

# General Prudential sourcebook

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# Chapter 1

## Application



## 1.1 Application

### 1.1.1

**FCA** **PRA**

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There is no overall application statement for *GENPRU*. Each chapter or section has its own application statement.

### 1.1.2

**FCA** **PRA**

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Broadly speaking however, *GENPRU* applies to:

- (1) an *insurer*;
- (2) a *bank*;
- (3) a *building society*;
- (4) a *BIPRU investment firm*; and
- (5) groups containing such *firms*.

### 1.1.2A

**FCA** **PRA**

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A firm should refer to ■ GEN 2.2.13A R (cross-references in the Handbook) and ■ GEN 2.2.23 R to ■ GEN 2.2.25 G (cutover: application of provisions made by both the *FCA* and the *PRA*) when applying the rules and guidance in *GENPRU*. In particular, many rules in *GENPRU* are made by both the *PRA* (in relation to *PRA-authorised persons*) and by the *FCA* (in relation to *BIPRU investment firms* that are *FCA-authorised persons*).

### 1.1.2B

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As the *FCA* does not have the power to impose prudential rules and guidance on *PRA-authorised persons*, references to *PRA-authorised persons* or *PRA rules* that are included in *FCA GENPRU* provisions will not be relevant in the *FCA*'s application of that provision, unless otherwise stated.

### Scope

### 1.1.3

**FCA** **PRA**

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



**1.2 Adequacy of financial resources**

**Application**

1.2.1

**R**

**FCA PRA**

This section applies to:

- (1) a *BIPRU firm*; and
- (2) an *insurer*, unless it is:
  - (a) a *non-directive friendly society*; or
  - (b) a *Swiss general insurer*; or
  - (c) an *EEA-deposit insurer*; or
  - (d) an *incoming EEA firm*; or
  - (e) an *incoming Treaty firm* .
- (3) [deleted]

1.2.2

**R**

[deleted]

1.2.2A

**R**

**FCA PRA**

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".

1.2.3

**R**

[deleted]

1.2.3A

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**FCA PRA**

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.

1.2.4 R [deleted]

1.2.5 R [deleted]

1.2.6 R If an *insurer* carries on:

PRA

(1) *long-term insurance business*; and

(2) *general insurance business*;

This section applies separately to each type of business.

1.2.7 G The *guidance* in this section is drafted with respect to a *firm* to which this section and the other provisions of *GENPRU* and *BIPRU* (except ■ BIPRU 12) referred to in this section apply in full.

FCA PRA

1.2.8 G [deleted]

1.2.9 G [deleted]

1.2.10 G The scope of application of this section is not restricted to *insurers* that are subject to the relevant *EU* Directives.

PRA

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 *UCITS investment firm* this means that this section is not limited to *designated investment business* excluding *scheme management activity*. It also applies to *scheme management activity* and to activities that are not *designated investment business*.

FCA PRA

**Purpose**

1.2.12 G Adequate financial resources and adequate systems and controls are necessary for the effective management of prudential risks. This section therefore has requirements relating to both of these topics.

FCA PRA

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 1.2.3A G, 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.

FCA PRA

**1.2.14** FCA PRA 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 Article 34 of the *Capital Adequacy Directive* so far as that Article applies Article 123 of the *Banking Consolidation Directive*.

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

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

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

### Outline of other related provisions

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

**1.2.19** FCA PRA G

- (1) ■ BIPRU 2.2 (Internal capital adequacy standards) and ■ INSPRU 7.1 (Individual capital assessment) set out detailed *guidance* on how a *firm* should carry out the assessment referred to in ■ GENPRU 1.2.15 G. The more thorough, objective, and prudent a *firm's* assessment is, and can be demonstrated as being, the more reliance the *appropriate regulator* will be able to place on the results of that assessment.
- (2) ■ BIPRU 2.2 and ■ INSPRU 7.1 also have information on how the *appropriate regulator* will review and respond to the assessments referred to in ■ GENPRU 1.2.15 G and, in the case of *BIPRU firms*, in ■ GENPRU 1.2.16 G. In particular they deal with the giving of *individual capital guidance* to a *firm*,

which is *guidance* about the amount and quality of capital resources that the *appropriate regulator* thinks a *firm* should hold at all times under the *overall financial adequacy rule* as it applies on a solo level and a consolidated level. ■ BIPRU 2.2. also deals with the giving of a *capital planning buffer* to a BIPRU *firm* on a solo level and a consolidated level.

1.2.20  
FCA PRA

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

1.2.21  
FCA PRA

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- (1) ■ SYSC 11 sets out material on systems and controls that apply specifically to *liquidity risk* as that concept relates to an *insurer*.
- (2) [deleted]
- (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*.
- (3) [deleted]
- (4) ■ SYSC 11.1.21 E is an *evidential provision* relating to the *general stress and scenario testing rule* concerning stress testing and scenario analyses.  
■ SYSC 11.1.24 E is an *evidential provision* relating to the *overall Pillar 2 rule* about *contingency funding plans*. Both of these *evidential provisions* apply only to an *insurer* to which that section of SYSC applies.
- (5) ■ GENPRU 2.2 (Adequacy of financial resources) requires certain BIPRU *investment firms* to deduct *illiquid assets* when calculating their *capital resources*.

1.2.22  
FCA PRA

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

1.2.23  
FCA PRA

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

1.2.24  
FCA PRA

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■ BIPRU 10.2.22 R (Stress testing of credit risk concentrations) sets out further stress tests that a *firm* should carry out if it uses certain approaches to collateral for the purposes of the *rules* about *large exposures*.

1.2.25  
FCA PRA

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

**Requirement to have adequate financial resources**

1.2.26

FCA PRA

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

1.2.26A

FCA PRA

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

1.2.27

FCA PRA

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

1.2.28

FCA PRA

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

1.2.29

FCA PRA

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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. ■ SYSC 11.1.24 E is an *evidential provision* relating to the *overall financial adequacy rule* concerning *contingency funding plans*.

**Systems, strategies, processes and reviews**

1.2.30

FCA PRA

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

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

the following categories where they are relevant to the *firm* given the nature and scale of its business:

- (a) credit risk;
- (b) *market risk*;
- (c) *liquidity risk*;
- (d) *operational risk*;
- (e) insurance risk;
- (f) concentration risk;
- (g) residual risk;
- (h) *securitisation risk*;
- (i) business risk;
- (j) interest rate risk (including, in the case of a *BIPRU firm*, interest rate risk in the *non-trading book*);
- (k) pension obligation risk ; and
- (l) group risk.

1.2.31

FCA PRA

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

## 1.2.32

FCA PRA

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- (1) This paragraph gives *guidance* on some of the terms used in the *overall Pillar 2 rule*.
- (2) Insurance risk refers to the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities.
- (3) Interest rate risk in the *non-trading book* is explained in ■ BIPRU 2.3 (Interest rate risk in the non-trading book).
- (4) In a narrow sense, business risk is the risk to a *firm* that it suffers losses because its income falls or is volatile relative to its fixed cost base. However, in a broader sense, it is exposure to a wide range of macro-economic, geopolitical, industry, regulatory and other external risks that might deflect a *firm* from its desired strategy and business plan. ■ GENPRU 1.2.73 G provides further *guidance* on business risk.
- (5) Further material on pension obligation risk can be found in ■ GENPRU 1.2.79 G - ■ GENPRU 1.2.86 G.
- (6) Group risk is the risk that the financial position of a *firm* may be adversely affected by its relationships (financial or non-financial) with other entities in the same *group* or by risks which may affect the financial position of the whole *group*, for example reputational contagion. Further *guidance* on group risk can be found in ■ GENPRU 1.2.87 G to ■ GENPRU 1.2.91 G.

## 1.2.33

FCA PRA

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- (1) This *rule* amplifies some of the obligations in the *overall Pillar 2 rule*.
- (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).
- (3) As part of its obligations in respect of *market risk*, a *BIPRU firm* must consider whether the value adjustments and provisions taken for *positions* and portfolios in the *trading book* enable the *firm* to sell or hedge out its *positions* within a short period without incurring material losses under normal market conditions.
- (4) The processes, strategies and systems required by the *overall Pillar 2 rule* must take into account stress tests and scenario analyses that the *firm* is required to carry out under any other provision of the *Handbook*.

## 1.2.34

FCA PRA

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

- 1.2.35** **R** The processes, strategies and systems required by the *overall Pillar 2 rule* must be comprehensive and proportionate to the nature, scale and complexity of the *firm's* activities.  
**FCA** **PRA**
- 1.2.36** **R** As part of its obligations under **■ GENPRU 1.2.30 R (1)** (Main requirement relating to risk processes, strategies and systems), a *firm* must identify separately the amount of *tier one capital*, *tier two capital*, *tier three capital*, other capital eligible to form part of its *capital resources* and each category of capital (if any) that is not eligible to form part of its *capital resources* which it considers adequate for the purposes described in **■ GENPRU 1.2.30 R (1)**.  
**FCA** **PRA**
- 1.2.37** **R** The processes and systems required by the *overall Pillar 2 rule* must:  
**FCA** **PRA**
- (1) include an assessment of how the *firm* intends to deal with each of the major sources of risk identified in accordance with **■ GENPRU 1.2.30 R (2)**;
  - (2) take into account the impact of diversification effects and how such effects are factored into the *firm's* systems for measuring and managing risks; and
  - (3) include an assessment of the *firm-wide* impact of the risks identified in accordance with **■ GENPRU 1.2.30 R (2)**, to which end a *firm* must aggregate the risks across its various business lines and units, making appropriate allowance for the correlation between risks.
- 1.2.38** **G** Certain risks such as systems and controls weaknesses may not be adequately addressed by, for example, holding additional capital and a more appropriate response would be to rectify the weakness. In such circumstances, the amount of financial resources required to address these risks might be zero. However, a *firm* should consider whether holding additional capital might be an appropriate response until the identified weaknesses are rectified. A *firm*, should, in accordance with **■ GENPRU 1.2.60 R** (Documentation of risk assessments), document the approaches taken to manage these risks.  
**FCA** **PRA**
- 1.2.39** **R** A *firm* must:  
**FCA** **PRA**
- (1) carry out regularly the assessments required by the *overall Pillar 2 rule*; and
  - (2) carry out regularly assessments of the processes, strategies and systems required by the *overall Pillar 2 rule* to ensure that they remain compliant with **■ GENPRU 1.2.35 R**.
- 1.2.40** **G** A *firm* should carry out assessments of the sort described in the *overall Pillar 2 rule* and **■ GENPRU 1.2.39 R** at least annually, or more frequently if changes in the business, strategy, nature or scale of its activities or operational environment suggest that the current level of financial resources is no longer adequate. The appropriateness of the  
**FCA** **PRA**

internal process, and the degree of involvement of senior management in the process, will be taken into account by the *appropriate regulator* when reviewing a *firm's* assessment as part of the *appropriate regulator's* own assessment of the adequacy of a *firm's* financial resources. The processes and systems should ensure that the assessment of the adequacy of a *firm's* financial resources is reported to its senior management as often as is necessary.

1.2.41

PRA

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The assessments undertaken by *firms in run-off* may not need to be as comprehensive or frequent compared to a *firm* not in run off since this may better reflect the reduced nature and complexity of its business and reduced access to new capital. Whilst a *firm in run-off* will still need to carefully monitor the progress of the run off, a more comprehensive assessment may only be appropriate on commencement of the run off or when considering a reduction in capital through the payment of a dividend or other capital distribution or if the *firm's* circumstances change materially.

### Stress and scenario tests

1.2.42

FCA PRA

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- (1) As part of its obligation under the *overall Pillar 2 rule*, a *firm* must, for the major sources of risk identified in accordance with ■ GENPRU 1.2.30 R (2), carry out stress tests and scenario analyses that are appropriate to the nature, scale and complexity of those major sources of risk and to the nature, scale and complexity of the *firm's* business.
  - (a) [deleted]
  - (b) [deleted]
    - (i) [deleted]
    - (ii) [deleted]
    - (iii) [deleted]
    - (iv) [deleted]
- (2) In carrying out the stress tests and scenario analyses in (1), a *firm* must identify an appropriate range of adverse circumstances of varying nature, severity and duration relevant to its business and risk profile and consider the exposure of the *firm* to those circumstances, including:
  - (a) circumstances and events occurring over a protracted period of time;
  - (b) sudden and severe events, such as market shocks or other similar events; and
  - (c) some combination of the circumstances and events described in (a) and (b), which may include a sudden and severe market event followed by an economic recession.
- (3) In carrying out the stress tests and scenario analyses in (1), the *firm* must estimate the financial resources that it would need in

order to continue to meet the *overall financial adequacy rule* and the *CRR* in the adverse circumstances being considered.

- (4) In carrying out the stress tests and scenario analyses in (1), the *firm* must assess how risks aggregate across business lines or units, any material non-linear or contingent risks and how risk correlations may increase in stressed conditions.
- (5) As part of its obligation under the *overall Pillar 2 rule*, a *BIPRU firm* must also incorporate and take into account any stress tests and scenario analyses that it is required to carry out under *BIPRU*. In particular, a *BIPRU firm* with an *IRB permission* must incorporate and take into account the stress test required to be carried out under ■ *BIPRU 4.3.40 R (2)*.

1.2.42A

FCA PRA

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

1.2.42B

FCA PRA

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

1.2.42C

PRA

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An *insurer* may choose to carry out its *ICA* through the use of stress testing and scenario analyses (see ■ *INSRU 7.1.10 G* and ■ *INSRU 7.1.68 G*). If it does so, in carrying out the stress tests and scenario analyses referred to in ■ *GENPRU 1.2.42 R*, an *insurer* should take into account the stress tests it uses for its *ICA*.

1.2.42D

FCA PRA

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

1.2.42E

FCA PRA

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

1.2.42F

FCA PRA

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

1.2.43

FCA PRA

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Stress tests and scenario analyses should be carried out at least annually. A *firm* should, however, consider whether the nature of the major sources of risks identified by it in accordance with ■ GENPRU 1.2.30 R (2) (Main requirement relating to risk processes, strategies and systems) and their possible impact on its financial resources suggest that such tests and analyses should be carried out more frequently. For instance, a sudden change in the economic outlook may prompt a *firm* to revise the parameters of some of its stress tests and scenario analyses. Similarly, if a *firm* has recently become exposed to a particular sectoral concentration, it may wish to add some stress tests and scenario analyses in order to reflect that concentration. ■ SYSC 11.1.21 E is an *evidential provision* relating to the *general stress and scenario testing rule* concerning scenario analysis in relation to *liquidity risk*.

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

1.2.44

FCA PRA

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

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

1.2.45

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If an *insurer* is a member of an *insurance group* and ■ INSPRU 6.1.9 R, ■ INSPRU 6.1.10 R or ■ INSPRU 6.1.15 R (Requirement to maintain group capital) apply to it with respect to that *insurance group* the *ICAAP rules*:

- (1) apply to that *insurer* on a consolidated basis; and
- (2) do not apply to it on a solo basis.

1.2.46

FCA PRA

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

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

1.2.47

FCA PRA

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The *ICAAP rules* apply on a solo basis:

- (1) to an *insurer* to which those *rules* do not apply on a consolidated basis under ■ GENPRU 1.2.45 R;
- (2) to a *BIPRU firm* to which those *rules* do not apply on a consolidated or sub-consolidated basis as referred to in ■ GENPRU 1.2.46 R (including a *BIPRU investment firm* with an *investment firm consolidation waiver*); and

1.2.48

FCA PRA

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

- (3) a *firm* referred to in ■ GENPRU 1.2.2 R (Application of this section to certain non-EEA firms).
- (1) (if ■ GENPRU 1.2.45 R applies) that *insurance group*;
  - (2) (if ■ BIPRU 8.2.1 R (Basic consolidation rule for a UK consolidation group) applies) the *UK consolidation group* of which the *firm* is a member; and
  - (3) (if ■ BIPRU 8.3.1 R (Basic consolidation rule for a non-EEA sub-group) applies) the non-EEA *sub-group* of which the *firm* is a member.

1.2.49

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- (1) In accordance with the general principles in ■ GENPRU 1.2.48 R and ■ BIPRU 8 (Group risk - consolidation), for the purpose of the *ICAAP rules* as they apply on a consolidated basis:
  - (a) the *firm* must ensure that the relevant group as defined in (2) have the processes, strategies and systems required by the *overall Pillar 2 rule*;
  - (b) the risks to which the *overall Pillar 2 rule* and the *general stress and scenario testing rule* refer are those risks as they apply to each member of the relevant group;
  - (c) the reference in the *overall Pillar 2 rule* to amounts and types of financial resources, *capital resources* and internal capital (referred to in this *rule* as resources) must be read as being to the amounts and types that the *firm* considers should be held by the members of the relevant group as defined in (2);
  - (d) other references to resources must be read as being to resources of the members of the relevant group as defined in (2);
  - (e) references to the *CRR* are to the consolidated capital requirements applicable to the relevant group under ■ BIPRU 8 (Group risk - consolidation) or, as the case may be, ■ INSPRU 6 (Group risk: Insurance groups);
  - (f) the reference in the *overall Pillar 2 rule* to the distribution of resources must be read as including a reference to the distribution between members of the relevant group as defined in (2); and
  - (g) the reference in the *overall Pillar 2 rule* to the *overall financial adequacy rule* must be read as being to that *rule*

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

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

1.2.50

FCA PRA

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

1.2.51

FCA PRA

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

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

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

1.2.52

FCA PRA

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

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

1.2.53

FCA PRA

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

consolidated basis between each *firm* which is a member of the relevant group (as defined in ■ GENPRU 1.2.49 R) on the following basis:

- (1) the amount allocated to each *firm* must be decided on the basis of the principles in ■ GENPRU 1.2.52 R (2); and
- (2) if the process in (1) were carried out for each group member, the total so allocated would equal the total amount of resources identified as necessary under the *overall Pillar 2 rule* as applied on a consolidated basis.

1.2.54

FCA PRA

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

1.2.55

FCA PRA

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The purpose of ■ GENPRU 1.2.51 R - ■ GENPRU 1.2.53 R is to enable the *appropriate regulator* to assess the extent, if any, to which a *firm's* assessment, calculated on a consolidated basis, is lower than it would be if each separate legal entity were to assess the amount of capital it would require to mitigate its risks (to the same level of confidence) were it not part of a group subject to consolidated supervision under ■ BIPRU 8 (Group risk - consolidation) or ■ INSPRU 6.1 (Group risk: Insurance groups). The reason the *appropriate regulator* wishes to make this assessment is so that individual capital *guidance* which it gives is fair and comparable as between different *firms* and groups. Group diversification benefits which a *firm* might assert exist can be a material consideration in a capital adequacy assessment. Understanding the methods used to aggregate the different risks (for example, the correlation assumptions) is crucial to a proper evaluation of such benefits.

1.2.56

FCA PRA

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

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

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

1.2.57

FCA PRA

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

1.2.58

FCA PRA

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

1.2.59

FCA PRA

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

#### Documentation of risk assessments

1.2.60

FCA PRA

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A *firm* must make a written record of the assessments required under this section. These assessments include assessments carried out on a consolidated basis and on a solo basis. In particular it must make a written record of:

- (1) the major sources of risk identified in accordance with ■ GENPRU 1.2.30 R (2) (Main requirement relating to risk processes, strategies and systems);
- (2) how it intends to deal with those risks; and
- (3) details of the stress tests and scenario analyses carried out, including any assumptions made in relation to scenario design, and the resulting financial resources estimated to be required in accordance with the *general stress and scenario testing rule*.

1.2.61

FCA PRA

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

1.2.62

FCA PRA

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Where a *firm* assesses the adequacy of its *CRR* in its particular circumstances in accordance with ■ BIPRU 2.2 (Internal capital adequacy standards) and ■ INSPRU 7.1 (Individual capital assessment) as a basis for deciding what financial resources are adequate, it should include this in the documentation produced in accordance with ■ GENPRU 1.2.60 R.

#### Additional guidance on stress tests and scenario analyses

1.2.63

FCA PRA

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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*.

<p>1.2.64 FCA PRA</p>	<p>G</p>	<p>Stress testing typically refers to shifting the values of individual parameters that affect the financial position of a <i>firm</i> and determining the effect on the <i>firm's</i> financial position.</p>
<p>1.2.65 FCA PRA</p>	<p>G</p>	<p>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 <i>firm's</i> financial position, for example, simultaneous movements in a number of risk categories affecting all of a <i>firm's</i> business operations, such as business volumes, investment values and interest rate movements.</p>
<p>1.2.66 FCA PRA</p>	<p>G</p>	<p>There are three broad purposes of stress testing and scenario analysis. Firstly, it can be used as a means of quantifying how much capital might be absorbed if an adverse event or events occurred. As such it represents a simple 'what if' approach to estimating exposure to risks. This might be a proportionate approach to risk management for an unsophisticated business. Secondly, it can be used to provide a check on the outputs and accuracy of risk models; particularly, in identifying non-linear effects when aggregating risks. Thirdly, it can be used to explore the sensitivities in longer term business plans and how capital needs might change over time.</p>
<p>1.2.67</p>	<p>G</p>	<p>[deleted]</p>
<p>1.2.68 FCA PRA</p>	<p>G</p>	<p>Subject to ■ GENPRU 1.2.76 G, the purpose of stress tests and scenario analyses under the <i>general stress and scenario testing rule</i> 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 <i>firm's</i> capital strength and the robustness of its risk prevention and risk mitigation measures.</p>
<p>1.2.69 FCA PRA</p>	<p>G</p>	<p>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 <i>firm</i> should decide how far forward to look. This should depend upon:</p> <ol style="list-style-type: none"> <li>(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</li> <li>(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.</li> </ol>
<p>1.2.70 FCA PRA</p>	<p>G</p>	<p>Where a firm is exposed to <i>market risk</i>, 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 <i>positions</i> stressed. For example, for the <i>market risk</i> arising from the holding of investments, this will depend upon:</p> <ol style="list-style-type: none"> <li>(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</li> </ol>

- (2) the extent to which the market in those assets is sufficiently liquid (and would remain liquid in the changed circumstances contemplated in the stress test or scenario analysis) to allow the *firm*, if needed, to sell, hedge or otherwise mitigate the risks relating to its holding so as to prevent or reduce exposure to future price fluctuations. In devising stress tests and scenario analyses for *market risk*, a *BIPRU firm* should also take into account ■ BIPRU 7.1.17 R to ■ BIPRU 7.1.20 G.

1.2.71

FCA PRA

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

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

1.2.72

FCA PRA

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

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

1.2.73

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- (1) [deleted]
- (1A) [deleted]
- (2) [deleted]
- (3) [deleted]
- (4) [deleted]
- (5) [deleted]

**Capital planning**

1.2.73A

FCA PRA

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- (1) In identifying an appropriate range of adverse circumstances and events in accordance with ■ GENPRU 1.2.42R (2):
  - (a) a *firm* will need to consider the cycles it is most exposed to and whether these are general economic cycles or specific to particular markets, sectors or industries;
  - (b) for the purposes of ■ GENPRU 1.2.42R (2)(a), the amplitude and duration of the relevant cycle should include a severe downturn scenario based on forward looking hypothetical events, calibrated against the most adverse movements in individual risk drivers experienced over a long historical period;
  - (c) the adverse scenarios considered should in general be acyclical and, accordingly, the scenario should not become more severe during a downturn

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

■ GENPRU 1.2.60 R. These records should be included within the *firm's ICAAP* or *ICA* submission document.

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

1.2.73B  
FCA PRA

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

1.2.73C  
FCA PRA

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For an *insurer*:

- (1) the treatment of new business when making capital projections is likely to be different from its *ICA*. In projecting its financial position, an *insurer* should take account of new business based on the *firm's* business plan, but flexed to take account of potential changes in trading conditions and strategy. When assessing its current capital adequacy under its *ICA*, an *insurer* should take account of the effects of closure to new business (see , and and to ). Also, an *insurer* may use methods that are more approximate than used for its *ICA* (for example, in projecting the *with-profits insurance capital component* for *realistic basis life firms* and the *capital resources* needed to meet the *overall financial adequacy rule*); and
- (2) where management discretion is exercised as a normal part of an *insurer's* business (for example, in changing bonus rates or *surrender values* in accordance with the *PPFM* for *with-profits business*), under ■ GENPRU 1.2.73AG (3)(c) the *insurer* does not need to estimate the effect of an adverse event on its financial position without adjusting for such changes. However, the effect on the financial position of varying such actions should be estimated and understood.

1.2.74  
FCA PRA

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A *firm* may consider scenarios in which expected future profits will provide capital reserves against future risks. However, it would only be appropriate to take into account profits that can be foreseen with a reasonable degree of certainty as arising before the risk against

which they are being held could possibly arise. In estimating future reserves, a *firm* should deduct future dividend payment estimates from projections of future profits.

1.2.75

FCA PRA

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

1.2.76

FCA PRA

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

1.2.77

FCA PRA

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Additional *guidance* on stress tests and scenario analyses for the assessment of *capital resources* is available in ■ BIPRU 2.2 (Internal capital adequacy standards) and ■ INSPRU 7.1 (Individual capital assessment).

1.2.78

FCA PRA

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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*.

### Pension obligation risk

1.2.79

FCA PRA

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

1.2.80

FCA PRA

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The pension scheme itself (i.e. the scheme's assets and liabilities) is not the focus of the risk assessment but rather the *firm's* obligations towards the pension scheme. A *firm* should include in its estimate of financial resources both its expected obligations to the pension scheme and any increase in obligations that may arise in a stress scenario.

1.2.81

FCA PRA

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If a *firm* has a current funding obligation in excess of normal contributions or there is a risk that such a funding obligation will arise then, when calculating available capital resources, it should reverse out any accounting deficit and replace this in its capital adequacy assessment with its best estimate, calculated in discussion with the scheme's actuaries or trustees, of the cash that will need to be paid into the scheme in addition to normal contributions over the foreseeable future. This may differ from the approach taken in assessing pension scheme risks for the purposes of calculating resources to meet the CRR, where a *firm* may not need to consider funding obligations beyond the next five years.

1.2.82

FCA PRA

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A *firm* should also assess the risks that may increase its current funding obligations towards the pension scheme and that might lead to the *firm* not being able to pay its other liabilities as they fall due.

1.2.83

FCA PRA

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A *firm* may wish to consider the following scenarios:

- (1) one in which the *firm* gets into difficulties with an effect on its ability to fund the pension scheme; and
- (2) one in which the pension scheme position deteriorates (for example, because investment returns fall below expected returns or because of increases in life expectancy) with an effect on the *firm's* funding obligations; taking into account the management actions the *firm* could and would take.

1.2.83A

FCA PRA

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A *firm* is expected to determine where the scope of any stress test impacts upon its pension obligation risk and estimate how the relevant measure of pension obligation risk will change in the scenario in question. For example, in carrying out stress tests under ■ GENPRU 1.2.42 R a *firm* must consider how a stress scenario, such as an economic recession, would impact on the *firm's* current obligations towards its pension scheme and any potential increase in those obligations. Risks such as interest rate risk or reduced investment returns may have a direct impact on a *firm's* financial position as well as an indirect impact resulting from an increase in the *firm's* pension scheme obligations. Both effects should be taken into account in a *firm's* estimate of financial resources under

■ GENPRU 1.2.30 R.

1.2.84

FCA PRA

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Scenarios in which a *firm's* employees suffer a loss or members of a pension scheme suffer a loss do not necessarily affect the *firm's* ability to pay its liabilities as they fall due.

1.2.85

FCA PRA

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A *firm* should consider issues such as:

- (1) the extent to which trustees of the pension scheme or a pension regulator (such as the one created under the Pensions Act 2004) can compel a certain level of contributions or a one-off payment in adverse financial situations or in order to meet the minimum legal requirements under the scheme's trust deed and rules or under the applicable laws relating to the pension scheme;
- (2) whether the valuation bases used to set pension scheme contribution rates are consistent with the *firm's* current business plans and anticipated changes in the workforce; and
- (3) which valuation basis is appropriate given the expected investment return on scheme assets and actions the *firm* can take if those returns do not materialise.

1.2.86  
FCA PRA

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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**

1.2.87  
FCA PRA

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

1.2.88  
FCA PRA

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

1.2.89  
FCA PRA

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

1.2.90  
FCA PRA

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

1.2.91  
FCA PRA

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

## 1.3 Valuation

### Application

1.3.1

R

FCA PRA

- (1) This section of the *Handbook* applies to an *insurer*, unless it is:
- non-directive friendly society*;
  - an *incoming EEA firm*; or
  - an *incoming Treaty firm*.
- (2) This section of the *Handbook* applies to a *BIPRU firm*.
- (3) This section of the *Handbook* applies to a *UK ISPV*.

### Purpose

1.3.2

G

FCA PRA

This section sets out, for the purposes of *GENPRU*, *BIPRU* and *INSPRU*, *rules* and *guidance* as to how a *firm* should recognise and value assets, liabilities, *exposures*, equity and income statement items.

1.3.3

G

FCA PRA

- (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*.
- (2) In the case of an *insurer*, ■ GENPRU 1.3.4 R implements the requirements of Articles 23.3(viii) and 24.2(iv) of the *Consolidated Life Directive*.

### General requirements: Accounting principles to be applied

1.3.4

R

FCA PRA

Subject to ■ GENPRU 1.3.9 R to ■ GENPRU 1.3.10 R and ■ GENPRU 1.3.36 R, except where a *rule* in *GENPRU*, *BIPRU* or *INSPRU* provides for a different method of recognition or valuation, whenever a *rule* in *GENPRU*, *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:

- (1) the *insurance accounts rules*, or the Friendly Societies (Accounts and Related Provisions) Regulations 1994;

- (2) Financial Reporting Standards and Statements of Standard Accounting Practice issued or adopted by the Accounting Standards Board;
- (3) Statements of Recommended Practice, issued by industry or sectoral bodies recognised for this purpose by the Accounting Standards Board;
- (4) the Building Societies (Accounts and Related Provisions) Regulation 1998;
- (5) *international accounting standards*;
- (6) the Companies Act 1985; and
- (7) the Companies Act 2006;

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

## 1.3.5

FCA PRA

G

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

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

## 1.3.6

FCA PRA

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

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

1.3.7

PRA

G

In the case of an *insurer* or a *UK ISPV*, where assets or liabilities are securitised, ■ GENPRU 1.3.4 R only permits de-recognition where Financial Reporting Standards (or, where applicable, International Accounting Standards) permit either de-recognition or the linked presentation. However, the *PRA* will consider granting a *waiver* to permit de-recognition in other circumstances provided that the *firm* can demonstrate that securitisation has effectively transferred risk

1.3.8

PRA

G

Articles 23.3(viii) and 24.2(iv) of the *Consolidated Life Directive* require assets of an *insurer* that are managed on its behalf by a *subsidiary undertaking* to be taken into account for the purposes of determining the *insurer's admissible assets* and its assets in excess of concentration limits. The application of ■ GENPRU 1.3.4 R will result in such assets remaining on the balance sheet of the *insurer*.

#### General requirements: Adjustments to accounting values

1.3.9

FCA PRA

R

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

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

1.3.10

FCA PRA

R

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

1.3.11

FCA PRA

G

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

1.3.12

FCA PRA

G

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

#### General requirements: Methods of valuation and systems and controls

1.3.13

FCA PRA

R

- (1) Except to the extent that *GENPRU*, *BIPRU* or *INSPRU* provide for another method of valuation, ■ GENPRU 1.3.14 R to ■ GENPRU 1.3.34 R (Marking to market, Marking to model,

Independent price verification, Valuation adjustments or, in the case of an insurer or a UK ISPV, valuation adjustments or reserves) apply:

- (a) for the purposes set out in ■ GENPRU 1.3.41 R;
- (b) for the purposes set out in ■ GENPRU 1.3.39 R; and
- (c) to any balance sheet position measured at market value or fair value.

(2) A *firm* must establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates.

(3) Systems and controls under (2) must include at least the following elements:

- (a) documented policies and procedures for the process of valuation, including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month-end and ad-hoc verification procedures, and, in the case of a *BIPRU firm*, guidelines for the use of unobservable inputs reflecting the *firm's* assumptions of what market participants would use in pricing the *position*; and
- (b) reporting lines for the department accountable for the valuation process that are:
  - (i) clear and independent of the front office; and
  - (ii) ultimately to a main board executive director.

**General requirements: Marking to market**

1.3.14  
FCA PRA

R

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

1.3.15  
FCA PRA

R

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

1.3.16  
FCA PRA

R

- (1) When marking to market, a *firm* must use the more prudent side of bid/offer unless the *firm* is a significant market maker in a particular position type and it can close out at the mid-market price.

- (2) When calculating the current *exposure* value of a credit risk *exposure* for *counterparty credit risk* purposes:
  - (a) a *firm* must use the more prudent side of bid/offer or the mid-market price and the *firm* must be consistent in the basis it chooses; and
  - (b) where the difference between the more prudent side of bid/offer and the mid-market price is material, the *firm* must consider making adjustments or, in the case of an *insurer* or a *UK ISPV*, making adjustments or establishing reserves.

**General requirements: Marking to model**

1.3.17

FCA PRA

R

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

1.3.18

FCA PRA

R

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

- (1) based on appropriate assumptions which have been assessed and challenged by suitably qualified parties independent of the development process;
- (2) independently tested, including validation of the mathematics, assumptions, and software implementation; and
- (3) (in the case of a *BIPRU firm*) developed or approved independently of the front office.

1.3.19

FCA PRA

R

A *firm* must ensure that its senior management are aware of the positions which are subject to mark to model and understand the materiality of the uncertainty this creates in the reporting of the performance of the business of the *firm* and the risks to which it is subject.

1.3.20

FCA PRA

R

A *firm* must source market inputs in line with market prices so far as possible and assess the appropriateness of the market inputs for the position being valued and the parameters of the model on a frequent basis.

1.3.21

FCA PRA

R

A *firm* must use generally accepted valuation methodologies for particular products where these are available.

1.3.22

FCA PRA

R

A *firm* must establish formal change control procedures, hold a secure copy of the model, and periodically use that model to check valuations.

**1.3.23** **R** A *firm* must ensure that its risk management functions are aware of the weaknesses of the models used and how best to reflect those in the valuation output.  
**FCA** **PRA**

**1.3.24** **R** A *firm* must periodically review the model to determine the accuracy of its performance.  
**FCA** **PRA**

**1.3.25** **R** Examples of periodical review are assessing the continued appropriateness of the assumptions, analysis of profit and loss versus risk factors and comparison of actual close out values to model outputs.  
**FCA** **PRA**

**General requirements: Independent price verification**

**1.3.26** **R** In addition to marking to market or marking to model, a *firm* must perform independent price verification. This is the process by which market prices or model inputs are regularly verified for accuracy and independence.  
**FCA** **PRA**

**1.3.27** **G** For independent price verification, where independent pricing sources are not available or pricing sources are more subjective (for example, only one available broker quote), prudent measures such as valuation adjustments may be appropriate.  
**FCA** **PRA**

**1.3.28** **R** In the case of the *trading book* positions of a *BIPRU firm*, while daily marking to market may be performed by dealers, verification of market prices and model inputs must be performed by a unit independent of the dealing room, at least monthly (or, depending on the nature of the market/trading activity, more frequently).  
**FCA** **PRA**

**General requirements: Valuation adjustments or, in the case of an insurer or a UK ISPV, valuation adjustments or reserves**

**1.3.29** **R** The recognition of any gains or losses arising from valuations subject to ■ GENPRU 1.3.13 R and ■ GENPRU 1.3.38 R to ■ GENPRU 1.3.41 R must be recognised for the purpose of calculating *capital resources* in accordance with ■ GENPRU 1.3.14 R to ■ GENPRU 1.3.34 R (Marking to market, Marking to model, Independent price verification, Valuation adjustments or, in the case of an insurer or a UK ISPV, valuation adjustments or reserves). However if *GENPRU*, *BIPRU* or *INSPRU* provide for another treatment of such gains or losses, that other treatment must be applied.  
**FCA** **PRA**

**1.3.30** **R** A *firm* must establish and maintain procedures for considering valuation adjustments or, in the case of an *insurer* or a *UK ISPV*, valuation adjustments or reserves. These procedures must be compliant with the requirements set out in ■ GENPRU 1.3.33 R.  
**FCA** **PRA**

**1.3.31** **R** A *firm* using third-party valuations, or marking to model, must consider whether valuation adjustments are necessary.  
**FCA** **PRA**

1.3.32

FCA PRA

R

A *firm* must consider the need for making adjustments or, in the case of an *insurer* or a *UK ISPV*, establishing reserves for less liquid positions and, on an ongoing basis, review their continued appropriateness in accordance with the requirements set out in ■ GENPRU 1.3.33 R. Less liquid positions could arise from both market events and institution-related situations e.g. concentration positions and/or stale positions.

1.3.33

FCA PRA

R

- (1) This paragraph sets out the requirements referred to in ■ GENPRU 1.3.30 R and ■ GENPRU 1.3.32 R.
- (2) A *firm* must consider the following adjustments or, in the case of an *insurer* or a *UK ISPV*, adjustments or reserves: unearned credit spreads, close-out costs, operational risks, early termination, investing and funding costs, future administrative costs and, where appropriate, model risk.
- (3) (a) In the case of a *BIPRU firm*, a *firm* must establish and maintain procedures for calculating adjustments to the current valuation of less liquid positions. Those adjustments must, where necessary, be in addition to any changes to the value of the position required for financial reporting purposes and must be designed to reflect the illiquidity of the position.
- (b) A *firm* must consider several factors when determining whether a valuation adjustment or, in the case of an *insurer* or a *UK ISPV*, valuation adjustment or reserve is necessary for less liquid positions. These factors include the amount of time it would take to hedge out the position/risks within the position; the average and volatility of bid/offer spreads; the availability of market quotes (number and identity of market makers); the average and volatility of trading volumes; market concentrations; the ageing of positions; the extent to which valuation relies on marking to model and the impact of other model risks.
- (4) With regard to complex products including, but not limited to, *securitisation exposures* and *nth-to-default credit derivatives*, a *BIPRU firm* must explicitly consider the need for valuation adjustments for model risk arising from using a valuation which may be incorrect or the risk from using unobservable calibration parameters in the valuation model.

1.3.34

FCA PRA

R

If the result of making adjustments or, in the case of an *insurer* or a *UK ISPV*, making adjustments or establishing reserves under ■ GENPRU 1.3.29 R to ■ GENPRU 1.3.33 R is a valuation which differs from the fair value determined in accordance with ■ GENPRU 1.3.4 R, a *firm* must reconcile the two valuations.

1.3.35  
FCA PRA

G

Reconciliation differences under ■ GENPRU 1.3.34 R should not be reflected in the valuations under ■ GENPRU 1.3 but should be disclosed to the *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 16.16.4 R.

1.3.35A  
FCA PRA

G

UK banks and BIPRU 730k firms are reminded that they may, in respect of their prudent valuation assessments under ■ GENPRU 1.3.4 R and ■ GENPRU 1.3.14 R to ■ GENPRU 1.3.34 R, be subject to the requirement under ■ SUP 16.16.4 R to submit a Prudent Valuation Return to the *appropriate regulator*.

**Specific requirements: BIPRU firms**

1.3.36  
FCA PRA

R

**Adjustments to accounting values**

- (1) For the purposes of GENPRU and BIPRU, the adjustments in (2) and (3) apply to values calculated pursuant to ■ GENPRU 1.3.4 R in addition to those required by ■ GENPRU 1.3.9 R to ■ GENPRU 1.3.10 R.
- (2) A BIPRU firm must not recognise either:
  - (a) the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost; or
  - (b) any unrealised gains or losses on debt instruments held, or formerly held, in the available-for-sale category.
- (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.
- (4) The items referred to in (2) and (3) must be excluded from *capital resources*.

1.3.37  
FCA PRA

G

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

**Trading book and other fair-valued positions, and revaluations**

1.3.38  
FCA PRA

R

■ GENPRU 1.3.39 R to ■ GENPRU 1.3.40 R apply only to a BIPRU firm.

1.3.39  
FCA PRA

R

Both trading book positions and other fair-valued positions are subject to prudent valuation rules as specified in ■ GENPRU 1.3.14 R to ■ GENPRU 1.3.34 R (Marking to market, Marking to model, Independent price verification, Valuation adjustments or, in the case of an insurer or

a UK ISPV, valuation adjustments or reserves). In accordance with those *rules*, a *firm* must ensure that the value applied to each of its *trading book* positions and other fair-valued positions appropriately reflects the current market value. This value must contain an appropriate degree of certainty having regard to the dynamic nature of *trading book* positions, the demands of prudential soundness and the mode of operation and purpose of capital requirements in respect of *trading book* positions and other fair-valued positions.

1.3.40

FCA PRA

R

*Trading book* positions must be re-valued at least daily.

#### Specific requirements: firms carrying on insurance business

##### Investments, derivatives and quasi-derivatives

1.3.41

PRA

R

(1) For the purposes of *GENPRU* and *INSPRU*, an *insurer* or a *UK ISPV* must apply ■ GENPRU 1.3.14 R to ■ GENPRU 1.3.34 R (Marking to market, Marking to model, Independent price verification, Valuation adjustments or, in the case of an insurer or a UK ISPV, valuation adjustments or reserves) to account for:

- (a) investments that are, or amounts owed arising from the disposal of:
  - (i) *debt securities*, bonds and other money- and capital-market instruments;
  - (ii) loans;
  - (iii) *shares* and other variable yield participations;
  - (iv) *units* in *UCITS schemes*, *non-UCITS retail schemes*, *recognised schemes* and any other *collective investment scheme* falling within paragraph(1)(A)(d)(iv) of ■ GENPRU 2 Annex 7 R; and

(b) *derivatives* and *quasi-derivatives*

(2) In the case of an *insurer*, (1) is subject to ■ GENPRU 1.3.43 R.

##### Shares in and debts due from related undertakings

1.3.42

PRA

R

■ GENPRU 1.3.43 R to ■ GENPRU 1.3.57 R apply only to *insurers*.

1.3.43

PRA

R

■ GENPRU 1.3.13 R and ■ GENPRU 1.3.41 R do not apply to *shares* in, and debts due from a *related undertaking* that is:

- (1) a *regulated related undertaking*;
- (2) an *ancillary services undertaking*; or
- (3) any other *subsidiary undertaking*, the *shares* of which a *firm* elects to value in accordance with ■ GENPRU 1.3.47 R.

1.3.44

PRA

G

The effect of ■ GENPRU 1.3.43 R is that *shares* in, and debts due from, *related undertakings* of the types referred to are not valued on a mark to market basis by *insurers*. As a result, debts due from these *undertakings*, and *shares* in *related undertakings* which are *ancillary services undertakings*, are valued at their accounting book value in accordance with ■ GENPRU 1.3.4 R. *shares* in *related undertakings* referred to in ■ GENPRU 1.3.43 R (1) or ■ (3) are valued by *insurers* in accordance with ■ GENPRU 1.3.45 R to ■ GENPRU 1.3.50 R.

1.3.45

PRA

R

Except where the contrary is expressly stated in *GENPRU*, whenever a *rule* in *GENPRU* or *INSPRU* refers to *shares* held in, and debts due from, an *undertaking* referred to in ■ GENPRU 1.3.43 R (1) or ■ GENPRU 1.3.43 R (3), a *firm* must value the *shares* held in accordance with ■ GENPRU 1.3.47 R.

