be desirable if the VaR model or market conditions have changed to the extent that historical data is no longer relevant.

6.3.16 G The *FCA* will review as part of a *firm's* VaR model permission application the processes and documentation relating to the derivation of profit and loss used for backtesting. A *firm's* documentation should clearly set out the basis for cleaning profit and loss. To the extent that certain profit and loss elements are not updated every day (for example, certain reserve calculations) the documentation should clearly set out how such elements are included in the profit and loss series.

Planned changes to the VaR model

6.3.17 G In accordance with article 362(3) of the *EU CRR* (Specific and general risks), the *FCA* expects a *firm* to provide and discuss with us details of any significant planned changes to the VaR model before those changes are implemented. These details must include detailed information about the nature of the change, including an estimate of the impact on *VaR* numbers and the incremental risk charge.

Bias from overlapping intervals for 10-day VaR and stressed VaR

6.3.18 G The use of overlapping intervals of 10-day holding periods for article 365 of the *EU CRR* (VaR and stressed VaR calculation) introduces an autocorrelation into the data that would not exist should truly independent 10-day periods be used. This may give rise to an under-estimation of the volatility and the VaR at the 99% confidence level. To obtain clarity on the materiality of the bias, a *firm* should measure the bias arising from the use of overlapping intervals for 10-day VaR and stressed VaR when compared to using independent intervals. A report on the analysis, including a proposal for a multiplier on VaR and stressed VaR to adjust for the bias, should be submitted to the *FCA* for review and approval.

VaR and stressed VaR calculation

6.3.19 G Article 365 of the *EU CRR* requires a *firm* that uses an internal model for calculating its *own funds requirement* to calculate, at least weekly, a stressed VaR (sVaR) of their current portfolio. When the *FCA* considers a *firm's* application to use a sVaR internal model it would expect the features in *IFPRU* 6.3.20G to *IFPRU* 6.3.24G to be present prior to permission being granted, as indicative that the conditions for granting permission have been met.

Quantile estimator

6.3.20 G The *firm* should calculate the sVaR measure to be greater than or equal to the average of the 2nd and 3rd worst loss in a 12-month time series comprising of 250 observations. The *FCA* expects, as a minimum, that a corresponding linear weighting scheme should be applied if the *firm* uses a larger number of observations.

Meaning of "period of significant financial stress relevant to the institution's portfolio

6.3.21 G The *firm* should ensure that the sVaR period chosen is equivalent to the period that would maximise VaR, given the *firm's* portfolio. There is an expectation that a stressed period should be identified at each legal entity level at which capital is reported. Therefore, group level sVaR measures should be based on a period that maximises the group level VaR, whereas entity level sVaR should be based on a period that maximises VaR for that entity.

Antithetic data

6.3.22 G The *firm* should consider whether the use of antithetic data in the calculation of the sVaR measure is appropriate to the *firm's* portfolio. A justification for using or not using antithetic data should be provided to the *FCA*.

Absolute and relative shifts

6.3.23 G The *firm* should explain the rationale for the choice of absolute or relative

shifts for both VaR and sVaR methodologies. In particular, statistical processes driving the risk factor changes need to be evidenced for both VaR and sVaR.

6.3.24 G The following information is expected to be submitted quarterly:

(1) analysis to support the equivalence of the *firm's* current approach to a VaR-maximising approach on an ongoing basis;

(2) the rationale behind the selection of key major risk factors;

(3) summary of ongoing internal monitoring of stressed period selection with respect to current portfolio;

(4) analysis to support capital equivalence of upscaled 1-day VaR and sVaR measures to corresponding full 10-day VaR and sVaR measures;

(5) graphed history of sVaR/VaR ratio;

(6) analysis to demonstrate accuracy of partial revaluation approaches specifically for sVaR purposes (for *firms* using revaluation ladders or spot/vol-matrices), which should include a review of the ladders/matrices or spot/vol-matrices, ensuring that they are extended to include wider shocks to risk factors that incur in stress scenarios; and

(7) minutes of Risk Committee meeting or other form of evidence to reflect governance and *senior management* oversight of stressed VaR methodology.

Requirement to have an internal IRC model

6.3.25 G Article 372 of the *EU CRR* (Requirement to have an internal IRC model) requires a *firm* that use an internal model for calculating own funds requirements for specific risk of traded debt instruments to also have an internal incremental default and migration risk (IRC) model in place to capture the default and migration risk of its *trading book positions* that are incremental to the risks captured by its VaR model. When the *FCA* considers a *firm's* application to use an IRC internal model, it expects that the matters in *IFPRU* 6.3.26G to 6.3.28G will be included as demonstrating compliance with the standards in article 372.

Basis risks for migration

6.3.26 G The *FCA* expects the IRC model to capitalise pre-default basis risk. In this respect, the model should reflect that in periods of stress the basis could widen substantially. The *firm* should disclose to us its material basis risks that are incremental to those already captured in existing market risk capital measures (VaR-based and others). This must take actual close-out periods during periods of illiquidity into account.

Price/spread change model

6.3.27 G A *firm* is advised to amend the price/spread change model used to capture the profit and loss impact of migration such that the spread changes are calibrated to long-term averages of differences between spreads for relevant ratings. These should either be conditioned on actual rating events, or using the entire history of spreads regardless of migration. Point-in-time estimates are not considered acceptable, unless they can be shown to be as conservative as using long-term averages.

Dependence of the recovery rate on the economic cycle

6.3.28 G To achieve a soundness standard comparable to those under the IRB approach, LGD estimates should reflect the economic cycle. Therefore, the *FCA* expects a *firm* to incorporate dependence of the recovery rate on the economic cycle into the IRC model. Should the *firm* use a conservative parameterisation to comply with the IRB standard of the use of downturn estimates, evidence of this should be submitted in quarterly reporting to the *FCA*, bearing in mind that for trading portfolios, which contain long and short positions, downturn estimates would not in all cases be a conservative choice.

7 Liquidity

7.1 Application

7.1.1 R *IFPRU* 7 applies to an *IFPRU investment firm*.

Purpose

7.1.2 G This section contains *rules* that exercise the discretion afforded to the *FCA* as *competent authority* under article 6(4) of the *EU CRR* (Exemption for certain investment firms).

Application of BIPRU 12 (Liquidity standards)

7.1.3 G The *FCA's* liquidity regime and liquidity reporting in *BIPRU* 12 (Liquidity standards) and *SUP* 16 (Reporting requirements) continue to apply to an *IFPRU investment firm* until the liquidity coverage requirement in article 412 of the *EU CRR* becomes applicable in 2015.

7.1.4 G Pending specification of a uniform definition under article 460 of the *EU CRR* (Liquidity) of high and extremely high liquidity and credit quality, a *firm* should be guided by *BIPRU* 12 (Liquidity standards) when complying with article 416 of the *EU CRR* (Reporting on liquid assets).

Exemption from Part Six of EU CRR on individual basis

7.1.5 R For the purpose of article 6(4) of the *EU CRR*, a *firm* is exempt from compliance with the obligations in Part Six of the *EU CRR* (Liquidity) on an

individual basis if it meets the following conditions:

(1) it is not an *ILAS BIPRU firm*; and

(2) it is not a *significant IFPRU firm*.

Exemption from Part Six of EU CRR on consolidated basis

7.1.6 R For the purpose of article 11(3) of the *EU CRR*, a *FCA consolidation group* that meets the condition in *IFPRU* 7.1.7R is exempt from compliance with the obligations in Part Six of the *EU CRR* (Liquidity) on a *consolidated basis*.

7.1.7 R The members of the *FCA consolidation group* comprise only *firms* that meet the conditions in *IFPRU* 7.1.5R.

8 Prudential consolidation and large exposures

8.1 Prudential consolidation

Application

8.1.1 R (1) This section applies to an *IFPRU investment firm*, unless it is an *exempt IFPRU commodities firm* and the conditions in (2) are met.

(2) The conditions are:

(a) article 493 of the *EU CRR* applies to it;

(b) the *exempt IFPRU commodities firm* is a member of a *FCA consolidation group* or *non-EEA sub-group* that:

(c) the *FCA consolidation group* or *non-EEA sub-group* in (2)(b) does not contain any *credit institution* or *designated investment firm*;

(d) each *investment firm* in the *FCA consolidation group* or *non-EEA sub-group* in 2(b) meets the conditions in article 493 of the *EU CRR*; and

(e) any *investment firm* in the *FCA consolidation group* or *non-EEA sub-group* in 2(b) whose head office is outside the *EEA* would have been a *firm* to whom the *ISD* would not have applied if it had remained in force in the form it was in on 31 December 2006 if:

(i) its head office had been in an *EEA State*; and

(ii) It had carried on all its business in the *EEA* and had obtained whatever authorisations for doing so were required under the *ISD* in the form that directive was in

on 31 December 2006.

Purpose

8.1.2 G This section contains:

(1) *rules* that exercise the discretion afforded to the *FCA* as *competent authority* under article 18 of the *EU CRR* (Methods of prudential consolidation); and

(2) *guidance* on the criteria that the *FCA* will take into account when considering whether to grant a permission to a *firm* on a case by case basis for the individual consolidation method under article 9 of the *EU CRR* (Individual consolidation method).

Methods of prudential consolidation: proportional consolidation

8.1.3 R (1) In carrying out the calculations for the purposes of Part One, Title II, Chapter 2 of the *EU CRR* (Prudential consolidation), a *firm* must include the relevant proportion of an *undertaking* with whom it has:

(a) a *consolidation Article 12(1) relationship*; or

(b) an *article 18(6) relationship*.

(2) In (1), the relevant proportion is such proportion (if any) as stated in the *Part 4A permission* of the *firm*.

[**Note**: article 18(3) and (6) of the *EU CRR*]

8.1.4 R In carrying out the calculations for the purposes of Part One, Title II, Chapter 2 of the *EU CRR* (Prudential consolidation), a *firm* (for whom the *FCA* is the *consolidating supervisor*) must include the proportion according to the share of capital held of *participations* in *institutions* and *financial institutions* managed by an *undertaking* included in the consolidation together with one or more *undertakings* not included in the consolidation, where those *undertakings'* liability is limited to the share of capital they hold.

[**Note**: article 18(4) of the *EU CRR*]

8.1.5 R In carrying out the calculations for the purposes of Part One, Title II, Chapter 2 of the *EU CRR* (Prudential consolidation), a *firm* (for whom the *FCA* is the *consolidating supervisor*) must carry out a full consolidation of any *undertaking* with whom it has an *article 18(5) relationship*.

[**Note**: article 18(5) of the *EU CRR*]

Individual consolidation method

8.1.6 G Article 9(2) of the *EU CRR* (Individual consolidation method) requires a *firm* to demonstrate fully to the *competent authority* 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 *own funds* of the *subsidiary* referred to in article 9(1) of the *EU CRR*, or repayment of liabilities when due by that *subsidiary* to the *firm*.

8.1.7 G The *FCA* will assess an application for individual consolidation against articles 9 and 396(2) (Compliance with large exposure requirements) of the *EU CRR* on a case-by-case basis. The *FCA* will exercise its judgement in relation to its statutory objectives as to whether it is still appropriate to permit the treatment even where the conditions in articles 9 and 396(2) of the *EU CRR* are met. The *FCA* will apply a high level of scrutiny to applications under articles 9 and 396(2) of the *EU CRR*, consistent with the previous solo consolidation regime.

Application of criteria for individual consolidation method

8.1.8 G The permission for individual consolidation method is subject to meeting the condition in article 7(1)(d) of the *EU CRR* (Derogation from individual basis) which requires the *parent undertaking* to hold more than 50% of the voting rights attached to *shares* in the capital of the *subsidiary*. Article 9(2) also requires parent institutions to demonstrate fully to the *FCA*, as *competent authority*, that there are no material practical or legal impediments to the prompt transfer of *own funds* or repayment of liabilities when due by the *subsidiary* to its *parent undertaking*.

8.1.9 G When making the assessment in *IFPRU* 8.1.8G, the *FCA* will consider whether any minority interest may represent an impediment of any kind to the prompt transfer of *own funds* or repayment of liabilities from the *subsidiary* to the *parent undertaking*. The effect of this is that the parent institution will be required to demonstrate that any minority interest in a *subsidiary* will not result in the blocking or delay of prompt transfer of *own funds* or repayment of liabilities. Therefore, it may be possible for a *firm* to meet the condition in article 7(1)(d) of the *EU CRR* but not meet the condition in article 9(2).

8.1.10 G The *FCA* will consider the criteria below when determining whether the condition in article 9(2) of the *EU CRR* is 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 *subsidiary* and what impact those other interests may have on the *firm's* control over the *subsidiary* and on the ability of the *firm* to require a transfer of funds or repayment of liabilities;

(3) whether the prompt transfer of funds or repayment of liabilities to the *firm* might harm the reputation of the *firm* or its *subsidiary*;

(4) whether there are any tax disadvantages for the *firm* or the *subsidiary* as a result of the transfer of funds or repayment of liabilities;

(5) whether there are any exchange controls that may have an impact on

the transfer of funds or repayment of liabilities;

(6) whether there are assets in the *subsidiary* available either to be transferred or liquidated for the purposes of the transfer of funds or repayment of liabilities;

(7) whether any regulatory requirements impact on the ability of the *subsidiary* to transfer funds or repay liabilities promptly;

(8) whether the purpose of the *subsidiary* prejudices the prompt transfer of funds or repayment of liabilities;

(9) whether the legal structure of the *subsidiary* prejudices the prompt transfer of funds or repayment of liabilities;

(10) whether the contractual relationships of the *subsidiary* with the *firm* and other third parties prejudices the prompt transfer of funds or repayment of liabilities;

(11) whether past and proposed flows of funds between the *subsidiary* and the *firm* demonstrate the ability to make prompt transfer of funds or repayment of liabilities; and

(12) whether the degree of individual consolidation by the *firm* undermines the *FCA's* ability to assess the soundness of the *firm* as a legal entity (taking into account any other *subsidiary* to which the individual consolidation method under article 9(1) of the *EU CRR* is being applied).

Entities excluded from the scope of prudential consolidation

8.1.11 G The *FCA* will assess applications to exclude entities from the scope of prudential consolidation against article 19(2) of the *EU CRR* on a case-by-case basis. The *FCA* will only grant this treatment with respect to undertakings where one of the conditions in article 19(2) is met. The *FCA* will still make a judgement as to whether it is appropriate to grant this treatment even where one of the conditions in article 19(2) is met.

Application of criteria for exclusion

8.1.12 G Article 19(2) of the *EU CRR* allows the *consolidating supervisor* to decide in the following cases that an *institution*, *financial institution* or *ancillary services undertaking* which is a *subsidiary* or in which a *participation* is held need not be included in the consolidation:

(1) where the *undertaking* concerned is situated in a third country where there are legal impediments to the transfer of necessary information;

(2) where the *undertaking* concerned is of negligible interest only with respect to the objectives of monitoring *credit institutions*;

(3) where, in the opinion of the *competent authorities* responsible for exercising supervision on a *consolidated basis*, the consolidation of

the financial situation of the *undertaking* concerned would be inappropriate or misleading as far as the objectives of the supervision of *credit institutions* are concerned.

8.1.13 G If several *undertakings* meet the criteria in *IFPRU* 8.1.12G(2) above, the *FCA* will not agree to exclude them all from the consolidation where collectively they are not of negligible interest with respect to the specified objectives.

8.1.14 G The *FCA* may require a *firm* to provide information about the undertakings excluded from consolidation.

Core UK groups

8.1.15 G Under article 113(6) of the *EU CRR* (Intra-group credit risk exemption), *institutions* may apply to the *FCA* for approval to incorporate *undertakings* within a sub-consolidated group in order to achieve a 0% risk-weighting for any *exposures* between these entities and to fully exempt such *exposures* from the *large exposures* limit stipulated in article 395(1) of the *EU CRR* (Limits to large exposures).

8.1.16 G The *FCA* will assess *core UK group* applications against article 113(6) on a case-by-case basis. The *FCA* will only approve this treatment for *core UK group undertakings* where the conditions stipulated in article 113(6) are met. A *firm* should note that the *FCA* will still make a wider judgement whether it is appropriate to grant this treatment even where the conditions in article 113(6) are met.

8.1.17 G This permission in the *EU CRR* is subject to meeting the specific conditions in article 113(6)(a) to (e):

(a) the counterparty is an *institution*, a *financial holding company* or a *mixed financial holding company*, *financial institution*, *asset management company* or *ancillary services undertaking* subject to appropriate prudential requirements;

(b) the counterparty is included in the same consolidation as the *institution* on a full basis;

(c) the counterparty is subject to the same risk evaluation, measurement and control procedures as the *institution*;

(d) the counterparty is established in the same *EEA State* as the *institution*;

(e) there is no current or foreseen material practical or legal impediment to the prompt transfer of *own funds* or repayment of liabilities from the counterparty to the *institution*.

8.1.18 G In relation to article 113(6)(d), the *FCA* will consider that if an *undertaking* 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 *UK* other than by incorporation, and if the *firm* can demonstrate that the counterparty's centre of main interests is situated in the *UK* within the meaning of that Regulation, then the condition in article 113(6)(d) will be deemed to be satisfied.

8.1.19 G In relation to article 113(6)(e), the *FCA* will consider the following criteria when assessing whether this condition has been 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 undertaking and what impact those other interests may have on the *firm's* control over the undertaking 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 counterparty as a result of the transfer of funds or repayment of liabilities;

(4) whether the purpose of the *undertaking* prejudices the prompt transfer of funds or repayment of liabilities;

(5) whether the legal structure of the undertaking prejudices the prompt transfer of funds or repayment of liabilities;

(6) whether the contractual relationships of the undertaking 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 undertaking and the *firm* demonstrate the ability to make prompt transfer of funds or repayment of liabilities.

8.1.20 G For the purpose of Article 113(6)(e), the *FCA* will consider that the obligation to increase the *firm's own funds* may be limited to capital resources available to the *undertaking* and may reasonably exclude such amount of capital resources that, if transferred to the *firm*, would cause the *undertaking* to become balance sheet insolvent in the manner contemplated in section 123(2) of the Insolvency Act 1986.

8.1.21 G For the purpose of article 113(6), the *FCA* 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 stipulated in article 395(1) of the *EU CRR* (Limits to large exposures).

8.2 Large exposures

Application

8.2.1 R This section applies to an *IFPRU investment firm*, unless it is an *exempt IFPRU commodities firm* to whom article 493 of the *EU CRR* applies.

8.2.2 R This section does not apply to a *FCA consolidation group* on the basis of its

consolidated situation if the *group* only contains *limited activity firms* or *limited licence firms*.

Purpose

8.2.3 G This section contains the *rules* that exercise the discretion afforded to the *FCA* as *competent authority* under article 400(2)(c) and (3) of the *EU CRR* (Large exposures: exemptions). The *FCA* does not intend to exercise its discretion for any of the other exemptions in article 400(2).

Intra-group exposures: non-core large exposures group

8.2.4 R A *firm* with a *non-core large exposures group direction* may (in line with that direction) exempt from the application of article 395(1) of the *EU CRR* (Limits to large exposures) *exposures*, including *participations* or other kinds of holdings, incurred by a *firm* to:

(1) its *parent undertaking*;

(2) other *subsidiaries* of that *parent undertaking*; or

(3) its own *subsidiaries*,

in so far as those *undertakings* are covered by the supervision on a *consolidated basis* to which the *firm* itself is subject, in accordance with the *EU CRR*, Directive 2002/87/EC regarding the supplementary supervision of financial entities in a *financial conglomerate* or with equivalent standards in force in a *third country*; *exposures* that do not meet these criteria, whether or not exempted from article 395(1), shall be treated as *exposures* to a third party.

[**Note**: article 400(2) of the *EU CRR*]

8.2.5 R A *firm* may only make use of the *non-core large exposure group exemption* where the following conditions are met:

(1) the total amount of the non-*trading book exposures* from the *firm* to its *non-core large exposures group* does not exceed 100% of the *firm's eligible capital*; or

(if the *firm* has a *core UK group direction*) the total amount of non-*trading book exposures* from its *core UK group* (including the *firm*) to its *non-core large exposures group* does not exceed 100% of the *core UK group eligible capital*;

(2) the total amount of *trading book exposures* from the *firm* to its *non-core large exposures group* does not exceed 500% of the *firm's eligible capital*; or

(if the *firm* has a *core UK group direction*) the total amount of *trading book exposures* from its *core UK group* (including the *firm*) to its *non-core large exposures group* does not exceed 500% of the *core UK*

group eligible capital;

(3) (if the *firm* has a *core UK group direction*) it gives the *FCA* prior written notice if it intends to concentrate its intra-group exposure to a particular member of its *non-core large exposures group* in excess of 25% of *core UK group eligible capital*.

The written notice must contain the following:

(a) an explanation of how the *firm* will ensure that it will still meet the condition in (1) on a continuing basis;

(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*;

(5) if the *firm* stops concentrating its intra-group *exposure* to a particular member of its *non-core large exposures group* in excess of 25% of *core UK group eligible capital*, it gives the *FCA* prior written notice as set out in (1) if it intends to start to do so again; and

(4) the *firm* submits FSA018 under *SUP* 16.12 (Integrated regulatory reporting) as applicable to it.

[**Note**: article 400(2)(c) of the *EU CRR*]

Core UK group eligible capital

8.2.6 R For the purposes of the conditions in *IFPRU* 8.2.5R, a *firm* must calculate *core UK group eligible capital* in line with the deduction and aggregation method in *IFPRU* 8.2.7R.

8.2.7 R (1) *Core UK group eligible capital* is equal to the sum of the following amounts for each member of the *core UK group* and the *firm* (the sub-group):

(a) for ultimate *parent undertaking* of the sub-group, the amount calculated in line with article 6 of the *EU CRR* (or other prudential requirements that apply);

(b) for any other member of the sub-group, the amount calculated in line with article 6 of the *EU CRR* (or other prudential requirements that apply) less the book value of the sub-group's holdings of capital instruments in that member, to the extent not already deducted in calculations in line with article 6 of the *EU CRR* (or other prudential requirements that apply) for:

(i) the ultimate *parent undertaking* of the sub-group; or

(ii) any other member of the sub-group.

(2) The deduction in (1)(b) must be carried out separately for each type of capital instrument eligible as *own funds*.

8.2.8 G The *FCA* will assess *core UK group* and *non-core large exposure group*

applications against article 400(2)(c) on a case-by-case basis. The *FCA* will only approve this treatment for *non-core large exposure group* undertakings where the conditions in article 400(2)(c) are met. A *firm* should note that the *FCA* will still make a wider judgement whether it is appropriate to grant this treatment even where the conditions in article 400(2)(c) are met.

Notification

8.2.9 R A *firm* must immediately notify the *FCA* in writing if it becomes aware that any *exposure* that it has treated as exempt under *IFPRU* 8.2.4R 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.

Conditions for exemptions

8.2.10 R A *firm* may only make use of the exemptions provided in this section where the following conditions are met:

(1) the specific nature of the *exposure*, the counterparty or the relationship between the *firm* and the counterparty eliminate or reduce the risk of the *exposure*; and

(2) any remaining concentration risk can be addressed by other equally effective means, such as the arrangements, processes and mechanisms in article 81 of *CRD* (Concentration risk).

[**Note**: article 400(3) of the *EU CRR*]

Exposures to trustees

8.2.11 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.

8.2.12 G When considering whether the treatment described is misleading, factors a *firm* should consider include:

(1) the degree of independence of control of the fund, including the relation of the fund's board and *senior management* to the *firm* or to other funds or to both;

(2) the terms on which the counterparty, when acting as trustee, is able to satisfy its obligation to the *firm* out of the fund of which it is trustee;

(3) whether the beneficial owners of the fund are connected to the *firm*, or related to other funds managed within the *firm's group*, or both; and

(4) for a counterparty that is connected to the *firm* itself, whether the *exposure* arises from a transaction entered into on an arm's length

basis.

8.2.13 G In deciding whether a transaction is at arm's length, the following factors should be taken into account:

(1) the extent to which the person to whom the *firm* has an *exposure* ('A') can influence the *firm's* operations through, for example, the exercise of voting rights;

(2) the management role of A where A is also a director of the *firm*; and

(3) whether the *exposure* would be subject to the *firm's* usual monitoring and recovery procedures if repayment difficulties emerged.

9 Capital buffers

9.1 Application

9.1.1 R *IFPRU* 9 applies to an *IFPRU investment firm*, unless it is one of the following:

(1) an *IFPRU limited licence firm*; or

(2) an *exempt IFPRU commodities firm*.

Purpose

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

9.2 Capital conservation buffer

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

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

9.3 Countercyclical capital buffer

Main requirement

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

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

Calculation of countercyclical capital buffer rates

9.3.2 R (1) To calculate the weighted average in *IFPRU* 9.3.1R, a *firm* must apply to each applicable *countercyclical buffer rate* its total *own funds* requirements for credit risk, specific risk, incremental default and migration risk that relates to *the relevant credit exposures* in the jurisdiction in question, divided by its total *own funds* requirements for credit risk that relates to all of its *relevant credit exposures* are located.

(2) A *firm* must calculate its total *own funds requirement* for credit risk, specific risk, incremental default and migration risk in accordance with Part Three, Titles II (Capital requirements for credit risk) and IV, Chapter 5 (Own funds requirements for market risk) of the *EU CRR.*

(3) The *countercyclical buffer rate* for an *exposure* located in the *UK* is the rate set by the *UK countercyclical buffer authority*.

(4) The *countercyclical buffer rate* for an *exposure* located in an *EEA State* other than the *UK* is:

(a) the rate set by the *EEA countercyclical buffer authority* for that jurisdiction; or

(b) if that rate exceeds 2.5% of *total risk exposure amount* and has not been recognised by the *UK countercyclical buffer authority*, 2.5%

(5) The *countercyclical buffer rate* for an *exposure* located in a *third country* is the rate set by the *UK countercyclical buffer authority* for that jurisdiction.

(6) If the *UK countercyclical buffer authority* has not set a rate for a *third country*, *the countercyclical buffer rate* for an *exposure* located in that jurisdiction is:

(a) the rate set by the *third country countercyclical buffer authority* for that jurisdiction; or

(b) if that rate exceeds 2.5% and has not been recognised by the *UK countercyclical buffer authority*, 2.5%.

(7) If the *UK countercyclical buffer authority* has not set a rate for a *third country* and either there is no *third country countercyclical buffer authority* for that country or the authority has not set a rate for that jurisdiction, the *countercyclical buffer rate* for an *exposure* located in that jurisdiction is zero.

(8) If the *countercyclical buffer rate* for the *UK* is increased, that increase takes effect from the date specified by the *UK countercyclical buffer authority*.

(9) If the *countercyclical buffer rate* for an *EEA State* other than the *UK* is increased, subject to (4)(b), that increase takes effect from:

(a) the date specified by the *EEA countercyclical buffer authority* for that jurisdiction, if the rate applied under this Chapter does not exceed 2.5%; or

(b) the date specified by the *UK countercyclical buffer authority* if the rate applied under this Chapter exceeds 2.5%.

(10) If the *countercyclical buffer rate* for a *third country* is increased by the *UK countercyclical buffer authority*, that increase takes effect from the date specified by the *UK countercyclical buffer authority*.

(11) If the *UK countercyclical buffer authority* does not set a *countercyclical buffer rate* for a *third country* and that rate is increased by the *third country countercyclical buffer authority* for that jurisdiction, subject to 6(b), that increase takes effect from:

(a) the date 12 months after the date on which the increase was published by the *third country countercyclical buffer authority* in accordance with the relevant law of the *third country*, if the rate applied under this Chapter does not exceed 2.5%; or

(b) the date specified by the *UK countercyclical buffer authority* if the rate applied under this Chapter exceeds 2.5%.

(12) If a *countercyclical buffer rate* is reduced, that reduction takes effect immediately.

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

Location of exposures

9.3.3 G A *firm* must identify the geographical location of a *relevant credit exposure* in accordance with Regulation [insert reference to regulatory technical standards adopted in accordance with article 140(7) of *CRD*].

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

9.4 Capital conservation measures

Combined buffer

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

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

Restrictions on distributions

9.4.2 R A *firm* that meets the *combined buffer* must not make a *distribution in*

connection with common equity tier 1 capital to an extent that would decrease its *common equity tier 1 capital* to a level where the *combined buffer* is no longer met.

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

9.4.3 R (1) A *firm* that does not meet the *combined buffer* must:

(a) calculate the *MDA* in accordance with (4); and

(b) report the *MDA* to the *FCA* in writing no later than five *business days* after the *firm* identified that it did not meet the *combined buffer.*

(2) A *firm* that does not meet the *combined buffer* must not undertake any of the following actions before it has calculated the *MDA*:

(a) make a *distribution in connection with common equity tier 1 capital*;

(b) create an obligation to pay variable remuneration or *discretionary pension benefits* or pay variable remuneration or *discretionary pension benefits* if the obligation to pay was created at a time when the *firm* did not meet the *combined buffer*;

(c) make payments on *additional tier 1 instruments*.

(3) If a *firm* does not meet the *combined buffer*, it must not distribute more than the *MDA*, calculated in (4), through any action in (2)(a) to (c).

(4) (a) Subject to (b), a *firm* must calculate the *MDA* by multiplying the sum calculated in (5) by the factor determined in (6).

(b) Any of the actions in (2)(a), (b) or (c) shall have the effect of reducing the *MDA.*

(5) The sum to be multiplied in (4) shall consist of:

(a) interim profits not included in *common equity tier 1 capital* under article 26(2) of the *EU CRR* (Common equity tier 1 items) that have been generated since the most recent decision on the distribution of profits or any of the actions in 2(a), (b) or (c);

plus

(b) year-end profits not included in *common equity tier 1 capital* under article 26(2) of the *EU CRR* that have been generated since the most recent decision on the distribution of profits or any of the actions in (2) (a), (b) or (c);

minus

(c) amounts which would be payable by tax if the items specified in (a) and (b) were to be retained.

(6) The factor in (4) shall be determined as follows:

(a) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds requirement* under article 92(1)(c) of the *EU CRR* expressed as a percentage of the *firm's total risk exposure amount* is within the first (that is, the lowest) quartile of the *combined buffer*, the factor shall be 0;

(b) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds* requirement under article 92(1)(c) of the *EU CRR*, expressed as a percentage of the *firm's total risk exposure amount* is within the second quartile of the *combined buffer*, the factor shall be 0.2;

(c) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds* requirement under article 92(1)(c) of the *EU CRR* expressed as a percentage of the *firm's total risk exposure amount* is within the third quartile of the *combined buffer*, the factor shall be 0.4;

(d) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds* requirement under article 92(1)(c) of the *EU CRR* expressed as a percentage of the *firm's total risk exposure amount* is within the fourth (that is, the highest) quartile of the *combined buffer*, the factor shall be 0.6.

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

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

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

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

(8) The restrictions imposed by this *rule* only apply to payments that result in a reduction of *common equity tier 1 capital* or in a reduction of profits, and where a suspension of payment or failure to pay does not constitute an event of default or a condition for the commencement of proceedings for an order for the appointment of a liquidator or administrator of the *firm*.

(9) If a *firm* does not meet the *combined buffer* and intends to distribute any of its distributable profits or undertake an action in (2)(a), (b) and (c) it must give the *FCA* not less than three *months'* notice before the intended date of distribution or action. When giving notice a *firm* must provide the following information:

(a) the amount of *own funds* maintained by the *firm*, subdivided as follows:

(i) *common equity tier 1 capital*;

(ii) *additional tier 1 capital*; and

(iii) *tier 2 capital*;

(b) the amount of its interim and year-end profits;

(c) the *MDA* calculated in (4);

(d) the amount of distributable profits it intends to allocate between the following:

(i) dividend payments;

(ii) share buybacks;

(iii) payments on *additional tier 1 instruments*; and

(iv) the payment of variable remuneration or *discretionary pension benefits*, whether by creation of a new obligation to pay, or payment pursuant to an obligation to pay created at a time when the *firm* did not meet its *combined buffer*.

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

9.5 Capital conservation plan

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

period up to 10 *business days* which the *FCA* has notified to the *firm*.

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

9.5.2 R The capital conservation plan must include the following

(1) the *MDA*;

(2) estimates of income and expenditure and a forecast balance sheet;

(3) measures to increase the capital ratios of the *firm*; and

(4) a plan and timeframe for the increase of *own funds* with the objective of meeting the *combined buffer*.

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

9.6 Application on an individual and consolidated basis

Application on an individual basis

9.6.1 R This section applies to a *firm* on an individual basis whether or not it also applies to the *firm* on a *consolidated basis*.

Application on a consolidated basis

9.6.2 R A *firm* that is a *parent institution in a Member State* must comply with this chapter on the basis of its *consolidated situation*.

9.6.3 R A *firm* controlled by a *parent financial holding company in a Member State* or a *parent mixed financial holding company in a Member State* must comply with this Chapter on the basis of the *consolidated situation* of that holding company in the *FCA consolidation group*.

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

Sub-consolidation in cases of entities in third countries

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

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

[**9.7** **Exemptions**

9.7.1 G A *firm* that meets the condition in *IFPRU* 9.7.2G may apply to the *FCA* for a *waiver* of the *capital conservation buffer* or the *countercyclical capital buffer* if the *FCA* considers that granting of such a *waiver* does not threaten the stability of the *UK financial system* as part of its consideration of whether the conditions in section 138A of the *Act* are met.

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

9.7.2 G (1) The condition referred to in *IFPRU* 9.7.1G is that the *firm* is a small and medium-sized *investment firm*.

(2) For this purpose, a *firm* is categorised as small and medium-sized in accordance with the European Commission Recommendation 2003/361/EC concerning the definition of micro, small and medium-sized enterprises.

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

10 **Public disclosure**

Application

10.1.1 R *IFPRU* 10 applies to an *IFPRU investment firm*.

Purpose

10.1.2 G This chapter implements article 90 (Public disclosure on return on assets) of *CRD*.

Public disclosure on return of assets

10.1.3 R A *firm* must disclose in its *annual report and accounts* among the key indicators their return on assets, calculated as their net profit divided by their total balance sheet.

[**Note**: article 90 of *CRD*]

Transitional Provisions and Schedules

TP 1 **GENPRU and BIPRU waivers: transitional**

Application

1.1	R	*IFPRU* TP 1 applies to an *IFPRU investment firm*.
1.2	R	*IFPRU* TP 1 applies where immediately before 1 January 2014, a *waiver*

		given or *requirement* imposed in relation to a *rule* listed in column A of the table in *IFPRU* 1.5R has effect.
	Duration of transitional	
1.3	R	This section applies to each *waiver* or *requirement* in *IFPRU* 1.2R, until the direction given in respect of that *waiver* or *requirement* ceases to have effect on its terms, or is revoked, whichever is the earlier.
	Transitional	
1.4	R	Subject to *IFPRU* TP 1.7R and TP 1.8R, each *waiver* given or a *requirement* imposed in relation to a *FCA rule* listed in column A of the tables in *IFPRU* TP 1.10R (Internal model waivers) and TP 1.11R (Other waivers) is to be treated as a permission given by the *FCA* to the *firm* under the *EU CRR* article listed in the same row in column B of those tables.
1.5	R	Each permission given in accordance with *IFPRU* TP 1.4R shall continue in force and effect until the expiry date specified in the direction of the relevant *waiver* or in the written notice of the *requirement* issued under section 55L of the *Act*.
1.6		Where a *waiver* listed in *IFPRU* TP 1.10R (Internal model waivers) and TP 1.11R (Other waivers) specifies that it applies to a *firm* on a consolidated basis in accordance with a relevant provision in *BIPRU* 8 (Group risk consolidation), the permission shall apply to the *firm* on the basis of its *consolidated situation* in accordance with article 11 of the *EU CRR* (Application of requirements on a consolidated basis: general treatment).
1.7	R	A *waiver* listed in *IFPRU* TP 1.10R (Internal model waivers) only has effect in accordance with this TP where the *firm* has confirmed to the *FCA* that it materially complies with the requirements relevant to the *rules* listed in Column A of the table, as waived or modified by the *waiver*, and any conditions relevant to the application of the *waiver.*
1.8	R	A *waiver* listed in *IFPRU* TP 1.11R (Other waivers) does not have effect in accordance with this TP if the *firm* ceased to comply with the *rules* listed in Column A of the table, as modified or waived by the *waiver*, or any conditions relevant to the application of the *waiver*.
	Meaning of permission	
1.9	R	For the purpose of *IFPRU* TP 1*,* “permission” means a direction given by the *FCA* under any *EU CRR* article listed in column B of the tables in *IFPRU* 1.9R (Internal waivers) and *IFPRU* TP 1.10R (Other waivers) in the exercise of the discretion afforded to it as a *competent authority*.
	Tables	
1.10	R	Table on internal model waivers

	Permission	Column A FCA rule (rule waiver or modification)	Column B EU CRR reference
1	Internal Ratings Based (IRB) permission for credit risk	- *BIPRU* 4 applies to a *firm* with an *IRB permission* - *Rules* waived or modified: (a) *GENPRU* 2.1.51R (b) *BIPRU* 3.1.1R	- Part Three, Title II, Chapter 3 - Art. 143 - Art. 178.1(b) (where a *firm* is authorised to replace 90 days with 180 days for *exposures* secured by residential or SME commercial real estate in the retail *exposure* class)
2	Eligibility of physical collateral under the IRB Approach	- *BIPRU* 4.10.16R (Where authorised by the *firm's IRB permission*)	Art. 199.6
3	Master netting agreement internal models approach	- *BIPRU* 5.6.1R, in accordance with *BIPRU* 5.6.12R	Art. 221
4	Supervisory formula method for *securitisation* transactions	- *BIPRU* 9.12.3R - *BIPRU* 9.12.5R - *BIPRU* 9.12.21R (Where authorised by the *firm's IRB permission*)	Art. 259.1(b) Art. 262
5	ABCP internal assessment approach	- *BIPRU* 9.12.20R (Where authorised by the *firm's IRB permission*)	Art. 259.3
6	Exceptional treatment for liquidity facilities where pre-	- *BIPRU* 9.11.10R as modified in accordance with *BIPRU* 9.12.28G	Art. 263.2

	securitisation risk-weighted exposure amount cannot be calculated	(Where authorised by the *firm's IRB permission*)	
7	Advanced Measurement Approach (AMA) permission	- *BIPRU* 6.5 applies to a firm with an *AMA permission* - *Rule* waived or modified: *BIPRU* 6.2.1R	- Art. 312.2 - Part Three, Title III, Chapter 4
8	Combined use of different approaches for operational risk – AMA and Standardised Approach or Basic Indicator Approach	- *BIPRU* 6.2.9R (in accordance with *BIPRU* 6.2.10G and the *firm's AMA permission*)	Art. 314, par. 2 and 3
9	Permission to use internal models to calculate *own funds requirements* for market risk (Value at Risk)	- *BIPRU* 7.10 applies to a firm with a *VaR model permission* - *Standard market risk PRR rules* as specified and waived or modified by the *firm's VaR model permission waiver* - *GENPRU* 2.1.52R	- Art. 363 - Part Three; Title IV; Chapter 5; Sections 2, 3 and 4
10	Permission to use internal models to calculate *own fund requirements* for the correlation trading portfolio	*BIPRU* 7.10.55T R to *BIPRU* 7.10 55ZAR (Where the *firm* is authorised to use the *all price risk measure* in its *VaR model permission waiver*)	Art. 377

1.11	R	Table on other waivers and requirements

	Permission	**Column A** **FCA Rule (rule waiver or modification)**	**Column B** **EU CRR Reference**
1	Individual consolidation method	- *BIPRU* 2.1.7R (*Solo consolidation waivers*)	Art. 9
2	Derogation to the application of *own funds requirements* on a	- *BIPRU* 8.4 applies to a *firm* with an *investment firm consolidation waiver*	Art. 15 Art. 17

	consolidated basis for groups of *investment firms*	- *Rules* waived: (a) *BIPRU* 8.2.1R (b) *BIPRU* 8.2.2R (c) *BIPRU* 8.3.1R (d) *BIPRU* 8.3.2R	
3	Methods of prudential consolidation – art. 12(1) relationship	- *BIPRU* 8.5.6(2)R (as required in the *Part 4A permission* of the *firm*)	Art. 18.3
4	Methods of prudential consolidation- Significant influence or single management relationship	- *BIPRU* 8.5.6(2)R - "*Art. 134 relationship*" (as required in the *Part 4A permission* of the *firm*)	Art. 18.6
5	Entities excluded from the scope of prudential consolidation	- *BIPRU* 8.5.9R - *BIPRU* 8.5.10R	Art. 19.2
6	Permission to revert to the use of a less sophisticated approach for credit risk	- *BIPRU* 4.2.23R (as modified in accordance with *BIPRU* 4.2.25G) - *BIPRU* 4.2.24R (as modified in accordance with *BIPRU* 4.2.25G)	Art. 149
7	Traditional *securitisation* – recognition of significant risk transfer	- *BIPRU* 9.4.11R - *BIPRU* 9.4.12R (subject to conditions in *BIPRU* 9.4.15D)	Art. 243 par. 2, 3, 4 and 5
8	Synthetic *securitisation* – recognition of significant risk transfer	- *BIPRU* 9.5.1R (6) and(7) (subject to conditions in *BIPRU* 9.5.1BD)	Art. 244, par. 2, 3, 4 and 5
9	*Securitisations* of revolving exposures with *early amortisation provisions* – similar transactions	- *BIPRU* 9.3.11R - *BIPRU* 9.13.13R - *BIPRU* 9.13.14R - *BIPRU* 9.13.15R - *BIPRU* 9.13.16R - *BIPRU* 9.13.17R	Art. 256.7

		(subject to conditions in *BIPRU* 9.13.18G)	
10	Permission to revert to the use of a less sophisticated approach for *operational risk*	- *BIPRU* 6.2.5R (as modified in accordance with *BIPRU* 6.2.6G) - *BIPRU* 6.2.7R (as modified in accordance with *BIPRU* 6.2.8G)	Art. 313
11	Combined use of different approaches for *operational risk* – Standardised Approach and Basic Indicator Approach	- *BIPRU* 6.2.12R (as modified in accordance with *BIPRU* 6.2.13G)	Art. 314.4
12	Waiver of the three-year average for calculating the *own funds requirement* under the Basic Indicator Approach for *operational risk*	- *BIPRU* 6.3.2R (as modified in accordance with *BIPRU* 6.3.9G)	Art. 315
13	Waiver of the three-year average for calculating the *own funds requirement* under the Standardised Approach for *operational risk*	- *BIPRU* 6.4.5R (as modified in accordance with *BIPRU* 6.4.8G)	Art. 317.4
14	*Own funds requirements* for position risk for options and warrants on: (a) interest rates; (b) debt instruments; (c) equities; (d) equity indices; (e) financial futures; (f) swaps; and (g) foreign currencies	- *BIPRU* 7.9 applies to a *firm* with a *CAD1 model waiver*. - *Rules* waived or modified: (a) *GENPRU* 2.1.52R (b) *BIPRU* 7.6.1R	Art. 329

15	*Own funds requirements* for commodities risk for options and warrants on: (a) commodities; and (b) commodities derivatives	- *BIPRU* 7.9 applies to a *firm* with a *CAD1 model waiver*. - *Rules* waived or modified: (a) *GENPRU* 2.1.52R (b) *BIPRU* 7.4.1R	Art. 358.3
16	Interest-rate risk on derivative instruments	- *CAD 1 model waiver* for the use of an interest rate pre-processing model in line with *BIPRU* 7.9.44G - *Rule waived*: *GENPRU* 2.1.52R	Art. 331 Art. 340
17	Waiver of 100% large exposure limits where the €150 million limit applies	- *BIPRU* 10.6.32R (as waived in accordance with *BIPRU* 10.6.33G) - *SUP* 15.3.11R	Art. 396 in relation to the 100% large exposure limit set out in Art. 395(1)
18	Waiver of large exposure limits in relation to intra-group exposures: core group waivers	- *BIPRU* 3.2.25R(2) - *BIPRU* 10.8A	Art. 113.6 Art. 400.1(f)
19	Waiver of large exposure limits in relation to intra-group exposures: non-core group waivers	- *BIPRU* 10.9A	Art. 400.2(c) as implemented by *IFPRU* 8.2.4R to 8.2.7R (Intra-group exposures: non-core large exposures group)

TP 2 Own funds requirements

	Application	
2.1	R	*IFPRU* TP 2 applies to an *IFPRU investment firm*, unless it is an *exempt*

		IPFRU commodities firm.
	Purpose	
2.2	G	*IFPRU* TP 2 contains the *rules* that exercise the discretion afforded to the *FCA* as *competent authority* under article 465 of the *EU CRR*. *IFPRU* TP 2 applies instead of article 92(1)(a) and (b) of the *EU CRR* (Own funds requirements) for the duration of the transitional.
	Duration of transitional	
2.3	R	*IFPRU* TP 2 applies until 31 December 2014.
	Common equity tier 1 ratio	
2.4	R	The *common equity tier 1 capital* ratio which a *firm* must meet or exceed for the period from 1 January 2014 until 31 December 2014 shall be 4%.
		[**Note**: article 465(1)(a) of the *EU CRR*]
	Tier 1 capital ratio	
2.5	R	The *tier 1 capital* ratio which a *firm* must meet or exceed for the period from 1 January 2014 until 31 December 2014 shall be 5.5%.
		[**Note**: article 465(1)(b) of the *EU CRR*]

TP 3 Gains and losses

	Application	
3.1	R	*IFPRU* TP 3 applies to an *IFPRU investment firm*, unless it is an *exempt IPFRU commodities firm.*
	Purpose	
3.2	G	*IFPRU* TP 3 contains the *rules* that exercise the discretion afforded to the *FCA* as *competent authority* under articles 467 and 468 of the *EU CRR*. The applicable percentages in *IFPRU* TP 3 apply instead of articles 33(1)(c) (Changes in the value of own liabilities) and 35 (Unrealised gains and losses measured at fair value) of the *EU CRR* for the duration of the transitional.
	Duration of transitional	
3.3	R	*IFPRU* TP 3 applies until 31 December 2017.
	Inclusion of unrealised losses at fair value	

3.4	R	For the purposes of article 467(1) of the *EU CRR*, the applicable percentages are:	
		(1)	20% during the period from 1 January 2014 to 31 December 2014;
		(2)	60% during the period from 1 January 2015 to 31 December 2015;
		(3)	60% during the period from 1 January 2016 to 31 December 2016; and
		(4)	80% for the period from 1 January 2017 to 31 December 2017.
		[**Note**: article 467(2) of the *EU CRR*]	
	Removal of unrealised gains at fair value		
3.5	R	For the purposes of article 468(1) of the *EU CRR*, the applicable percentages are:	
		(1)	60% during the period from 1 January 2015 to 31 December 2015;
		(2)	40% during the period from 1 January 2016 to 31 December 2016; and
		(3)	20% for the period from 1 January 2017 to 31 December 2017.
		[**Note**: article 468(2) of the *EU CRR*]	
	Inclusion of fair value gains and losses		
3.6	R	For the purposes of article 468(4) of the *EU CRR*, the applicable percentages are:	
		(1)	20% during the period from 1 January 2014 to 31 December 2014;
		(2)	40% during the period from 1 January 2015 to 31 December 2015;
		(4)	60% during the period from 1 January 2016 to 31 December 2016; and
		(4)	80% for the period from 1 January 2017 to 31 December 2017.