1.3.46

PRA

R

In relation to *shares* in, and debts due from, an *undertaking* referred to in ■ GENPRU 1.3.43 R (1), ■ GENPRU 1.3.45 R does not apply for the purposes of ■ GENPRU 2.2.256 R (Adjustments for regulated related undertakings other than insurance undertakings) and ■ INSPRU 6.1 (Group risk: Insurance groups).

1.3.47

PRA

R

For the purposes of ■ GENPRU 1.3.45 R, the value of the *shares* held in an *undertaking* referred to in ■ GENPRU 1.3.43 R (1) or ■ GENPRU 1.3.43 R (3) is the sum of:

- (1) the *regulatory surplus value* of that *undertaking*; less
- (2) for the purposes of ■ GENPRU 2.2.256 R (Adjustments for regulated related undertakings other than insurance undertakings), the book value of the total investments in the *tier one capital resources* and *tier two capital resources* of that *undertaking* by the *firm* and its *related undertakings*; or
- (3) for other purposes in *GENPRU* and *INSPRU*, the sum of:
  - (a) the book value of the investments by the *firm* and its *related undertakings* in the *tier two capital resources* of the *undertaking*; and
  - (b) if the *undertaking* is an *insurance undertaking*, its ineligible surplus capital and any restricted assets of the *undertaking* which have been excluded under ■ INSPRU 6.1.41 R (1).

1.3.48

PRA

R

For the purposes of ■ GENPRU 1.3.47 R (1), the regulatory surplus value of an *undertaking* referred to in ■ GENPRU 1.3.43 R (1) or ■ GENPRU 1.3.43 R (3) is, subject to ■ GENPRU 1.3.49 R, the sum of:

- (1) the total capital after deductions of the *undertaking*; less
- (2) the *individual capital resources requirement* of the *undertaking*.

1.3.49

PRA

R

- (1) Subject to ■ GENPRU 1.3.50 R, for the purposes of ■ GENPRU 1.3.48 R, only the relevant proportion of the:
- (a) total capital after deductions of the *undertaking*; and
  - (b) *individual capital resources requirement* of the *undertaking*; is to be taken into account.
- (2) In (1), the relevant proportion is the proportion of the total number of *shares* issued by the *undertaking* held, directly or indirectly, by the *firm*.

1.3.50

PRA

R

If the *individual capital resources requirement* of an *undertaking* in ■ GENPRU 1.3.43 R (1) that is a *subsidiary undertaking* exceeds total capital after deductions, then the full amount of the items referred to in ■ GENPRU 1.3.49 R (1) must be taken into account for the purposes of ■ GENPRU 1.3.48 R.

1.3.51

PRA

R

For the purposes of ■ GENPRU 1.3.47 R to ■ GENPRU 1.3.50 R:

- (1) in relation to an *undertaking* referred to in ■ GENPRU 1.3.43 R (1):
- (a) subject to (2), *individual capital resources requirement* has the meaning given by ■ INSPRU 6.1.34 R;
  - (b) total capital after deductions means:
    - (i) when used in relation to a *regulated related undertaking* that is subject to the *capital resources table*, the total capital after deductions (as calculated at stage M of the *capital resources table*) of the *undertaking*; and
    - (ii) when used in relation to a *regulated related undertaking* that is not subject to the *capital resources table*, the total capital after deductions calculated as if that *undertaking* were required to calculate its total capital after deductions in accordance with stage M of the calculation in the *capital resources table*, but with such adjustments being made to secure that the *undertaking's* calculation of its total capital after deductions complies with the relevant *sectoral rules* applicable to it; and
  - (c) ineligible surplus capital has the meaning given by ■ INSPRU 6.1.67 R;
- (2) in relation to an *undertaking* referred to in ■ GENPRU 1.3.43 R (3),
- (a) the *individual capital resources requirement* is zero; and
  - (b) the total capital after deductions means the total capital after deductions of the *undertaking* calculated as if the *undertaking* were an *insurance holding company* required to calculate its

total capital resources in accordance with the *capital resources table* but with such adjustments being made to secure that the *undertaking's* calculation of its total capital after deductions complies with the *sectoral rules* for the *insurance sector*.

1.3.52

PRA

G

■ GENPRU 1.3.47 R to ■ GENPRU 1.3.51 R set out several different valuation bases for an *insurer's shares* in *related undertakings*. The *regulatory surplus value* (defined in ■ GENPRU 1.3.48 R) measures the *related undertaking's* own capital surplus or deficit. This is used: (i) in ■ GENPRU 1.3.47 R as a basis for calculating the impact on the firm's position of its investments in *related undertakings*; and (ii) in ■ INSPRU 6.1 as a starting point for the calculation of ineligible surplus capital.

1.3.53

PRA

G

■ GENPRU 1.3.47 R determines how, for the purposes of the solo capital adequacy calculation of an *insurer*, that *insurer's capital resources* should be adjusted to take into account its investments in *related undertakings*.

1.3.54

PRA

G

The *rules* that specify how, for the purposes of the adjusted solo capital calculation, an *insurer* should incorporate its *related undertakings* into its *capital resources* and *capital resources requirement* are set out in ■ INSPRU 6.1.

### Insurance Special Purpose Vehicles

1.3.55

PRA

R

Except where a *rule* in *GENPRU* or *INSPRU* makes a different provision, an *insurer* must not place any value on amounts recoverable from an *ISPV* for the purposes of any *rule* in *GENPRU* or *INSPRU*.

1.3.56

PRA

G

An *insurer* may value amounts recoverable from an *ISPV* if it obtains a *waiver* of ■ GENPRU 1.3.55 R under section 138A of the *Act*. The conditions that will need to be met, in addition to the statutory tests under section 138A(4) of the *Act*, before the *PRA* will consider granting such a *waiver* are set out in ■ INSPRU 1.6.13 G to ■ INSPRU 1.6.18 G.

### General insurance business: Community co-insurance operations -

1.3.57

PRA

R

Where a *relevant insurer* determines the amount of a liability in order to make provision for outstanding *claims* under a *Community co-insurance operation*, then, if the *leading insurer* has informed the *relevant insurer* of the amount of the provision made by the *leading insurer* for such *claims*, the amount determined by the *relevant insurer*:

- (1) must be at least as great as the amount of the provision made by the *leading insurer*; or
- (2) in a case where it is not the practice in the *United Kingdom* to make such provision separately, must be sufficient, when all liabilities are taken into account, to include provision at least as great as that made by the *leading insurer* for such *claims*,

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due regard being had in either case to the proportion of the risk covered by the *relevant insurer* and by the *leading insurer* respectively.

1



## 1.4 Actions for damages

1.4.1

FCA

R

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



## 1.5 Application of GENPRU 1 to Lloyd's

### Application of GENPRU 1.2

1.5.1  
PRA

**R** ■ GENPRU 1.2 applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, ■ INSPRU 8.1.4 R; and
- (2) for the *Society*, ■ INSPRU 8.1.2 R.

1.5.2  
PRA

**R** ■ GENPRU 1.5.7 R applies to *members*, pursuant to the *insurance market direction* in ■ GENPRU 1.5.5 D.

### Insurance market direction

1.5.3  
PRA

**G** The *insurance market direction* in ■ GENPRU 1.5.5 D is given under section 316(1) of the *Act* (Direction by Authority) and applies to *members*.

1.5.4  
PRA

**G** The purpose of the *insurance market direction* in ■ GENPRU 1.5.5 D is to enable the *PRA* to make the rule in ■ GENPRU 1.5.7 R applying to *members*, in order to:

- (1) protect *policyholders* against the risk that *members* may not have adequate financial resources to meet liabilities under or in respect of *contracts of insurance* as they fall due;
- (2) promote confidence in the market at Lloyd's by requiring *members* to maintain financial resources which are adequate to meet their liabilities.

1.5.5  
PRA

**D** With effect from 1 January 2005, Part 9A of the *Act* (Rules and Guidance) applies to the *members* of the *Society* taken together in relation to the *insurance market activities* of *effecting* and *carrying out contracts of insurance* written at Lloyd's, for the purpose of applying the *rules* and *guidance* in ■ GENPRU 1.5.7 R to ■ GENPRU 1.5.9 G.

PAGE  
39  
1.5.6  
PRA

**G** Part 9A of the *Act* is a *core provision* specified in section 317(1) of the *Act* (The core provisions). Section 317(2) provides that references in an applied *core provision* to an *authorised person* are to be read as references to a *person* in the class to which the *insurance market direction* applies. From 1 January 2005, references in Part 9A of the *Act* are to be read as references to *members* for the purposes of ■ GENPRU 1.5.7 R to ■ GENPRU 1.5.9 G.

1.5.7  
PRA

R

**Members' obligation to maintain adequate financial resources**

The *members* taken together must at all times maintain overall financial resources, including capital and liquidity resources, that are adequate, both as to amount and quality, to ensure that there is no significant risk that liabilities under or in respect of *contracts of insurance* written at Lloyd's will not be met as they fall due.

1.5.8  
PRA

G

Under GENPRU:

- (1) *managing agents* must ensure that adequate financial resources are available to support the *insurance business* carried on through each *syndicate* that they manage; and
- (2) the *Society* must, having regard to the availability and value of the *central assets*, ensure that the financial resources supporting the *insurance business* of each *member* are adequate at all times.

1.5.9  
PRA

G

In practice, compliance with the requirements described in ■ GENPRU 1.5.8 G is likely to have the effect that *members* comply with ■ GENPRU 1.5.7 R.

**Application of GENPRU 1.3**

1.5.10  
PRA

R

■ GENPRU 1.3 applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, ■ INSPRU 8.1.4 R; and
- (2) for the *Society*, ■ INSPRU 8.1.2 R.

**Amounts receivable but not yet received**

1.5.11  
PRA

R

When recognising and valuing assets that are available to meet liabilities arising from a *member's insurance business*, neither the *Society* nor *managing agents* may attribute any value to any amounts receivable but not yet received from that *member* or another *member*, except for:

- (1) timing differences provided that a corresponding amount has been deducted from *syndicate assets* or *funds at Lloyd's*;
- (2) the *Society's callable contributions*, which are valued according to ■ GENPRU 1.5.17 R to ■ GENPRU 1.5.18 R; and
- (3) debts owed by a *member* to another *member* of the *Society* where the debt is a liability arising out of the *insurance business* he carries on at Lloyd's.

**Letters of credit, guarantees and life assurance policies**

1.5.12  
PRA

R

When recognising and valuing assets held as *members' funds at Lloyd's* the *Society* may, if the conditions in ■ GENPRU 1.5.13 R are satisfied,

attribute a value to letters of credit and guarantees that it holds in respect of a *member's insurance business*.

1.5.13  
PRA

**R** The conditions referred to in ■ GENPRU 1.5.12 R are that letters of credit and guarantees must be:

- (1) in the form prescribed by the *Society* from time to time and notified to the *PRA*; and
- (2) issued by a *credit institution* or an *insurance undertaking*.

1.5.14  
PRA

**R** When recognising and valuing assets held as *members' funds at Lloyd's* the *Society* may attribute a value to verifiable sums arising out of life assurance policies.

1.5.15  
PRA

**R** The *Society* must value any letter of credit, guarantee or life assurance policy at its net realisable value. The *Society* must make all appropriate deductions, including those in respect of:

- (1) the expenses of realisation; and
- (2) any reduction in value that would be likely to occur if the asset needed to be realised at short notice to meet liabilities falling due earlier than expected.

1.5.16  
PRA

**R** If a *member* relies on a value attributed to a letter of credit or guarantee to meet any applicable *capital resources requirement* and that letter of credit or guarantee will expire in less than one month, the *Society* must take appropriate steps to ensure that the applicable *capital resources requirement* will continue to be met, including taking steps to ensure that sums due under the letter of credit or guarantee are drawn down when due and carried to the appropriate *Lloyd's trust fund*.

**The Society's callable contributions**

1.5.17  
PRA

**R** For the purposes of ■ GENPRU 1.5.15 R (2), the amount assumed to be callable from a *member* must not exceed the lower of:

- (1) the maximum *callable contribution* that *member* is or may be liable to make in that *financial year*; and
- (2) the amount by which the *member's own capital resources* exceed the *member's own capital resources requirement*.

PAGE 41  
1.5.18  
PRA

**R** The *Society* must value *callable contributions* taking appropriate account of any legal, constructive or other limits on its ability to call for contributions from *members* or to realise the amount called.

- 1.5.19** **R** The *Society* must give the *PRA* adequate advance notice if it proposes to change the maximum amount of the *callable contribution* that *members* may be liable to make in any *financial year*.  
**PRA**
- 1.5.20** **G** The *PRA* would normally expect not less than six months' notice under  
**PRA** ■ GENPRU 1.5.19 R.
- Liabilities**  
.....
- 1.5.21** **R** Subject to ■ GENPRU 1.5.22 R, the *Society* must recognise and value all of a *member's* liabilities in respect of its *insurance business*.  
**PRA**
- 1.5.22** **R** The *Society* need not recognise or value a *member's* liabilities that are recognised and valued at *syndicate* level by *managing agents* in accordance with ■ GENPRU 1.3.  
**PRA**
- 1.5.23** **R** For the purposes of calculating a *member's capital resources*, when valuing a *member's funds at Lloyd's* the *Society* must deduct the value of a *member's* liabilities determined under ■ GENPRU 1.5.21 R.  
**PRA**
- 1.5.24** **G** The liabilities to be valued under ■ GENPRU 1.5.21 R and deducted under ■ GENPRU 1.5.23 R include:  
**PRA**
- (1) amounts owing to *members' agents*;
  - (2) amounts owing to the *Society*;
  - (3) an appropriate accrual for tax payable on any profits;
  - (4) (where required under any applicable accounting principle in accordance with ■ GENPRU 1.3.4 R), any contingent liability relating to liabilities reinsured into Equitas Reinsurance Ltd; and
  - (5) amounts apportioned to *members* in respect of the *credit equalisation provision* in ■ INSPRU 1.4.
- 1.5.25** **R** In recognising and valuing a *member's* liabilities, the *Society* and *managing agents* may, to the extent permitted by applicable accounting principles, leave out of account the liabilities in respect of 1992 and prior *general insurance business* reinsured by Equitas Reinsurance Limited.  
**PRA**
- 1.5.26** **G** There may be contingent liabilities associated with the reinsurance into Equitas. ■ GENPRU 1.3 requires *managing agents* and the *Society* to treat those contingent liabilities in accordance with applicable accounting principles: see ■ GENPRU 1.3.4 R. Depending on the circumstances, *managing agents* or the *Society* may need to disclose or account for such a liability.  
**PRA**

# Chapter 2

# Capital



## 2.1 Calculation of capital resources requirements

### Application

2.1.1

FCA PRA

R

This section applies to:

- (1) a *BIPRU firm*; and
- (2) an *insurer*, unless it is:
  - (a) a *non-directive friendly society*; or
  - (b) a *Swiss general insurer*; or
  - (c) an *EEA-deposit insurer*; or
  - (d) an *incoming EEA firm*; or
  - (e) an *incoming Treaty firm*.

2.1.2

FCA PRA

G

The scope of application of this section is not restricted to *firms* that are subject to the relevant *EU Directives*.

2.1.3

FCA PRA

R

- (1) This section applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.
- (2) Where an *insurer* carries on both *long-term insurance business* and *general insurance business*, except where a particular provision provides otherwise, this section applies separately to each type of business.

2.1.4

FCA PRA

G

The adequacy of a *firm's capital resources* needs to be assessed in relation to all the activities of the *firm* and the risks to which they give rise.

2.1.5

FCA PRA

G

The requirements in this section apply to a *firm* on a solo basis.

2.1.6

FCA PRA

G

### Purpose

*Principle 4* requires a *firm* to maintain adequate financial resources. ■ GENPRU 2 sets out provisions that deal specifically with the adequacy of that part of a *firm's* financial

resources that consists of *capital resources*. The adequacy of a *firm's capital resources* needs to be assessed both by that *firm* and the *appropriate regulator*. Through its *rules*, the *appropriate regulator* sets minimum *capital resources requirements* for *firms*. It also reviews a *firm's* own assessment of its capital needs, and the processes and systems by which that assessment is made, in order to see if the minimum *capital resources requirements* are appropriate (see ■ GENPRU 1.2 (Adequacy of financial resources), ■ BIPRU 2.2 (Internal capital adequacy standards) and ■ INSPRU 7.1 (Individual capital assessment)).

2.1.7

FCA PRA

G

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

2.1.8

FCA PRA

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.
- (2) This section also implements 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 75 of the *Banking Consolidation Directive* and Articles 5, 9, 10 and 18 of the *Capital Adequacy Directive*.
- (3) In the case of a *UCITS investment firm* this section implements (in part) Article 7 of the *UCITS Directive*.

**Monitoring requirements**

2.1.9

FCA PRA

R

A *firm* must at all times monitor whether it is complying with ■ GENPRU 2.1.13 R (the main capital adequacy rule for *insurer*) or the main *BIPRU firm Pillar 1 rules* and be able to demonstrate that it knows at all times whether it is complying with those *rules*.

2.1.10

FCA PRA

G

For the purposes of ■ GENPRU 2.1.9 R, a *firm* should have systems in place to enable it to be certain whether it has adequate *capital resources* to comply with ■ GENPRU 2.1.13 R and the main *BIPRU firm Pillar 1 rules* (as applicable) at all times. This does not necessarily mean that a *firm* needs to measure the precise amount of its *capital resources* and its *CRR* on a daily basis. A *firm* should, however, be able to demonstrate the adequacy of its *capital resources* at any particular time if asked to do so by the *appropriate regulator*.

2.1.11

FCA PRA

R

A *firm* must notify the *appropriate regulator* immediately of any breach, or expected breach, of ■ GENPRU 2.1.13 R (in the case of an *insurer*) or the main *BIPRU firm Pillar 1 rules* (in the case of a *BIPRU firm*).

**Additional capital requirements**

2.1.12

FCA PRA

G

The *appropriate regulator* may impose a higher capital requirement than the minimum requirement set out in this section as part of the *firm's Part 4A permission* (see

■ GENPRU 1.2 (Adequacy of financial resources), ■ BIPRU 2.2 (Internal capital adequacy standards) and ■ INSPRU 7.1 (Individual capital assessment)).

**Main requirement: Insurers**

2.1.13  
PRA

R

(1) Subject to (2), an *insurer* must maintain at all times *capital resources* equal to or in excess of its *capital resources requirement (CRR)*.

(2) An *insurer* which is a *participating insurance undertaking* and, in relation to its own *group capital resources*, is in compliance with ■ INSPRU 6.1.9 R (Requirement to maintain group capital), is deemed to comply with this *rule*.

2.1.14  
PRA

R

An *insurer* must comply with ■ GENPRU 2.1.13 R separately in respect of both its *long-term insurance business* and its *general insurance business* unless it is a *pure reinsurer* or a *captive reinsurer* which has a single MCR in respect of its entire business in accordance with ■ GENPRU 2.1.26 R.

2.1.15  
PRA

G

In order to comply with ■ GENPRU 2.1.14 R, an *insurer* carrying on both *general insurance business* and *long-term insurance business* will need to allocate its *capital resources* between its *general insurance business* and *long-term insurance business* so that the *capital resources* allocated to its *general insurance business* are equal to or in excess of its CRR for its *general insurance business* and the *capital resources* allocated to its *long-term insurance business* are equal to or in excess of its CRR for its *long-term insurance business*. Whereas *long-term insurance assets* cannot be used towards meeting a *firm's* CRR for its *general insurance business*, surplus general insurance assets may be used towards meeting the CRR for its *long-term insurance business* (see ■ INSPRU 1.5.30 R to ■ INSPRU 1.5.32 G). ■ INSPRU 1.5 (Internal-contagion risk) sets out the detailed requirements for the separation of *long-term* and *general insurance business*.

2.1.16  
PRA

G

*Insurers* commonly use different terminology for the various GENPRU requirements. For example, the MCR is traditionally known as the required minimum margin.

**Calculation of the CRR for an insurer**

2.1.17  
PRA

R

The CRR for any *insurer* carrying on *general insurance business* is equal to the MCR in ■ GENPRU 2.1.24 R or, for a *pure reinsurer* or a *captive reinsurer* carrying on both *general insurance business* and *long-term insurance business*, in ■ GENPRU 2.1.26 R.

2.1.18  
PRA

R

The CRR for any *insurer* to which this *rule* applies (see ■ GENPRU 2.1.19 R and ■ GENPRU 2.1.20 R) is the higher of:

- (1) the MCR in ■ GENPRU 2.1.24A R; and
- (2) the ECR in ■ GENPRU 2.1.38 R.

2.1.19

PRA

R

Subject to ■ GENPRU 2.1.20 R, ■ GENPRU 2.1.18 R applies to an *insurer* carrying on *long-term insurance business*, other than:

- (1) a *non-directive mutual*;
- (2) an *insurer* which has no *with-profits insurance liabilities*; and
- (3) an *insurer* which has *with-profits insurance liabilities* that are, and at all times since 31 December 2004 (the coming into force of ■ GENPRU 2.1.18 R) have remained, less than £500 million.

2.1.20

PRA

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■ GENPRU 2.1.18 R also applies to an *insurer* of a type listed in ■ GENPRU 2.1.19 R (3) if:

- (1) the *insurer* makes an election that ■ GENPRU 2.1.18 R is to apply to it; and
- (2) that election is made by written notice given to the *appropriate regulator* in a way that complies with the requirements for written notice in ■ SUP 15.7 (Form and method of notification).

2.1.21

PRA

G

The effect of ■ GENPRU 2.1.19 R (3) is that an *insurer* to which ■ GENPRU 2.1.18 R applies because it has *with-profits insurance liabilities* of £500 million or more, will continue to be subject to ■ GENPRU 2.1.18 R even if its *with-profits insurance liabilities* fall below £500 million. However, if that happens, it may apply for a *waiver* from ■ GENPRU 2.1.18 R under section 138A of the *Act*. In exercising its discretion under section 138A of the *Act*, the *appropriate regulator* will have regard (among other factors) to whether there has been a material and permanent change to the *insurer's* business and to the prospects of it continuing to have *with-profits insurance liabilities* of less than £500 million.

2.1.22

PRA

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An *insurer* that has always had *with-profits insurance liabilities* of less than £500 million since ■ GENPRU 2.1.18 R came into force may wish to "opt in" to ■ GENPRU 2.1.18 R and therefore become a *realistic basis life firm*. By doing so, it becomes obliged to calculate a *with-profits insurance capital component* (see ■ GENPRU 2.1.38 R and ■ INSPRU 1.3 (With-profits insurance capital component)), but it also becomes entitled to certain modifications to the way that a *firm* is required to calculate its *mathematical reserves* (see ■ INSPRU 1.2.46 R (Future net premiums: adjustment for deferred acquisition costs) and ■ INSPRU 1.2.76 R (Persistency assumptions)). The *firm* is also then required to report its liabilities on a realistic basis (see *IPRU(INS)* rule 9.31R(b)). In order to "opt in", the *insurer* must make an election under ■ GENPRU 2.1.20 R that ■ GENPRU 2.1.18 R is to apply to it. If an *insurer* that has elected to calculate and report its *with-profits insurance liabilities* on a realistic basis subsequently decides that it no longer wishes to do so, it may seek to "opt out" by applying for a *waiver* from ■ GENPRU 2.1.18 R under section 138A of the *Act*. In exercising its discretion under section 138A of the *Act*, the *appropriate regulator* will have regard (among other factors) to whether there has been a material and permanent change to the *firm's* business and to whether it continues to have *with-profits insurance liabilities* of less than £500 million.

2.1.23

PRA

R

The *CRR* for an *insurer* carrying on *long-term insurance business*, but to which ■ GENPRU 2.1.18 R does not apply, is equal to the *MCR* in

2.1.24

PRA

R

■ GENPRU 2.1.25 R or, for a *pure reinsurer* or a *captive reinsurer* carrying on both *general insurance business* and *long-term insurance business*, in ■ GENPRU 2.1.26 R.

**Calculation of the MCR (Insurer only)**

Subject to ■ GENPRU 2.1.26 R, for an *insurer* carrying on *general insurance business* the MCR in respect of that business is the higher of:

- (1) the *base capital resources requirement* for *general insurance business* applicable to that *firm*; and
- (2) the *general insurance capital requirement*.

2.1.24A

PRA

R

Subject to ■ GENPRU 2.1.26 R, for an *insurer* carrying on *long-term insurance business* to which ■ GENPRU 2.1.18 R applies the MCR in respect of that business is the higher of:

- (1) the *base capital resources requirement* for *long-term insurance business* applicable to that *firm*; and
- (2) the *long-term insurance capital requirement*.

2.1.25

PRA

R

Subject to ■ GENPRU 2.1.26 R, for an *insurer* carrying on *long-term insurance business*, but to which ■ GENPRU 2.1.18 R does not apply, the MCR in respect of that business is the higher of:

- (1) the *base capital resources requirement* for *long-term insurance business* applicable to that *firm*; and
- (2) the sum of:
  - (a) the *long-term insurance capital requirement*; and
  - (b) the *resilience capital requirement*.

2.1.26

PRA

R

For a *pure reinsurer* or a *captive reinsurer* carrying on both *general insurance business* and *long-term insurance business*:

- (1) the MCR in respect of its *general insurance business* is the *general insurance capital requirement*; and
- (2) the MCR in respect of its *long-term insurance business* is the sum of:
  - (a) the *long-term insurance capital requirement*; and
  - (b) the *resilience capital requirement*;

unless the sum of:

- (3) the *general insurance capital requirement*; and
- (4) the sum of:
  - (a) the *long-term insurance capital requirement*; and
  - (b) the *resilience capital requirement*;

is lower than the *base capital resources requirement*, in which case the *firm* has a single MCR in respect of its entire business equal to the *base capital resources requirement*.

2.1.27

PRA

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The MCR gives effect to the EU Directive minimum requirements. For *general insurance business*, the EU Directive minimum is the higher of the *general insurance capital requirement* and the relevant *base capital resources requirement*. For *long-term insurance business*, the EU Directive minimum is the higher of the *long-term insurance capital requirement* and the *base capital resources requirement*. For *pure reinsurers* and *captive reinsurers* carrying on both *general insurance business* and *long-term insurance business*, however, the *base capital resources requirement* is the EU Directive required minimum only when it is higher than the sum of the *general insurance capital requirement* and the *long-term insurance capital requirement*. The *base capital resources requirement* is the minimum guarantee fund for the purposes of article 29(2) of the *Consolidated Life Directive* (2002/83/EC), article 17(2) of the *First Non-Life Directive* (1973/239/EEC) as amended and article 40(2) of the *Reinsurance Directive* (2005/68/EC). The *resilience capital requirement* is a PRA minimum requirement for *long-term insurance business* for *regulatory basis only life firms* that is additional to the EU minimum requirement for *long-term insurance business*.

2.1.28

PRA

G

The calculation of the *resilience capital requirement* is set out in ■ INSPRU 3.1 (Market Risk in insurance).

**Calculation of the base capital resources requirement for an insurer**

2.1.29

PRA

R

The amount of an *insurer's base capital resources requirement* is set out in the table in ■ GENPRU 2.1.30 R. If an *insurer* falls within one or more of the descriptions of type of *firm* set out in ■ GENPRU 2.1.30 R, its *base capital resources requirement* is the highest amount set out against the different types of *firm* within whose description it falls.

**Table: Base capital resources requirement for an insurer**

2.1.30

PRA

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This table belongs to ■ GENPRU 2.1.29 R

<i>Firm category</i>	<i>Amount: Currency equivalent of</i>
<b>General insurance business</b>	
<b>Liability insurer (classes Directive mutual 10-15)</b>	<b>€ 2.775 million</b>
<i>Non-directive insurer</i>	<b>€ 350 ,000</b>

<i>Firm category</i>	<i>Amount: Currency equivalent of</i>
<b>Other insurer</b>	<b>Other (including mixed insurer but excluding pure reinsurer )</b> € 3.7 million <b>Directive mutual</b> € 1.875 million <b>Non-directive insurer (classes 1 to 8, 16 or 18)</b> € 260 ,000 <b>Non-directive insurer (classes 9 or 17)</b> €175 ,000 <b>Mixed insurer</b> € 3.7 million <b>Other (excluding pure reinsurer)</b> € 2.5 million
<b>Long-term insurance business</b>	
<b>Mutual</b>	<b>Directive</b> € 2.775 million <b>Non-directive mutual</b> € 700 ,000
<b>Any other insurer (including mixed insurer but excluding pure reinsurer )</b>	€ 3.7 million
<b>All business (general insurance business and long-term insurance business)</b>	
<b>Pure reinsurer excluding captive reinsurer</b>	€ 3.7 million
<b>Captive reinsurer</b>	€ 1.2 million

2.1.31  
PRA

G

- (1) Under the *Insurance Directives* the amount of the *base capital resources requirement* specified in the last column of the table in ■ GENPRU 2.1.30 R for an *insurer* which is not a *Non-directive insurer* is subject to annual review. The relevant amounts will be increased by the percentage change in the European index of consumer prices (comprising all EU member states, as published by Eurostat) from 20 March 2002, to the relevant review date, rounded up to a multiple of €100,000, provided that where the percentage change since the last increase is less than 5%, no increase will take place.
- (2) Similar provisions for the index-linking of the *base capital resources requirement* are included in the *Reinsurance Directive*, although in that case the index-linking starts from 10 December 2005. However, to ensure consistency as between all *firms* affected by the index-linking of the *base capital resources requirement* under the *Insurance Directives* and the *Reinsurance Directive*, the PRA intends, so far as possible, to amend the amounts in ■ GENPRU 2.1.30 R for all such *firms* (and ■ GENPRU 2.3.9 R for the *base capital resources requirements* applying to Lloyd's) when an index-linked increase is required by the *Insurance Directives*. The PRA may, however, have to depart from this approach where the result would be that the *base capital resources requirement* required for any type of *firm* under ■ GENPRU 2.1.30 R is less than the increased amount resulting from the operation of an index-linking provision to which it is subject.

**2.1.32** **G** Any increases in the *base capital resources requirement* referred to in ■ GENPRU 2.1.31 G will be published on the PRA website.  
**PRA**

**2.1.33** **R** In the case of an *insurer* and for the purposes of the *base capital resources requirement*, the exchange rate from the Euro to the pound sterling for each year beginning on 31 December is the rate applicable on the last day of the preceding October for which the exchange rates for the currencies of all the European Union member states were published in the Official Journal of the European Union.  
**PRA**

#### **Calculation of the general insurance capital requirement (Insurer only).....**

**2.1.34** **R** An *insurer* must calculate its *general insurance capital requirement* as the highest of:  
**PRA**

- (1) the *premiums amount*;
- (2) the *claims amount*; and
- (3) the *brought forward amount*.

**2.1.35** **G** The calculation of each of the *premiums amount*, *claims amount* and *brought forward amount* is set out in ■ INSPRU 1.1 (Capital resources requirement and technical provisions for insurance business).  
**PRA**

#### **Calculation of the long-term insurance capital requirement (Insurer only).....**

**2.1.36** **R** An *insurer* must calculate its *long-term insurance capital requirement* as the sum of:  
**PRA**

- (1) the *insurance death risk capital component*;
- (2) the *insurance health risk and life protection reinsurance capital component*;
- (3) the *insurance expense risk capital component*; and
- (4) the *insurance market risk capital component*.

**2.1.37** **G** The calculation of each of the capital components is set out in ■ INSPRU 1.1 (Capital resources requirement and technical provisions for insurance business).  
**PRA**

#### **Calculation of the ECR (Insurer only).....**

**2.1.38** **R** For an *insurer* carrying on *long-term insurance business* the *ECR* in respect of that business is the sum of:  
**PRA**

- (1) the *long-term insurance capital requirement*; and
- (2) the *with-profits insurance capital component*.

**2.1.39** PRA G Details of the *resilience capital requirement* and the *with-profits insurance capital component* are set out in ■ INSPRU 3.1 (Market Risk in insurance) and ■ INSPRU 1.3 (With-profits insurance capital component) respectively.

**Main requirement: BIPRU firms**

**2.1.40** FCA PRA R A *BIPRU firm* must maintain at all times *capital resources* equal to or in excess of the amount specified in the table in ■ GENPRU 2.1.45 R (Calculation of the variable capital requirement for a BIPRU firm).

**2.1.41** FCA PRA R A *BIPRU firm* must maintain at all times *capital resources* equal to or in excess of the *base capital resources requirement* (see the table in ■ GENPRU 2.1.48 R).

**2.1.42** FCA PRA 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*.

**2.1.43** FCA PRA G The purpose of the *base capital resources requirement* for a *BIPRU firm* is to act as a minimum capital requirement or floor. It has been written as a separate requirement as there are restrictions in ■ GENPRU 2.2 (Capital resources) on the types of capital that a *BIPRU firm* may use to meet the *base capital resources requirement* which do not apply to some other parts of the capital requirement calculation. In order to preserve the *base capital resources requirement's* role as a floor rather than an additional requirement, ■ GENPRU 2.2.60 R allows a *BIPRU firm* to meet the *base capital resources requirement* with capital that is also used to meet the variable capital requirements in ■ GENPRU 2.1.40 R.

**2.1.44** FCA PRA G The *base capital resources requirement* and the variable capital requirement in ■ GENPRU 2.1.40 R are together called the *capital resources requirement (CRR)* in the case of a *BIPRU firm*.

**Calculation of the variable capital requirement for a BIPRU firm**

**2.1.45** FCA PRA R Table: Calculation of the variable capital requirement for a BIPRU firm

This table belongs to ■ GENPRU 2.1.40 R

<i>Firm category</i>	<i>Capital requirement</i>
<i>Bank, building society or full scope BIPRU investment firm</i>	the sum of the following: <ol style="list-style-type: none"> <li>(1) the <i>credit risk capital requirement</i>;</li> <li>(2) the <i>market risk capital requirement</i>; and</li> <li>(3) the <i>operational risk capital requirement</i>.</li> </ol>
<i>BIPRU limited activity firm</i>	the sum of the following: <ol style="list-style-type: none"> <li>(1) the <i>credit risk capital requirement</i>;</li> <li>(2) the <i>market risk capital requirement</i>; and</li> <li>(3) the <i>fixed overheads requirement</i>.</li> </ol>

***BIPRU limited licence firm (including UCITS investment firm)*** the higher of (1) and (2):

(1) the sum of:

(a) the *credit risk capital requirement*; and

(b) the *market risk capital requirement*; and

(2) the *fixed overheads requirement*.

**Adjustment of the variable capital requirement calculation for UCITS investment firms**

2.1.46

FCA

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

2.1.47

FCA PRA

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**Calculation of the base capital resources requirement for a BIPRU firm**

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

2.1.48

FCA PRA

R

**Table: Base capital resources requirement for a BIPRU firm**

This table belongs to ■ GENPRU 2.1.47 R

<i>Firm category</i>	<i>Amount: Currency equivalent of</i>
<i>Bank</i>	€5 million
<i>Building society</i>	The higher of €1 million and £1 million
<i>BIPRU 730K firm</i>	€730,000
<i>BIPRU 125K firm</i>	€125,000
<i>BIPRU 50K firm</i>	€50,000
<i>UCITS investment firm</i>	€125,000 plus, if the <i>funds under management</i> 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

FCA PRA

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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 2.1.50 G briefly summarises them.

**Table: Definition of BIPRU 730K firm, BIPRU 125K firm and BIPRU 50K firm**

2.1.50

FCA PRA

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This table belongs to ■ GENPRU 2.1.49 G

Category of BIPRU investment firm		Definition
<i>BIPRU 50K firm</i>	(1)	it does not deal in any <i>financial instruments</i> for its own account or underwrite issues of <i>financial instruments</i> on a firm commitment basis;
	(2)	it offers one or more of the following services: <ul style="list-style-type: none"> <li>(a) reception and transmission of investors' orders for <i>financial instruments</i>; or</li> <li>(b) the execution of investors' orders for <i>financial instruments</i>; or</li> <li>(c) the management of individual portfolios of investments in <i>financial instruments</i>; and</li> </ul>
	(3)	it does not hold clients' money and/or securities and it is not authorised to do so (it should have a <i>limitation</i> or <i>requirement</i> prohibiting the holding of client money and its <i>permission</i> should not include <i>safeguarding and administering investments</i> ).
<i>BIPRU 125K firm</i>	(1)	it does not deal in any <i>financial instruments</i> for its own account or underwrite issues of <i>financial instruments</i> on a firm commitment basis;
	(2)	it offers one or more of the following services: <ul style="list-style-type: none"> <li>(a) reception and transmission of investors' orders for <i>financial instruments</i>; or</li> <li>(b) the execution of investors' orders for <i>financial instruments</i>; or</li> <li>(c) the management of individual portfolios of investments in <i>financial instruments</i>; and</li> </ul>
	(3)	it holds clients' money and/or securities or it is authorised to do so.
<i>BIPRU 730K firm</i>		is subject to the <i>Capital Adequacy Directive</i> and is neither a <i>BIPRU 50K firm</i> nor a <i>BIPRU 125K firm</i> .

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

2.1.51

FCA PRA

R

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

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

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

2.1.52

FCA PRA

R

- (1) A *BIPRU firm* must calculate its *market risk capital requirement* as the sum of:
- (a) the *interest rate PRR* (including the basic *interest rate PRR* for equity derivatives set out in ■ BIPRU 7.3 (Equity PRR and basic interest rate PRR for equity derivatives));
  - (b) the *equity PRR*;
  - (c) the *commodity PRR*;
  - (d) the *foreign currency PRR*;
  - (e) the *option PRR*; and
  - (f) the *collective investment undertaking PRR*.
- (2) Any amount calculated under ■ BIPRU 7.1.9 R - ■ BIPRU 7.1.13 R (Instruments for which no PRR treatment has been specified) must be allocated between the *PRR* charges in (1) in the most appropriate manner.

**Calculation of the fixed overheads requirement (BIPRU investment firm only)**

2.1.53

FCA

R

In relation to a *BIPRU investment firm* which is required to calculate a *fixed overheads requirement*, the amount of that requirement is equal to one quarter of the *firm's* relevant fixed expenditure calculated in accordance with ■ GENPRU 2.1.54 R.

2.1.54

FCA

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For the purpose of ■ GENPRU 2.1.53 R, and subject to ■ GENPRU 2.1.55 R to ■ GENPRU 2.1.57 R, a *BIPRU 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):

- (1) staff bonuses, except to the extent that they are guaranteed;
- (2) employees' and directors' shares in profits, except to the extent that they are guaranteed;
- (3) other appropriations of profits;
- (4) shared commission and fees payable which are directly related to commission and fees receivable, which are included within total revenue;
- (5) interest charges in respect of borrowings made to finance the acquisition of the *firm's readily realisable investments*;
- (6) interest paid to customers on *client money*;

- (7) interest paid to counterparties;
- (8) fees, brokerage and other charges paid to *clearing houses*, exchanges and *intermediate brokers* for the purposes of *executing*, registering or clearing transactions;
- (9) foreign exchange losses; and
- (10) other variable expenditure.

2.1.55

FCA

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

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

2.1.56

FCA

R

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

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

2.1.57

FCA

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If a *firm* has a material proportion of its expenditure incurred on its behalf by third parties and such expenditure is not fully recharged to that *firm* then the *firm* must adjust its relevant fixed expenditure calculation by adding back in the whole of the difference between the amount of the expenditure and the amount recharged.

2.1.58

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

2.1.59

FCA

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

### Calculation of base capital resources requirement for banks authorised before 1993

2.1.60

PRA

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

2.1.61

PRA

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

2.1.62

PRA

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For the purpose of ■ GENPRU 2.1.60 R:

- (1) an existing controller of a *bank* means:
- (a) a *person* who has been a *parent undertaking* of that *bank* since 31 December 2006 or earlier; or

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

## 2.2 Capital resources

### Application

2.2.1

R

This section applies to:

FCA PRA

- (1) a *BIPRU firm*; and
- (2) an *insurer* unless it is:
  - (a) a *non-directive friendly society*; or
  - (b) a *Swiss general insurer*; or
  - (c) an *EEA-deposit insurer*; or
  - (d) an *incoming EEA firm*; or
  - (e) an *incoming Treaty firm*.

### Purpose

2.2.2

G

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

FCA PRA

2.2.3

G

This section implements minimum EC standards for the composition of *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 *First Non-Life Directive* (1973/239/EEC) as amended or the *Reinsurance Directive* (2005/68/EC).

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2.2.4

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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 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).