TP 4 Deductions from own funds

	Application	
4.1	R	*IFPRU* TP 4 applies to an *IFPRU investment firm*, unless it is an *exempt IPFRU commodities firm.*

	Purpose		
4.2	G	*IFPRU* TP 4 contains the *rules* that exercise the discretion afforded to the *FCA* as *competent authority* under articles 469, 474 and 477 of the *EU CRR*. The applicable percentages in *IFPRU* TP 4 apply instead of articles 36(1), 56 (1)(c) and 66 of the *EU CRR* for the duration of the transitional.	
	Duration of transitional		
4.3	R	*IFPRU* TP 4 applies until 31 December 2023.	
	Deduction from common equity tier 1		
4.4	R	For the purposes of article 469(1)(a) of the *EU CRR,* as it applies to the items in points (b), (d), (f), (g) and (h) of article 36(1) of the *EU CRR* (Deductions from Common Equity Tier 1 items), the applicable percentages are:	
		(1)	20% during the period from 1 January 2014 to 31 December 2014;
		(2)	40% during the period from 1 January 2015 to 31 December 2015;
		(3)	60% during the period from 1 January 2016 to 31 December 2016; and
		(4)	80% for the period from 1 January 2017 to 31 December 2017.
4.5	R	For the purposes of article 469(1)(a) of the *EU CRR* as it applies to the items in points (a), (e) and (i) of article 36(1)) of the *EU CRR* (Deductions from Common Equity Tier 1 items), the applicable percentages are:	
		(1)	100% during the period from 1 January 2014 to 31 December 2014;
		(2)	100% during the period from 1 January 2015 to 31 December 2015;
		(3)	100% during the period from 1 January 2016 to 31 December 2016; and
		(4)	100% for the period from 1 January 2017 to 31 December 2017.
4.6	R	For the purposes of article 469(1)(c) of the *EU CRR*, as it applies to the items in point (c) of article 36(1)) of the *EU CRR* (Deductions from Common Equity Tier 1 items) that existed prior to 1 January 2014, the applicable percentages are:	
		(1)	10% for the period from 1 January 2014 to 31 December 2014;
		(2)	20% for the period from 1 January 2015 to 31 December 2015;
		(3)	30% for the period from 1 January 2016 to 31 December 2016;

		(4)	40% for the period from 1 January 2017 to 31 December 2017;
		(5)	50% for the period from 1 January 2018 to 31 December 2018;
		(6)	50% for the period from 1 January 2019 to 31 December 2019;
		(7)	60% for the period from 1 January 2020 to 31 December 2020;
		(8)	70% for the period from 1 January 2021 to 31 December 2021;
		(9)	80% for the period from 1 January 2022 to 31 December 2022; and
		(10)	90% for the period from 1 January 2023 to 31 December 2023.
4.7	R	For the purposes of article 469(1)(c) of the *EU CRR*, as it applies to the items in point (c) of article 36(1)) of the *EU CRR* (Deductions from Common Equity Tier 1 items) that did not exist prior to 1 January 2014, the applicable percentages are:	
		(1)	20% during the period from 1 January 2014 to 31 December 2014;
		(2)	40% during the period from 1 January 2015 to 31 December 2015;
		(3)	60% during the period from 1 January 2016 to 31 December 2016; and
		(4)	80% for the period from 1 January 2017 to 31 December 2017.
	Deductions from additional tier 1 items		
4.8	R	For the purposes of article 474(a) of the *EU CRR*, the applicable percentages are:	
		(1)	20% during the period from 1 January 2014 to 31 December 2014;
		(2)	40% during the period from 1 January 2015 to 31 December 2015;
		(3)	60% during the period from 1 January 2016 to 31 December 2016; and
		(4)	80% for the period from 1 January 2017 to 31 December 2017.
	Deductions from tier 2 items		
4.9	R	For the purposes of article 476(a) of the *EU CRR*, the applicable percentages are:	
		(1)	20% during the period from 1 January 2014 to 31 December 2014;

		(2)	40% during the period from 1 January 2015 to 31 December 2015;
		(3)	60% during the period from 1 January 2016 to 31 December 2016; and
		(4)	80% for the period from 1 January 2017 to 31 December 2017.

TP 5 Own funds: other transitionals

	Application		
5.1	R	*IFPRU* TP 5 applies to an *IFPRU investment firm*, unless it is an *exempt IPFRU commodities firm.*	
	Purpose		
5.2	G	*IFPRU* TP 5 contains the *rules* that exercise the discretion afforded to the *FCA* as *competent authority* under articles 479 to 480 of the *EU CRR*. The applicable percentages in *IFPRU* TP 5 apply for the duration of the transitional.	
	Duration of transitional		
5.3	R	*IFPRU* TP 5 applies until 31 December 20121.	
	Recognition of instruments and items not qualifying as minority interests		
5.4	R	For the purposes of article 479(2) of the *EU CRR*, the applicable percentages are:	
		(1)	0% during the period from 1 January 2014 to 31 December 2014;
		(2)	0% during the period from 1 January 2015 to 31 December 2015;
		(3)	0% during the period from 1 January 2016 to 31 December 2016; and
		(4)	0% for the period from 1 January 2017 to 31 December 2017.
	Recognition of minority interests and qualifying additional tier 1 and tier 2 capital		
5.5	R	For the purposes of article 480(1) of the *EU CRR*, the applicable factors are:	
		(1)	0.2 during the period from 1 January 2014 to 31 December 2014;
		(2)	0.4 during the period from 1 January 2015 to 31 December 2015;

		(3)	0.6 during the period from 1 January 2016 to 31 December 2016; and
		(4)	0.8 for the period from 1 January 2017 to 31 December 2017.
	Additional filters and deductions		
5.6	R	For the purposes of article 481(1) of the *EU CRR*, the applicable percentages are:	
		(1)	0% during the period from 1 January 2014 to 31 December 2014;
		(2)	0% during the period from 1 January 2015 to 31 December 2015;
		(3)	0% during the period from 1 January 2016 to 31 December 2016; and
		(4)	0% for the period from 1 January 2017 to 31 December 2017.
	Limits on grandfathering		
5.7	R	For the purposes of article 486 of the *EU CRR*, the applicable percentages are:	
		(1)	80% during the period from 1 January 2014 to 31 December 2014;
		(2)	70% during the period from 1 January 2015 to 31 December 2015;
		(3)	60% during the period from 1 January 2016 to 31 December 2016;
		(4)	50% during the period from 1 January 2017 to 31 December 2017;
		(5)	40% during the period from 1 January 2018 to 31 December 2018;
		(6)	30% during the period from 1 January 2019 to 31 December 2019;
		(7)	20% during the period from 1 January 2020 to 31 December 2020; and
		(8)	10% during the period from 1 January 2021 to 31 December 2021.

[TP 6 Capital conservation buffer: transitional

	Application	
6.1	R	*IFPRU* TP 6 applies to an *IFPRU investment firm*, unless it is an *IFPRU*

		limited licence firm or *exempt IFPRU commodities firm*.	
	Purpose		
6.2	G	This section implements article 160 of *CRD* in relation to the *capital conservation buffer*. The amounts of the *capital conservation buffer* in *IFPRU* TP 6 apply instead of the amount of the *capital conservation buffer* in *IFPRU* 9.2.1R (Main requirement) for the duration of the transitional.	
	Duration of transitional		
6.3	R	*IFPRU* TP 6 applies with effect from 1 January 2016 (which is the date that *IFPRU* 9.2 (Capital conservation buffer) comes into effect) until 31 December 2018.	
	Modified main requirement		
6.4	R	This *rule* modifies *IFPRU* 9.2.1R (Main requirement) in the following manner:	
		(1)	from 1 January 2016 until 31 December 2016, the *capital conservation buffer* is the amount of *common equity tier 1 capital* equal to 0.625% of a *firm's total risk exposure amount*;
		(2)	from 1 January 2017 until 31 December 2017, the *capital conservation buffer* is the amount of *common equity tier 1 capital* equal to 1.25% of a *firm's total risk exposure amount*; and
		(3)	from 1 January 2018 until 31 December 2018, the *capital conservation buffer* is the amount of *common equity tier 1 capital* equal to 1.875% of a *firm's total risk exposure amount*.]

[TP 7 Countercyclical capital buffer: transitional

	Application	
7.1	R	*IFPRU* TP 7 applies to an *IFPRU investment firm*, unless it is an *IFPRU limited licence firm* or *exempt IFPRU commodities firm*.
	Purpose	
7.2	G	This section implements article 160 of *CRD* in relation to the *countercyclical capital buffer*. The amounts of the *countercyclical capital buffer* in *IFPRU* TP 7 apply instead of the amount of the *countercyclical capital buffer* in *IFPRU* 9.3.1R (Main requirement) for the duration of the transitional.
	Duration of transitional	
7.3	R	*IFPRU* TP 7 applies with effect from 1 January 2016 (which is the date that

		IFPRU 9.3 (Countercyclical capital buffer) comes into effect) until 31 December 2018.	
	Modified main requirement		
7.4	R	This *rule* modifies *IFPRU* 9.3.1R (Main requirement) in the following manner:	
		(1)	from 1 January 2016 until 31 December 2016, the *countercyclical capital buffer* is the amount of *common equity tier 1 capital* equal to 0.625% of a *firm's total risk exposure amount*;
		(2)	from 1 January 2017 until 31 December 2017, the *countercyclical capital buffer* is the amount of *common equity tier 1 capital* equal to 1.25% of a *firm's total risk exposure amount*; and
		(3)	from 1 January 2018 until 31 December 2018, the *countercyclical capital buffer* is the amount of *common equity tier 1 capital* equal to 1.875% of a *firm's total risk exposure amount*.]

TP 8 Leverage

	Application	
8.1	R	*IFPRU* TP 8 applies to an *IFPRU investment firm*.
	Purpose	
8.2	G	*IFPRU* TP 8 contains the *rules* that exercise the discretion afforded to the *FCA* as *competent authority* under article 499(3) of the *EU CRR*. *IFPRU* TP 9 applies instead of article 429(2) of the *EU CRR* (Leverage) for the duration of the transitional.
	Duration of transitional	
8.3	R	*IFPRU* TP 8 applies until 31 December 2017.
	End of quarter level ratio	
8.4	R	A *firm* may calculate the end-of-quarter leverage ratio instead of the leverage ratio that is an arithmetic mean of the monthly leverage ratios over a quarter.

Sch 1G Record-keeping requirements

(1)	The aim of the *guidance* in the following table is to give the reader a quick

	overall view of the relevant record keeping requirements.
(2)	It is not a complete statement of those requirements and should not be relied on as if it were.
(3)	Table

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
IFPRU 2.1.43R	*Firm's* assessment of its financial resources	(1) The major sources of risk the *firm* has identified (2) How the *firm* intends to deal with those risks (3) Details of the stress and scenario analyses carried out and the resulting financial resources estimated to be required	Not specified	At least three years

Sch 2G Notification and reporting requirements

(1)	The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant notification requirements.
(2)	It is not a complete statement of those requirements and should not be relied on as if it were.
(3)	Table

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
IFPRU 2.2.31R	Changes to evaluation as a result of change in interest rates	Decline in economic value of the *firm* by more than 20% of its *own funds*	Change in interest rates	Not specified
IFPRU 2.2.37R(6)	Results of stress test and scenario analysis	Results of stress test and scenario analysis	Completion of stress test and scenario analysis	Annually, not later than three *months* of its annual reporting date
IFPRU	Intention to	Fact of intention and details of	Intention to enter	At least one

3.2.6R	enter into a connected transaction	each connected transaction sufficient to allow evaluation	into a connected transaction	*month* prior to entry into the relevant transaction
IFPRU 3.2.8R	*Additional tier 1 instrument* or *tier 2 instrument* governed by the law of *third country* are capable of being written down or converted into *common equity tier 1 instrument*	Information sufficient to demonstrate that any *additional tier 1 instrument* or *tier 2 instrument* issued by ot that are governed by the law of *third country* are capable of being written down or converted into *common equity tier 1 instrument* to the same extent as an equivalent *own funds* instrument, including a properly reasoned legal opinion from an individual appropriately qualified in the relevant *third country*	Intention to issue	Not specified
IFPRU 3.2.10R	Intention by *firm* or member of its *group* to issue a capital instrument, other than *common equity tier 1 capital*, for inclusion in *capital resources*	Fact of intention and information in *IFPRU* 3.2.12R, eg. details of intended amount, issue date, type of investor, stage of capital, features of instrument and confirmation of compliance with the conditions for qualification as *own funds*	Intention to issue	One *month* prior to issue
IFPRU 3.2.13R	Intention by *firm* or member of its *group* to issue ordinary *shares* or debt instrument issued under a debt securities programme previously issued	Confirmation that terms of the capital instrument have not changed since the previous issue of that type of capital instrument and information in *IFPRU* 3.2.12R(1) and (3), eg. details of intended amount, issue date, type of investor, stage of capital, features of instrument and confirmation of compliance with the conditions for qualification as *own funds*	Intention to issue	No later than the date of issue
IFPRU 3.2.15R	Proposed changes to details of the issue of a capital instrument	Proposed change to intended date of issue, amount of issue, type of investors, type of *own funds* or other feature	Intention to change any details of the issue previously notified to the	As soon as changes are proposed

	notified		*FCA*	
IFPRU 3.2.16R	Intention by *firm* or member of its *group* member to amend or vary details of a capital instrument included in *own funds* or consolidated *own funds*	Proposed change and all information required under *IFPRU* 3.2.12R(1) to (4)	Intention to change any details of the issue previously notified to the *FCA*	One *month* prior to intended date of amendment
IFPRU 3.2.17R	Intention by *firm* or member of its *group* member to reduce *own funds* or consolidated *own funds*	Actions described in article 77 of the *EU CRR*	Intention to carry out the actions described in article 77 of the *EU CRR*	As soon as intention is formed
IFPRU 4.3.1R	Results of calculations for supervisory benchmarking of internal approaches	Results of the calculations of a *firm's internal approaches* for its *exposures* or positions included in benchmark portfolios and an explanation of the methodologies uses	Calculation of the results of its *internal approaches*	Annually
IFPRU 4.4.1R	Reliance on deemed transfer of significant risk under articles 243(2) and 244(2) of the *EU CRR*	Sufficient information to allow the *FCA* to assess whether the possible reduction in risk weighted exposure amounts achieved by the *securitisation* is justified by a commensurate transfer of credit risk to third parties	Intention to rely on deemed transfer of significant risk	Within a reasonable period before or after a relevant transfer, not being later than one *month* after the date of transfer
IFPRU 8.2.5R(4)	Intention to concentrate intra-group *exposures* to	Explanation of how *IFPRU* 8.2.5R(1) is met on a continuing basis and details of the counterparty, the size	Intention to concentrate intra-group *exposures* to *group*	Prior written notice before the *exposures* are

	group members in excess of 25% of *core UK group eligible capital*	and expected duration of the *exposure*	members in excess of 25% of *core UK group eligible capital*	concentrated
IFPRU 8.2.5R(6)	After ceasing to have concentration intra-group *exposures* in excess of 25% of *core UK group eligible capital*, intention to start to do so again	Explanation of how *IFPRU* 8.2.5R(1) is met on a continuing basis, details of the counterparty, the size and expected duration of the *exposure* and the reason for the *exposure*	Intention to start to concentrate intra-group *exposures* to *group* members in excess of 25% of *core UK group eligible capital*	Prior written notice before the start of concentrating *exposures* again
IFPRU 9.4.3R(2)	Failure to meet the *combined buffer*	Failure to meet the *combined buffer*	Failure to meet the *combined buffer*	No later than five *business days* from when it identified its failure
IFPRU 9.4.3R(9)	Intention to distribute any distributable profits or undertake any action under *IFPRU* 9.4.3R(2)	Matters described in *IFPRU* 9.4.3R(9)(a) to (d)	Intention to distribute any distributable profits or undertake any of the specified action	Not less than three *months* before intended date of distribution or action
IFPRU 9.5.2R	Capital conservation plan	Capital conservation plan	Failure to meet the *combined buffer*	No later than five *business days* from when it identified its failure, or such longer period up to 10 *business days* as notified by the *FCA*

Sch 3G Fees and other requirement payments

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

Sch 4 [Intentionally left blank]

Sch 5G Rights of action for damages

(1)	The table below sets out the rules in *IFPRU* contravention of which by an *authorised person* may be actionable under section 138D of the *Act* (Actions for damages) by a person who suffers loss as a result of the contravention.
(2)	If a "Yes" appears in the column headed "For private person", the *rule* may be actionable by a private person under section 138D (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001/2256)). A "Yes" in the column headed "Removed" indicates that the *FCA* has removed the right of action under section 138D(3) of the *Act*. If so, a reference to the rule in which it is removed is also given.
(3)	The column headed "For other person" indicates whether the *rule* may be actionable by a *person* other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of *person* by whom the *rule* may be actionable is given.

Chapter/Appendix	Section/Annex	Right of action under section 138D		
		For private person	Removed	For other person
All *rules* in *IFPRU*		No	Yes – *IFPRU* 1.3.1R	No

Sch 6G Rules that can be waived

The rules in *IFPRU* may be waived by the *FCA* under section 138A of the *Act* (Modification or waiver of rules). However, if the *rules* incorporate requirements laid down in European directives or regulations, it will not be possible for the

FCA to grant a *waiver* that would be incompatible with the *UK's* responsibilities under those directives and regulations. It therefore follows that if a *rule* in *IFPRU* contains provisions which derive partly from a directive or regulation, and partly not, the *FCA* will be able to consider a *waiver* of the latter requirements only, unless the directive or regulation provisions are optional rather than mandatory

Annex B

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.

additional tier 1 capital	as defined in article 61 of the *EU CRR*.
additional tier 1 instrument	a capital instrument that qualifies as an additional tier 1 capital instrument under article 52 of the *EU CRR*.
article 18(5) relationship	the relationship where there are participations or capital ties other than those referred to in article 18(1) and (2) of the *EU CRR* (Methods for prudential consolidation).
article 18(6) relationship	(in accordance with article 18 of the *EU CRR* (Methods for prudential consolidation)) a relationship of one of the following kinds: (1) where an *institution* exercises a significant influence over one or more *institutions* or *financial institutions*, but without holding a *participation* or other capital ties in these *institutions*; or (2) where two or more *institutions* or *financial institutions* are placed under single management other than under a contract or clauses of their memoranda or articles of association.
base own funds requirement	(for the purpose of *IFPRU*) an amount of *own funds* that an *IFPRU investment firm* must hold as set out in *IFPRU* 3.1.6R (Own funds: main requirement).
capital conservation buffer	(in accordance with article 129(1) of *CRD* (Definitions)) the amount of *common equity tier 1 capital* a *firm* must calculate in accordance with *IFPRU* 9.2.1R.
combined buffer	the sum of: (1) the *capital conservation buffer*; and (2) the *countercyclical capital buffer*.
common equity tier 1 capital	as defined in article 50 of the *EU CRR*.
common equity tier 1 instrument	a capital instrument that qualifies as a common equity tier 1 instrument under article 26 of the *EU CRR*.

consolidated basis	has the meaning in article 4(1)(48) of the *EU CRR*.
consolidated situation	has the meaning in article 4(1)(47) of the *EU CRR*.
consolidating supervisor	has the meaning in Article 4(1)(41) of the *EU CRR*.
core UK group direction	a direction given by the *FCA* under article 113(6) of the *EU CRR*.
core UK group eligible capital	means the eligible capital in the *core UK group* calculated in line with *IFPRU* 8.2.7R.
countercyclical capital buffer	(in accordance with article 130(2) of *CRD* (Definitions)) the amount of *common equity tier 1 capital* a *firm* must calculate in accordance with *IFPRU* 9.3.1R.
countercyclical capital buffer rate	(in accordance with article 130(7) of the *CRD* (Definitions)): (a) the rate set by the *UK countercyclical buffer authority* or an *EEA countercyclical buffer authority* expressed as a percentage of *total risk exposure amount*; or (b) the rate set by a *third country countercyclical buffer authority* expressed in terms equivalent to a percentage of *total risk exposure amount*, that a *firm* must apply in order to calculate its *countercyclical capital buffer*.
CRD full-scope firm	an investment firm as defined in article 4(1)(2) of the *EU CRR* that is subject to the requirements imposed by *MiFID* (or which would be subject to that Directive if its head office were in an *EEA State*) and that is not a *limited activity firm* or a *limited licence firm*.
designated investment firm	an *authorised person* that has been designated by the *PRA* under article 3 of the *PRA-regulated Activities Order*.
distribution in connection with common equity tier 1 capital	(in accordance with article 141(10) of *CRD*) includes: (a) a payment of cash dividends; (b) a distribution of fully or partly paid bonus *shares* or other capital instruments referred to in article 26(1)(a) of the *EU CRR* (Common equity tier 1 items); (c) a redemption or purchase by a *firm* of its own *shares* or other capital instruments referred to in article 26(1)(a) of the *EU CRR* (Common equity tier 1 items);

	(d) a repayment of amounts paid in connection with capital instruments referred to in article 26(1)(a) of the *EU CRR* (Common equity tier 1 items); (e) a distribution of items referred to in article 26(1)(b) to (e) of the *EU CRR* (Common equity tier 1 items).
EEA countercyclical buffer authority	the authority of a *EEA State*, other than the *UK*, designated for the purpose of article 136 of *CRD* with responsibility for setting the *countercyclical buffer rate* for that *EEA State*.
eligible capital	has the meaning in article 4(1)(71) of the *EU CRR*.
EU CRR	the Regulation of the European Parliament and the Council on prudential requirements for credit institutions and investment firms (Regulation (EU) No 575/2013) and amending Regulation (EU) No 648/2012.
exempt IFPRU commodities firm	an *IFPRU investment firm* which falls within the meaning in articles 493(1) and 498(1) of the *EU CRR*.
FCA consolidation group	the *undertakings* included in the scope of prudential consolidation to the extent and in the manner prescribed in Part One, Title II, Chapter 2, Sections 2 and 3 of the *EU CRR* and *IFPRU* 8.1.3R to *IFPRU* 8.1.4R (Prudential consolidation) for which the *FCA* is the *consolidating supervisor* under [Art. 111 of the CRD].
financial sector entity	has the meaning in article 4(1)(27) of the *CRR*.
full CRD credit institution	an *undertaking* whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account and that has its registered office (or, if it has no registered office, its head office) in an *EEA state*, excluding an institution to which *CRD* does not apply under article 2 of *CRD*.
full-scope IFPRU investment firm	a *CRD full-scope firm* that is an *IFPRU investment firm*.
IFPRU	the Prudential sourcebook for Investment Firms
IFPRU investment firm	an *investment firm*, as defined in article 4(1)(2) of the *CRR* (including a *collective portfolio management investment firm*), that satisfies the following conditions: (a) it is a *firm*; (b) its head office is in the *UK* and it is not otherwise excluded under *IFPRU* 1.1.5R; and (c) it is not a *designated investment firm*;

	that is not excluded under *IFPRU* 1.1.5R(Exclusion of certain types of firms).
IFPRU limited-activity firm	a *limited activity firm* that meets the following conditions: (a) it is a *firm*; and (b) its head office is in the *UK* and it is not otherwise excluded under *IFPRU* 1.1.5R.
IFPRU limited-licence firm	a *limited licence firm* that meets the following conditions: (a) it is a *firm*; and (b) its head office is in the *UK* and it is not otherwise excluded under *IFPRU* 1.1.5R.
interest-rate contract	interest-rate contracts listed in paragraph 1 of Annex II to the *CRR*.
internal approaches	one or more of the following, as referred to in the *CRR*: (1) the Internal Ratings Based Approach in article 143(1); (2) the Internal Models Approach in article 221; (3) the Advanced Measurement Approaches in article 312(2); (4) the Internal Model Method and internal models in articles 283 and 363; (5) the internal assessment approach in article 259(3).
management body	(in accordance with article 3(7) of *CRD*) the *governing body* and *senior personnel* of a *CRR firm* who are empowered to set the *firm's* strategy, objectives and overall direction, and which oversee and monitor management decision-making.
management body in its supervisory function	the *management body* acting in its role of overseeing and monitoring management decision-making.
MDA	the maximum distributable amount calculated in line with *IFPRU* 9.4.3R.
model risk	the potential loss an *institution* may incur, as a consequence of decisions that could be principally based on the output of internal models used under any of the internal approaches, due to errors in the development, implementation or use of such models.
non-core large exposures group	a direction given by the *FCA* under article 400(2)(c) of the *CRR* (Large exposures: exemptions).

direction	
non-core large exposures group exemption	the exemption in *IFPRU* 8.2.4R (Intra-group exposures: non-core large exposures group).
OTC derivative transaction	a derivative financial instrument of a type listed on Annex II to the *CRR* that is traded *over the counter*.
own funds instruments	has the meaning in article 4(1)(119) of the *EU CRR*.
own funds requirements	as defined in article 92 (Own funds requirements) of the *CRR*.
PRA-regulated Activities Order	the Financial Services and Market Act 2000 (PRA-regulated Activities) Order 2013 (SI 2013/556).
relevant credit exposures	(in accordance with article 140(4) of *CRD*) *exposures*, other than those referred to in article 112(a) to (f) of *CRR* (Exposure classes), that are subject to: (a) the *own funds requirements* for credit risk under Part Three, Title II of the *CRR*; (b) where the *exposure* is held in the *trading book*, *own funds requirements* for specific risk under Part Three, Title IV, Chapter 5 of the *CRR*; or (c) where the *exposure* is a *securitisation*, the *own funds requirements* under Part Three, Title II, Chapter 5 of the *CRR*.
risk control rules	*IFPRU* 2.2.58R to *IFPRU* 2.2.60R.
risk of excessive leverage	has the meaning in article 4(1)(94) of the *CRR*.
significant IFPRU firm	has the meaning in *IFPRU* 1.1.20R (Significant IFPRU firm).
sub-consolidated basis	has the meaning in article 4(1)(49) of the *CRR*.
systemically important institution	(in accordance with article 3(30) of *CRD*) an *EEA parent institution*, an *EEA parent financial holding company*, an *EEA parent mixed financial holding company* or an *institution* the failure or malfunction of which could lead to systemic risk.
systemic risk	a risk of disruption in the financial system with the potential to have serious negative consequences for the financial system and the real economy.
third country	a territory or country which is not an *EEA State*.

third country countercyclical authority	the authority of a *third country* empowered by law or regulation with responsibility for setting the *countercyclical buffer rate* for that *third country*.
tier 2 capital	as defined in article 71 of the *CRR*.
tier 2 instruments	a capital instrument that qualify as tier 2 instruments under article 62 of the *CRR*.
total risk exposure amount	the total risk exposure amount of a *firm* calculated in accordance with article 92(3) of the *CRR* (Own funds requirements).
UK countercyclical buffer authority	the [Bank / FPC] designated for the purpose of Article 136 of the *CRD* with responsibility for setting the *countercyclical buffer rate* for the *UK*.
UK designated investment firm	(in *BIPRU* 12) a *designated investment firm* which is a *body corporate* or *partnership* formed under the law of any part of the *UK*.
UK parent mixed financial holding company in a Member State	a *parent mixed financial holding company in a Member State* where the *EEA State* in question is the *UK*.

Amend the following definitions as shown.

ancillary services undertaking	(1) (in accordance with Article 4(21) of the *Banking Consolidation Directive* (Definitions) for the purpose of *GENPRU* (except in *GENPRU* 3) and *BIPRU* (except in *BIPRU* 12) and subject to (2)) and in relation to an *undertaking* in a *consolidation group*, *sub-group* or another group of *persons*) an *undertaking* complying with the following conditions: … (3) (except in (1)) has the meaning in article 4(1)(18) of the *EU CRR*.
base capital resources requirement	(except in *IPRU(INV)*) an amount of *capital resources* that an *insurer* must hold as set out in *GENPRU* 2.1.30R (Table: Base capital resources requirement for an insurer) or a *BIPRU firm* must hold under *GENPRU* 2.1.41R (Base capital resources requirement for a BIPRU firm) and *GENPRU* 2.1.48R (Table: Base capital resources requirement for a BIPRU firm) ~~or, as the case may be, *GENPRU* 2.1.60R (Calculation of the base capital resources requirement for banks authorised before 1993)~~.

BIPRU firm

~~has the meaning set out in *BIPRU* 1.1.6R (The definition of a BIPRU firm), which is in summary a *firm* that is:~~

~~(a) a *building society*; or~~

~~(b) a *bank*; or~~

~~(c) a *full scope BIPRU investment firm*; or~~

~~(d) a *BIPRU limited licence firm*; or~~

~~(e) *a BIPRU limited activity firm*;~~

a *firm*, as defined in article 4(1)(2)(c) of the *CRR* that is authorised to provide only one or more the following *investment services*:

(a) execution of orders on behalf of *clients*;

(b) *portfolio management*,

but excluding *firms* of the type listed in *BIPRU* 1.1.7R (Exclusion of certain types of firm from the definition of BIPRU firm).

CAD investment firm

~~has the meaning set out *BIPRU* 1.1.14R (Types of investment firm: CAD investment firm), which in summary is an *investment firm*~~ a *firm* that is subject to the requirements imposed by *MiFID* (or which would be subject to that Directive if its head office were in an *EEA State*) but excluding a *bank*, a *building society*, a *credit institution*, a *local* and an *exempt CAD firm* that meet the following conditions:

(a) it is a *firm* as defined in article 4(1)(2)(c) of the *CRR*; and

(b) it is authorised to provide only one or more the following *investment services*:

(i) execution of orders on behalf of *clients*;

(ii) *portfolio management*.

capital planning buffer

(in *BIPRU* 2.2 and *IFPRU* 2) the amount and quality of capital resources that a *firm* should hold at a given time in accordance with the *general stress and scenario testing rule*, so that the *firm* is able to continue to meet the *overall financial adequacy rule* throughout the relevant capital planning period in the face of adverse circumstances, after allowing for realistic management actions.

capital resources

(1) in relation to a *BIPRU firm* or an *insurer*, the *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~~

~~purpose of *BIPRU* 10 (Large exposures requirements)~~; or

(2) (in relation to ~~an *institution*~~ a *CAD investment firm* that is an *EEA firm* and not a *BIPRU firm* and which is required to meet the capital resources requirements of the *CRD implementation measures* for its *EEA State* on an individual basis) capital resources calculated under those *CRD implementation measures*; or

(3) (for the purpose of *GENPRU* and *BIPRU* (except *BIPRU* 12 (Liquidity standards)), in relation to an undertaking not falling within (1) or (2) and subject to (4)) capital resources calculated in accordance with (1) on the assumption that:

…

(4) (for the purposes of *GENPRU* and *BIPRU* (except *BIPRU* 12 (Liquidity standards) and in relation to any *undertaking* not falling within (1) or (2) for which the methodology in (3) does not give an answer whose *capital resources* a *BIPRU firm* (the "relevant firm") is required to calculate under a *Handbook rule*) capital resources calculated under (1) on the assumption that it is a *BIPRU firm* of the same category as the relevant firm.

central bank

(1) (in accordance with Article 4(23) of the *Banking Consolidation Directive* (Definitions) and for the purposes of *GENPRU* and *BIPRU*) includes the European Central Bank unless otherwise indicated

(2) (for the purposes of *IFPRU*) has the meaning in article 4(1)(46) of the *CRR*.

CIU

(1) (except in *IFPRU*) collective investment undertaking.

(2) (in *IFPRU*) has the meaning in article 4(1)(40) of the *CRR*.

competent authority

…

(8) (for the purposes of *IFPRU*) has the meaning in article 4(1)(7) of the *CRR*.

convertible

(for the purpose of *BIPRU* and *IFPRU*) a *security* which gives the investor the right to convert the *security* into a *share* at an agreed price or on an agreed basis.

core UK group

(1) (in relation to a *BIPRU 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)~~.

	(2)	(for a *IFPRU investment firm* (unless it is an *IFPRU limited-activity firm* or *IFPRU limited-licence firm*, or an *exempt IFPRU commodities firm* to which article 493(1) of the *CRR* (Transitional provision for large exposures) apply)) all counterparties which satisfy the conditions in article 113(6) of the *CRR* (Calculation of risk weighted exposure amounts: intragroup) and for which *exposures* are exempted, under article 400(1)(f) of the *CRR* (Large exposures: exemptions), from the application of article 395(1) of the *CRR* (Limits to large exposures).
core UK group waiver		(in *BIPRU*) 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).
CRD	(1)	(in *GENPRU* (except in *GENPRU* 3 (Cross sector groups) and *BIPRU* (except in *BIPRU* 12 (Liquidity standards)) the *Capital Adequacy Directive* and the *Banking Consolidation Directive*.
	(2)	(except in (1)) the Directive of the European Parliament and the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (No 2013/36/EU) and amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.
credit institution	(1)	(except in *REC*, *GENPRU*, *BIPRU* and *IFPRU*) (in accordance with articles 4(1) and 107 of the *BCD*):
		(a) an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account; or
		(d) for the purpose of *BIPRU* 10 (Large exposures requirements) it means:
		(i) a credit institution defined by (1)(a) to (1)(b) that has been authorised in an *EEA State*;

(ii) any private or public undertaking which meets the definition in (1)(a) – 1(b) and which has been authorised in a *non-EEA State*. [deleted]

(see also *BCD credit institution*, *full credit institution*, *full BCD credit institution* and *Zone A credit institution*.)

(1A) (in *GENPRU*, *BIPRU* and *IFPRU*) has the meaning in article 4(1)(1) of the *EU CRR*.

…

credit risk mitigation	(1)	(in *GENPRU* and *BIPRU*) (in accordance with Article 4(30) of the *Banking Consolidation Directive* (Definitions)) a technique used by an *undertaking* to reduce the credit risk associated with an *exposure* or *exposures* which the *undertaking* continues to hold.
	(2)	(in *IFPRU*) has the meaning in article 4(1)(58) of the *EU CRR*.
deal on own account	(1)	(for the purposes of *GENPRU* and *BIPRU*) has the meaning in *BIPRU* 1.1.23R (Meaning of dealing on own account) which is in summary the service referred to in point 3 of Section A Annex I to *MiFID*, subject to the adjustments in *BIPRU* 1.1.23R(2) and *BIPRU* 1.1.23R(3) (Implementation of Article 5(2) of the *Capital Adequacy Directive*).
	(2)	(for the purposes of *IFPRU*) has the meaning in *IFPRU* 1.1.12R (Meaning of dealing on own account) which is, in summary, the service referred to in point 3 of Section A of Annex I to *MiFID*, subject to the adjustments in *IFPRU* 1.1.12R(2) and *IFPRU* 1.1.12R(3) (Implementation of article 29(2) of *CRD*).
discretionary pension benefit	(1)	(in *SYSC* 19A19C) enhanced pension benefits granted on a discretionary basis by a *firm* to an *employee* as part of that *employee's* variable *remuneration* package, but excluding accrued benefits granted to an *employee* under the terms of his company pension scheme. [Note: article 4(9) of the *Banking Consolidation Directive*]
	(2)	(in *IFPRU* and *SYSC* 19A) has the meaning in article 4(1)(73) of the *EU CRR*.
early amortisation provision	(1)	(in *BIPRU*) (in accordance with Article 100 of the *Banking Consolidation Directive* (Securitisation of revolving exposures) and in relation to a *securitisation* within the meaning of paragraph (2) of the definition of securitisation)

a contractual clause which requires, on the occurrence of defined events, investors' positions to be redeemed prior to the originally stated maturity of the securities issued.

(2) (in *IFPRU*) has the meaning in article 242(14) of the *EU CRR*.

ECAI — an external credit assessment institution, as defined in article 4(1)(98) of the *EU CRR*.

EEA parent financial holding company

(1) (in accordance with Article 4(17) of the *Banking Consolidation Directive* (Definitions) and Article 3 of the *Capital Adequacy Directive* (Definitions) for the purpose of *BIPRU* (except in (2)) a *parent financial holding company in a Member State* which is not a *subsidiary undertaking* of an *institution* authorised in any *EEA State* or of another *financial holding company* or *mixed financial holding company* established in any *EEA State*.

(2) (for the purpose of *GENPRU* 3 (Cross sector groups), *IFPRU* and *BIPRU* 12 (Liquidity standards)) has the meaning as given to EU parent financial holding company in article 4(1)(31) of the *EU CRR*.

EEA parent institution

(1) (in accordance with Article 4(16) of the *Banking Consolidation Directive* and Article 2 of the *Capital Adequacy Directive* (Definitions) for the purpose of *BIPRU* (except in (2)) a *parent institution in a Member State* which is not a *subsidiary undertaking* of another *institution* authorised in any *EEA State*, or of a *financial holding company* or *mixed financial holding company* established in any *EEA State*.

(2) (for the purpose of *GENPRU* 3 (Cross sector groups), *IFPRU* and *BIPRU* 12 (Liquidity standards)) has the meaning as given to EU parent institution in article 4(1)(29) of the *EU CRR*.

EEA parent mixed financial holding company

(1) (in accordance with Article 4(17a) of the *Banking Consolidation Directive* (Definitions) for the purpose of *BIPRU* (except in (2)) a *parent mixed financial holding company in a Member State* which is not a *subsidiary undertaking* of an *institution* authorised in any *EEA State* or of another *financial holding company* or *mixed financial holding company* established in any *EEA State*.

(2) (for the purpose of *GENPRU* 3 (Cross sector groups), *IFPRU* and *BIPRU* 12 (Liquidity standards)) has the meaning as given to EU parent mixed financial holding company in article 4(1)(33) of the *EU CRR*.

EEA prudential sectoral legislation

(in relation to a financial sector) requirements applicable to *persons* in that *financial sector* in accordance with EEA legislation about prudential supervision of *regulated entities* in that *financial sector* and so that:

(a) (in relation to the *banking sector* and the *investment services sector*) in particular this includes the requirements laid down in the *EU CRR* and (in relation to a *CAD investment firm*) the *Banking Consolidation Directive* and the *Capital Adequacy Directive*; and

…

eligible ECAI

…

(c) (in *BIPRU* 12) that is listed in the first row in the table set out in *BIPRU* 12 Annex 1R.

equity

(for the purpose of *BIPRU* 7 and *IFPRU* 6) a *share*.

exempt full scope ~~BIPRU~~ IFPRU investment firm

A ~~*full scope BIPRU*~~ *full-scope* *IFPRU* *investment firm* falling into *BIPRU* 12.1.4R.

exempt CAD firm

(1) (except in *SYSC* and *IPRU(INV)*) ~~has the meaning set out in *BIPRU* 1.1.16R (Types of investment firm: exempt CAD firm) which is in summary an *investment firm* that satisfies certain specified conditions~~ a *firm* as defined in article 4(1)(2)(c) of the *EU CRR* that is authorised to provide only one or more the following *investment services*:

(a) investment advice;

(b) receive and transmit orders from investors as referred to in Section A of Annex I of *MiFID*).

exposure

…

(3) ~~(for the purposes of *BIPRU* 10 (Large exposures requirements)) has the meaning in *BIPRU* 10.2 (Identification of exposures and recognition of credit risk mitigation).~~ [deleted]

(4) (in *IFPRU* and to calculate *own funds requirements* under Part Three Title II (credit risk and counterparty credit risk) and the *combined buffers* in *IFPRU* 9 (Capital buffers)) has the meaning in article 5(1) of the *EU CRR*.

(5) (in *IFPRU* 8.2 (Large exposures) and for the purpose of Part Four ((Large exposures) of the *EU CRR*) has the meaning in article 389 of the *EU CRR* (Large exposures:

definitions).

financial holding company	(1)	(except in *BIPRU*) a *financial institution* that fulfils the following conditions:
		…
	(2)	(in *BIPRU* (except in (3)) a *financial institution* that fulfils the following conditions:
		(a) its *subsidiary undertakings* are exclusively or mainly *CAD investment firms* or *financial institutions*;
		(b) at least one of those *subsidiary undertakings* is a *CAD investment firm*; and
		(c) it is not a *mixed financial holding company*.
	(3)	(in *IFPRU* and *BIPRU* 12 (Liquidity standards)) has the meaning in article 4(1)(20) of the *EU CRR*.
financial institution	…	
	(2)	for the purposes of *GENPRU*, *BIPRU* (except in (3)) and *INSPRU* and in accordance with Article 1(3) (Scope) and 4(5) (Definitions) of the *Banking Consolidation Directive*) ~~the following~~:
		(a) an *undertaking*, other than a *credit institution* or an *investment firm*, the principal activity of which is to acquire holdings or to carry out one or more of the *listed activities* provided for in Sections A and B of Annex I of the *MiFID* when referring to the financial instruments provided in Section C of Annex I of that Directive;
		…
	(3)	(in *IFPRU*, *GENPRU* 3 (Cross sector groups) and *BIPRU* 12 (Liquidity standards)) has the meaning in article 4(1)(26) of the *EU CRR*.
	(4)	(for the purposes of consolidated requirements in *IFPRU* and in accordance with article 2(6) of *CRD*) the following:
		(a) financial institutions within the meaning in article 4(1)(26) of the *EU CRR*; and
		(b) those institutions permanently excluded by article 2(5) of *CRD* (Scope) with the exception of the ESCB central banks as defined in article 4(1)(45) of the *EU CRR*.

financial instrument

(1) (other than in (2) and (3)) instruments specified in Section C of Annex I to *MiFID*, that is:

…

(3) (in *IFPRU*) has the meaning in article 4(50) of the *EU CRR*.

general stress and scenario testing rule

(1) (in *GENPRU*, *BIPRU* and *INSPRU*) *GENPRU* 1.2.42R (Stress and scenario tests)

(2) (for the purpose of *IFPRU*) *IFPRU* 2.2.37R (Stress and scenario tests).

group

…

(3) (for the purposes of *SYSC* 12 (Group risk systems and controls requirement), *SYSC* 20 (Reverse stress testing) and *GENPRU* 1.2 (Adequacy of financial resources) as applicable to a *BIPRU firm* and in relation to a *person* "A"), A and any *person*:

…

(3A) (for the purposes of *SYSC* 12 (Group risk systems and controls requirement) and *SYSC* 20 (Reverse stress testing), as applicable to an *IFPRU investment firm* and *IFPRU*) and in relation to a *person* "A"), A and any *person*:

(a) who falls into (1);

(b) who is a member of the same *financial conglomerate* as A;

(c) who has a *consolidation Article 12(1) relationship* with A;

(d) who has a *consolidation Article 12(1) relationship* with any *person* in (a);

(e) who is a *subsidiary* of a *person* in (c) or (d);

(f) whose omission from an assessment of the risks to A of A's connection to any *person* coming within (a) to (e) or an assessment of the financial resources available to such *persons* would be misleading.

group of connected clients

(1) (in *BIPRU*) has the meaning given to it in *BIPRU* 10.3.5G.

(2) (in *IFPRU*) has the meaning in article 4(1)(39) of the *EU CRR*.

ICAAP rules	(1)	(in *GENPRU*) the *rules* in *GENPRU* 1.2.30R to *GENPRU* 1.2.39R (Systems, strategies, processes and reviews), *GENPRU* 1.2.42R (Main Requirements: Stress and scenario tests) and *GENPRU* 1.2.60R to *GENPRU* 1.2.61R (Documentation of risk assessments) as they apply on a solo level and on a consolidated level.
	(2)	(for the purpose of *IFPRU*) the *rules* in *IFPRU* 2.2.2R to *IFPRU* 2.2.7R (Strategies, processes and systems) to *IFPRU* 2.2.16R, *IFPRU* 2.2.37G (Stress and scenario tests) in relation to a *significant IFPRU firm* and *IFPRU* 2.2.43R (Documentation of risk assessments) as they apply on a individual basis and on a *consolidated basis*.
ILAS BIPRU firm		a *firm* falling into *BIPRU* 12.1.1R, but excluding a *firm* that is:
	(a)	an *exempt* ~~*full scopeBIPRU*~~ *full-scope IFPRU investment firm*; or
	(b)	~~a *BIPRU limited licence firm*~~ an *IFPRU limited-licence firm*; or
	(c)	~~a *BIPRU limited activity firm*~~ an *IPFRU limited-activity firm*; or
	(d)	an *exempt* ~~*BIPRU*~~ *IFPRU commodities firm*.
initial capital	…	
	(6)	(for the purpose of the definition of *dealing on own account* in *BIPRU* and in the case of an *undertaking* not falling within (3) or (4)) *capital resources* calculated in accordance with (3) and paragraphs (3) and (4) of the definition of *capital resources*; and
	…	
	(8)	(for an *IFPRU investment firm* and in accordance with article 28(1) of *CRD*) the amount of *own funds* referred to in article 26(1)(a) to (e) of the *EU CRR* and calculated in accordance with Part Two of those Regulations (Own funds).
	(9)	(for the purpose of the definition of *dealing on own account* in *IFPRU*) the amount of *own funds* referred to in article 26(1)(a) to (e) of the *EU CRR* and calculated in accordance with Part Two of those Regulations (Own funds).
institution	(1)	(for the purposes of *GENPRU* 3 (Cross sector groups), *BIPRU* 12 (Liquidity standards) and *IFPRU*) has the meaning in article 4(1)(3) of the *EU CRR*).

	(2)	(in accordance with Article 3(1)(c) of the *Capital Adequacy Directive* and Article 4(6) of the *Banking Consolidation Directive* (Definitions) and for the purposes of *GENPRU* and *BIPRU* (except in (1)) a *credit institution* or a *CAD investment firm*, whether or not it is incorporated in, or has its head office in, an *EEA State*.
investment firm	…	
	(3)	(in *IFPRU* and *BIPRU* 12 (Liquidity standards)) has the meaning in article 4(1)(2) of the *EU CRR*.
	(4)	(in *GENPRU* and *BIPRU* (except in (3)) any of the following: (a) a *firm* in (3); (b) a *BIPRU firm*.
investment services sector	(1)	a sector composed of one or more of the following entities: …
	(2)	(in *BIPRU* (except in *BIPRU* 12 (Liquidity standards)) a sector comprised of one or more of the following entities: (a) the entities in (1); and (b) a *CAD investment firm*.
large exposure	has the meaning set out in *BIPRU* 10.5.1R, which in summary is the *total exposure* of a *firm* to a *counterparty*, or a *group of connected clients*, whether in the *firm's non-trading book* or *trading book* or both, and *counterparties* falling within *BIPRU* 10.10A.1R within the trading book, which in aggregate equals or exceeds 10% of the *firm's capital resources*. has the meaning in article 392 of the *EU CRR* (Definition of a large exposure).	
limited activity firm	has the meaning set out in *BIPRU* 1.1.11R (Types of investment firm: Limited activity firms) article 96(1) of the *EU CRR*.	
limited licence firm	has the meaning set out in *BIPRU* 1.1.12R (Types of investment firm: Limited licence firms) article 95(1) of the *EU CRR*.	
local	(1)	(except in *BIPRU* 1.1 (Application and purpose) *IFPRU* 1.1 (Application and purpose) a *firm* which is a member of a *futures* and *options* exchange and whose *permission* includes a *requirement* that: …

(2) ~~(in *BIPRU* 1.1 (Application and purpose) and in accordance with article 3(1)(p) of the *Capital Adequacy Directive* (Definitions)) an *undertaking* dealing for its own account on markets in financial-futures or options or other derivatives and on cash markets for the sole purpose of hedging *positions* on derivatives markets or which deals for the accounts of other members of those markets and which are guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such an *undertaking* is assumed by clearing members of the same markets; for these purposes a clearing member means a member of the exchange or the clearing house which has a direct contractual relationship with the central counterparty (market guarantor).~~ [deleted]

(3) (in *IFPRU* 1.1 (Application and purpose) has the meaning given to the definition of "local firm" in article 4(1)(4) of the *EU CRR*.

loss

(1) (in *BIPRU* and in accordance with Article 4(26) of the *Banking Consolidation Directive* (Definitions) and for the purposes of the *IRB approach*, the *standardised approach* to credit risk and *BIPRU* 5 (Credit risk mitigation)) economic loss, including material discount effects and material direct and indirect costs associated with collection on the instrument.

(2) (in *IFPRU*) has the meaning in article 5(1) of the *EU CRR*.

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)~~ all counterparties which satisfy the conditions in *IFPRU* 8.2.4R (Intra-group exposures: non-core large exposures group) and for which *exposures* are partially exempted, under article 400(2)(c) of the *EU CRR* (Exemptions), from the application of article 395(1) of the *EU CRR* (Limits to large exposures).

non-EEA sub-group

(1) (in *BIPRU*) a group of *undertakings* identified as a *non-EEA sub-group* in *BIPRU* 8.3.1R (Main consolidation rule for non-EEA sub-groups); however where the provision in question refers to a *non-EEA sub-group* in another *EEA State* it means a group of *undertakings* identified in Article 73(2) of the *Banking Consolidation Directive* (Non-EEA sub-groups) required to be supervised on a consolidated

		basis under Article 73(2) of the *Banking Consolidation Directive* by a competent authority in that *EEA State*.
	(2)	(in *IFPRU*) a group of *undertakings* identified in article 22 of the *EU CRR* (Sub-consolidation in cases of entities in third countries).
operational risk	…	
	(3)	(in *IFPRU*) has the meaning in article 4(1)(52) of the *EU CRR*.
originator	(1)	(in *GENPRU* and *BIPRU*) (in accordance with Article 4(41) of the *Banking Consolidation Directive* (Definitions) and in relation to a *securitisation* within the meaning of paragraph (2) of the definition of securitisation) either of the following:
		…
	(2)	(in *IFPRU*) has the meaning in article 4(1)(13) of the *EU CRR*.
overall financial adequacy rule	(1)	(in *GENPRU*, *BIPRU* and *INSPRU*) *GENPRU* 1.2.26R (Requirement for certain *firms* to have adequate financial resources).
	(2)	(in *IFPRU*) *IFPRU* 2.2.1R (Adequacy of financial resources).
overall Pillar 2 rule	(1)	(in *GENPRU*, *BIPRU* and *INSPRU*) *GENPRU* 1.2.30R (Systems, strategies, processes and review for certain *firms*).
	(2)	(in *IFPRU*) *IFPRU* 2.2.7R (Strategy processes and systems).
own funds	(1)	(in *GENPRU* (except *GENPRU* 3 (Cross sector groups) and *BIPRU* (except *BIPRU* 12 (Liquidity standards)) own funds described in articles 56 to 57 of the *Banking Consolidation Directive*.
	…	
	(5)	(in *IFPRU*) has the meaning in article 4(1)(118) of the *EU CRR*.
parent financial holding company in a Member State	(1)	(in *GENPRU* and *BIPRU* (except in (2)) (in accordance with Article 4(15) of the *Banking Consolidation Directive* (Definitions) and Article 3 of the *Capital Adequacy Directive* (Definitions)) a *financial holding company* which is not itself a *subsidiary undertaking* of an *institution*

authorised in the same *EEA State*, or of a *financial holding company* or *mixed financial holding company* established in the same *EEA State*.

(2) (in *GENPRU* 3 (Cross sector groups), *BIPRU* 12 (Liquidity standards) and *IFPRU*) has the meaning in article 4(1)(30) of the *EU CRR*.

parent institution in a Member State

(1) (in *GENPRU* and *BIPRU* (except in (2)) (in accordance with Article 4(14) of the *Banking Consolidation Directive* and Article 3 of the *Capital Adequacy Directive* (Definitions)) an *institution* which has an *institution* or a *financial institution* as a *subsidiary undertaking* or which holds a *participation* in such an institution, and which is not itself a *subsidiary undertaking* of another *institution* authorised in the same *EEA State*, or of a *financial holding company* or *mixed financial holding company* established in the same *EEA State*.

(2) (in *GENPRU* 3 (Cross sector groups), *BIPRU* 12 (Liquidity standards) and *IFPRU*) has the meaning in article 4(1)(28) of the *EU CRR*.

parent mixed financial holding company in a Member State

(1) (in *GENPRU* and *BIPRU* (except in (2)) (in accordance with Article 4(15a) of the *Banking Consolidation Directive* (Definitions)) a *mixed financial holding company* which is not itself a *subsidiary undertaking* of an *institution* authorised in the same *EEA State*, or of a *financial holding company* or *mixed financial holding company* established in the same *EEA State*.

(2) (in *GENPRU* 3 (Cross sector groups), *BIPRU* 12 (Liquidity standards) and *IFPRU*) has the meaning in article 4(1)(32) of the *EU CRR*.

parent undertaking

(1) …

(c) for the purpose for the purposes of *BIPRU* (other than in (3)), *GENPRU* and *INSPRU* as they apply on a consolidated basis~~, for the purposes of *BIPRU* 10 (Large exposures requirements)~~ and for the purposes of *SYSC* 12 (Group risk systems and controls requirement) and *SYSC* ~~19A~~ 19C (Remuneration Code for BIPRU firms) and in relation to whether an *undertaking* is a parent *undertaking*) an *undertaking* which has the following relationship to another *undertaking* ("S"):

…

…

	(3)	(in *BIPRU* 12 (Liquidity standards), *IFPRU* and *SYSC* 19A (Remuneration Code)) has the meaning in article 4(1)(15) of the *EU CRR*.
participation	(1)	(for the purposes of *UPRU* and *GENPRU* and for the purposes of *BIPRU* and *INSPRU* as they apply on a consolidated basis):
		…
	(2)	(in *IFPRU*) has the meaning in article 4(1)(35) of the *EU CRR*.
position	(1)	(in accordance *BIPRU* 1.2.4R (Definition of the trading book: Positions)) includes proprietary positions and positions arising from client servicing and market making.
	(2)	(in *IFPRU*) has the meaning which it has, or is used, in the *EU CRR*.
sectoral rules	(in relation to a *financial sector*) rules and requirements relating to the prudential supervision of *regulated entities* applicable to *regulated entities* in that *financial sector* as follows:	
	…	
	(d)	(in relation to ~~prudential rules about~~ consolidated supervision for any *financial sector*) those requirements include ones relating to the form and extent of consolidation;
	…	
	(h)	references to the *appropriate regulator's sectoral rules* are to *sectoral rules* in the form of *rules* and, as applicable, the *EU CRR*.
securitisation	(1)	(subject to (2) and (3)) a process by which assets are sold to a bankruptcy-remote *special purpose vehicle* in return for immediate cash payment and that vehicle raises the immediate cash payment through the issue of debt securities in the form of tradable notes or commercial paper.
	…	
	(3)	(in *IFPRU*) has the meaning in article 4(1)(61) of the *EU CRR*.
securitisation position	(1)	(in *GENPRU* and *BIPRU*) (in accordance with Article 4(40) (Definitions) and Article 96 (Securitisation) of the *Banking Consolidation Directive*) an *exposure* to a *securitisation*

within the meaning of paragraph (2) of the definition of securitisation; and so that:

…

(2) (in *IFPRU*) has the meaning in article 4(1)(62) of the *EU CRR*.

senior management

(1) (in *BIPRU* 7.10 (Use of a value risk model) and in relation to a *firm*) the *firm's governing body* and those of the *firm's senior managers* and other senior management who have responsibilities relating to the measurement and control of the risks which the *firm's VaR model* is designed to measure or whose responsibilities require them to take into account those risks.

(2) (in *SYSC* and *IFPRU* and in accordance with article 3(9) of *CRD*) those *persons* who are a natural person and who exercise executive functions in an *institution* and who are responsible and accountable to the *management body* for the day-to-day management of the *institution*.

solo capital resources …

(2) ~~for the purpose of *BIPRU* 10 (Large exposures requirements) the definition in (1) is adjusted in accordance with *BIPRU* 10.8A.10R (Calculation of capital resources for a 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).~~ [deleted]

sponsor …

(3) (in *IFPRU*) has the meaning in article 4(1)(14) of the *EU CRR*.

subsidiary …

(3) (in *IFPRU*) has the meaning in article 4(1)(16) of the *EU CRR*.

supervisory review and evaluation process

(1) the *appropriate regulator's* assessment of the adequacy of certain *firms'* capital, as more fully described in *BIPRU* 2.2.9G (*BIPRU firms*) and *INSPRU* 7.1.91G to *INSPRU* 7.1.199G (*insurers*).

(2) the *FCA's* assessment of the adequacy of an *IFPRU investment firm's* capital, as more fully described in *IFPRU*

		2.3 (Supervisory review and evaluation process).
third country BIPRU firm	(1)	(in *BIPRU* (except in *BIPRU* 12 (Liquidity standards)) an *overseas firm* that:
		…
	(2)	(in *BIPRU 12* (Liquidity standards)) an *overseas firm* that: (a) is a *bank*; (b) is not an *EEA firm*; and (c) has its head office outside the *EEA*.
third country ~~banking or~~ investment services undertaking		(in *BIPRU*) ~~an *institution*~~ a *CAD investment firm*, a *financial institution* or an *asset management company* in a *non-EEA state*.
trading book	…	
	(4)	(in *IFPRU* and in relation to an *IFPRU investment firm*) has the meaning in article 4(1)(86) of the *EU CRR*.
trading book policy statement	(1)	(in *BIPRU*) has the meaning in *BIPRU* 1.2.29R (Trading book policy statements) which is in summary a single document of a *person* recording the policies and procedures referred to in *BIPRU* 1.2.26R and *BIPRU* 1.2.27R.
	(2)	(in *IFPRU*) the statement of policies and procedures relating to the *trading book*.
unfunded credit protection	(1)	(in *BIPRU* and in accordance with Article 4(32) of the *Banking Consolidation Directive* (Definitions)) a technique of *credit risk mitigation* where the reduction of the credit risk on the *exposure* of an undertaking derives from the *undertaking* of a third party to pay an amount in the event of the default of the borrower or on the occurrence of other specified events.
	(2)	(in *IFPRU*) has the meaning in article 4(1)(59) of the *EU CRR*.

Delete the following definitions. The deleted text is not shown.

BIPRU 50K firm

BIPRU 125K firm

BIPRU 730K firm

BIPRU investment firm

BIPRU limited activity firm

BIPRU limited licence firm

CAD full scope firm

EEA banking and investment group

full scope BIPRU investment firm

non-core large exposures group waiver

sovereign large exposures waiver

Annex C

Amendments to the Senior Management Arrangements, Systems and Controls sourcebook (SYSC)

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

20 Reverse stress testing

20.1 Application and purpose

Application

20.1.1 R (1) *SYSC* 20 applies to:

(a) a ~~*BIPRU*~~ *firm* which is:

…

(iii) a ~~*BIPRU*~~ *designated investment firm* which meets any of the criteria set out in (2) on an individual basis, or in (3) on a consolidated basis: and

…

(2) Subject to (4), *SYSC* 20 applies to a ~~*BIPRU*~~ *designated investment firm* if:

…

(3) Subject to (4), where all of the ~~*BIPRU*~~ *designated investment firms* within the same ~~*UK*~~ *consolidation group* or *non-EEA sub-group*, taken together as if they were one *firm*, meet any of the criteria in (2), *SYSC* 20 applies to each of those ~~*BIPRU*~~ *designated investment firms* as if it individually met the inclusion criteria in (2).

(4) Any ~~*BIPRU*~~ *designated investment firm* which is included within the scope of *SYSC* 20 in accordance with (2) or (3) in any given year will continue to be subject to *SYSC* 20 for the following two years irrespective of whether or not it continues to meet the inclusion criteria in any of those subsequent years.]

20.1.1A R (1) *SYSC* 20 applies to:

(a) an *IFPRU investment firm*; and

(b) a *BIPRU firm* which meets any of the criteria in (2) on an individual basis, or in (3) on a consolidated basis.

(2) Subject to (4), *SYSC* 20 applies to a *BIPRU firm* if:

(a) it has assets under management or administration of at least £10 billion (or the equivalent amount in foreign currency); or

(b) the total annual fee and commission arising from regulated activities is at least £250 million (or the equivalent amount in foreign currency); or

(c) it has assets or liabilities of at least £2 billion (or the equivalent amount in foreign currency).

(3) Subject to (4), where all of the *BIPRU firms* within the same *UK consolidation group* or *non-EEA sub-group*, taken together, as if they were one *firm*, meet any of the criteria in (2), *SYSC* 20 applies to each of those *BIPRU firms* as if it individually met the criteria in (2).

(4) Any *BIPRU firm* which is included within the scope of *SYSC* 20 in accordance with (2) or (3) in any given year will continue to be subject to *SYSC* 20 for the following two years, irrespective of whether or not it continues to meet the inclusion criteria in any of those subsequent years.

CAPITAL REQUIREMENTS DIRECTIVE IV (GENPRU AND BIPRU AMENDMENTS) INSTRUMENT 2013

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137A (The FCA's general rules);
(2) section 137T (General supplementary powers);
(3) section 138D (Actions for damages); and
(4) section 139A (Power of the FCA to give guidance).

B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 31 December 2013.

Amendments to the FCA Handbook

D. The General Prudential sourcebook (GENPRU) is amended in accordance with Annex A to this instrument.

E. The Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU) is amended in accordance with Annex B to this instrument.

Citation

F. This instrument may be cited as the Capital Requirements Directive IV (GENPRU and BIPRU Amendments) Instrument 2013.

By order of the Board of the Financial Conduct Authority
[*date*]

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.

1 Application

1.1 Application

…

1.1.2 G Broadly speaking however, *GENPRU* applies to:

(1) *insurer*;

(2) ~~a *bank*;~~ [deleted]

(3) ~~a *building society*;~~ [deleted]

(4) a *BIPRU* ~~*investment*~~ *firm*; and

(5) groups containing such *firms*.

…

1.2 Adequacy of financial resources

…

1.2.2A R ~~In relation to any provision in this section which applies to a *BIPRU firm*, a reference in that provision to "financial resources" does not constitute a reference to "liquidity resources".~~ [deleted]

1.2.3A G ~~In relation to:~~

~~(1)~~ ~~a *BIPRU firm*;~~

~~(2)~~ ~~an *incoming EEA firm* which:~~

~~(a)~~ ~~is a *full BCD credit institution*; and~~

~~(b)~~ ~~has a *branch* in the *United Kingdom*; and~~

~~(3)~~ ~~a *third country BIPRU firm* which:~~

~~(a)~~ ~~is a *bank*; and~~

~~(b) has a *branch* in the *United Kingdom*:~~

~~*BIPRU* 12 contains *rules* and *guidance* in relation to the adequacy of that *firm's* liquidity resources.~~ [deleted]

…

1.2.11 G The adequacy of a *firm's* financial resources needs to be assessed in relation to all the activities of the *firm* and the risks to which they give rise and so this section applies to a *firm* in relation to the whole of its business. ~~In the case of a *collective portfolio management investment firm* this means that this section is also applies to *scheme management activity* and to activities that are not *designated investment business* its activities in relation to the management of *AIFs* and/or *UCITS*.~~

Purpose

…

1.2.13 G This section amplifies *Principle* 4, under which a *firm* must maintain adequate financial resources. It is concerned with the adequacy of the financial resources that a *firm* needs to hold in order to be able to meet its liabilities as they fall due. These resources include both capital and liquidity resources. ~~As noted in *GENPRU* 1.2.3AG, however, the *appropriate regulator's rules* and *guidance* in relation to the adequacy of the liquidity resources of a *BIPRU firm* are set out in *BIPRU* 12.~~

1.2.14 G ~~In the case of a *bank* or *building society* this section implements Article 123 and (in part) Annex XI of the *Banking Consolidation Directive*.~~ In the case of a *BIPRU* ~~*investment*~~ *firm* this section implements the third paragraph of article 95(2) of the *EU CRR* applying Article 34 of the *Capital Adequacy Directive* so far as that Article applies Article 123 of the *Banking Consolidation Directive*.

…

Outline of other related provisions

…

1.2.21 G …

(2A) ~~*BIPRU* 12 sets out material on systems and controls that apply specifically to *liquidity risk* in relation to a *BIPRU firm*, a *branch* of an *incoming EEA firm* that is a *full BCD credit institution* and a *branch* of a *third country BIPRU firm* that is a *bank*.~~ [deleted]

…

…

Requirement to have adequate financial resources

…

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

…

Systems, strategies, processes and reviews

…

1.2.33 R …

(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 (*Large exposures* requirements).~~ [deleted]

…

…

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

…

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

(3) ~~a *firm* referred to in *GENPRU* 1.2.2R (Application of this section to certain non-*EEA firms*).~~[deleted]

…

Capital planning

…

1.2.78 G Additional *guidance* in relation to stress tests and scenario analysis for *liquidity risk* as that concept relates to an *insurer* is available in SYSC 11 (Liquidity risk systems and controls). ~~*BIPRU* 12 sets out the main *Handbook* provisions in relation to *liquidity risk* for a *BIPRU firm*.~~

…

1.3 Valuation

…

Purpose

…

1.3.3 G (1) In the case of a *BIPRU firm*, this section implements ~~Article 74 of the *Banking Consolidation Directive*,~~ Articles 64(4) and 64(5) of the *Banking Consolidation Directive* (Own funds) and Article 33 and Part B of Annex VII of the *Capital Adequacy Directive*.

…

General requirements: Accounting principles to be applied

1.3.4 R Subject to *GENPRU* 1.3.9R to *GENPRU* 1.3.10R and *GENPRU* 1.3.36R, except where a *rule* in *GENPRU*, *BIPRU* or *INSPRU* provides for a different method of recognition or valuation, whenever a *rule* in *GENPRU*, *BIPRU* or *INSPRU* refers to an asset, liability, *exposure*, equity or income statement item, a *firm* must, for the purpose of that *rule*, recognise the asset, liability, *exposure*, equity or income statement item and measure its value in accordance with whichever of the following are applicable:

…

(4) ~~the Building Societies (Accounts and Related Provisions) Regulation 1998;~~

…

…

General requirements: Valuation adjustments or, in the case of an insurer or a UK ISPV, valuation adjustments or reserves

…

1.3.35 G Reconciliation differences under *GENPRU* 1.3.34R should not be reflected in the valuations under *GENPRU* 1.3 but should be disclosed to the *appropriate regulator* in prudential returns. ~~*Firms* which are subject to the reporting requirement under *SUP* 16.*16* should disclose those reconciliation differences in the Prudent Valuation Return which they are required to submit to the *appropriate regulator* under *SUP* 16.16.4R.~~

1.3.35A G ~~*UK banks* and *BIPRU 730k firms* are reminded that they may, in respect of their prudent valuation assessments under *GENPRU* 1.3.4R and *GENPRU* 1.3.14R to *GENPRU* 1.3.34R, be subject to the requirement under *SUP* 16.16.4R to submit a Prudent Valuation Return to the *appropriate regulator*.~~

[deleted]

Specific requirements: BIPRU firms

1.3.36 R …

(3) A *BIPRU* ~~*investment*~~ *firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

…

…

2 Capital

2.1 Calculation of capital resources requirements

…

2.1.8 G (1) ~~This section implements minimum EC standards for the *capital resources* required to be held by an *insurer* undertaking business that falls within the scope of the *Consolidated Life Directive* (2002/83/EC), the *Reinsurance Directive* (2005/68/EC) or the *First Non-Life Directive* (1973/239/EEC) as amended.~~ [deleted]

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

(3) ~~In the case of a *collective portfolio management investment firm* this section implements article 9 of *AIFMD* and (in part) Article 7 of the *UCITS Directive*.~~ [deleted]

…

Main requirement: BIPRU firms

…

2.1.42 R At the time that it first becomes a ~~*bank*, *building society* or~~ *BIPRU* ~~*investment*~~ *firm*, a *firm* must hold *initial capital* of not less than the *base capital resources requirement* applicable to that *firm*.

…

Calculation of the variable capital requirement for a BIPRU firm

2.1.45 R Table: Calculation of the variable capital requirement for a BIPRU firm

This table belongs to *GENPRU* 2.1.40R.

Firm category	Capital requirement	
~~*Bank*, *building society* or *full scope BIPRU investment firm*~~	~~the sum of the following:~~	
	~~(1)~~	~~the *credit risk capital requirement*;~~
	~~(2)~~	~~the *market risk capital requirement*; and~~
	~~(3)~~	~~the *operational risk capital requirement*.~~
~~*BIPRU limited activity firm*~~	~~the sum of the following:~~	
	~~(1)~~	~~the *credit risk capital requirement*;~~
	~~(2)~~	~~the *market risk capital requirement*; and~~
	~~(3)~~	~~the *fixed overheads requirement*.~~
BIPRU ~~*limited licence*~~ *firm* ~~(including *collective portfolio management investment firms*)~~	…	

~~**Adjustment of the variable capital requirement calculation for UCITS investment firms**~~

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

…

Table: Base capital resources requirement for a BIPRU firm

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

Firm category	Amount: Currency equivalent of

~~*Bank*~~	~~€5 million~~
~~*Building society*~~	~~The higher of €1 million and £1 million~~
~~*BIPRU 730K firm*~~	~~€730,000~~
~~*BIPRU 125K firm*~~	~~€125,000~~
BIPRU ~~*50K*~~ *firm*	€50,000
~~*Collective portfolio management investment firm*~~	~~€125,000 plus, if the *funds under management* exceed €250,000,000, 0.02% of the excess, subject to a maximum of €10,000,000.~~

Definition of ~~BIPRU 730K firm, BIPRU 125K firm and~~ BIPRU 50K firm

2.1.49 G ~~The terms *BIPRU 730K firm*, *BIPRU 125K firm* and *BIPRU 50K firm* are defined in *BIPRU* 1.1 (Application and purpose). However for convenience the table in *GENPRU* 2.1.50G briefly summarises them.~~ The *Capital Adequacy Directive* sets out various categories of firms subject to differing levels of initial capital. For the purpose of the third paragraph of article 95(2) of the *EU CRR*, a *BIPRU firm* falls into the category in article 5(3) of the *Capital Adequacy Directive*. In summary, a *BIPRU firm*:

(1) does not provide the *ancillary service* of safekeeping and administration of *financial instruments* for the account of *clients*, including custodianship and related services such as cash/collateral management, and is not authorised to do so;

(2) does not deal in any *financial instruments* for its own account or underwrite issues of *financial instruments* on a firm commitment basis;

(3) offers one or more of the following services:

(a) reception and transmission of investors' orders for *financial instruments*;

(b) the execution of investors' orders for *financial instruments*; or

(c) the management of individual portfolios of investments in *financial instruments*; and

(4) does not hold clients' money and/or securities and is not authorised to do so (it should have a *limitation* or *requirement* prohibiting the holding of client money and its permission should not include *safeguarding and administering investments*).

~~Table: Definition of BIPRU 730K firm, BIPRU 125K firm and BIPRU 50K firm~~

The table in GENPRU 2.1.50G is deleted in its entirety. The deleted text is not shown.

…

Calculation of the fixed overheads requirement ~~(BIPRU investment firm only)~~

2.1.53 R ~~In relation to a~~ A *BIPRU* ~~*investment*~~ *firm* ~~which is required to~~ must calculate a *fixed overheads requirement*, ~~the~~ an amount ~~of that requirement~~ that is equal to one quarter of the *firm's* relevant fixed expenditure calculated in accordance with *GENPRU* 2.1.54R.

2.1.54 R For the purpose of *GENPRU* 2.1.53R, and subject to *GENPRU* 2.1.55R to *GENPRU* 2.1.57R, a *BIPRU* ~~*investment*~~ *firm's* relevant fixed expenditure is the amount described as total expenditure in its most recent audited *annual report and accounts*, less the following items (if they are included within such expenditure):

…

…

GENPRU 2.1.63R to GENPRU 2.1.74G are deleted in their entirety. The deleted text is not shown.

2.2 Capital resources

…

Purpose

…

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

…

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

Topic	Location of text
…	

~~Calculation of *capital resources* for *insurers*~~	~~*GENPRU* 2.2.22G to *GENPRU* 2.2.23G; *GENPRU* 2 Annex 1R~~
~~Limits on the use of different forms of capital for *insurer* (capital resources gearing rules for *insurer*)~~	~~*GENPRU* 2.2.29R to *GENPRU* 2.2.41R~~
~~Calculation of *capital resources* for *banks*~~	~~*GENPRU* 2 Annex 2R~~
~~Calculation of *capital resources* for *building societies*~~	~~*GENPRU* 2 Annex 3R~~
~~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* 2.2.44R to *GENPRU* 2.2.45R; *GENPRU* 2.2.47R to *GENPRU* 2.2.48R~~
~~Limits on the use of different forms of capital for *banks* and *building societies* (*capital resources gearing rules*)~~	~~*GENPRU* 2.2.29R to *GENPRU* 2.2.31G; *GENPRU* 2.2.46R; *GENPRU* 2.2.49R~~
Calculation of *capital resources* for *BIPRU* ~~*investment*~~ *firms*	…
Limits on the use of different forms of capital for *BIPRU* ~~*investment*~~ *firms* (certain types of capital resources cannot be used for certain purposes)	…
Limits on the use of different forms of capital for *BIPRU* ~~*investment*~~ *firms* (*capital resources gearing rules*)	…
…	…
~~*Core tier one capital*: valuation differences and fund for future appropriations for *insurer*~~	~~*GENPRU* 2.2.104R to *GENPRU* 2.2.108R~~
~~*Core tier one capital*: *deferred shares* (*building society* only)~~	~~*GENPRU* 2.2.108AR to *GENPRU* 108BG~~
~~*Tier one capital*: perpetual non-cumulative *preference shares* (*insurers* only)~~	~~*GENPRU* 2.2.109R to *GENPRU* 2.2.110G~~
~~*Innovative tier one capital* (excluding issues through *SPVs*) (*insurer* only)~~	~~*GENPRU* 2.2.76R; *GENPRU* 2.2.113R to *GENPRU* 2.2.122R~~
…	
Deductions from *tier one capital resources* and *tier two capital resources*	*GENPRU* ~~2.2.202R~~ 2.2.208R to *GENPRU* 2.1.216G; *GENPRU* 2.2.217G to *GENPRU*

	2.2.220R; *GENPRU* 2.2.236R to *GENPRU* 2.2.240G
...	…
Deductions from total *capital resources*	*GENPRU* 2.2.14G to *GENPRU* 2.2.16G; *GENPRU* ~~2.2.250R~~ 2.2.259R to *GENPRU* ~~2.2.265R~~ 2.2.62G
…	…
~~Other capital resources for *insurers*: unpaid *share* capital or *unpaid initial funds* and calls for supplementary contributions~~	~~*GENPRU* 2.2.266G to *GENPRU* 2.2.269G~~
Additional requirements for *insurer* carrying on *with-profits insurance business*	*GENPRU* 2.2.270R to *GENPRU* ~~2.2.275G~~ 2.2.272G; *GENPRU* 2.2.274G

…

Deductions from capital

2.2.14 G Deductions should be made at the relevant stage of the calculation of *capital resources* to reflect capital that may not be available to the *firm* or assets of uncertain value (for example, holdings of intangible assets and assets that are inadmissible for an *insurer*~~, or, in the case of a *bank* or *building society*, where that *firm* has made investments in a *subsidiary undertaking* or in another *financial institution* or in respect of *participations* that it holds~~).

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

…

Table: Applicable capital resources calculation

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

Type of *firm*	Location of *rules*	Remarks
~~*Insurer*~~	~~*GENPRU* 2 Annex 1R~~	
~~*Bank*~~	~~*GENPRU* 2 Annex 2R~~	
~~*Building society*~~	~~*GENPRU* 2 Annex 3R~~	

BIPRU ~~*investment*~~ *firm* without an *investment firm consolidation waiver*	…	Applies to a *BIPRU* ~~*investment*~~ *firm* not using *GENPRU* 2 Annex 5R or *GENPRU* 2 Annex 6R
BIPRU ~~*investment*~~ *firm* without an *investment firm consolidation waiver*	…	A *BIPRU* ~~*investment*~~ *firm* must give one *Month's* prior notice to the ~~*appropriate regulator*~~ <u>*FCA*</u> before starting to use or stopping using this method
BIPRU ~~*investment*~~ *firm* with an *investment firm consolidation waiver*	…	A *firm* with an *investment firm consolidation waiver* must use this method. No other *BIPRU* ~~*investment*~~ *firm* may use it.

Calculation of capital resource: Which rules apply to BIPRU ~~investment~~ firms

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

…

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

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

…

(2) ~~the *operational risk capital requirement*;~~ <u>[deleted]</u>

…

…

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

2.2.47 R For the purpose of meeting:

…

(3) the *fixed overheads requirement* ~~(where applicable)~~;

…

…

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

…

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

…

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

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

Description of the stage of the capital resources calculation	Stage in the *capital resources table*	Amount (£)
…	…	…
Credit~~, operational~~ and counterparty risk requirement	…	…
…		

…

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

In order to calculate the relevant *tier one capital* for the *upper tier three*

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

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

In practical terms, the same result is achieved for the relevant *tier one capital* for gearing by taking the amount carried forward to meet market risk of £40 and adding back the £10 in respect of the counterparty risk requirement. Again, there are other options as to the allocation to credit~~,~~ ~~operational~~ and counterparty risk of the constituent elements of Stage N of the *capital resources table*.