FCA PRA

### Contents guide

2.2.5

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

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2.2.6

FCA PRA

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**Table: Arrangement of GENPRU 2.2**

This table belongs to ■ GENPRU 2.2.5 G

Topic	Location of text
Application and purpose of the <i>rules</i> in this section	GENPRU 2.2.1 R to GENPRU 2.2.4 G
<i>BIPRU firms</i> that only have simple types of <i>capital resources (simple capital issuers)</i>	GENPRU 2.2.7 G
Principles underlying the definition of <i>capital resources</i>	GENPRU 2.2.8 G
Which method of calculating <i>capital resources</i> applies to which type of <i>firm</i>	GENPRU 2.2.17 R to GENPRU 2.2.19 R
Purpose of the limits on the use of different forms of capital	GENPRU 2.2.24 G
Use of higher tier capital in lower tiers	GENPRU 2.2.25 R to GENPRU 2.2.28 R
Calculation of <i>capital resources</i> for <i>insurers</i>	GENPRU 2.2.22 G to GENPRU 2.2.23 G; GENPRU 2 Annex 1 R
Limits on the use of different forms of capital for <i>insurer (capital resources gearing rules for insurer)</i>	GENPRU 2.2.29 R to GENPRU 2.2.41 R
Calculation of <i>capital resources</i> for <i>banks</i>	GENPRU 2 Annex 2 R
Calculation of <i>capital resources</i> for <i>building societies</i>	GENPRU 2 Annex 3 R
Limits on the use of different forms of capital for <i>banks</i> and <i>building societies</i> (certain types of <i>capital resources</i> cannot be used for certain purposes)	GENPRU 2.2.44 R to GENPRU 2.2.45 R; GENPRU 2.2.47 R to GENPRU 2.2.48 R
Limits on the use of different forms of capital for <i>banks</i> and <i>building societies (capital resources gearing rules)</i>	GENPRU 2.2.29 R to GENPRU 2.2.31 G; GENPRU 2.2.46 R; GENPRU 2.2.49 R
Calculation of <i>capital resources</i> for <i>BIPRU investment firms</i>	GENPRU 2.2.20 G to GENPRU 2.2.21 G; GENPRU 2 Annex 4 R to GENPRU 2 Annex 6 R
Limits on the use of different forms of capital for <i>BIPRU investment firms</i> (certain types of <i>capital resources</i> cannot be used for certain purposes)	GENPRU 2.2.44 R to GENPRU 2.2.45 R; GENPRU 2.2.47 R to GENPRU 2.2.48 R
Limits on the use of different forms of capital for <i>BIPRU investment firms (capital resources gearing rules)</i>	GENPRU 2.2.29 R to GENPRU 2.2.31 G; GENPRU 2.2.46 R; GENPRU 2.2.50 R
Example of how the <i>capital resources</i> calculation for <i>BIPRU firms</i> works	GENPRU 2.2.51 G to GENPRU 2.2.59 G
Capital used to meet the <i>base capital resources requirement</i> for <i>BIPRU firms</i>	GENPRU 2.2.60 R to GENPRU 2.2.61 G
Notification of issuance of <i>capital instruments</i> .	GENPRU 2.2.61A R to GENPRU 2.2.61H G
<i>Tier one capital instruments: general</i>	GENPRU 2.2.9 G to GENPRU 2.2.10 G; GENPRU 2.2.62 R to GENPRU 2.2.69 G; GENPRU 2.2.80 R to GENPRU 2.2.82 G

Topic	Location of text
<i>Tier one capital: payment of coupons (BIPRU firm only)</i>	GENPRU 2.2.69A R to GENPRU 2.2.69F G
<i>Core tier one capital: permanent share capital</i>	GENPRU 2.2.83 R to GENPRU 2.2.84A G
General conditions for eligibility of <i>capital instruments as core tier one capital (BIPRU firm only)</i>	GENPRU 2.2.83A R to GENPRU 2.2.83D G; GENPRU 2.2.84A G
<i>Core tier one capital: exception to eligibility criteria (building societies only)</i>	GENPRU 2.2.83E R to GENPRU 2.2.83H G
<i>Core tier one capital: profit and loss account and other reserves: material applicable to all firms</i>	GENPRU 2.2.85 R; GENPRU 2.2.87 R to GENPRU 2.2.89 G; GENPRU 2.2.91 G
<i>Core tier one capital: profit and loss account and other reserves: material specific to BIPRU firms</i>	GENPRU 2.2.86 R; GENPRU 2.2.90 R; GENPRU 2.2.92 G
<i>Core tier one capital: provisions relating to partnerships and limited liability partnerships</i>	GENPRU 2.2.93 R to GENPRU 2.2.100 R
<i>Core tier one capital: share premium account</i>	GENPRU 2.2.101 R
<i>Core tier one capital: externally verified interim net profits</i>	GENPRU 2.2.102 R to GENPRU 2.2.103 G
<i>Core tier one capital: valuation differences and fund for future appropriations for insurer</i>	GENPRU 2.2.104 R to GENPRU 2.2.108 R
<i>Core tier one capital: deferred shares (building society only)</i>	GENPRU 2.2.108A R to GENPRU 2.2.108B G
<i>Tier one capital: perpetual non-cumulative preference shares (insurer only)</i>	GENPRU 2.2.109 R to GENPRU 2.2.110 G
<i>Innovative tier one capital (excluding issues through SPVs) (insurer only)</i>	GENPRU 2.2.76 R; GENPRU 2.2.113 R to GENPRU 2.2.122 G
<i>Hybrid capital (excluding issues through SPVs) (BIPRU firm only)</i>	GENPRU 2.2.115A R to GENPRU 2.2.119 G
<i>Hybrid capital (issues through SPVs) (BIPRU firm only)</i>	GENPRU 2.2.123 R to GENPRU 2.2.137 R
<i>Tier one capital: conversion ratio</i>	GENPRU 2.2.138 R to GENPRU 2.2.144 G
<i>Tier one capital: requirement to have sufficient unissued stock</i>	GENPRU 2.2.145 R
Deductions from <i>tier one capital resources</i>	GENPRU 2.2.155 R to GENPRU 2.2.156 G
<i>Tier two capital</i>	GENPRU 2.2.11 G; GENPRU 2.2.157 G to GENPRU 2.2.197 G
Deductions from <i>tier one capital resources and tier two capital resources</i>	GENPRU 2.2.202 R to GENPRU 2.2.240 G
<i>Tier three capital</i>	GENPRU 2.2.12 G; GENPRU 2.2.241 R to GENPRU 2.2.249 R
Deductions from total <i>capital resources</i>	GENPRU 2.2.14 G to GENPRU 2.2.16 G; GENPRU 2.2.250 R to GENPRU 2.2.265 R
The effect of swaps	GENPRU 2.2.198 R to GENPRU 2.2.201 R

Topic	Location of text
<i>Step-ups (Tier one capital and tier two capital)</i>	GENPRU 2.2.76 R; GENPRU 2.2.146 R to GENPRU 2.2.154 G
Redemption of <i>tier one instruments</i>	GENPRU 2.2.64 R (3); GENPRU 2.2.70 R to GENPRU 2.2.79 G
Purchases of <i>tier one instruments: BIPRU firm only</i>	GENPRU 2.2.79A R to GENPRU 2.2.79H G; GENPRU 2.2.79L G
Redemption of <i>tier two instruments</i>	GENPRU 2.2.172 R to GENPRU 2.2.174 R; GENPRU 2.2.177 R to GENPRU 2.2.178 R ( <i>upper tier two instruments</i> ); GENPRU 2.2.194 R to GENPRU 2.2.197 G ( <i>lower tier two instruments</i> )
Non-standard capital instruments	GENPRU 2.2.13 G
Standard form documentation for subordinated debt	GENPRU 2.2.164 G
Public sector guarantees	GENPRU 2.2.276 R
Other capital resources for insurers: unpaid <i>share capital or unpaid initial funds</i> and calls for supplementary contributions	GENPRU 2.2.266 G to GENPRU 2.2.269 G
Additional requirements for <i>insurer</i> carrying on <i>with-profits insurance business</i>	GENPRU 2.2.270 R to GENPRU 2.2.275 G

**Simple capital issuers**

2.2.7  
FCA PRA

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Parts of this section are irrelevant to a *BIPRU firm* whose *capital resources* consist of straightforward *capital instruments*.

**Principles underlying the definition of capital resources**

2.2.8  
FCA PRA

G

The *appropriate regulator* has divided its definition of capital into categories, or tiers, reflecting differences in the extent to which the *capital instruments* concerned meet the purpose and conform to the characteristics of capital listed in ■ GENPRU 2.2.9 G. The *appropriate regulator* generally prefers a *firm* to hold higher quality capital that meets the characteristics of permanency and loss absorbency that are features of *tier one capital*. *Capital instruments* falling into *core tier one capital* can be included in a *firm's* regulatory capital without limit. Typically, other forms of capital are either subject to limits (see the *capital resources gearing rules*) or, in the case of some specialist types of capital, may only be included with the express consent of the *appropriate regulator* (which takes the form of a *waiver* under section 138A of the *Act*). Details of the individual components of capital are set out in the *capital resources table*.

**Tier one capital**

2.2.9  
FCA PRA

G

*Tier one capital* typically has the following characteristics:

- (1) it is able to absorb losses;
- (2) it is permanent or (in the case of a *BIPRU firm*) available when required;
- (3) it ranks for repayment upon winding up, administration or similar procedure after all other debts and liabilities; and

- (4) it has no fixed costs, that is, there is no inescapable obligation to pay dividends or interest.

## 2.2.10

FCA PRA

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

- (1) in the case of an *insurer*, *core tier one capital*, perpetual non-cumulative *preference shares* and *innovative tier one capital*; and
- (2) in the case of a *BIPRU firm*, *core tier one capital* and *hybrid capital*. *Hybrid capital* is further divided into the different stages B1, B2 and C of the calculation in the *capital resources table*.

### Upper and lower tier two capital

## 2.2.11

FCA PRA

G

*Tier two capital* includes forms of capital that do not meet the requirements for permanency and absence of fixed servicing costs that apply to *tier one capital*. *Tier two capital* includes, for example:

- (1) capital which is perpetual (that is, has no fixed term) but cumulative (that is, servicing costs cannot be waived at the issuer's option, although they may be deferred - for example, cumulative *preference shares*); only perpetual *capital instruments* may be included in *upper tier two capital*;
- (2) capital which is not perpetual (that is, it has a fixed term) or which may have fixed servicing costs that cannot generally be either waived or deferred (for example, most subordinated debt); such capital should normally be of a medium to long-term maturity (that is, an original maturity of at least five years); dated *capital instruments* are included in *lower tier two capital*;
- (3) (for *BIPRU firms*) certain revaluation reserves such as reserves arising from the revaluation of land and buildings, including any net unrealised gains for the fair valuation of equities held in the available-for-sale financial assets category; and
- (4) (for *BIPRU firms*) general/collective provisions.

### Tier three capital

## 2.2.12

FCA PRA

G

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

### Non-standard capital instruments

## 2.2.13

FCA PRA

G

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

**Deductions from capital**

2.2.14

FCA PRA

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

FCA PRA

G

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

2.2.16

FCA PRA

G

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

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

2.2.17

FCA PRA

R

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

2.2.18

FCA PRA

R

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

**Table: Applicable capital resources calculation**

2.2.19

FCA PRA

R

This table belongs to ■ GENPRU 2.2.17 R

Type of <i>firm</i>	Location of <i>rules</i>	Remarks
<i>Insurer</i>	GENPRU 2 Annex 1 R	
<i>Bank</i>	GENPRU 2 Annex 2 R	
<i>Building society</i>	GENPRU 2 Annex 3 R	
<i>BIPRU investment firm without an investment firm consolidation waiver</i>	GENPRU 2 Annex 4 R (Deducts <i>material holdings</i> )	Applies to a <i>BIPRU investment firm</i> not using GENPRU 2 Annex 5 R or GENPRU 2 Annex 6 R
<i>BIPRU investment firm without an investment firm consolidation waiver</i>	GENPRU 2 Annex 5 R (Deducts <i>illiquid assets</i> )	A <i>BIPRU investment firm</i> must give one <i>Month's</i> prior notice to the <i>appropriate regulator</i> before starting to use or stopping using this method

Type of <i>firm</i>	Location of <i>rules</i>	Remarks
<b><i>BIPRU investment firm with an investment firm consolidation waiver</i></b>	<b>GENPRU 2 Annex 6 R (Deducts illiquid assets and material holdings)</b>	<b>A firm with an investment firm consolidation waiver must use this method. No other BIPRU investment firm may use it.</b>

**Calculation of capital resources: Which rules apply to BIPRU investment firms**

2.2.20

FCA PRA

G

■ GENPRU 2.2.19 R 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*, *illiquid assets*.

2.2.21

FCA PRA

G

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

**Calculation of capital resources: Insurers**

2.2.22

PRA

G

*Capital resources* for an *insurer* can be calculated either as the total of eligible assets less foreseeable liabilities (which is the approach taken in the *Insurance Directives*) or by identifying the components of capital. Both calculations give the same result for the total amount of *capital resources*. The approach taken in this section has been to specify the components of capital and the relevant deductions. This is set out in the *capital resources table*. This approach is the same as that used for the calculation of *capital resources* for *banks*, *building societies* and *BIPRU investment firms*. A simple example, showing the reconciliation of the two methods, is given in the table in ■ GENPRU 2.2.23 G.

**Table: Approaches to calculating capital resources**

2.2.23

PRA

G

This table belongs to ■ GENPRU 2.2.22 G

Liabilities		Assets	
Borrowings	100	Admissible assets	350
Ordinary <i>shares</i>	200	Intangible assets	100
Profit and loss account and other reserves	100	Other inadmissible assets	100
Perpetual subordinated debt	150		
Total		Total	
Calculation of <i>capital resources</i> : eligible assets less foreseeable liabilities			
Total assets		550	
less intangible assets		(100)	

Liabilities	Assets
less inadmissible assets	(100)
less liabilities (borrowings)	(100)
<i>Capital resources</i>	
Calculation of <i>capital resources</i> : components of capital	
Ordinary <i>shares</i>	200
Profit and loss account and other reserves	100
Perpetual subordinated debt	150
less intangible assets	(100)
less inadmissible assets	(100)
<i>Capital resources</i>	

**Limits on the use of different forms of capital: General**

2.2.24 **G**  
FCA PRA

As the various components of capital differ in the degree of protection that they offer the *firm* and its *customers* and *consumers*, restrictions are placed on the extent to which certain types of capital are eligible for inclusion in a *firm's capital resources*. These *rules* are called the *capital resources gearing rules*.

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

2.2.25 **R**  
FCA PRA

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

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

2.2.26 **R**  
FCA PRA

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

2.2.26A **R**  
FCA PRA

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

2.2.27 **R**

[deleted]

2.2.28

FCA PRA

R

In the case of a *BIPRU firm*, the requirement to obtain a legal opinion in

- GENPRU 2.2.159 R (12) does not apply to *hybrid capital* treated under
- GENPRU 2.2.25 R but the requirements to obtain a legal opinion in
- GENPRU 2.2.118 R continue to apply.

#### Limits on the use of different forms of capital: Limits relating to tier one capital applicable to insurers

2.2.29

PRA

R

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

2.2.30

PRA

R

In relation to the *tier one capital resources* of an *insurer*, calculated at stage F of the calculation in the *capital resources table* (Total tier one capital after deductions), no more than 15% may be accounted for by *innovative tier one capital*.

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

2.2.30A

FCA PRA

R

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

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

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

2.2.31

FCA PRA

G

The purpose of the requirements in ■ GENPRU 2.2.29 R and ■ GENPRU 2.2.30A R (1) is to ensure that the *firm's tier one capital resources* includes a minimum proportion of *core tier one capital* which provides the highest quality capital. Within the 50% limit on non-*core tier one capital*:

- (1) ■ GENPRU 2.2.30 R places a further sub-limit on the amount of *innovative tier one capital* that an *insurer* may include in its *tier one capital resources*; and
- (2) ■ GENPRU 2.2.30A R (2) and ■ GENPRU 2.2.30A R (3) place further sub-limits on the amounts of *hybrid capital* included at stages B2 and C of the calculation in the *capital resources table* that a *BIPRU firm* may include in its *tier one capital resources*.

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

**Limits on the use of different forms of capital: Insurers**

2.2.32

PRA

R

At least 50% of an *insurer's* MCR must be accounted for by the sum of:

- (1) the amount calculated at stage A of the calculation in the *capital resources table* (Core tier one capital); and
- (2) notwithstanding ■ GENPRU 2.2.29 R, the amount calculated at stage B of the calculation in the *capital resources table* (Perpetual non-cumulative preference shares);

less the amount calculated at stage E of the calculation in the *capital resources table* (Deductions from tier one capital).

2.2.33

PRA

R

Subject to ■ GENPRU 2.2.34A R, an *insurer* carrying on *long-term insurance business* must meet the higher of:

- (1) 1/3 of the *long-term insurance capital requirement*; and
- (2) the *base capital resources requirement*;

with the sum of the items listed at stages A (Core tier one capital), B (Perpetual non-cumulative preference shares), G (Upper tier two capital) and H (Lower tier two capital) in the *capital resources table* less the sum of the items listed at stage E in the *capital resources table* (Deductions from tier one capital).

2.2.34

PRA

R

Subject to ■ GENPRU 2.2.34A R, an *insurer* carrying on *general insurance business* must meet the higher of:

- (1) 1/3 of the *general insurance capital requirement*; and
- (2) the *base capital resources requirement*;

with the sum of the items listed at stages A (Core tier one capital), B (Perpetual non-cumulative preference shares), G (Upper tier two capital) and H (Lower tier two capital) in the *capital resources table* less the sum of the items listed at stage E (Deductions from tier one capital) in the *capital resources table*.

2.2.34A

PRA

R

A *pure reinsurer* carrying on both *long-term insurance business* and *general insurance business* must meet the higher of:

- (1) 1/3 of the sum of the *long-term insurance capital requirement* and the *general insurance capital requirement*; and
- (2) the *base capital resources requirement*;

with the sum of the items listed at stages A (Core tier one capital), B (Perpetual non-cumulative preference shares), G (Upper tier two capital) and H (Lower tier two capital) in the *capital resources table* less the

sum of the items listed at stage E (Deductions from tier one capital) in the *capital resources table*.

2.2.35

PRA

R

In ■ GENPRU 2.2.33 R , ■ GENPRU 2.2.34 R and ■ GENPRU 2.2.34A R :

- (1) items listed at stage B (Perpetual non-cumulative preference shares) in the *capital resources table* may be included notwithstanding ■ GENPRU 2.2.29 R;
- (2) *innovative tier one capital* that meets the conditions (other than ■ GENPRU 2.2.159 R (12) (Requirement for a legal opinion)) for it to be included as *upper tier two capital* at stage G (Upper tier two capital) in the *capital resources table* may be treated as an item listed at stage G; and
- (3) an *insurer* must exclude from the calculation the higher of the following:
  - (a) the amount (if any) by which the sum of the items listed at stages G (Upper tier two capital) and H (Lower tier two capital) in the *capital resources table* exceeds the total (net of deductions) of the remaining constituents of adjusted stage M; and
  - (b) the amount (if any) by which the sum of the items listed at stage H in the *capital resources table* exceeds one-third of the total (net of deductions) of the remaining constituents of adjusted stage M;

where adjusted stage M means the amount calculated at stage M of the calculation in the *capital resources table* (Total capital after deductions) less the amount of any *innovative tier one capital* that is not treated as *upper tier two capital* for the purpose of ■ GENPRU 2.2.33 R , ■ GENPRU 2.2.34 R or ■ GENPRU 2.2.34A R , as the case may be.

2.2.36

PRA

G

The purpose of the requirements in ■ GENPRU 2.2.33 R to ■ GENPRU 2.2.34A R is to comply with the requirements of the *Insurance Directives* and the *Reinsurance Directive* that an insurer must maintain a *guarantee fund* of higher quality *capital resources* items .

2.2.37

PRA

R

Subject to ■ GENPRU 2.2.38 R, an *insurer* must exclude from the calculation of its *capital resources* the following:

- (1) the amount (if any) by which *tier two capital resources* exceed the amount calculated at stage F (Total tier one capital after deductions) of the calculation in the *capital resources table*; and
- (2) the amount (if any) by which *lower tier two capital resources* exceed 50% of the amount calculated at stage F of the calculation in the *capital resources table*.

2.2.38

PRA

R

At least 75% of an *insurer's MCR* must be accounted for by the sum of:

- (1) the amount calculated at stage A (Core tier one capital) plus, notwithstanding ■ GENPRU 2.2.29 R, the amount calculated at stage B (Perpetual non-cumulative preference shares) less the amount calculated at stage E (Deductions from tier one capital) of the calculation in the *capital resources table*; and
- (2) the amount calculated at stage G (Upper tier two capital) of the calculation in the *capital resources table*.

2.2.39

PRA

G

In ■ GENPRU 2.2.38 R the amount of any *innovative tier one capital* that meets the conditions for it to be included as *upper tier two capital* at stage G (Upper tier two capital) in the *capital resources table* may be included in the amount calculated at stage G.

2.2.40

PRA

G

■ GENPRU 2.2.32 R, ■ GENPRU 2.2.37 R and ■ GENPRU 2.2.38 R give effect to the requirements of the *Insurance Directives* and the *Reinsurance Directive* that no more than 50% of the amount which is the lesser of the available solvency margin and the required solvency margin should consist of *tier two capital resources* and that no more than 25% of that amount should consist of *lower tier two capital resources*.

2.2.41

PRA

R

An *insurer* (other than a *pure reinsurer*) that carries on both *long-term insurance business* and *general insurance business* must apply the relevant limits in ■ GENPRU 2.2.32 R to ■ GENPRU 2.2.38 R separately for each type of business.

2.2.42

R

[deleted]

2.2.43

G

[deleted]

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

2.2.44

FCA PRA

R

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

- (1) the *credit risk capital component*;
- (2) the *operational risk capital requirement*;
- (3) the *counterparty risk capital component*; and
- (4) the *base capital resources requirement*.

2.2.45

FCA PRA

R

■ GENPRU 2.2.44 R (and the *capital resources gearing rules* that relate to it) also applies for the purposes of any other requirement in the *Handbook* for which it is necessary to calculate the *capital resources* of

a *BIPRU firm*, except for the purposes described in ■ GENPRU 2.2.47 R and except as may otherwise be stated in the relevant part of the *Handbook*.

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

2.2.46

R

FCA PRA

For the purpose of ■ GENPRU 2.2.44 R:

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

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

2.2.47

R

FCA PRA

For the purposes of meeting:

- (1) the *market risk capital requirement*;
- (2) the *concentration risk capital component*; and
- (3) the *fixed overheads requirement* (where applicable);

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

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

2.2.48

FCA PRA

R

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

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

2.2.49

FCA PRA

R

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

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

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

- (3) calculate the amount at stage F of the calculation in the *capital resources table* (Total tier one capital after deductions); and
- (4) deduct from (3) those parts of the *firm's tier one capital* used to meet the requirements in ■ GENPRU 2.2.44 R (1) and ■ (2) as established by ■ GENPRU 2.2.48 R.

2.2.50

FCA PRA

R

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

#### Example of how the capital resources calculation for BIPRU firms works

2.2.51

FCA PRA

G

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

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

2.2.52

FCA PRA

G

This table belongs to ■ GENPRU 2.2.51 G

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

2.2.53

G

[deleted]

2.2.54

FCA PRA

G

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

2.2.55

FCA PRA

G

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

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

2.2.56

FCA PRA

G

This table belongs to ■ GENPRU 2.2.55 G

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

2.2.57  
FCA PRA

G

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

2.2.58  
FCA PRA

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 2.2.49 R 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 2.2.48 R. The calculation in ■ GENPRU 2.2.49 R (3) and ■ GENPRU 2.2.49 R (4) then focuses on the *tier one* element of this earlier calculation.

In this worked example, if it is assumed that the counterparty risk requirement has been met by *tier one capital*, the relevant *tier one capital* for gearing is £50. This is because the deductions of £20 and the credit and operational risk requirements 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 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*.

The outcome of these calculations can be summarised as follows:

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

2.2.59  
FCA PRA

G

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

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

2.2.60  
FCA PRA

R

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

2.2.61  
FCA PRA

G

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

**Notification of issuance of capital instruments**

2.2.61A

FCA PRA

R

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

2.2.61B

FCA PRA

R

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

- (1) provide details of the amount of capital the *firm* is seeking to raise through the intended issue and whether the capital is intended to be issued to external investors or within its *group*;
- (2) identify the stage of the *capital resources table* the *capital instrument* is intended to fall within;
- (3) include confirmation from a *senior manager* of the *firm* responsible for authorising the intended issue that the *capital instrument* complies with the *rules* applicable to instruments included in the stage of the *capital resources table* identified in (2); and
- (4) provide a copy of the term sheet and details of any features of the *capital instrument* which are novel, unusual or different from a *capital instrument* of a similar nature previously issued by the *firm* or widely available in the market or not specifically contemplated by ■ GENPRU 2.2.

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

2.2.61C

FCA PRA

R

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

2.2.61D

FCA PRA

R

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

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

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

2.2.61E

FCA PRA

R

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

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

2.2.61F

FCA PRA

R

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

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

2.2.61G

FCA PRA

G

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

2.2.61H

FCA PRA

G

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

another *undertaking* in its *group* for inclusion in its *group capital resources* are set out in ■ INSPRU 6.1.43A R to ■ INSPRU 6.1.43F R.

### Tier one capital: General

2.2.62

FCA PRA

R

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

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

2.2.63

FCA PRA

R

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

- (1) *permanent share capital*;
- (2) *eligible partnership capital*;
- (3) *eligible LLP members' capital*;
- (4) *sole trader capital*;
- (5) (in the case of an *insurer*) a perpetual non-cumulative *preference share*;
- (6) [deleted]
- (7) (in the case of an *insurer*) an *innovative tier one instrument*; and
- (8) (in the case of a *BIPRU firm*) *hybrid capital*.

### General conditions for eligibility as tier one capital

2.2.64

FCA PRA

R

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

- (1) it is issued by the *firm*;
- (2) it is fully paid and the proceeds of issue are immediately and fully available to the *firm*;
- (3) it:
  - (a) cannot be redeemed at all or can only be redeemed on a winding up of the *firm*; or

- (b) complies with the conditions in ■ GENPRU 2.2.70 R (Basic requirements for redeemability) and ■ GENPRU 2.2.76 R (Redeemable instrument subject to a *step-up*);
- (4) the item of capital meets the following conditions in relation to any *coupon*:
- (a) the *firm* is under no obligation to pay a *coupon*; or
  - (b) (if the *firm* is obliged to pay the *coupon*) the *coupon* is payable in the form of an item of capital that is:
    - (i) in the case of a *BIPRU firm*, *core tier one capital*; and
    - (ii) in the case of an *insurer*, included in a *higher stage of capital* or the *same stage of capital* as that first item of capital;
- (5) any *coupon* is either:
- (a) non-cumulative; or
  - (b) (if it is cumulative) it must, if deferred, be paid by the *firm* in the form of *tier one capital* complying with (4)(b);
- (6) it is able to absorb losses to allow the *firm* to continue trading and :
- (a) in the case of an *insurer*, in particular it complies with ■ GENPRU 2.2.80 R to ■ GENPRU 2.2.81 R (Loss absorption) and, in the case of an *innovative tier one instrument*, ■ GENPRU 2.2.116 R to ■ GENPRU 2.2.118 R (Other tier one capital: loss absorption); and
  - (b) in the case of a *BIPRU firm*, it does not, through appropriate mechanisms, hinder the recapitalisation of the *firm*, and in particular it complies with:
    - (i) ■ GENPRU 2.2.80 R to ■ GENPRU 2.2.81 R (Loss absorption);
    - (ii) in the case of *core tier one capital*, ■ GENPRU 2.2.83A R (9) to ■ GENPRU 2.2.83A R (10) (General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only)); and
    - (iii) in the case of *hybrid capital*, ■ GENPRU 2.2.116 R to ■ GENPRU 2.2.118 R (Other tier one capital: loss absorption);

- (7) the amount of the item included must be net of any foreseeable tax charge at the moment of its calculation or must be suitably adjusted in so far as such tax charges reduce the amount up to which that item may be applied to cover risks or losses;
- (8) it is available to the *firm* for unrestricted and immediate use to cover risks and losses as soon as these occur;
- (9) it ranks for repayment upon winding up, administration or any other similar process:
  - (a) in the case of an *insurer*, no higher than a *share* of a company incorporated under the Companies Act 2006 (whether or not it is such a *share*); or
  - (b) in the case of a *BIPRU firm*, lower than any items of capital that are:
    - (i) eligible for inclusion within the *firm's tier two capital resources*; and
    - (ii) not eligible for inclusion within the *firm's tier one capital resources*; and
- (10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9) and, where it applies, ■ GENPRU 2.2.271 R (Other requirements: insurers carrying on with-profits business (Insurer only)).

2.2.65

FCA PRA

R

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

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

2.2.66

FCA PRA

G

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

2.2.67

FCA PRA

G

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

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

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

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

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

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

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

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

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

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

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

- (1) the *firm* meets its *capital resources requirement*; and

(2) such a substituted payment preserves the *firm's* financial resources.

2.2.69D

FCA PRA

G

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

- (1) there is no decrease in the amount of the *firm's core tier one capital*;
- (2) the deferred *coupon* is satisfied without delay using newly issued *core tier one capital* that has an aggregate fair value no more than the amount of the *coupon*;
- (3) the *firm* is not obliged to find new investors for the newly issued instruments; and
- (4) if the holder of the newly issued instruments subsequently sells the instruments and the sale proceeds are less than the value of the *coupon*, the *firm* is not obliged to issue further new instruments to cover the loss incurred by the holder of the instruments.

2.2.69E

FCA PRA

R

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

2.2.69F

FCA PRA

G

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

newly issued *core tier one capital* in accordance with ■ GENPRU 2.2.64 R (4)(b) and ■ GENPRU 2.2.69C R. The *appropriate regulator* may consider using its powers under 55J of the *Act* to, on its own initiative, vary a *firm's Part 4A permission* to impose conditions on the use of such a mechanism or to require its cancellation, based on the factors outlined in this *guidance*.

### Redemption of tier one instruments

2.2.70

FCA PRA

R

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

- (1) (if it is redeemable other than in circumstances set out in ■ GENPRU 2.2.64 R (3)(a) (redemption on a winding up)) it is redeemable only at the option of the *firm* or, in the case of a *BIPRU firm*, on the date of maturity;
- (2) the *firm* cannot exercise that redemption right:
  - (a) before the fifth anniversary of its date of issue;
  - (b) unless it has given notice to the *appropriate regulator* in accordance with ■ GENPRU 2.2.74 R; and
  - (c) unless at the time of exercise of that right it complies with ■ GENPRU 2.1.13 R (the main capital adequacy rule for *insurers*) or the *main BIPRU firm Pillar 1 rules* and will continue to do so after redemption ;
- (3) (in the case of a *BIPRU firm* and if it is undated) if it provides for a moderate incentive for the *BIPRU firm* to redeem it, that incentive does not occur before the tenth anniversary of its date of issue; and
- (4) (in the case of a *BIPRU firm* and if it is dated):
  - (a) it has an original maturity date of at least 30 years after its date of issue; and
  - (b) it does not provide an incentive to redeem on any date other than its maturity date.

2.2.70A

FCA PRA

G

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

2.2.71

FCA PRA

R

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

- (1) the other conditions in ■ GENPRU 2.2.70 R are met;
- (2) the circumstance that entitles the *firm* to exercise that right is:
  - (a) (in the case of an *insurer*) a change in law or regulation in any relevant jurisdiction or in the interpretation of such law or regulation by any court or authority entitled to do so; and
  - (b) (in the case of a *BIPRU firm*) a change in the applicable tax treatment or regulatory classification of those instruments;
- (3) (a) (in the case of an *insurer*) it would be reasonable for the *firm* to conclude that it is unlikely that that circumstance will occur, judged at the time of issue or, if later, at the time that the term is first included in the terms of the *tier one instrument*; and
  - (b) (in the case of a *BIPRU firm*) the circumstance that entitles the *firm* to exercise that right was not reasonably foreseeable at the date of issue of the *tier one instrument*; and
- (4) the *firm's* right is conditional on it obtaining the *appropriate regulator's* consent in the form of a *waiver* of ■ GENPRU 2.2.72 R.

2.2.72

FCA PRA

R

A *firm* must not redeem a *tier one instrument* in accordance with a term included under ■ GENPRU 2.2.71 R.

2.2.73

FCA PRA

G

The purpose of ■ GENPRU 2.2.71 R to ■ GENPRU 2.2.72 R is this. In general a *tier one instrument* should not be redeemable by the *firm* before its fifth anniversary. However there may be circumstances in which it would be reasonable for the *firm* to redeem it before then. ■ GENPRU 2.2.71 R allows the *firm* to include a right to redeem the instrument before the fifth anniversary in certain circumstances. A tax call is an example of a term that may be allowed. ■ GENPRU 2.2.71 R says that the terms of the *tier one instrument* should provide that the *firm* should not be able to exercise that right without the *appropriate regulator's* consent. Any such consent will be given in the form of a *waiver* allowing early repayment. Thus although a *firm* may include a right to redeem early in the terms of a *tier one instrument* without the need to apply for a *waiver* the actual exercise of that right will require a *waiver*.

2.2.74

FCA PRA

R

A *firm* must not redeem any *tier one instrument* that it has included in its *tier one capital resources* unless it has notified the *appropriate regulator* of its intention at least one month before it becomes committed to do so. When giving notice, the *firm* must provide details of its position after such redemption in order to show how it will:

- (1) meet its *capital resources requirement*;

- (2) have sufficient financial resources to meet the *overall financial adequacy rule* ; and
- (3) in the case of a *BIPRU firm*, not otherwise suffer any undue effects to its financial or solvency conditions.

2.2.74A

FCA PRA

G

The *appropriate regulator* considers that, in order to comply with ■ GENPRU 2.2.74 R, the *firm* should, at a minimum, provide the *appropriate regulator* with the following information:

- (1) a comprehensive explanation of the rationale for the redemption;
- (2) the *firm's* financial and solvency position before and after the redemption, in particular whether that redemption, or other foreseeable internal and external events or circumstances, may increase the risk of the *firm* breaching its *capital resources requirement*;
- (3) an appropriately stressed capital plan covering 3-5 years, which includes the effect of the proposed redemption; and
- (4) an evaluation of the risks to which the *firm* is or might be exposed and whether the level of *tier one capital* ensures the coverage of such risks including stress tests on the main risks showing potential loss under different scenarios.

2.2.74B

FCA PRA

R

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

2.2.75

FCA PRA

R

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

**Step-ups and redeemable tier one instruments: Insurer only**.....

2.2.76

PRA

R

In the case of an *insurer*, in relation to an *innovative tier one instrument* which is redeemable and which satisfies the following conditions:

- (1) it is or may become subject to a *step-up*; and
  - (2) a reasonable *person* would think that:
    - (a) the *firm* is likely to redeem it before the tenth anniversary of its date of issue; or
    - (b) the *firm* is likely to have an economic incentive to redeem it before the tenth anniversary of its date of issue;
- the redemption date in ■ GENPRU 2.2.70 R (2)(a) is amended by replacing "fifth anniversary" with "tenth anniversary".

**Meaning of redemption**

2.2.77

FCA PRA

R

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

2.2.78

FCA PRA

R

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

2.2.79

FCA PRA

G

This section generally uses the term repay and redeem interchangeably.

**Purchases of tier one instruments: BIPRU firm only**

2.2.79A

FCA PRA

R

A *BIPRU firm* must not purchase a *tier one instrument* that it has included in its *tier one capital resources* unless:

- (1) the *firm* initiates the purchase;
- (2) [deleted]
- (3) the *firm* has given notice to the *appropriate regulator* in accordance with ■ GENPRU 2.2.79G R; and

- (4) (in the case of *hybrid capital*) it is on or after the fifth anniversary of the date of issue of the instrument.

2.2.79B

FCA PRA

G

In exceptional circumstances a *BIPRU firm* may apply for a *waiver* of ■ GENPRU 2.2.79AR (4) under section 138A (Modification or waiver of rules) of the *Act*.

2.2.79C

FCA PRA

R

■ GENPRU 2.2.79AR (4) does not apply if:

- (1) the *firm* replaces the *capital instrument* it intends to purchase with a *capital instrument* that is included in a *higher stage of capital* or the *same stage of capital*; and
- (2) the replacement *capital instrument* has already been issued.

2.2.79D

FCA PRA

R

■ GENPRU 2.2.79AR (4) does not apply if:

- (1) the *firm* intends to hold the purchased instrument for a temporary period as *market maker*; and
- (2) the purchased instruments held by the *firm* do not exceed the lower of:
  - (a) 10% of the relevant issuance; or
  - (b) 3% of the *firm's* total issued *hybrid capital*.

2.2.79E

FCA PRA

G

In the circumstances provided for in ■ GENPRU 2.2.79D R, a *firm* would purchase the instrument and, instead of cancelling it, the *firm* would hold the instrument for a temporary period. In that case a *firm* should have in place adequate policies to take into account any relevant regulations and *rules*, which include those relating to market abuse.

2.2.79F

FCA PRA

R

For the purposes of calculating its *tier one capital resources*, a *firm* must deduct the amount of any item of *hybrid capital* which it then holds.

2.2.79G

FCA PRA

R

A *BIPRU firm* must not purchase a *tier one instrument* in accordance with ■ GENPRU 2.2.79A R unless it has notified the *appropriate regulator* of its intention at least one month before it becomes committed to doing so. When giving notice, the *firm* must provide details of its position after the purchase in order to show how, over an appropriate timescale, adequately stressed, and without planned recourse to the capital markets, it will:

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

2.2.79H

FCA PRA

G

The *appropriate regulator* considers that:

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

2.2.79I

FCA PRA

R

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

2.2.79J

FCA PRA

R

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

2.2.79K

FCA PRA

R

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

2.2.79L

FCA PRA

G

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

### Loss absorption

2.2.80

FCA PRA

R

A *firm* may not include a *share* in its *tier one capital resources* unless (in addition to complying with the other relevant *rules* in ■ GENPRU 2.2):

- (1) (in the case of a *firm* that is a company as defined in the Companies Act 2006 it is "called-up *share capital*" within the meaning given to that term in that Act ; or
- (2) (in the case of a *building society*) it is a *deferred share*; or

- (3) (in the case of any other *firm*) it is:
  - (a) in economic terms; and
  - (b) in its characteristics as capital (including loss absorbency, permanency, ranking for repayment and fixed costs);
 substantially the same as called-up *share* capital falling into (1).

2.2.81  
FCA PRA

**R** A *firm* may not include a *capital instrument* other than a *share* in its *tier one capital resources* unless it complies with ■ GENPRU 2.2.80 R (3).

2.2.82  
FCA PRA

**G** There are additional loss absorption requirements for (in the case of an *insurer*) *innovative tier one capital* and (in the case of a *BIPRU firm*) *hybrid capital* in ■ GENPRU 2.2.116 R to ■ GENPRU 2.2.118 R (Other tier one capital: loss absorption) and (in the case of a *BIPRU firm*) for *core tier one capital* in ■ GENPRU 2.2.83AR (9) to ■ (10) (General conditions for eligibility of capital instruments as core tier one capital (*BIPRU firm* only)).

**Core tier one capital: permanent share capital**

2.2.83  
FCA PRA

**R** *Permanent share capital* means an item of capital which (in addition to satisfying ■ GENPRU 2.2.64 R) meets the following conditions:

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

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

2.2.83A  
FCA PRA

**R** The conditions that a *BIPRU firm's permanent share capital* must comply with under ■ GENPRU 2.2.83A R (4) or that a *BIPRU firm's eligible*

*partnership capital* or *eligible LLP members' capital* must comply with under ■ GENPRU 2.2.95 R are as follows:

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

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

2.2.83B  
FCA PRA

**R**

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

2.2.83C  
FCA PRA

**R**

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

2.2.83D  
FCA PRA

**G**

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

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

2.2.83E  
PRA

**R**

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

- (1) the *capital instrument* satisfies all other conditions for eligibility as *core tier one capital* set out in ■ GENPRU 2.2.83 R to ■ GENPRU 2.2.83A R;
- (2) the *coupon* limit has been imposed by law or the constitutional documents of the *firm*;
- (3) the objective of the limit is to protect the capital reserves of the *firm*;

- (4) the *firm* continues to have the effective right to choose the amount of any *coupon* that it pays;
- (5) all other *capital instruments* issued by the *firm* and included in stage A of the *capital resources table*:
  - (a) meet the conditions set out in ■ GENPRU 2.2.83 R (2), ■ GENPRU 2.2.83 R (3) and ■ GENPRU 2.2.83A R (General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only)); and
  - (b) if subject to a *coupon* limit, are subject to the same *coupon* limit; and
- (6) any preferential *coupon* on a *capital instrument* included in stage A of the *capital resources table*, arising as a result of the inclusion of a *coupon* limit on another *capital instrument*, must be restricted to a fixed multiple of the *coupon* payment on the *capital instrument* that is subject to the *coupon* limit.
 

■ GENPRU 2.2.83A R (2) to ■ (3) do not prevent a *capital instrument* from being included in stage A of the *capital resources table* if the only reason for those prohibitions not being met is that a preferential *coupon* arises, and is restricted, in the manner referred to in this paragraph (6).

2.2.83F

PRA

R

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

2.2.83G

PRA

G

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

2.2.83H

PRA

G

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

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

2.2.84

FCA PRA

G

**Core tier one capital: additional information**

In the case of an *insurer*, ■ GENPRU 2.2.83 R (2) and ■ GENPRU 2.2.83 R (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 2.2.83A R to ■ GENPRU 2.2.83F R impose more specific conditions on *coupon* payment and winding up which are applicable to *BIPRU firms*.

2.2.84A

FCA PRA

G

Under ■ GENPRU 2.2.83A R (13) a *tier one instrument* does not meet the conditions for inclusion as *core tier one capital* if in isolation it does meet those requirements but fails to meet those requirements when other transactions are taken into account. Examples of those transactions include guarantees, pledges of assets or other side agreements provided by the *firm* to the holder of a *tier one instrument* designed to enhance the legal or economic seniority of the *tier one instrument*.

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

2.2.85

FCA PRA

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.
- (2) For these purposes material interim net losses mean unaudited interim losses arising from a *firm's trading book* and *non-trading book* business which exceed 10% of the sum of its *capital resources* calculated at stage A (Core tier one capital) in the *capital resources table*.
- (3) If interim losses as referred to in (2) exceed the 10% figure in (2) then a *BIPRU investment firm* must deduct the whole amount of those losses and not just the excess.

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

2.2.86

FCA PRA

R

- (1) This *rule* applies to *trading book* valuation adjustments or reserves referred to in ■ GENPRU 1.3.29 R to ■ GENPRU 1.3.35A G (Valuation adjustments and reserves). It applies to a *BIPRU firm*.
- (2) When valuation adjustments or reserves give rise to losses of the current financial year, a *firm* must treat them in accordance with ■ GENPRU 2.2.85 R.

- (3) Valuation adjustments or reserves which exceed those made under the accounting framework to which a *firm* is subject must be treated in accordance with (2) if they give rise to losses and under ■ GENPRU 2.2.248 R (Net interim *trading book* profits) otherwise.

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

2.2.87  
FCA PRA

R

Dividends must be deducted from reserves as soon as they are foreseeable

2.2.87A  
FCA PRA

G

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

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

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

2.2.88  
FCA PRA

R

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

2.2.89  
FCA PRA

G

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

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

2.2.90  
FCA PRA

R

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

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

2.2.91  
FCA PRA

G

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

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

2.2.92  
FCA PRA

G

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

2.2.93

FCA PRA

R

**Core tier one capital: partnership capital account (BIPRU firm only)***Eligible partnership capital* means a partners' account:

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

2.2.94

FCA PRA

R

**Core tier one capital: Eligible LLP members' capital (BIPRU firm only)***Eligible LLP members' capital* means a members' account:

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

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

2.2.95

FCA PRA

R

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

2.2.96

FCA PRA

G

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

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

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

2.2.97

FCA PRA

R

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

2.2.98

FCA PRA

R

Without prejudice to ■ GENPRU 2.2.62 R (Tier one capital: General), the item other reserves (which forms part of the item profit and loss and other reserves) applies to a *BIPRU firm* that is a partnership or a *limited liability partnership* to the extent the reserves correspond to reserves that are eligible for inclusion as other reserves in the case of a *BIPRU firm* that is incorporated under the Companies Act 2006 .

2.2.99

FCA PRA

G

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

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

2.2.100

FCA PRA

R

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

**Core tier one capital: Share premium account**

2.2.101

FCA PRA

R

- (1) A *firm* must include *share premium account* relating to the issue of a *share* forming part of its *core tier one capital* in its *core tier one capital*.

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

**Core tier one capital: externally verified interim net profits**

2.2.102  
FCA PRA

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

2.2.103  
FCA PRA

**G** A *firm* may include interim profits before a formal decision has been taken only if these profits have been verified, in accordance with the relevant Auditing Practices Board's Practice Note, by *persons* responsible for the auditing of the accounts.

**Core tier one capital: valuation differences (insurer only)**

2.2.104  
PRA

**R** ■ GENPRU 2.2.104 R to ■ GENPRU 2.2.107 R only apply to an *insurer*.

2.2.105  
PRA

**R** Valuation differences are all differences between the valuation of assets and liabilities as valued in *GENPRU* and the valuation that the *insurer* uses for its external financial reporting purposes, except valuation differences which are dealt with elsewhere in the *capital resources table*. The sum of these valuation differences must either be added to (if positive) or deducted from (if negative) an *insurer's capital resources* in accordance with the *capital resources table*.

2.2.106  
PRA

**G** Additions to and deductions from *capital resources* will arise from the application of asset and liability valuation and admissibility *rules* (see ■ GENPRU 1.3 (Valuation), ■ GENPRU 2.2.251 R (Deductions from total capital: Inadmissible assets) and ■ GENPRU 2 Annex 7 R (Admissible assets in insurance)). Downward adjustments include *discounting of technical provisions* for *general insurance business* (which is optional for financial reporting but not permitted for regulatory valuation - see ■ GENPRU 2.2.107 R) and derecognition of any *defined benefit asset* in respect of a *defined benefit occupational pension scheme* (see ■ GENPRU 1.3.9 R (2) (General requirements: Adjustments to accounting values)). Details of valuation differences relating to *technical provisions* and liability adjustments for *long-term insurance business* are set out in ■ INSPRU 1.2 (Mathematical reserves). In particular, contingent loans or other arrangements which are not valued as a liability under ■ INSPRU 1.2.79 R (2) (Reinsurance) result in a positive valuation difference.

2.2.107

PRA

R

- (1) Subject to (3), this *rule* applies to an *insurer* that carries on *general insurance business* and which *discounts* or reduces its *technical provisions* for *claims* outstanding.
- (2) An *insurer* of a kind referred to in (1) must deduct from its *capital resources* the difference between the undiscounted *technical provisions* or *technical provisions* before deductions, and the discounted *technical provisions* or *technical provisions* after deductions. This adjustment must be made for all *general insurance business classes*, except for risks listed under *classes 1 and 2*. For *classes* other than 1 and 2, no adjustment needs to be made in respect of the discounting of annuities included in *technical provisions*. For *classes 1 and 2* (other than annuities), if the expected average interval between the settlement date of the *claims* being discounted and the accounting date is not at least four years, the *insurer* must deduct:
  - (a) the difference between the undiscounted *technical provisions* and the discounted *technical provisions*; or
  - (b) where it can identify a subset of *claims* such that the expected average interval between the settlement date of the *claims* and the accounting date is at least four years, the difference between the undiscounted *technical provisions* and the discounted *technical provisions* for the other claims.
- (3) This *rule* does not apply to a *pure reinsurer* which became a *firm in run-off* before 31 December 2006 and whose *Part 4A permission* has not subsequently been varied to add back the *regulated activity of effecting contracts of insurance*.

**Core tier one capital: fund for future appropriations (insurer only)**

2.2.108

PRA

R

In relation to an *insurer* the fund for future appropriations means the fund of the same name required by the *insurance accounts rules*, comprising all funds the allocation of which either to *policyholders* or to shareholders has not been determined by the end of the *financial year*, or the balance sheet items under *international accounting standards* which in aggregate represent as nearly as possible that fund.

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

2.2.108A

PRA

R

A *building society* may include a *deferred share* at stage A of the calculation in the *capital resources table* if (in addition to satisfying all the other requirements in relation to *tier one capital*) it is *permanent share capital* and is otherwise equivalent to an ordinary *share* in terms of its capital qualities, taking into account the specific constitution of *building societies* under the Building Societies Act 1986.

2.2.108B

PRA

G

The other main provisions relevant to inclusion of a *deferred share* in *tier one capital* are ■ GENPRU 2.2.62 R (Tier one capital: General), ■ GENPRU 2.2.64 R (General conditions for

eligibility as tier one capital), ■ GENPRU 2.2.65 R (Connected transactions) and ■ GENPRU 2.2.80 R (Loss absorption).

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

2.2.109

PRA

R

In the case of an *insurer*, a perpetual non-cumulative *preference share* may be included at stage B of the calculation in the *capital resources table* if (in addition to satisfying all the other requirements in relation to *tier one capital*) it satisfies the following conditions:

- (1) any *coupon* on it is not cumulative, and the *firm* is under no obligation to pay a *coupon* in any circumstances; and
- (2) it is not an *innovative tier one instrument*.

2.2.110

PRA

G

The other main provisions relevant to the eligibility of a perpetual non-cumulative *preference share* for inclusion by an *insurer* in *tier one capital* are ■ GENPRU 2.2.62 R (Tier one capital: General), ■ GENPRU 2.2.64 R (General conditions for eligibility as tier one capital), ■ GENPRU 2.2.65 R (Connected transactions), ■ GENPRU 2.2.70 R to ■ GENPRU 2.2.75 R (Redemption of *tier one instruments*) and ■ GENPRU 2.2.80 R (Loss absorption). The *rules* about *innovative tier one capital* are also relevant as they may result in perpetual non-cumulative *preference shares* being treated as *innovative tier one capital*. Perpetual non-cumulative *preference shares* should be perpetual and redeemable only at the *firm's* option. Perpetual *preference shares* should be non-cumulative if they are to be included at stage B of the calculation in the *capital resources table*. Any feature that, in conjunction with a call, would make a *firm* more likely to redeem perpetual non-cumulative *preference shares* would normally result in classification as an *innovative tier one instrument*. Such features would include, but not be limited to, a *step-up*, bonus *coupon* on redemption or redemption at a premium to the original issue price of the *share*.

2.2.111

R

[deleted]

2.2.112

G

[deleted]

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

2.2.113

PRA

R

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

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

2.2.114

PRA

R

If, in the case of an *insurer*, a *tier one instrument* :

- (1) is redeemable; and

- (2) a reasonable *person* would think that:
  - (a) the *firm* is likely to redeem it; or
  - (b) the *firm* is likely to have an economic incentive to redeem it;

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

2.2.115

PRA

G

Any feature that in conjunction with a call would make an *insurer* more likely to redeem a *tier one instrument* would normally result in classification as *innovative tier one capital resources*. *Innovative tier one instruments* include but are not limited to those incorporating a *step-up* or principal stock settlement.

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

2.2.115A

FCA PRA

R

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

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

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

2.2.115G

FCA PRA

G

An incentive to redeem is a feature of a *capital instrument* that would lead a reasonable market participant to have an expectation that the *firm* will redeem the instrument. The effect of ■ GENPRU 2.2.115F R (2) is that the classification of an instrument that provides an incentive to redeem is always assessed at the date of its issue, and it cannot be reclassified.

#### Other tier one capital: loss absorption

2.2.116

PRA

R

An *insurer* must not include a *capital instrument* that is not a *share* in its *innovative tier one capital resources* unless (in addition to satisfying all the other requirements in relation to *tier one capital* and *innovative tier one capital*) the *firm's* obligations under the instrument either:

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

2.2.116A

FCA PRA

R

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

- (1) do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986; or
- (2) do constitute such a liability but the terms of the instrument are such that:
  - (a) any such liability is not relevant for the purposes of deciding whether:

(i) the *firm* is, or is likely to become, unable to pay its debts;  
or

(ii) its liabilities exceed its assets;

(b) a *person* (including, but not limited to, a holder of the instrument) is not able to petition for the winding up or administration of the *firm* or for any similar procedure in relation to the *firm* on the grounds that the *firm* is or may become unable to pay any such liability; and

(c) the *firm* is not obliged to take into account such a liability for the purposes of deciding whether or not the *firm* is, or may become, insolvent for the purposes of section 214 of the Insolvency Act 1986 (Wrongful trading).

## 2.2.117

FCA PRA

G

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

## 2.2.117A

FCA PRA

R

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

(1) is clearly defined and legally certain;

(2) is disclosed and transparent to the market;

(3) makes the recapitalisation of the *firm* more likely by adequately reducing the potential future outflows to a holder of the *capital instrument* at certain trigger points;

(4) enables the *firm*, at and after the trigger points, to operate the mechanism; and

(5) when initiated, operates in one of the following ways:

(a) the principal of the instrument is written down permanently;  
or

(b) the principal of the instrument is written down temporarily. During the write-down period any *coupon* payable on the

instrument must be cancelled and any related dividend stoppers and pushers must operate in a way that does not hinder recapitalisation; or

- (c) the instrument is converted into *core tier one capital*. The maximum number of *capital instruments* which are *core tier one capital* into which it must be converted must:
  - (i) be determined at the date of its issue;
  - (ii) be determined on the basis of the market value of those other instruments at the date of its issue;
  - (iii) have an aggregate value no more than 150% of its par value; and
  - (iv) not increase if the share price decreases; or
- (d) an alternative process applies which has the same or greater effect on the likelihood of recapitalisation as (a), (b), and (c).

## 2.2.117B

R

FCA PRA

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

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

## 2.2.117C

G

FCA PRA

- (1) The effects of the mechanisms described in ■ GENPRU 2.2.117A R will be more meaningful if they happen immediately after losses cause a significant deterioration of the financial as well as the solvency situation and even before the reserves are exhausted.
- (2) If a *firm* does not operate the loss absorption mechanism in a prudent and timely way, then the *appropriate regulator* may consider using its powers under 55J of the *Act* to, on its own initiative, vary the *firm's Part 4A permission* to require it to operate the mechanism.

2.2.118 **R**  
 FCA PRA

- (1) An *insurer* may not include an *innovative tier one instrument*, unless it is a *preference share*, in its *tier one capital resources* unless it has obtained a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the criteria in ■ GENPRU 2.2.64R (6) (loss absorption) and ■ GENPRU 2.2.80 R to ■ GENPRU 2.2.81 R (Loss absorption) are met.
- (2) A *BIPRU firm* may not include a *capital instrument* at stage B1, B2 or C of the calculation in the *capital resources table* unless it has obtained a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the criteria in ■ GENPRU 2.2.62 R (Tier one capital: General), ■ GENPRU 2.2.64 R (1) to ■ GENPRU 2.2.64 R (9) (General conditions for eligibility as tier one capital) and ■ GENPRU 2.2.80 R to ■ GENPRU 2.2.81 R (Loss absorption) are met.

2.2.118A **G**  
 FCA PRA

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

2.2.119 **G**  
 FCA PRA

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

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

2.2.120 **R**  
 PRA

In the case of an *insurer*, a *tier one instrument* with a cumulative or mandatory *coupon* is an *innovative tier one instrument*.

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

2.2.121 **R**  
 PRA

If, in the case of an insurer:

- (1) a *potential tier one instrument* is or may become subject to a *step-up*; and
- (2) that *potential tier one instrument* is redeemable at any time (whether before, at or after the time of the *step-up*);

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

2.2.122 **G**  
 PRA

See ■ GENPRU 2.2.146 R to ■ GENPRU 2.2.154 G for further *rules* and *guidance* on *step-ups*.

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

2.2.123

R

FCA PRA

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

2.2.124

R

FCA PRA

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

2.2.125

R

FCA PRA

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

2.2.126

R

FCA PRA

For the purpose of ■ GENPRU 2.2, an *SPV* is, in relation to a *BIPRU firm*, any *undertaking* whose main activity is to raise funds for that *firm* or for a *group* to which that *BIPRU firm* belongs.

2.2.127

R

FCA PRA

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

- (1) it is controlled by the *firm* and may not operate independently of the *firm*;
- (2) the rights of investors in the *SPV* who do not belong to the *group* of the *BIPRU firm* in question are not such as to affect the ability of the *firm* to control the *SPV*;
- (3) all or virtually all of its *exposures* (calculated by reference to the amount) consist of *exposures* to the *firm* or to that *firm's group*; and

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

2.2.128

FCA PRA

G

An *SPV* could take the form of a limited partnership. In such an arrangement, holders of a *capital instrument* issued by the *SPV* which do not belong to the *group* of the *BIPRU firm* in question should have no right to participate in the management of the partnership, whether under the partnership's constitutional documents or the transaction documents. In general, this means that they should be treated as limited partners. It is expected that the general partner, having control of the *SPV*, would be the *firm*.

2.2.128A

FCA PRA

R

■ GENPRU 2.2.127 R (4) does not apply if the *firm* has conducted a properly reasoned analysis confirming that any potential risks, including legal and operational risks, associated with cross-border issues, which undermine the quality of the capital for the issuer, that arise from an *SPV* not being incorporated under or governed by the laws and jurisdiction of England and Wales, Scotland or Northern Ireland, are adequately mitigated.

2.2.128B

FCA PRA

R

The analysis must be set out in writing and dated before the date of issue of the *capital instrument* and the *firm* must be able to show that the analysis has been fully considered as part of its decision to proceed with the issue. The analysis must be conducted by a person or persons appropriately qualified to assess the relevant risks and that person may be an independent adviser or an employee of the *firm* who is not part of the business unit responsible for the transaction (including the drafting of the issue documentation).

2.2.129

FCA PRA

R

The *SPV* referred to in ■ GENPRU 2.2.124 R (2)(a) must fund its subscription for the capital issued by the *firm* by the issue of capital that satisfies the following conditions:

- (1) it must comply with the conditions for qualification as *tier one capital*, as amended by ■ GENPRU 2.2.130 R, as if the *SPV* was itself a *firm* seeking to include that capital in its *tier one capital resources*;
- (2) (a) its terms must include an obligation on the *firm* that, in the event of a collapse of the *SPV* structure, and if the mechanism contained within the instrument under ■ GENPRU 2.2.117A R is a conversion, the *firm* must substitute the *capital instrument* issued by the *SPV* with *core tier one capital* issued by the *firm*; and
  - (b) there must be no obstacle to the *firm's* issue of new securities;
- (3) the conversion ratio in respect of the substitution described in (2) must be fixed when the *SPV* issues the *capital instrument*;

- (4) to the extent that investors have the benefit of an obligation by a *person* other than the *SPV*:
- (a) that obligation must be one owed by a member of the *firm's group*; and
  - (b) the extent of that obligation must be no greater than would be permitted by *GENPRU* if that obligation formed part of the terms of a *capital instrument* issued by that member which complied with the *rules* in *GENPRU* relating to *tier one capital* included at stage C of the calculation in the *capital resources table*; and
- (5) if the *SPV* structure collapses, the holder of it has no better a claim against the *firm* than a holder of the same type of instrument directly issued by the *firm*.

2.2.130 **R** For the purpose of ■ GENPRU 2.2.129 R and ■ GENPRU 2.2.132 R, ■ GENPRU 2.2.118 R (Requirement to obtain a legal opinion) does not apply.

FCA PRA

2.2.131 **R** In relation to the obligation to substitute described in ■ GENPRU 2.2.129 R (2), a *firm* must take all reasonable steps to ensure that it has at all times authorised and unissued *capital instruments* which are *core tier one capital* (and the authority to issue them) sufficient to discharge its obligation to substitute.

FCA PRA

2.2.131A **G** ■ GENPRU 2.2.129 R (2) and ■ GENPRU 2.2.131 R allow a *firm* to replace the capital issued by the *SPV* with *capital instrument* which are *core tier one capital*.

FCA PRA

2.2.132 **R** The capital which the *firm* seeks to include in its *capital resources* under ■ GENPRU 2.2.124 R (3)(a) must satisfy the following conditions:

FCA PRA

- (1) it meets the conditions for inclusion in *tier one capital* (subject to ■ GENPRU 2.2.130 R);
- (2) its first call date (if any) must not arise before that on the instrument issued by the *SPV*; and
- (3) its terms relating to repayment must be the same as those of the instrument issued by the *SPV*.

2.2.133 **R** (1) This rule deals with any transaction:

FCA PRA

- (a) under which an *SPV* directly or indirectly funds the subscription for capital issued by the *firm* as described in ■ GENPRU 2.2.124 R; or
- (b) that is directly or indirectly funded by a transaction in (1)(a).

- (2) Each *undertaking* that is a party to a transaction to which this *rule* applies (other than the *firm*) must be a *subsidiary undertaking* of the *firm*.
- (3) Each *SPV* that is a party to a transaction to which this *rule* applies must comply with ■ GENPRU 2.2.127 R.
- (4) Any capital to which (1) applies (other than the capital that is to be included in the *firm's capital resources*) must be in the form of capital that complies with ■ GENPRU 2.2.129 R (1) and ■ GENPRU 2.2.129 R (4), whether or not issued by an *SPV*.
- (5) The obligations in ■ GENPRU 2.2.129 R (2) and ■ GENPRU 2.2.129 R (3) only apply to capital issued by an *SPV* at the end of the chain of transactions beginning with the issue of capital by the *firm* referred to in ■ GENPRU 2.2.124 R.
- (6) ■ GENPRU 2.2.132 R applies to the capital issued by the *firm* as referred to in ■ GENPRU 2.2.124 R. For these purposes references in ■ GENPRU 2.2.132 R to the instrument issued by the *SPV* are to the instrument referred to in (5).

2.2.134

FCA PRA

G

The purpose of ■ GENPRU 2.2.133 R is to deal with a capital-raising under which the capital raised by a special purpose vehicle is passed through a number of *undertakings* before it is invested in the *firm*. If the *capital resources* of the *firm* fall below, or are likely to fall below, its *capital resources requirement* the *firm* should replace the capital issued by that first special purpose vehicle with a *tier one instrument* directly issued by the *firm* which complies with ■ GENPRU 2.2.129 R (2) .

2.2.135

FCA PRA

R

A *firm* which satisfies the conditions for the inclusion of capital set out in ■ GENPRU 2.2.124 R, must, in addition, if that transaction is in any respect unusual, notify the *appropriate regulator* at least one *Month* in advance of the date on which the *firm* intends to include that capital in its *capital resources*.

2.2.136

FCA PRA

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The *appropriate regulator* is likely to consider as unusual a transaction which involves the raising by the *firm* of *tier one capital* through a *subsidiary undertaking* of that *firm* that is not an *SPV*. The *appropriate regulator* would expect a *firm* to request individual *guidance* in such circumstances.

2.2.137

FCA PRA

R

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

- (1) the marketing document for the transaction contains all the information which a reasonable third party would require to understand the transaction fully and its effect on the financial position of the *firm* and its *group*; and

- (2) the information in (1) and the transaction are easily comprehensible without the need for additional information about the *firm* and its *group*.

#### Tier one capital: Conversion ratio

2.2.138

FCA PRA

R

- (1) This *rule* applies to a *potential tier one instrument* if:
- it is redeemable by the *firm* (ignoring ■ GENPRU 2.2.77 R (Meaning of redemption));
  - it provides that if the issuer does not exercise that right or does not do so in specified circumstances the issuer must or may have to redeem it in whole or in part through the issue of *shares* eligible for inclusion in the *firm's tier one capital resources* or the instrument converts or may convert into such *shares*; and
  - GENPRU 2.2.77 R means that the obligation in (1)(b) is treated as not being inconsistent with ■ GENPRU 2.2.70 R (1) (*Tier one capital* should not be redeemable at the option of the holder).
- (2) A *firm* must not include a *potential tier one instrument* to which this *rule* applies in its *tier one capital resources* if:
- the conversion ratio as at the date of redemption may be greater than the conversion ratio as at the time of issue by more than:
    - in the case of a *BIPRU firm*, 150%; and
    - in the case of an *insurer*, 200%; or
  - the market price of the conversion instruments issued in relation to one unit of the original capital item (plus any cash element of the redemption) may be greater than the issue price of that original capital item.
- (3) All determinations under this *rule* are made as at the date of issue of the original capital item.

2.2.139

FCA PRA

R

In ■ GENPRU 2.2.138 R to ■ GENPRU 2.2.142 R:

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

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2.2.140

FCA PRA

R

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

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

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

(2) one unit of the original capital item.

2.2.141

FCA PRA

R

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

2.2.142

FCA PRA

R

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

2.2.143

FCA PRA

G

- (1) The significance of the limitations on conversion in ■ GENPRU 2.2.138 R (2) can be seen in the example in this paragraph, which uses the conversion ratio applicable to an *insurer*.
- (2) An *insurer* issues innovative notes with a par value of £100 each. The terms of the instrument provide that if the instrument is not called at par at the first call date the notes convert into a variable number of ordinary *shares*.
- (3) If the market price of the ordinary *shares* is 400 pence per share on the day of issue of the innovative notes then the maximum number of ordinary *shares* (M) that a single £100 par value innovative note can be converted into is calculated as follows:
  - (a)  $M = \text{Par value of innovative instrument} * 200\% / \text{market value of ordinary share}$ ;
  - (b)  $M = £100 * 2 / £4 = 50 \text{ shares}$ .
- (4) The practical effect is that conversion will result in the holder of an innovative capital note receiving ordinary *shares* equal to the par value of that note only when the market price of the ordinary *shares* remains above half the market price of the *shares* at the date of issue of the notes.
- (5) If the market price of the ordinary *shares* fell by half to 200 pence, the maximum permitted number of *shares* (50) would have to be issued in order to give an investor in the innovative note ordinary *shares* with a market value equal to £100. If the market price of the ordinary *shares* fell below 200 pence, the issue of the maximum permitted number of ordinary *shares* would have a market value below £100.

2.2.144

FCA PRA

G

- (1) In addition to the maximum conversion ratios of 200% for an *insurer* and 150% for a *BIPRU firm*, ■ GENPRU 2.2.138 R (2)(b) does not permit a *firm* to issue *shares* that would have a market value that exceeds the issue price of the instrument being redeemed.
- (2) In the example in ■ GENPRU 2.2.143 G, if the market value of the ordinary *shares* was 250 pence at the conversion date, the maximum number of ordinary *shares* that may be issued to satisfy the redemption of one of the £100 par value innovative notes would be 40 (= £100 / £2.5).

2.2.145

FCA PRA

R

**Tier one capital: Requirement to have sufficient unissued stock**

- (1) This *rule* applies to a *potential tier one instrument* of a *firm* where either:
- (a) the redemption proceeds; or
  - (b) any *coupon* on that capital item;

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

- (2) A *firm* may only include an item of capital to which this *rule* applies in its *tier one capital resources* if the *firm* has authorised and unissued *capital instruments* of the kind in question (and the authority to issue them):
- (a) that are sufficient to satisfy all such payments then due; and
  - (b) are of such amount as is prudent in respect of such payments that could become due in the future.

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

2.2.146

FCA PRA

R

- (1) Where a *rule* in this section says that a particular treatment applies to an item of capital that is subject to a *step-up* of a specified amount, the question of whether that *rule* is satisfied must be judged by reference to the cumulative amount of all *step-ups* since the issue of that item of capital rather than just by reference to a particular *step-up*.
- (2) Where a *step-up* arises through a change from paying a *coupon* on a debt instrument to paying a dividend on a *share* issued in settlement of the *coupon*, any net cost to the *firm* arising from the different tax treatment of the dividend compared to the tax treatment of interest may be ignored for the purpose of assessing the effect of that *step-up*.

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

2.2.147

FCA PRA

R

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

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

2.2.148

FCA PRA

G

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

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

2.2.149

FCA PRA

G

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

2.2.150

FCA PRA

G

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

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

- (a) *stepped-up* floating *coupon* rate = L + 200 less 40bp swap spread (difference between 5.5% and 5.9%) + 100bp step-up = 8.5%
- (b) effective *step-up* from initial rate of 100bp (= 8.5% - 7.5%).

2.2.151

R

FCA PRA

- (1) Subject to (2), if a *tier two instrument* is or may be subject to a *step-up* that does not meet the definition of moderate in the press release of the Basle Committee on Banking Supervision referred to in ■ GENPRU 2.2.147 R (1) as adjusted under ■ GENPRU 2.2.147 R (2), the first date that a *step-up* can take effect is deemed to be its final maturity date if that date is before its actual maturity date.
- (2) If a *tier two instrument*:
  - (a) is or may be subject to a *step-up* during the period beginning on the fifth anniversary of the date of issue of that item and ending immediately before the tenth anniversary of the date of issue; and
  - (b) the *step-up* or possible *step-up* is one which may result in an increase over the initial rate that is greater than 50 basis points, less the swap spread between the initial index basis and the stepped-up index basis (all these terms must be interpreted in accordance with ■ GENPRU 2.2.147 R);

the first date that a *step-up* can take effect is deemed to be its final maturity date if that date is before its actual maturity date.

2.2.152

R

FCA PRA

An instrument does not breach ■ GENPRU 2.2.147 R or as the case may be, is not subject to a deemed maturity date under ■ GENPRU 2.2.151 R, even though it is or may be subject to a *step-up* that exceeds the amount specified in those *rules* if:

- (1) the instrument is fungible with other instruments (the "existing stock") that are included in the *firm's tier one capital resources* (in the case of ■ GENPRU 2.2.147 R) or *tier two capital resources* (in the case of ■ GENPRU 2.2.151 R);
- (2) (if there has been no more than one previous issue of the existing stock) the existing stock complied with those limits on its date of issue;
- (3) (if there has been more than one previous issue of the existing stock) the first such issue of the existing stock complied with those limits on its date of issue; and
- (4) the result of the *step-up* on the instrument to which this *rule* applies is that the *coupon* on that instrument and the *coupon* on the existing stock is the same.

2.2.153 **R**  
FCA PRA

- (1) A *firm* must not include in its *tier one capital resources* a *potential tier one instrument* that is or may become subject to a *step-up* if that *step-up* can arise earlier than the tenth anniversary of the date of issue of that item of capital.
- (2) A *firm* must not include in its *tier two capital resources* a *capital instrument* that is or may become subject to a *step-up* if that *step-up* can arise earlier than the fifth anniversary of the date of issue of that item of capital.

2.2.154 **G**  
FCA PRA

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

#### Deductions from tier one: Intangible assets

2.2.155 **R**  
FCA PRA

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

2.2.156 **G**  
FCA PRA

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

#### Tier two capital: General

2.2.157 **G**  
FCA PRA

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

2.2.158 **G**  
FCA PRA

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

#### General conditions for eligibility as tier two capital instruments

2.2.159 **R**  
FCA PRA

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

- (1) the claims of the creditors must rank behind those of all unsubordinated creditors;
- (2) the only events of default must be non-payment of any amount falling due under the terms of the *capital instrument* or the

- winding-up of the *firm* and any such event of default must not prejudice the subordination in (1);
- (3) to the fullest extent permitted under the laws of the relevant jurisdictions, the remedies available to the subordinated creditor in the event of non-payment or other breach of the terms of the *capital instrument* must (subject to ■ GENPRU 2.2.161 R) be limited to petitioning for the winding-up of the *firm* or proving for the debt in the liquidation or administration;
  - (4) any:
    - (a) remedy permitted by (3);
    - (b) remedy that cannot be excluded under the laws of the relevant jurisdictions as referred to in (3);
    - (c) remedy permitted by ■ GENPRU 2.2.161 R; and
    - (d) terms about repayment as referred to in (5);must not prejudice the matters in (1) and (2) and in particular any damages permitted by (b) or (c) and repayment obligation must be subordinated in accordance with (1);
  - (5) without prejudice to (1), the debt must not become due and payable before its stated final maturity date (if any) except on an event of default complying with (2) or as permitted by ■ GENPRU 2.2.172 R (Repayment at the option of the issuer) or ■ GENPRU 2.2.194 R (2) (Repayment of *lower tier two capital* at the option of the holder) and any remedy described in (4)(a) to (c) must not prejudice this requirement;
  - (6) the debt agreement or terms of the *capital instrument* are governed by the law of England and Wales, or of Scotland or of Northern Ireland;
  - (7) to the fullest extent permitted under the laws of the relevant jurisdictions, creditors must waive their right to set off amounts they owe the *firm* against subordinated amounts included in the *firm's capital resources* owed to them by the *firm*;
  - (8) the terms of the *capital instrument* must be set out in a written agreement that contains terms that provide for the conditions set out in (1) to (7);
  - (9) the debt must be unsecured and fully paid up;
  - (10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9) and, where it applies, ■ GENPRU 2.2.271 R (Other requirements: insurers carrying on with-profits business (Insurer only));

- (11) the amount of the item included must be net of any foreseeable tax charge at the moment of its calculation or must be suitably adjusted in so far as such tax charges reduce the amount up to which that item may be applied to cover risks or losses; and
- (12) the *firm* has obtained a properly reasoned independent legal opinion from an appropriately qualified individual stating that the requirements in (1) to (7) and (insofar as it relates to whether the *capital instrument* is unsecured) (9) have been met.

2.2.160

PRA

R

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

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

2.2.161

FCA PRA

R

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

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

2.2.162

FCA PRA

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

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

2.2.163

FCA PRA

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

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

2.2.164

FCA PRA

G

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

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

2.2.165

FCA PRA

G

For the purposes of ■ GENPRU 2.2.159 R (5) the debt agreement or terms of the instrument should not contain any clause which might require early repayment of the debt (e.g. cross default clauses, negative pledges and restrictive covenants). A cross default clause is a clause which says that the loan goes into default if any of the borrower's other loans go into default. It is intended to prevent one creditor being repaid before other creditors, e.g. obtaining full repayment through the courts. A negative pledge is a clause which puts the loan into default if the borrower gives any further charge over its assets. A restrictive covenant is a term of contract that directly, or indirectly, could lead to early repayment of the debt. Some covenants, e.g. relating to the provision of management information or ownership restrictions, are likely to comply with ■ GENPRU 2.2.159 R (3) as long as monetary redress is ruled out, or any payments are covered by the subordination clauses.

2.2.166

FCA PRA

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

2.2.167

FCA PRA

G

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

2.2.168

FCA PRA

G

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

### Tier two capital instruments: Connected transactions

2.2.169

FCA PRA

R

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

2.2.170

FCA PRA

G

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

### Amendment of tier two instruments

2.2.171

FCA PRA

R

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

- (1) at least one *Month* before the amendment is due to take effect, the *firm* has given the *appropriate regulator* notice in writing of the

proposed amendment and the *appropriate regulator* has not objected; and

- (2) that notice includes confirmation that the legal opinions referred to in ■ GENPRU 2.2.159 R (12) and, if applicable,
  - GENPRU 2.2.163 R (General conditions for eligibility as tier two *capital instruments*: Alternative governing laws) and
  - GENPRU 2.2.181 R (Legal opinions for *upper tier two instruments*), continue in full force and effect in relation to the terms of the debt and documents after any proposed amendment.

**Redemption of tier two instruments**

2.2.172  
FCA PRA

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

2.2.173  
FCA PRA

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

2.2.174  
FCA PRA

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

- (1) in the case of an *insurer*, six *Months*; and
- (2) in the case of a *BIPRU firm*, one *Month*;

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

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

**Tier two capital: step-ups**

2.2.175  
FCA PRA

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

**Upper tier two capital: General**

2.2.176  
FCA PRA

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

- (1) perpetual cumulative *preference shares*;

- (2) perpetual subordinated debt; and
- (3) other instruments that have the same economic characteristics as (1) or (2).

2.2.177

R

FCA PRA

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

- (1) it must have no fixed maturity date;
- (2) the terms of the instrument must provide for the *firm* to have the option to defer any *coupon* on the debt, except that the *firm* need not have that right in the case of a *coupon* payable in the form of an item of capital that is included in the *same stage of capital* or a *higher stage of capital* as that first item of capital;
- (3) the terms of the instrument must provide for the loss-absorption capacity of the *capital instrument* and unpaid *coupons*, whilst enabling the *firm* to continue its business;
- (4) it meets the conditions in ■ GENPRU 2.2.169 R (Connected transactions) and ■ GENPRU 2.2.180 R (Loss absorption); and
- (5) the terms of the instrument are such that either the instrument or debt is not redeemable or repayable or it is repayable or redeemable only at the option of the *firm*.

2.2.178

R

FCA PRA

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

2.2.179

G

FCA PRA

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

2.2.180

FCA PRA

R

**Upper tier two capital: Loss absorption**

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

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

2.2.181

FCA PRA

R

**Upper tier two capital: Legal opinions**

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

2.2.182

FCA PRA

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**Upper tier two capital: Guidance**

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

2.2.183

FCA PRA

G

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

2.2.184

FCA PRA

G

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

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

2.2.185

**R**

FCA PRA

- (1) This *rule* applies to a *BIPRU firm*.
- (2) A *BIPRU firm* must, in relation to equities held in the available-for-sale financial assets category:
  - (a) deduct any net losses at stage E of the calculation in the *capital resources table* (Deductions from tier one capital); and
  - (b) include any net gains (after deduction of deferred tax) in revaluation reserves at stage G of the calculation in the *capital resources table* (Upper tier two capital).
- (3) A *BIPRU firm* must include any net gains, after deduction of deferred tax, on revaluation reserves of investment properties at stage G of the calculation in the *capital resources table*. A *firm* must include any losses on such revaluation reserves in profit and loss account and other reserves.
- (4) A *BIPRU firm* must include any net gains, after deduction of deferred tax, on revaluation reserves of land and buildings at stage G of the calculation in the *capital resources table*. A *firm* must include any losses on such revaluation reserves in profit and loss account and other reserves.
- (5) (2) only applies to a *firm* to the extent that the category of asset referred to in that paragraph exists under the accounting framework that applies to the *firm* as referred to in
  - GENPRU 1.3.4 R (General requirements: accounting principles to be applied).
- (6) (3) and (4) apply to a *firm* whatever the accounting treatment of those items is under the accounting framework that applies to the *firm* as referred to in ■ GENPRU 1.3.4 R.

2.2.186

**G**

FCA PRA

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

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

2.2.187

**R**

FCA PRA

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

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

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

**FCA** **PRA**

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

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

**FCA** **PRA**

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

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

**FCA** **PRA**

**2.2.191** **R** A *BIPRU firm* calculating *risk weighted exposure amounts* under the *IRB approach* may not include in its *capital resources* value adjustments and provisions included in the calculation in ■ BIPRU 4.3.8 R (Treatment of expected loss amounts under the *IRB approach* for *trading book exposures*) or value adjustments and provisions for *exposures* that would otherwise have been eligible for inclusion in general/collective provisions other than in accordance with ■ GENPRU 2.2.190 R.

**FCA** **PRA**

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

**FCA** **PRA**

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

**FCA** **PRA**

#### Lower tier two capital

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

**FCA** **PRA**

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

2.2.195

G

FCA PRA

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

2.2.196

R

FCA PRA

- (1) For the purposes of calculating the amount of a *lower tier two instrument* which may be included in a *firm's capital resources*:
  - (a) in the case of an instrument with a fixed maturity date, in the final five years to maturity; and
  - (b) in the case of an instrument with or without a fixed maturity date but where five years' or more notice of redemption or repayment has been given, in the final five years to the date of redemption or repayment;

the principal amount must be amortised on a straight line basis.
- (2) If a *firm* gives notice of the redemption or repayment of a *lower tier two instrument* and (1) does not apply, the *firm* must no longer include it in its *lower tier two capital resources*.

2.2.197

G

FCA PRA

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

### The effect of swaps on debt capital

2.2.198

R

FCA PRA

■ GENPRU 2.2.198 R to ■ GENPRU 2.2.201 R apply to a *tier one instrument*, *tier two instrument* or *tier three instrument* of a *firm* that is treated as a liability under the accounting framework to which it is subject as referred to in ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied) (a "debt instrument").

2.2.199

R

FCA PRA

A *firm* must recognise for the purpose of this section any effect that changes in exchange rates or interest rates have on a debt instrument (as defined in ■ GENPRU 2.2.198 R) under the accounting framework to which the *firm* is subject as referred to in ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied).

2.2.200

R

FCA PRA

A *firm* must recognise, in accordance with ■ GENPRU 2.2.201 R, the effect of a *foreign currency* hedge on a debt instrument (as defined in ■ GENPRU 2.2.198 R) denominated in a *foreign currency* or of an interest rate hedge on a fixed rate *coupon* debt instrument if:

- (1) the accounting framework to which the *firm* is subject as referred to in ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied) provides for a fair value hedge accounting relationship between a liability and its related hedge;
- (2) such a relationship exists under that accounting framework between that debt instrument and that hedge;
- (3) (if the debt instrument is a *tier one instrument*) the *firm's* obligations under that hedge comply with the conditions in ■ GENPRU 2.2.64 R to ■ GENPRU 2.2.65 R (General conditions for eligibility as tier one capital);
- (4) (if the debt instrument is a *tier two instrument* or an *upper tier three instrument*) the *firm's* obligations under that hedge comply with the conditions in ■ GENPRU 2.2.159 R to ■ GENPRU 2.2.169 R (General conditions for eligibility as tier two capital instruments) as modified, in the case of an *upper tier three instrument*, by ■ GENPRU 2.2.244 R (Application of *tier two capital rules* to *tier three capital debt*) except as follows:
  - (a) ■ GENPRU 2.2.159 R (9) only applies to the extent that it requires that hedge to be unsecured; and
  - (b) ■ GENPRU 2.2.159 R (12) (legal opinion) does not apply.

2.2.201  
FCA PRA

**R** A *firm* must recognise the effect of a hedge as referred to in ■ GENPRU 2.2.200 R by including the net accounting fair value of the hedging instrument in the valuation of the debt instrument (as defined in ■ GENPRU 2.2.198 R).

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

2.2.202  
PRA

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

2.2.203  
PRA

**R** A *qualifying holding* is a direct or indirect holding of a *bank* or *building society* in a non-financial *undertaking* which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that *undertaking*.

2.2.204  
PRA

**R** For the purpose of ■ GENPRU 2.2.203 R, a non-financial *undertaking* is an *undertaking* other than:

- (1) a *credit institution* or *financial institution*;
- (2) an *undertaking* whose exclusive or main activities are a direct extension of banking or concern services ancillary to banking,

such as leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity; or

(3) an *insurer*.

2.2.205

PRA

R

The amount of *qualifying holdings* that a *bank* or *building society* must deduct in the calculation in the *capital resources table* is:

- (1) (if the *firm* has one or more *qualifying holdings* that exceeds 15% of its relevant *capital resources*) the sum of such excesses; and
- (2) to the extent not already deducted in (1), the amount by which the sum of each of that *firm's qualifying holdings* exceeds 60% of its relevant *capital resources*.

2.2.206

PRA

R

The relevant *capital resources* of a *firm* mean for the purposes of this *rule* the sum of the amount of *capital resources* calculated at stages L (Total tier one capital plus tier two capital) and Q (Total tier three capital) of the calculation in the *capital resources table* as adjusted in accordance with the following:

- (1) the *firm* must not take into account the items referred to in any of the following:
  - (a) ■ GENPRU 2.2.190 R to ■ GENPRU 2.2.193 R (surplus provisions); or
  - (b) ■ GENPRU 2.2.236 R (*expected loss* amounts and other negative amounts); or
  - (c) ■ GENPRU 2.2.237 R (*securitisation positions*);
- (2) the *firm* must make the deductions to be made at stage S of the calculation in the *capital resources table* (Deductions from total capital); and
- (3) the *firm* need not deduct any *excess trading book position* under (2).

2.2.207

PRA

R

The following are not included as *qualifying holdings*:

- (1) *shares* that are not held as investments; or
- (2) *shares* that are held temporarily during the normal course of underwriting; or
- (3) *shares* held in a *firm's* name on behalf of others.

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

2.2.208

R

FCA PRA

2.2.209

R

FCA PRA

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

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

- (ii) a *financial institution* the principal activity of which is to perform any activity other than the acquisition of holdings in other *undertakings*;
- (c) the relevant proportion of the Venture Capital Investor is included in the *firm's UK consolidation group* in accordance with ■ BIPRU 8.5; and
- (d) the *firm* assigns a *risk weight* to its *exposure* to the Venture Capital Investor as if it were an *equity exposure* to which the simple *risk weight* approach is applied as set out in ■ BIPRU 4.7.9 R to ■ BIPRU 4.7.12 R (and in calculating its *capital resources requirement* the *firm* must assign a *risk weight* to that *exposure* in accordance with those *rules* and notwithstanding that those *rules* would not otherwise apply to that calculation);

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

- (3) If a *BIPRU firm* holds *shares* in the capital of a *subsidiary undertaking* which is a *financial institution* solely by reason of its principal activity being the acquiring of holdings and which in turn holds (directly or indirectly) *shares* in the capital of a Venture Capital Investor (in this section and its related annexes, a "Venture Capital Holding Company") and the following conditions are met:
  - (a) the Venture Capital Investor meets the conditions in (2)(a) and (b);
  - (b) the Venture Capital Holding Company is included in the *firm's UK consolidation group* in accordance with ■ BIPRU 8.5;
  - (c) the proportion of the value of the Venture Capital Holding Company attributable to investment in Venture Capital Investors and the proportion of the value of the Venture Capital Holding Company attributable to investment in other investments can be identified and valued on a regular basis; and
  - (d) the *firm* assigns a *risk weight* to its *exposure* to the proportion of the Venture Capital Holding Company that represents the value of its investment in Venture Capital Investors as if it were an *equity exposure* to which the simple *risk weight* approach is applied as set out in ■ BIPRU 4.7.9 R to ■ BIPRU 4.7.12 R (and in calculating its *capital resources requirement* the *firm* must assign a *risk weight* to that *exposure* in accordance with those *rules* and notwithstanding that those *rules* would not otherwise apply to that calculation);

the proportion of the *firm's* investment in the Venture Capital Holding Company that represents the value of its investment in Venture Capital Investors may be ignored for the purposes of

- determining whether there is a *material holding*. The proportion of the *firm's* investment in the Venture Capital Holding Company that represents the value of other investments is a *material holding*.
- 2.2.210** FCA PRA G For the purpose of the definition of a *material holding*, *share capital* includes *preference shares*. *Share premium* should be taken into account when determining the amount of *share capital*.
- 2.2.211** FCA PRA R When calculating the size of its *material holdings* a *firm* must only include an actual holding (that is, a long cash position). A *firm* must not net such holdings with a short position.
- 2.2.212** FCA PRA R A *material insurance holding* means the holdings of a *BIPRU firm* of items of the type set out in ■ GENPRU 2.2.213 R in any:
- (1) *insurance undertaking*; or
  - (2) *insurance holding company*;
- that fulfils one of the following conditions:
- (3) it is a *subsidiary undertaking* of that *firm*; or
  - (4) that *firm* holds a *participation* in it.
- 2.2.213** FCA PRA R An item falls into this provision for the purpose of ■ GENPRU 2.2.212 R if it is:
- (1) an *ownership share*; or
  - (2) subordinated debt or another item of capital that falls into Article 16(3) of the *First Non-Life Directive* or, as applicable, Article 27(3) of the *Consolidated Life Directive*.
- 2.2.214** FCA PRA R The amount to be deducted with respect to each *material insurance holding* is the higher of:
- (1) the book value of the *material insurance holding*; and
  - (2) the *solo capital resources requirement* for the *insurance undertaking* or *insurance holding company* in question calculated in accordance with Part 3 of ■ GENPRU 3 Annex 1 R (Method 3 of the capital adequacy calculations for financial conglomerates).
- 2.2.215** FCA PRA R For the purpose of the definition of a *material holding*, holdings must be valued using the valuation method which the holder uses for its external financial reporting purposes.

## 2.2.216

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FCA PRA

- (1) This paragraph gives *guidance* on how the calculation under ■ GENPRU 2.2.214 R (1) should be carried out where an *insurance undertaking* is accounted for using the embedded value method.
- (2) On acquisition, any "goodwill" element (that is, the difference between the acquisition value according to the embedded value method and the actual investment) should be deducted from *tier one capital resources*.
- (3) The embedded value should be deducted from the total of *tier one capital resources* and *tier two capital resources*.
- (4) Post-acquisition, where the embedded value of the *undertaking* increases, the increase should be added to reserves, while the new embedded value is deducted from total *capital resources*.
- (5) This means that the net impact on the level of total *capital resources* is zero, although *tier two capital resources* headroom will increase with any increase in *tier one capital resources* reserves.
- (6) Embedded value is the value of the *undertaking* taking into account the present value of the expected future inflows from existing life assurance business.

## 2.2.216A

G

PRA

- (1) This paragraph gives *guidance* as to the amount to be deducted at Part 2 of stage M (Deductions from the totals of tier one and two) of ■ GENPRU 2 Annex 2 R (Capital resources table for a bank) and ■ GENPRU 2 Annex 3 R (Capital resources table for a building society) in respect of investments in *subsidiary undertakings* and *participations* (excluding any amount which is already deducted as *material holdings* or *qualifying holdings*).
- (2) The effect of those *rules* is to achieve the deduction of all investments in *subsidiary undertakings* and *participations* for *banks* and *building societies* by ensuring that amounts not already deducted under other *rules* are accounted for at this stage of the calculation of *capital resources*, except where the investment has been made in:
  - (a) a Venture Capital Investor and the conditions in ■ GENPRU 2.2.209R (2) are met; or
  - (b) a Venture Capital Holding Company and the conditions in ■ GENPRU 2.2.209R (3) are met;
- (3) The following investments in *subsidiary undertakings* and *participations* should be deducted at this stage:
  - (a) those not deducted in Part 1 of stage M because of the operation of the thresholds in ■ GENPRU 2.2.205 R (on qualifying holdings) and ■ GENPRU 2.2.209 R (on material holdings); and
  - (b) those which do not meet the definition of *qualifying holding* or *material holding*, but excluding investments in Venture Capital Investors which are ignored in accordance with ■ GENPRU 2.2.209R (2) and investments in Venture Capital Holding Companies which are ignored in accordance with ■ GENPRU 2.2.209R (3), for the purposes of determining whether there is a *material holding*.