…

…

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*; or~~ [deleted]

…

…

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) …

(d) ~~a *deferred share*;~~ [deleted]

…

…

Core tier one capital: additional information

2.2.84 G In the case of an *insurer*, *GENPRU* 2.2.8 R(2) and *GENPRU* 2.2.83R(3) have 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~~ *GENPRU* 2.2.83DG impose more specific conditions on *coupon* payment and winding up which are applicable to *BIPRU firms*.

…

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

2.2.85 R (1) Negative amounts, including any interim net losses (but in the case of a *BIPRU* ~~*investment*~~ *firm*, only material interim net losses), must be deducted from profit and loss account and other reserves.

…

(3) If interim losses as referred to in (2) exceed the 10% figure in (2) then a *BIPRU* ~~*investment*~~ *firm* must deduct the whole amount of those losses and not just the excess.

…

Deduction from tier one: Intangible assets

…

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

2.2.156A G The treatment of deferred acquisition cost assets for *BIPRU firms* is dealt with in *GENPRU* 1.3 (Valuation); they should not be deducted as an intangible asset.

…

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

…

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

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

…

2.2.245 R This table belongs to *GENPRU* 2.2.244R.

Tier two capital rule	Adjustment
…	
~~*GENPRU* 2.2.160R (Holder of a non-deferred share of a building society to be treated as senior creditor)~~	
…	

…

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

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

…

2 Annex 4R Capital resources table for a BIPRU ~~investment~~ firm deducting material holdings

…

2 Annex 5R Capital resources table for a BIPRU ~~investment~~ firm deducting illiquid assets

…

2 Annex Capital resources table for a BIPRU ~~investment~~ firm with a waiver from

6R consolidated supervision

…

Part 2 of the capital resources calculation for an investment firm with a waiver from consolidated supervision	
… Note (4): The *material holdings* that must be deducted at part 2 of stage E are *material holdings* issued by *undertakings* which would have been members of the *firm's UK consolidation group* or *non-EEA sub-group* if the *firm* did not have an *investment firm consolidation waiver* if:	
(1)	in relation to a *BIPRU* ~~*investment*~~ *firm*, the holding forms part of the *undertaking's tier one capital resources*; or
…	
Note (6): The contingent liabilities that must be deducted by a *firm* at Part 1 of stage M are any contingent liabilities which the *firm* has in favour of *BIPRU* ~~*investment*~~ *firms*, *financial institutions*, *asset management companies* and *ancillary services undertakings* which would have been members of the *firm's UK consolidation group* or *non-EEA sub-group* if the *firm* did not have an *investment firm consolidation waiver*.	

…

GENPRU TP 7 is deleted in its entirety. The deleted text is not shown.

TP 8 Miscellaneous capital resources definitions for BIPRU firms

…			
		Preference shares	
8.7	R	A ~~*bank* or~~ *BIPRU* ~~*investment*~~ *firm* may treat a *preference share* as eligible for inclusion within stage B of the *capital resources table* (Perpetual non-cumulative preference shares) if it would not otherwise be eligible if:	
		(1)	on 31 December 2006 the *firm* was subject to ~~*IPRU(BANK)* or~~ *IPRU(INV)*;
		…	
		(3)	as at 31 December 2006 the *firm* included it, and was entitled to

			include it, in the calculation of its capital resources under ~~*IPRU(BANK)* or~~ *IPRU(INV)* as capital of a type that corresponded to *tier one capital resources*;	
		…		
		Upper tier 2 instruments: Deferral of interest		
8.9	R	A ~~*bank* or~~ *BIPRU* ~~*investment*~~ *firm* may treat a *capital instrument* as eligible for inclusion within stage G of the *capital resources table* (Upper tier two capital) if it would not otherwise be eligible if:		
		(1)	on 31 December 2006 the *firm* was subject to ~~*IPRU(BANK)* or~~ *IPRU(INV)*;	
		…		
		(3)	as at 31 December 2006 the *firm* included it, and was entitled to include it, in the calculation of its capital resources under ~~*IPRU(BANK)* or~~ *IPRU(INV)* as capital of a type that corresponded to *upper tier two capital resources*;	
		…		
		Conversion ratio		
8.11	R	*GENPRU* 2.2.138R(2) (Tier one capital: Conversion ratio) does not apply to a *capital instrument* issued by a *firm* if:		
		(1)	on 31 December 2006 the *firm* was subject to ~~*IPRU(BANK)*, *IPRU(BSOC)* or~~ *IPRU(INV)*;	
		…		
		(3)	as at 31 December 2006 the *firm* included it, and was entitled to include it, in the calculation of its capital resources under:	
			(a)	~~(in the case of a *bank*) *IPRU(BANK)* as innovative tier one capital as referred to in chapter CA of *IPRU(BANK)*; or~~ [deleted]
			(b)	~~(in the case of any other type of *firm*) *IPRU(BSOC)* or~~ *IPRU(INV)* as capital of a type that corresponded to *tier one capital*.
		Legal opinions		
8.12	R	*GENPRU* 2.2.118R (Legal opinions for *innovative tier one capital*) does not apply to a *capital instrument* issued by a *firm* if:		
		(1)	on 31 December 2006 the *firm* was subject to ~~*IPRU(BANK)*,~~	

			~~*IPRU(BSOC)* or~~ *IPRU(INV)*;	
		(2)	the *firm* issued the *capital instrument* on or before 31 December 2006; and	
		(3)	~~(in the case of a *bank*) as at 31 December 2006 the *bank* included the *capital instrument*, and was entitled to include it, in the calculation of its capital resources under *IPRU(BANK)* as innovative tier one capital as referred to in chapter CA of *IPRU(BANK)*; and~~ [deleted]	
		(4)	~~(in any other case)~~ the *firm* included the *capital instrument*, and was entitled to include it, in the calculation of its capital resources under ~~*IPRU(BSOC)* or~~ *IPRU(INV)* as capital of a type that corresponded to *tier one capital*.	
8.13	R	…		
		do not apply to a *capital instrument* issued by a *firm* if:		
		(5)	on 31 December 2006 the *firm* was subject to ~~*IPRU(BANK)*, *IPRU(BSOC)* or~~ *IPRU(INV)*;	
		…		
		(7)	as at 31 December 2006 the *firm* included the *capital instrument*, and was entitled to include it, in the calculation of its capital resources under ~~*IPRU(BANK)*, *IPRU(BSOC)* or~~ *IPRU(INV)* as capital of the type that corresponds to:	
			…	
…				
		Waivers and concessions		
8.16	G	A reference to a *firm* being entitled to include *capital instruments* in the calculation of its capital resources under *IPRU* at a particular level includes the *firm* being able to do this under a *waiver* ~~or, in the case of *IPRU(BANK)* or *IPRU(BSOC)*, a written approval by the *FSA*~~.		
…				

TP 8A Further miscellaneous capital resources definitions for BIPRU firms

…				
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*:		

		…		
		(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);~~ [deleted]	
		(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;~~ [deleted]
		…		
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):		
		…		
			(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~~ [deleted]
		…		

TP 8B Miscellaneous capital resources definitions for BIPRU firms: Core tier one capital

…				
		Core tier one capital		

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 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 issue entered into on 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*.~~ [deleted]	
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.~~ [deleted]		
…				

GENPRU TP 14 and GENPRU TP 16 are deleted in their entirety. The deleted text is not shown.

In the following table, the words in Column (2) in the provisions in Column (1) are replaced by the word in Column (3), except where indicated in Column (4), unless the context otherwise requires.

Column (1) (Handbook provisions to be amended)	**Column (2) (current wording)**	**Column (3) (new wording)**	**Column (4) (Handbook provisions not amended)**

GENPRU	*appropriate regulator*	*FCA*	GENPRU 1.2.15G GENPRU 1.2.19G GENPRU 1.2.40G GENPRU 1.2.55G GENPRU 1.2.73AG GENPRU 1.2.73BG GENPRU 1.3 (Valuation) GENPRU 2.1.6G GENPRU 2.1.10G GENPRU 2.1.11R GENPRU 2.1.12G GENPRU 2.2.8G GENPRU 2.2.61AR to GENPRU 2.2.61HG GENPRU 2.2.67AG GENPRU 2.2.68G GENPRU 2.2.69FG(1) and (2) GENPRU 2.2.70R GENPRU 2.2.71R GENPRU 2.2.73G GENPRU 2.2.74R GENPRU 2.2.74AG GENPRU 2.2.164G GENPRU 2.2.171R

			GENPRU 2.2.174R GENPRU 2.2.179G GENPRU 2.2.197G GENPRU 2.2.220R GENPRU 3 (Cross sector groups) Schedule 2G Schedule 6G

Annex B

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 Application

1.1 Application

1.1.1 G There is no overall application statement for *BIPRU*. Each chapter or section has its own application statement. Broadly speaking however, *BIPRU* applies ~~to~~ in the following manner:

(1) ~~a *bank*;~~ [deleted]

(2) ~~a *building society*;~~ [deleted]

(3) to a *BIPRU* ~~*investment*~~ *firm*; ~~and~~

(3A) to an *IFPRU investment firm*, only *BIPRU* 12 (Liquidity standards); and

(4) in relation to groups containing such *firms*:

(a) only *BIPRU* 12 (Liquidity standards) applies to the group containing any of the *firms* in (3) and (3A); and

(b) *BIPRU* as a whole applies to the group containing only the *firms* in (3).

…

1.1.3 G ~~In the main *BIPRU* only applies to a *collective portfolio management investment firm* in respect of *designated investment business* (excluding *managing an AIF* and *managing a UCITS*). However *BIPRU* 2.2 (Internal capital adequacy standards), *BIPRU* 2.3 (Interest rate risk in the non-trading book), *BIPRU* 8 (Group risk - consolidation) and *BIPRU* 11 (Disclosure) apply to the whole of its business.~~ [deleted]

Purpose

1.1.4 G *BIPRU* 1.1 implements in part the third paragraph of article 95(2) of the *EU CRR* that permit the *FCA* to apply the *Banking Consolidation Directive* and ~~Articles 3(1)(b), 5, 9, 10 and 20 of~~ the *Capital Adequacy Directive*.

~~Guidance on the categorisation of BIPRU investment firms~~

1.1.5 G ~~*Guidance* on the categorisation of *investment firms* for the purposes of *BIPRU* and *GENPRU* is included in PERG 13 (Guidance on the scope of the Markets in Financial Instruments Directive and the recast Capital Adequacy Directive).~~ [deleted]

~~The definition of a BIPRU firm~~

1.1.6 R ~~Subject to *BIPRU* 1.1.7R, a *BIPRU firm* means a *firm* that is:~~

~~(1) a *building society*; or~~

~~(2) a *bank*; or~~

~~(3) a *full scope BIPRU investment firm*; or~~

~~(4) a *BIPRU limited licence firm*; or~~

~~(5) *a BIPRU limited activity firm.*~~ [deleted]

1.1.7 R None of the following is a *BIPRU firm* ~~and each is excluded from each of the categories of *BIPRU investment firm* listed in *BIPRU* 1.1.6R(3) to *BIPRU* 1.1.6R(5) and *BIPRU* 1.1.18R(2) to (4)~~:

…

1.1.8 R ~~A *firm* falling within *BIPRU* 1.1.6R(3) to *BIPRU* 1.1.6R(5) is a *BIPRU investment firm*. A *BIPRU investment firm* includes a *collective portfolio management investment firm* that is not excluded under *BIPRU* 1.1.7R.~~ [deleted]

1.1.9 G ~~*EEA firms* are subject to the prudential standards of their home state regulator. But the *Banking Consolidation Directive* permits a host state *competent authority* to require a *BCD credit institution* to meet certain standards relating to its liquidity. The *appropriate regulator's* approach to liquidity for such *firms* is set out in *BIPRU* 12.~~ [deleted]

1.1.10 G …

(2) …

(a) it is unlikely that a *firm* that is not subject to equivalent supervision will be able to satisfy the *threshold conditions* (and in particular *threshold condition* 5 (Suitability)) and it is unlikely that it will be possible to establish that the *firm* does satisfy them; and

(b) such a *firm* is likely to pose a threat to the interests of *consumers* and potential *consumers*, particularly as effective supervision of an *overseas firm* depends on cooperation between the *appropriate regulator* and the *regulatory body* that authorises the *firm* in its home country and on the *appropriate regulator* being able to place appropriate reliance

on the supervision carried out by such *regulatory body*~~; and~~ .

(c) ~~under Article 38(1) of the *Banking Consolidation Directive* the *appropriate regulator* should not apply to *branches* of *credit institutions* having their head office outside the *EEA*, when commencing or carrying on their business, provisions which result in more favourable treatment than that accorded to *branches* of *credit institutions* having their head office in the *EEA*.~~ [deleted]

…

(5) An *overseas firm* that is subject to equivalent supervision is subject to the *threshold conditions* and the *Principles*. *BIPRU* and *GENPRU* do not generally apply. ~~However *BIPRU* 12 applies to a *credit institution* with respect to liquidity risk in relation to its *United Kingdom branch*.~~

BIPRU 1.1.11R to BIPRU 1.1.26R are deleted in their entirety. The deleted text is not shown.

1.2 Definition of the trading book

…

1.2.2 G ~~The~~ Pursuant to the third paragraph of article 95(2) of the *EU CRR*, the section implements certain provisions of the *Capital Adequacy Directive* and the *Banking Consolidation Directive* relating to the *trading book*. The precise provisions being implemented as listed as a note after each *rule*.

…

1.3 Applications for advanced approaches and waivers

…

1.3.2 G (1) A *firm* may apply for an *Article 129 permission* or a *waiver* in respect of:

…

(b) ~~the *advanced measurement approach*;~~

…

(2) A *firm* should apply for a *waiver* if it wants to:

…

(da) apply the treatment for a *core UK group* in *BIPRU* 3.2.25R (Zero risk-weighting for intra-group exposures) or in BIPRU 10.8A (Intra-group exposures: core UK group); or.

(e) apply the treatment for a *non-core large exposures group* in *BIPRU* 10.9A (Intra-group exposures: non-core large exposures group); or [deleted]

(f) apply the treatment in *BIPRU* 10.6.35R (Sovereign large exposure waiver). [deleted]

…

Forms and method of application

…

1.3.14 D If a *firm* wishes to apply for a *waiver* or an *Article 129 permission* to use the *advanced measurement approach*, it must complete and submit the form in *BIPRU* 1 Annex 1D D. [deleted]

…

2 Capital

2.1 Solo consolidation

…

2.1.2 G The Pursuant to the third paragraph of article 95(2) of the *EU CRR*, the purpose of this section is to implement Articles 70 and 118 of the *Banking Consolidation Directive*. so far as they apply under It also implements Articles 2 and 28 of the *Capital Adequacy Directive* so far as they apply those provisions of the *Banking Consolidation Directive* to *CAD investment firms* that are subject to the requirements imposed by *MiFID* (or which would have been subject to that Directive if its head office were in an *EEA State*), but excluding a *bank*, *building society*, a *credit institution*, a *local* and an *exempt CAD firm*.

…

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 (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 (Large exposure requirements) in accordance with *BIPRU* 8.9A (Consolidated large exposures requirements). Accordingly the *firm* must apply *BIPRU* 8.9A 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* 8.9A applies to a *UK consolidation group* or *non-EEA sub-group*.~~ [deleted]

2.1.17 G ~~One effect of *BIPRU* 2.1.16R is that *BIPRU* 10.8A (Core UK groups) and *BIPRU* 10.9A (Non-core large exposures groups) do not apply. The corresponding provisions of *BIPRU* 8.9A (Consolidated large exposures requirements) apply instead.~~ [deleted]

…

2.2 Internal capital adequacy standards

…

2.2.48 G (1) *BIPRU* ~~2.2.49G~~ 2.2.61G to *BIPRU* 2.2.70G set out guidance for:

(a) ~~a *bank* or *building society*;~~ [deleted]

…

…

2.3 Interest rate risk in the non-trading book

…

2.3.2 G (1) ~~Interest rate risk in the non-trading book will normally be a major source of risk for:~~

~~(a) a *bank*;~~

~~(b) a *building society*; and~~

~~(c) a *BIPRU investment firm* that deals on own account (including underwriting on a *firm* commitment basis) and whose *non-trading book* business equals or exceeds 15% of its total business.~~ [deleted]

(2) ~~However it will not normally be a significant risk for any other *BIPRU investment firm*.~~ [deleted]

(3) ~~The test in (1)(c) should be carried out in the same way as it is for the~~

~~purpose of the 5% test in *BIPRU* 1.2.17R (Definition of the trading book).~~ [deleted]

(4) ~~The test in (1)(c) should be carried out in the same way as it is for the purpose of the 5% test in *BIPRU* 1.2.17R (Definition of the trading book).~~ [deleted]

…

3 Standardised credit risk

3.1 Application and purpose

…

3.1.2 G Pursuant to the third paragraph of article 95(2) of the *EU CRR*, *BIPRU* 3 implements:

…

…

3.2 The central principles of the standardised approach to credit risk

…

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.~~ [deleted]

(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.~~ [deleted]

…

3.2.27A G …

(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*.

…

3.2.30 G For the purpose of *BIPRU* 3.2.25R(1)(e) (Prompt transfer of capital resources):

(1) 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 *appropriate regulator* 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.~~ [deleted]

…

4 The IRB approach

4.1 The IRB approach: Application, purpose and overview

Application

4.1.1 R *BIPRU* 4 applies to a BIPRU *firm* with an *IRB permission*.

Purpose

4.1.2 G Pursuant to the third paragraph of article 95(2) of the *EU CRR*, *BIPRU* 4 implements the following provisions of the *Banking Consolidation Directive*:

…

4.1.3 G Pursuant to the third paragraph of article 95(2) of the *EU CRR*, *BIPRU* 4 also implements Annex VIII of the *Banking Consolidation Directive* so far

as it applies to the *IRB approach*. In particular, it implements) in part:

…

4.1.4 G Similarly, *BIPRU* 4 also implements Article 40 of the *Capital Adequacy Directive* as it applies to the *IRB approach*.

…

4.2 The IRB approach: High level material

…

4.2.33 G (1) ~~This *guidance* sets out at what level the tests in *BIPRU* 4.2.30R – *BIPRU* 4.2.32G will be applied in the case of a *firm* that is a member of a group that is part of a bigger group.~~ [deleted]

(2) ~~If an *EEA banking and investment group* for which the *appropriate regulator* is the lead regulator is part of a wider *EEA banking and investment group* for which the *appropriate regulator* is also lead regulator then *BIPRU* 4.2.30R – *BIPRU* 4.2.32G apply with respect to that wider group.~~ [deleted]

(3) ~~If an *EEA banking and investment group* for which the *appropriate regulator* is the lead regulator is part of a wider *EEA banking and investment group* for which another *competent authority* is lead regulator then *BIPRU* 4.2.26R(4) applies with respect to that wider group but the requirements of that lead regulator will generally apply in place of *BIPRU* 4.2.30R - *BIPRU* 4.2.32G.~~ [deleted]

(4) ~~If an *EEA banking and investment group* for which the *appropriate regulator* is the lead regulator is part of a wider *third-country banking and investment group* that is subject to equivalent supervision by a regulatory authority outside the *EEA*, then *BIPRU* 4.2.26R(4) applies with respect to both that wider group and the sub-group of which the *appropriate regulator* is lead regulator. However the requirements of that third country regulator apply in place of *BIPRU* 4.2.30R - *BIPRU* 4.2.32G. The question of whether supervision is equivalent is decided in accordance with *GENPRU* 3.2 (Third country groups).~~ [deleted]

(5) ~~If an *EEA banking and investment group* for which the *appropriate regulator* is the lead regulator is part of a wider *third-country banking and investment group* that is not subject to equivalent supervision by a regulatory authority outside the *EEA*, then *BIPRU* 4.2.30R - *BIPRU* 4.2.32G will apply. *BIPRU* 4.2.30R – *BIPRU* 4.2.32G will apply to the whole group if *GENPRU* 3.2.9R (Supervision by analogy) applies. If *GENPRU* 3.2.4G (Alternative measures) applies, *BIPRU* 4.2.30R - *BIPRU* 4.2.32G will apply to~~

~~the *EEA banking and investment group*.~~ [deleted]

(6) ~~In the case of a group described in (2) or (3) in respect of which the *Article 129 procedure* applies then *BIPRU* 4.2.26R(4) applies with respect to that wider group. The detailed requirements that apply will be decided in accordance with that procedure.~~ [deleted]

…

5 Credit risk mitigation

5.1 Application and purpose

…

5.1.2 G Pursuant to the third paragraph of article 95(2) of the *EU CRR*, *BIPRU* 5 implements, in part, Articles 78(1) and 91 to 93 and Annex VIII of the *Banking Consolidation Directive*.

…

BIPRU 6 is deleted in its entirety. The deleted text is not shown.

7 Market risk

7.1 Application, purpose, general provisions and non-standard transactions

…

7.1.2 G ~~The~~ Pursuant to the third paragraph of article 95(2) of the *EU CRR*, the purpose of this chapter is to implement Annexes I, III, IV and V of the *Capital Adequacy Directive*.

…

7.2 Interest rate PRR

…

7.2.49 R A debt *security* is a *qualifying debt security* if:

…

(4) it is a debt *security* issued by an *institution* subject to the capital adequacy requirements set out in the *EU CRR* or, as may be

applicable, the *Banking Consolidation Directive* that satisfies the following conditions:

…

…

8 Group risk consolidation

8.1 Application

…

8.1.2A R A *firm* is not subject to consolidated supervision under *BIPRU* 8 where any of the following conditions are fulfilled:

(1) the *firm* is included in the supervision on a *consolidated basis* of the *group* of which it is a member by the *FCA* or *PRA* under the *EU CRR*; or

(2) the *firm* is included in the supervision on a consolidated basis of the *group* of which it is a member by a *competent authority* other than the *FCA* under the *EU CRR* as implemented by that *competent authority*.

8.1.2B R Where a *group* includes one or more *BIPRU firms* and one or more *IFPRU investment firms* which has permission under article 19 of the *EU CRR* (Exclusion from the scope of prudential consolidation) from the *FCA* not to be included in the supervision on a *consolidated basis* of the *group* of which it is a member, consolidated supervision under *BIPRU* 8 applies to those *IFPRU investment firms* and the *BIPRU firms*.

8.1.3 G ~~This~~ Pursuant to the third paragraph of article 95(2) of the *EU CRR*, this chapter implements articles 71,73(1) and (2), 125, 126, 127(1), 133 and 134 of the *Banking Consolidation Directive* and articles 2 (in part), 22 – 27 and 37(1) (in part) of the *Capital Adequacy Directive*.

…

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)~~,~~ and the *main BIPRU firm Pillar 1 rules* (but not the *base capital resources requirement*) ~~and *BIPRU* 10 (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*.

…

…

8.3.5 G ~~*BIPRU* 8 Annex 3G (Examples of how to identitfy a non-EEA sub-group) sets out examples of how to identify a *non-EEA sub-group*.~~ [deleted]

…

8.3.7 G A *firm* will not be a member of a *non-EEA sub-group* unless it is also a member of a *UK consolidation group*. So the first step is to identify each *undertaking* in the *firm's UK consolidation group* that satisfies the following conditions:

(1) it is ~~an *institution*~~ a *CAD investment firm*, *financial institution* or *asset management company* whose head office is outside the *EEA* (a *third country* ~~*banking or*~~ *investment services undertaking*);

…

…

8.3.9 G If more than one *BIPRU firm* is a direct or indirect *parent undertaking* in accordance with *BIPRU* 8.3.7G(2)(a) then the *sub-groups* of each of them are all potential *non-EEA sub-group*s. ~~This is illustrated in example three in *BIPRU* 8 Annex 3G (Examples of how to identify a non-EEA sub-group), where the *sub-group* of UK bank 1 and the *sub-group* of UK bank 2 are potential *non-EEA sub-groups*.~~

8.3.10 G Similarly if there is more than one *BIPRU firm* that holds a *participation* in the *third country* ~~*banking or*~~ *investment services undertaking* in accordance with *BIPRU* 8.3.7 G(2)(b) then the *sub-group* of each such *BIPRU firm* is a potential *non-EEA sub-group*.

8.3.11 G The effect of *BIPRU* 8.3.7G(3) is that a *non-EEA sub-group* cannot be headed by a *parent institution in a Member State*. ~~This is illustrated in example one of *BIPRU* 8 Annex 3G (Examples of how to identify a non-EEA sub-group).~~

8.3.12 G The *firm* should then identify each *undertaking* in the *firm's UK consolidation group* that satisfies the following conditions:

(1) it is ~~an *institution*~~ a *CAD investment firm*, *financial institution* or *asset management company* whose head office is outside the *EEA* (a *third country* ~~*banking or*~~ *investment services undertaking*);

…

…

8.3.14 G The *financial holding company* identified in *BIPRU* 8.3.12G may be a *parent financial holding company in a Member State*. ~~This is illustrated by example 2 of *BIPRU* 8 Annex 3G (Examples of how to identify a non-EEA sub-group).~~

…

8.3.16 G Similarly if there is more than one *financial holding company* that holds a *participation* in the *third country* ~~*banking or*~~ *investment services undertaking* in accordance with *BIPRU* 8.3.12G(2)(b) then the *sub-group* of each such *financial holding company* is a potential *non-EEA sub-group*.

8.3.17 G The *firm* should apply the process in *BIPRU* 8.3.12G to a *third country* ~~*banking or*~~ *investment services undertaking* even though it may be also be part of a potential *non-EEA sub-group* under *BIPRU* 8.3.7G.

8.3.18 G Having identified potential *non-EEA sub-group*s for each *third country* ~~*banking or*~~ *investment services undertaking* in its *UK consolidation group* the *firm* should then eliminate overlapping potential *non-EEA sub-group*s in the following way. If:

…

(2) the *third country* ~~*banking or*~~ *investment services undertaking*s in the two potential *non-EEA sub-group*s are the same;

…

8.3.19 G If there is a chain of three or more potential *non-EEA sub-group*s, each with the same *third country* ~~*banking or*~~ *investment services undertaking*s, the elimination process may remove all but the highest. ~~This is illustrated in example three in *BIPRU* 8 Annex 3G (Examples of how to identify a non-EEA sub-group). In this example there are four potential *non-EEA sub-group*s and the elimination process results in just one remaining (the one headed by the *UK parent financial holding company in a Member State*).~~

…

8.3.21 G ~~Examples four and five in *BIPRU* 8 Annex 3G (Examples of how to identify a *non-EEA sub-group*) show how the same group may contain two *non-EEA sub-group*s even though the smaller potential *non-EEA sub-group* is part of a bigger one. The reason for there being two *non-EEA sub-group*s in these examples is that one of the *third country banking or investment services undertaking*s is not a member of both potential *non-EEA sub-group*s.~~ [deleted]

8.3.22 G If a *UK consolidation group* is headed by a *parent financial holding company in a Member State* the result of the elimination process may be that a *firm's UK consolidation group* contains only one *non-EEA sub-group* and

that the *non-EEA sub-group* is the same as the *UK consolidation group*. In theory that means that there are two sets of consolidation requirements, one in relation to the *UK consolidation group* and one in relation to the *non-EEA sub-group*. However as the *UK consolidation group* and the *non-EEA sub-group* are the same, in practice this means that the additional *non-EEA sub-group* consolidation disappears. ~~This is illustrated in example three in *BIPRU* 8 Annex 3G (Examples of how to identify a non-EEA sub-group). The effect of *BIPRU* 8.3.7G(3) is that this is not the case if the *UK consolidation group* is headed by a *parent institution in a Member State*, as illustrated in example 1 in *BIPRU* 8 Annex 3G.~~

…

8.3.24 G The examples in this section have so far assumed that the only *EEA State* involved is the *United Kingdom*. If a potential *non-EEA sub-group* that would otherwise be regulated by the *appropriate regulator* contains a potential *non-EEA sub-group* in another *EEA State* then the *United Kingdom* one is eliminated if the *third country* ~~*banking or*~~ *investment services undertaking* in the *UK* potential *non-EEA sub-group* and the potential *non-EEA sub-group* in the other *EEA State* are the same. The intention here is that the *EEA competent authority* closest to the *third country* ~~*banking or*~~ *investment services undertaking* should be responsible for the *non-EEA sub-group* subconsolidation. Example 6 in *BIPRU* 8 Annex 3G (Examples of how to identify a non-EEA sub-group) illustrates this situation.

8.4 CAD Article 22 groups and investment firm consolidation waiver

Application

8.4.1 R This section applies to a *BIPRU* ~~*investment*~~ *firm* with an *investment firm consolidation waiver*.

…

8.4.9 R …

(2) There must be no *bank*, *building society*, ~~or~~ *credit institution* or *investment firm* in the *UK consolidation group* or *non-EEA sub-group*.

…

(6) Each *BIPRU* ~~*investment*~~ *firm* in the *UK consolidation group* or *non-EEA sub-group* must comply with the *main BIPRU firm Pillar1 rules* on an individual basis.

8.4.10 G *GENPRU* 2.2 (Capital resources) says that a *BIPRU* ~~*investment*~~ *firm* with an *investment firm consolidation waiver* should calculate its *capital resources* on a solo basis using *GENPRU* 2 Annex 6R (Capital resources table for a BIPRU ~~investment~~ firm with a waiver from consolidated supervision).

GENPRU 2 Annex 6R requires a *BIPRU* ~~*investment*~~ *firm* to deduct contingent liabilities in favour of other members of the *UK consolidation group* or *non-EEA sub-group*. Therefore *BIPRU* 8.4.9R(5)(b) only imposes the requirement to deduct them on *EEA firms*.

…

8.4.13 R The solo notional capital resources requirement as referred to in *BIPRU* 8.4.11R(1) is calculated in the same way as the *capital resources requirement* for a *BIPRU* ~~*limited licence*~~ *firm*

~~(1)~~ ~~(if each *CAD investment firm* in the *UK consolidation group* or *non-EEA sub-group* is a *limited licence firm*) the *capital resources requirement* for a *BIPRU limited licence firm*; or~~

~~(2)~~ ~~(in any other case) the *capital resources requirement* for a *BIPRU limited activity firm*~~.

…

8.4.19 G Although an *investment firm consolidation waiver* switches off most of this chapter, a *firm* should still carry out the capital adequacy calculations in *BIPRU* 8.3 to *BIPRU* 8.8 as if those parts of this chapter still applied to the *UK consolidation group* or *non-EEA sub-group* and report these to the *FCA*. ~~It should also still monitor *large exposure* risk on a consolidated basis.~~

8.5 Basis of consolidation

Undertakings to be included in consolidation

8.5.1 R A *firm* must include only the following types of *undertaking* in a *UK consolidation group* or *non-EEA sub-group* for the purposes of this chapter:

…

(2) ~~an *institution*;~~ [deleted]

…

8.5.3 G An example of *BIPRU* 8.5.2G is as follows. Say that the *undertaking* at the head of a ~~*bank's*~~ *BIPRU firm's UK group* is a *parent financial holding company in a Member State*. One of its *subsidiary undertakings* is the ~~*bank*~~ *firm*. The *parent financial holding company in a Member State* also has an *insurer* as a *subsidiary undertaking*. That *insurer* has several ~~*investment*~~ *BIPRU firms* as *subsidiary undertakings*. Say that the *UK group* is not a *financial conglomerate*. The *UK consolidation group* will include the *parent financial holding company in a Member State* and the ~~*bank*~~ *firm*. It will also include the ~~*investment*~~ *BIPRU firms* that are *subsidiary undertakings* of the *insurer*. This is because the ~~*investment*~~ *BIPRU firms* are *subsidiary undertakings* of the *parent financial holding company in a Member State*

through the *parent financial holding company in a Member State's* holding in the *insurer*. However it will not include the *insurer* itself.

…

~~Basis of inclusion of collective portfolio management investment firms in consolidation~~

8.5.7 R ~~*GENPRU* 2.1.46R (Adjustment of the variable requirement calculation for collective portfolio management investment firms) does not apply for the purpose of this chapter.~~ [deleted]

8.5.8 G ~~In general a *collective portfolio management investment firm* only calculates the capital and concentration risk requirements in relation to its *designated investment business* and does not calculate them with respect to *managing an AIF* or *managing a UCITS*. The effect of *BIPRU* 8.5.7R is that this does not apply on a consolidated basis. For the purpose of this chapter the calculations are carried with respect to the whole of the activities of a *collective portfolio management investment firm*.~~ [deleted]

8.5.9 R A *firm* may, having first notified the *appropriate regulator* in writing in accordance with *SUP* 15.7 (Form and method of notification), exclude ~~an *institution*,~~ a *BIPRU firm,* *asset management company*, *financial institution* or *ancillary services undertaking* that is a *subsidiary undertaking* in, or an *undertaking* in which a *participation* is held by, the *UK consolidation group* or *non-EEA sub-group* if the balance sheet total of that *undertaking* is less than the smaller of the following two amounts:

…

…

8.5.11 G Article 73(1) of the *Banking Consolidation Directive* allows the *appropriate regulator* to decide to exclude ~~an *institution*~~ a *BIPRU firm*, *financial institution*, *asset management company* or *ancillary services undertaking* that is a *subsidiary undertaking* in, or an *undertaking* in which a *participation* is held by, the *UK consolidation group* or *non-EEA sub-group* for the purposes of this chapter in the following circumstances:

…

(2) where, in the opinion of the *appropriate regulator*, the *undertaking* concerned is of negligible interest only with respect to the objectives of monitoring ~~*institutions*~~ *BIPRU firms*; or

(3) where, in the opinion of the *appropriate regulator*, the consolidation of the financial situation of the *undertaking* concerned would be inappropriate or misleading as far as the objectives of the supervision of ~~*institutions*~~ *BIPRU firms* are concerned.

…

8.6 Consolidated capital resources

…

~~Calculation of consolidated capital resources if there is a building society in the group~~

8.6.6 R ~~Where a *firm's UK consolidation group* or *non-EEA sub-group* includes a *building society*, the *firm* must calculate that group's *consolidated capital resources* using the calculation of *capital resources* for *building societies*.~~ <u>[deleted]</u>

~~Calculation of consolidated capital resources if there is a bank or credit institution in the group~~

8.6.7 R ~~Where a *firm's UK consolidation group* or *non-EEA sub-group* includes a *bank* or *credit institution* but not a *building society*, the *firm* must calculate that group's *consolidated capital resources* using the calculation of *capital resources* for *banks*.~~ <u>[deleted]</u>

Calculation of consolidated capital resources for an investment firm group

8.6.8 R ~~Where a *firm's UK consolidation group* or *non-EEA sub-group* does not include a *bank*, *building society* or *credit institution*, the~~ <u>A</u> *firm* must calculate that group's *consolidated capital resources* using the calculation of *capital resources* in *GENPRU* 2 Annex 4R (Capital resources table for a BIPRU investment firm deducting material holdings) or *GENPRU* 2 Annex 5 (Capital resources table for a BIPRU investment firm deducting illiquid assets).

…

~~Venture Capital Investments~~

8.6.21 R ~~Part 2 of stage M in the *capital resources table* for *banks* in *GENPRU* 2 Annex 2R and the *capital resources table* for *building societies* in *GENPRU* 2 Annex 3R is adjusted so as to read as follows in relation to the deduction of investments in *subsidiary undertakings* and *participations*:~~ <u>[deleted]</u>

~~**Deductions from the totals of tier one and tier two**~~		~~**(M)**~~
~~…~~	…	…

~~…~~ ~~Investments in *subsidiary undertakings* and *participations* excluding:~~ ~~(1) any amount which is already deducted as *material holdings* or *qualifying holdings*; and~~ ~~(2) any investment in an *undertaking* that meets the following conditions:~~ ~~(a) the investment has been made by a Venture Capital Investor and the *firm* is entitled to ignore (i) the Venture Capital Investor making that investment in accordance with *GENPRU* 2.2.209R(2) or (ii) the Venture Capital Holding Company (or a proportion of it) which holds the Venture Capital Investor in accordance with *GENPRU* 2.2.209R(3) for the purpose of determining whether there is a *material holding*;~~ ~~(b) the investment is a *venture capital investment*; and~~ ~~(c) the *undertaking* is not (i) a *credit institution* or (ii) *financial institution* the principal activity of which is to perform any activity other than the acquisition of holdings in other *undertakings*.~~	… ~~*GENPRU* 2.2.216AG~~	~~(Part 2 of stage M)~~

8.7 Consolidated capital resources requirements

…

8.7.3 G ~~The first step is for a *firm* to identify what sort of group it belongs to as the calculation of the *consolidated capital resources requirement* differs between different types of groups. This is set out in *BIPRU* 8 Annex 5R (Decision tree for identifying the consolidated capital resources requirement of a UK consolidation group or a non-EEA sub-group). *BIPRU* 8 Annex 5R shows, for each type of group:~~

~~(1) which of the *consolidated requirement components* apply and which do not; and~~

~~(2) how to add up the different *consolidated requirement components* to reach the overall *consolidated capital resources requirement*.~~

[deleted]

8.7.4 G ~~*BIPRU* 8 Annex 5 R (Decision tree for identifying the consolidated capital resources requirement of a UK consolidation group or a non-EEA sub-group) categorises groups by reference to what kind of *undertakings* they contain (*credit institutions*, *limited licence firm*s, *limited activity firm*s or *CAD full scope firms*).~~ [deleted]

…

8.7.10 R ~~A *firm* must calculate the~~ The *consolidated capital resources requirement* of its *UK consolidation group* or *non-EEA sub-group* ~~in accordance with the method identified by the decision tree in *BIPRU* 8 Annex 5R (Decision tree for identifying the consolidated capital resources requirement of a UK consolidation group or a non-EEA sub-group)~~ as the higher of the following *consolidated requirements components*:

(1) the sum of the *consolidated credit risk requirement* and the *consolidated market risk requirement*; and

(2) the *consolidated fixed overheads requirement*.

…

8.7.12 R This table belongs to *BIPRU* 8.7.11R

Consolidated requirement component	*Rules* on which the *consolidated requirement component* are based (the applicable *risk capital requirement*)
…	…
~~*Consolidated operational risk requirement*~~	~~*Operational risk capital requirement*~~

…

8.7.18 R The *credit risk capital requirement* (on which the *consolidated credit risk requirement* is based) is split into ~~three~~ two 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). This is called the *concentration risk capital component*.~~

…

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)(c). Those conditions are as follows~~

~~(1) each of the *undertakings* in that group or sub-group is an *institution* that is:~~

~~(a) a *BIPRU firm*;~~

~~(b) an *EEA firm*;~~

~~(c) a *recognised third country credit institution*; or~~

~~(d) a *recognised third country investment firm*;~~

~~(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 (Large exposures requirements);~~

~~(3) each of the *undertakings* referred to in (1) that is an *EEA firm* complies with the *CRD implementation measures* in its *EEA State* that correspond to the requirements in (2);~~

~~(4) each of the *undertakings* referred to in (1) that is a *recognised third country credit institution* or *recognised third country investment firm* complies with laws in the state or territory in which it has its head office that are equivalent to the requirements of the *Banking Consolidation Directive* or *Capital Adequacy Directive* relating to capital adequacy and concentration risk;~~

~~(5) there is no material legal, regulatory or contractual impediment to the transfer of funds between those *undertakings* in that group or sub-group;~~

~~(6) there is no material legal, regulatory or contractual impediment to mutual financial support between those *undertakings* in that group or sub-group;~~

~~(7) the *market risk position* of the *undertakings* are monitored and managed on a co-ordinated basis; and~~

~~(8) there is satisfactory allocation of capital within the group or sub-group.~~ [deleted]

…

8.7.30 R (1) ~~This *rule* applies when the *rules* applicable under *BIPRU* 8.7.12 R~~

~~apply differently for different types of *firms*.~~ [deleted]

(2) ~~Where a *firm's UK consolidation group* or *non-EEA sub-group* is a group identified at Stage 1 in BIPRU 8 Annex 5 R (Decision tree for identifying the consolidated capital resources requirement of a UK consolidation group or a non-EEA sub-group), the *rules* that apply are those that apply to a *bank* that is a *BIPRU firm*.~~ [deleted]

(3) ~~Where a *firm's UK consolidation group* or *non-EEA sub-group* is a group identified at Stage 2 in *BIPRU* 8 Annex 5R, the *rules* that apply are those that apply to a *full scope BIPRU investment firm*.~~ [deleted]

(4) ~~Where a *firm's UK consolidation group* or *non-EEA sub-group* is a group identified at Stage 3 in *BIPRU* 8 Annex 5R, the *rules* that apply are those that apply to a *BIPRU limited activity firm*.~~ [deleted]

(5) ~~Where a *firm's UK consolidation group* or *non-EEA sub-group* is a group identified at Stage 4 in *BIPRU* 8 Annex 5R, the *rules* that apply are those that apply to a *BIPRU limited licence firm*.~~ [deleted]

…

8.7.32 G ~~Similarly *BIPRU* 8.7.30R may have the effect that the *risk capital requirement* for a *BIPRU firm* is calculated differently from the way it is on a solo basis. Thus for example if the *risk capital requirement* is being calculated for a *BIPRU limited licence firm* that is a *subsidiary undertaking* of a *bank* the *risk capital requirement* should be calculated using the *rules* for a *bank*.~~ [deleted]

…

8.8 Advanced prudential calculation approaches

…

~~Special provisions relating to the advanced measurement approach~~

8.8.5 R ~~*BIPRU* 6.5.27 R(6) (Insurance should be provided by a third party entity for the purposes of the advanced measurement approach) is amended to provide that the insurance must be provided by an *undertaking* that is not in the same *group* as the *firm* or other members of the *UK consolidation group* or *non-EEA sub-group*. In the case of insurance through captives and affiliates, the exposure must be laid off to an independent *undertaking* that is not in the same *group* as the *firm* or other members of the *UK consolidation group* or *non-EEA sub-group*, for example through reinsurance that meets the eligibility criteria.~~ [deleted]

8.8.6 G ~~In the case of insurance through captives and affiliates, the *exposure* should be laid off outside the *firm's group* to an independent third party.~~ [deleted]

8.8.7 G ~~*BIPRU* 8.7.26R deals with the combination of the *advanced measurement approach* with other approaches to *operational risk* on a group level.~~ [deleted]

…

8.8.9 G The governance arrangements that apply to the *governing body*, the senior management and any *designated committee* of a *firm* in relation to the *IRB approach* ~~or the *AMA*~~ also apply to the body or *persons* with equivalent powers with respect to the *UK consolidation group* or *non-EEA sub-group*. Where the *parent undertaking* and its *subsidiary undertakings* use rating systems on a unified basis, the approval and reporting process described in *BIPRU* 4.3.12G (Approval and reporting arrangements for the *IRB approach* where rating systems are used on a unified group basis) ~~and *BIPRU* 6.5.32G (Approval and reporting arrangements for the *AMA* where rating systems are used on a unified group basis)~~ apply for the purpose of this paragraph too.

BIPRU 8.9A is deleted in its entirety. The deleted text is not shown.

…

BIPRU 8 Annex 2G is deleted in its entirety. The deleted text is not shown.

BIPRU 8 Annex 3G is deleted in its entirety. The deleted text is not shown.

…

BIPRU 8 Annex 5R is deleted in its entirety. The deleted text is not shown.

…

8 Annex 6R Non-EEA regulators' requirements deemed CRD-equivalent for individual risks

Regime regulators	Market risk	Credit risk	Operational risk

Part 1 (Non-EEA regulators' requirements deemed CRD-equivalent for individual risks)			
…			
Switzerland ~~Swiss Federal Banking Commission [EBK]~~ Swiss Financial Market Supervisory Authority [FINMA]	…	…	…
…			

…

9 Securitisation

9.1 Application and purpose

Application

9.1.1 R *BIPRU* 9.1 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*~~.

Purpose

9.1.2 G ~~The~~ Pursuant to the third paragraph of article 95(2) of the *EU CRR*, the purpose of *BIPRU* 9 is to implement:

…

…

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] [deleted]

…

BIPRU 10 is deleted in its entirety. The deleted text is not shown.

11 Disclosure (Pillar 3)

11.1 Application and purpose

…

11.1.2 G The Pursuant to the third paragraph of article 95(2) of the *EU CRR*, the purpose of *BIPRU* 11 is to implement:

…

…

11.5 Technical criteria on disclosure: General requirements

…

Disclosure: Compliance with BIPRU 3, BIPRU 4, BIPRU 6, BIPRU 7, BIPRU 10 and the overall Pillar 2 rule

11.5.4 R A *firm* must disclose the following information regarding compliance with *BIPRU* 3, *BIPRU* 4, *BIPRU* 6, *BIPRU* 7, *BIPRU* 10 and the *overall Pillar 2 rule*:

…

(4) …

(b) …

(ii) *foreign currency PRR*;.

(5) its *operational risk capital requirement* calculated in accordance with the *basic indicator approach*, the *standardised approach* and the *advanced measurement approach* and disclosed separately.

[Note: *BCD* Annex XII Part 2 point 4(part)] [deleted]

…

~~Disclosure: Operational risk~~

11.5.14 R ~~The following information must be disclosed by a *firm* on *operational risk*:~~

~~(1)~~ ~~the approaches for the assessment of the *operational risk capital requirement* that the *firm* qualifies for; and~~

~~(2)~~ ~~if the *firm* uses the *advanced measurement approach*:~~

~~(a)~~ ~~a description of the methodology used in the *advanced measurement approach*, including a discussion of relevant internal and external factors considered in the *firm's* measurement approach; and~~

~~(b)~~ ~~in the case of partial use, the scope and coverage of the different methodologies used.~~

~~[Note: *BCD* Annex XII Part 2 point 11]~~ <u>[deleted]</u>

…

11.5.20 R …

[**Note**: The *appropriate regulator* has given *guidance* for the purpose of providing a framework for complying with the disclosure requirements of *BIPRU* 11.5.18R in accordance with the proportionality test set out in *BIPRU* 11.5.20R(2). ~~The *guidance* divides firms into four levels, and indicates which requirements should be complied with for each level. This was published as finalised *guidance* FG12/19 'General Guidance on Proportionality'~~<u>.</u> ~~and is available at http://www.bankofengland.co.uk/PRA/Pages/publications/default.aspx . Feedback on CP10/27 and final rules' and is available at http://www.bankofengland.co.uk/PRA/Pages/publications/default.aspx~~]

…

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]~~ <u>[deleted]</u>

12 Liquidity standards

12.1 Application

12.1.1 R ~~Subject to *BIPRU* 12.1.2R, *BIPRU* 12 applies to:~~

~~(1)~~ ~~a *BIPRU firm*;~~

~~(2)~~ ~~an *incoming EEA firm* which:~~

~~(a)~~ ~~a *full BCD* CRD *credit institution*;~~

~~(b)~~ ~~has a *branch* in the *United Kingdom*; and~~

~~(3)~~ ~~a *third country BIPRU firm* which:~~

~~(a)~~ ~~is a *bank*; and~~

~~(b)~~ ~~has a *branch* in the *United Kingdom*.~~ [deleted]

12.1.1A R Subject to *BIPRU* 12.1.2R, *BIPRU* 12 applies to:

(1) an *IFPRU investment firm*; and

(2) a *BIPRU firm*.

…

12.1.4 R (1) An *exempt full scope* ~~*BIPRU*~~ *IFPRU investment firm* is a ~~*full scope BIPRU*~~ *full-scope IFPRU investment firm* that at all times has total net assets which are less than or equal to £50 million.

…

…

12.3 Liquidity risk management

…

12.3.4 R A *firm* must have in place robust strategies, policies, processes and systems that enable it to identify, measure, manage and monitor *liquidity risk* over an appropriate set of time horizons, including intra-day, so as to ensure that it maintains adequate levels of liquidity buffers. These strategies, policies, processes and systems must be tailored to business lines, currencies, *branches* and legal entities and must include adequate allocation mechanisms of liquidity costs, benefits and risks.

[**Note:** ~~annex V paragraph 14 of the *Banking Consolidation Directive*~~ article 86(1) of *CRD*]

…

12.3.5 R …

[**Note:** ~~annex V paragraph 14a of the *Banking Consolidation Directive*~~ article 86(2) (part) of *CRD*]

…

12.3.7A R A *firm* must, taking into account the nature, scale and complexity of its activities, have liquidity risk profiles that are consistent with, and not in excess of, those required for a well-functioning and robust system.

[**Note:** article 86(3) of *CRD*]

Governing body and senior management oversight: liquidity risk tolerance

12.3.8 R …

[**Note:** ~~annex V paragraph 14a of the *Banking Consolidation Directive*~~ article 86(2) of *CRD*]

…

Management of collateral

…

12.3.22A R …

[**Note:** ~~annex V paragraph 16 of the *Banking Consolidation Directive*~~ article 86(5) of *CRD*]

12.3.22B R …

[**Note:** ~~annex V paragraph 17 of the *Banking Consolidation Directive*~~ article 86(6) of *CRD*]

…

12.3.27 R …

[**Note:** ~~annex V paragraph 15 of the *Banking Consolidation Directive*~~ article 86(4) of *CRD*]

…

12.4 Stress testing and contingency funding

12.4.-2 R …

[Note: ~~annex V paragraph 18 of the *Banking Consolidation Directive*~~ article 86(7) of *CRD*]

Stress testing

12.4.-1 R A *firm* must consider alternative scenarios on liquidity positions and on risk mitigants and must review ~~regularly~~ the assumptions underlying decisions concerning the funding position at least annually. For these purposes, alternative scenarios must address, in particular, off-balance sheet items and other contingent liabilities, including those of *securitisation special purpose entities (SSPEs)* or other special purpose entities, as referred to in the *EU CRR*, in relation to which the *firm* acts as *sponsor* or provides material liquidity support.

[**Note:** ~~annex V paragraph 19 of the *Banking Consolidation Directive*~~ article 86(8) of *CRD*]

…

12.4.5A R A *firm* must consider the potential impact of institution-specific, market-wide and combined alternative scenarios. Different time ~~horizons~~ periods and varying degrees of stressed conditions must be considered.

[**Note:** ~~annex V paragraph 20 of the *Banking Consolidation Directive*~~ article 86(9) of *CRD*]

…

Contingency funding plans

12.4.10 R …

[**Note:** ~~annex V paragraph 21 of the *Banking Consolidation Directive*~~ article 86(10) of *CRD*]

12.4.11 R ~~In order to deal with liquidity crisis, a~~ A *firm* must have in place ~~contingency~~ liquidity recovery plans setting out adequate strategies and proper implementation measures in order to address possible liquidity shortfalls, including in relation to *branches* established in another *EEA State*. Those plans must be ~~regularly~~ tested at least annually, updated on the basis of the outcome of the alternative scenarios set out in *BIPRU* 12.4.-1R, and be reported to and approved by the *firm's governing body*, so that internal policies and processes can be adjusted accordingly. A *firm* must take the necessary operational steps in advance to ensure that liquidity recovery plans can be implemented immediately.

[**Note:** ~~annex V paragraph 22 of the *Banking Consolidation Directive*~~ article

86(11) (part) of *CRD*]

…

12.7 Liquidity assets buffer

…

12.7.4 R For the purpose of *BIPRU* 12.7.3R, a *firm* may not include a debt security unless:

(1) the central government or central bank in question has been assessed by at least two *eligible ECAIs* as having a credit rating associated with ~~*credit quality step* in the *credit quality assessment scale* published by the *appropriate regulator* for the purpose of *BIPRU* 3 (The Standardised Approach: mapping of the ECAIs credit assessments to credit quality steps (Long term mapping))~~ credit quality step 1 in the table set out in *BIPRU* 12 Annex 1R (Mapping of credit assessments of ECAIs to credit quality steps); and

…

12.7.6 R For the purpose of *BIPRU* 12.7.5R, a *firm* may not include reserves held at a central bank unless:

(1) the central bank in question has been assessed by at least two *eligible ECAIs* as having a credit rating associated with ~~*credit quality step* in the *credit quality assessment scale* published by the *appropriate regulator* for the purpose of *BIPRU* 3 (The Standardised Approach: mapping of the ECAIs credit assessments to credit quality steps (Long term mapping))~~ credit quality step 1 in the table set out in *BIPRU* 12 Annex 1R (Mapping of credit assessments of ECAIs to credit quality steps); and

…

12.7.6A R For the purpose of *BIPRU* 12.7.2R(2), a *firm* may not include securities issues by a *designated multilateral development bank* unless:

(1) the *designated multilateral development bank* in question has been assessed by at least two *eligible ECAIs* as having a credit rating associated with ~~*credit quality step* in the *credit quality assessment scale* published by the *appropriate regulator* for the purpose of *BIPRU 3* (The Standardised Approach: mapping of the ECAIs' credit assessments to credit quality steps (Long term mapping))~~ credit quality step 1 in credit quality step 1 in the table set out in *BIPRU* 12 Annex 1R (Mapping of credit assessments of ECAIs to credit quality steps); and

…

…

After BIPRU 12, insert the following new annex. The text is all new and is not underlined.

12 Annex 1 R Mapping of credit assessments of ECAIs to credit quality steps

Credit Quality Step	**Fitch's assessments**	**Moody's assessments**	**S&P's assessments**	**DBRS assessments**	**Corporate**	**Institution (includes banks)**			**Sovereign**
						Sovereign method	Credit Assessment method		
							Maturity > 3 months	Maturity 3 months or less	
1	AAA to AA-	Aaa to Aa3	AAA to AA-	AAA to AAL	20%	20%	20%	20%	0%
2	A+ to A-	A1 to A3	A+ to A-	AH to AL	50%	50%	50%	20%	20%
3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	BBBH to BBBL	100%	100%	50%	20%	50%
4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-	BBH to BBL	100%	100%	100%	50%	100%
5	B+ to B-	B1 to B3	B+ to B-	BH to BL	150%	100%	100%	50%	100%
6	CCC+ and below	Caa1 and below	CCC+ and below	CCCH and below	150%	150%	150%	150%	150%

13 The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions

13.1 Application and purpose

…

13.1.4 G Pursuant to the third paragraph of article 95(2) of the *EU CRR*, *BIPRU* 13 implements:

…

…

14 Capital requirements for settlement and counterparty risk

14.1 Application and purpose

…

14.1.3 G Pursuant to the third paragraph of article 95(2) of the *EU CRR*, *BIPRU* 14 implements:

…

…

BIPRU TP 1 is deleted in its entirety. The deleted text is not shown.

TP 2 Capital floors for a firm using the IRB ~~or AMA approaches~~ approach

	Application	
2.1	R	Subject to *BIPRU* TP 2.2R, this section applies to a *BIPRU firm* that applies the *IRB approach* ~~or the *advanced measurement approach*~~.
2.2	R	*BIPRU* TP 2.30R to *BIPRU* TP 2.34G apply to any *firm* to which *BIPRU* 8 (Group risk - consolidation) applies and which applies the *IRB approach* ~~or the *advanced measurement approach*~~ on a consolidated basis.
	Purpose	
2.3	G	~~This~~ Pursuant to the third paragraph of article 95(2) of the *EU CRR*, this section in part implements Articles 152(1) - (7) of the *Banking Consolidation Directive* and Article 43 of the *Capital Adequacy Directive*.
…		
2.7	G	~~*BIPRU* TP 9 explains how the general principle in this section is applied to a *personal investment firm*.~~

	Capital floors: solo	
…		
2.9	R	~~A *firm* using the *advanced measurement approach* must, during each of the second, third and subsequent twelve-month periods after 31 December 2006, provide capital resources which are at all times more than or equal to the amounts indicated in *BIPRU* TP 2.8R(2) and *BIPRU* TP 2.8R(3).~~
…		
2.11 A	G	Article 152(5d) and (5e) of the *Banking Consolidation Directive* allows the *appropriate regulator* to waive the capital floor calculation based on the *IPRU* capital resources requirement in *BIPRU* TP 2.8R(3)~~, or *BIPRU* TP 2.8R(3) as applied in *BIPRU* TP 2.9R~~, on a case-by-case basis only if a *firm* started to use the *IRB approach* ~~or the *advanced measurement approach*~~ on or after 1 January 2010. The *appropriate regulator* will consider an application for such a *waiver* in the light of the criteria in section 138A of the *Act* (Modification or waiver of rules).
2.11 B	R	If a *firm* has a *waiver* referred to in *BIPRU* TP 2.11AG, it must provide *capital resources* that equal or exceed 80% of the *capital resources requirement* that the *firm* would be required to provide under the relevant sections of *BIPRU* applicable to it immediately before it started to use the *IRB approach* ~~or the *advanced measurement approach*~~ as those sections were in force on 31 December 2010.
	~~**Explanation of the calculation**~~	
2.12	G	~~The following provides an illustrative example of the application of this section to a *bank* in a period in which *BIPRU* TP 2.8R(1) applies (i.e. the 95% requirement). Say that under *IPRU(BANK)* the *firm's* capital resources requirement would be £8.00mn and this would be met in part by general/collective provisions of £0.5mn. This establishes the capital resources requirement under this section at 95% times (£8.0mn less £0.5mn), which equals £7.125mn.~~
2.13	G	~~Say that in the absence of this section, the Pillar 1 capital resources requirement of the *firm* in *BIPRU* TP 2.12G would be £6.4m, and the sum of value adjustments and provisions are £0.25mn less than *expected losses*. For the purposes of the *expected loss* calculation, if the result is negative (i.e. value adjustments and provisions are less than *expected losses*) that amount is deducted from *capital resources* (which is equivalent to an increase in the *capital resources requirement*). If the result is positive it is added to *capital resources* (which is equivalent to a decrease in the *capital resources requirement*). In this example the result is negative. As the sum of these two amounts (£6.65mn) is still less than the *IPRU* capital resources requirement of £7.125mn, the effect of this section is that the *firm* is subject to the (higher) *IPRU* requirement. If the sum of the *BIPRU* requirements had been greater than £7.125mn, then the *firm* would not have been subject to the capital~~

		~~resources requirement in this section.~~
…		
	Individual capital guidance	
2.20	R	~~The *IPRU* capital resources requirement does not include any individual capital ratio notified to a *bank* under Chapter CO of *IPRU(BANK)* or any similar notification by the *appropriate regulator* to any other *firm*.~~
…		
	How to apply IPRU	
2.22	R	If the part of *IPRU* that applies to a *firm* applies different calculations to different types of *firm* the *firm* must use the calculations that it would have to use under *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) as applicable before its expiry.
…		
2.24	G	*BIPRU* TP 4 to *BIPRU* TP 9 (Pre CRD capital requirements applying on a solo basis during 2007) as applicable before their expiry explain how concepts in *IPRU* and *GENPRU* map onto the ones in *IPRU*. This will enable a *firm* to decide which calculations it should use for the purposes of *BIPRU* TP 2.22R and *BIPRU* TP 2.23R.
…		
2.25	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 (Large exposures requirements) except to the extent that *BIPRU* 10 involves the *IRB approach*.~~
2.26	G	~~The *concentration risk capital component* is the capital requirement for a *firm* that chooses to have *trading book exposures* that exceed the *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 (Large exposures requirements) in order to avoid having to apply the *IPRU* large exposure requirements for this purpose only.~~
…		
	Capital floors: consolidation	
2.30	R	If a *firm* calculates *risk weighted exposure amounts* on a consolidated basis in accordance with the *IRB approach* ~~or uses the *advanced measurement approach*~~ on a consolidated basis, *BIPRU* TP 2.8R to *BIPRU* TP 2.27G apply

		on a consolidated basis in accordance with *BIPRU* TP 2.30R to *BIPRU* TP 2.31R.	
2.31	R	A *firm* must calculate the consolidation requirements under *BIPRU* TP 2.30R for the group in question (the group in question is specified in *BIPRU* TP 2.32R) in accordance with the following:	
		(1)	~~if the group is a banking group as defined in *BIPRU* TP 1.7R (Classification of groups for certain consolidation rules), the consolidation provisions of *IPRU(BANK)* apply;~~
		(2)	~~if the group is a building society group as defined in *BIPRU* TP 1.7R, the consolidation provisions of *IPRU(BSOC)* apply; and~~
		(3)	…
2.32	R	…	
		(1)	if a *firm* is a member of a *UK consolidation group* and applies the *IRB approach* ~~or the *AMA*~~ with respect to that *UK consolidation group*, *BIPRU* TP 2.30R applies with respect to that *UK consolidation group*; and
		(2)	if a *firm* is a member of a *non-EEA sub-group* and applies the *IRB approach* ~~or the *AMA*~~ with respect to that *non-EEA sub-group*, *BIPRU* TP 2.30R applies with respect to that *non-EEA sub-group*.
…			
	Capital floors: waiver from consolidation		
2.34	G	If a *firm* has an *investment firm consolidation waiver* and it is applying the *IRB approach* ~~or the *AMA*~~, the *waiver* will explain how the *investment firm consolidation waiver* applies for the purpose of this section.	

TP 21 Close substitutes for commodities

…

21.3	R	Table: Commodity treatments under IPRU This table belongs to *BIPRU* TP 21.2R

IPRU provisions setting out *commodity* approach	*IPRU* provisions under which notice given
Paragraph 22(2) of appendix 6 of chapter 10 of *IPRU(INV)*	Paragraph 23 of appendix 6 of chapter 10 of *IPRU(INV)*

~~Paragraph 22(2) of chapter CM of *IPRU(BANK)*~~ [deleted]	~~Paragraph 23 of chapter CM of *IPRU(BANK)*~~

		Explanation
~~21.3~~ 21.4	G	*BIPRU* 7.4.22R(1)(b) says that a *firm* should treat *positions* in different grades or brands of the same *commodity*-class as different *commodities* unless they are close substitutes and have price movements which have exhibited a stable correlation coefficient of at least 0.9 over the last 12 months. *BIPRU* 7.4.23R says that a *firm* should notify the ~~*FSA*~~ *FCA* in writing at least 20 *business days* prior to the date the *firm* starts relying on this treatment. The purpose of this section is to allow a notice given under the corresponding provisions of chapter 10 of *IPRU(INV)* ~~or *IPRU(BANK)*~~ to continue to have effect without the *firm* having to serve a new notice under *BIPRU* 7.4.23R.

BIPRU TP 11, BIPRU TP 13, BIPRU TP 15, BIPRU TP16, BIPRU TP 22, BIPRU TP 33 and BIPRU TP 34 are deleted in their entirety. The deleted text is not shown.

In the following table, the words in Column (2) in the provisions in Column (1) are replaced by the word in Column (3), except where indicated in Column (4), unless the context otherwise requires.

Column (1) (Handbook provisions to be amended)	**Column (2) (current wording)**	**Column (3) (new wording)**	**Column (4) (Handbook provisions not amended)**
BIPRU	*appropriate regulator*	*FCA*	BIPRU 12 (Liquidity Standards) Schedule 5G Schedule 6G

CAPITAL REQUIREMENTS DIRECTIVE IV (GOVERNANCE AND REMUNERATION) INSTRUMENT 2013

Powers exercised by the Financial Conduct Authority

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137A (The FCA's general rules);
(2) section 137H (General rules about remuneration); and
(3) section 139A (Power of the FCA to give guidance).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. Annex A comes into force on 1 January 2014
D. Part 1 of Annex B comes into force on 1 January 2014
E. Part 2 of Annex B comes into force on 1 July 2014.

Amendments to the Handbook

F. The Senior Management Arrangements, Systems and Controls sourcebook (SYSC) is amended in accordance with the Annex to this instrument.

Notes

G. In the Annex 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

H. This instrument may be cited as the Capital Requirements Directive IV (Governance and Remuneration) Instrument 2013.

By order of the Board of the Financial Conduct Authority
[*date*]

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 and amendments in the appropriate alphabetical position. The text is not underlined

BIPRU Remuneration Code	*SYSC* 19C (BIPRU Remuneration Code)
BIPRU Remuneration Code staff	for a *BIPRU firm* and a *third country BIPRU firm)* has the meaning given in *SYSC* 19C.3.4R.
BIPRU remuneration principles proportionality rule	(in *SYSC* 19C) has the meaning given in *SYSC* 19C.3.3R
CRR firm	for the purposes of *SYSC* means *UK banks, buildings societies* and *investment firms* that are subject to the *EU CRR*.

Annex B

Amendments to the Senior Management Arrangements, Systems and Controls sourcebook (SYSC)

In this Annex, underlining indicates new text and striking through indicates deleted text except where indicated otherwise.

Part 1: Comes into force on 1 January 2014

4.1 General organisational requirements

4.1.1 R

…

(2) ~~A *BIPRU firm* and a *third country BIPRU firm* must comply with the *Remuneration Code*.~~ [deleted]

[**Note**: ~~article 22(1) of the *Banking Consolidation Directive*~~ article 74(1) of *CRD*, article 13(5) second paragraph of *MiFID* and article 12(1)(a) of the *UCITS Directive*]

4.1.1C R A *BIPRU firm* and a *third country BIPRU firm* must comply with the *BIPRU Remuneration Code.*

4.1.2 R For a *common platform firm*, the arrangements, processes and mechanisms referred to in *SYSC* 4.1.1R must be comprehensive and proportionate to the nature, scale and complexity of the risks inherent in the business model and of the *common platform firm's* activities and must take into account the specific technical criteria described in *SYSC* 4.1.7R, *SYSC* 5.1.7R, *SYSC* 7 and (for a ~~*BIPRU firm* and a *third country BIPRU firm*~~ for a *firm* to which *SYSC* 19A applies) *SYSC* 19A.

[**Note**: ~~article 22(2) of the *Banking Consolidation Directive*~~ article 74(2) of *CRD*]

…

4.1.2AB R Where *SYSC* 4.1.2R applies to a *BIPRU firm*, it must take into account the specific technical criteria described in *SYSC* 19C.

…

Mechanisms and procedures for a ~~BIPRU~~ firm

4.1.3 R ~~A *BIPRU firm* must ensure that its internal control mechanisms and administrative and accounting procedures permit the verification of its compliance with *rules* adopted in accordance with the *Capital Adequacy Directive* at all times.~~
~~[**Note**: article 35(1) final sentence of the *Capital Adequacy Directive*]~~

[deleted]

…

4.2 Persons who effectively direct the business

…

4.2.2 R A *common platform firm*, a *management company* and the *UK* branch of a *non-EEA bank* must ensure that its management is undertaken by at least two persons meeting the requirements laid down in *SYSC* 4.2.1R.

[**Note**: article 9(4) first paragraph of *MiFID*, article 7(1)(b) of the *UCITS Directive* and ~~11(1) first paragraph of the *Banking Consolidation Directive*~~ article 13(1) of *CRD*]

…

Insert the following new sub-chapter after *SYSC* 4.3. All text is new and is not underlined.

4.3A CRR firms

Management body

4.3A.-1 R In *SYSC* 4.3A.7R and *SYSC* 4.3A.9R a '*CRR firm* that is *significant'* means a *significant IFPRU firm.*

4.3A.1 R A *CRR firm* must ensure that the *management body* defines, oversees and is accountable for the implementation of governance arrangements that ensure effective and prudent management of the *firm*, including the segregation of duties in the organisation and the prevention of conflicts of interest. The *firm* must ensure that the *management body*:

(1) has overall responsibility for the *firm*;

(2) approves and oversees implementation of the *firm*'s strategic objectives, risk strategy and internal governance;

(3) ensures the integrity of the *firm*'s accounting and financial reporting systems, including financial and operational controls and compliance with the *regulatory system*;

(4) oversees the process of disclosure and communications;

(5) has responsibility for providing effective oversight of *senior management*; and

(6) monitors and periodically assesses the effectiveness of the *firm*'s governance arrangements and takes appropriate steps to address any deficiencies.

[**Note**: article 88(1) of *CRD*]

4.3A.2 R A *CRR firm* must ensure that the chairman of the *firm*'s *management body* does not exercise simultaneously the *chief executive function* within the same *firm*, unless justified by the *firm* and authorised by the *appropriate regulator*.

[**Note**: article 88(1)(e) of *CRD*]

4.3A.3 R A *CRR firm* must ensure that the members of the *management body* of the *firm*:

(1) are of sufficiently good repute;

(2) possess sufficient knowledge, skills and experience to perform their duties and possess adequate collective knowledge, skills and experience to understand the *firm*'s activities, including the main risks;

(3) reflect an adequately broad range of experiences;

(4) commit sufficient time to perform their functions in the *firm*; and

(5) act with honesty, integrity and independence of mind to effectively assess and challenge the decisions of *senior management* where necessary and to effectively oversee and monitor management decision-making.

[**Note**: article 91(1)-(2) and (7)-(8) of *CRD*]

4.3A.4 R A *CRR firm* that is either:

(1) a *financial holding company* or a *mixed financial holding company*; or

(2) a subsidiary of a *financial holding company* or a *mixed financial holding company*;

must ensure that the members of the *management body* of the *financial holding company* or *mixed financial holding company* are of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties taking into account the specific role of a *financial holding company* or a *mixed financial holding company*.

[**Note**: article 121 of *CRD*]

4.3A.5 R A *CRR firm* must devote adequate human and financial resources to the induction and training of members of the *management body*.

[**Note**: article 91(9) of *CRD*]

4.3A.6 R A *CRR firm* must ensure that the members of the *management body* of the *firm* do not hold more directorships than is appropriate, taking into account the individual circumstances and the nature, scale and complexity of the *firm*'s activities.

[**Note**: article 91(3) of *CRD*]

…

4.3A.8 R For the purposes of *SYSC* 4.3A.6R and *SYSC* 4.3A.7R:

(1) directorships in organisations which do not pursue predominantly commercial objectives shall not count; and

(2) the following shall count as a single directorship:

(a) executive or non-executive directorships held within the same *group*; or

(b) executive or non-executive directorships held within:

(i) *firms* that are members of the same institutional protection scheme provided that the conditions set out in article 113(7) of the *CRR* are fulfilled; or

(ii) *undertakings* (including non-financial entities) in which the *firm* holds a *qualifying holding*.

[**Note**: article 91(4) and (5) of *CRD*]

Nomination Committee

4.3A.9 R A *CRR firm* that is *significant* and a *significant IFPRU firm* must:

(1) establish a nomination committee composed of members of the *management body* who do not perform any executive function in the *firm*;

(2) ensure that the nomination committee is able to use any forms of resources the nomination committee deems appropriate, including external advice; and

(3) ensure that the nomination committee receives appropriate funding.

[**Note**: article 88(2) of *CRD*]

4.3A.10 R A *CRR firm* that has a nomination committee must ensure that the nomination committee:

(1) engages a broad set of qualities and competences when recruiting members to the *management body* and puts in place a policy promoting diversity on the *management body*;

(2) identifies and recommends for approval, by the *management body* or by general meeting, candidates to fill *management body* vacancies, having evaluated the balance of knowledge, skills, diversity and experience of the *management body*;

(3) prepares a description of the roles and capabilities for a particular appointment , and assesses the time commitment required;

(4) decides on a target for the representation of the underrepresented gender in the *management body* and prepares a policy on how to increase the underrepresented gender in the *management body* to meet that target;

(5) periodically, and at least annually, assesses the structure, size, composition and performance of the *management body* and makes recommendations to the *management body* with regard to any changes;

(6) periodically, and at least annually, assesses the knowledge, skills and experience of individual members of the *management body* and of the *management body* collectively, and reports this to the *management body*;

(7) periodically reviews the policy of the *management body* for selection and appointment of *senior management* and makes recommendations to the *management body*; and

(8) in performing its duties, and to the extent possible, on an ongoing basis, takes account of the need to ensure that the *management body*'s decision making is not dominated by any one individual or small group of individuals in a manner that is detrimental to the interest of the *firm* as a whole.

[**Note**: article 88(2) and article 91(10) of *CRD*]

4.3A.11 R A *CRR firm* that does not have a nomination committee must engage a broad set of qualities and competences when recruiting members to the *management body* and for that purpose a *CRR firm* that does not have a nomination committee must put in place a policy promoting diversity on the *management body*.

[**Note**: article 91(10) of *CRD*]

Website

4.3A.12 R A *CRR firm* that maintains a website must explain on the website how it complies with the requirements of *SYSC* 4.3A.1R to *SYSC* 4.3A.3R and *SYSC*

4.3A.5R to *SYSC* 4.3A.12R.

[**Note**: article 96 of *CRD*]

Amend the following provisions.

7.1 Risk control

…

7.1.4 R The ~~*senior personnel*~~ *management body* of a *common platform firm* must approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating the risks the *firm* is or might be exposed to, including those posed by the macroeconomic environment in which it operates in relation to the status of the business cycle.

[**Note**: ~~annex V paragraph 2 of the *Banking Consolidation Directive*~~ article 76(1) of *CRD*]

…

7.1.7B G In setting the method of determining the *remuneration* of *employees* involved in the risk management function, ~~*BIPRU firms*~~ *firms that SYSC* 19A applies to will also need to comply with the *Remuneration Code*.

7.17BA G In setting the method of determining the *remuneration* of *employees* involved in the risk management function, *BIPRU firms* will also need to comply with the *BIPRU Remuneration Code*.

7.1.8 G (1) ~~*SYSC* 4.1.3R requires a *BIPRU firm* to ensure that its internal control mechanisms and administrative and accounting procedures permit the verification of its compliance with *rules* adopted in accordance with the *Capital Adequacy Directive* at all times. In complying with this obligation, a *BIPRU firm* should document the organisation and responsibilities of its risk management function and it should document its risk management framework setting out how the risks in the business are identified, measured, monitored and controlled.~~ [deleted]

…

~~Credit and counterparty risk~~

7.1.9 R …

~~[**Note**: annex V paragraph 3 of the *Banking Consolidation Directive*]~~

7.1.10 R …

~~[**Note**: annex V paragraph 4 of the *Banking Consolidation Directive*]~~

7.1.11 R …

~~[**Note**: annex V paragraph 5 of the *Banking Consolidation Directive*]~~

…

Residual risk

7.1.13 R …

~~[**Note**: annex V paragraph 6 of the *Banking Consolidation Directive*]~~

Market risk

7.1.14 R …

~~[**Note**: annex V paragraph 10 of the *Banking Consolidation Directive*]~~

Interest rate risk

7.1.15 R …

~~[**Note**: annex V paragraph 11 of the *Banking Consolidation Directive*]~~

Operational risk

7.1.16 R …

~~[**Note**: annex V paragraph 12 of the *Banking Consolidation Directive*]~~

…

Additional rules for *CRR firm*s

7.1.16C R In *SYSC* 7.1.18 a '*CRR firm* that is *significant'* means a *significant IFPRU firm.*

7.1.17 R (1) The *management body* of a *CRR firm* is overall responsible for risk. It must devote sufficient time to the consideration of risk issues.

(2) The *management body* of a *CRR firm* must be actively involved in and ensure that adequate resources are allocated to the management of all material risks addressed in the *rules* implementing *CRD* and the *EU CRR*, as well as in the valuation of assets, the use of external ratings and internal models related to those risks.

[**Note**: article 76(2) of *CRD*]

7.1.18 R (1) A *CRR firm* that is *significant* must establish a risk committee composed of members of the *management body* who do not perform any executive function in the *firm.*

(2) The risk committee must advise the *management body* on the institution's overall current and future risk appetite and assist the *management body* in overseeing the implementation of that strategy by senior management.

(3) The risk committee must review whether prices of liabilities and assets offered to clients take fully into account the *firm's* business model and risk strategy. Where prices do not properly reflect risks in accordance with the business model and risk strategy, the risk committee must present a remedy plan to the *management body.*

[**Note:** article 76(3) of *CRD*]

7.1.19 R (1) A *CRR firm* must ensure that the *management body* in its supervisory function and, where a risk committee has been established, the risk committee have adequate access to information on the risk situation of the *firm* and, if necessary and appropriate, to the risk management function and to external expert advice.

(2) The *management body* and, where one has been established, the risk committee must determine the nature, the amount, the format, and the frequency of the information on risk which it is to receive.

[**Note:** article 76(4) of *CRD*]

7.1.20 R In order to assist in the establishment of sound remuneration policies and practices, the risk committee must, without prejudice to the tasks of the remuneration committee, examine whether incentives provided by the remuneration system take into consideration risk, capital, liquidity and the likelihood and timing of earnings.

[**Note:** article 76(4) of *CRD*]

7.1.21 R (1) A *CRR firm's* risk management function (*SYSC* 7.1.6R) must be independent from the operational functions and have sufficient authority, stature, resources and access to the *management body.*

(2) The risk management function must ensure that all material risks are identified, measured and properly reported. It must be actively involved in elaborating the *firm's* risk strategy and, in all material risk management decisions, it must be able to deliver a complete view of the whole range of risks of the *firm.*

(3) A *CRR firm* must ensure that the risk management function is able to report directly to the *management body* in its supervisory function, independent from senior management and that it can raise concerns and warn the *management body*, where appropriate, where specific risk developments affect or may affect the *firm*, without prejudice to

the responsibilities of the *management body* in its supervisory and/or managerial functions pursuant to the *CRD* and the *EU CRR*.

[**Note**: article 76(5) of *CRD*]

7.1.22 R The head of the risk management function must be an independent *senior manager* with distinct responsibility for the risk management function. Where the nature, scale and complexity of the activities of the *CRR firm* do not justify a specially appointed person, another senior person within the *firm* may fulfil that function, provided there is no conflict of interest. The head of the risk management function must not be removed without prior approval of the *management body* and must be able to have direct access to the *management body* where necessary.

[**Note**: article 76(5) of *CRD*]

…

12.1 Application

…

~~BIPRU firms and other firms to which BIPRU 8 applies~~ **CRR firms and non-CRR firms that are parent financial holding companies in a Member State**

12.1.13 R If this *rule* applies under *SYSC* 12.1.14R to a *firm*, the *firm* must:

…

(2) ensure that the risk management processes and internal control mechanisms at the level of any ~~*UK*~~ *consolidation group* or non-*EEA sub-group* of which it is a member comply with the obligations set out in the following provisions on a consolidated (or sub-consolidated) basis:

(a) *SYSC* 4.1.1R and *SYSC* 4.1.2R;

(b) *SYSC* 4.1.7R;

(bA) *SYSC* 4.3A;

(c) *SYSC* 5.1.7 R;

(d) *SYSC* 7

(dA) the *Remuneration Code*;

(e) *BIPRU* 12.3.4R, *BIPRU* 12.3.5R, *BIPRU* 12.3.7A R, *BIPRU* 12.3.8R ~~(3)~~, *BIPRU* 12.3.22AR, *BIPRU* 12.3.22BR, *BIPRU* 12.3.27R, *BIPRU* 12.4.-2R, *BIPRU*

12.4.-1R, *BIPRU* 12.4.5AR, *BIPRU* 12.4. 10R, ~~and~~ *BIPRU* 12.4.11R and *BIPRU* 12.4.11A R;

(f) ~~BIPRU 2.3.7 R (1);~~

(g) ~~BIPRU 9.1.6 R and BIPRU 9.13.21 R (Liquidity Plans);~~

(h) ~~BIPRU 10.12.3 R (Concerntration risk policies).~~

[**Note:** ~~article 73(3) of the *Banking Consolidation Directive*~~] article 109(2) of the *CRD*]

(3) ensure that compliance with the obligations in (2) enables the *consolidation gro*up or the non-*EEA sub-group* to have arrangements, processes and mechanisms that are consistent and well integrated and that any data relevant to the purpose of supervision can be produced.

[**Note**: article 109(2) of the *CRD*]

12.1.14 R *SYSC* 12.1.13R applies to a *firm* that is:

…

(2) ~~a *BIPRU firm*~~ a *CRR firm*; or

(3) a ~~non-*BIPRU firm*~~ non-*CRR firm* that is a *parent financial holding company in a Member State* and is a member of a *consolidation group*.

12.1.15 R In the case of a *firm* that:

(1) is a ~~*BIPRU firm*~~ *CRR firm*; and

…

12.1.15A R *SYSC* 12.1.13 R applies to a *BIPRU firm* as if it was a *CRR firm* but the reference to *Remuneration Code* is to the *BIPRU Remuneration Code.*

…

19A Remuneration Code

19A.1 General application and purpose

Who? What? Where?

19A1.1 R (1) The *Remuneration Code* applies ~~to a *BIPRU firm* and a *third country BIPRU firm*~~ to:.

(a) a *building society*;

(b) a *bank*;

(c) an *investment firm*;

(d) a *limited activity firm*;

(e) a *limited licence firm*; or

(f) an *overseas firm* that:

(i) is not an *EEA firm*;

(ii) has its head office outside the *EEA*; and

(iii) would be a *firm* in (a), (b), (c), (d) or (e) if it had been a *UK domestic firm*, had carried on all its business in the *UK* and had obtained whatever authorisations for doing so as required under the *Act*.

(2) In relation to a ~~*third country BIPRU firm*~~ *firm* that falls under (1)(f), the *Remuneration Code* applies only in relation to activities carried on from an establishment in the *United Kingdom*.

…

…

Purpose

19A.1.6 G …

(2) The *Remuneration Code* implements the main provisions of the ~~Third Capital Requirements Directive (Directive 2010/76/EU)~~ *CRD* which relate to *remuneration*. The Committee of European Banking Supervisors published Guidelines on Remuneration Policies and Practices on 10 December 2010. ~~Provisions of the Third Capital Requirements Directive relating to Pillar 3 disclosures of information relating to *remuneration* have been implemented through amendments to *BIPRU* 11 (specifically the *rules* and *guidance* in *BIPRU* 11.5.18R to *BIPRU* 11.5.21G).~~ Provisions of the Capital Requirements (Amendment) Regulations 2012 (SI 2012/917) together with the European Banking Authority's Guidelines to article 22(3) and (5) of the *Banking Consolidation Directive* relating to the collection of *remuneration* benchmarking information and *high earners* information have been implemented through SUP 16 Annex 33AR and SUP 16 Annex 34AR. The Guidelines can be found at *http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2012/EBA-GL-2012-04---GL-4-on-remuneration-benchmarking-exercise-.pdf* and

http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2012/EBA-GL-2012-05---GL-5-on-remuneration-data-collection-exercise-.pdf.

…

…

19A.2 General requirement

Remuneration policies must promote effective risk management

19A.2.1 R …

[**Note:** ~~Article 22(1) of the *Banking Consolidation Directive*~~ article 74(1) of *CRD*]

…

19A.3 Remuneration principles for banks, building societies and investment firms

19A.3.1 R …

[**Note:** ~~Paragraph 23 (final, unnumbered point) of Annex V to the *Banking Consolidation Directive*~~ article 92(1) of *CRD*]

19A.3.2 G *SYSC* 12.1.13 R(2)(dA) requires the *firm* to ensure that the risk management processes and internal control mechanisms at the level of any *UK consolidation group* or *non-EEA sub-group* of which a *firm* is a member comply with the obligations set out in this section on a consolidated (or sub-consolidated) basis. In the *appropriate regulator's* view, the requirement to apply this section at *group*, *parent undertaking* and *subsidiary undertaking* levels (as provided for in *SYSC* 19A.3.1R(1)) is in line with the requirements in ~~article 73(3) of the *Banking Consolidation Directive*~~ article 109(2) of *CRD* concerning the application of systems and controls requirements to *groups* (as implemented in *SYSC* 12.1.13R).