- (4) For example, an investment in an *undertaking* which is not a *qualifying holding* under ■ GENPRU 2.2.204 R (2) (on the definition of a non-financial undertaking), that is whose exclusive or main activities are a direct extension of banking or concern services ancillary to banking, such as leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity, should be deducted at this stage.

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

2.2.217 R

FCA PRA

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

2.2.218 R

FCA PRA

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

2.2.219 R

FCA PRA

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

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

that satisfies the following conditions:

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

2.2.220 R

FCA PRA

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

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

- 2.2.221 **R** (1) ■ GENPRU 2.2.221 R to ■ GENPRU 2.2.235 G only apply to a bank.  
**PRA**
- (2) If a *firm* has elected to ignore an investment in a Venture Capital Investor or a Venture Capital Holding Company in accordance with ■ GENPRU 2.2.209R (2) or ■ (3), for the purposes of determining whether there is a *material holding*, ■ GENPRU 2.2.221 R to ■ GENPRU 2.2.233 R do not apply to any lending by the *firm* to that Venture Capital Investor or Venture Capital Holding Company, provided that any lending to the Venture Capital Holding Company is made to and deployed by the *firm* solely in connection with the Venture Capital Investor.
- 2.2.222 **R** *Connected lending of a capital nature* means all lending within  
**PRA** ■ GENPRU 2.2.227 R or ■ GENPRU 2.2.229 R and guarantees within ■ GENPRU 2.2.231 R or ■ GENPRU 2.2.233 R.
- 2.2.223 **R** A *bank* must not deduct any item as *connected lending of a capital nature*  
**PRA** to the extent that it falls to be deducted at Part 1 of stage M of the calculation in the *capital resources table* (Deductions for *material holdings*, *qualifying holdings* and certain other items) or as a *reciprocal cross-holding*.
- 2.2.224 **R** For the purpose of the *rules* in this section about *connected lending of a*  
**PRA** *capital nature* and in relation to a *bank*, a connected party means another *person* ("P") who fulfils at least one of the following conditions and is not solo-consolidated with the *bank* under ■ BIPRU 2.1 (Solo consolidation):
- (1) P is *closely related* to the *bank*; or
  - (2) P is an *associate* of the *bank*; or
  - (3) the same *persons* significantly influence the *governing body* of P and the *bank*.
- 2.2.225 **R** For the purpose of ■ GENPRU 2.2.224 R, in relation to a *person* ("P") to  
**PRA** which a *bank* has an *exposure* when P is acting on his own behalf and also an *exposure* to P when P acts in his capacity as a trustee, custodian or general partner of an investment trust, unit trust, venture capital or other investment fund, pension fund or similar fund (a "fund") the *bank* may choose to treat this latter *exposure* as an *exposure* to the fund, unless such treatment would be misleading.
- 2.2.226 **G** ■ BIPRU 10.3.13 G (*Guidance* on exposures to trustees) applies to ■ GENPRU 2.2.225 R .  
**PRA**

2.2.227

PRA

R

A loan is *connected lending of a capital nature* if:

- (1) it is made by the *bank* to a connected party; and
- (2) it falls into ■ GENPRU 2.2.228 R.

2.2.228

PRA

R

A loan falls into this *rule* for the purposes of ■ GENPRU 2.2.227 R (2) if, whether through contractual, structural, reputational or other factors:

- (1) based on the terms of the loan and the other knowledge available to the *bank*, the borrower would be able to consider it from the point of view of its characteristics as capital as being similar to *share* capital or subordinated debt; or
- (2) the position of the lender from the point of view of maturity and repayment is inferior to that of the senior unsecured and unsubordinated creditors of the borrower.

2.2.229

PRA

R

A loan is also *connected lending of a capital nature* if:

- (1) it funds directly or indirectly a loan to a connected party of the *bank* falling into ■ GENPRU 2.2.228 R or an investment in the capital of a connected party of the *bank*; and
- (2) it falls into ■ GENPRU 2.2.228 R.

2.2.230

PRA

G

It is likely that a loan is not *connected lending of a capital nature* if:

- (1) it is secured by collateral that is eligible for the purposes of *credit risk mitigation* under the *standardised approach* to credit risk as set out in ■ BIPRU 5.4 (Financial collateral) and ■ BIPRU 5.5 (Other funded credit risk mitigation); or
- (2) it is repayable on demand (and should be treated as such for accounting purposes by the borrower and lender) and the *bank* can demonstrate that there are no potential obstacles to exercising the right to repay, whether contractual or otherwise.

2.2.231

PRA

R

A guarantee is *connected lending of a capital nature* if it is a guarantee by the *bank* of a loan from a third party to a connected party of the *bank* and:

- (1) the loan meets the requirements of ■ GENPRU 2.2.228 R; or
- (2) the rights that the *bank* would have against the borrower with respect to the guarantee meet the requirements of ■ GENPRU 2.2.228 R (2).

**2.2.232** **R** A guarantee is also *connected lending of a capital nature* if it is a guarantee  
**PRA** by the *bank* of a loan falling into ■ GENPRU 2.2.229 R (1); and

- (1) the loan meets the conditions in ■ GENPRU 2.2.228 R; or
- (2) the guarantee meets the conditions in ■ GENPRU 2.2.231 R (2).

**2.2.233** **R** The amount of a guarantee that constitutes *connected lending of a capital*  
**PRA** *nature* that a *firm* must deduct is the amount guaranteed.

**2.2.234** **G** A loan may initially fall outside the definition of *connected lending of a capital nature*  
**PRA** but later fall into it. For example, if the initial lending to a connected party is subsequently  
downstreamed to another connected party the relationship between the *bank* and the  
ultimate borrower may be such that, looking at the arrangements as a whole, the  
*undertaking* to which the *bank* lends is able to regard the loan to it as being capable of  
absorbing losses.

**2.2.235** **G** Lending to a connected party will not normally be *connected lending of a capital nature*  
**PRA** where that party:

- (1) is acting as a vehicle to pass funding to an unconnected party; and
- (2) has no other creditors whose claims could be senior to those of the lender.

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

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

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

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

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

- (1) the exposure amount of *securitisation positions* which receive a *risk weight* of 1250% under ■ BIPRU 9 (Securitisation), unless the *firm* includes the *securitisation positions* in its calculation of *risk*

*weighted exposure amounts* (see ■ BIPRU 9.10 (Reduction in risk-weighted exposure amounts)); and

- (2) the exposure amount of *securitisation positions* in the *trading book* that would receive a *risk weight* of 1250% if they were in the *firm's non-trading book*.

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

2.2.238

FCA PRA

R

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

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

2.2.239

FCA PRA

R

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

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

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

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

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

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

2.2.240

PRA PRA

G

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

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

2.2.241 **R**

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

**FCA PRA**

2.2.242 **R**

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

**FCA PRA**

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

2.2.243 **R**

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

**FCA PRA**

2.2.244 **R**

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

**FCA PRA**

2.2.245 **R**

Table: Application of tier two capital rules to tier three debt

**FCA PRA**

This table belongs to ■ GENPRU 2.2.244 R

<i>Tier two capital rule</i>	<i>Adjustment</i>
<b>GENPRU 2.2.159 R (General conditions for eligibility as tier two capital)</b>	<p>The references in <b>GENPRU 2.2.159 R (5)</b> (Capital must not become repayable prior to stated maturity date except in specified circumstances) to repayment at the option of the holder are replaced by a reference to <b>GENPRU 2.2.242 R (1)</b> (<i>Upper tier three capital</i> should have maturity or notice period of at least two years)</p> <p>The reference in <b>GENPRU 2.2.159 R (10)</b> (Description of <i>tier two capital</i> in marketing documents) to <b>GENPRU 2.2.271 R (Other requirements: insurers carrying on with-profits business (Insurer only))</b> does not apply</p>
<b>GENPRU 2.2.160 R (Holder of a non-deferred share of a <i>building society</i> to be treated as a senior creditor)</b>	

<i>Tier two capital rule</i>	Adjustment
GENPRU 2.2.161 R (Additional remedies)	
GENPRU 2.2.163 R (Legal opinion where debt subject to a law of a country outside the <i>United Kingdom</i> )	
GENPRU 2.2.169 R (Ineligibility as <i>tier two capital</i> owing to connected transactions)	The reference to GENPRU 2.2.177 R (General eligibility conditions for <i>upper tier two capital</i> ) does not apply
GENPRU 2.2.171 R (Amendments to terms of the <i>capital instrument</i> )	
GENPRU 2.2.172 R to GENPRU 2.2.173 R (Redeemability at the option of the issuer)	
GENPRU 2.2.174 R (Notification of redemption)	
References in the <i>rules</i> in the first column to the fifth anniversary are amended so as to refer to the second anniversary.	

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

2.2.246  
FCA PRA  
 2.2.247  
FCA PRA

**R** ■ GENPRU 2.2.246 R to ■ GENPRU 2.2.249 R only apply to a *BIPRU firm*.

**R** A *BIPRU firm's* net interim *trading book* profits mean its net *trading book* profits adjusted as follows:

- (1) they are net of any foreseeable charges or dividends and less net losses on its other business; and
- (2) a *firm* must not take into account items that have already been included in the calculation of *capital resources* as part of the calculation of the following items:
  - (a) interim net profits (see stage (A) of the *capital resources table*); or
  - (b) interim net losses or material interim net losses (see stage (A) of the *capital resources table*); or
  - (c) profit and loss and other reserves (see stage (A) of the *capital resources table*).

2.2.248  
FCA PRA

**R** *Trading book* profits and losses, other than those losses to which ■ GENPRU 2.2.86 R (2) (Valuation adjustment and reserves) refers, originating from valuation adjustments or reserves as referred to in

2.2.249  
FCA PRA

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■ GENPRU 1.3.29 R to ■ GENPRU 1.3.35A G (Valuation adjustments or reserves) must be included in the calculation of net interim *trading book* profits and be added to or deducted from *tier three capital resources*.

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

**Deductions from total capital: Inadmissible assets (insurers only)**

2.2.250  
PRA

R

■ GENPRU 2.2.250 R to ■ GENPRU 2.2.253 G only apply to an *insurer*.

2.2.251  
PRA

R

For the purposes of the *capital resources table*, an *insurer* which is not a *pure reinsurer* must deduct from total *capital resources* the value of any asset which is not an *admissible asset* as listed in ■ GENPRU 2 Annex 7 R (Admissible assets in insurance), unless the asset is held to cover *property-linked liabilities* or *index-linked liabilities* under ■ INSPRU 3.1.57 R or ■ INSPRU 3.1.58 R (Covering linked liabilities).

2.2.252  
PRA

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■ GENPRU 2.2.251 R does not apply to intangible assets which should be deducted from *tier one capital resources* under ■ GENPRU 2.2.155 R (Deductions from tier one: Intangible assets).

2.2.253  
PRA

G

The list of *admissible assets* has been drawn with the aim of excluding assets:

- (1) for which a sufficiently objective and verifiable basis of valuation does not exist; or
- (2) whose realisability cannot be relied upon with sufficient confidence; or
- (3) whose nature presents an unacceptable custody risk; or
- (4) the holding of which may give rise to significant liabilities or onerous duties.

**Deductions from total capital: Adjustments for related undertakings**

2.2.254  
PRA

R

■ GENPRU 2.2.254 R to ■ GENPRU 2.2.258 G only apply to an *insurer*.

2.2.255  
PRA

R

An *insurer* must deduct from its *capital resources* the value of its investments in each of its *related undertakings* that is an *ancillary services undertaking*.

PAGE 95  
2.2.256  
PRA

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In relation to each of its *related undertakings* that is a *regulated related undertaking* (other than an *insurance undertaking*) an *insurer* must add to (if positive), at stage J in the *capital resources table* (Positive adjustments for related undertakings), or deduct from (if negative), at stage L in the *capital resources table* (Deductions from total capital), its *capital resources*

the value of its *shares* in that *undertaking* calculated in accordance with ■ GENPRU 1.3.47 R (Shares in and debts due from related undertakings).

2.2.257  
PRA

G

For the purposes of ■ GENPRU 2.2.255 R, investments must be valued at their accounting book value in accordance with ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied).

2.2.258  
PRA

G

*Related undertakings* which are also *insurance undertakings* are not included in ■ GENPRU 2.2.256 R because an *insurer* that is a *participating insurance undertaking* is subject to the requirements of ■ INSPRU 6.1 (Group Risk: Insurance Groups).

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

2.2.259  
FCA PRA

R

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

2.2.260  
FCA PRA

R

*Illiquid assets* means illiquid assets including

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

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

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

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

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

- 2.2.264** PRA R
- (1) The *excess trading book position* is the excess of:
    - (a) a *bank* or *building society's* aggregate net long (including notional) *trading book positions* in *shares*, subordinated debt or any other interest in the capital of *credit institutions* or *financial institutions*;
    - over;
    - (b) 25% of that *firm's capital resources* calculated at stage T (Total capital after deductions) of the *capital resources table* (calculated before deduction of the *excess trading book position*).

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

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

**Other capital resources: Unpaid share capital or initial funds and calls for supplementary contributions (Insurer only)**

**2.2.266** PRA G ■ GENPRU 2.2.266 G to ■ GENPRU 2.2.269 G only apply to an *insurer*.

**2.2.267** PRA G Unpaid *share* capital or, in the case of a *mutual*, *unpaid initial funds* and calls for supplementary contributions are excluded from the *capital resources* of a *firm* except to the extent allowed in a *waiver* under section 138A of the *Act* (Modification or waiver of rules).

**2.2.268** PRA G Subject to a *waiver*, under the *Insurance Directives* a maximum of one half of unpaid *share capital* or, in the case of a *mutual*, one half of the *unpaid initial fund* may be included in an *insurer's capital resources*, once the paid-up part amounts to 25% of that *share capital* or fund, up to 50% of total *capital resources*.

**2.2.269** PRA G In the case of a *mutual* carrying on *general insurance business* and subject to a *waiver*, calls for supplementary contributions within the *financial year* may only be included in a *firm's capital resources* up to a maximum of 50% of the difference between the maximum contributions and the contributions actually called in, subject to a limit of 50% of total *capital resources*. In the case of a *mutual* carrying on *long-term insurance business*, the *Consolidated Life Directive* does not permit calls for supplementary contributions to be included in a *firm's capital resources*.

**Other requirements: insurers carrying on with-profits business (Insurer only)**

**2.2.270** FCA PRA R ■ GENPRU 2.2.270 R to ■ GENPRU 2.2.275 G only apply to an *insurer*.

**2.2.270A** FCA PRA G ■ GENPRU 2.2.271 R to ■ GENPRU 2.2.272 G and ■ GENPRU 2.2.274 G are made by both the *PRA* and *FCA* for the purpose of applying these provisions to *insurers* pursuant to the *statutory objectives*.

**2.2.271** FCA PRA R An *insurer* carrying on *with-profits insurance business* must, in addition to the other requirements in respect of *capital resources* elsewhere in ■ GENPRU 2.2, meet the following conditions before a *capital instrument* can be included in that *insurer's capital resources*:

- (1) the *insurer* must manage the *with-profits fund* so that discretionary benefits under a *with-profits insurance contract* are calculated and paid disregarding, insofar as is necessary for its *customers* to be treated fairly, any liability the *firm* may have to make payments under the *capital instrument*;
- (2) the intention to manage the *with-profits fund* on the basis set out in (1) must be disclosed in the *firm's Principles and Practices of Financial Management*; and
- (3) no amounts, whether interest, principal, or other amounts, must be payable by the *firm* under the *capital instrument* if the *firm's* assets would then be insufficient to enable it to declare and pay under a *with-profits insurance contract* discretionary benefits that are consistent with the *firm's* obligations under the *FCA's Principle 6 (Customers' interests)*.

**2.2.272** FCA PRA G The purpose of ■ GENPRU 2.2.271 R is to achieve practical subordination of *capital instruments* if they are to qualify as *capital resources* to the liabilities an *insurer* has to *with-profits policyholders*, including liabilities which arise from the regulatory duty (as regulated by the *FCA*) to treat *customers* fairly in setting discretionary benefits. (*FCA's Principle 6 (Customers' interests)* requires a *firm* to pay due regard to the interests of its customers and treat them fairly.) It is not sufficient for a *capital instrument* to be subordinated to such liabilities only on winding up of the *firm* because

such liabilities to *policyholders* may have been reduced by the inappropriate use of management discretion to enable funds to be applied in repaying subordinated *capital instruments* before winding up proceedings commence.

2.2.273

PRA

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■ GENPRU 2.2.271 R is an additional requirement to all other *rules* in this section concerning the eligibility of a *capital instrument* to count as a component of an *insurer's capital resources*. Subordinated debt instruments will be the main type of *capital instrument* to which this *rule* is relevant, including both *upper tier two* (undated) and *lower tier two* (dated) subordinated debt instruments. Subordinated debt instruments which are issued by a *related undertaking* are not intended to be covered by this *rule* and may be included in *group capital resources* as appropriate if the other eligibility criteria are met.

2.2.274

FCA PRA

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■ GENPRU 2.2.64 R (10) and ■ GENPRU 2.2.159 R (10) contain provisions concerning the marketing of a *capital instrument*. In relation to a *firm* to which ■ GENPRU 2.2.271 R applies, in order to comply with ■ GENPRU 2.2.64 R (10) and ■ GENPRU 2.2.159 R (10), it should draw to the attention of subscribers the risk that payments may be deferred or cancelled in order to operate the *with-profits fund* so as to give priority to the payment of discretionary benefits to *with-profits policyholders*.

2.2.275

PRA

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- (1) *Upper tier two instruments* should meet the requirements of ■ GENPRU 2.2.177 R (3) which goes beyond the requirement in ■ GENPRU 2.2.271 R (3) since it requires a *firm* to have the option to defer payments in all circumstances, not just if necessary to treat *customers* fairly. However, for *lower tier two instruments*, ■ GENPRU 2.2.271 R (3) represents an additional requirement since a failure to pay amounts of interest or principal on a due date must not constitute an event of default under ■ GENPRU 2.2.159 R (2) for *firms* carrying on *with-profits insurance business*.
- (2) For *firms* which are *realistic basis life firms* compliance with ■ GENPRU 2.2.271 R (3) would usually be achieved if the *capital instrument* provides that no amounts will be payable under it unless the *firm's capital resources* exceed its *capital resources requirement*. However, such *firms* should ensure that the terms of the *capital instrument* refer to *capital resources requirements* in force from time to time, including the current realistic reserving requirements and are not restricted to former minimum capital requirements based only on the *Insurance Directives'* required minimum margin of solvency. For *firms* which are not *realistic basis life firms*, compliance with ■ GENPRU 2.2.271 R (3) will probably require specific reference to be made to treating *customers* fairly in the terms of the *capital instrument*.

**Public sector guarantees**

2.2.276

FCA PRA

R

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

## 2.3 Application of GENPRU 2 to Lloyd's

### Application of GENPRU 2.1

2.3.1 **R** ■ GENPRU 2.1 applies to the *Society* in accordance with ■ INSPRU 8.1.2 R.

PRA

2.3.2 **R** ■ GENPRU 2.1.38 R to ■ GENPRU 2.2.39 G apply to *managing agents* in accordance with ■ INSPRU 8.1.4 R.

PRA

2.3.3 **G** ■ GENPRU 2.1.13 R requires the *Society* to ensure, in relation to each *member's insurance business*, that *capital resources* equal to or in excess of the *member's capital resources* requirement (CRR) are maintained. ■ GENPRU 2.1 sets out the overall framework of the CRR. ■ INSPRU 1.1 sets out the calculation of the components of the *general insurance capital requirement* and the *long-term insurance capital requirement*.

PRA

2.3.4 **G** *Managing agents* are required to calculate the ECR for the purposes of carrying out *syndicate ICAs* under ■ INSPRU 7.1. As *with-profits insurance business* is not carried on through any *syndicate*, the calculation of the *with-profits insurance capital component* will not be applicable. ■ INSPRU 1.3 is not applied to Lloyd's.

PRA

### Calculation of the MCR

2.3.5 **R** For the purposes of ■ GENPRU 2.1.24 R, the *Society* must calculate the MCR in respect of the *general insurance business* of each *member* as the higher of:

PRA

- (1) the *member's share* of the *base capital resources requirement* in respect of *general insurance business* for the *members* in aggregate; and
- (2) the *general insurance capital requirement* for the *members*, calculated according to ■ GENPRU 2.3.11 R.

2.3.6 **R** For the purposes of ■ GENPRU 2.3.5 R (1), the *Society* must determine the *member's share* by apportioning the *base capital resources requirement* in respect of *general insurance business* for the *members* in aggregate between *members* in proportion to the result for each *member* of ■ GENPRU 2.3.11 R.

PRA

2.3.7

PRA

R

For the purposes of ■ GENPRU 2.1.25 R, the *Society* must calculate the MCR in respect of the *long-term insurance business* of each *member* as the higher of:

- (1) the *member's* share of the *base capital resources requirement* in respect of *long-term insurance business* for the *members* in aggregate; and
- (2) the sum of, for each *member*:
  - (a) the *long-term insurance capital requirement*; and
  - (b) the *resilience capital requirement*.

2.3.8

PRA

R

For the purposes of ■ GENPRU 2.3.7 R (1), the *Society* must determine the *member's* share by applying to the aggregate long-term business *base capital resources requirement* the ratio of the result for the *member* of ■ GENPRU 2.3.7 R (2) to the aggregate of the results of ■ GENPRU 2.3.7 R (2) for all *members*.

#### Calculation of the base capital resources requirement

2.3.9

PRA

R

The amount of the *base capital resources requirement* for the *members* in aggregate is:

- (1) for *general insurance business*, € 3.7 million; and
- (2) for *long-term insurance business*, € 3.7 million.

#### Calculation of the general insurance capital requirement

2.3.10

PRA

R

For the purposes of ■ GENPRU 2.1.34 R, the *Society* must calculate the *general insurance capital requirement* for the *members* in aggregate as the higher of:

- (1) the aggregate for all *members* of the higher of, for each *member*, the result of the *premiums amount* and the *claims amount*; and
- (2) the *brought forward amount*.

2.3.11

PRA

R

The *Society* must determine the *general insurance capital requirement* for each *member* by apportioning the result of ■ GENPRU 2.3.10 R between *members* on a fair and reasonable basis, provided that the *general insurance capital requirement* for a *member* must not be less than the higher of the result of the *premiums amount* and the *claims amount* for that *member*.

2.3.12

PRA

G

The *Society* should calculate the *premiums amount* and the *claims amount* for each *member* on the basis of the *member's* own *general insurance business*, including *insurance business* that attaches to the reinsuring *member* for the purposes of GENPRU following an *approved reinsurance to close* (see ■ INSPRU 8.2.16 R).

**2.3.13** **R** The *Society* must calculate the *general insurance capital requirement* it would have to determine under ■ GENPRU 2.1.34 R if it were an *insurer* carrying on all the *general insurance business* carried on by its *members*, but eliminating *inter-syndicate reinsurance* (the *Society GICR*).

**2.3.14** **G** For the purpose of ■ GENPRU 2.3.13 R the *Society* may make appropriate approximations, taking reasonable care to avoid underestimating the *Society GICR*.

**2.3.15** **R** The *Society* must determine each *member's* share of the *Society GICR* by allocating the *Society GICR* between the *members* in proportion to the result for each *member* of ■ GENPRU 2.3.11 R.

**Application of GENPRU 2.2**

**2.3.16** **R** Subject to ■ GENPRU 2.3.18 R, ■ GENPRU 2.3.19 R and ■ GENPRU 2.3.21 R, ■ GENPRU 2.2 applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, ■ INSPRU 8.1.4 R; and
- (2) for the *Society*, ■ INSPRU 8.1.2 R.

**2.3.17** **G** ■ GENPRU 2.1 sets out minimum *capital resources requirements* for a *firm* and for Lloyd's *members*. ■ GENPRU 2.2 sets out how, for the purpose of these requirements, *capital resources* are defined and measured. ■ GENPRU 2.2 applies:

- (1) to *managing agents* for their calculation of the *capital resources* managed by them in respect of each *syndicate* they manage (by reference, where there is a change in the underlying capital provision, to each open *syndicate* year); and
- (2) to the *Society* for its calculation of:
  - (a) each *member's capital resources*; and
  - (b) its own *capital resources*.

**2.3.18** **R** ■ GENPRU 2.2.32 R to ■ GENPRU 2.2.41 R (Limits on the use of different forms of capital) do not apply to *managing agents*.

**2.3.19** **R** ■ GENPRU 2.2.32 R to ■ GENPRU 2.2.41 R (Limits on the use of different forms of capital) do apply to the *Society* with respect to:

- (1) the *capital resources* requirements for the *members* in aggregate; and
- (2) the aggregate *capital resources* supporting the *insurance business* of all the *members*.

2.3.20

PRA

**R** ■ GENPRU 2.2.74 R does not apply to the *Society* or to *managing agents*.

2.3.21

PRA

**R** In this section ( ■ GENPRU 2.3), "the aggregate *capital resources* supporting the *insurance business* of all the *members*" are:

- (1) the aggregate of all the *members' capital resources* calculated under ■ GENPRU 2.3.25 R; and
- (2) the *Society's capital resources* excluding callable contributions.

**Calculation of capital resources**

2.3.22

PRA

**R** The *capital resources table* applies with the modifications that:

- (1) *Core tier one capital* includes *Lloyd's members' contributions* in accordance with ■ GENPRU 2.3.34 R, subject, in the case of letters of credit, guarantees and verifiable sums arising out of life assurance policies, to compliance with ■ GENPRU 1.5.8 G to ■ GENPRU 1.5.12 R; and
- (2) the *Society* may also recognise and value *callable contributions*, pursuant to ■ GENPRU 2.3.24 R.

2.3.23

PRA

**G** *Lloyd's member's contributions* are *admissible assets* under ■ GENPRU 2.3.34 R and include letters of credit, guarantees and verifiable sums arising out of life assurance policies held as *funds at Lloyd's*. Assets that may be valued as part of *capital resources* under PRU are not necessarily, however, permitted investments for *members* under the terms of any *Lloyd's trust deed*.

2.3.24

PRA

**R** In calculating its *capital resources*, the *Society* may, subject to ■ GENPRU 1.5.13 R to ■ GENPRU 1.5.14 R, recognise and value *callable contributions*.

2.3.25

PRA

**R** The *Society* must calculate each *member's capital resources* as the sum of:

- (1) a *member's* proportionate share of the *capital resources* held at *syndicate* level for each *syndicate* in which the *member* participates; and
- (2) the value of a *member's funds at Lloyd's* after deducting liabilities in compliance with ■ GENPRU 1.5.18 R.

2.3.26

PRA

**R** In order to comply with ■ GENPRU 2.1.13 R the *Society* must ensure at all times that:

- (1) each *member's capital resources requirement* is covered by:
  - (a) that *member's capital resources*, calculated according to ■ GENPRU 2.3.25 R; and

(b) to the extent that (a) is insufficient, by the *Society's* own *capital resources*; and

(2) the *Society GICR* is covered by the aggregate *capital resources* supporting the *insurance business* of all the *members*.

2.3.27

PRA

R

For the purposes of ■ GENPRU 2.3.26 R (1)(b), the *Society* must maintain at all times *capital resources* sufficient to meet the aggregate of, for each *member*, the amount, if any, by which the *member's capital resources* fall short of the *member's capital resources requirement*.

2.3.28

PRA

R

The *Society* must calculate each *member's* share of the amount of *capital resources* required to comply with ■ GENPRU 2.2.33 R as the higher of:

(1) 1/3 of the *long-term insurance capital requirement* for the *members* in aggregate; and

(2) the *base capital resources requirement*;

allocated between the *members* in proportion to the result for each *member* of ■ GENPRU 2.3.7 R (2).

2.3.29

PRA

R

For the purposes of ■ GENPRU 2.2.34 R, the *Society* must ensure that the aggregate *capital resources* supporting the *insurance business* of all the *members* meet the higher of:

(1) 1/3 of the *general insurance capital requirement* for the *members* in aggregate;

(2) 1/3 of the *Society GICR*; and

(3) the *base capital resources requirement*;

with the sum of the items listed in ■ GENPRU 2.2.34 R.

2.3.30

PRA

R

The *Society* must calculate each *member's* share of the amount of *capital resources* required to comply with ■ GENPRU 2.2.34 R as the higher of:

(1) 1/3 of the *general insurance capital requirement* for the *members* in aggregate;

(2) 1/3 of the *Society GICR*; and

(3) the *base capital resources requirement*;

allocated between the *members* in proportion to the result for each *member* of ■ GENPRU 2.3.11 R.

**Characteristics of tier one capital**

2.3.31

PRA

R

A Lloyd's member's contribution may be included in tier one capital resources to the extent that:

- (1) the proceeds are immediately and fully available in respect of the member's insurance business at Lloyd's;
- (2) (except in relation to letters of credit), it complies with ■ GENPRU 2.2.64 R (3) or cannot be repaid to a member until all of the member's liabilities in respect of its insurance business at Lloyd's have been extinguished, covered or reinsured by an approved reinsurance to close;
- (3) it otherwise complies with ■ GENPRU 2.2.64 R (5) to ■ GENPRU 2.2.64 R (10).

**Adjustments for related undertakings**

2.3.32

PRA

R

■ GENPRU 2.2.256 R (Adjustment for regulated related undertakings other than insurance undertakings) applies to the Society with the modification that the Society must also value its insurance undertakings in accordance with ■ GENPRU 2.2.256 R.

2.3.33

PRA

R

If a related undertaking is an insurance undertaking which has a deficit in the capital resources available to cover its capital resources requirement, the Society must make provision for:

- (1) its proportionate share of that deficit; or
- (2) in the case of a subsidiary undertaking, the whole of that deficit.

**Modification of GENPRU 2 Annex 7R for Lloyd's**

2.3.34

PRA

R

In the case of members, Lloyd's members' contributions are included in ■ GENPRU 2 Annex 7 R and include:

- (1) letters of credit;
- (2) guarantees; and
- (3) verifiable sums arising out of life assurance policies;

held as funds at Lloyd's.

2.3.35

PRA

G

The effect of ■ GENPRU 2.3.34 R is that Lloyd's members' contributions, including letters of credit, guarantees and life assurance policies, are admissible assets.



## Capital resources table for an insurer

**PRA**

## Capital resources calculation for an insurer

Type of capital	Related text	Stage
<b>Core tier one capital</b>		<b>(A)</b>
<i>Permanent share capital</i>	GENPRU 2.2.83 R	
<b>Profit and loss account and other reserves (taking into account interim net losses)</b>	GENPRU 2.2.85 R; GENPRU 2.2.87 R to GENPRU 2.2.88 R	
<i>Share premium account</i>	GENPRU 2.2.101 R	
<b>Externally verified interim net profits</b>	GENPRU 2.2.102 R	
<b>Positive valuation differences</b>	GENPRU 2.2.105 R	
<b>Fund for future appropriations</b>	GENPRU 2.2.108 R	
<b>Perpetual non-cumulative preference shares</b>		<b>(B)</b>
<i>Perpetual non-cumulative preference shares</i>	GENPRU 2.2.109 R	
<b>Innovative tier one capital</b>		<b>(C)</b>
<i>Innovative tier one instruments</i>	GENPRU 2.2.113 R to GENPRU 2.2.121 R	
<b>Total tier one capital before deductions = A+B+C</b>		<b>(D)</b>
<b>Deductions from tier one capital</b>		<b>(E)</b>
<i>Investments in own shares</i>	None	
<i>Intangible assets</i>	GENPRU 2.2.155 R	
<i>Amounts deducted from technical provisions for discounting and other negative valuation differences</i>	GENPRU 2.2.105 R to GENPRU 2.2.107 R	
<b>Total tier one capital after deductions = D-E</b>		<b>(F)</b>
<b>Upper tier two capital</b>		<b>(G)</b>
<i>Perpetual cumulative preference shares</i>	GENPRU 2.2.159 R to GENPRU 2.2.181 R	

Capital resources calculation for an insurer		
Type of capital	Related text	Stage
Perpetual subordinated debt	See previous entry	
Perpetual subordinated securities	See previous entry	
<b>Lower tier two capital</b>		<b>(H)</b>
Fixed term <i>preference shares</i>	GENPRU 2.2.159 R to GENPRU 2.2.175 G; GENPRU 2.2.194 R to GENPRU 2.2.196 R	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
<b>Total tier two capital = G+H</b>		<b>(I)</b>
<b>Positive adjustments for related undertakings</b>		<b>(J)</b>
<i>Related undertakings that are regulated related undertakings (other than insurance undertakings)</i>	GENPRU 2.2.256 R	
<b>Total capital after positive adjustments for insurance undertakings but before deductions = F + I + J</b>		<b>(K)</b>
<b>Deductions from total capital</b>		<b>(L)</b>
Inadmissible assets	GENPRU 2.2.250 R to GENPRU 2.2.251 R; GENPRU 2 Annex 7 R	
Assets in excess of <i>market risk and counterparty limits</i>	INSPRU 2.1.22 R	
<i>Related undertakings that are ancillary services undertakings</i>	GENPRU 2.2.255 R	
Negative adjustments for <i>Related undertakings that are regulated related undertakings (other than insurance undertakings)</i>	GENPRU 2.2.256 R	
<b>Total capital after deductions = K - L</b>		<b>(M)</b>
<b>Other capital resources*</b>		<b>(N)</b>
Unpaid <i>share capital or, in the case of a mutual, unpaid initial funds</i> and calls for supplementary contributions	GENPRU 2.2.266 G to GENPRU 2.2.269 G	
<i>Implicit items</i>	GENPRU 2 Annex 8 G	

Capital resources calculation for an insurer		
Type of capital	Related text	Stage
<b>Total capital resources after deductions = M + N</b>		(O)
<p><b>* Items in section (N) of the table can be included in <i>capital resources</i> if subject to a <i>waiver</i> under section 138A of the <i>Act</i>.</b></p> <p><b>Note: Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.</b></p>		



Capital resources table for a bank

**PRA**

The capital resources calculation for a bank

Type of capital	Related text	Stage
<b>Core tier one capital</b>		<b>(A)</b>
<i>Permanent share capital</i>	GENPRU 2.2.83 R	
<b>Profit and loss account and other reserves (taking into account interim net losses)</b>	GENPRU 2.2.85 R to 2.2.90	
<i>Eligible partnership capital</i>	GENPRU 2.2.93 R; GENPRU 2.2.95 R	
<i>Eligible LLP members' capital</i>	GENPRU 2.2.94 R; GENPRU 2.2.95 R	
<i>Share premium account</i>	GENPRU 2.2.101 R	
<b>Externally verified interim net profits</b>	GENPRU 2.2.102 R	
<b>Hybrid capital</b>		
<b>Stage B1</b>	GENPRU 2.2.115A R to GENPRU 2.2.117B R	<b>(B1)</b>
<b>Stage B2</b>	GENPRU 2.2.115D R to GENPRU 2.2.117B R	<b>(B2)</b>
<b>Stage C</b>	GENPRU 2.2.115F R to GENPRU 2.2.117B R	<b>(C)</b>
<b>Total tier one capital before deductions = A + B1 + B2 + C</b>		<b>(D)</b>
<b>Deductions from tier one capital</b>		<b>(E)</b>
<b>Investments in own shares</b>	None	
<b>Intangible assets</b>	GENPRU 2.2.155 R	
<b>Excess of drawings over profits for partnerships and limited liability partnerships</b>	GENPRU 2.2.100 R	

The capital resources calculation for a bank

Type of capital	Related text	Stage
Net losses on equities held in the available-for-sale financial asset category	GENPRU 2.2.185 R	
(For certain limited purposes only certain additional deductions are made here)	GENPRU 2.2.239 R (2) to GENPRU 2.2.239 R (4)	
<b>Total tier one capital after deductions = D-E</b>		<b>(F)</b>
<b>Upper tier two capital</b>		<b>(G)</b>
Perpetual cumulative <i>preference shares</i>	GENPRU 2.2.159 R to GENPRU 2.2.181 R	
Perpetual subordinated debt	See previous entry	
Perpetual subordinated securities	See previous entry	
Revaluation reserves	GENPRU 2.2.185 R	
General/collective provisions	GENPRU 2.2.187 R to GENPRU 2.2.189 R	
Surplus provisions	GENPRU 2.2.190 R to GENPRU 2.2.193 R	
<b>Lower tier two capital</b>		<b>(H)</b>
Fixed term <i>preference shares</i>	GENPRU 2.2.159 R to GENPRU 2.2.174 R; GENPRU 2.2.194 R to GENPRU 2.2.196 R	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
<b>Total tier two capital = G+H</b>		<b>(I)</b>
<b>Deductions from tier two capital</b>		<b>(J)</b>
(For certain limited purposes only certain additional deductions are made here)	GENPRU 2.2.239 R (2) to GENPRU 2.2.239 R (4)	
<b>Total tier two capital after deductions = I - J</b>		<b>(K)</b>
<b>Total tier one capital plus tier two capital = F+K</b>		<b>(L)</b>
<b>Deductions from the totals of tier one and two</b>		<b>(M)</b>
<i>Qualifying holdings</i>	GENPRU 2.2.202 R to GENPRU 2.2.207 R	<b>(Part 1 of stage M)</b>

The capital resources calculation for a bank		
Type of capital	Related text	Stage
<i>Material holdings</i>	GENPRU 2.2.208 R to GENPRU 2.2.215 R	
<i>Expected loss amounts and other negative amounts</i>	GENPRU 2.2.236 R	
<i>Securitisation positions</i>	GENPRU 2.2.237 R	
<i>Reciprocal cross-holdings</i>	GENPRU 2.2.217 R to GENPRU 2.2.220 R	
Investments in <i>subsidiary undertakings</i> and <i>participations</i> excluding:	GENPRU 2.2.216A G	(Part 2 of stage M)
(1) any amount which is already deducted as <i>material holdings</i> or <i>qualifying holdings</i> ; and		
(2) any investment in a Venture Capital Investor or a Venture Capital Holding Company which has been ignored in accordance with GENPRU 2.2.209R (2) or (3) for the purposes of determining whether there is a <i>material holding</i> .		
<i>Connected lending of a capital nature</i>	GENPRU 2.2.221 R to GENPRU 2.2.233 R	
Total tier one capital plus tier two capital after deductions = L-M		(N)
In calculating whether a <i>bank's capital resources</i> exceed its <i>capital resources requirement</i> :		
(1) the <i>credit risk capital component</i> , the <i>operational risk capital requirement</i> and the <i>counterparty risk capital component</i> ; or		
(2) the <i>base capital resources requirement</i> ; as the case may be, must be deducted here.		
Upper tier three		(O)
Short term subordinated debt	GENPRU 2.2.241 R to GENPRU 2.2.245 R	
Lower tier three		(P)

The capital resources calculation for a bank

Type of capital	Related text	Stage
Net interim <i>trading book</i> profit and loss	GENPRU 2.2.246 R to GENPRU 2.2.249 R	
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)
Deductions from total capital		(S)
<i>Excess trading book position</i>	GENPRU 2.2.263 R to GENPRU 2.2.265 R	
<i>Free deliveries</i>	BIPRU 14.4	
Total capital after deductions (R - S)		(T)
<p>In calculating whether a <i>bank's capital resources</i> exceed its <i>capital resources requirement</i>, the <i>market risk capital requirement</i> and the <i>concentration risk capital component</i> must be deducted here.</p>		

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

**Note (2):** If the amount calculated at:

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

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

## Capital resources table for a building society

**PRA**

## The capital resources calculation for a building society

Type of capital	Related text	Stage
<b>Core tier one capital</b>		<b>(A)</b>
<i>Deferred shares</i>	GENPRU 2.2.108A R	
<b>Profit and loss account and other reserves (taking into account interim net losses)</b>	GENPRU 2.2.85 R to 2.2.90	
<b>Externally verified interim net profits</b>	GENPRU 2.2.102 R	
<b>Hybrid capital</b>		
<b>Stage B1</b>	GENPRU 2.2.115A R to GENPRU 2.2.117B R	<b>(B1)</b>
<b>Stage B2</b>	GENPRU 2.2.115D R to GENPRU 2.2.117B R	<b>(B2)</b>
<b>Stage C</b>	GENPRU 2.2.115F R to GENPRU 2.2.117B R	<b>(C)</b>
<b>Total tier one capital before deductions = A + B1 + B2 + C</b>		<b>(D)</b>
<b>Deductions from tier one capital</b>		<b>(E)</b>
<b>Investments in own shares</b>	None	
<b>Intangible assets</b>	GENPRU 2.2.155 R	
<b>Net losses on equities held in the available-for-sale financial asset category</b>	GENPRU 2.2.185 R	
<b>(For certain limited purposes only certain additional deductions are made here)</b>	GENPRU 2.2.239 R (2) to GENPRU 2.2.239 R (4)	
<b>Total tier one capital after deductions = D-E</b>		<b>(F)</b>
<b>Upper tier two capital</b>		<b>(G)</b>
<b>Perpetual subordinated debt</b>	GENPRU 2.2.159 R to GENPRU 2.2.181 R	

The capital resources calculation for a building society

2

Type of capital	Related text	Stage
Perpetual subordinated securities	See previous entry	
Revaluation reserves	GENPRU 2.2.185 R	
General/collective provisions	GENPRU 2.2.187 R to GENPRU 2.2.189 R	
Surplus provisions	GENPRU 2.2.190 R to GENPRU 2.2.193 R	
<b>Lower tier two capital</b>		<b>(H)</b>
Long term subordinated debt	GENPRU 2.2.159 R to GENPRU 2.2.174 R; GENPRU 2.2.194 R to GENPRU 2.2.196 R	
Fixed term subordinated securities	See previous entry	
<b>Total tier two capital = G+H</b>		<b>(I)</b>
<b>Deductions from tier two capital</b>		<b>(J)</b>
(For certain limited purposes only certain additional deductions are made here)	GENPRU 2.2.239 R (2) to GENPRU 2.2.239 R (4)	
<b>Total tier two capital after deductions = I - J</b>		<b>(K)</b>
<b>Total tier one capital plus tier two capital = F+K</b>		<b>(L)</b>
<b>Deductions from the totals of tier one and two</b>		<b>(M)</b>
<i>Qualifying holdings</i>	GENPRU 2.2.202 R to GENPRU 2.2.207 R	
<i>Material holdings</i>	GENPRU 2.2.208 R to GENPRU 2.2.215 R	<b>(Part 1 of stage M)</b>
<i>Expected loss amounts and other negative amounts</i>	GENPRU 2.2.236 R	
<i>Securitisation positions</i>	GENPRU 2.2.237 R	
<i>Reciprocal cross-holdings</i>	GENPRU 2.2.217 R to GENPRU 2.2.220 R	<b>(Part 2 of stage M)</b>
<b>Investments in subsidiary undertakings and participations excluding:</b>	GENPRU 2.2.216A G	
(1) any amount which is already deducted as <i>material</i>		

The capital resources calculation for a building society

Type of capital	Related text	Stage
<p><i>holdings or qualifying holdings; and</i></p> <p>(2) any investment in a Venture Capital Investor or a Venture Capital Holding Company which has been ignored in accordance with GENPRU 2.2.209R (2) or (3) for the purposes of determining whether there is a <i>material holding</i>.</p>		
Total tier one capital plus tier two capital after deductions = L-M		(N)
In calculating whether a <i>building society's capital resources</i> exceed its <i>capital resources requirement</i> :		
(1) the <i>credit risk capital component, the operational risk capital requirement and the counterparty risk capital component</i> ; or		
(2) the <i>base capital resources requirement</i> ;		
as the case may be, must be deducted here.		
Upper tier three		(O)
Short term subordinated debt	GENPRU 2.2.241 R to GENPRU 2.2.245 R	
Lower tier three		(P)
Net interim <i>trading book profit and loss</i>	GENPRU 2.2.246 R to GENPRU 2.2.249 R	
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)
Deductions from total capital		(S)
<i>Excess trading book position</i>	GENPRU 2.2.263 R to GENPRU 2.2.265 R	
<i>Free deliveries</i>	BIPRU 14.4	
Total capital after deductions (R - S)		(T)
In calculating whether a <i>building society's capital resources</i> exceed its <i>capital resources requirement, the market risk capital requirement and the concentration risk capital component</i> must be deducted here.		

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

**Note (2):** If the amount calculated at:

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

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

Capital resources table for a BIPRU investment firm deducting material holdings

**FCA** **PRA**

The capital resources calculation for an investment firm deducting material holdings		
Type of capital	Related text	Stage
<b>Core tier one capital</b>		<b>(A)</b>
<i>Permanent share capital</i>	GENPRU 2.2.83 R	
<b>Profit and loss account and other reserves (taking into account material interim net losses)</b>	GENPRU 2.2.85 R to 2.2.90	
<i>Eligible partnership capital</i>	GENPRU 2.2.93 R; GENPRU 2.2.95 R	
<i>Eligible LLP members' capital</i>	GENPRU 2.2.94 R; GENPRU 2.2.95 R	
<i>Sole trader capital</i>	None	
<i>Share premium account</i>	GENPRU 2.2.101 R	
<b>Externally verified interim net profits</b>	GENPRU 2.2.102 R	
<b>Hybrid capital</b>		
Stage B1	GENPRU 2.2.115A R to GENPRU 2.2.117B R	<b>(B1)</b>
Stage B2	GENPRU 2.2.115D R to GENPRU 2.2.117B R	<b>(B2)</b>
Stage C	GENPRU 2.2.115F R to GENPRU 2.2.117B R	<b>(C)</b>
<b>Total tier one capital before deductions = A + B1 + B2 + C</b>		<b>(D)</b>
<b>Deductions from tier one capital</b>		<b>(E)</b>
<i>Investments in own shares</i>	None	
<b>Intangible assets</b>	GENPRU 2.2.155 R	
<b>Excess of drawings over profits for partnerships, limited liability partnerships and sole traders</b>	GENPRU 2.2.100 R; there is no related text for <i>sole traders</i>	

The capital resources calculation for an investment firm deducting material holdings

Type of capital	Related text	Stage
<b>Net losses on equities held in the available-for-sale financial asset category</b>	GENPRU 2.2.185 R	
<b>(For certain limited purposes only certain additional deductions are made here)</b>	GENPRU 2.2.239 R (2) to GENPRU 2.2.239 R (4)	
<b>Total tier one capital after deductions = D-E</b>		<b>(F)</b>
<b>Upper tier two capital</b>		<b>(G)</b>
<b>Perpetual cumulative <i>preference shares</i></b>	GENPRU 2.2.159 R to GENPRU 2.2.181 R	
<b>Perpetual subordinated debt</b>	See previous entry	
<b>Perpetual subordinated securities</b>	See previous entry	
<b>Revaluation reserves</b>	GENPRU 2.2.185 R	
<b>General/collective provisions</b>	GENPRU 2.2.187 R to GENPRU 2.2.189 R	
<b>Surplus provisions</b>	GENPRU 2.2.190 R to GENPRU 2.2.193 R	
<b>Lower tier two capital</b>		<b>(H)</b>
<b>Fixed term <i>preference shares</i></b>	GENPRU 2.2.159 R to GENPRU 2.2.174 R; GENPRU 2.2.194 R to GENPRU 2.2.196 R	
<b>Long term subordinated debt</b>	See previous entry	
<b>Fixed term subordinated securities</b>	See previous entry	
<b>Total tier two capital = G+H</b>		<b>(I)</b>
<b>Deductions from tier two capital</b>		<b>(J)</b>
<b>(For certain limited purposes only certain additional deductions are made here)</b>	GENPRU 2.2.239 R (2) to GENPRU 2.2.239 R (4)	
<b>Total tier two capital after deductions = I - J</b>		<b>(K)</b>
<b>Total tier one capital plus tier two capital = F+K</b>		<b>(L)</b>
<b>Deductions from the totals of tier one and two</b>		<b>(M)</b>
<b><i>Material holdings</i></b>	GENPRU 2.2.208 R to GENPRU 2.2.215 R	

The capital resources calculation for an investment firm deducting material holdings		
Type of capital	Related text	Stage
<i>Expected loss amounts and other negative amounts</i>	GENPRU 2.2.236 R	(Part 1 of stage M)
<i>Securitisation positions</i>	GENPRU 2.2.237 R	
<i>Reciprocal cross-holdings</i>	GENPRU 2.2.217 R to GENPRU 2.2.220 R	(Part 2 of stage M)
<b>Total tier one capital plus tier two capital after deductions = L-M</b>		(N)
<p><b>In calculating whether a firm's capital resources exceed its capital resources requirement:</b></p> <p>(1) the <i>credit risk capital component</i>, the <i>operational risk capital requirement</i> (if applicable) and the <i>counterparty risk capital component</i>; or</p> <p>(2) the <i>base capital resources requirement</i>; as the case may be, must be deducted here.</p>		
<b>Upper tier three</b>		(O)
<b>Short term subordinated debt</b>	GENPRU 2.2.241 R to GENPRU 2.2.245 R	
<b>Lower tier three</b>		(P)
<b>Net interim trading book profit and loss</b>	GENPRU 2.2.246 R to GENPRU 2.2.249 R	
<b>Total tier three capital=O+P</b>		(Q)
<b>Total capital before deductions = N+Q</b>		(R)
<b>Deductions from total capital</b>		(S)
<i>Free deliveries</i>	BIPRU 14.4	
<b>Total capital after deductions (R - S)</b>		(T)
<p><b>In calculating whether a firm's capital resources exceed its capital resources requirement, the market risk capital requirement, the concentration risk capital component and (if applicable) the fixed overheads requirement must be deducted here.</b></p>		

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

**Note (2):** If the amount calculated at:

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

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

## Capital resources table for a BIPRU investment firm deducting illiquid assets

**FCA** **PRA**

### The capital resources calculation for an investment firm that deducts illiquid assets

Type of capital	Related text	Stage
<b>Core tier one capital</b>		<b>(A)</b>
<i>Permanent share capital</i>	GENPRU 2.2.83 R	
<b>Profit and loss account and other reserves (taking into account material interim net losses)</b>	GENPRU 2.2.85 R to GENPRU 2.2.90 R	
<i>Eligible partnership capital</i>	GENPRU 2.2.93 R; GENPRU 2.2.95 R	
<i>Eligible LLP members' capital</i>	GENPRU 2.2.94 R; GENPRU 2.2.95 R	
<i>Sole trader capital</i>	None	
<i>Share premium account</i>	GENPRU 2.2.101 R	
<b>Externally verified interim net profits</b>	GENPRU 2.2.102 R	
<b>Hybrid capital</b>		
Stage B1	GENPRU 2.2.115A R to GENPRU 2.2.117B R	<b>(B1)</b>
Stage B2	GENPRU 2.2.115D R to GENPRU 2.2.117B R	<b>(B2)</b>
Stage C	GENPRU 2.2.115F R to GENPRU 2.2.117B R	<b>(C)</b>
<b>Total tier one capital before deductions = A + B1 + B2 + C</b>		<b>(D)</b>
<b>Deductions from tier one capital</b>		<b>(E)</b>
<i>Investments in own shares</i>	None	
<b>Intangible assets</b>	GENPRU 2.2.155 R	
<b>Excess of drawings over profits for partnerships, limited liability partnerships and sole traders</b>	GENPRU 2.2.100 R; there is no related text for <i>sole traders</i>	

The capital resources calculation for an investment firm that deducts illiquid assets

Type of capital	Related text	Stage
<b>Net losses on equities held in the available-for-sale financial asset category</b>	GENPRU 2.2.185 R	
<b>(For certain limited purposes only certain additional deductions are made here)</b>	GENPRU 2.2.239 R (2) to GENPRU 2.2.239 R (4)	
<b>Total tier one capital after deductions = D-E</b>		<b>(F)</b>
<b>Upper tier two capital</b>		<b>(G)</b>
<b>Perpetual cumulative <i>preference shares</i></b>	GENPRU 2.2.159 R to GENPRU 2.2.181 R	
<b>Perpetual subordinated debt</b>	See previous entry	
<b>Perpetual subordinated securities</b>	See previous entry	
<b>Revaluation reserves</b>	GENPRU 2.2.185 R	
<b>General/collective provisions</b>	GENPRU 2.2.187 R to GENPRU 2.2.189 R	
<b>Surplus provisions</b>	GENPRU 2.2.190 R to GENPRU 2.2.193 R	
<b>Lower tier two capital</b>		<b>(H)</b>
<b>Fixed term <i>preference shares</i></b>	GENPRU 2.2.159 R to GENPRU 2.2.174 R; GENPRU 2.2.194 R to GENPRU 2.2.196 R	
<b>Long term subordinated debt</b>	See previous entry	
<b>Fixed term subordinated securities</b>	See previous entry	
<b>Total tier two capital = G+H</b>		<b>(I)</b>
<b>Deductions from tier two capital</b>		<b>(J)</b>
<b>(For certain limited purposes only certain additional deductions are made here)</b>	GENPRU 2.2.239 R (2) to GENPRU 2.2.239 R (4)	
<b>Total tier two capital after deductions = I - J</b>		<b>(K)</b>
<b>Total tier one capital plus tier two capital = F+K</b>		<b>(L)</b>
<b>Deductions from the totals of tier one and two</b>		<b>(M)</b>
<b><i>Expected loss amounts and other negative amounts</i></b>	GENPRU 2.2.236 R	<b>(Part 1 of stage M)</b>

The capital resources calculation for an investment firm that deducts illiquid assets

Type of capital	Related text	Stage
<i>Securitisation positions</i>	GENPRU 2.2.237 R	
<i>Reciprocal cross-holdings</i>	GENPRU 2.2.217 R to GENPRU 2.2.220 R	(Part 2 of stage M)
<b>Total tier one capital plus tier two capital after deductions = L-M</b>		(N)
<p>In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i>:</p> <p>(1) the <i>credit risk capital component</i>, the <i>operational risk capital requirement</i> (if applicable) and the <i>counterparty risk capital component</i>; or</p> <p>(2) the <i>base capital resources requirement</i>; as the case may be, must be deducted here.</p>		
<b>Upper tier three</b>		(O)
Short term subordinated debt	GENPRU 2.2.241 R to GENPRU 2.2.245 R	
<b>Lower tier three</b>		(P)
Net interim <i>trading book profit and loss</i>	GENPRU 2.2.246 R to GENPRU 2.2.249 R	
<b>Total tier three capital=O+P</b>		(Q)
<b>Total capital before deductions = N+Q</b>		(R)
<b>Deductions from total capital</b>		(S)
<i>Illiquid assets</i>	GENPRU 2.2.259 R to GENPRU 2.2.260 R	
<i>Free deliveries</i>	BIPRU 14.4	
<b>Total capital after deductions = R-S</b>		(T)
<p>In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i>, the <i>market risk capital requirement</i>, the <i>concentration risk capital component</i> and (if applicable) the <i>fixed overheads requirement</i> must be deducted here.</p>		

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

**Note (2):** If the amount calculated at:

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

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

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

**FCA**

Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision		
Type of capital	Related text	Stage
<b>Core tier one capital</b>		<b>(A)</b>
<i>Permanent share capital</i>	GENPRU 2.2.83 R	
<b>Profit and loss account and other reserves (taking into account material interim net losses)</b>	GENPRU 2.2.85 R to 2.2.90	
<i>Eligible partnership capital</i>	GENPRU 2.2.93 R; GENPRU 2.2.95 R	
<i>Eligible LLP members' capital</i>	GENPRU 2.2.94 R; GENPRU 2.2.95 R	
<i>Sole trader capital</i>	None	
<i>share premium account</i>	GENPRU 2.2.101 R	
<b>Externally verified interim net profits</b>	GENPRU 2.2.102 R	
<b>Hybrid capital</b>		
<b>Stage B1</b>	GENPRU 2.2.115A R to GENPRU 2.2.117B R	<b>(B1)</b>
<b>Stage B2</b>	GENPRU 2.2.115D R to GENPRU 2.2.117B R	<b>(B2)</b>
<b>Stage C</b>	GENPRU 2.2.115F R to GENPRU 2.2.117B R	<b>(C)</b>
<b>Total tier one capital before deductions = A + B1 + B2 + C</b>		<b>(D)</b>
<b>Deductions from tier one capital</b>		<b>(E)</b>
<b>Investments in own shares</b>	None	<b>(Part 1 of stage E)</b>
<b>Intangible assets</b>	GENPRU 2.2.155 R	

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

Type of capital	Related text	Stage
<b>Excess of drawings over profits for partnerships, <i>limited liability partnerships</i> and <i>sole traders</i></b>	<b>GENPRU 2.2.100 R; there is no related text for <i>sole traders</i></b>	
<b>Net losses on equities held in the available-for-sale financial asset category</b>	<b>GENPRU 2.2.185 R</b>	<b>(Part 1 of stage E)</b>
<b>(For certain limited purposes only certain additional deductions are made here. This line does not include <i>material holdings</i>.)</b>	<b>GENPRU 2.2.239 R (2) to GENPRU 2.2.239 R (4)</b>	
<b><i>Material holdings</i> falling into Note (4)</b>	<b>Note (4) of Part 2 of this table; GENPRU 2.2.208 R to GENPRU 2.2.215 R</b>	<b>(Part 2 of stage E)</b>
<b>(For certain limited purposes only certain additional deductions of <i>material holdings</i> are made here)</b>	<b>Note (5) of Part 2 of this table; GENPRU 2.2.239 R (2) to GENPRU 2.2.239 R (4)</b>	<b>(Part 3 of stage E)</b>
<b>Total tier one capital after deductions = D-E</b>		<b>(F)</b>
<b>Upper tier two capital</b>		<b>(G)</b>
<b>Perpetual cumulative <i>preference shares</i></b>	<b>GENPRU 2.2.159 R to GENPRU 2.2.181 R</b>	
<b>Perpetual subordinated debt</b>	<b>See previous entry</b>	
<b>Perpetual subordinated securities</b>	<b>See previous entry</b>	
<b>Revaluation reserves</b>	<b>GENPRU 2.2.185 R</b>	
<b>General/collective provisions</b>	<b>GENPRU 2.2.187 R to GENPRU 2.2.189 R</b>	
<b>Surplus provisions</b>	<b>GENPRU 2.2.190 R to GENPRU 2.2.193 R</b>	
<b>Lower tier two capital</b>		<b>(H)</b>
<b>Fixed term <i>preference shares</i></b>	<b>GENPRU 2.2.159 R to GENPRU 2.2.174 R; GENPRU 2.2.194 R to GENPRU 2.2.196 R</b>	
<b>Long term subordinated debt</b>	<b>See previous entry</b>	
<b>Fixed term subordinated securities</b>	<b>See previous entry</b>	

Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision		
Type of capital	Related text	Stage
<b>Total tier two capital = G+H</b>		<b>(I)</b>
<b>Deductions from tier two capital</b>		<b>(J)</b>
(For certain limited purposes only certain additional deductions are made here)	Note (5) of Part 2 of this table; GENPRU 2.2.239 R (2) to GENPRU 2.2.239 R (4)	
<b>Total tier two capital after deductions = I - J</b>		<b>(K)</b>
<b>Total tier one capital plus tier two capital = F+K</b>		<b>(L)</b>
<b>Deductions from the totals of tier one and two</b>		<b>(M)</b>
<i>Material holdings falling into Note (5)</i>	Note (5) of Part 2 of this table; GENPRU 2.2.208 R to GENPRU 2.2.215 R	<b>(Part 1 of stage M)</b>
<i>Contingent liabilities</i>	Note (6) of Part 2 of this table	
<i>Expected loss amounts and other negative amounts</i>	GENPRU 2.2.236 R	
<i>Securitisation positions</i>	GENPRU 2.2.237 R	
<i>Reciprocal cross-holdings</i>	GENPRU 2.2.217 R to GENPRU 2.2.220 R	<b>(Part 2 of stage M)</b>
<b>Total tier one capital plus tier two capital after deductions = L-M</b>		<b>(N)</b>
In calculating whether a firm's capital resources exceed its capital resources requirement:		
(1) the credit risk capital component, the operational risk capital requirement (if applicable) and the counterparty risk capital component; or		
(2) the base capital resources requirement;		
as the case may be, must be deducted here.		
<b>Upper tier three</b>		<b>(O)</b>
Short term subordinated debt	GENPRU 2.2.241 R to GENPRU 2.2.245 R	
<b>Lower tier three</b>		<b>(P)</b>
Net interim trading book profit and loss	GENPRU 2.2.246 R to GENPRU 2.2.249 R	
<b>Total tier three capital=O+P</b>		<b>(Q)</b>

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

Type of capital	Related text	Stage
<b>Total capital before deductions = N+Q</b>		<b>(R)</b>
<b>Deductions from total capital</b>		<b>(S)</b>
<i>Illiquid assets</i>	GENPRU 2.2.259 R to GENPRU 2.2.260 R	
<i>Free deliveries</i>	BIPRU 14.4	
<b>Total capital after deductions = R-S</b>		<b>(T)</b>
<p>In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i>, the <i>market risk capital requirement</i>, the <i>concentration risk capital component</i> and (if applicable) the <i>fixed overheads requirement</i> must be deducted here.</p>		

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

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

**Note (2):** If the amount calculated at:

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

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

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

- (1) in relation to a *BIPRU investment firm*, the holding forms part of the *undertaking's tier one capital resources*; or
- (2) (subject to (3)) in relation to any other *undertaking*, the holding would form part of the *undertaking's tier one capital resources* if:
  - (a) that *undertaking* were a *BIPRU firm* with a *Part 4A permission*; and
  - (b) it had carried on all its business in the *United Kingdom* and had obtained whatever *permissions*

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

- (3) **for doing so are required under the Act; or**  
**in relation to any *undertaking* not falling within (1) and for which the methodology in (2) does not give an answer, the holding would form part of its *tier one capital resources* if the *undertaking* were a *BIPRU firm* of the same category as the *firm* carrying out the calculation under this Annex.**

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

**Note (6):** The contingent liabilities that must be deducted by a *firm* at Part 1 of stage M are any contingent liabilities which the *firm* has in favour of *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*.



## Admissible assets in insurance

**PRA**

- (1) (A) Investments that are, or amounts owed arising from the disposal of:
- (a) *debt securities*, bonds and other money and capital market instruments;
  - (b) loans;
  - (c) *shares* and other variable yield participations;
  - (d) *units* in:
    - (i) *collective investment schemes* falling within the *UCITS Directive*;
    - (ii) *non-UCITS retail schemes*;
    - (iii) *recognised schemes*; and
    - (iv) any other *collective investment scheme* where the *insurer's* investment in the scheme is sufficiently small to be consistent with a prudent overall investment strategy, having regard to the investment policy of the scheme and the information available to the *insurer* to enable it to monitor the investment risk being taken by the scheme
  - (e) land, buildings and immovable property rights;
  - (f) an *approved derivative* or *quasi-derivative* transaction that satisfies the conditions in **INSPRU 3.2.5 R** or an *approved stock lending transaction* that satisfies the conditions in **INSPRU 3.2.36 R**.
- (B) Debts and claims
- (a) debts owed by *reinsurers*, including *reinsurers' shares of technical provisions* (but excluding amounts recoverable from an *ISPV\**);
  - (b) deposits with and debts owed by *ceding undertakings*;
  - (c) debts owed by *policyholders* and intermediaries arising out of direct and *reinsurance* operations (except where overdue for more than 3 months and other than *commission* prepaid to agents or intermediaries);
  - (d) for *general insurance business* only, claims arising out of salvage and subrogation;

- (e) for *long-term insurance business* only, advances secured on, and not exceeding the *surrender value* of, *long-term insurance contracts* issued by the *insurer*;
  - (f) tax recoveries;
  - (g) claims against *compensation funds*.
- (C) Other assets
- (a) tangible fixed assets, other than land and buildings;
  - (b) cash at *bank* and in hand, *deposits with credit institutions* and any other bodies authorised to receive *deposits*;
  - (c) for *general insurance business* only, *deferred acquisition costs*;
  - (d) accrued interest and rent, other accrued income and prepayments;
  - (e) for *long-term insurance business* only, reversionary interests.
- \* An *insurer* may treat amounts recoverable from an *ISPV* as an *admissible asset* if it obtains a *waiver* under section 138A of the *Act*. The conditions that will need to be met, in addition to the statutory tests under section 138A(4) of the *Act*, before the *appropriate regulator* will consider granting such a *waiver* are set out in **INSPRU 1.6.13 G** to **INSPRU 1.6.18 G**.
- (2) Subject to paragraph (3) below a *unit* in a *collective investment scheme* is only admissible for the purposes of paragraph (1) above if it falls within paragraph (1)(A)(d), notwithstanding that it may also fall into one or more other categories in paragraph (1).
- (3) A *derivative, quasi-derivative* or *stock lending* transaction is only admissible for the purposes of paragraph (1) above if it falls within paragraph (1)(A)(f), notwithstanding that it may also fall into one or more other categories in paragraph (1).

## Guidance on applications for waivers relating to Implicit items

### PRA

#### G Implicit items under the Act

- 1 The *capital resources table* does not permit *implicit items* to be included in the calculation of a *firm's capital resources*, except subject to a *capital resources* under section 138A of the *Act*. Article 27(4) of the *Consolidated Life Directive* states that *implicit items* can be included in the calculation of a *firm's capital resources*, within limits, provided that the supervisory authority agrees. Certain *implicit items*, however, are not eligible for inclusion beyond 31 December 2009 (see paragraph 5). The *appropriate regulator* may be prepared to grant a *capital resources* from the *capital resources table* to allow *implicit items*, in line with the purpose of the *Consolidated Life Directive*, and provided the conditions as set out in article 27(4) of the *Consolidated Life Directive* are met. Such a *capital resources* would allow an *implicit item* to count towards the *firm's capital resources* available to count against its *capital resources requirement (CRR)* set out for *realistic basis life firms* in GENPRU 2.1.18 R and for *regulatory basis only life firms* in GENPRU 2.1.23 R. An *implicit item* may potentially count as *tier one capital* (but not *core tier one capital*) or *tier two capital*. Where a *capital resources* is granted allowing an *implicit item* as *tier one capital*, the value of the *implicit item* so allowed must be included at stage B of the *capital resources table*. If the application of the value of the *implicit item* is restricted by GENPRU 2.2.29 R, which requires that at least 50% of a *firm's tier one capital resources* must be accounted for by *core tier one capital*, the remainder may be included at stage G of the calculation in the *capital resources table*, subject to GENPRU 2.2.31 G. An *implicit item* treated as *tier two capital* will also be included at stage G of the calculation, again subject to GENPRU 2.2.81 R. Article 29(1) of the *Consolidated Life Directive* requires that *implicit items* be excluded from the capital eligible to cover the *guarantee fund*. Under GENPRU 2.2.33 R a *firm* must meet the *guarantee fund* from the sum of the items listed at stages A, B, G and H of the *capital resources table* less the sum of the items listed at stage E of the *capital resources table*. The *appropriate regulator* will only grant an *implicit items capital resources* if the *capital resources* includes a modification to GENPRU 2.2.33 R to ensure that the *implicit item* does not count towards meeting the *guarantee fund*.
- 2 Under section 138A of the *Act*, the *appropriate regulator* may, on the application of a *firm*, grant a *capital resources* from PRU. There are general requirements that must be met before any *capital resources* can be granted. As explained in SUP 8, the *appropriate regulator* may not give a *waiver* unless the *appropriate regulator* is satisfied that:
  - (1) compliance by the *firm* with the *rules* will be unduly burdensome, or would not achieve the purpose for which the *rules* were made; and
  - (2) the *waiver* would not result in undue risk to *persons* whose interests the *rules* are intended to protect.
- 3 The *appropriate regulator* will assess compliance with the requirements in the light of all the relevant circumstances. This will include consideration of the costs incurred by compliance with a particular *rule* or whether a *rule* is framed in a way that would make compliance difficult in view of the *firm's* circumstances. For example, the *firm* may demonstrate that if an *implicit item* were not allowed, the *firm* would either have to suffer increased (and unwarranted) costs in injecting further *capital resources* or operate with a lower equity backing ratio (see case studies in paragraph 43). Even if a *firm* can demonstrate a case for an *implicit item waiver*, it should not assume that the *appropriate regulator* will grant the *capital resources* requested, or that any *capital resources* will be granted for the full amount of the *implicit item* which could be granted, as set out in this annex. The *appropriate regulator* will consider each application on its own merits, and taking into

account all relevant circumstances, including the financial situation and business prospects of the *firm*.

4 *Implicit items* are economic reserves which are contained within the long-term insurance business provisions. Article 27(4) of the *Consolidated Life Directive* identifies three types of *implicit item*, in respect of: future profits, *zillmerisation* and hidden reserves. This annex is intended to amplify the *guidance* in SUP 8 relating to the granting of *waivers* for *implicit items* and to provide *guidance* on other aspects. Whilst this *guidance* applies to applications for *waivers* for *implicit items* generally, for a *realistic basis life firm*, to the extent that an *implicit item* is allocated to a *with-profits fund*, this *guidance* relates to *implicit items* for the purposes of determining the *regulatory value of assets* (see INSPRU 1.4.24 R).

5 The *Consolidated Life Directive* (reflecting the changes introduced by the Solvency 1 Directive) requires member states to end a *firm's* ability to take into account future profits *implicit items* by (at the latest) 31 December 2009. Until then, the maximum amount of the *implicit item* relating to future profits permitted under the *Consolidated Life Directive* is limited to 50% of the product of the estimated annual profits and the average period to run (not exceeding six years) on the *policies* in the portfolio. The *Consolidated Life Directive* further limits the maximum amount of these economic reserves that can be counted to 25% of the lesser of the available solvency margin and the required solvency margin. The changes introduced by the *Solvency 1 Directive* take effect for financial years beginning on or after 1 January 2004. However, the *Consolidated Life Directive* allows for a transitional period of five years, which runs from 20 March 2002 (the publication date of the *Solvency 1 Directive*), for *firms* to become fully compliant with these new requirements. *firms* will need to consider the potential impact of these changes when engaging in future capital planning. When applying for an *implicit item waiver* a *firm* should provide the appropriate regulator with a plan showing how the *firm* intends to maintain its capital adequacy over the period to 31 December 2009. *firms* should also be aware that the appropriate regulator will typically only grant *waivers* for a maximum of 12 months.

#### Future Profits

6 The future profits *implicit item* allows *firms* to take credit for margins in the *mathematical reserves* to the extent that these are expected to emerge from in force business. The future profit from in force business should be assessed, in the first instance, on prudent assumptions, to demonstrate that there is an 'economic reserve'. Having demonstrated that it exists, the amount should be limited to an amount calculated using a formula that takes into account the actual profit which has emerged over the last five years (see paragraph 28).

#### Zillmerisation

7 *Zillmerisation* is an allowance for acquisition costs that are expected, under prudent assumptions, to be recoverable from future *premiums*. *firms* can make a direct adjustment to their reserves for *zillmerisation*, subject to the *rules* on *mathematical reserves*. However, where no such adjustment has been made, the appropriate regulator will consider an application for a *capital resources* to take into account an *implicit item*.

#### Hidden reserves

8 Hidden reserves are reserves resulting from the underestimation of assets (other than *mathematical reserves*).

#### Process for applying for a waiver, including limits applicable when a waiver is granted

9 This annex sets out the procedures to be followed and the form of calculations and data which should be submitted by *firms* to the appropriate regulator. This *guidance* should also be read in conjunction with the general requirements relating to the *capital resources* process described in SUP 8. The appropriate regulator expects that applications for *waivers* in respect of future profits and *zillmerising* will not normally be considered to pass the "not result in undue risk to persons whose interests the *rules* are intended to protect" test unless the relevant criteria set out in this *guidance* have been satisfied and an application for such a *capital resources* may require further criteria to be satisfied for this test to be passed. As set out below, *waivers* in respect of either *zillmerising* or hidden reserves will not normally be given except in very exceptional circumstances.

## Timing

- 10 *A long-term insurer may apply to the appropriate regulator for a capital resources in respect of implicit items. A capital resources will not apply retrospectively (see SUP 8.3.6 G). Consequently, applications intended for a particular accounting reference date will normally need to be made well before that reference date. Applications by firms must be made to the appropriate regulator in writing and include the relevant details specified under SUP 8.3.3 D. Given the uncertainty in predicting the future, waivers will normally be granted for a maximum of 12 months at a time and any further applications will need to be made accordingly.*
- 11 *The information that will be required to enable an application to be considered as set out below, should normally include a demonstration of how the capital resources requirement is to be met, with and without the capital resources. Clearly, up-to-date information may not be available before the financial year-end. In some cases information from the previous year-end's return may be used, as long as any known significant changes in the structure of the firm, or the assumptions used, have been taken into account.*
- 12 *If the application for a capital resources is granted, when a firm submits its next return the amount of the implicit item shown should not exceed that supported by the firm's calculations as at the valuation date. In the event that the amount of the future profits item calculated by the firm based on these updated assumptions is less than the amount calculated at the time of the firm's waiver application, the lower figure should be used in the return.*
- 13 *An implicit item in respect of zillmerising or hidden reserves is related to the basis on which liabilities or assets have been valued. In the case of hidden reserves, as explained below, the granting of a capital resources will be dependent on the overall capital resources of the firm. waivers in respect of these implicit items will, therefore, only be made in relation to the position shown in a particular set of returns and it will be essential for firms to submit applications to the appropriate regulator well in advance of the latest date for the submission of the relevant return.*
- 14 *Waivers may be withdrawn by the appropriate regulator at any time (e.g. where the appropriate regulator considers the amount in respect of which a capital resources has been given can no longer be justified). This may be as a result of changes in the firm's position or as a result of queries arising on scrutiny of the returns.*

## Information to be submitted

- 15 *An application for a capital resources (which includes an application for an extension to or other variation of a capital resources) should be prepared using the standard application form for a capital resources (see SUP 8 Annex 2 D). In addition, the application should be accompanied by full supporting information to enable the appropriate regulator to arrive at a decision on the merits of the case. In particular, the application should state clearly the nature and the amounts of the implicit items that a firm wishes to count against its capital resources requirement and whether it proposes to treat the implicit item as tier one capital or tier two capital. In order to assess an application, the appropriate regulator needs information as to the make-up of the firm's capital resources, the quality of the capital items which have been categorised into each tier of capital and a breakdown of capital both within and outside the firm's long-term insurance fund or funds and between the firm's with-profits funds and non-profit funds. An explanation as to the appropriateness of the proposed treatment of the implicit item under the capital resources table should also be provided, including a demonstration that, in allowing for implicit items, there has been no double counting of future margins and that the basis for valuing such margins is prudent.*
- 16 *The PRA recognises that the assessment of the insurance technical provisions reflects the contractual obligations of the firm. Implicit items are therefore margins over and above an economic assessment in these technical provisions only. Non-contractual "constructive" obligations arising from a firm's regulatory duty (as regulated by the FCA) to treat customers fairly e.g. regarding future terminal bonuses, are not fully captured by the technical provisions. A firm must instead be satisfied that it has sufficient capital resources at all times to meet its obligations under the FCA's Principle 6. The granting of a waiver for an implicit item does not in any way detract from this requirement and a firm will need to be satisfied that this condition is still met.*

17 As a minimum, applications for a future profits *implicit item* should be supported by the information contained in Forms 13, 14, 18, 19, 40, 41, 42, 48, 49, the answers to questions 1 to 12 of the abstract of the valuation report, Appendix 9.4 of *IPRU(INS)*, the abstract of the valuation report for the realistic valuation, Appendix 9.4A of *IPRU(INS)* and Forms 51, 52, 53, 54 and 58. For a *zillmerisation* implicit item, only those items noted above forming part of the abstract valuation report will normally be needed. Applications for a *capital resources* in respect of a hidden reserves *implicit item* will normally be considered only if accompanied by the information which is contained in the annual regulatory *returns*. In particular, the balance sheet forms, *long-term insurance business* revenue accounts, and abstract of the valuation report as set out in Appendices 9.1, 9.3 and 9.4 of *IPRU(INS)* should be provided. This is not to say that a full regulatory *return* must be provided in the specified format, simply that the information contained in these forms should be provided. Where appropriate, the information may be summarised.

18 The following supporting information relating to the calculation of the amounts claimed should be supplied for each type of *implicit item* in respect of which a *capital resources* is sought: Future profits: in addition to information related to the prospective calculation and retrospective calculation described below, the profits reported in each of the last five *financial years* up to the date of the most recent available valuation under *rule 9.4* of *IPRU(INS)* which has been submitted to the appropriate regulator prior to, or together with, the application, and the amounts and nature of any exceptional items left out of account; the method used for calculating the average period to run and the results for each of the main categories of business, both before and after allowing for premature termination (where the calculation has been made in two stages); and the basis on which this allowance has been made. *Zillmerising*: the categories of contracts for which an item has been calculated and the percentages of the *relevant capital sum* in respect of which an adjustment has been made. Hidden reserves: particulars, with supporting evidence, of the undervaluation of assets for which recognition is sought.

#### Continuous monitoring by firms

19 *Firms* should take into account any material changes in financial conditions or other relevant circumstances that may have an impact on the level of future profits that can prudently be taken into account. *firms* should also re-evaluate whether an application to vary an *implicit item waiver* should be made whenever circumstances have changed. In the event that circumstances have changed such that an amendment is appropriate, the *firm* must contact the appropriate regulator as quickly as possible in accordance with Principle 11. (See SUP 8.5.1 R). In this context, the appropriate regulator would expect notice of any matter that materially impacts on the *firm's* financial condition, or any *waivers* granted.

#### Future profits - factors to take into account when submitting calculations to support waiver applications

20 Where an application is made in respect of a *firm* which has separate *with-profits funds* and *non-profit funds*, the *firm* should ensure that the *capital resources requirement* in respect of the *non-profit fund* is not covered by future profits attributable to *policyholders* arising in the *with-profits fund*. Furthermore, for a *realistic basis life firm* the amount of the *implicit item* allocated to each *with-profits fund* should be calculated separately, as the amount allocated to each *with-profits fund* will be taken into consideration in the calculation of the *with-profits insurance capital component* (see INSPRU 1.4.24 R).

21 *firms* need to assess prospective future profit (i.e. how much can reasonably be expected to arise) and compare this to maximum limits (in article 27(4) of the *Consolidated Life Directive*), which relate to past profits.

#### Future profits - prospective calculation

22 The application for a *capital resources* should be supported by details of a prospective calculation of future profits arising from in-force business. The information supplied to the appropriate regulator should include a description of the method used in the calculation and of the assumptions made, together with the results arising. From 31 December 2009 at the latest, future profits *implicit items* will no longer be permitted under the *Consolidated Life Directive*. Where a *firm* first applies for an *implicit item waiver* after GENPRU 2.2 comes into effect, under the prospective calculation a *firm* should only take into consideration future profits that are expected to emerge in the period

up to 31 December 2009. *Implicit item waivers* granted before GENPRU 2.2 comes into effect will continue to operate under the terms of those *wavers*, but an application to vary the terms of such a *capital resources*, for example to extend the effective period, is an application for a new *capital resources* for which a *firm* should usually only take into consideration future profits that are expected to emerge in the period up to 31 December 2009.

#### Assumptions

23 The assumptions made should be prudent, rather than best estimate, assumptions of future experience (that is, the prudent assumptions should allow for the fair market price for assuming that risk including associated expenses). In particular, it would not normally be considered appropriate for the projected return on any asset to be taken to be higher than the risk-free yield (that is, assessed by reference to the yield arrived at using a model of future risk free yields properly calibrated from the forward gilts market). It may also be appropriate to bring future withdrawals into account on a suitably prudent basis. For *with-profits business*, the assumptions for future investment returns should not capitalise future bonus loadings except where the *with-profits policyholders* share in risks other than the investment performance of the fund. Furthermore, the rate at which future profits are discounted should include an appropriate margin over a risk free rate of return. Calculations should also be carried out to demonstrate that the prospective calculation of the future profits arising from the in-force business supporting the application for the *implicit item* would be sufficient to support the amount of the *implicit item* under each scenario described for use in determining the *resilience capital requirement* - where the *capital resources* relates to an *implicit item* allocated to more than one fund, this should be demonstrated separately for that element of the *implicit item* allocated to each fund. For an *implicit item* allocated to a *with-profits fund*, proper allowance should be made for any shareholder transfers to ensure that the *implicit item* is not supported by future profits which will be required to support those transfers. To the extent, if any, that future profits are dependent on the levying of explicit expense related charges (for example as in the case of unit-linked business) the documentation submitted should include a demonstration of the prudence of the assumptions made as to the level at which future charges will be levied and expenses incurred.

Other limitations on the extent to which waivers for implicit items will be granted to a realistic basis life firm

24 Where a *capital resources* in respect of an *implicit item* is granted to a *realistic basis life firm* additional limits may apply by reference to a comparison of *realistic excess capital* and *regulatory excess capital* including allowance for the effect of the *capital resources*. Where the *capital resources* relates to an *implicit item* allocated partly or entirely to a *with-profits fund*, the *capital resources* will contain a limitation to the effect that the *regulatory excess capital* for that *with-profits fund*, allowing for the effect of the *capital resources*, may not exceed that fund's *realistic excess capital*. This limitation will apply on an ongoing basis so that, for example, in the case of an *implicit item* allocated to a *with-profits fund*, the amount of the *implicit item* would be limited to zero whenever the *regulatory excess capital* exceeded the *realistic excess capital* of that fund.

#### Other charges to future profits

25 To avoid double counting, no account should be taken of any future surplus arising from assets corresponding to explicit items which have been counted towards the *capital resources requirement* such as shareholders funds, surplus carried forward or investment reserves. Deductions should be made in the calculation of future surpluses for the impact of any other arrangements which give rise to a charge over future surplus emerging (e.g. financial *reinsurance* arrangements, subordinated loan capital or contingent loan agreements). Deductions should also be made to the extent that any credit has been taken for the purposes of INSPRU 1.4.45 R (2) for the present value of future profits relating to non-profit business written in a *non-profit fund*. The information supplied to the appropriate regulator should identify the amount and reason for any adjustments made to the calculation of the prospective amount of future profits.

26 The *firm* should confirm to the appropriate regulator that the calculations have been properly carried out and that there are no other factors that should be taken into account.

#### Future profits - retrospective calculation

#### Overriding limit

27 The maximum amount of the *implicit item* relating to future profits permitted under the *Consolidated Life Directive* is 50% of the product of the estimated annual profit and the average period to run (not exceeding six years (ten years during the transitional period referred to in paragraph 5)) on the *policies* in the portfolio. Article 27(4) of the *Consolidated Life Directive* also imposes a further limit on the amount of the *implicit item* equal to 25% of the lower of:

- (1) the *firm's capital resources*; and
- (2) the higher of its *base capital resources requirement for long-term insurance business* and its *long-term insurance capital requirement*.

Once the transitional period set out in article 71(1) of the *Consolidated Life Directive* has expired in 2007 (see paragraph 5), the appropriate regulator will not allow a *capital resources* for more than the amount permitted by article 27(4) of the Directive.

#### Definition of profits

28 The estimated annual profit should be taken as the average annual surplus arising in the *long-term insurance fund* over the last five *financial years* up to the date of the most recent available valuation which has been submitted to the appropriate regulator prior to, or together with, the application. For this purpose, deficiencies arising should be treated as negative surpluses. Where a *firm's financial year* has altered, the surplus arising in a period falling partly outside the relevant five year period should be assumed to accrue uniformly over the period in question for the purpose of estimating the profits arising within the five year period. When there has been a transfer of a block of business into the *firm* (or out of the *firm*) during the period, surplus arising from the transferred block should be included (or excluded) for the full five year period. Where a portion of a block of business is transferred, the surplus included (or excluded) should be a reasonable estimate of the surplus arising from the portion transferred.

29 Where a *firm* has been carrying on *long-term insurance business* for less than 5 years, the total profits made during the past five years should be taken to be the aggregate of any surpluses that have arisen during the period in which *long-term insurance business* has been carried on less any deficiencies that may have arisen during that period. The resulting total should still be divided by five to obtain the estimated annual profit.

#### Exceptional items

30 Substantial items of an exceptional nature should be excluded from the calculation of the estimated annual profit. Such items include profits arising from an exceptional change in the value at which assets are brought into account, where this is not reflected in a similar change in the amount of the liabilities, and profits arising from a change in the overall valuation approach between one year and another. An exceptional loss (i.e. a reduction of an exceptional nature in the surplus arising) may be excluded from the calculation only to the extent that it can be set against a profit or profits up to the amount of the loss and arising from a similar cause. It is not intended, however, that any adjustment should be made for the effect on surplus of a net strengthening of reserves for costs associated with an expansion of the business or for special capital expenditure, such as the purchase of computer systems.

#### Double counting

31 The inclusion of investment income arising from the assets representing the explicit components of *capital resources* (as part of the estimated annual profit for the purpose of determining the future profits *implicit item*) would result in double-counting. If those assets were required to meet the effects of adverse developments, this would automatically result in the cessation of the contribution to profits from the associated investment income. It would clearly not be appropriate for the appropriate regulator to grant a *capital resources* which would enable a *firm* to meet the *capital resources requirement* on the basis of counting both the capital values of the assets and the value of the income flow which they can be expected to generate.

32 The definition of the estimated annual profit as the surplus arising in the *long-term insurance fund* ensures that any contribution to surplus arising from transfers from the profit and loss account, including investment income on shareholders' assets, is not included in the estimated annual profit. Thus double-counting should not arise in respect of shareholders' assets. Double-counting

may arise, however, in respect of the investment income from the assets representing the explicit components of *capital resources* carried within the *long-term insurance fund* (e.g. surplus carried forward or investment reserves), but the amount of such investment income is not separately identified in the *return*.

- 33 Where there is reason to suspect that the elimination of any such double-counting would reduce a *firm's capital resources* to close to or below the required level, or would otherwise be significant, the appropriate regulator will request this information with a view to taking account of this factor in determining the amount of the *implicit item*. Additional information concerning investment income should be furnished with an application for a *capital resources*, if a *firm* believes that any double-counting would fall into one of the categories mentioned above.

#### Average period to run

- 34 The average number of years remaining to run on *policies* should be calculated on the basis of the weighted average of the periods for individual *contracts of insurance*, using as weights the actuarial present value of the benefits payable under the contracts. A separate weighted average should be calculated for each of the various categories of contract and the results combined to obtain the weighted average for the portfolio as a whole. Approximate methods of calculation, which the *firm* considers will give results similar to the full calculation, will be accepted. In particular, the appropriate regulator will normally accept the calculation of an average period to run for a specific category of contract on the basis of the average valuation factor for future benefits derived from data contained in the abstract of the valuation report in the regulatory *returns*. A *firm* will be asked to demonstrate the validity of the method adopted only where an abnormal distribution of the business in force gives grounds for doubt about its accuracy.