Application: categories of staff and proportionality

19A.3.3 R …

[**Note:** ~~Paragraph 23 of Annex V to the *Banking Consolidation Directive*~~ article 92(2) of *CRD*]

…

19A.3.4 R …

[**Note:** ~~paragraph 23 of Annex V to the *Banking Consolidation Directive*~~ article 92(2) of *CRD*]

…

19A.3.7 R …

[**Note:** ~~Paragraph 23(a) of Annex V to the *Banking Consolidation Directive*~~ article 92(2)(a) of *CRD*]

Remuneration Principle 2: Supporting business strategy, objectives, values and long-term interests of the firm

19A.3.8 R …

[**Note:** ~~Paragraph 23(b) of Annex V to the *Banking Consolidation Directive*~~ article 92(2)(b) of *CRD*]

…

19A.3.9 R …

[**Note:** ~~Paragraph 23(b) of Annex V to the *Banking Consolidation Directive*~~ article 92(2)(b) of *CRD*]

…

19A.3.10 R A *firm* must ensure that its ~~*governing body*~~ *management body* in its *supervisory function* adopts and periodically reviews the general principles of the *remuneration* policy and is responsible for overseeing its implementation.

[**Note:** ~~Paragraph 23(c) of Annex V to the *Banking Consolidation Directive*~~ article 92(2)(c) of *CRD* and Standard 1 of the *FSB Compensation Standards*]

19A.3.11 R A *firm* must ensure that the implementation of the *remuneration* policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for *remuneration* adopted by the ~~*governing body*~~ *management body* in its *supervisory function*.

[**Note:** ~~Paragraph 23(d) of Annex V to the *Banking Consolidation Directive*~~ article 92(2)(d) of *CRD* and Standard 1 of the *FSB Compensation Standards*]

19A.3.12 R (1) A *CRR firm* that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities must establish a *remuneration* committee.

…

(3) The chairman and the members of the *remuneration* committee must be members of the ~~*governing body*~~ *management body* who do not perform any executive function in the *firm*.

(4) The *remuneration* committee must be responsible for the preparation of decisions regarding *remuneration*, including those which have implications for the risk and risk management of the *firm* and which are to be taken by the ~~*governing body*~~ *management body* ~~in its *supervisory function*~~.

(5) When preparing such decisions, the *remuneration* committee must take into account the long-term interests of shareholders, investors and other stakeholders in the *firm* and the public interest.

[**Note:** ~~Paragraph 24 of Annex V of the *Banking Consolidation Directive*~~ article 95 of *CRD* and Standard 1 of the *FSB Compensation Standards*]

…

19A.3.12A R A *firm* that maintains a website must explain on the website how it complies with the *Remuneration Code*.

[**Note:** article 96 of *CRD*]

19A.3.12B R In *SYSC* 19A.3.12R a '*CRR firm* that is significant' means a *significant IFPRU firm*.

…

19A.3.14 R …

[**Note:** ~~Paragraph 23(e) of Annex V to the *Banking Consolidation Directive*~~ article 92(2)(e) of *CRD* and Standard 2 of the *FSB Compensation Standards*]

…

19A.3.16 R …

[**Note:** ~~Paragraph 23(f) of Annex V to the *Banking Consolidation Directive*~~ article 92(2)(f) of *CRD*]

…

19A.3.18 R …

[**Note:** ~~Paragraph 23(i) of Annex V to the *Banking Consolidation Directive*~~ article 94(1)(c) of *CRD* and Standard 3 of the *FSB Compensation Standards*]

…

Remuneration Principle 7: Exceptional government intervention

19A.3.20 R A *firm* that benefits from exceptional government intervention must ensure that:

…

(2) it restructures *remuneration* in a manner aligned with sound risk management and long-term growth, including when appropriate establishing limits to the *remuneration* of ~~*senior personnel*~~ members of its *management body*; and

(3) no variable *remuneration* is paid to members of its ~~*senior personnel*~~ *management body* unless this is justified.

[**Note:** ~~Paragraph 23(k) of Annex V to the *Banking Consolidation Directive*~~ article 93 of *CRD* and Standard 10 of the *FSB Compensation Standards*]

19A.3.21 G The *appropriate regulator* would normally expect it to be appropriate for the ban on paying variable *remuneration* to ~~*senior personnel*~~ members of the *management body* of a *firm* that benefits from exceptional government intervention to apply only in relation to ~~*senior personnel*~~ members of the *management body* who were in office at the time that the intervention was required.

Remuneration Principle 8: Profit-based measurement and risk adjustment

19A.3.22 R …

[**Note:** ~~Paragraph 23(n) of Annex V to the *Banking Consolidation Directive*~~ article 94(1)(j) and (k) of *CRD* and Standard 4 of the *FSB Compensation Standards*]

…

19A.3.27 R A *firm* must ensure that its total variable *remuneration* is generally considerably contracted where subdued or negative financial performance of the *firm* occurs, taking into account both current *remuneration* and reductions in payouts of amounts previously earned, including through malus or clawback arrangements.

[**Note:** ~~Paragraph 23(q) of Annex V to the *Banking Consolidation Directive*~~ article 94(1)(n) of *CRD* and Standard 5 of the *FSB Compensation Standards*]

…

Remuneration Principle 9: Pension policy

19A.3.29 R A *firm* must ensure that:

…

(3) ~~in the case of~~ when an *employee* ~~reaching~~ reaches retirement, *discretionary pension benefits* are paid to the *employee* in the form of instruments referred to in *SYSC* 19A.3.47R(1) and subject to a five-year retention period.

[**Note:** ~~Paragraph 23(r) of Annex V to the *Banking Consolidation Directive*~~ article 94(1)(o) of *CRD*]

Remuneration Principle 10: Personal investment strategies

19A.3.30 R …

[**Note:** ~~Paragraph 23(s) of Annex V to the *Banking Consolidation Directive*~~ article 94(1)(p) of *CRD* and Standard 14 of the *FSB Compensation Standards*]

…

Remuneration Principle 11: ~~Avoidance of~~ Non-compliance with the Remuneration Code

19A.3.32 R A *firm* must ensure that variable *remuneration* is not paid through vehicles or methods that facilitate ~~the avoidance of~~ non-compliance with the *Remuneration Code*.

[**Note:** ~~Paragraph 23(t) of Annex V to the *Banking Consolidation Directive*~~ article 94(1)(q) of *CRD*]

…

Remuneration Principle 12(b): Remuneration structures – assessment of performance

…

19A.3.35A R A *firm* must ensure that the remuneration policy makes a clear distinction between criteria for setting:

(1) basic fixed *remuneration* that primarily reflects an *employee*'s professional experience and organisational responsibility as set out in the *employee*'s job description and terms of employment; and

(2) variable *remuneration* that reflects performance in excess of that required to fulfil the *employee*'s job description and terms of employment and that is subject to performance adjustment in accordance with the *Remuneration Code*.

[**Note:** article 92(2)(g) of *CRD*]

Remuneration Principle 12(b): Remuneration structures – assessment of performance

19A.3.36 R …

[**Note:** Paragraph 23(g) of Annex V to the *Banking Consolidation Directive* article 94(1)(a) of *CRD* and Standard 6 of the *FSB Compensation Standards*]

…

19A.3.38 R …

[**Note:** Paragraph 23(h) of Annex V to the *Banking Consolidation Directive* article 94(1)(b) of *CRD*]

…

19A.3.40 R A *firm* must ensure that guaranteed variable *remuneration* is not part of prospective *remuneration* plans. A *firm* must not award, pay or provide guaranteed variable *remuneration* unless it:

(1) it is exceptional;

(2) it occurs in the context of hiring new *Remuneration Code staff*; and

(3) the *firm* has a sound and strong capital base; and

(4) it is limited to the first year of service.

[**Note:** Paragraph 23(j) of Annex V to the *Banking Consolidation Directive* article 94(1)(d) to (e) of *CRD* and Standard 11 of the *FSB Compensation Standards*]

…

Remuneration Principle 12(e): Remuneration structures - payments related to early termination

19A.3.45 R A *firm* must ensure that payments related relating to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure or misconduct.

[**Note:** Paragraph 23(m) of Annex V to the *Banking Consolidation Directive* article 94(1)(h) of *CRD* and Standard 12 of the *FSB Compensation Standards*]

…

…

19A.3.47 R

(1) …

…

(b) where ~~appropriate, *capital instruments* which are eligible for inclusion at stage B1 of the calculation in the *capital resources table*, where applicable that~~ possible other instruments which are eligible as Additional Tier 1 instruments or are eligible as Tier 2 instruments or other instruments that can be fully converted to Common Equity Tier 1 instruments or written down, that in each case adequately ~~reflects~~ reflect the credit quality of the *firm* as a going concern and are appropriate for use as variable remuneration.

…

[**Note:** ~~Paragraph 23(o) of Annex V to the *Banking Consolidation Directive*~~ article 94(1)(l) of *CRD* and Standard 8 of the *FSB Compensation Standards*]

…

19A.3.49 R …

[**Note:** ~~Paragraph 23(p) of Annex V to the *Banking Consolidation Directive*~~ article 94(1)(m) of *CRD* and Standards 6 and 7 of the *FSB Compensation Standards*]

…

…

19A.3.51 R A *firm* must ensure that any variable *remuneration*, including a deferred portion, is paid or vests only if it is sustainable according to the financial situation of the *firm* as a whole, and justified ~~according to~~ on the basis of the performance of the *firm*, the business unit and the individual concerned.

[**Note:** ~~Paragraph 23(q) of Annex V to the *Banking Consolidation Directive*~~ article 94(1)(n) of *CRD* and Standards 6 and 9 of the *FSB Compensation Standards*]

19A.3.51A R A *firm* must:

(1) ensure that any of the total variable *remuneration* is subject to malus or clawback arrangements;

(2) set specific criteria for the application of malus and clawback; and

(3) ensure that the criteria for the application of malus and clawback in particular cover situations where the *employee*:

(a) participated in or was responsible for conduct which resulted in significant losses to the *firm*;

(b) failed to meet appropriate standards of fitness and propriety.

[**Note:** article 94(1)(n) of *CRD* and Standards 6 and 9 of the *FSB Compensation Standards*]

…

Insert the following section after SYSC 19B. The following text is new and is not underlined.

19.C BIPRU Remuneration Code

19C.1 General application and purpose

Who? What? Where?

19C.1.1 R (1) The *BIPRU Remuneration Code* applies to a *BIPRU firm* and a *third country BIPRU firm*.

(2) In relation to a *third country BIPRU firm*, the *BIPRU Remuneration Code* applies only in relation to activities carried on from an establishment in the *UK*.

19C.1.2 G Part 2 of *SYSC* 1 Annex 1 provides for the application of *SYSC* 4.1.1R and *SYSC* 4.1.1C R(General Requirements). In particular, and subject to the provisions on group risk systems and controls requirements in *SYSC* 12, this means that:

(1) the *BIPRU Remuneration Code*:

(a) applies to *regulated activities, ancillary activities* and applicable *ancillary services*;

(b) applies to the carrying on of *unregulated activities* in a *prudential context*; and

(c) takes into account activities of other *group* members; and

(2) where the *BIPRU Remuneration Code* applies, it applies to:

(a) a *firm's UK* activities;

(b) a *firm's passported activities* carried on from a *branch* in another *EEA State*; and

(c) a *UK domestic firm's* activities wherever they are carried on, in a *prudential context*.

When?

19C.1.3 R A *firm* must apply the *remuneration* requirements in *SYSC* 19C.3 to:

(1) *remuneration* awarded, whether under a contract or otherwise, on or after 1 January 2014;

(2) *remuneration* due on the basis of contracts concluded before 1 January 2014 which is awarded or paid on or after 1 January 2014; and

(3) *remuneration* awarded, but not yet paid, before 1 January 2014, for services provided in 2013.

19C.1.4 G Subject to the requirements of *SYSC* 19C.1.5R, in the *FCA's* view *SYSC* 19C.1.3R does not require a *firm* to breach requirements of applicable contract or employment law.

19C.1.5 R (1) This *rule* applies to a *firm* that is unable to comply with the *BIPRU Remuneration Code* because of an obligation it owes to a *BIPRU Remuneration Code staff member* under a provision of an agreement made on or before 29 July 2010.

(2) A *firm* must take reasonable steps to amend or terminate the provision in (1) in a way that enables it to comply with the *BIPRU Remuneration Code* at the earliest opportunity.

(3) Until the provision in (1) ceases to prevent the *firm* from complying with the *BIPRU Remuneration Code*, the *firm* must adopt specific and effective arrangements, processes and mechanisms to manage the risks raised by the provision.

Purpose

19C.1.6 G The aim of the *BIPRU Remuneration Code* is to ensure that *firms* have risk-focused *remuneration* policies, which are consistent with and promote effective risk management and do not expose them to excessive risk. It expands upon the general organisational requirements in *SYSC* 4.

Notifications to the FCA

19C.1.7 G (1) The *BIPRU Remuneration Code* does not contain specific notification requirements. However, general circumstances in which the *FCA* expects to be notified by *firms* of matters relating to their compliance with requirements under the *regulatory system* are

set out in *SUP* 15.3 (General notification requirements).

(2) In particular, in relation to *remuneration* matters, such circumstances should take into account *unregulated activities* as well as *regulated activities* and the activities of other members of a *group* and would include each of the following:

(a) significant breaches of the *BIPRU Remuneration Code*;

(b) any proposed *remuneration* policies, procedures or practices which could:

(i) have a significant adverse impact on the *firm's* reputation; or

(ii) affect the *firm's* ability to continue to provide adequate services to its *customers* and which could result in serious detriment to a *customer* of the *firm*; or

(iii) result in serious financial consequences to the *financial system* or to other *firms*;

(c) any proposed changes to *remuneration* policies, practices or procedures which could have a significant impact on the *firms* risk profile or resources; and

(d) fraud, errors and other irregularities described in *SUP* 15.3.17R which may suggest weaknesses in, or be motivated by, the *firms remuneration* policies, procedures or practices.

(3) Such notifications should be made immediately as the *firm* becomes aware, or has information which reasonably suggests such circumstances have, or may have, occurred or may occur in the foreseeable future.

Individual guidance

19C.1.8 G The *FCA's* policy on individual *guidance* is set out in *SUP* 9. *Firms* should particularly note the policy on what the *FCA* considers to be a reasonable request for *guidance* (see *SUP* 9.2.5G). For example, where a *firm* is seeking *guidance* on a proposed *remuneration* structure, the *FCA* will expect the *firm* to provide a detailed analysis of how the structure complies with the *BIPRU Remuneration Code*, including the general requirement for *remuneration* policies, procedures and practices to be consistent with and promote sound and effective risk management.

19C.2 General requirement

Remuneration policies must promote effective risk management

19C.2.1 R A *firm* must establish, implement and maintain *remuneration* policies, procedures and practices that are consistent with and promote sound and effective risk management.

19C.2.2 G (1) If a *firm's remuneration* policy is not aligned with effective risk management, it is likely that *employees* will have incentives to act in ways that might undermine effective risk management.

(2) The *BIPRU Remuneration Code* covers all aspects of *remuneration* that could have a bearing on effective risk management including salaries, bonuses, long-term incentive plans, options, hiring bonuses, severance packages and pension arrangements. In applying the *BIPRU Remuneration Code*, a *firm* should have regard to applicable good practice on *remuneration* and corporate governance, such as guidelines on executive contracts and severance produced by the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF). In considering the risks arising from its *remuneration* policies, a *firm* will also need to take into account its statutory duties in relation to equal pay and non-discrimination.

(3) As with other aspects of a *firm's* systems and controls, in line with *SYSC* 4.1.2R and *SYSC* 4.1.2ABR, *remuneration* policies, procedures and practices must be comprehensive and proportionate to the nature, scale and complexity of the *common platform firm's* activities. Therefore, what a *firm* must do to comply with the *BIPRU Remuneration Code* will vary. For example, while the *BIPRU Remuneration Code* refers to a *firm's remuneration* committee and risk management function, it may be appropriate for the *governing body* of a smaller *firm* to act as the *remuneration* committee, and for the *firm* not to have a separate risk management function.

(4) The principles in the *BIPRU Remuneration Code* are used by the *FCA* to assess the quality of a *firm's remuneration* policies and whether they encourage excessive risk-taking by a *firm's employees*.

(5) The *FCA* may also ask *remuneration* committees to provide the *FCA* with evidence of how well the *firm's remuneration* policies meet the *BIPRU Remuneration Code's* principles, together with plans for improvement where there is a shortfall. The *FCA* also expects relevant *firms* to use the principles in assessing their exposure to risks arising from their *remuneration* policies as part of the *internal capital adequacy assessment process (ICAAP)*.

(6) The *BIPRU Remuneration Code* is principally concerned with the risks created by the way *remuneration* arrangements are structured, not with the absolute amount of *remuneration*, which is generally a

matter for *firms' remuneration* committees.

19C.2.3 G (1) The specific *remuneration* requirements in this chapter may apply only to certain categories of *employee*. However, the *FCA* expects *firms*, in complying with the *BIPRU Remuneration Code general requirement*, to apply certain principles on a *firm*-wide basis.

(2) In particular, the *FCA* considers that *firms* should apply the principle relating to guaranteed variable *remuneration* on a *firm*-wide basis (Remuneration Principle 12(c); *SYSC* 19C.3.40R to *SYSC* 19C.3.43G).

(3) The *FCA* also expects *firms* to apply, as a minimum, the principles relating to risk management and risk tolerance (Remuneration Principle 1); supporting business strategy, objectives, values and long-term interests of the firm (Remuneration Principle 2); conflicts of interest (Remuneration Principle 3); governance (Remuneration Principle 4); risk adjustment (Remuneration Principle 8); pension policy (Remuneration Principle 9); personal investment strategies (Remuneration Principle 10); payments related to early termination (Remuneration Principle 12(e)) and deferral (Remuneration Principle 12(g)) on a *firm*-wide basis.

Record-keeping

19C.2.4 G In line with the record-keeping requirements in *SYSC* 9, a *firm* should ensure that its *remuneration* policies, practices and procedures are clear and documented. Such policies, practices and procedures would include performance appraisal processes and decisions.

Interpretation of references to remuneration

19C.2.5 R (1) In this chapter, references to *remuneration* include *remuneration* paid, provided or awarded by any *person* to the extent that it is paid, provided or awarded in connection with *employment* by a *firm*.

(2) Paragraph (1) is without prejudice to the meaning of *remuneration* elsewhere in the *Handbook*.

19C.2.6 G *Remuneration* includes, for example, payments made by a seconding organisation which is not subject to the *BIPRU Remuneration Code* to a secondee in respect of their *employment* by a *firm* which is subject to the *BIPRU Remuneration Code*.

19C.3 Remuneration principles for banks, building societies and investment firms

Application: groups

19C.3.1 R (1) A *firm* must apply the requirements of this section at *group*, *parent undertaking* and *subsidiary undertaking* levels, including those *subsidiaries* established in a country or territory which is not an *EEA State*.

(2) Paragraph (1) does not limit *SYSC* 12.1.13R and *SYSC* 12.1.15R (which relates to the application of the *BIPRU Remuneration Code* within *UK consolidation groups* and *non-EEA sub-groups*).

19C.3.2 G The effect of *SYSC* 12.1.13R(2)(dA) and *SYSC* 12.1.15R is that the *firm* is required to ensure that the risk management processes and internal control mechanisms at the level of any *consolidation group* or *non-EEA sub-group* of which a *firm* is a member comply with the obligations set out in this section on a consolidated (or sub-consolidated) basis.

Application: categories of staff and proportionality

19C.3.3 R (1) This section applies to *BIPRU Remuneration Code staff*, except as set out in (3).

(2) When establishing and applying the total *remuneration* policies for *BIPRU Remuneration Code staff*, a *firm* must comply with this section in a way and to the extent that is appropriate to its size, internal organisation and the nature, scope and complexity of its activities (the *BIPRU remuneration principles proportionality rule*).

(3) Paragraphs (1) and (2) do not apply to the requirement for significant *firms* to have a *remuneration* committee (*SYSC* 19C.3.12R).

[**Note:** In addition to the *guidance* in this section which relates to the *BIPRU remuneration principles proportionality rule*, the *FCA* gave guidance on the operation of the *BIPRU remuneration principles proportionality rule*. This *guidance* was published in Policy Statement [xxx]and is available at [web address*]*.

19C.3.4 R *BIPRU Remuneration Code staff* comprises categories of staff including senior management, risk-takers, staff engaged in control functions and any *employee* receiving total remuneration that takes them into the same *remuneration* bracket as senior management and risk-takers, whose professional activities have a material impact on the *firm's* risk profile.

19C.3.5 R A *firm* must:

(1) maintain a record of its *BIPRU Remuneration Code staff* in line with the general record-keeping requirements (*SYSC* 9); and

(2) take reasonable steps to ensure that its *BIPRU Remuneration Code staff* understand the implications of their status, including the potential for *remuneration* which does not comply with certain

requirements of the *BIPRU Remuneration Code* to be rendered void and recoverable by the *firm*.

19C.3.6 G (1) In the *FCA's* view:

(a) a *firm's* staff includes its *employees*;

(b) a *person* who performs a *significant influence function* for, or is a *senior manager* of, a *firm* would normally be expected to be part of the *firm's BIPRU Remuneration Code staff*;

(c) the table in (2) provides a non-exhaustive list of examples of key positions that should, subject to (d), be within a *firm's* definition of staff who are risk takers;

(d) *firms* should consider how the examples in the table in (2) apply to their own organisational structure (as the description of suggested business lines in the first row may be most appropriate to a *firm* which *deals on its own account* to a significant extent);

(e) *firms* may find it useful to set their own metrics to identify their risk takers based, for example, on trading limits; and

(f) a *firm* should treat a *person* as being *BIPRU Remuneration Code staff* in relation to *remuneration* in respect of a given performance year if they were *BIPRU Remuneration Code staff* for any part of that year.

[**Note:** The *FCA* gave *guidance* on the application of particular rules on *remuneration* structures in relation to individuals who are *BIPRU Remuneration Code staff* for only part of a given performance year. This *guidance* was published in Policy Statement [xxx] and is available at [web address].]

(2)

High-level category	**Suggested business lines**
Heads of significant business lines (including regional heads) and any individuals or groups within their control who have a material impact on the *firm's* risk profile	Fixed income Foreign exchange Commodities Securitisation Sales areas Investment banking (including mergers and acquisitions advisory) Commercial banking Equities

	Structured finance Lending quality Trading areas Research
Heads of support and control functions and other individuals within their control who have a material impact on the *firm's* risk profile	Credit/market/operational risk Legal Treasury controls Human resources Compliance Internal audit

Remuneration Principle 1: Risk management and risk tolerance

19C.3.7 R A *firm* must ensure that its *remuneration* policy is consistent with and promotes sound and effective risk management, and does not encourage risk-taking that exceeds the level of tolerated risk of the *firm*.

Remuneration Principle 2: Supporting business strategy, objectives, values and long-term interests of the firm

19C.3.8 R A *firm* must ensure that its *remuneration* policy is in line with the business strategy, objectives, values and long-term interests of the *firm*.

Remuneration Principle 3: Avoiding conflicts of interest

19C.3.9 R A *firm* must ensure that its *remuneration* policy includes measures to avoid conflicts of interest.

Remuneration Principle 4: Governance

19C.3.10 R A *firm* must ensure that its *governing body*, in its *supervisory function*, adopts and periodically reviews the general principles of the *remuneration* policy and is responsible for its implementation.

19C.3.11 R A *firm* must ensure that the implementation of the *remuneration* policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for *remuneration* adopted by the *governing body* in its *supervisory function*.

19C.3.12 R (1) A *firm* that is significant in terms of its size, internal organisation and the nature, scope and complexity of its activities must establish a *remuneration* committee.

(2) The *remuneration* committee must be constituted in a way that enables it to exercise competent and independent judgement on *remuneration* policies and practices and the incentives created for managing risk, capital and liquidity.

(3) The chairman and the members of the *remuneration* committee must

be members of the *governing body* who do not perform any executive function in the *firm*.

(4) The *remuneration* committee must be responsible for the preparation of decisions regarding *remuneration*, including those which have implications for the risk and risk management of the *firm* and which are to be taken by the *governing body* in its *supervisory function*.

(5) When preparing such decisions, the *remuneration* committee must take into account the long-term interests of shareholders, investors and other stakeholders in the *firm*.

[**Note:** The *guidance* referred to in the note to *SYSC* 19C.3.3R also gives *guidance* on proportionality in relation to *remuneration* committees]

19C.3.13 G (1) A *firm* should be able to demonstrate that its decisions are consistent with an assessment of its financial condition and future prospects. In particular, practices by which *remuneration* is paid for potential future revenues whose timing and likelihood remain uncertain should be evaluated carefully and the *governing body* or *remuneration* committee (or both) should work closely with the *firm's* risk function in evaluating the incentives created by its *remuneration* system.

(2) The *governing body* and any *remuneration* committee are responsible for ensuring that the *firm's remuneration* policy complies with the *BIPRU Remuneration Code* and, where relevant, should take into account relevant guidance, such as that issued by the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO).

(3) The periodic review of the implementation of the *remuneration* policy should assess compliance with the *BIPRU Remuneration Code*.

(4) Guidance on what the *supervisory function* might involve is set out in *SYSC* 4.3.3G.

Remuneration Principle 5: Control functions

19C.3.14 R A *firm* must ensure that *employees* engaged in control functions:

(1) are independent from the business units they oversee;

(2) have appropriate authority; and

(3) are *remunerated*:

(a) adequately to attract qualified and experienced staff; and

(b) in line with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control.

19C.3.15 E (1) A *firm's* risk management and compliance functions should have appropriate input into setting the *remuneration* policy for other business areas. The procedures for setting *remuneration* should allow risk and compliance functions to have significant input into the setting of individual *remuneration* awards where those functions have concerns about the behaviour of the individuals concerned or the riskiness of the business undertaken.

(2) Contravention of (1) may be relied on as tending to establish contravention of the *rule* on *employees* engaged in control functions having appropriate authority (*SYSC* 19C.3.14R(2)).

19C.3.16 R A *firm* must ensure that the *remuneration* of the senior officers in risk management and compliance functions is directly overseen by the *remuneration* committee referred to in *SYSC* 19C.3.12R, or, if such a committee has not been established, by the *governing body* in its *supervisory function*.

19C.3.17 G (1) This Remuneration Principle is designed to manage the conflicts of interest which might arise if other business areas had undue influence over the *remuneration* of *employees* within control functions. Conflicts of interest can easily arise when *employees* are involved in the determination of *remuneration* for their own business area. Where these do arise they need to be managed by having in place independent roles for control functions (including, notably, risk management and compliance) and human resources. It is good practice to seek input from a *firm's* human resources function when setting *remuneration* for other business areas.

(2) The need to avoid undue influence is particularly important where *employees* from the control functions are embedded in other business areas. This Remuneration Principle does not prevent the views of other business areas being sought as an appropriate part of the assessment process.

(3) The *FCA* generally expects the ratio of the potential variable component of *remuneration* to the fixed component of *remuneration* to be significantly lower for *employees* in risk management and compliance functions than for *employees* in other business areas whose potential bonus is a significant proportion of their *remuneration*. *Firms* should nevertheless ensure that the total *remuneration* package offered to those *employees* is sufficient to attract and retain staff with the skills, knowledge and expertise to discharge those functions. The requirement that the method of determining the *remuneration* of *relevant persons* involved in the compliance function must not compromise their objectivity or be

likely to do so also applies (see *SYSC* 6.1.4 R(4)).

Remuneration Principle 6: Remuneration and capital

19C.3.18 R A *firm* must ensure that total variable *remuneration* does not limit the *firm's* ability to strengthen its capital base.

19C.3.19 G This Remuneration Principle underlines the link between a *firm's* variable *remuneration* costs and the need to manage its capital base, including forward-looking capital planning measures. Where a *firm* needs to strengthen its capital base, its variable *remuneration* arrangements should be sufficiently flexible to allow it to direct the necessary resources towards capital building.

Remuneration Principle 7: Exceptional government intervention

19C.3.20 R A *firm* that benefits from exceptional government intervention must ensure that:

(1) variable *remuneration* is strictly limited as a percentage of net revenues when it is inconsistent with the maintenance of a sound capital base and timely exit from government support;

(2) it restructures *remuneration* in alignment with sound risk management and long-term growth, including when appropriate establishing limits to the *remuneration* of *senior personnel*; and

(3) no variable *remuneration* is paid to its *senior personnel* unless justified.

19C.3.21 G The *FCA* would normally expect it to be appropriate for the ban on paying variable *remuneration* to *senior personnel* of a *firm* that benefits from exceptional government intervention to apply only in relation to *senior personnel* who were in office at the time that the intervention was required.

Remuneration Principle 8: Profit-based measurement and risk adjustment

19C.3.22 R (1) A *firm* must ensure that any measurement of performance used to calculate variable *remuneration* components or pools of variable *remuneration* components:

(a) includes adjustments for all types of current and future risks, taking into account the cost and quantity of the capital and the liquidity required; and

(b) takes into account the need for consistency with the timing and likelihood of the firm receiving potential future revenues incorporated into current earnings.

(2) A *firm* must ensure that the allocation of variable *remuneration* components within the *firm* also takes into account all types of

current and future risks.

19C.3.23 G (1) This Remuneration Principle stresses the importance of risk adjustment in measuring performance, and the importance of applying judgment and common sense. A *firm* should ask the risk management function to validate and assess risk-adjustment techniques and to attend a meeting of the *governing body* or *remuneration* committee for this purpose.

(2) A number of risk-adjustment techniques and measures are available, and a *firm* should choose those that are most appropriate to its circumstances. Common measures include those that are based on economic profit or economic capital. Whichever technique is chosen, the full range of future risks should be covered. The *FCA* expects a *firm* to be able to provide it with details of all adjustments that the *firm* has made under a formulaic approach.

(3) The *FCA* expects a *firm* to apply qualitative judgments and common sense in the final decision about the performance-related components of variable *remuneration* pools.

(4) A *firm's governing body* (or *remuneration* committee, where appropriate) should take the lead in determining the measures to be used. It should offer the appropriate checks and balances to prevent inappropriate manipulation of the measures used. It should consult closely and frequently with the *firm's* risk management functions, in particular those relating to operational, market, credit and liquidity risk.

19C.3.24 G (1) Long-term incentive plans should be treated as pools of variable *remuneration*. Many common measures of performance for long-term incentive plans, such as earnings per *share* (EPS), are not adjusted for longer-term risk factors. Total shareholder return (TSR) includes dividend distributions in its measurement, which can also be based on unadjusted earnings data. If incentive plans mature within a two- to four-year period and are based on EPS or TSR, strategies can be devised to boost EPS or TSR during the life of the plan, to the detriment of the longer-term health of a *firm*. For example, increasing leverage is a technique can be used to boost EPS and TSR. *Firms* should take account of these factors when developing risk-adjustment methods.

(2) *Firms* that have long-term incentive plans should structure them with vesting, subject to appropriate performance conditions, and at least half of the award vesting after not less than five years and the remainder after not less than three years.

(3) Long-term incentive plan awards may be included in the calculation of the deferred portion of variable *remuneration* only if upside incentives are adequately balanced by downside adjustments. The valuation of the award should be based on its value when the award

is granted, and determined using an appropriate technique.

19C.3.25 R Assessments of financial performance used to calculate variable *remuneration* components or pools of variable *remuneration* components must be based principally on profits.

19C.3.26 G (1) Performance measures based primarily on revenues or turnover are unlikely to pay sufficient regard to the quality of business undertaken or services provided. Profits are a better measure provided they are adjusted for risk, including future risks not adequately captured by accounting profits.

(2) Management accounts should provide profit data at such levels within the *firm's* structure as to enable a *firm* to see as accurate a picture of contributions of relevant staff to a *firm's* performance, as reasonably practicable. If revenue or turnover is used as a component in performance assessment, processes should be in place to ensure that the quality of business undertaken or services provided and their appropriateness for *clients* are taken into account.

19C.3.27 R A *firm* must ensure that its total variable *remuneration* is generally considerably contracted where subdued or negative financial performance of the *firm* occurs, taking into account both current *remuneration* and reductions in payouts of amounts previously earned.

[**Note:** Standard 5 of the *FSB Compensation Standards*]

19C.3.28 G Where a *firm* makes a loss, the *FCA* generally expects no variable *remuneration* to be awarded. Variable *remuneration* may nevertheless be justified. For example, to incentivise *employees* involved in new business ventures which could be loss-making in their early stages.

Remuneration Principle 9: Pension policy

19C.3.29 R A *firm* must ensure that:

(1) its pension policy is in line with its business strategy, objectives, values and long-term interests;

(2) when an *employee* leaves the *firm* before retirement, any *discretionary pension benefits* are held by the *firm* for a period of five years in the form of instruments referred to in *SYSC* 19C.3.47R(1) ; and

(3) when *employees* reach retirement, *discretionary pension benefits* are paid to the *employee* in the form of instruments in *SYSC* 19C.3.47R(1) and subject to a five-year retention period.

Remuneration Principle 10: Personal investment strategies

19C.3.30 R (1) A *firm* must ensure that its *employees* undertake not to use personal hedging strategies or *remuneration*- or liability-related *contracts of*

insurance to undermine the risk-alignment effects embedded in their *remuneration* arrangements.

(2) A *firm* must maintain effective arrangements designed to ensure that *employees* comply with their undertaking.

19C.3.31 G Circumstances in which a *person* will be using a personal hedging strategy include entering into an arrangement with a third party under which the third party will make payments, directly or indirectly, to that *person* linked to, or commensurate with, the amounts by which the *person's remuneration* is subject to reductions.

Remuneration Principle 11: Avoidance of the Remuneration Code

19C.3.32 R A *firm* must ensure that variable *remuneration* is not paid through vehicles or methods that facilitate the avoidance of the *BIPRU Remuneration Code*.

Remuneration Principle 12: Remuneration structures - introduction

19C.3.33 G This Remuneration Principle consists of a series of *rules*, *evidential provisions* and *guidance* relating to *remuneration* structures.

19C.3.34 G (1) Taking account of the *BIPRU remuneration principles proportionality rule*, the *FCA* does not generally consider it necessary for a *firm* to apply the *rules* in (2) where, in relation to an individual ("X"), both the following conditions are satisfied:

(a) condition 1 requires that X's variable *remuneration* is no more than 33% of total *remuneration*; and

(b) condition 2 requires that X's total *remuneration* is no more than 500,000.

(2) The *rules* referred to in (1) relate to:

(a) guaranteed variable *remuneration* (*SYSC* 19C.3.40R);

(b) retained *shares* or other instruments (*SYSC* 19C.3.47R);

(c) deferral (*SYSC* 19C.3.49 R); and

(d) performance adjustment (*SYSC 19C.3.51 R*).

[**Note:** The *FCA* also gave *guidance* on the application of certain *rules* on *remuneration* structures in relation to individuals who are *BIPRU Remuneration Code staff* for only part of a given performance year. This guidance was published in Policy Statement [xxxxx] and is available at [web address].]

Remuneration Principle 12(a): Remuneration structures - general requirement

19C.3.35 R A *firm* must ensure that the structure of an *employee's remuneration* is

consistent with, and promotes, effective risk management.

Remuneration Principle 12(b): Remuneration structures - assessment of performance

19C.3.36 R A *firm* must ensure that where *remuneration* is performance-related:

(1) the total amount of *remuneration* is based on a combination of the assessment of the performance of:

(a) the individual;

(b) the business unit concerned; and

(c) the overall results of the *firm*; and

(2) when assessing individual performance, financial as well as non-financial criteria are taken into account.

19C.3.37 G Non-financial performance metrics should form a significant part of the performance assessment process and should include adherence to effective risk management and compliance with the *regulatory system* and with relevant overseas regulatory requirements. Poor performance as assessed by non-financial metrics, such as poor risk management or other behaviours contrary to *firm* values, can pose significant risks for a *firm* and should, as appropriate, override metrics of financial performance. The performance assessment process and the importance of non-financial assessment factors in the process should be clearly explained to relevant *employees* and implemented. A balanced scorecard can be a good technique.

19C.3.38 R A *firm* must ensure that the assessment of performance is set in a multi-year framework, to ensure that the assessment process is based on longer-term performance and that the actual payment of performance-based components of *remuneration* is spread over a period which takes account of the underlying business cycle of the *firm* and its business risks.

19C.3.39 G The requirement for assessment of performance to be in a multi-year framework reflects the fact that profits from a *firm's* activities can be volatile and subject to cycles. The financial performance of *firms* and individual *employees* can be exaggerated as a result. Performance assessment on a moving average of results can be a good way of meeting this requirement. However, other techniques, such as good quality risk adjustment and deferral of a sufficiently large proportion of *remuneration*, may also be useful.

Remuneration Principle 12(c): Remuneration structures - guaranteed variable remuneration

19C.3.40 R A *firm* must not award, pay or provide guaranteed variable *remuneration* unless it:

(1) is exceptional;

(2) occurs in the context of hiring new *BIPRU Remuneration Code staff*; and

(3) is limited to the first year of service.

19C.3.41 E (1) A *firm* should not award, pay or provide guaranteed variable *remuneration* in hiring new *BIPRU Remuneration Code staff* (X) unless:

(a) it has taken reasonable steps to ensure that the *remuneration* is not more generous in its amount or terms (including any deferral or retention periods) than the variable *remuneration* awarded or offered by X's previous employer; and

(b) it is subject to appropriate performance adjustment requirements.

(2) Contravention of (1) may be relied on as tending to establish contravention of the *rule* on guaranteed variable *remuneration* (*SYSC* 19C.3.40R).

19C.3.42 G Guaranteed variable *remuneration* should be subject to the same deferral criteria as other forms of variable *remuneration* awarded by the *firm*.

19C.3.43 G Variable *remuneration* can be awarded to *BIPRU Remuneration Code staff* in the form of retention awards where it is compatible with the *BIPRU Remuneration Code general requirement* to do so. The *FCA* considers this is likely to be the case only where a *firm* is undergoing a major restructuring and a good case can be made for retention of particular key staff members on prudential grounds. Proposals to give retention awards should form part of any notice of the restructuring proposals required in accordance with *Principle* 11 and the general notification requirements in *SUP* 15.3.

Remuneration Principle 12(d): Remuneration structures - ratios between fixed and variable components of total remuneration

19C.3.44 R A *firm* must set appropriate ratios between the fixed and variable components of total *remuneration* and ensure that:

(1) fixed and variable components of total *remuneration* are appropriately balanced; and

(2) the fixed component represents a sufficiently high proportion of the total *remuneration* to allow the operation of a fully flexible policy on variable *remuneration* components, including the possibility to pay no variable *remuneration* component.

Remuneration Principle 12(e): Remuneration structures - payments related to early termination

19C.3.45 R A *firm* must ensure that payments related to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure.

19C.3.46 G *Firms* should review existing contractual payments related to termination of employment with a view to ensuring that these are payable only where there is a clear basis for concluding that they are consistent with the *BIPRU Remuneration Code general requirement*.

[**Note:** Standard 12 of the *FSB Compensation Standards*]

Remuneration Principle 12(f): Remuneration structures - retained shares or other instruments

19C.3.47 R (1) A *firm* must ensure that a substantial portion, at least 50%, of any variable *remuneration* consists of an appropriate balance of:

(a) *shares* or equivalent ownership interests, subject to the legal structure of the *firm* concerned, or *share*-linked instruments or equivalent non-cash instruments for a non-listed *firm*; and

(b) where appropriate, *capital instruments* which are eligible for inclusion at stage B1 of the calculation in the *capital resources table*, where applicable, adequately reflect the credit quality of the *firm* as a going concern.

(2) The instruments in (1) must be subject to an appropriate retention policy designed to align incentives with the longer-term interests of the *firm*.

(3) This *rule* applies to the portion of the variable *remuneration* component deferred, and not deferred, in line with *SYSC* 19C.3.49R.

[**Note:** Standard 8 of the *FSB Compensation Standards*]

19C.3.48 G (1) Regarding *SYSC* 19C.3.47R(3), the 50% minimum threshold for instruments must be applied equally to the non-deferred and the deferred components; in other words, *firms* must apply the same chosen ratio between instruments and cash for their total variable *remuneration* to both the upfront and deferred components.

(2) This simplified example illustrates the operation of (1). The variable remuneration of a material risk taker (X) is 100, and by *SYSC* 19C.3.49R(3) X is required to defer 60%. X's upfront component is 40 and X's deferred component is 60. At least 20 of X's upfront component, and at least 30 of X's deferred component, must be in instruments referred to in *SYSC* 19C.3.47R(1).

Remuneration Principle 12(g): Remuneration structures - deferral

19C.3.49 R (1) A *firm* must not award, pay or provide a variable *remuneration*

component unless a substantial portion of it, which is at least 40%, is deferred over a period of not less than three to five years.

(2) *Remuneration* under (1) must vest no faster than on a pro-rata basis.

(3) In the case of a variable *remuneration* component:

(a) of a particularly high amount, or

(b) payable to a *director* of a *firm* that is significant in its size, internal organisation and the nature, scope and complexity of its activities; at least 60% of the amount must be deferred.

(4) Paragraph (3)(b) does not apply to a *non-executive director*.

(5) The length of the deferral period must be established in line with the business cycle, the nature of the business, its risks and the activities of the *employee* in question.

[**Note:** Standards 6 and 7 of the *FSB Compensation Standards*]

(6) 500,000 is a particularly high amount for the purpose of (3)(a).

(7) Paragraph (6) is without prejudice to the possibility of lower sums being considered a particularly high amount.

19C.3.50 G (1) Deferred *remuneration* paid in *shares* or *share*-linked instruments should be made under a scheme which meets appropriate criteria, including risk adjustment of the performance measure used to determine the initial allocation of shares. Deferred *remuneration* paid in cash should also be subject to performance criteria.

(2) The *FCA* generally expects a *firm* to have a *firm*-wide policy (and *group*-wide policy, where appropriate) on deferral. The proportion deferred should generally rise with the ratio of variable *remuneration* to fixed *remuneration* and with the amount of variable *remuneration*. While any variable *remuneration* component of 500,000 or more paid to *BIPRU Remuneration Code staff* must be subject to 60% deferral, *firms* should also consider whether lesser amounts should be considered to be 'particularly high' taking account, for example, of whether there are significant differences within *BIPRU Remuneration Code staff* in the levels of variable *remuneration* paid.

Remuneration Principle 12(h): Remuneration structures - performance adjustment, etc.

19C.3.51 R A *firm* must ensure that any variable *remuneration*, including a deferred portion, is paid or vests only if it is sustainable according to the financial situation of the *firm* as a whole, and justified according to the performance of the *firm*, the business unit and the individual concerned.

[**Note:** Standards 6 and 9 of the *FSB Compensation Standards*]

19C.3.52 E (1) A *firm* should reduce unvested deferred variable *remuneration* when, as a minimum:

(a) there is reasonable evidence of *employee* misbehaviour or material error; or

(b) the *firm* or the relevant business unit suffers a material downturn in its financial performance; or

(c) the *firm* or the relevant business unit suffers a material failure of risk management.

(2) For performance adjustment purposes, awards of deferred variable *remuneration* made in *shares* or other non-cash instruments should provide the ability for the *firm* to reduce the number of *shares* or other non-cash instruments.

(3) Contravention of (1) or (2) may be relied on as tending to establish contravention of the *rule* on performance adjustment (*SYSC* 19C.3.51R).

19C.3.53 G (1) Variable *remuneration* may be justified, for example, to incentivise *employees* involved in new business ventures which could be loss-making in their early stages.

(2) The *governing body* (or, where appropriate, the *remuneration* committee) should approve performance adjustment policies, including the triggers under which adjustment would take place. The *FCA* may ask *firms* to provide a copy of their policies and expects *firms* to make adequate records of material decisions to operate the adjustments.

Part 2: Comes into force on 1 July 2014.

4.3A.7 R (1) A *CRR firm* that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities must ensure that the members of the *management body* of the *firm* do not hold more than one of the following combinations of directorship in any organisation at the same time:

(a) one executive directorship with two non-executive directorships; and

(b) four non-executive directorships.

(2) (1) does not apply to members of the *management body* that represent the UK.

[**Note**: article 91(3) of the *CRD*]

GENERAL GUIDANCE ON PROPORTIONALITY:
THE REMUNERATION CODE (SYSC 19A)

Contents

PART A: INTRODUCTION & INTERPRETATION 2
Guidance on the remuneration principles proportionality rule 2
Individual guidance 3
Arrangement of guidance statement 3
Interpretation 3
PART B: PROPORTIONALITY LEVELS 5
PART C: PROCESS FOR DIVIDING FIRMS INTO PROPORTIONALITY LEVELS 6
Overview 6
Solo Remuneration Code firms 6
Groups with more than one Remuneration Code firm 7
PART D: GUIDANCE TO FIRMS IN PARTICULAR PROPORTIONALITY LEVELS 9
Purpose of proportionality levels 9
Firms to continue to consider proportionality in their individual circumstances, etc. 9
Disapplication of certain remuneration principles for firms in particular proportionality levels 10
PART E: GUIDANCE ABOUT PART-YEAR REMUNERATION CODE STAFF 10
Introduction 10
Part-year Remuneration Code staff for more than three months 11
Certain part-year Remuneration Code staff for three months or less 13
Part-year Remuneration Code staff for three months or less, but where exceptional etc. payments made 13
APPENDIX 1: SUPPLEMENTAL GUIDANCE ON DIVIDING FIRMS INTO PROPORTIONALITY LEVELS 14
Groups with more than one Remuneration Code firm: examples 14
Role of individual guidance 15

PART A: INTRODUCTION & INTERPRETATION

Introduction and Status of guidance statement

1. This statement is general *guidance* given under section 139A(1) of the Financial Services and Markets Act (FSMA). It relates to the *Remuneration Code* of *SYSC* 19A of the *Handbook*.

2. Paragraphs 13 and 14 make provision about the interpretation of this *guidance* statement. Expressions in italics either bear the meaning given in the *Handbook Glossary*, or in the table in paragraph 15.

3. This *guidance* statement has effect from 1January 2014.

Remuneration principles proportionality rule

4. The *remuneration principles proportionality rule* is set out in *SYSC* 19A.3.3R (2).

5. The *Remuneration Code* requires (amongst other things) a *firm* to apply requirements in *SYSC* 19A.3 to *Remuneration Code staff*. The *remuneration principles proportionality rule* requires a *firm*, when establishing and applying the total *remuneration* policies for *Remuneration Code staff*, to comply with *SYSC* 19A.3 in a way and to the extent that is appropriate to its size, internal organisation and the nature, the scope and the complexity of its activities.

Guidance on the remuneration principles proportionality rule

6. General *guidance* is given in relation to specific aspects of the *remuneration principles proportionality rule* in *SYSC* 19A.3 itself.[1]

7. Part D of this *guidance* statement provides additional general *guidance* in relation to the application of the *remuneration principles proportionality rule* to different types of *firm*.

8. Part E of this *guidance* statement provides additional general *guidance* in relation to the application of the *remuneration principles proportionality rule* to *Remuneration Code staff* who have, in relation to a given performance year, been *Remuneration Code staff* for only part of the year.

9. This *guidance* statement represents our *guidance* in a field where requirements relating to *remuneration* are being implemented within the EEA. We recognise this will be an evolving process, and intend to keep the *guidance* set out here under review.

---

[1] The main provisions of guidance which specifically refer to the *remuneration principles proportionality rule* are *SYSC* 19A.3.34G (giving guidance in relation to *Remuneration Code staff* and certain rules on *remuneration* structures).

Individual guidance

10. We may give individual *guidance* to a *firm*, either on its own initiative or on the application of the *firm*. Our policy on individual *guidance* is set out in *SUP* 9. In consequence, we may give individual *guidance* to a *firm* in relation to the *remuneration principles proportionality rule* (*SYSC* 19A.3.3R). Such *guidance* may relate to the application of the *rule* by the *firm* generally, or in specific areas.

Arrangement of guidance statement

11. This general *guidance* statement is divided into five Parts:

    (1) This Part, Part A: Introduction & interpretation.

    (2) Part B: Proportionality levels.

    (3) Part C: Division of firms into proportionality levels.

    (4) Part D: Guidance to firms in particular proportionality levels.

    (5) Part E: Guidance about part-year Remuneration Code staff.

12. It is supplemented by Appendix 1 – Supplemental guidance on dividing firms into proportionality levels.

Interpretation

13. This *guidance* statement is to be interpreted as if it was an Annex to *SYSC* 19A.3 R. In consequence, *GEN* 2 (interpreting the Handbook) applies to the interpretation of this *guidance* statement.

14. In particular, an expression in italics which is defined in the *Glossary* has the meaning given there (*GEN* 2.2.7R). Where an expression in italics is not defined in the *Glossary*, it has the meaning given by the following table:

Table 1: Glossary of terms defined in this guidance statement

Defined expression	Definition
group	has the meaning given in the *Glossary* under paragraph (3).
overseas Remuneration Code firm	an *overseas firm* that: (i) is not an *EEA firm;* (ii) has its head office outside the *EEA*; and (iii) would be a *building society, a bank, an investment firm, a limited activity firm or a limited licence firm* if it had been a *UK domestic firm*, had carried on all its business in the United Kingdom and had obtained whatever authorisation for doing so as required under the Act.
proportionality level	has the meaning given in paragraph 17, and references to *proportionality level one*, etc. are to be construed accordingly.
Remuneration Code firm	a *firm* specified in *SYSC* 19A.1.1 R(1)(a)-(e).
relevant total assets	has the meanings given in paragraph 24(3).
relevant date	has the meanings given in paragraph 24(3).
solo Remuneration Code firm	a *Remuneration Code firm* which is not part of a *group* containing one or more further *Remuneration Code firms*.

PART B: PROPORTIONALITY LEVELS

15. *SYSC* 19A.1.1R provides that the *Remuneration Code* applies to a *Remuneration Code firm* and an *overseas Remuneration Code firm* , in relation to the activities carried on from an establishment in the *UK*).

16. This *guidance* statement provides for the division of *Remuneration Code firms* into three categories:

    (1) *proportionality level one*,

    (2) *proportionality level two*, and

    (3) *proportionality level three*

17. The process by which firms are divided into *proportionality levels* is provided in Part C (as supplemented by Appendix 1), and may also depend on individual *guidance*.

18. The *proportionality levels* provide a framework for the operation of the *remuneration principles proportionality rule*. Guidance is given to firms *in* different *proportionality levels* in Part D.

PART C: PROCESS FOR DIVIDING FIRMS INTO PROPORTIONALITY LEVELS

Overview

19. This Part provides the process by which a *Remuneration Code firm* should ascertain the *proportionality level* into which it falls. Appendix 1 provides supplementary *guidance* (including examples).

20. A *Remuneration Code firm*, in order to ascertain its *proportionality level*, must first establish whether it is part of a *group* which contains one or more other *Remuneration Code firms*:

    (1) If the *firm* is not part of such a *group* (a *solo Remuneration Code firm*), its *proportionality level* will depend on its individual characteristics (as determined in accordance with paragraph 22).

    (2) If the *firm* is part of such a *group*, its *proportionality level* will depend on a two-stage process (as provided in paragraphs 23 and 24).

    (This requires all *Remuneration Code firms* that are part of the *group* to fall into the highest *proportionality level* that any individual *Remuneration Code firm* in the group would fall into on the assumption that it was a *solo Remuneration Code firm*.)

21. Individual *guidance* may vary the *proportionality level* into which a *firm* would otherwise fall under paragraphs 22 to 24.

Solo Remuneration Code firms

22. The following table shows the *proportionality level* into which a *solo Remuneration Code firm* that is an *IFPRU investment firm* or an *overseas Remuneration Code firm* falls:

    (1) A *firm* of the description given in the second column falls into the *proportionality level* listed in the first column.

    (2) Where applicable, the *firm's proportionality level* will further depend on whether it held *relevant total assets* on the *relevant date* of the amount listed in the third column of the table.

    (3) In (2) —

        (a) 'relevant total assets' means:

            (i) for *IFPRU investment firms*, the average of the firm's total assets on the firm's last three *relevant dates*; and

            (ii) for *overseas Remuneration Code firms*, the average of the firm's total assets that covered the activities of the branch operation in the *United Kingdom* on the firm's last three *relevant dates*;

        (b) 'relevant date' means:

            (i) for *IFPRU investment firms*, an accounting reference date; and

            (ii) for *overseas Remuneration Code firm* 'relevant date' means 31 December.

The limit confining *relevant total assets* to those that cover the activities of the branch operation in the UK is taken from *SUP* 16.12.3R(1)(a)(iv), which relates to a reporting requirement in relation to *non-EEA banks* (among others). We consider that a *firm* which needs to ascertain its *relevant total assets* should apply the general policy on valuation set out in *GENPRU* 1.3.

Table 2: Proportionality levels: solo Remuneration Code firms which include, but not limited to, *IFPRU Investment firms* and overseas Remuneration Code firms

Proportionality level	**Type of firm**	***Relevant total assets* on *relevant date* of firm** (where applicable)
Proportionality level one	*UK Bank.*	Exceeding £50bn
	Building society.	Exceeding £50bn
	IFPRU 730k Investment firms that is a that is a *full scope IFPRU investment firm'*	Exceeding £50bn
Proportionality level two	*UK Bank.*	Exceeding £15bn but not exceeding £50bn
	Building society.	Exceeding £15bn, but not exceeding £50bn
	IFPRU 730k Investment firms that is a that is a *full scope IFPRU investment firm'*	Exceeding £15bn, but not exceeding £50bn
Proportionality level three	*UK Bank.*	Not exceeding £15bn
	Building society.	Not exceeding £15bn
	Any *full scope IFPRU Investment firms* that does not fall within *proportionality level one* or *proportionality level two* (in accordance with this Table).	Not applicable
	IFPRU limited licence firm.	
	IFPRU limited activity firm.	

Groups with more than one Remuneration Code firm

23. This paragraph applies where a *Remuneration Code firm* is part of a *group* containing one or more other *Remuneration Code firms*:

    (1) Each *Remuneration Code firm* in the *group* must determine the *proportionality level* into which it would fall on the assumption it was a

solo Remuneration Code firm.

(2) Where each *Remuneration Code firm* falls into the same *proportionality level* on the assumption that it was a *solo Remuneration Code firm*, each *firm* falls into that *proportionality level*.

(3) Where the *Remuneration Code firms* fall into different *proportionality levels* on the assumption that they were *solo Remuneration Code firms*, each *firm* falls into the highest *proportionality level*.

(4) For the purposes of (3), *proportionality level one* is the highest and *proportionality level three* is the lowest.

24. Appendix 1 provides examples of this approach. A *firm* which has a higher *proportionality level* as a result of the *guidance* in paragraph 25 than would have been the case had the *firm* been a *solo Remuneration Code firm* should note the scope to apply for individual *guidance* to vary its *proportionality level* (as discussed in paragraphs 5 and 6 of Appendix 1).

PART D: GUIDANCE TO FIRMS IN PARTICULAR PROPORTIONALITY LEVELS

Purpose of proportionality levels

25. In relation to the *remuneration principles proportionality rule*, the *proportionality levels* provide the following:

    (1) A framework for our supervisory approach, and a broad indication of our likely expectations.

    (2) *Guidance* on which remuneration principles may normally be disapplied under the *remuneration principles proportionality rule*.

Firms to continue to consider proportionality in their individual circumstances etc.

26. It follows from the nature of the *remuneration principles proportionality rule*, and the limited purposes noted in paragraph 25, that the *proportionality levels* do not provide comprehensive *guidance* on how the *remuneration principles proportionality rule will* apply to a particular firm. A *firm* will still need to consider the application of the *remuneration principles proportionality rule* to its individual circumstances.

27. A *firm* should bear in mind that the Remuneration Code may require different responses from *firms* that fall into the same *proportionality level*. This is illustrated by the following example:

    (1) Firm A is a global bank with *relevant total assets* of £800bn, with substantial investment banking business, foreign exchange exposures and a complex business model seeking aggressive growth. It falls into *proportionality level one*.

    (2) Firm B is a large mortgage and savings bank with *relevant total assets* of £100bn and a comparatively simple, conservative business model. It falls into *proportionality level one*.

    (3) Firm C is a large building society, with *relevant total assets* of £25bn and a comparatively simple, conservative business model. It falls into *proportionality level two*.

    (4) Remuneration Principle 8 requires, amongst other things, a *firm* to risk-adjust performance measures to take account of all types of current and future risks (*SYSC* 19A.3.22R(1)(a)).

    (5) Clearly the processes necessary to identify such risks will need to be more sophisticated for Firm A than for Firm B, despite the fact that they fall into the same *proportionality level*. Indeed, the difference in the necessary sophistication is likely to be greater as between Firm A and Firm B than as between Firm B and Firm C.

Disapplication of certain remuneration principles for firms in particular proportionality levels

28. The *CRD* can be interpreted such that it may not be necessary for certain *firms* to apply certain *remuneration* principles at all.[2]

29. In our view, it will normally be appropriate for a *firm* in *proportionality level three* to disapply under the *remuneration principles proportionality rule* the following *rules*—

    (1) retained *shares* or other instruments (*SYSC* 19A.3.47R),

    (2) deferral (*SYSC* 19A.3.49R),

    (3) performance adjustment (*SYSC* 19A.3.51R), and

    It may also be appropriate for *limited licence firms* and *limited activity firms* to disapply under the *remuneration principles proportionality rule* the ratios between fixed and variable components of total *remuneration* (*SYSC* 19A.3.44R).

    We are also of the opinion that such firms may take into account the specific features of their types of activities in applying the 'requirement on the multi-year framework …, in particular the accrual and ex-ante risk adjustment aspects of it'.[3]

30. However, *firms* should also note that some *remuneration* principles set specific numerical criteria (such as on the minimum period of deferral, the minimum portion to be deferred and the minimum portion to be issued in *shares*). The following *guidance* applies where such principles apply to *Remuneration Code staff* and are not capable of disapplication under the approach set out above. In such circumstances, we do not consider that the *remuneration principles proportionality rule* permits a *firm* to apply lower numerical criteria. (For the avoidance of doubt, this *guidance* does not apply where a *firm* chooses to use deferral or issuance in shares more widely than required by *SYSC* 19A.3, for example in order to comply with the *Remuneration Code general requirement*).

PART E: GUIDANCE ABOUT PART-YEAR REMUNERATION CODE STAFF

Introduction

31. *SYSC* 19A.3.34G provides *guidance* on when we do not generally consider it necessary for a *firm* to apply to certain *Remuneration Code staff* certain *rules* relating to *remuneration* structures. This Part provides supplementary guidance on how certain *rules* on *remuneration* structures might normally be applied to *Remuneration Code staff*

[2] *Capital Requirements Directive* Art 92(2) provides that the principles should be applied 'in a manner and to the extent that is appropriate to their size, internal organisation and the nature, the scope and complexity of their activities' (emphasis added).

[3] As per the FSA's Policy Statement 10/20. See link http://www.fsa.gov.uk/pubs/policy/ps10_20.pdf

who have, in relation to a given performance year, been *Remuneration Code staff* for only part of the year.

32. In giving this *guidance*, we have taken account of the *remuneration principles proportionality rule*.

Part-year Remuneration Code staff for more than three months

33. This paragraph applies where an individual (A) has, in relation to a given performance year, been *Remuneration Code staff* for a period more than three months, but less than 12 months:

    (1) Sub-paragraphs (3) and (4) explain how the *guidance* in *SYSC* 19A.3.34G (as mentioned in the introduction to this Part) is to be applied in relation to A. Sub-paragraphs (5) and (6) provide that in certain circumstances it may be appropriate to apply certain *rules* to only a proportion of A's variable *remuneration*. Sub-paragraphs (7) to (9) provide examples.

    (2) In this paragraph:

        (a) 'relevant fraction' means the fraction derived by dividing the number of days in the given performance year for which A has been *Remuneration Code staff* by the number of days in the year;

        (b) 'qualifying fixed *remuneration*' means A's annual fixed *remuneration* in A's capacity as *Remuneration Code staff* multiplied by the relevant fraction;

        (c) 'qualifying variable *remuneration*' means:

            (i) in the case where A was an *employee* of the *firm* for the whole of the given performance year, A's variable *remuneration* in relation to the performance year multiplied by the relevant fraction;

            (ii) in the case where A was only ever employed in the given performance year as *Remuneration Code staff*, A's actual variable *remuneration*;

        (d) 'total qualifying *remuneration*' means qualifying fixed *remuneration* added to qualifying variable *remuneration*;

        (e) 'threshold amount' means £500,000 multiplied by the relevant fraction.

    (3) We do not generally consider it necessary for a *firm* to apply the rules referred to in (4) where, in relation to A, the following conditions are satisfied:

        (a) Condition 1 is that A's qualifying variable *remuneration* is no more than 33% of total qualifying remuneration, and

        (b) Condition 2 is that A's total qualifying remuneration is no more than the threshold amount.

    (4) The rules referred to in (3) are those relating to:

        (a) guaranteed variable *remuneration* (*SYSC* 19A.3.40R),

        (b) retained *shares* or other instruments (*SYSC* 19A.3.47R),

        (c) deferral (*SYSC* 19A.3.49R), and

        (d) performance adjustment (*SYSC* 19A.3.51R).

(5) Sub-paragraph (6) applies where the conditions in (3) are not satisfied and the *firm* should apply the rules referred to in (6).

(6) Where this sub-paragraph applies, we generally consider that it would be appropriate to apply the following rules to qualifying variable *remuneration* only:

(a) retained *shares* or other instruments (*SYSC* 19A.3.47R),

(b) deferral (*SYSC* 19A.3.49R), and

(c) performance adjustment (*SYSC* 19A.3.51R).

(7) The examples in (8) and (9) illustrate this *guidance*. The performance year in each case is 1 January to 31 December.

(8) Example 1:

(a) A1 is an *employee* of the *firm* through the performance year and is promoted to a *Remuneration Code staff* role with effect from 1 September. A1's previous fixed *remuneration* was £150,000. In his *Remuneration Code staff* role A1's fixed remuneration increases to £250,000. For the performance year, A1 is awarded variable *remuneration* of £130,000.

(b) The relevant fraction is 122/365. A1's qualifying fixed *remuneration* is £83,560 (£250,000 multiplied by 122/365). A1's qualifying variable remuneration is £43,452 (£130,000 multiplied by 122/365). A1's total qualifying *remuneration* is £127,012. The threshold amount is £167,120 (£500,000 multiplied by 122/365).

(c) A1's total qualifying remuneration is below the threshold amount, so condition 2 of (3) is satisfied. But A1's qualifying variable *remuneration* is more than 33% of A1's total qualifying *remuneration*, and condition 1 of (3) is not satisfied.

(d) The rule *on* guaranteed variable remuneration applies to A1. In addition, the *rules* on retained shares and other instruments, deferral and performance adjustment must be applied to A1's qualifying variable *remuneration* of £43,452.

(9) Example 2:

(a) A2 joins the *firm* as a *Remuneration Code staff* member with effect from 1 July. A2's annual fixed remuneration is £450,000. For period of 1 June to 31 December, A2 is awarded variable *remuneration* of £50,000.

(b) The relevant fraction is 184/365. A2's qualifying fixed *remuneration* is £226,850 (£450,000 multiplied by 184/365). A2's qualifying variable *remuneration* is £50,000 (the actual amount). A2's total qualifying remuneration *is* £276,850. The threshold amount is £252,050 (£500,000 multiplied by 184/365).

(c) A2's qualifying variable *remuneration* is not more than 33% of A2's total qualifying *remuneration*, and condition 1 of (3) is satisfied. But A2's total qualifying *remuneration* is more than the threshold amount, so condition 2 of (3) is not satisfied.

(d) The rule *on* guaranteed variable remuneration applies to A2. In addition, the *rules* on retained shares and other instruments, deferral and performance adjustment must be applied to A2's qualifying variable *remuneration* of £50,000.

Certain part-year Remuneration Code staff for three months or less

34. Paragraphs 38 and 39 apply where:

    (1) an individual (B) has, in relation to a given performance year, been *Remuneration Code staff* for a period of three months or less, and

    (2) an exceptional or irregular payment (such as a sign-on award) has not been or is not to be made in relation to B's appointment as *Remuneration Code staff*.

35. Where this paragraph applies, we do not generally consider it necessary to apply the following rules in relation to B for the performance year in question:

    (1) retained *shares* or other instruments (*SYSC* 19A.3.47R),

    (2) deferral (*SYSC* 19A.3.49R), and

    (3) performance adjustment (*SYSC* 19A.3.51R).

36. Where this paragraph applies, the guidance in paragraph 36(2), (3) and (4)(a) should be applied for the purposes of determining whether or not it will generally be necessary to apply the rule on guaranteed variable *remuneration* to B (substituting in that paragraph, for references to 'A', references to 'B').

Part-year Remuneration Code staff for three months or less, but where exceptional etc. payments made

37. Paragraph 38 applies where an individual (C) has, in relation to a given performance year, been *Remuneration Code staff* for a period of three months or less, but where an exceptional or irregular payment (such as a sign-on award) has or is to be made in relation to C's appointment.

38. The guidance in paragraph 33 applies in relation to C (substituting in that paragraph, for references to 'A', references to 'C'). The amount of exceptional or irregular payment is to be added to C's qualifying variable *remuneration* without pro rating.

APPENDIX 1:SUPPLEMENTAL GUIDANCE ON DIVIDING FIRMS INTO PROPORTIONALITY LEVELS

Groups with more than one Remuneration Code firm: examples

1. The following non-exhaustive examples illustrate the operation of the guidance provided in paragraph 25 of Part C. (It should be borne in mind that in each case individual *guidance* could vary the outcome provided by the operation of the guidance provided in that paragraph.)

2. Example 1:

   (1) Firm A is the *parent undertaking* of Firm B.

   (2) Firm A is a *UK bank* that had *relevant total assets* of £800bn on its last *accounting reference date*. Firm B is a *limited activity firm*.

   (3) On the assumption that they were *solo Remuneration Code firms*, Firm A falls into *proportionality level one* and Firm B falls into *proportionality level three*.

   (4) As a result of the guidance at paragraph 25 of Part C, both Firms A and B fall into *proportionality level one*.

3. Example 2:

   (1) Firm C is the *parent undertaking* of Firm D.

   (2) Firm C is a *limited activity firm* and Firm D is a *UK bank* that had *relevant total assets* of £100bn on its last *accounting reference date*.

   (3) On the assumption that they were *solo Remuneration Code firms*, Firm C falls into *proportionality level three* and Firm D falls into *proportionality level one*.

   (4) As a result of the guidance at paragraph 25 of Part C, both Firms C and D fall into *proportionality level one*.

4. Example 3:

   (1) Company E is the *parent undertaking* of Firms F and G and Company H. Company H is the *parent undertaking* of Firm I. Firm J is a member of the group because of an *Article 12(1) consolidation relationship*.

   (2) The firms and companies have the following characteristics:

      (a) Neither Companies E nor H are *Remuneration Code firms*.

      (b) Firm F is an IFPRU 730k firm that is a full scope *IFPRU investment firm* and that had *relevant total assets* of £40bn on its last *accounting reference date*.

      (c) Firms G and J are *limited activity firms*.

      (d) Firm I is a *UK bank* that had *relevant total assets* of £10bn on its last *accounting reference date*.

   (3) On the assumption that they were *solo Remuneration Code firms*—

      (a) Firm F falls into *proportionality level two*,

      (b) Firms G and J fall into *proportionality level three*, and

(c) Firm I falls into *proportionality level three*.

(4) As a result of the guidance at paragraph 25 of Part C, Firms F, G, I and J all fall into *proportionality level two*.

Role of individual guidance

5. Individual *guidance* may vary the *proportionality level* into which a *firm* would fall under the general *guidance* set out in Part C and supplemented by this Appendix. In consequence, the definitions and thresholds provided in Part C do not provide an immutable classification.

6. The following provide non-exhaustive high level examples of where we might consider providing individual guidance to vary a *proportionality level*:

(1) Where a *firm* was just below the threshold for a particular proportionality level (as determined in accordance with Part C), but where features of its business model or growth strategy suggest that it should fall within the higher *proportionality level*.

(2) Where a *group* of *firms* contained several *firms* falling into a common *proportionality level*, but where the aggregate prudential risk posed by the group suggested that a higher *proportionality level* was more appropriate.

(3) Where a *firm* falls into a higher proportionality level as a result of the guidance at paragraph 23 of Part C than would be the case on the assumption that it was a *solo Remuneration Code firm*, depending on the particular circumstances of the case.

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

GENERAL GUIDANCE ON PROPORTIONALITY:
THE REMUNERATION CODE (SYSC 19A) ~~&~~
~~PILLAR 3 DISCLOSURES ON REMUNERATION (BIPRU 11)~~

Contents

PART A: INTRODUCTION & INTERPRETATION 3

Guidance on the remuneration principles proportionality rule 3

Individual guidance ..... 5~~4~~

Arrangement of guidance statement ..... 5~~4~~

Interpretation ..... 5~~4~~

PART B: PROPORTIONALITY LEVELS ..... 8~~6~~

PART C: PROCESS FOR DIVIDING FIRMS INTO PROPORTIONALITY LEVELS ..... 9~~7~~

Overview ..... 9~~7~~

Solo Remuneration Code firms ..... 9~~7~~

Groups with more than one Remuneration Code firm ..... 10~~8~~

PART D: GUIDANCE TO FIRMS IN PARTICULAR PROPORTIONALITY LEVELS ..... 13~~11~~

Purpose of proportionality levels ..... 13~~11~~

Firms to continue to consider proportionality in their individual circumstances, etc. ..... 13~~11~~

Disapplication of certain remuneration principles for firms in particular proportionality levels ..... 14~~12~~

PART E: GUIDANCE ABOUT PART-YEAR REMUNERATION CODE STAFF ..... 14~~12~~

Introduction ..... 14~~12~~

Part-year Remuneration Code staff for more than three months ..... 16~~12~~

Certain part-year Remuneration Code staff for three months or less ..... 18~~15~~

Part-year Remuneration Code staff for three months or less, but where exceptional etc. payments made ..... 18~~15~~

APPENDIX 1: SUPPLEMENTAL GUIDANCE ON DIVIDING FIRMS INTO PROPORTIONALITY LEVELS ..... 21~~18~~

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

Groups with more than one Remuneration Code firm: examples.......................................2118

Role of individual guidance..2219

~~No table of contents entries found.~~

~~PART A: INTRODUCTION & INTERPRETATION ....2~~
~~*Introduction* ....2~~
~~Status of guidance statement ....2~~
~~Remuneration principles proportionality rule...2~~
~~Guidance on the remuneration principles proportionality rule ....2~~
~~Guidance on proportionality in relation to remuneration committees and Pillar 3 remuneration disclosures...3~~
~~Individual guidance..3~~
~~Arrangement of guidance statement...3~~
~~*Interpretation* ....3~~
~~PART B: PROPORTIONALITY LEVELS ....5~~
~~PART C: PROCESS FOR DIVIDING FIRMS INTO PROPORTIONALITY LEVELS...........................6~~
~~*Overview* ....6~~
~~*Solo Remuneration Code firms* ....6~~
~~BIPRU firms and Third Country BIPRU firms ....6~~
~~*Groups with more than one Remuneration Code firm* ....7~~
~~PART D: GUIDANCE TO FIRMS IN PARTICULAR PROPORTIONALITY LEVELS ....9~~
~~*Purpose of proportionality levels*...9~~
~~*Firms to continue to consider proportionality in their individual circumstances, etc.* ....9~~
~~*Disapplication of certain remuneration principles for firms in particular proportionality levels* 10~~
~~PART E: GUIDANCE ABOUT PART-YEAR REMUNERATION CODE STAFF ....10~~
~~*Introduction* ....10~~
~~*Part-year Remuneration Code staff for more than three months*...................................11~~
~~*Certain part-year Remuneration Code staff for three months or less* ....13~~
~~*Part-year Remuneration Code staff for three months or less, but where exceptional etc. payments made*..13~~
~~PART F: REMUNERATION COMMITTEES...14~~
~~*General*...14~~
~~*Subsidiaries of overseas groups / third country BIPRU firms* ....14~~
~~PART G: PILLAR 3 REMUNERATION DISCLOSURES (BIPRU 11) ....15~~
~~*Requirement to make Pillar 3 remuneration disclosures*..15~~
~~*Pillar 3 remuneration disclosures & proportionality* ....15~~
~~APPENDIX 1: SUPPLEMENTAL GUIDANCE ON DIVIDING FIRMS INTO PROPORTIONALITY LEVELS..16~~
~~*Groups with more than one Remuneration Code firm: examples* ....16~~
~~*Role of individual guidance* ....17~~
~~APPENDIX 2: PILLAR 3 DISCLOSURE REQUIREMENTS BY PROPORTIONALITY LEVEL ....18~~

Formatted: Font: 11 pt

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

PART A: INTRODUCTION & INTERPRETATION

Introduction and Status of guidance statement

~~**Status of guidance statement**~~

1. This statement is general *guidance* given under section ~~157~~139A(1) of the Financial Services and Markets Act (FSMA). It relates ~~both~~ to ~~:~~

~~(1)~~ the *Remuneration Code* of *SYSC* 19A of the *Handbook*~~;~~. ~~and~~

~~(2) the requirement to make Pillar 3 disclosures in relation to *remuneration* (in accordance with *BIPRU* 11 of the *Handbook*).~~

2. Paragraphs ~~14~~ 13 and ~~15~~ 14 make provision about the interpretation of this *guidance* statement. Expressions in italics either bear the meaning given in the *Handbook Glossary*, or in the table in paragraph 15.

3. This *guidance* statement has effect from ~~25 September 2012~~ 1January 2014~~3~~.

Remuneration principles proportionality rule

4. The *remuneration principles proportionality rule* is set out in *SYSC* 19A.3.3R(2).

5. The *Remuneration Code* requires (amongst other things) a *firm* to apply requirements in *SYSC* 19A.3 to *Remuneration Code staff*. The *remuneration principles proportionality rule* requires a *firm*, when establishing and applying the total *remuneration* policies for *Remuneration Code staff*, to comply with *SYSC* 19A.3 in a way and to the extent that is appropriate to its size, internal organisation and the nature, the scope and the complexity of its activities.

Guidance on the remuneration principles proportionality rule

6. General *guidance* is given in relation to specific aspects of the *remuneration principles proportionality rule* in *SYSC* 19A.3 itself.[1] ~~.[1]~~

7. Part D of this *guidance* statement provides additional general *guidance* in relation to the application of the *remuneration principles proportionality rule* to different types of *firm*.

8. Part E of this *guidance* statement provides additional general *guidance* in relation to the application of the *remuneration principles proportionality rule* to *Remuneration Code staff* who have, in relation to a given performance year, been *Remuneration Code staff* for only part of the year.

9. This *guidance* statement represents our *guidance* in a field where ~~new~~ requirements relating to *remuneration* are being implemented within the EEA. We recognise this will be an evolving process, and intend to keep the *guidance* set out here under review.

---

[1] The main provisions of guidance which specifically refer to the *remuneration principles proportionality rule* are *SYSC* 19A.3.34G (giving guidance in relation to *Remuneration Code staff* and certain rules on *remuneration* structures).

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

[1] ~~The main provisions of guidance which specifically refer to the *remuneration principles proportionality rule* are *SYSC* 19A.3.34G (giving guidance in relation to *Remuneration Code staff* and certain rules on *remuneration* structures).~~

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

Guidance on proportionality in relation to remuneration committees and Pillar 3 remuneration disclosures

10. The *remuneration principles proportionality rule* does not apply to the requirement to establish a *remuneration* committee or to make disclosures in relation to *remuneration* under *BIPRU* 11 (as part of Pillar 3). But these requirements are governed by similar proportionality tests, on which *guidance* is given in Parts F and G of this *guidance* statement.

Individual guidance

1110. We may give individual *guidance* to a *firm*, either on its own initiative or on the application of the *firm*. Our policy on individual *guidance* is set out in *SUP* 9. In consequence, we may give individual *guidance* to a *firm* in relation to the *remuneration principles proportionality rule* (*SYSC* 19A.3.3R). Such *guidance* may relate to the application of the *rule* by the *firm* generally, or in specific areas.

Arrangement of guidance statement

1221. This general *guidance* statement is divided into seven five Parts: (1) This Part, Part A: Introduction & interpretation.

(2) Part B: Proportionality levels.

(3) Part C: Division of firms into proportionality levels.

(4) Part D: Guidance to firms in particular proportionality levels.

(5) Part E: Guidance about part-year Remuneration Code staff.

(6) Part F: Remuneration committees.

(7) Part G: Pillar 3 remuneration disclosures (BIPRU 11).

1332. It is supplemented by Appendix 1 – Supplemental guidance on dividing firms into proportionality levels. two Appendices:

(1) Appendix 1: Supplemental guidance on dividing firms into proportionality levels.

(2) Appendix 2: Pillar 3 disclosure requirements by proportionality level.

Interpretation

134. This *guidance* statement is to be interpreted as if it was an Annex to *SYSC* 19A.3 R. (other than Part G and Appendix 2, which are to be interpreted as if they were an Annex to *BIPRU* 11). In consequence, *GEN* 2 (interpreting the Handbook) applies to the interpretation of this *guidance* statement.

1554. In particular, an expression in italics which is defined in the *Glossary* has the meaning given there (*GEN* 2.2.7R). Where an expression in italics is not defined in the *Glossary*, it has the meaning given by the following table:

Table 1: Glossary of terms defined in this guidance statement

Defined expression	**Definition**

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

~~*CEBS Guidelines*~~	~~Guidelines on Remuneration Policies and Practices of 10 December 2010 of the Committee of European Banking Supervisors.~~

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

Defined expression	**Definition**
group	has the meaning given in the *Glossary* under paragraph (3).
overseas Remuneration Code firm	an *overseas firm* that: (i) is not an *EEA firm;* (ii) has its head office outside the *EEA*; and (iii) would be a *building society, a bank, an investment firm, a limited activity firm or a limited licence firm* if it had been a *UK domestic firm*, had carried on all its business in the United Kingdom and had obtained whatever authorisation for doing so as required under the Act.
proportionality level	has the meaning given in paragraph 17, and references to *proportionality level one*, etc. are to be construed accordingly.
Remuneration Code firm	a *firm* specified in *SYSC* 19A.1.1 R(1)(a)-(e). ~~*BIPRU firm* or *third country BIPRU*~~
relevant total assets	has the meanings given in paragraph 24(3).
relevant date	has the meanings given in paragraph 24(3).
solo Remuneration Code firm	a *Remuneration Code firm* which is not part of a *group* containing one or more further *Remuneration Code firms*.

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

PART B: PROPORTIONALITY LEVELS

~~16~~15. *SYSC* 19A.1.1R provides that the *Remuneration Code* applies to a *Remuneration Code firm* and an *overseas Remuneration Code firm* ~~*BIPRU firm* and a *third country BIPRU firm* (in the case of a *third country BIPRU firm*~~, in relation to the activities carried on from an establishment in the *UK*). ~~In this *guidance* statement, such *firms* are referred to as *Remuneration Code firms*.~~

~~17~~16. This *guidance* statement provides for the division of *Remuneration Code firms* into three categories:

(1) *proportionality level one*,

(2) *proportionality level two*, and

(3) *proportionality level three*

~~18~~17. The process by which firms are divided into *proportionality levels* is provided in Part C (as supplemented by Appendix 1), and may also depend on individual *guidance*.

~~19~~18. The *proportionality levels* provide a framework for the operation of the *remuneration principles proportionality rule*. Guidance is given to *firms* in different *proportionality levels* in Part D.

~~20. The *proportionality levels* are also used as the basis for guidance on separate proportionality tests which apply in relation to *remuneration* committees (Part F) and Pillar 3 remuneration disclosures (Part G and Appendix 2).~~

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

PART C: PROCESS FOR DIVIDING FIRMS INTO PROPORTIONALITY LEVELS

Overview

~~21~~19. This Part provides the process by which a *Remuneration Code firm* should ascertain the *proportionality level* into which it falls. ~~–~~Appendix 1 provides supplementary *guidance* (including examples).

~~22~~20. A *Remuneration Code firm*, in order to ascertain its *proportionality level*, must first establish whether it is part of a *group* which contains one or more other *Remuneration Code firms*:

(1) If the *firm* is not part of such a *group* (a *solo Remuneration Code firm*), its *proportionality level* will depend on its individual characteristics (as determined in accordance with paragraph 2~~4~~2).

(2) If the *firm* is part of such a *group*, its *proportionality level* will depend on a two-stage process (as provided in paragraphs 2~~5~~3 and 2~~6~~4).

(This requires all *Remuneration Code firms* that are part of the *group* to fall into the highest *proportionality level* that any individual *Remuneration Code firm* in the group would fall into on the assumption that it was a *solo Remuneration Code firm*.)

2~~3~~1. Individual *guidance* may vary the *proportionality level* into which a *firm* would otherwise fall under paragraphs 2~~4~~2 to 2~~6~~4.

Solo Remuneration Code firms

~~BIPRU firms and Third Country BIPRU firms~~

2~~2~~4. The following table shows the *proportionality level* into which a *solo Remuneration Code firm* that is an ~~*BIPRU*~~ *IFPRU investment firm* or ~~a *third country BIPRU firm*~~ an *overseas Remuneration Code firm* falls:

(1) A *firm* of the description given in the second column falls into the *proportionality level* listed in the first column.

(2) Where applicable, the *firm's proportionality level* will further depend on whether it held *relevant total assets* on the *relevant date* of the amount listed in the third column of the table.

(3) In (2) —

(a) 'relevant total assets' means:

(i) for ~~*BIPRU firms*~~ *IFPRU investment firms*, the average of the firm's total assets on the firm's last three *relevant dates*; and

(ii) for ~~*third country BIPRU firms*~~ *overseas Remuneration Code firms*, the average of the firm's total assets that covered the activities of the branch operation in the *United Kingdom* on the firm's last three *relevant dates*;

(b) 'relevant date' means:

(i) for ~~*BIPRU firms*~~ *IFPRU investment firms*, an accounting reference date; and

(ii) for ~~*third country BIPRU firms*~~ *overseas Remuneration Code firm* –'relevant date' –means –31 December.

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

The limit confining *relevant total assets* to those that cover the activities of the branch operation in the UK is taken from *SUP* 16.12.3R(1)(a)(iv), which relates to a reporting requirement in relation to *non-EEA banks* (among others). We consider that a *firm* which needs to ascertain its *relevant total assets* should apply the general policy on valuation set out in *GENPRU* 1.3.