- 35 Calculations will normally be requested only for the main categories of *insurance business*, accounting for not less than 90% of the *mathematical reserves*, except where there are grounds for expecting that the exclusion of certain categories of *policies* under this provision might have a significant effect on the resulting average period to run. Detailed calculations will not be required where a *capital resources* is sought in respect of a low multiple of the annual profits, well within the average period to run for the *firm*.

- 36 Where, for a particular category of business, a method of valuation is used which does not involve the calculation of the value of future benefits and which is significant for the *firm* in question, the calculation of the average period to run should be based on estimates of the value of future benefits.

#### Premature termination of contracts

- 37 Allowance should be made for the premature termination of *contracts of insurance*, based on the actual experience of the *firm* over the last five years, or other appropriate period, and taking into account specific features of contracts such as options which can be expected to lead to premature termination (e.g. guaranteed surrender values on income bonds written as *long-term insurance contracts* and option dates on flexible whole-life contracts). The adjustment should be made separately for each of the main categories of business. The use of industry-wide rates of termination will be acceptable where a *firm* is satisfied that this will result in sufficient allowance being made having regard to the *firm's* own experience. Methods of calculation that involve a degree of approximation will be permitted.

- 38 For certain types of contract, where the period left to run is most naturally defined as the term to a fixed maturity or expiry date, the allowance for premature termination should also take into account terminations resulting from death.

#### Overall limit

- 39 The overall average period left to run calculated as described above should be limited to a maximum of six years under article 27(4) of the *Consolidated Life Directive* (or a maximum of ten years during the transitional period referred to in paragraph 5) before applying it to the estimated annual profit in order to determine the maximum value of the future profits *implicit item*.

#### Definition of period to run

- 40 The definition of the period to run and the basis of the allowance for early termination should clearly be considered together. For certain types of contracts (e.g. pension contracts with a range

of retirement ages or other options), there is inherent uncertainty about the likely term to run. In such circumstances any estimate for determining the amount of the future profits *implicit item* for which a *capital resources* is sought should be based on prudent assumptions tending, if anything, to underestimate the average period to run.

### Zillmerising

41 The appropriate regulator does not normally expect to grant *capital resources* permitting *implicit items* due to *zillmerisation* except in very exceptional circumstances. *Zillmerisation* is an allowance for acquisition costs that are expected, under prudent assumptions, to be recoverable from future *premiums*. *Firms* can make a direct adjustment to their reserves for *zillmerisation*, subject to the requirements on *mathematical reserves* set out in INSPRU 1.3.43 R, and this is the usual approach. However, where no such adjustment has been made, or where the maximum adjustment has not been made in the *mathematical reserves*, the appropriate regulator will consider an application for an *implicit item*, if the amount is consistent with the amount that would have been allowed as an adjustment to *mathematical reserves* under INSPRU 1.3.43 R.

### Hidden reserves

42 The appropriate regulator will grant *waivers* permitting *implicit items* due to hidden reserves only in very exceptional circumstances. These items relate to hidden reserves resulting from the under-estimation of assets. The *rules* for the valuation of assets and liabilities (see GENPRU 1.3) which apply to assets and liabilities other than *mathematical reserves* are based on the valuation used by the *firm* for the purposes of its external accounts, with adjustments for regulatory prudence such as concentration limits for large holdings, and would not normally be expected to contain hidden reserves.

### Case studies on "unduly burdensome"

43 Some examples of situations where the existing *rules* might be considered to be unduly burdensome are given below:

- A *firm* writes *with-profits business*. The *firm's* investment policy is affected by its published financial position. Application of the *rules* without an *implicit item* would result in the *firm* adopting a lower equity backing ratio. It may be possible to demonstrate that, in the circumstances, it would be unduly burdensome to require the *firm* to incur costs (which might prejudice *policyholders*) resulting from the lower equity backing ratio, rather than take allowance for an *implicit item*.
- A *firm* has purchased a block of in-force business, on which the future profits may be reasonably estimated. However, this asset is given no value under the *rules*. It may be possible to demonstrate that it is unduly burdensome for the *firm* to recognise the cost of acquiring the assets whilst giving no value to the asset acquired.
- A *firm* has a block of in-force business, on which the future profits may be reasonably estimated. Application of the *rules* without an *implicit item* would result in a need to obtain additional capital. It may be possible to demonstrate that it is unduly burdensome, having regard to the particular circumstances of the *firm*, to require it to incur the costs involved in the injection of further capital rather than take allowance for an *implicit item*.
- A *firm* has purchased matching assets for guaranteed annuity liabilities. The operation of the asset and liability valuation *rules* leads to statutory losses in certain circumstances in spite of good matching of assets and liabilities on a realistic basis of assessment. It may be possible to demonstrate that it is unduly burdensome to require the *firm* to incur the costs involved in the injection of further capital rather than take allowance for an *implicit item*.

### Conditions which will typically be applied to implicit items waivers

#### Limits

44 Where *implicit items waivers* are granted, the value cannot exceed (and will normally be less than) the monetary limits described in paragraph 27, except that during the transitional period the pre-Solvency I limits will apply. In addition, time limits will apply and *waivers* will normally only last for 12 months.

#### Publicity

45

The appropriate regulator will publish the *capital resources* (see SUP 8.6 and SUP 8.7). Public disclosure is standard practice unless the appropriate regulator is satisfied that publication is inappropriate or unnecessary (see section 138A of the *Act*). Any request that a direction not be published should be made to the appropriate regulator in writing with grounds in support, as set out in SUP 8.6. Disclosure of a *capital resource* will normally be required in the *firm's annual returns*.

2



## Chapter 3

# Cross sector groups

## 3.1 Application

### 3.1.1

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- (1) ■ GENPRU 3.1 applies to every *firm* that is a member of a *financial conglomerate* other than:
  - (a) an *incoming EEA firm*;
  - (b) an *incoming Treaty firm*;
  - (c) a *UCITS qualifier*; and
  - (d) an *ICVC*.
- (2) ■ GENPRU 3.1 does not apply to a *firm* with respect to a *financial conglomerate* of which it is a member if the interest of the *financial conglomerate* in that *firm* is no more than a *participation*.
- (3) ■ GENPRU 3.1.25 R (Capital adequacy requirements: high level requirement), ■ GENPRU 3.1.26 R (Capital adequacy requirements: application of Method 4 from Annex I of the Financial Groups Directive), ■ GENPRU 3.1.29 R (Capital adequacy requirements: application of Methods 1, 2 or 3 from Annex I of the Financial Groups Directive) and ■ GENPRU 3.1.35 R (Risk concentration and intra group transactions: the main rule) do not apply with respect to a *third-country financial conglomerate*.

### Purpose

### 3.1.2

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

- (1) further material on *third-country financial conglomerates* can be found in ■ GENPRU 3.2;
- (2) ■ SUP 15.9 contains notification *rules* for members of *financial conglomerates*;
- (3) material on reporting obligations can be found in ■ SUP 16.12.32 R and ■ SUP 16.12.33 R ; and
- (4) material on systems and controls in *financial conglomerates* can be found in ■ SYSC 12.

## 3.1.3

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**Introduction: identifying a financial conglomerate**

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

**Introduction: The role of other competent authorities**

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

## 3.1.4

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3.1.5

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**Definition of financial conglomerate: basic definition**

A *financial conglomerate* means a *consolidation group* that is identified as a *financial conglomerate* in accordance with the decision tree in

- GENPRU 3 Annex 4 R.

3.1.6

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**Definition of financial conglomerate: sub-groups**

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

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

3.1.7

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**Definition of financial conglomerate: the financial sectors: general**

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

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

3.1.8

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- (1) This *rule* applies for the purpose of the definition of *financial conglomerate* and the *financial conglomerate definition decision tree*.
- (2) Any *mixed financial holding company* is considered to be outside the *overall financial sector* for the purpose of the tests set out in the boxes titled Threshold Test 1, Threshold Test 2 and Threshold Test 3 in the *financial conglomerate definition decision tree*.
- (3) Determining whether the tests set out in the boxes titled Threshold Test 2 and Threshold Test 3 in the *financial conglomerate definition decision tree* are passed is based on considering the consolidated and/or aggregated activities of the members of the *consolidation group* within the *insurance sector* and the consolidated and/or aggregated activities of the members of the *consolidation group* within the *banking sector* and the *investment services sector*.

3.1.9

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**Definition of financial conglomerate: adjustment of the percentages**

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

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

3.1.10

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

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

#### Definition of financial conglomerate: balance sheet totals

3.1.11

FCA PRA

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The calculations referred to in the *financial conglomerate definition decision tree* regarding the balance sheet must be made on the basis of the aggregated balance sheet total of the members of the *consolidation group*, according to their annual accounts. For the purposes of this calculation, *undertakings* in which a *participation* is held must be taken into account as regards the amount of their balance sheet total corresponding to the aggregated proportional share held by the *consolidation group*. However, where consolidated accounts are available, they must be used instead of aggregated accounts.

#### Definition of financial conglomerate: solvency requirement

3.1.12

FCA PRA

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

#### Definition of financial conglomerate: discretionary changes to the definition

3.1.13

FCA PRA

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

- (1) change the definition of *financial conglomerate* and the obligations applying with respect to a *financial conglomerate*;
- (2) apply the scheme in the *Financial Groups Directive* to *EEA regulated entities* in specified kinds of group structures that do not come within the definition of *financial conglomerate*; and
- (3) exclude a particular entity in the scope of capital adequacy requirements that apply with respect to a *financial conglomerate*.

**Capital adequacy requirements: introduction**

3.1.14

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

3.1.15

FCA PRA

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

3.1.16

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■ GENPRU 3.1.26 R to ■ GENPRU 3.1.31 R and ■ GENPRU 3 Annex 1 R implement the detailed capital adequacy requirements of the *Financial Groups Directive*. They only deal with a *financial conglomerate* for which the *appropriate regulator* is the *coordinator*. If another *competent authority* is *coordinator* of a *financial conglomerate*, those *rules* do not apply with respect to that *financial conglomerate* and instead that *coordinator* will be responsible for implementing those detailed requirements.

3.1.17

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Annex I of the *Financial Groups Directive* lays down four methods for calculating capital adequacy at the level of a *financial conglomerate*. Those four methods are implemented as follows:

- (1) Method 1 calculates capital adequacy using accounting consolidation. It is implemented by ■ GENPRU 3.1.29 R to ■ GENPRU 3.1.31 R and Part 1 of ■ GENPRU 3 Annex 1 R.
- (2) Method 2 calculates capital adequacy using a deduction and aggregation approach. It is implemented by ■ GENPRU 3.1.29 R to ■ GENPRU 3.1.31 R and Part 2 of ■ GENPRU 3 Annex 1 R.
- (3) Method 3 calculates capital adequacy using book values and the deduction of capital requirements. It is implemented by ■ GENPRU 3.1.29 R to ■ GENPRU 3.1.31 R and Part 3 of ■ GENPRU 3 Annex 1 R.
- (4) Method 4 consists of a combination of Methods 1, 2 and 3 from Annex I of the *Financial Groups Directive*, or a combination of two of those Methods. It is implemented by ■ GENPRU 3.1.26 R to ■ GENPRU 3.1.28 R, ■ GENPRU 3.1.30 R and Part 4 of ■ GENPRU 3 Annex 1 R.

3.1.18

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Part 4 of ■ GENPRU 3 Annex 1 R (Use of Method 4 from Annex I of the *Financial Groups Directive*) applies the *appropriate regulator's sectoral rules* with respect to the *financial conglomerate* as a whole, with some adjustments. Where Part 4 of ■ GENPRU 3 Annex 1 R applies the *appropriate regulator's sectoral rules* for:

- (1) the *insurance sector*, that involves a combination of Methods 2 and 3; and
- (2) the *banking sector* and the *investment services sector*, that involves a combination of Methods 1 and 3.

3.1.19

FCA PRA

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Paragraph 5.7 of ■ GENPRU 3 Annex 1 R (Capital adequacy calculations for financial conglomerates) deals with a case in which there are no capital ties between entities in a *financial conglomerate*. In particular, the *appropriate regulator*, after consultation with the other *relevant competent authorities* and in accordance with Annex I of the

*Financial Groups Directive*, will determine which proportional share of a solvency deficit in such an entity will have to be taken into account, bearing in mind the liability to which the existing relationship gives rise.

3.1.20

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- (1) In the following cases, the *appropriate regulator* (acting as *coordinator*) may choose which of the four methods for calculating capital adequacy laid down in Annex I of the *Financial Groups Directive* should apply:
- (a) where a *financial conglomerate* is headed by a *regulated entity* that has been authorised by the *appropriate regulator*; or
  - (b) the only *relevant competent authority* for the *financial conglomerate* is the *appropriate regulator*.
- (2) ■ GENPRU 3.1.28 R automatically applies Method 4 from Annex I of the *Financial Groups Directive* in these circumstances except in the cases set out in ■ GENPRU 3.1.28 R (1)(e) and ■ GENPRU 3.1.28 R (1)(f). The process in ■ GENPRU 3.1.22 G does not apply.

3.1.21

FCA PRA

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Where ■ GENPRU 3.1.20 G does not apply, the Annex I method to be applied is decided by the *coordinator* after consultation with the *relevant competent authorities* and the *financial conglomerate* itself.

3.1.22

FCA PRA

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The method of calculating capital adequacy chosen in respect of a *financial conglomerate* as described in ■ GENPRU 3.1.21 G will be applied with respect to that *financial conglomerate* by varying the *Part 4A permission* of a *firm* in that *financial conglomerate* to include a *requirement*. That *requirement* will have the effect of obliging the *firm* to ensure that the *financial conglomerate* has capital resources of the type and amount needed to comply with whichever of the methods in ■ GENPRU 3 Annex 1 R is to be applied with respect to that *financial conglomerate*. The powers in the *Act* relating to *waivers* and varying a *firm's Part 4A permission* can be used to implement one of the methods from Annex I of the *Financial Groups Directive* in a way that is different from that set out in ■ GENPRU 3.1 and ■ GENPRU 3 Annex 1 R if that is necessary to reflect the consultations referred to in ■ GENPRU 3.1.21 G.

3.1.23

FCA PRA

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If there is more than one *firm* in a *financial conglomerate* with a *Part 4A permission*, the *appropriate regulator* would not normally expect to apply the *requirement* described in ■ GENPRU 3.1.22 G to all of them. Normally it will only be necessary to apply it to one.

3.1.24

FCA PRA

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The *appropriate regulator* expects that in all or most cases falling into ■ GENPRU 3.1.21 G, the *rules* in Part 4 of ■ GENPRU 3 Annex 1 R will be applied.

### Capital adequacy requirements: high level requirement

3.1.25

FCA PRA

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- (1) A *firm* that is a member of a *financial conglomerate* must at all times have capital resources of such an amount and type that results in the capital resources of the *financial conglomerate* taken as a whole being adequate.

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

#### Capital adequacy requirements: application of Method 4 from Annex I of the Financial Groups Directive

3.1.26

FCA PRA

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If this *rule* applies under ■ GENPRU 3.1.27 R to a *firm* with respect to a *financial conglomerate* of which it is a member, the *firm* must at all times have capital resources of an amount and type:

- (1) that ensure that the *financial conglomerate* has capital resources of an amount and type that comply with the *rules* applicable with respect to that *financial conglomerate* under Part 4 of ■ GENPRU 3 Annex 1 R (as modified by that annex); and
- (2) that as a result ensure that the *firm* complies with those *rules* (as so modified) with respect to that *financial conglomerate*.

3.1.27

FCA PRA

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■ GENPRU 3.1.26 R applies to a *firm* with respect to a *financial conglomerate* of which it is a member if one of the following conditions is satisfied:

- (1) the condition in ■ GENPRU 3.1.28 R is satisfied; or
- (2) this *rule* is applied to the *firm* with respect to that *financial conglomerate* as described in ■ GENPRU 3.1.30 R.

#### Capital adequacy requirements: compulsory application of Method 3 from Annex I of the Financial Groups Directive

3.1.28

FCA PRA

R

- (1) The condition in this *rule* is satisfied for the purpose of ■ GENPRU 3.1.27 R (1) with respect to a *firm* and a *financial conglomerate* of which it is a member (with the result that ■ GENPRU 3.1.26 R automatically applies to that *firm*) if:
  - (a) notification has been made in accordance with regulation 2 of the *Financial Groups Directive Regulations* that the *financial conglomerate* is a *financial conglomerate* and that the *appropriate regulator* is *coordinator* of that *financial conglomerate*;
  - (b) the *financial conglomerate* is not part of a wider UK regulated EEA *financial conglomerate*;
  - (c) the *financial conglomerate* is not a UK regulated EEA *financial conglomerate* under another *rule* or under paragraph (b) of the definition of UK regulated EEA *financial conglomerate* (application of supplementary supervision through a *firm's Part 4A permission*);

- (d) one of the following conditions is satisfied:
- (i) the *financial conglomerate* is headed by a *regulated entity* that is a *UK domestic firm*; or
  - (ii) the only *relevant competent authority* for that *financial conglomerate* is the *appropriate regulator*;
- (e) this *rule* is not disapplied under paragraph 5.7 of ■ GENPRU 3 Annex 1 R (No capital ties); and
- (f) the *financial conglomerate* meets the condition set out in the box titled Threshold Test 2 (10% average of balance sheet and solvency requirements) in the *financial conglomerate definition decision tree*.
- (2) Once ■ GENPRU 3.1.26 R applies to a *firm* with respect to a *financial conglomerate* of which it is a member under ■ GENPRU 3.1.27 R (1), (1)(f) ceases to apply with respect to that *financial conglomerate*. Therefore the fact that the *financial conglomerate* subsequently ceases to meet the condition in (1)(f) does not mean that the condition in this *rule* is not satisfied.

#### Capital adequacy requirements: application of Methods 1, 2 or 3 from Annex I of the Financial Groups Directive

3.1.29

FCA PRA

R

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

#### Capital adequacy requirements: use of Part 4A permission to apply Annex I of the Financial Groups Directive

3.1.30

FCA PRA

R

With respect to a *firm* and a *financial conglomerate* of which it is a member:

- (1) ■ GENPRU 3.1.26 R (Method 4 from Annex I of the *Financial Groups Directive*) is applied to the *firm* with respect to that *financial conglomerate* for the purposes of ■ GENPRU 3.1.27 R (2); or
- (2) ■ GENPRU 3.1.29 R (Methods 1 to 3 from Annex I of the *Financial Groups Directive*) is applied to the *firm* with respect to that *financial conglomerate*;

if the *firm's Part 4A permission* contains a *requirement* obliging the *firm* to comply with ■ GENPRU 3.1.26 R or, as the case may be, ■ GENPRU 3.1.29 R.

3.1.31

FCA PRA

R

If ■ GENPRU 3.1.29 R (Methods 1-3 from Annex I of the *Financial Groups Directive*) applies to a *firm* with respect to a *financial conglomerate* of which it is a member, the definitions of *conglomerate capital resources* and *conglomerate capital resources requirement* that apply for the purposes of that *rule* are the ones from whichever of Part 1, Part 2 or Part 3 of ■ GENPRU 3 Annex 1 R is specified in the *requirement* referred to in ■ GENPRU 3.1.30 R.

### Risk concentration and intra-group transactions: introduction

3.1.32

FCA PRA

G

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

3.1.33

FCA PRA

G

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

### Risk concentration and intra-group transactions: application

3.1.34

FCA PRA

R

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

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

### Risk concentration and intra group transactions: the main rule

3.1.35

FCA PRA

R

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

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

3.1.36

**R**

FCA PRA

Table: application of sectoral rules

This table belongs to ■ GENPRU 3.1.35 R

The most important financial sector	Applicable sectoral rules	
	Risk concentration	Intra-group transactions
<i>Banking and investment services sector</i>	<b>BIPRU 8.9A (Consolidated large exposure requirements) including BIPRU TP as it applies to a UK consolidation</b>	<b>BIPRU 10 (Large exposures requirements) including BIPRU TP as it applies on a solo basis and relates to BIPRU 10.</b>
<i>Insurance sector</i>	None	<b>Rule 9.39 of IPRU(INS)</b>
<b>Note</b>	Any waiver granted to a member of the <i>financial conglomerate</i> , on a solo or consolidated basis, shall not apply in respect of the <i>financial conglomerate</i> for the purposes of GENPRU 3.1.36 R.	

3.1.37

**R**

FCA PRA

- (1) Where the *rules* for the *banking and investment services sector* are being applied, a *mixed financial holding company* must be treated as being a *financial holding company*.
- (2) Where the *rules* for the *insurance sector* are being applied, a *mixed financial holding company* must be treated as being an *insurance holding company*.

3.1.38

**R**

FCA PRA

- (1) This *rule* applies for the purposes of the definitions of:
  - (a) a *core concentration risk group counterparty*; and
  - (b) a *non-core concentration risk group counterparty*;
 as they apply for the purposes of the *rules* for the *banking and investment services sector* as applied by ■ GENPRU 3.1.36 R.
- (2) For the purposes of ■ BIPRU 10.9A.4 R (1) and ■ BIPRU 10.9A.4 R (2) (as they apply to the definitions in ■ GENPRU 3.1.38R (1)), the conditions are also satisfied if the *counterparty* and the *firm* are included within the scope of consolidated supervision on a full basis with respect to the same *financial conglomerate* under ■ GENPRU 3.1 or the relevant implementation measures in another *EEA State* for the *Financial Groups Directive*.
- (3) [deleted]

(4) [deleted]

#### The financial sectors: asset management companies

3.1.39

FCA PRA

R

- (1) In accordance with Article 30 of the *Financial Groups Directive* (Asset management companies), this *rule* deals with the inclusion of an *asset management company* that is a member of a *financial conglomerate* in the scope of regulation of *financial conglomerates*. This *rule* does not apply to the definition of *financial conglomerate*.
- (2) An *asset management company* is in the *overall financial sector* and is a *regulated entity* for the purpose of:
  - (a) ■ GENPRU 3.1.26 R to ■ GENPRU 3.1.36 R;
  - (b) ■ GENPRU 3 Annex 1 R (Capital adequacy calculations for financial conglomerates) and ■ GENPRU 3 Annex 2 R (Prudential rules for third country groups); and
  - (c) any other provision of the *Handbook* relating to the supervision of *financial conglomerates*.
- (3) In the case of a *financial conglomerate* for which the *appropriate regulator* is the *coordinator*, all *asset management companies* must be allocated to one *financial sector* for the purposes in (2), being either the *investment services sector* or the *insurance sector*. But if that choice has not been made in accordance with (4) and notified to the *appropriate regulator* in accordance with (4)(d), an *asset management company* must be allocated to the *investment services sector*.
- (4) The choice in (3):
  - (a) must be made by the *undertaking* in the *financial conglomerate* holding the position referred to in Article 4(2) of the *Financial Groups Directive* (group member to whom notice must be given that the group has been found to be a *financial conglomerate*);
  - (b) applies to all *asset management companies* that are members of the *financial conglomerate* from time to time;
  - (c) cannot be changed; and
  - (d) must be notified to the *appropriate regulator* as soon as reasonably practicable after the notification in (4)(a).
- (5) This *rule* applies even if:
  - (a) a *UCITS management company* is a *BIPRU investment firm*; or

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(b) *an asset management company is an investment firm.*

## 3.2 Third-country groups

### Application

3.2.1

FCA PRA

R

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

- (1) an *incoming EEA firm*; or
- (2) an *incoming Treaty firm*; or
- (3) a *UCITS qualifier*; or
- (4) an *ICVC*.

### Purpose

3.2.2

FCA PRA

G

■ GENPRU 3.2 implements in part Article 18 of the *Financial Groups Directive* and Article 143 of the *Banking Consolidation Directive*.

### Equivalence

3.2.3

FCA PRA

G

The first question that must be asked about a *third-country financial group* is whether the *EEA regulated entities* in that *third-country group* are subject to supervision by a *third-country competent authority*, which is equivalent to that provided for by the *Financial Groups Directive* (in the case of a *financial conglomerate*) or the *EEA prudential sectoral legislation* for the *banking sector* or the *investment services sector* (in the case of a *banking and investment group*). Article 18(1) of the *Financial Groups Directive* sets out the process for establishing equivalence with respect to *third-country financial conglomerates* and Article 143 (1) and (2) of the *Banking Consolidation Directive* does so with respect to *third-country banking and investment groups*.

### Other methods: General

3.2.4

FCA PRA

G

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

**Supervision by analogy: introduction**

3.2.5

FCA PRA

G

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

3.2.6

FCA PRA

G

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

3.2.7

FCA PRA

G

■ GENPRU 3.2.8 R and ■ GENPRU 3.2.9 R and ■ GENPRU 3 Annex 2 R set out *rules* to deal with the situation covered in ■ GENPRU 3.2.5 G. Those *rules* do not apply automatically. Instead, they can only be applied with respect to a particular *third-country group* through the *Part 4A permission* of a *firm* in that *third-country group*. Broadly speaking the procedure described in ■ GENPRU 3.1.22 G also applies to this process.

**Supervision by analogy: rules for third-country conglomerates**

3.2.8

FCA PRA

R

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

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

3.2.9

FCA PRA

R

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



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

**FCA** **PRA**

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

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

PAGE 1

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

Capital resources	2.1	The <i>conglomerate capital resources</i> of a <i>financial conglomerate</i> calculated in accordance with this Part are equal to the sum
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		<p>of the following amounts (so far as they qualify under paragraph 2.3) for each member of the <i>overall financial sector</i>:</p> <p>(1) (for the <i>person</i> at the head of the <i>financial conglomerate</i>) its <i>solo capital resources</i>;</p> <p>(2) (for any other member):</p> <p>(a) its <i>solo capital resources</i>; less</p> <p>(b) the book value of the <i>financial conglomerate's</i> investment in that member , to the extent not already deducted in the calculation of the <i>solo capital resources</i> for:</p> <p>(i) the <i>person</i> at the head of the <i>financial conglomerate</i>; or</p> <p>(ii) any other member.</p>
	2.2	The deduction in paragraph 2.1(2) must be carried out separately for each type of capital represented by the <i>financial conglomerate's</i> investment in the member concerned.
	2.3	The elements of capital that qualify for the purposes of paragraph 2.1 are those that qualify in accordance with the <i>applicable sectoral rules</i> . In particular, the portion of the <i>conglomerate capital resources requirement</i> attributable to a particular member of a <i>financial sector</i> must be met by capital resources that would be eligible under the <i>sectoral rules</i> that apply to the calculation of its <i>solo capital resources</i> .
Capital resources requirement	2.4	The <i>conglomerate capital resources requirement</i> of a <i>financial conglomerate</i> calculated in accordance with this Part is equal to the sum of the <i>solo capital resources requirement</i> for each member of the <i>financial conglomerate</i> that is in the <i>overall financial sector</i> .
Partial inclusion	2.5	The capital resources and capital resources requirements of a member of the <i>financial conglomerate</i> in the <i>overall financial sector</i> must be included proportionally. If however the member is a <i>subsidiary undertaking</i> and it has a <i>solvency deficit</i> , they must be included in full.
Accounts	2.6	The information required for the purpose of establishing whether or not a <i>firm</i> is complying with GENPRU 3.1.29 R (insofar as the definitions in this Part are applied for the purpose of that <i>rule</i> ) must be based on the individual accounts of members of the <i>financial conglomerate</i> , together with such other sources of information as appropriate.

3. Table: PART 3: Method 3 of Annex I of the Financial Groups Directive(Book value/Requirement Method)

Capital resources	3.1	The <i>conglomerate capital resources</i> of a <i>financial conglomerate</i> calculated in accordance with this Part are equal to the capital resources of the <i>person</i> at the head of the <i>financial conglomerate</i> that qualify under paragraph 3.2.
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	3.2	The elements of capital that qualify for the purposes of paragraph 3.1 are those that qualify in accordance with the <i>applicable sectoral rules</i> . In particular, the portion of the <i>conglomerate capital resources requirement</i> attributable to a particular member of a <i>financial sector</i> must be met by capital resources that would be eligible under the <i>sectoral rules</i> that apply to the calculation of its <i>solo capital resources</i> .
Capital resources requirement	3.3	<p>The <i>conglomerate capital resources requirement</i> of a <i>financial conglomerate</i> calculated in accordance with this Part is equal to the sum of the following amounts for each member of the <i>overall financial sector</i>:</p> <p>(1) (in the case of the <i>person</i> at the head of the <i>financial conglomerate</i>) its <i>solo capital resources requirement</i>;</p> <p>(2) (in the case of any other member) the higher of the following two amounts:</p> <p>(a) its <i>solo capital resources requirement</i>; and</p> <p>(b) the book value of the interest of the <i>person</i> at the head of the <i>financial conglomerate</i> in that member.</p>
	3.4	A <i>participation</i> may be valued using the equity method of accounting.
Partial inclusion	3.5	The capital resources requirement of a member of the <i>financial conglomerate</i> in the <i>overall financial sector</i> must be included proportionally. If however the member has a <i>solvency deficit</i> and is a <i>subsidiary undertaking</i> , it must be included in full.
Accounts	3.6	The information required for the purpose of establishing whether or not a <i>firm</i> is complying with GENPRU 3.1.29 R (insofar as the definitions in this Part are applied for the purpose of that <i>rule</i> ) must be based on the individual accounts of members of the <i>financial conglomerate</i> , together with such other sources of information as appropriate.

4 Table: PART 4: Method 4 of Annex I of the Financial Groups Directive(Combination of Methods 1, 2 and 3)

Applicable sectoral rules	4.1	The <i>rules</i> that apply with respect to a particular <i>financial conglomerate</i> under GENPRU 3.1.26 R are those relating to capital adequacy and solvency set out in the table in paragraph 4.2.
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5 Table: Paragraph 4.2: Application of sectoral consolidation rules

Type of financial conglomerate	Applicable sectoral consolidation rules
<i>Banking and investment services conglomerate</i>	BIPRU 8 and <i>BIPRU TP</i> , subject to paragraph 4.5.
<i>Insurance conglomerate</i>	INSPRU 6.1 amended in accordance with Part 5.

6 Table

Types of financial conglomerate	4.3	<p>(1) This paragraph sets out how to determine the category of <i>financial conglomerate</i> for the purposes of paragraphs 4.1 and 4.2.</p> <p>(2) If there is an <i>EEA regulated entity</i> at the head of the <i>financial conglomerate</i>, then:</p> <p>(a) if that entity is in the <i>banking sector</i> or the <i>investment services sector</i>, the <i>financial conglomerate</i> is a <i>banking and investment services conglomerate</i>; or</p> <p>(b) if that entity is in the <i>insurance sector</i>, the <i>financial conglomerate</i> is an <i>insurance conglomerate</i>.</p> <p>(3) If (2) does not apply and the <i>most important financial sector</i> is the <i>banking and investment services sector</i>, it is a <i>banking and investment services conglomerate</i>.</p> <p>(4) If (2) and (3) does not apply, it is an <i>insurance conglomerate</i>.</p>
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7 Table

A mixed financial holding company	4.4	<p>A <i>mixed financial holding company</i> must be treated in the same way as:</p> <p>(1) a <i>financial holding company</i> (if the rules in BIPRU 8 ) are applied; or</p> <p>(2) an <i>insurance holding company</i> (if the rules in INSPRU 6.1 are applied).</p>
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8 Table: PART 5: Principles applicable to all methods

Transfer-ability of capital	5.1	<p>Capital may not be included in:</p> <p>(1) a <i>firm's conglomerate capital resources</i> under GENPRU 3.1.29 R; or</p> <p>(2) in the capital resources of the <i>financial conglomerate</i> for the purposes of GENPRU 3.1.26 R;</p> <p>if the effectiveness of the transferability and availability of the capital across the different members of the <i>financial conglomerate</i> is insufficient, given the objectives (as referred to in the third unnumbered sub-paragraph of paragraph</p>
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## Double counting

5.2

2(ii) of Annex I of the *Financial Groups Directive* (Technical principles)) of the capital adequacy rules for *financial conglomerates*.

Capital must not be included in:

- (1) a *firm's conglomerate capital resources* under GENPRU 3.1.29 R; or
- (2) the capital resources of the *financial conglomerate* for the purposes of GENPRU 3.1.26 R;

if:

- (3) it would involve double counting or multiple use of the same capital; or
- (4) it results from any inappropriate intra-group creation of capital.

## Cross sectoral capital

5.3

In accordance with the second sub-paragraph of paragraph 2(ii) of Section I of Annex I of the *Financial Groups Directive* (Other technical principles and insofar as not already required in Parts 1-3):

- (1) the solvency requirements for each different *financial sector* represented in a *financial conglomerate* required by GENPRU 3.1.26 R or, as the case may be, GENPRU 3.1.29 R must be covered by own funds elements in accordance with the corresponding *applicable sectoral rules*; and
- (2) if there is a deficit of own funds at the *financial conglomerate* level, only cross sectoral capital (as referred to in that sub-paragraph) shall qualify for verification of compliance with the additional solvency requirement required by GENPRU 3.1.26 R or, as the case may be, GENPRU 3.1.29 R.

## Application of sectoral rules: General

5.4

The following adjustments apply to the *applicable sectoral rules* as they are applied by the *rules* in this annex.

- (1) The scope of those *rules* will be extended to cover any *mixed financial holding company* and each other member of the *overall financial sector*.
- (2) If any of those *rules* would otherwise not apply to a situation in which they are applied by GENPRU 3 Annex 1 R, those *rules* nevertheless still apply (and in particular, any of those *rules* that would otherwise have the effect of disapplying consolidated supervision (or, in the case of the *insurance sector*, supplementary supervision) do not apply).
- (3) (If it would not otherwise have been included) an *ancillary insurance services undertaking* is included in the *insurance sector*.
- (4) The scope of those *rules* is amended so as to remove restrictions relating to where members of the *financial conglomerate*

### Application of sectoral 5.5 rules: Insurance sector

*erate* are incorporated or have their head office, so that the scope covers every member of the *financial conglomerate* that would have been included in the scope of those *rules* if those members had their head offices in an *EEA State*.

(5) (For the purposes of Parts 1 to 3) those *rules* must be adjusted, if necessary, when calculating the capital resources, capital resources requirements or solvency requirements for a particular *financial sector* to exclude those for a member of another *financial sector*.

(6) Any *waiver* granted to a member of the *financial conglomerate* under those *rules* does not apply for the purposes of this annex.

(1) This *rule* applies an adjustment to the *applicable sectoral rules* for the *insurance sector* as they are applied by the *rules* in this annex.

(2) To the extent that:

- (a) those *rules* merely require a report on whether or not a specified level of solvency is met (a soft limit); or
- (b) the requirements in those *rules* concern having certain net assets of an amount at or above certain levels;

those requirements are restated so as to include an obligation at all times actually to have capital at or above that level (a hard limit), thereby turning a soft limit into a hard limit and turning a limit drafted by reference to assets and liabilities into a requirement that the level of capital be maintained at or above a specified level. If those *rules* apply both a hard and a soft limit, and the level of the soft limit is higher, that soft limit is applied under this annex, but translated into a hard limit in accordance with the earlier provisions of this *rule*.

### Application of sectoral 5.6 rules: Banking sector and investment services sector

The following adjustments apply to the *applicable sectoral rules* for the *banking sector* and the *investment services sector* as they are applied by the *rules* in this annex.

(1) References in those *rules* to *non-EEA sub-groups* do not apply.

(2) (For the purposes of Parts 1 to 3), where those *rules* require a group to be treated as if it were a single *undertaking*, those *rules* apply to the *banking sector* and *investment services sector* taken together.

(3) Any *investment firm consolidation waivers* granted to members of the *financial conglomerate* do not apply.

(4) (For the purposes of Parts 1 to 4), without prejudice to the application of requirements in **BIPRU 8** preventing the use of an *advanced prudential calculation approach* on a consolidated basis, any *advanced prudential calculation ap-*

No capital ties

5.7

*proach permission* that applies for the purpose of BIPRU 8 does not apply.

(5) (For the purposes of Parts 1 to 4), BIPRU 8.5.9 R and BIPRU 8.5.10 R do not apply.

(6) (For the purposes of Parts 1 to 4), where the *financial conglomerate* does not include a *credit institution*, the method in GENPRU 2 Annex 4 R must be used for calculating the capital resources and BIPRU 8.6.8 R does not apply.

(1) This *rule* deals with a *financial conglomerate* in which some of the members are not linked by capital ties at the time of the notification referred to in GENPRU 3.1.28 R (1) (Capital adequacy requirements: Compulsory application of Method 4 from Annex I of the Financial Groups Directive).

(2) If:

(a) GENPRU 3.1.26 R (Capital adequacy requirements: Application of Method 4 from Annex I of the Financial Groups Directive) would otherwise apply with respect to a *financial conglomerate* under GENPRU 3.1.28 R; and

(b) all members of that *financial conglomerate* are linked directly or indirectly with each other by capital ties except for members that collectively are of negligible interest with respect to the objectives of supplementary supervision of *regulated entities in a financial conglomerate* (the "peripheral members");

GENPRU 3.1.28 R continues to apply. Otherwise GENPRU 3.1.28 R does not apply with respect to a *financial conglomerate* falling into (1).

(3) If GENPRU 3.1.28 R applies with respect to a *financial conglomerate* in accordance with (2) the peripheral members must be excluded from the calculations under GENPRU 3.1.26 R.

(4) If:

(a) GENPRU 3.1.26 R applies with respect to *financial conglomerate* falling into (1) under GENPRU 3.1.27 R (2) (Use of Part 4A permission to apply Annex I of the Financial Groups Directive); or

(b) GENPRU 3.1.29 R (Capital adequacy requirements: Application of Methods 1, 2 or 3 from Annex I of the Financial Groups Directive) applies with respect to a *financial conglomerate* falling into (1);

then:

(c) the treatment of the links in (1) (including the treatment of any *solvency deficit*) is as provided for in the *requirement* referred to in GENPRU 3.1.30 R; and

(d) GENPRU 3.1.26 R or GENPRU 3.1.29 R, as the case may be, apply even if the *applicable sectoral rules* do not deal with how *undertakings* not linked by capital ties are to be dealt with for the purposes of consolidated supervision (or, in the case of the *insurance sector*, supplementary supervision).

(5) Once GENPRU 3.1.26 R applies to a *firm* with respect to a *financial conglomerate* of which it is a member under GENPRU 3.1.27 R (1) (automatic application of Method 4 from Annex I of the *Financial Groups Directive* on satisfaction of the condition in GENPRU 3.1.28 R), the disapplication of GENPRU 3.1.28 R under (2) ceases to apply with respect to that *financial conglomerate*.

## 9 Table: PART 6: Definitions used in this Annex

Defining the financial sectors 6.1

For the purposes of Parts 1 to 3 of this annex (but, not for the purposes of the definition of *most important financial sector*):

(1) an *asset management company* is allocated in accordance with GENPRU 3.1.39 R; and

(2) a *mixed financial holding company* must be treated as being a member of the *most important financial sector*.

Solo capital resources requirement: Banking sector and investment service sector 6.2

(1) The *solo capital resources requirement* of an *undertaking* in the *banking sector* or the *investment services sector* must be calculated in accordance with this *rule*, subject to paragraphs 6.5 and 6.6.

(2) The *solo capital resources requirement* of a *building society* is its *CRR*.

(3) The *solo capital resources requirement* of an *electronic money institution* is the capital resources requirement that applies to it under the *Electronic Money Regulations*.

(4) If there is a *credit institution* in the *financial conglomerate*, the *solo capital resources requirement* for any *undertaking* in the *banking sector* or the *investment services sector* is, subject to (2) and (3), calculated in accordance with the *rules* for calculating the *CRR* of a *bank* that is a *BIPRU firm*.

(5) If:

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

(b) there is at least one *CAD investment firm* in the *financial conglomerate*; and

(c) all the *CAD investment firms* in the *financial conglomerate* are *limited licence firms* or *limited activity firms*;

the *solo capital resources requirement* for any *undertaking* in the *banking sector* or the *investment services sector* is cal-

		<p>culated in accordance with the <i>rules</i> for calculating the <i>CRR</i> of:</p> <p>(d) (if there is a <i>limited activity firm</i> in the <i>financial conglomerate</i>), a <i>BIPRU limited activity firm</i>; or</p> <p>(e) (in any other case), a <i>BIPRU limited licence firm</i>.</p> <p>(6) If:</p> <p>(a) the <i>financial conglomerate</i> does not include a <i>credit institution</i>; and</p> <p>(b) (5) does not apply;</p> <p>the <i>solo capital resources requirement</i> for any <i>undertaking</i> in the <i>banking sector</i> or the <i>investment services sector</i> is calculated in accordance with the <i>rules</i> for calculating the <i>CRR</i> of a <i>full scope BIPRU investment firm</i>.</p> <p>(7) Any <i>CRR</i> calculated under a <i>BIPRU TP</i> may be used for the purposes of the <i>solo capital resources requirement</i> in this <i>rule</i> in the same way that the <i>CRR</i> can be used under <b>BIPRU 8</b>.</p>
Solo capital resources requirement: application of rules	6.3	Any exemption that would otherwise apply under any <i>rules</i> applied by paragraph 6.2 do not apply for the purposes of this Annex.
Solo capital resources requirement: Insurance sector	6.4	<p>(1) The <i>solo capital resources requirement</i> of an <i>undertaking</i> in the <i>insurance sector</i> must be calculated in accordance with this <i>rule</i>.</p> <p>(2) Subject to (3), the <i>solo capital resources requirement</i> of an <i>undertaking</i> in the <i>insurance sector</i> is the capital resources requirement identified in <b>INSPRU 6.1.34 R</b> (1) to (8) as applying to that <i>undertaking</i>.</p> <p>(3) <b>INSPRU 6.1.34 R</b> (1)(b) does not apply for the purposes of this annex.</p>
Solo capital resources requirement: EEA firms in the banking sector or investment services sector	6.5	<p>The <i>solo capital resources requirement</i> for an <i>EEA regulated entity</i> (other than a <i>BIPRU firm</i>, an <i>insurer</i> or an <i>EEA insurer</i>) that is subject to the <i>solo capital adequacy sectoral rules</i> for its <i>financial sector</i> of the <i>competent authority</i> that authorised it is equal to the amount of capital it is obliged to hold under those <i>sectoral rules</i> provided that the following conditions are satisfied:</p> <p>(1) (for the purposes of the <i>banking sector</i> and the <i>investment services sector</i>) those <i>sectoral rules</i> must correspond to the <i>appropriate regulator's sectoral rules</i> identified in paragraph 6.2 as applying to that <i>financial sector</i>;</p> <p>(2) the entity must be subject to those <i>sectoral rules</i> in (1); and</p> <p>(3) paragraph 6.3 applies to the entity and those <i>sectoral rules</i>.</p>

<p><b>Solo capital resources requirement: non-EEA firms subject to equivalent regimes in the banking sector or investment services sector</b>      6.6</p>	<p>The <i>solo capital resources requirement</i> for a <i>recognised third country credit institution</i> or a <i>recognised third country investment firm</i> is the amount of capital resources that it is obliged to hold under the <i>sectoral rules</i> for its <i>financial sector</i> that apply to it in the state or territory in which it has its head office provided that:</p> <p>(1) there is no reason for the <i>firm</i> applying the <i>rules</i> in this annex to believe that the use of those <i>sectoral rules</i> would produce a lower figure than would be produced under paragraph 6.2; and</p> <p>(2) paragraph 6.3 applies to the entity and those <i>sectoral rules</i>.</p>
<p><b>Solo capital resources requirement: mixed financial holding company</b>      6.7</p>	<p>The <i>solo capital resources requirement</i> of a <i>mixed financial holding company</i> is a notional capital requirement. It is the capital adequacy requirement that applies to <i>regulated entities</i> in the <i>most important financial sector</i> under the table in paragraph 6.10.</p>

10 Table

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

11 Table: Paragraph 6.10: Application of sectoral consolidation rules

Financial sector	Appropriate regulator's sectoral rules
<i>Banking sector</i>	<b>BIPRU 8</b> and <i>BIPRU TP</i> , as adjusted under paragraph 4.5
<i>Insurance sector</i>	<b>INSPRU 6.1</b> .
<i>Investment services sector</i>	<b>BIPRU 8</b> and <i>BIPRU TP</i>

12 Table:

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

**FCA** **PRA**

## 1 Table: PART 1: Third-country financial conglomerates

- 1.1 This Part of this annex sets out the *rules* with which a *firm* must comply under GENPRU 3.2.8 R with respect to a *financial conglomerate* of which it is a member.
- 1.2 A *firm* must comply, with respect to the *financial conglomerate* referred to in paragraph 1.1, with whichever of GENPRU 3.1.26 R and GENPRU 3.1.29 R is applied under paragraph 1.3.
- 1.3 For the purposes of paragraph 1.2:
- (1) the *rule* in GENPRU 3.1 that applies as referred to in paragraph 1.2 is the one that is specified by the *requirement* referred to in GENPRU 3.2.8 R;
  - (2) (where GENPRU 3.1.29 R is applied) the definitions of *conglomerate capital resources* and *conglomerate capital resources requirement* that apply for the purposes of that *rule* are the ones from whichever of Part 1, Part 2 or Part 3 of GENPRU 3 Annex 1 R is specified in that *requirement*; and
  - (3) the *rules* so applied (including those in GENPRU 3 Annex 1 R) are adjusted in accordance with paragraph 3.1.
- 1.4 If the condition in Articles 7(4) and 8(4) of the *Financial Groups Directive* is satisfied (the *financial conglomerate* is headed by a *mixed financial holding company*) with respect to the *financial conglomerate* referred to in paragraph 1.1 the *firm* must also comply with GENPRU 3.1.35 R (as adjusted in accordance with paragraph 3.1) with respect to that *financial conglomerate*.
- 1.5 A *firm* must comply with the following with respect to the *financial conglomerate* referred to in paragraph 1.1:
- (1) SYSC 12 (as it applies to *financial conglomerates* and as adjusted under paragraph 3.1); and
  - (2) GENPRU 3.1.25 R.