Table 2: **Proportionality levels: solo Remuneration Code firms which include but are not limited to ~~are~~ ~~BIPRU firms~~** *IFPRU Investment firms* **~~or~~and overseas Remuneration Code firms~~third country BIPRU firms~~**

Proportionality level	**Type of firm**	***Relevant total assets* on *relevant date* of firm** (where applicable)
Proportionality level one	*UK Bank*.	Exceeding £50bn
	Building society.	Exceeding £50bn
	~~*BIPRU 730k firm* that is a *full scope BIPRU investment firm*.~~ *IFPRU 730k Investment firms* that is a that is a *full scope IFPRU investment firm'*	Exceeding £50bn
Proportionality level two	*UK Bank*.	Exceeding £15bn but not exceeding £50bn
	Building society.	Exceeding £15bn, but not exceeding £50bn
	~~*BIPRU 730k firm* that is a *full scope BIPRU investment firm*.~~ *IFPRU 730k Investment firms* that is a that is a *full scope IFPRU investment firm'*	Exceeding £15bn, but not exceeding £50bn
Proportionality level three	*UK Bank*.	Not exceeding £15bn
	Building society.	Not exceeding £15bn
	Any ~~*full scope BIPRU investment firm*~~ *full scope IFPRU Investment firms* that does not fall within *proportionality level one* or	Not applicable
	~~*BIPRU*~~ *IFPRU limited licence*	
	~~*BIPRU*~~ *IFPRU limited activity*	

Groups with more than one Remuneration Code firm

2~~5~~3. This paragraph applies where a *Remuneration Code firm* is part of a *group* containing one or more other *Remuneration Code firms*:

(1) Each *Remuneration Code firm* in the *group* must determine the *proportionality level* into which it would fall on the assumption it was a *solo*

Remuneration Code firm.

(2) Where each *Remuneration Code firm* falls into the same *proportionality level* on the assumption that it was a *solo Remuneration Code firm*, each *firm* falls into that *proportionality level*.

(3) Where the *Remuneration Code firms* fall into different *proportionality levels* on the assumption that they were *solo Remuneration Code firms*, each *firm* falls into the highest *proportionality level*.

(4) For the purposes of (3), *proportionality level one* is the highest and *proportionality level three* is the lowest.

264. Appendix 1 provides examples of this approach. —A *firm* which has a higher *proportionality level* as a result of the *guidance* in paragraph 25 than would have been the case had the *firm* been a *solo Remuneration Code firm* should note the scope to apply for individual *guidance* to vary its *proportionality level* (as discussed in paragraphs 5 and 6 of Appendix 1).

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

PART D: GUIDANCE TO FIRMS IN PARTICULAR PROPORTIONALITY LEVELS

Purpose of proportionality levels

25~~7~~. In relation to the *remuneration principles proportionality rule*, the *proportionality levels* provide the following:

(1) A framework for our supervisory approach, and a broad indication of our likely expectations.

(2) *Guidance* on which remuneration principles may normally be disapplied under the *remuneration principles proportionality rule*.

~~28. The *proportionality levels* also provide *guidance* on the separate but similar proportionality *rules* that apply in relation to:~~

~~(1) *remuneration* committees (Part F), and~~

~~(2) Pillar 3 disclosures in relation to *remuneration* (Part G and Appendix 2).~~

Firms to continue to consider proportionality in their individual circumstances, etc.

26~~9~~. It follows from the nature of the *remuneration principles proportionality rule*, and the limited purposes noted in paragraph 25~~7~~, that the *proportionality levels* do not provide comprehensive *guidance* on how the *remuneration principles* ~~*proportionality rule*~~*proportionality* ~~will~~*rule* ~~apply~~*will* ~~to~~apply ~~a~~to ~~particular~~a ~~*firm*~~particular firm. A *firm* will still need to consider the application of the *remuneration principles proportionality rule* to its individual circumstances.

~~30~~27. A *firm* should bear in mind that the Remuneration Code may require different responses from *firms* that fall into the same *proportionality level*. This is illustrated by the following example:

(1) Firm A is a global bank with *relevant total assets* of £800bn, with substantial investment banking business, foreign exchange exposures and a complex business model seeking aggressive growth. It falls into *proportionality level one*.

(2) Firm B is a large mortgage and savings bank with *relevant total assets* of £100bn and a comparatively simple, conservative business model. It falls into *proportionality level one*.

(3) Firm C is a large building society, with *relevant total assets* of £25bn and a comparatively simple, conservative business model. It falls into *proportionality level two*.

(4) Remuneration Principle 8 requires, amongst other things, a *firm* to risk-adjust performance measures to take account of all types of current and future risks (*SYSC* 19A.3.22R(1)(a)).

(5) Clearly the processes necessary to identify such risks will need to be more sophisticated for Firm A than for Firm B, despite the fact that they fall into the same *proportionality level*. Indeed, the difference in the necessary sophistication is likely to be greater as between Firm A and Firm B than as between Firm B and Firm C.

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

Disapplication of certain remuneration principles for firms in particular proportionality levels

3128. The *Banking Consolidation Directive* *Capital Requirements Directive* can be interpreted such that it may not be necessary for certain *firms* to apply certain *remuneration* principles at all.[22] This has been endorsed and elaborated in the *CEBS Guidelines*.[3]

3229. In our view, it will normally be appropriate for a *firm* in *proportionality level three* to disapply under the *remuneration principles proportionality rule* the following *rules*—

(1) retained *shares* or other instruments (*SYSC* 19A.3.47R),

(2) deferral (*SYSC* 19A.3.49R),

(3) performance adjustment (*SYSC* 19A.3.51R), and

It may also be appropriate for *BIPRU limited licence firms* and *BIPRU limited activity firms* to disapply under the *remuneration principles proportionality rule* the ratios between fixed and variable components of total *remuneration* (*SYSC* 19A.3.44R).

We are also of the opinion endorse the *CEBS Guidelines* where they state that such firms may 'take into account the specific features of their types of activities' in applying the 'requirement on the multi-year framework …, in particular the accrual and ex-ante risk adjustment aspects of it' as discussed further in section 4.2.2.a of the *Guidelines*.[4]

3330. However, *firms* should also note that some *remuneration* principles set specific numerical criteria (such as on the minimum period of deferral, the minimum portion to be deferred and the minimum portion to be issued in *shares*). The following *guidance* applies where such principles apply to *Remuneration Code staff* and are not capable of disapplication under the approach set out above. In such circumstances, in line with the *CEBS Guidelines*, we do not consider that the *remuneration principles proportionality rule* permits a *firm* to apply lower numerical criteria.[5] (For the avoidance of doubt, this *guidance* does not apply where a *firm* chooses to use deferral or issuance in shares more widely than required by *SYSC* 19A.3, for example in order to comply with the *Remuneration Code general requirement*).)

PART E: GUIDANCE ABOUT PART-YEAR REMUNERATION CODE STAFF

Introduction

3431. *SYSC* 19A.3.34G provides *guidance* on when we do not generally consider it necessary for a *firm* to apply to certain *Remuneration Code staff* certain *rules* relating to *remuneration* structures. This Part provides supplementary guidance on how certain *rules* on *remuneration* structures might normally be applied to *Remuneration Code staff*

Formatted: Indent: Left: 0 cm, Hanging: 1.27 cm

Formatted: Indent: Left: 0 cm, Hanging: 1.27 cm

[2] Banking Consolidation *Directive*, Annex V, paragraph 23 provides that the principles should be

[2] *Captial Requirements Directive* Art 92(2) provides that the principles should be applied 'in a manner and to the extent that is appropriate to their size, internal organisation and the nature, the scope and complexity of their activities' (emphasis added).

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

applied 'in a way and to the extent that is appropriate to their size, internal organisation and the nature, the scope and complexity of their activities' (emphasis added).

[3] *CEBS Guidelines*, paragraphs 19 to 23.

[4] *CEBS Guidelines*, paragraph 20

[5] *CEBS Guidelines*, paragraph 19.

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

~~*Remuneration Code staff*~~ who have, in relation to a given performance year, been *Remuneration* ~~*Remuneration*~~ *Code staff* for only part of the year.

~~35~~32. In giving this *guidance*, we have taken account of the *remuneration principles proportionality rule*.

Part-year Remuneration Code staff for more than three months

~~36~~33. This paragraph applies where an individual (A) has, in relation to a given performance year, been *Remuneration Code staff* for a period more than three months, but less than 12 months:

(1) Sub-paragraphs (3) and (4) explain how the *guidance* in *SYSC* 19A.3.34G (as mentioned in the introduction to this Part) is to be applied in relation to A. Sub-paragraphs (5) and (6) provide that in certain circumstances it may be appropriate to apply certain *rules* to only a proportion of A's variable *remuneration*. Sub-paragraphs (7) to (9) provide examples.

(2) In this paragraph:

(a) 'relevant fraction' means the fraction derived by dividing the number of days in the given performance year for which A has been *Remuneration Code staff* by the number of days in the year;

(b) 'qualifying fixed *remuneration*' means A's annual fixed *remuneration* in A's capacity as *Remuneration Code staff* multiplied by the relevant fraction;

(c) 'qualifying variable *remuneration*' means:

(i) in the case where A was an *employee* of the *firm* for the whole of the given performance year, A's variable *remuneration* in relation to the performance year multiplied by the relevant fraction;

(ii) in the case where A was only ever employed in the given performance year as *Remuneration Code staff*, A's actual variable *remuneration*;

(d) 'total qualifying *remuneration*' means qualifying fixed *remuneration* added to qualifying variable *remuneration*;

(e) 'threshold amount' means £500,000 multiplied by the relevant fraction.

(3) We do not generally consider it necessary for a *firm* to apply the rules referred to in (4) where, in relation to A, the following conditions are satisfied:

(a) Condition 1 is that A's qualifying variable *remuneration* is no more than 33% of total qualifying remuneration, and

(b) Condition 2 is that A's total qualifying *remuneration* is no more than the threshold amount.

(4) The rules referred to in (3) are those relating to:

(a) guaranteed variable *remuneration* (*SYSC* 19A.3.40R),

(b) retained *shares* or other instruments (*SYSC* 19A.3.47R),

(c) deferral (*SYSC* 19A.3.49R), and

(d) performance adjustment (*SYSC* 19A.3.51R).

(5) Sub-paragraph (6) applies where the conditions in (3) are not satisfied and the *firm* should apply the rules referred to in (6).

(6) Where this sub-paragraph applies, we generally consider that it would be appropriate to apply the following rules to qualifying variable *remuneration* only:

(a) retained *shares* or other instruments (*SYSC* 19A.3.47R),

(b) deferral (*SYSC* 19A.3.49R), and

(c) performance adjustment (*SYSC* 19A.3.51R).

(7) The examples in (8) and (9) illustrate this *guidance*. The performance year in each case is 1 January to 31 December.

(8) Example 1:

(a) A1 is an *employee* of the *firm* through the performance year and is promoted to a *Remuneration Code staff* role with effect from 1 September. A1's previous fixed *remuneration* was £150,000. In his *Remuneration Code staff* role A1's fixed remuneration increases to £250,000. For the performance year, A1 is awarded variable *remuneration* of £130,000.

(b) The relevant fraction is 122/365. A1's qualifying fixed *remuneration* is £83,560 (£250,000 multiplied by 122/365). A1's qualifying variable *remuneration* is £43,452 (£130,000 multiplied by 122/365). A1's total qualifying *remuneration* is £127,012. The threshold amount is £167,120 (£500,000 multiplied by 122/365).

(c) A1's total qualifying *remuneration* is below the threshold amount, so condition 2 of (3) is satisfied. But A1's qualifying variable *remuneration* is more than 33% of A1's total qualifying *remuneration*, and condition 1 of (3) is not satisfied.

(d) The *rule* on guaranteed variable *remuneration* applies to A1. In addition, the *rules* on retained shares and other instruments, deferral and performance adjustment must be applied to A1's qualifying variable *remuneration* of £43,452.

(9) Example 2:

(a) A2 joins the *firm* as a *Remuneration Code staff* member with effect from 1 July. A2's annual fixed *remuneration* is £450,000. For period of 1 June to 31 December, A2 is awarded variable *remuneration* of £50,000.

(b) The relevant fraction is 184/365. A2's qualifying fixed *remuneration* is £226,850 (£450,000 multiplied by 184/365). A2's qualifying variable *remuneration* is £50,000 (the actual amount). A2's total qualifying *remuneration* is £276,850. The threshold amount is £252,050 (£500,000 multiplied by 184/365).

(c) A2's qualifying variable *remuneration* is not more than 33% of A2's total qualifying *remuneration*, and condition 1 of (3) is satisfied. But A2's total qualifying *remuneration* is more than the threshold amount, so condition 2 of (3) is not satisfied.

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

(d) The *rule* on guaranteed variable *remuneration* applies to A2. In addition, the *rules* on retained shares and other instruments, deferral and performance adjustment must be applied to A2's qualifying variable *remuneration* of £50,000.

Certain part-year Remuneration Code staff for three months or less

~~37~~34. Paragraphs 38 and 39 apply where:

(1) an individual (B) has, in relation to a given performance year, been *Remuneration Code staff* for a period of three months or less, and

(2) an exceptional or irregular payment (such as a sign-on award) has not been or is not to be made in relation to B's appointment as *Remuneration Code staff*.

~~38~~35. Where this paragraph applies, we do not generally consider it necessary to apply the following rules in relation to B for the performance year in question:

(1) retained *shares* or other instruments (*SYSC* 19A.3.47R),

(2) deferral (*SYSC* 19A.3.49R), and

(3) performance adjustment (*SYSC* 19A.3.51R).

~~39~~36. Where this paragraph applies, the guidance in paragraph 36(2), (3) and (4)(a) should be applied for the purposes of determining whether or not it will generally be necessary to apply the rule on guaranteed variable *remuneration* to B (substituting in that paragraph, for references to 'A', references to 'B').

Part-year Remuneration Code staff for three months or less, but where exceptional etc. payments made

~~40~~37. Paragraph ~~41~~ 38 applies where an individual (C) has, in relation to a given performance year, been *Remuneration Code staff* for a period of three months or less, but where an exceptional or irregular payment (such as a sign-on award) has or is to be made in relation to C's appointment.

~~41~~38. The guidance in paragraph ~~36~~ 33 applies in relation to C (substituting in that paragraph, for references to 'A', references to 'C'). The amount of exceptional or irregular payment is to be added to C's qualifying variable *remuneration* without pro rating.

~~PART F: REMUNERATION COMMITTEES~~

~~General~~

~~42. Remuneration Principle 4 (Governance) provides, in *SYSC* 19A.3.12R(1), that a firm that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities must establish a *remuneration* committee.~~

~~43. The following table provides guidance on when we consider it would be appropriate for a *remuneration* committee to established under SYSC 19A.3.12R, based on the *proportionality level* into which the *firm* falls (as determined in accordance with Part C of this *guidance* statement (as supplemented by Appendix 1)):~~

~~Table 4: Guidance on whether remuneration committee required~~

~~**Proportionality level**~~	~~**SYSC 19A.3.12R remuneration committee?**~~
~~*Proportionality level one*~~	~~A *remuneration* committee should be established.~~
~~*Proportionality level two*~~	~~A *remuneration* committee should be established.~~
~~*Proportionality level three*~~	~~It would be desirable for such a *remuneration* committee to be established, and we would normally expect larger *proportionality level three* firms to do so.~~ ~~But we accept that it may be appropriate for the *governing body* of the *firm* to act as the *remuneration* committee.~~

~~Subsidiaries of overseas groups / third country BIPRU firms~~

~~44. This *guidance* relates, broadly speaking, to a *Remuneration Code firm* which is a *third country BIPRU firm*, or a *BIPRU firm* that is part of a *group* not subject to consolidated supervision by the *FSA*.~~

~~45. We accept that it may be possible for certain such *firms* to justify on the ground of proportionality not establishing under SYSC 19A.3.12R at solo level a *remuneration* committee of the *Remuneration Code firm*. However, in such circumstances it would be necessary to show how the functions which would otherwise have been performed by such a *remuneration* committee would be discharged with sufficient authority, and with sufficient independence from those performing executive functions within the *firm*. Where, for example, members of the *governing body* of the *firm* acted together with a *group remuneration* committee to discharge these functions, we would expect as a minimum to be satisfied that the operational arrangements ensured sufficient independence from those performing executive functions at *Remuneration Code firm* or *group* level, and allowed the *governing body* of the *firm to exercise* sufficient authority in relation to the *Remuneration Code firm*.~~

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

PART G: PILLAR 3 REMUNERATION DISCLOSURES (BIPRU 11)

Requirement to make Pillar 3 remuneration disclosures

46. *BIPRU* 11 requires certain *Remuneration Code firms* to disclose a series of qualitative and quantitative information relating to *remuneration* (*BIPRU* 11.3 and *BIPRU* 11.5.18R).

47. *BIPRU* 11 applies only to *BIPRU firms* *investment*.

Pillar 3 remuneration disclosures & proportionality

48. Two proportionality tests apply in relation to the requirement to make Pillar 3 disclosures in relation to *remuneration*:

    (1) A *BIPRU firm* that is significant in terms of its size, internal organisation and the nature, scope and the complexity of its activities must also disclose the quantitative information referred to in *BIPRU* 11.5.18R at the level of *senior personnel* (*BIPRU* 11.5.20R(1)).

    (2) *BIPRU firms* must comply with the requirements set out in *BIPRU* 11.5.18R in a manner that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities (*BIPRU* 11.5.20R(2)).

49. We consider that it is appropriate to give *guidance* on these proportionality tests by reference to the *proportionality levels* determined in accordance with Part C of, and Appendix 1 to, this *guidance* statement. However, as the disclosure requirement applies only to *BIPRU firms*, when applying the guidance in paragraph 25, only *Remuneration Code firms* which are *BIPRU firms* should be taken into account.

50. In relation to the proportionality test referred to in paragraph 48(1) the *FSA* considers that a firm should be regarded as 'significant' if it falls into *proportionality level one*.

51. In relation to the proportionality test set referred to in paragraph 48(2) the table in Appendix 2 sets out the categories of information that we consider *firms* in different *proportionality levels* should disclose.

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

APPENDIX 1:SUPPLEMENTAL GUIDANCE ON DIVIDING FIRMS INTO PROPORTIONALITY LEVELS

Groups with more than one Remuneration Code firm: examples

1. The following non-exhaustive examples illustrate the operation of the guidance provided in paragraph 25 of Part C. (It should be borne in mind that in each case individual *guidance* could vary the outcome provided by the operation of the guidance provided in that paragraph.)

2. Example 1:

   (1) Firm A is the *parent undertaking* of Firm B.

   (2) Firm A is a *UK bank* that had *relevant total assets* of £800bn on its last *accounting reference date*. Firm B is a *limited activity firm*.

   (3) On the assumption that they were *solo Remuneration Code firms*, Firm A falls into *proportionality level one* and Firm B falls into *proportionality level three*.

   (4) As a result of the guidance at paragraph 25 of Part C, both Firms A and B fall into *proportionality level one*.

3. Example 2:

   (1) Firm C is the *parent undertaking* of Firm D.

   (2) Firm C is a *limited activity firm* and Firm D is a *UK bank* that had *relevant total assets* of £100bn on its last *accounting reference date*.

   (3) On the assumption that they were *solo Remuneration Code firms*, Firm C falls into *proportionality level three* and Firm D falls into *proportionality level one*.

   (4) As a result of the guidance at paragraph 25 of Part C, both Firms C and D fall into *proportionality level one*.

4. Example 3:

   (1) Company E is the *parent undertaking* of Firms F and G and Company H. Company H is the *parent undertaking* of Firm I. Firm J is a member of the group because of an *Article 12(1) consolidation relationship*.

   (2) The firms and companies have the following characteristics:

      (a) Neither Companies E nor H are *Remuneration Code firms*.

      (b) Firm F is an IFPRU 730k firm that is a full scope ~~*BIPRU 730k firm* that is a *full scope BIPRU*~~ *IFPRU investment firm* and that had *relevant total assets* of £40bn on its last *accounting reference date*.

      (c) Firms G and J are *limited activity firms*.

      (d) Firm I is a *UK bank* that had *relevant total assets* of £10bn on its last *accounting reference date*.

   (3) On the assumption that they were *solo Remuneration Code firms*—

      (a) Firm F falls into *proportionality level two*,

      (b) Firms G and J fall into *proportionality level three*, and

(c) Firm I falls into *proportionality level three*.

(4) As a result of the guidance at paragraph 25 of Part C, Firms F, G, I and J all fall into *proportionality level two*.

Role of individual guidance

5. Individual *guidance* may vary the *proportionality level* into which a *firm* would fall under the general *guidance* set out in Part C and supplemented by this Appendix. In consequence, the definitions and thresholds provided in Part C do not provide an immutable classification. ~~The *CEBS Guidelines* also provide guidance on applying proportionality between different institutions.~~[6]

6. The following provide non-exhaustive high level examples of where we might consider providing individual guidance to vary a *proportionality level*:

   (1) Where a *firm* was just below the threshold for a particular proportionality level (as determined in accordance with Part C), but where features of its business model or growth strategy suggest that it should fall within the higher *proportionality level*.

   (2) Where a *group* of *firms* contained several *firms* falling into a common *proportionality level*, but where the aggregate prudential risk posed by the group suggested that a higher *proportionality level* was more appropriate.

   (3) Where a *firm* falls into a higher proportionality level as a result of the guidance at paragraph ~~25~~ 23 of Part C than would be the case on the assumption that it was a *solo Remuneration Code firm*, depending on the particular circumstances of the case.

[6] ~~*CEBS Guidelines*, paragraphs 24 and 25.~~

This document has no legal effect and it has been prepared with tracked changes to show the proposed amendments to the existing guidance that are being consulted on in this CP.

APPENDIX 2: PILLAR 3 DISCLOSURE REQUIREMENTS BY PROPORTIONALITY LEVEL

BIPRU 11.5.18R disclosure requirement	Relevant proportionality level		
	Proportionality level one	Proportionality level two	Proportionality level three
BIPRU 11.5.18R (1) (*'information concerning the decision-making process used for determining the remuneration policy, including if applicable, information about the composition and the mandate of a remuneration committee, the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders'*)	9	9	9
BIPRU 11.5.18R (2) (*'information on link between pay and performance'*)	9	9	9
BIPRU 11.5.18R (3) (*'the most important design characteristics of the remuneration system, including, information on the criteria used for performance measurement and risk adjustment, deferral policy and vesting criteria'*)	9	9	
BIPRU 11.5.18R (4) (*'information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based'*)	9		
BIPRU 11.5.18R (5) (*'the main parameters and rationale for any(…) variable component scheme and any other non-cash benefits'*)	9		
BIPRU 11.5.18R (6) (*'aggregate quantitative information on remuneration, broken down by business area'*)	9	9	9
BIPRU 11.5.18R (7) (*'aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the firm…'*) *…indicating the following:*	9	9	9
BIPRU 11.5.18R (7)(a) (*'amounts of remuneration for the financial year, split into fixed and variable remuneration, and number of beneficiaries'*)	9	9	
BIPRU 11.5.18R (7)(b) (*'amounts and form of variable remuneration, split into cash, shares and share-linked instruments and other'*)	9		
BIPRU 11.5.18R (7)(c) (*'amounts of outstanding deferred remuneration, split into vested and unvested portions'*)	9		
BIPRU 11.5.18R (7)(d) (*'the amounts of deferred remuneration awarded during the financial year, paid*			

~~*out and reduced through performance adjustments')*~~ ~~BIPRU 11.5.18R (7)(e) ('*new sign-on and severance payments made during the financial year, and number of beneficiaries of such payments')*~~ ~~BIPRU 11.5.18R (7)(f) ('*the amounts of severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person')*~~	~~9~~ ~~9~~ ~~9~~		

GENERAL GUIDANCE ON PROPORTIONALITY: THE REMUNERATION CODE (SYSC 19C) AND PILLAR 3 DISCLOSURES ON REMUNERATION (BIPRU 11)

CONTENTS

PART A: INTRODUCTION & INTERPRETATION 2

Introduction 2

Status of guidance statement 2

Remuneration principles proportionality rule 2

Guidance on the remuneration principles proportionality rule 2

Guidance on proportionality in relation to remuneration committees and Pillar 3 remuneration disclosures 3

Individual guidance 3

Arrangement of guidance statement 3

Interpretation 3

PART B: GUIDANCE TO BIPRU FIRMS ON THE APPLICATION OF PROPORTIONALITY 5

BIPRU firms that are a part of a group 5

Disapplication of certain remuneration principles for BIPRU firms 5

PART C: GUIDANCE ABOUT PART YEAR BIPRU REMUNERATION CODE STAFF 5

Introduction 5

Part-year BIPRU Remuneration Code staff for more than three months 6

Certain part-year BIPRU Remuneration Code staff for three months or less 8

Part-year BIPRU Remuneration Code staff for three months or less, but where exceptional etc. payments 8

PART D: REMUNERATION COMMITTEES 9

Remuneration Committee for BIPRU firms and third country BIPRU firms 9

PART E: PILLAR 3 REMUNERATION DISCLOSURES (BIPRU 11)

Requirement to make Pillar 3 remuneration disclosures 9

Pillar 3 remuneration disclosures & proportionality 9

APPENDIX 1: PILLAR 3 DISCLOSURE REQUIREMENTS BY PROPORTIONALITY LEVEL 10

PART A: INTRODUCTION & INTERPRETATION

Introduction

Status of guidance statement

1. This statement is general *guidance* given under section 139A(1) of the Financial Services and Markets Act (FSMA). It relates both to:

    (1) the *BIPRU Remuneration Code* of *SYSC* 19C of the *FCA Handbook*, and

    (2) the requirement to make Pillar 3 disclosures in relation to *remuneration* (in accordance with *BIPRU* 11 of the *Handbook*).

2. Paragraphs 14 and 15 make provision about the interpretation of this *guidance* statement. Expressions in italics either bear the meaning given in the *Handbook Glossary*, or in the table in paragraph 15.

3. This *guidance* statement has effect from 1 Jan 2014.

Remuneration principles proportionality rule

4. The *BIPRU remuneration principles proportionality rule* is set out in *SYSC* 19C.3.3R (2).

5. The *BIPRU Remuneration Code* requires (amongst other things) a *firm* to apply requirements in *SYSC* 19C.3 to *BIPRU Remuneration Code staff*. The *BIPRU remuneration principles proportionality rule* requires a *firm*, when establishing and applying the total *remuneration* policies for *BIPRU Remuneration Code staff*, to comply with *SYSC* 19C.3 in a way and to the extent that is appropriate to its size, internal organisation and the nature, the scope and the complexity of its activities.

Guidance on the remuneration principles proportionality rule

6. General *guidance* is given in relation to specific aspects of the *remuneration principles proportionality rule* in *SYSC* 19C.3 itself.[1]

7. Part C of this *guidance* statement provides additional general *guidance* in relation to the application of the *BIPRU remuneration principles proportionality rule* to *BIPRU Remuneration Code staff* who have, in relation to a given performance year, been *BIPRU Remuneration Code staff* for only part of the year.

9. This *guidance* statement represents our *guidance* in a field that may be subject to change, we intend to keep the *guidance* set out here under review.

[1] The main provisions of guidance which specifically refer to the *remuneration principles proportionality rule* are *SYSC* 19C.3.34G (giving guidance in relation to *BIPRU Remuneration Code staff* and certain rules on *remuneration* structures).

Guidance on proportionality in relation to remuneration committees and Pillar 3 remuneration disclosures

10. The *BIPRU remuneration principles proportionality rule* does not apply to the requirement to establish a *remuneration* committee or to make disclosures in relation to *remuneration* under *BIPRU* 11 (as part of Pillar 3). But these requirements are governed by similar proportionality tests, on which *guidance* is given in Parts D and E of this *guidance* statement.

Individual guidance

11. We may give individual *guidance* to a *firm*, either on its own initiative or on the application of the *firm*. Our policy on individual *guidance* is set out in *SUP* 9. In consequence, we may give individual *guidance* to a *firm* in relation to the *remuneration principles proportionality rule* (*SYSC* 19C.3.3R). Such *guidance* may relate to the application of the *rule* by the *firm* generally, or in specific areas.

Arrangement of guidance statement

12. This general *guidance* statement is divided into five Parts:
    (1) This Part, Part A: Introduction & interpretation.
    (2) Part B: Guidance to *BIPRU firms* on the application of proportionality
    (3) Part C: Guidance about part-year Remuneration Code staff.
    (4) Part D: Remuneration committees.
    (5) Part E: Pillar 3 remuneration disclosures (BIPRU 11).

13. It is supplemented by one Appendix:
    (1) Appendix 1: Pillar 3 disclosure requirements by proportionality level.

Interpretation

14. This *guidance* statement is to be interpreted as if it was an Annex to *SYSC* 19C.3 (other than Part E and Appendix 1, which are to be interpreted as if they were an Annex to *BIPRU* 11). In consequence, *GEN* 2 (interpreting the Handbook) applies to the interpretation of this *guidance* statement.

15. In particular, an expression in italics which is defined in the *Glossary* has the meaning given there (*GEN* 2.2.7R). Where an expression in italics is not defined in the *Glossary*, it has the meaning given by the following table:

Table 1: Glossary of terms defined in this guidance statement

Defined expression	Definition
group	has the meaning given in the *Glossary* under paragraph (3).
BIPRU Remuneration Code firm	a *BIPRU firm* or *third country BIPRU firm* to which the BIPRU Remuneration Code applies (in accordance with *SYSC* 19C.1.1R).

Part B: Guidance to BIPRU firms on the application of proportionality

BIPRU firms that are part of a group

16. Where a *BIPRU Remuneration Code firm* is part of a *group* comprised only of *BIPRU Remuneration Code firms*, each *firm* should apply this guidance.

17. Where a *BIPRU Remuneration Code firm* is part of a *group* in which a *firm t*o which *SYSC* 19A applies is a member, this guidance does not apply, SYSC 19A and applicable guidance applies instead.

Disapplication of certain remuneration principles for BIPRU firms

18. It may not be necessary for *BIPRU firms* to apply *BIPRU remuneration* principles at all.

19. In our view, it will normally be appropriate for a *BIPRU firm* to disapply under the *BIPRU remuneration principles proportionality rule* the following *rules*—

    (1) retained *shares* or other instruments (*SYSC* 19C.3.47R),

    (2) deferral (*SYSC* 19C.3.49R),

    (3) performance adjustment (*SYSC* 19C.3.51R), and

    (4) the ratios between fixed and variable components of total remuneration *(SYSC* 19C.3.44R).

    BIPRU firms may 'take into account the specific features of their types of activities' in applying the 'requirement on the multi-year framework, in particular the accrual and ex-ante risk adjustment aspects of it'.[1]

20. However, *BIPRU firms* should also note that some *remuneration* principles set specific numerical criteria (such as on the minimum period of deferral, the minimum portion to be deferred and the minimum portion to be issued in *shares*). The following *guidance* applies where such principles apply to *BIPRU Remuneration Code staff* and are not capable of disapplication under the approach set out above. In such circumstances, we do not consider that the *remuneration principles proportionality rule permits* a firm *to* apply lower numerical criteria. (For the avoidance of doubt, this *guidance* does not apply where a *firm* chooses to use deferral or issuance in shares more widely than required by *SYSC* 19C.3, for example in order to comply with the BIPRU *Remuneration Code general requirement*.)

PART C: GUIDANCE ABOUT PART-YEAR BIPRU REMUNERATION CODE STAFF

Introduction

21. *SYSC* 19C.3.34G provides *guidance* on when we do not generally consider it necessary for a *firm* to apply to certain *BIPRU Remuneration Code staff* certain *rules* relating to *remuneration* structures. This Part provides supplementary guidance on how certain *rules* on *remuneration* structures might normally be applied to *BIPRU Remuneration Code staff* who have, in relation to a given performance year, been *BIPRU Remuneration Code staff* for only part of the year.

22. In giving this *guidance*, we have taken account of the *remuneration principles*

[1] As per FSA's Policy Statement 10/20. See link at http://www.fsa.gov.uk/pubs/policy/ps10_20.pdf.

proportionality rule.

Part-year Remuneration Code staff for more than three months

23. This paragraph applies where an individual (A) has, in relation to a given performance year, been *BIPRU Remuneration Code staff* for a period more than three months, but less than 12 months:

    (1) Sub-paragraphs (3) and (4) explain how the *guidance* in *SYSC* 19C.3.34G (as mentioned in the introduction to this Part) is to be applied in relation to A. Sub-paragraphs (5) and (6) provide that in certain circumstances it may be appropriate to apply certain *rules* to only a proportion of A's variable *remuneration*. Sub-paragraphs (7) to (9) provide examples.

    (2) In this paragraph:

        (a) 'relevant fraction' means the fraction derived by dividing the number of days in the given performance year for which A has been *BIPRU Remuneration Code staff* by the number of days in the year;

        (b) 'qualifying fixed *remuneration*' means A's annual fixed *remuneration* in A's capacity as *BIPRU Remuneration Code staff* multiplied by the relevant fraction;

        (c) 'qualifying variable *remuneration*' means:

            (i) in the case where A was an *employee* of the *firm* for the whole of the given performance year, A's variable *remuneration in* relation to the performance year multiplied by the relevant fraction;

            (ii) in the case where A was only ever employed in the given performance year as *BIPRU Remuneration Code staff*, A's actual variable *remuneration*;

        (d) 'total qualifying *remuneration*' means qualifying fixed *remuneration* added to qualifying variable *remuneration*;

        (e) 'threshold amount' means £500,000 multiplied by the relevant fraction.

    (3) We do not generally consider it necessary for a *firm* to apply the rules referred to in (4) where, in relation to A, the following conditions are satisfied:

        (a) Condition 1 is that A's qualifying variable *remuneration* is no more than 33% of total qualifying *remuneration*, and

        (b) Condition 2 is that A's total qualifying *remuneration* is no more than the threshold amount.

    (4) The rules referred to in (3) are those relating to:

        (a) guaranteed variable *remuneration* (*SYSC* 19C.3.40R),

        (b) retained *shares* or other instruments (*SYSC* 19C.3.47R),

        (c) deferral (*SYSC* 19C.3.49R), and

        (d) performance adjustment (*SYSC* 19C.3.51R).

(5) Sub-paragraph (6) applies where the conditions in (3) are not satisfied and the *firm* should apply the rules referred to in (6).

(6) Where this sub-paragraph applies, we generally consider that it would be appropriate to apply the following rules to qualifying variable *remuneration* only:

  (a) retained *shares* or other instruments (*SYSC* 19C.3.47R),

  (b) deferral (*SYSC* 19C.3.49R), and

  (c) performance adjustment (*SYSC* 19C.3.51R).

(7) The examples in (8) and (9) illustrate this *guidance*. The performance year in each case is 1 January to 31 December.

(8) Example 1:

  (a) A1 is an *employee* of the *firm* through the performance year and is promoted to a *BIPRU Remuneration Code staff* role with effect from 1 September. A1's previous fixed *remuneration* was £150,000. In his *BIPRU Remuneration Code staff* role A1's fixed *remuneration* increases to £250,000. For the performance year, A1 is awarded variable *remuneration* of £130,000.

  (b) The relevant fraction is 122/365. A1's qualifying fixed *remuneration* is £83,560 (£250,000 multiplied by 122/365). A1's qualifying variable *remuneration* is £43,452 (£130,000 multiplied by 122/365). A1's total qualifying *remuneration* is £127,012. The threshold amount is £167,120 (£500,000 multiplied by 122/365).

  (c) A1's total qualifying *remuneration* is below the threshold amount, so condition 2 of (3) is satisfied. But A1's qualifying variable *remuneration* is more than 33% of A1's total qualifying *remuneration*, and condition 1 of (3) is not satisfied.

  (d) The rule *on* guaranteed variable *remuneration* applies to A1. In addition, the *rules* on retained shares and other instruments, deferral and performance adjustment must be applied to A1's qualifying variable *remuneration* of £43,452.

(9) Example 2:

  (a) A2 joins the *firm* as a *BIPRU Remuneration Code staff* member with effect from 1 July. A2's annual fixed *remuneration* is £450,000. For period of 1 June to 31 December, A2 is awarded variable *remuneration* of £50,000.

  (b) The relevant fraction is 184/365. A2's qualifying fixed *remuneration* is £226,850 (£450,000 multiplied by 184/365). A2's qualifying variable *remuneration* is £50,000 (the actual amount). A2's total qualifying *remuneration is* £276,850. The threshold amount is £252,050 (£500,000 multiplied by 184/365).

  (c) A2's qualifying variable *remuneration* is not more than 33% of A2's total qualifying *remuneration*, and condition 1 of (3) is satisfied. But A2's total qualifying *remuneration* is more than the threshold amount, so condition 2 of (3) is not satisfied.

(d) The rule *on* guaranteed variable *remuneration* applies to A2. In addition, the *rules* on retained shares and other instruments, deferral and performance adjustment must be applied to A2's qualifying variable *remuneration* of £50,000.

Certain part-year Remuneration Code staff for three months or less

24. Paragraphs 25 and 26 apply where:

    (1) an individual (B) has, in relation to a given performance year, been *BIPRU Remuneration Code staff* for a period of three months or less, and

    (2) an exceptional or irregular payment (such as a sign-on award) has not been or is not to be made in relation to B's appointment as *BIPRU Remuneration Code staff*.

25. Where this paragraph applies, we do not generally consider it necessary to apply the following rules in relation to B for the performance year in question:

    (1) retained *shares* or other instruments (*SYSC* 19C.3.47R),

    (2) deferral (*SYSC* 19C.3.49R), and

    (3) performance adjustment (*SYSC* 19C.3.51R).

26. Where this paragraph applies, the guidance in paragraph 24(2), (3) and (4)(a) should be applied for the purposes of determining whether or not it will generally be necessary to apply the rule on guaranteed variable *remuneration* to B (substituting in that paragraph, for references to 'A', references to 'B').

Part-year Remuneration Code staff for three months or less, but where exceptional etc. payments made

27. Paragraph 28 applies where an individual (C) has, in relation to a given performance year, been *BIPRU Remuneration Code staff* for a period of three months or less, but where an exceptional or irregular payment (such as a sign-on award) has or is to be made in relation to C's appointment.

28. The guidance in paragraph 24 applies in relation to C (substituting in that paragraph, for references to 'A', references to 'C'). The amount of exceptional or irregular payment is to be added to C's qualifying variable *remuneration* without pro rating.

PART D: REMUNERATION COMMITTEES

Remuneration Committee for BIPRU firms and third country BIPRU firms

29. Remuneration Principle 4 (Governance) provides, in *SYSC* 19C.3.12R(1), that a *BIPRU firm* that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities must establish a *remuneration* committee.

30. With regards to larger *BIPRU firms,* it would be desirable for a *remuneration* committee to be established under SYSC 19C.3.12R and we would normally expect such firms to do so.
However, we accept that it may be possible for such *firms* to justify on the ground of proportionality not establishing under SYSC 19C.3.12R at solo level a *remuneration* committee of the *BIPRU Remuneration Code firm*. In such circumstances it would be necessary to show how the functions which would otherwise have been performed by such a *remuneration* committee would be discharged with sufficient authority, and with sufficient independence from those performing executive functions within the *firm*. Where, for example, members of the *governing body* of the *firm* acted together with a *group remuneration* committee to discharge these functions, we would expect as a minimum to be satisfied that the operational arrangements ensured sufficient independence from those performing executive functions at *BIPRU Remuneration Code firm* or *group* level, and allowed the *governing body* of the *firm to exercise* sufficient authority in relation to the *BIPRU Remuneration Code firm*.

PART E: PILLAR 3 REMUNERATION DISCLOSURES (BIPRU 11)

Requirement to make Pillar 3 remuneration disclosures

31. *BIPRU* 11 requires certain *Remuneration Code firms* to disclose a series of qualitative and quantitative information relating to *remuneration* (*BIPRU* 11.3 and *BIPRU* 11.5.18R).

32. *BIPRU* 11 applies only to *BIPRU firms*.

Pillar 3 remuneration disclosures & proportionality

33. Two proportionality tests apply in relation to the requirement to make Pillar 3 disclosures in relation to *remuneration*:

    (1) A *BIPRU firm* that is significant in terms of its size, internal organisation and the nature, scope and the complexity of its activities must also disclose the quantitative information referred to in *BIPRU* 11.5.18R at the level of *senior personnel* (*BIPRU* 11.5.20R(1)).

    (2) *BIPRU firms* must comply with the requirements set out in *BIPRU* 11.5.18R in a manner that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities (*BIPRU* 11.5.20R (2)).

34. In relation to the proportionality test referred to in paragraph (1) the *FCA* considers that a *firm* should be regarded as 'significant' if on *relevant date* a firm has *relevant total assets* exceeding £50bn.

35. In relation to the proportionality test set referred to in paragraph 33(2) the table in Appendix 1 sets out the categories of information that we consider *BIPRU firms* should typically disclose –where applicable.

APPENDIX 1: PILLAR 3 DISCLOSURE REQUIREMENTS BY PROPORTIONALITY LEVEL

***BIPRU* 11.5.18R disclosure requirement**
BIPRU 11.5.18R (1) *('information concerning the decision-making process used for determining the remuneration policy, including if applicable, information about the composition and the mandate of a remuneration committee, the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders'*)
BIPRU 11.5.18R (2) (*'information on link between pay and performance')*
BIPRU 11.5.18R (6) (*'aggregate quantitative information on remuneration, broken down by business area')*
BIPRU 11.5.18R (7) ('*aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the firm…')*

Financial Conduct Authority

PUB REF: 004703

© Financial Conduct Authority 2013
25 The North Colonnade Canary Wharf
London E14 5HS
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk
All rights reserved