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

- 2.1 This Part of this annex sets out the *rules* with which a *firm* must comply under GENPRU 3.2.9 R with respect to a *third-country banking and investment group* of which it is a member.
- 2.2 A *firm* must comply with one of the sets of *rules* specified in paragraph 2.3 as adjusted under paragraph 3.1 with

	respect to the <i>third-country banking and investment group</i> referred to in paragraph 2.1.
2.3	The <i>rules</i> referred to in paragraph 2.2 are as follows:
	(1) the <i>applicable sectoral consolidation rules</i> in BIPRU 8; or
	(2) the <i>rules</i> in ELM 7.
2.4	The set of <i>rules</i> from paragraph 2.3 that apply with respect to a particular <i>third-country banking and investment group</i> (as referred to in paragraph 2.1) are those that would apply if they were adjusted in accordance with paragraph 3.1.
2.5	The <i>sectoral rules</i> applied by Part 2 of this annex cover all prudential <i>rules</i> applying on a consolidated basis including those relating to large exposures.
2.6	A <i>firm</i> must comply with SYSC 12 (as it applies to <i>banking and investment groups</i> and as adjusted under paragraph 3.1) with respect to the <i>third-country banking and investment group</i> referred to in paragraph 2.1.

### 3 Table: PART 3: Adjustment of scope

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

## Guidance Notes for Classification of Groups

**FCA** **PRA**

This annex consists only of one or more forms. Forms are to be found through the following address:

*Classification of Groups (GENPRU 3.1.3 G) - FSA/docs/genpru/genpru\_ch3\_annex3G.pdf*

### Purpose and scope

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

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

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

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

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

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

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

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

### *General guidance*

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

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

Please note the following:

- (a) Branches should be included as part of the parent entity.
- (b) Include in the calculations overseas entities owned by the relevant group or sub-group.
- (c) There are only two sectors for this purpose: banking/investment and insurance.
- (d) You will need to assign non-regulated financial entities to one of these sectors:
  - **banking/investment** activities are listed in - Annex 1 to the Banking Consolidation Directive
  - **insurance** activities are listed in - IPRU Insurers Annex 11.1 and 11.2 p 163-168.
  - Any **operator of a UCITS scheme, insurance intermediary, mortgage broker and mixed financial holding company** does not fall into the directive definitions of either financial sector or insurance sector and should be treated for these purposes as being outside the financial sector. They should therefore be ignored for the purposes of these calculations.

#### Threshold tests

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

#### Calculating balance sheet totals

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

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

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

(viii) The cross-sector subsidiaries or participations referred to above, valued according to their own accounts, are allocated pro-rata, according to the aggregated share owned by the parent/sub-group, to their own sector.

(ix) If the cross-sector entities above themselves own group entities in the first sector (i.e. that of the top parent/sub-group) these should (in accordance with the methods above) be excluded from the second sector and added to the first sector using individual accounts.

#### Solvency (capital adequacy) requirements

Generally, the solvency requirements should be according to sectoral rules of the *appropriate regulator* that would apply to the type of entity. However, you can use EEA rules or local rules in the circumstances set out in Part 6 of **■ GENPRU 3 Annex 1 R**. But if this choice makes a significant difference, either with respect to whether the group is a financial conglomerate or with respect to which sector is the biggest, you should consult with the *appropriate regulator*. Non-regulated financial entities should have proxy requirements calculated on the basis of the most appropriate sector. If sub-groups submit single sector consolidated returns then the solvency requirement may be taken from those returns.

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

- (i) If you complete a solvency return for a sub-group consisting of financial entities from only one of the two sectors, the total solvency requirement for the sub-group should be used.
- (ii) Solvency requirements taken must include any deductions from available capital so as to allow the appropriate aggregation of requirements.
- (iii) Where there is a regulated subsidiary or participation in the opposite sector from its parent/sub-group, the solvency requirement of the subsidiary or participation should be from its individual regulatory return. If there is an identifiable contribution to the parent's solvency requirement in respect of the cross-sector subsidiary or participation, the parent's solvency requirement may be adjusted to exclude this.
- (iv) Where there is an unregulated financial undertaking in the opposite sector from its parent/sub-group, the solvency requirement of the subsidiary or participation should be one of the following:
  - (a) as if the entity were regulated by the *appropriate regulator* under the appropriate sectoral rules;
  - (b) using EU minimum requirements for the appropriate sector; or
  - (c) using non-EU local requirements\* for the appropriate sector.

Please note on the form which of these options you have used, according to the country and sector, and whether this is the same treatment as in your latest overall group solvency calculation.

- (v) For banking/investment requirements, use the total amount of capital required.
- (vi) For insurance requirements, use the total amount of capital required.

#### Market share measures

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

Article I.

#### Article II. Threshold tests

##### Test F2

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

B/S total

##### Test F3/F4/F5

B/S of insurance sector

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

B/S of banking/investment sector

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

Solvency requirement of insurance sector

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

Solvency requirement of banking/investment sector

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

The relevant percentage for the insurance sector is:

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

The relevant percentage for the banking/investment sector is:

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

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

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

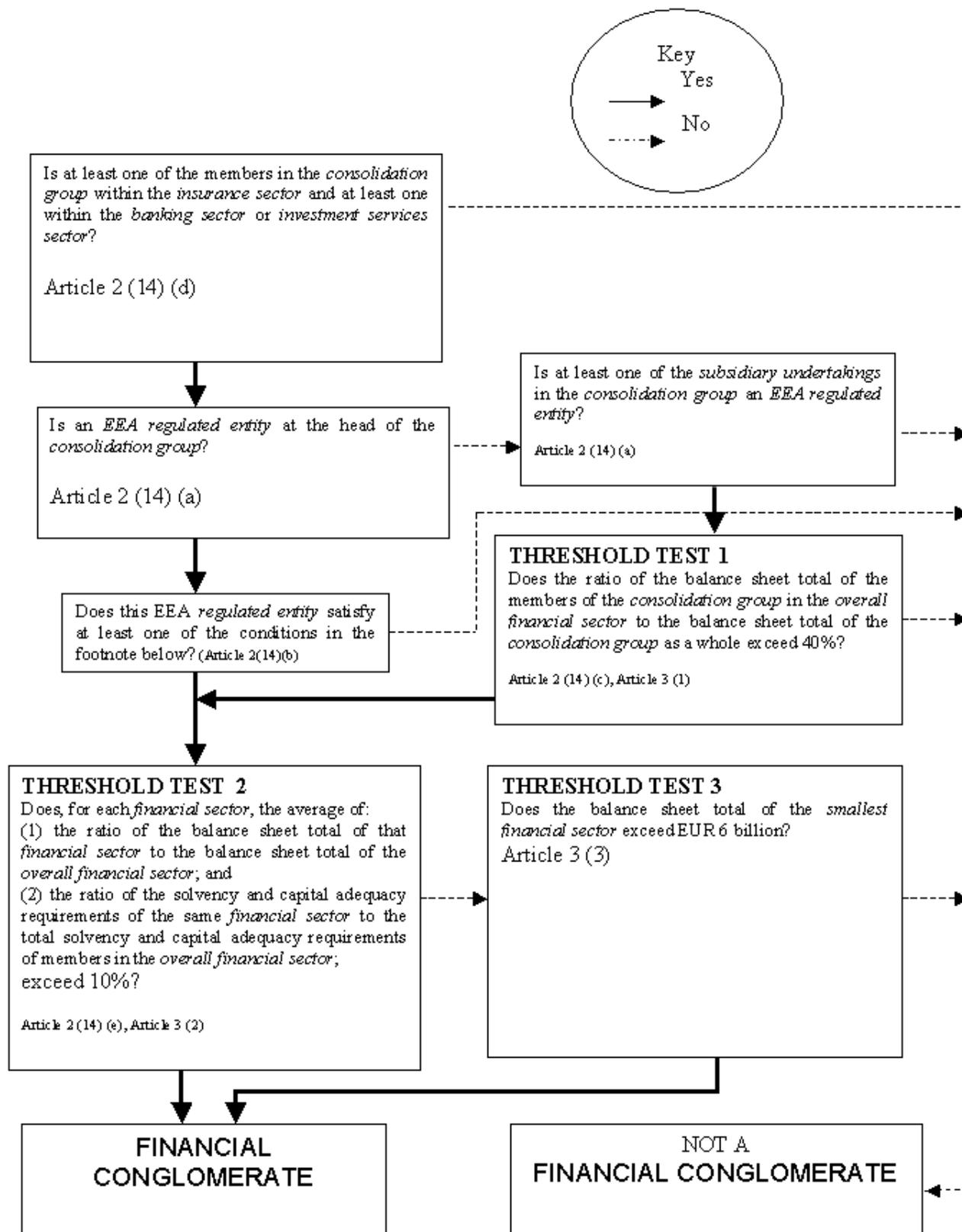
**Article IV.** If  $BI\% < I\%$  then F3 is banking/investment, F4 = B% and F5 = D%

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(see GENPRU 3.1.5R)

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3



Footnote: The conditions are that the EEA regulated entity at the head of the consolidation group:

- (1) is a *parent undertaking* of a member of the *consolidation group* in the *overall financial sector*;
- (2) has a *participation* in a member of the *consolidation group* that is in the *overall financial sector*; or
- (3) has a *consolidation Article 12(1) relationship* with a member of the *consolidation group* that is in the *overall financial sector*.



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## General Prudential sourcebook

### GENPRU TP 1

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

PRA

Application of GENPRU TP 1 to GENPRU TP 6		
1.1	R	GENPRU TP 1 - GENPRU TP 6 apply to an <i>insurer</i> .
1.2	G	GENPRU TP 1 - GENPRU TP 6 apply to an <i>insurer</i> to whom the relevant <i>GENPRU rule</i> listed in <i>GENPRU TP Table 3R</i> , <i>GENPRU TP 4.3R</i> , <i>GENPRU TP 5.2R</i> or <i>GENPRU TP 6.2R</i> applies. An <i>insurer</i> to whom <i>GENPRU</i> does not apply is not subject to <i>GENPRU TP</i> .
		Version of IPRU to be used
1.3	R	Any reference in GENPRU TP 1 - GENPRU TP 6 to <i>IPRU (INS)</i> or to <i>IPRU (FSOC)</i> is to the version in force on 30 December 2004.



# General Prudential sourcebook

## GENPRU TP 2 IPRU(INS) waivers

PRA

		<b>Duration of transitional</b>	
2.1	R	GENPRU TP 2 applies until the relevant <i>GENPRU rule</i> is revoked.	
		<b>Continuing effect of waivers</b>	
2.2	R	A <i>rule</i> in <i>GENPRU</i> listed in the Table at <i>GENPRU TP 3</i> is disapplied, or is modified in its application, to a <i>firm</i> :	
		(1)	in order to produce the same effect, including any conditions, as a <i>waiver</i> had on the corresponding <i>rule</i> in <i>IPRU (INS)</i> ;
		(2)	for the same period as the <i>waiver</i> would have lasted, if shorter than the period in <i>GENPRU TP 2.1R</i> ;
			provided the conditions set out in <i>GENPRU TP 2.3R</i> are satisfied.
2.3	R	The conditions referred to in <i>GENPRU TP 2.2R</i> are:	
		(1)	the <i>rule</i> is shown in the Table at <i>GENPRU TP 3</i> as corresponding with the <i>rule</i> in <i>IPRU (INS)</i> in relation to which the <i>waiver</i> was granted to the <i>firm</i> ;
		(2)	the <i>waiver</i> was current as respects the <i>firm</i> immediately before 31 December 2004; and

		(3)	there is no specific transitional <i>rule</i> relating to the <i>waiver</i> .
2.4	R		<i>GENPRU</i> TP 2.2R does not have effect if, and to the extent that, it would be inconsistent with any <i>EU</i> law obligation of the <i>United Kingdom</i> .
2.5	R		A <i>firm</i> which has the benefit of a <i>waiver</i> to which <i>GENPRU</i> TP 2.2R applies must:
		(1)	notify the <i>appropriate regulator</i> immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the <i>waiver</i> ;
		(2)	maintain a written record of the <i>rule</i> in <i>GENPRU</i> to which it considers the <i>waiver</i> applies; and
		(3)	make the record available to the <i>appropriate regulator</i> on request.

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## General Prudential sourcebook

### GENPRU TP 3 Table: IPRU(INS) waivers

PRA

3.1	R	This table belongs to GENPRU TP 2.
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PRA

Rules in GENPRU	Corresponding rules in IPRU (INS)
1.3.47R	4.2 (3)
2.1.13R	2.9 (3)
2.1.24R	2.9
2.1.25R	2.9
2.1.34R	2.4 (6)
2.2.107R	2.10 (7)
2.2.251R	4.14
	4.5 (7)



## General Prudential sourcebook

### GENPRU TP 4 Capital instruments

PRA

	<b>Duration</b>	
4.1	R	GENPRU TP 4 applies until the relevant <i>rule</i> is revoked
	<b>Application</b>	
4.2	R	Subject to GENPRU TP 4.4R, GENPRU TP 4 applies to a <i>firm</i> which immediately before 31 December 2004 had the benefit of a <i>waiver</i> in relation to IPRU (INS) rule 2.10 or 5.2, or a written concession in relation to a pre-commencement provision listed in GENPRU TP 4.7R, in either case allowing the <i>firm</i> to exclude from the calculation of its liabilities obligations under a particular capital instrument issued by the <i>firm</i> .
	<b>Waivers</b>	
4.3	R	Subject to GENPRU TP 4.4R and to compliance with the conditions set out in GENPRU TP 4.6R, a <i>firm</i> will be treated as complying with GENPRU 2.2.271 R (3), GENPRU 2.2.177 R (2), GENPRU 2.2.177 R (3), GENPRU 2.2.180 R and GENPRU 2.2.181 R, in relation to the capital instrument to which the <i>waiver</i> or written concession referred to in GENPRU TP 4.2R related, so long as the <i>firm</i> is not obliged to pay any interest under the terms of the capital instrument in circumstances where the <i>firm</i> does not have <i>capital resources</i> equal to or in excess of its required margin of solvency under the <i>Insurance Directives</i> .
4.4	R	<p>GENPRU TP 4.3R ceases to apply to a <i>firm</i>:</p> <p>(1) once the <i>firm</i> has redeemed the capital instrument; or</p> <p>(2) on or after any date upon which the <i>firm</i> has the</p>

			option to redeem the capital instrument and may prudently do so.
4.5	R	Subject to compliance with the conditions set out in <i>GENPRU</i> TP 4.6R, a <i>firm</i> will be treated as complying with <i>GENPRU</i> 2.2.159 R (6), <i>GENPRU</i> 2.2.159 R (10), <i>GENPRU</i> 2.2.159 R (12), and <i>GENPRU</i> 2.2.163 R in relation to the capital instrument to which the <i>waiver</i> or written concession referred to in <i>GENPRU</i> TP 4.2R related.	
4.6	R	The conditions referred to in <i>GENPRU</i> TP 4.3R and <i>GENPRU</i> TP 4.5R are:	
		(1)	the <i>firm</i> must notify the <i>PRA</i> immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the <i>waiver</i> or written concession;
		(2)	the <i>firm</i> must maintain a written record of the <i>rule</i> in <i>GENPRU</i> to which it considers the <i>waiver</i> or written concession applies; and
		(3)	the <i>firm</i> must make the record available to the <i>PRA</i> on request.
4.7	R	The <i>pre-commencement</i> provisions referred to in <i>GENPRU</i> TP 4.2R are those contained in:	
		(1)	the Insurance Companies Act 1982 and relevant secondary legislation; and
		(2)	the Friendly Societies Act 1992 and relevant secondary legislation.

## General Prudential sourcebook

### GENPRU TP 5 Calls for supplementary contributions

PRA

	<b>Duration</b>	
5.1	R	GENPRU TP 5 applies until the relevant <i>rule</i> is revoked
		<b>Application</b>
5.2	R	GENPRU TP 5 applies to a <i>firm</i> which immediately before 31 December 2004 had the benefit of a <i>waiver</i> in relation to IPRU ( <i>INS</i> ) rule 2.10 (4).
		<b>Waivers</b>
5.3	R	For the period specified in GENPRU TP 5.1R or the same period as the <i>waiver</i> would have lasted if shorter, subject to GENPRU TP 5.4R and to compliance with the conditions set out in GENPRU TP 5.5R, for the purposes of calculating its <i>capital resources</i> a <i>firm</i> may include the value of claims against its members by way of calls for supplementary contributions as <i>core tier one capital</i> to the same extent as it was permitted by the <i>waiver</i> to include the value of those claims in the calculation of its margin of solvency.
5.4	R	GENPRU TP 5.3R does not apply for the purposes of GENPRU 2.2.34 R (Guarantee fund) or SUP Appendix 2.4 (Capital resources below guarantee fund).
5.5	R	The conditions referred to in GENPRU TP 5.3R are: <ol style="list-style-type: none"> <li>(1) the limits specified in the <i>waiver</i> on the extent to which the <i>firm's</i> claim against its members by way of call for supplementary contributions may be brought into account apply as if the ref-</li> </ol>

erence (if any) in the *waiver* to the *firm's* required margin of solvency referred to its *general insurance capital requirement* and the reference (if any) in the *waiver* to the *firm's* margin of solvency referred to its *capital resources*; and

(2)

the *firm* must comply with any further conditions imposed by the *waiver*.

## General Prudential sourcebook

### GENPRU TP 6 Implicit items waivers

PRA

	<b>Duration</b>	
6.1	R	GENPRU TP 6 applies until the relevant <i>rule</i> is revoked
	<b>Application</b>	
6.2	R	GENPRU TP 6 applies to a <i>firm</i> which immediately before 31 December 2004 had the benefit of a <i>waiver</i> in relation to <i>IPRU (INS)</i> rule 2.10 (5) or <i>IPRU (FSOC)</i> rule 4.7 (3).
	<b>Waivers</b>	
6.3	R	For the period specified in <i>GENPRU TP 6.1R</i> or the same period as the <i>waiver</i> would have lasted if shorter, subject to <i>GENPRU TP 6.4R</i> and to compliance with the conditions set out in <i>GENPRU TP 6.5R</i> , for the purpose of calculating its <i>capital resources</i> a <i>firm</i> may include the value of <i>implicit items</i> at Stage B of the <i>capital resources table</i> applicable to the <i>firm</i> to the same extent to which it was permitted by the <i>waiver</i> to include the value of those <i>implicit items</i> in the calculation of its margin of solvency.
6.4	R	<i>GENPRU TP 6.3R</i> does not apply for the purposes of <i>GENPRU 2.2.41 R</i> (Limits on forms of capital apply separately to long-term insurance business and general insurance business).
6.5	R	The conditions referred to in <i>GENPRU TP 6.3R</i> are: <ol style="list-style-type: none"> <li>(1) the limits specified in the <i>waiver</i> on the extent to which the value of <i>implicit items</i> may be brought into account apply as if the reference (if any) in the <i>waiver</i> to the <i>firm's</i></li> </ol>

(2)

required margin of solvency referred to its *minimum capital requirement* and the reference (if any) in the *waiver* to the *firm's* margin of solvency referred to its *capital resources*; and

the *firm* must comply with any further conditions imposed by the *waiver*.

## General Prudential sourcebook

### GENPRU TP 7 Pillar 3 capital resources

FCA PRA

7.1	R	<p><b>Application</b></p> <p>This section applies to a <i>BIPRU firm</i>.</p>
7.2	G	<p><b>Purpose</b></p> <p>This section implements Article 154(4) of the <i>Banking Consolidation Directive</i>.</p>
7.3	R	<p><b>Duration</b></p> <p>This section applies until 31 December 2012.</p>
7.4	R	<p><b>Transitional provision</b></p> <p>A <i>firm</i> may elect not to apply GENPRU 2.2.239 R (2) to (4) (50:50 split between deductions from <i>tier one capital</i> and <i>tier two capital</i>) to <i>material insurance holdings</i> acquired before 20 July 2006. If a <i>firm</i> elects not to apply GENPRU 2.2.239 R (2) to (4), the <i>firm</i> must deduct such <i>material insurance holdings</i> from the total of <i>tier one capital</i> and <i>tier two capital</i>.</p>



## General Prudential sourcebook

### GENPRU TP 8 Miscellaneous capital resources definitions for BIPRU firms

			<b>Application</b>
8.1	R		This section applies to a <i>BIPRU firm</i> .
		[FCA] [PRA]	
8.2	R		Any provision of this section that applies on a consolidated basis under <i>GENPRU TP 8.3R</i> applies to any <i>firm</i> to which <i>BIPRU 8 (Group risk - consolidation)</i> applies.
		[FCA] [PRA]	
			<b>Consolidation</b>
8.3	R		A provision of this section applies on a consolidated basis for the purpose of <i>BIPRU 8 (Group risk -consolidation)</i> to the extent that, and in the same way that, the provision in <i>BIPRU</i> to which it relates applies on a consolidated basis.
		[FCA] [PRA]	
			<b>Specific issues of TONS and other securities</b>
8.4	R		A <i>bank</i> may treat a <i>security</i> forming part of an issue of <i>securities</i> listed in <i>GENPRU TP 8.5R</i> as eligible for inclusion within stage B of the <i>capital resources table</i> (Perpetual non cumulative preference shares) if it would not otherwise be eligible if:
		[PRA]	
			(1) on 31 December 2006 the <i>bank</i> was subject to <i>IPRU(BANK)</i> ;
			(2) the <i>bank</i> issued it on or before 31 December 2006; and
			(3) as at 31 December 2006 the <i>bank</i> included it, and was entitled to include it, in the calculation of its capital resources under <i>IPRU(BANK)</i> as permanent share capital and tier one capital as referred to in chapter CA of <i>IPRU(BANK)</i> .
8.5	R		The issues of <i>securities</i> referred to in <i>GENPRU TP 8.4R</i> are as follows:
		[PRA]	
			(1) Barclays £400mn 6% perpetual TONs;

			(2)	Abbey National £175m 6.984% perpetual TOPIC;
			(3)	Northern Rock £200m 7.053% perpetual TONs;
			(4)	Barclays \$1bn 6.86% perpetual TONs;
			(5)	Lloyds TSB \$1000m 6.90% perpetual capital securities; and
			(6)	Abbey National \$500m 7.375% T1MBS.
				<b>PIBS</b>
8.6	R			<i>A building society</i> may treat a <i>PIBS</i> as eligible for inclusion within stage B of the <i>capital resources table</i> (Perpetual non-cumulative preference shares) if it would not otherwise be eligible if:
[PRA]			(1)	on 31 December 2006 the <i>firm</i> was subject to <i>IPRU(BSOC)</i> ;
			(2)	the <i>building society</i> issued it before 18 November 2004; and
			(3)	as at 31 December 2006 the <i>building society</i> included it, and was entitled to include it, in the calculation of its capital resources under <i>IPRU(BSOC)</i> as tier one capital as referred to in Annex 1A of chapter 1 of volume 1 of <i>IPRU(BSOC)</i> .
				<b>Preference shares</b>
8.7	R			<i>A bank</i> or <i>BIPRU investment firm</i> may treat a <i>preference share</i> as eligible for inclusion within stage B of the <i>capital resources table</i> (Perpetual non-cumulative preference shares) if it would not otherwise be eligible if:
[FCA] [PRA]			(1)	on 31 December 2006 the <i>firm</i> was subject to <i>IPRU(BANK)</i> or <i>IPRU(INV)</i> ;
			(2)	the <i>firm</i> issued it on or before 31 December 2006;
			(3)	as at 31 December 2006 the <i>firm</i> included it, and was entitled to include it, in the calculation of its capital resources under <i>IPRU(BANK)</i> or <i>IPRU(INV)</i> as capital of a type that corresponded to <i>tier one capital resources</i> ;
			(4)	it would have been eligible for inclusion within stage B of the <i>capital resources</i>

*table* except for the fact that it does not meet GENPRU 2.2.64 R (4)(b) (Restrictions on mandatory *coupons* for *tier one capital*) or GENPRU 2.2.109 R (1) (Restrictions on mandatory *coupons* for perpetual non-cumulative *preference shares*) or both of those *rules*;

- (5) the only reason that it does not meet GENPRU 2.2.64 R (4)(b) or GENPRU 2.2.109 R (1) is because a mandatory cash *coupon* is payable;
- (6) the *firm* has the right not to pay the cash *coupon* if it is in breach of any of the *main BIPRU firm Pillar 1 rules* or to the extent that paying such *coupon* would result in a breach of any of those *rules*; and
- (7) any amount not paid under (6) does not accumulate.

#### **Innovative tier one capital**

8.8 R  
[PRA]

A *bank* may treat an item of a *capital instrument* as eligible for inclusion within stage C of the *capital resources table* (Innovative tier one capital) if it would not otherwise be eligible if:

- (1) on 31 December 2006 the *firm* was subject to *IPRU(BANK)*;
- (2) the *bank* issued it on or before 31 December 2006;
- (3) as at 31 December 2006 the *bank* included it, 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)*;
- (4) it would have been eligible for inclusion within stage C of the *capital resources table* except for the fact that it does not meet GENPRU 2.2.64 R (4)(b) (Restrictions on mandatory *coupons* for *tier one capital*);
- (5) the only reason that it does not meet GENPRU 2.2.64 R (4)(b) is because a mandatory cash *coupon* is payable;

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

- (1) on 31 December 2006 the *building society* was subject to *IPRU(BSOC)*;
- (2) the *building society* issued it on or before 31 December 2006;
- (3) as at 31 December 2006 the *building society* included it, and was entitled to include it, in the calculation of its capital resources under *IPRU(BSOC)* as Term Subordinated Debt falling within its Tier Two Capital (as referred to in Annex 1A of Chapter 1 and Chapter 2 of *IPRU(BSOC)*);
- (4) it would have been eligible for inclusion within stage H of the *capital resources table* except for the fact that it does not meet GENPRU 2.2.159 R (2) (Events of default); and
- (5) the only reason that it does not meet GENPRU 2.2.159 R (2) is because it contains an event of default permitted by paragraph 2.8.10G(3) of Volume 1 of *IPRU(BSOC)* (cancellation of a society's registration under the Building Societies Act 1986 otherwise than under section 103(1)(a) of that Act).

**Conversion ratio**

8.11 R  
[FCA] [PRA]

GENPRU 2.2.138 R (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)*;
- (2) the *firm* issued it on or before 31 December 2006; and
- (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

(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  
[FCA] [PRA]

GENPRU 2.2.118 R (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;
- (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
- (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  
[FCA] [PRA]

The following *rules*:

- (1) GENPRU 2.2.159 R (12) (Legal opinions for *tier two capital*);
- (2) GENPRU 2.2.163 R (Legal opinions for *tier two capital* governed by a foreign law);
- (3) GENPRU 2.2.181 R (Legal opinions for *upper tier two capital*); and
- (4) GENPRU 2.2.244 R (Application of certain *rules* about *tier two capital* to *tier three capital*) so far as it applies the *rules* in (1) to (3);

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)*;
- (6) the *firm* issued the *capital instrument* on or before 31 December 2006; and
- (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:
  - (a) (where the *firm* dis-applies the *rule* in (1) or (2)) *tier two capital*; or
  - (b) (where the *firm* dis-applies the *rule* in (3)) *upper tier two capital*; or
  - (c) (where the *firm* dis-applies the *rule* in (4)) *tier three capital*.

**Version of IPRU**

8.14 R  
[FCA] [PRA]

Any reference in this section to a type of capital in *IPRU* is to a type of capital in *IPRU* in the form *IPRU* was in on 31 December 2006.

**Eligibility**

8.15 G  
[FCA] [PRA]

If this section says that an item of capital is eligible for inclusion within a particular stage of the *capital resources table* this is still subject to the application of the *capital resources gearing rules*.

**Waivers and concessions**

8.16 G  
[FCA] [PRA]

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 *appropriate regulator*.

**Combinations of provisions**

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8.17	G	A <i>firm</i> may combine the use of two or more of the provisions in this section.
[FCA] [PRA]		

## General Prudential sourcebook

### GENPRU TP 8A Further miscellaneous capital resources definitions for BIPRU firms

FCA PRA

#### Application and interpretation

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

#### Tier one capital

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

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

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

- (1) if it included the *capital instrument* as *innovative tier one capital* as at 30 December 2010, must treat the *capital instrument* as *hybrid capital* included at stage C of the calculation in the *capital resources table*;
- (2) except where it is a *building society*, must apply the limit in *GENPRU 2.2.30A R (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 TP8A.2R* exceeds the limit in *GENPRU 2.2.30A R (3)*;
- (4) in the case of a *building society*, may include *hybrid capital* at stage C of the calculation in the *capital resources table*, notwithstanding (3), if the *firm* issued it after 30 December 2010 and:

- (a) the *capital instrument* would otherwise be eligible for inclusion as *hybrid capital* at stage C of the calculation in the *capital resources table* under GENPRU 2.2; and
  - (b) the *firm* issued it in order to replace a *PIBS* with an incentive to redeem that the *firm* treated as *hybrid capital* under GENPRU TP8A.2R ;
- (5) must not include *hybrid capital* at stage B2 of the calculation in the *capital resources table* under GENPRU 2.2, except as provided by GENPRU TP8A.4R, if and to the extent that the aggregate of the following exceeds the limit in GENPRU 2.2.30A R (2)
- (a) *capital instruments* included at stage C in the *capital resources table* under (1) and GENPRU 2.2 ; and
  - (b) *capital instruments* included at stage B of the calculation in the *capital resources table* as at 30 December 2010 and treated under GENPRU TP8A.2R ;
- (6) if it includes *hybrid capital* at stage B2 of the calculation in the *capital resources table* under GENPRU 2.2, except as provided by GENPRU TP8A.4R, must include *capital instruments* treated under GENPRU TP8A.2R in the calculation of the limit in GENPRU 2.2.30A R (2);
- (7) must not include *hybrid capital* at stage B1 of the calculation in the *capital resources table* under GENPRU 2.2, except as provided by GENPRU TP8A.5R, if and to the extent that the aggregate of the following exceeds the limit in GENPRU 2.2.30A R (1) :
- (a) *capital instruments* included at stage C in the *capital resources table* under (1) and GENPRU 2.2; and
  - (b) *capital instruments* included at stage B of the calculation in the *capital resources table* as at 30 December 2010 and treated under GENPRU TP8A.2R ; and
- (8) if it includes *hybrid capital* at stage B1 of the calculation in the *capital resources table* under GENPRU 2.2, except as provided by GENPRU TP8A.5R, must include *capital instruments* treated under GENPRU TP8A.2R in the calculation of the limit in GENPRU 2.2.30A R (1).

8A.4

R A BIPRU firm may include *hybrid capital* at stage B2 of the calculation in the *capital resources table*, notwithstanding GENPRU TP8A.3R(5), if the *firm* issued it after 30 December 2010 and:

- (1) the *capital instrument* would otherwise be eligible for inclusion as *hybrid capital* at stage B2 of the calculation in the *capital resources table* under GENPRU 2.2; and
- (2) the *firm* issued it in order to replace another *capital instrument* that the *firm* treated as *hybrid capital* under GENPRU TP8A.2R.

- 8A.5 R A BIPRU firm may include *hybrid capital* at stage B1 of the calculation in the *capital resources table*, notwithstanding GENPRU TP8A.3R(7), if the firm issued it after 30 December 2010 and:
- (1) the *capital instrument* would otherwise be eligible for inclusion as *hybrid capital* at stage B1 of the calculation in the *capital resources table* under GENPRU 2.2; and
  - (2) the firm issued it in order to replace another *capital instrument* that the firm treated as *hybrid capital* under GENPRU TP8A.2R.
- 8A.6 R In relation to the *tier one capital resources* of a BIPRU firm, calculated at stage F of the calculation in the *capital resources table* (Total tier one capital after deductions):
- (1) from 31 December 2020 until 30 December 2030:
    - (a) no more than 20% may be accounted for by items treated under GENPRU TP8A.2R as *tier one capital*; and
    - (b) in the case of a *building society*, any *PIBS* with an incentive to redeem treated under GENPRU TP8A.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 2.2.30A R (3); and
  - (2) from 31 December 2030 until 30 December 2040, no more than 10% may be accounted for by items treated under GENPRU TP8A.2R as *tier one capital*.
- 8A.7 R BIPRU firms which do not comply by 31 December 2010 with the limits set out in GENPRU 2.2.29 R to GENPRU 2.2.30A R (3) must develop strategies and processes on the necessary measures to resolve this situation before the dates set out in GENPRU TP8A.6R .



## General Prudential sourcebook

### GENPRU TP 8B Miscellaneous capital resources definitions for BIPRU firms: Core tier one capital

FCA PRA

#### Application

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

#### Core tier one capital

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

8B.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*.

8B.4 R The *shares* referred to in GENPRU TP 8B.3R are as follows:

- (1) The Royal Bank of Scotland Group plc Series 1 Class B Shares of 1p each; and
- (2) The Royal Bank of Scotland Group plc Series 1 Dividend Access Share of 1p; either as separate instruments or considered together as connected instruments

#### Voting rights

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

- (1) on 30 December 2010 the *firm* was subject to *GENPRU*;

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

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

## General Prudential sourcebook

### GENPRU TP 9 Individual capital guidance for BIPRU firms

PRA

		<b>Application</b>
9.1	G	<p>This section applies to a <i>BIPRU firm</i> that is a <i>bank</i> or <i>building society</i> for which the <i>FSA</i> has given:</p> <p>(1) (in the case of a <i>building society</i>) a threshold ratio under <i>IPRU(BSOC)</i>; or</p> <p>(2) (in the case of a <i>bank</i>) an individual capital ratio under <i>IPRU(BANK)</i>;</p> <p>that was in effect on 31 December 2006 but to which the <i>FSA</i> has not yet given <i>individual capital guidance</i>.</p>
		<b>Duration</b>
9.2	G	This section applies to a <i>firm</i> until it receives <i>individual capital guidance</i> .
9.3	G	GENPRU TP 9.4G - GENPRU TP 9.6G only apply until 31 December 2007. Thereafter (if they do not already apply) GENPRU TP 9.7G - GENPRU TP 9.10G apply.
		<b>Pre 2007 capital requirements</b>
9.4	G	GENPRU TP 9.5G - GENPRU TP 9.6G apply if, and for as long as, a <i>firm</i> applies the treatment in <i>BIPRU TP 3</i> (Pre CRD capital requirements applying on a solo basis during 2007) to all its <i>exposures</i> .
9.5	G	If GENPRU TP 9.4G applies, any threshold ratio or individual capital ratio remains in force. However compliance with such ratios should be measured by reference to <i>capital resources</i> .
9.6	G	Where necessary, a <i>firm</i> should apply the adjustment set out in section 4.1.3 of chapter CO of <i>IPRU(BANK)</i> (CAD banks) as it stood on 31 December 2006 to its <i>trading book</i> capital requirements.
		<b>BIPRU capital requirements</b>
9.7	G	GENPRU TP 9.8G - GENPRU TP 9.10G apply to a <i>firm</i> if GENPRU TP 9.5G - GENPRU TP 9.6G do not apply.

9.8	G	<p>Any threshold ratio or individual capital ratio remains in force adjusted as follows:</p> <ol style="list-style-type: none"> <li data-bbox="644 327 1396 510">(1) the <i>firm</i> should work out the percentage of its <i>capital resources requirement</i> as at the date in GENPRU TP 9.10G represented by the absolute amount in GENPRU TP 9.9G; and</li> <li data-bbox="644 533 1396 712">(2) the <i>firm</i> should hold <i>capital resources</i> of an amount at least equal to the percentage specified in (1) of its <i>capital resources requirement</i> from time to time.</li> </ol>
9.9	G	<p>The absolute amount referred to in GENPRU TP 9.8G is:</p> <ol style="list-style-type: none"> <li data-bbox="644 792 1396 1016">(1) (if GENPRU TP 9.7G - GENPRU TP 9.10G apply to the <i>firm</i> on 1 January 2007) the amount of capital resources it had to hold under <i>IPRU</i> on 31 December 2006 in order to meet the ratio referred to in GENPRU TP 9.1G; and</li> <li data-bbox="644 1039 1396 1220">(2) (in any other case) the amount of <i>capital resources</i> it had to hold immediately prior to the date in GENPRU TP 9.10G in order to meet the ratio referred to in GENPRU TP 9.1G.</li> </ol>
9.10	G	<p>The date referred to in GENPRU TP 9.8G and GENPRU TP 9.9G is:</p> <ol style="list-style-type: none"> <li data-bbox="644 1332 1396 1406">(1) (if GENPRU TP 9.9G(1) applies) 1 January 2007; and</li> <li data-bbox="644 1429 1396 1572">(2) (if GENPRU TP 9.9G(2) applies) the date on which GENPRU TP 9.7G - GENPRU TP 9.10G first apply to the <i>firm</i>.</li> </ol>
9.11	G	<p>The following illustrates how GENPRU TP 9.8G - GENPRU TP 9.10G work. This example relates to a <i>bank</i> to which GENPRU TP 9.7G - GENPRU TP 9.10G apply from 1 January 2007. The example is as follows (all figures in £millions):</p> <ol style="list-style-type: none"> <li data-bbox="644 1803 1396 2056">(1) as at 31 December 2006: <ol style="list-style-type: none"> <li data-bbox="900 1854 1396 1966">(a) the <i>bank</i> has risk-weighted assets of £1250;</li> <li data-bbox="900 1989 1396 2056">(b) its Pillar 1 capital resources require-</li> </ol> </li> </ol>

			ment was £100 (8% of £1250);
		(c)	its individual capital ratio was 10%; and
		(d)	its capital resources requirement expressed as an absolute amount and including the individual capital ratio is £125;
		(2)	on 1 January 2007 its <i>capital resources requirement</i> is £80;
		(3)	the result is that the new individual capital ratio is 156.25% (£125m/£80m); and
		(4)	its capital resources requirement expressed as an absolute amount and including the individual capital ratio remains at £125 despite the fall in the Pillar 1 charge.
9.12	G		Continuing the example, say that the <i>bank's capital resources requirement</i> falls to £70 on 31 July 2007. Its capital resources requirement, expressed as an amount and including the individual capital ratio, now falls to £109.375.
			<b>Adjustments</b>
9.13	G		No adjustment should be made to take into account differences between the calculation of capital resources under <i>IPRU</i> and of <i>capital resources</i> .
			<b>Consolidation</b>
9.14	G		This section also applies to threshold ratios and individual capital ratios that apply on a consolidated basis.



## General Prudential sourcebook

### GENPRU TP 10 Assets of former underwriting members

PRA

	<b>Application</b>	
10.1	R	GENPRU TP 10 applies to the <i>Society</i> .
	<b>Duration</b>	
10.2	R	GENPRU TP 10 applies until the <i>Society</i> is no longer required to identify or value assets of <i>individual members</i> that became <i>former underwriting members</i> before 1 January 2003.
	<b>Valuation and identification of assets</b>	
10.3	R	For the purposes of GENPRU 1 and GENPRU 2, the <i>Society</i> must identify and value the assets of <i>individual members</i> that became <i>former underwriting members</i> before 1 January 2003 in accordance with the requirements for the identification and valuation of assets contained in the "Conditions and Requirements Relating to Solvency and Reporting" which were approved by the <i>FSA</i> , exercising the powers of HM Treasury under section 83 of the Insurance Companies Act 1982, and which were applicable immediately before <i>commencement</i> .



## General Prudential sourcebook

### GENPRU TP 11 PRU waivers

PRA

		<b>Application</b>
11.1	R	GENPRU TP 11 applies to an <i>insurer</i> to whom a <i>GENPRU rule</i> listed in the Table in GENPRU TP 12 applies.
		<b>Version of PRU to be used</b>
11.2	R	A reference in GENPRU TP 11 to <i>PRU</i> is to the version in force on 30 December 2006.
		<b>Duration of transitional</b>
11.3	R	GENPRU TP 11 applies until the relevant <i>GENPRU rule</i> is revoked.
		<b>Continuing effect of waivers</b>
11.4	R	<p>A <i>rule</i> in <i>GENPRU</i> listed in the Table at GENPRU TP 12 is disappplied, or is modified in its application, to a <i>firm</i>:</p> <p>(1) in order to produce the same effect, including any conditions, as a <i>waiver</i> had on the corresponding <i>rule</i> in <i>PRU</i>;</p> <p>(2) for the same period as the <i>waiver</i> would have lasted, if shorter than the period in GENPRU TP 11.3R;</p> <p>provided the conditions set out in GENPRU TP 11.5R are satisfied.</p>
11.5	R	<p>The conditions referred to in GENPRU TP 11.4R are:</p> <p>(1) the <i>rule</i> is shown in the Table at GENPRU TP 12 as corresponding with the <i>rule</i> in <i>PRU</i> in relation</p>

			<p>to which the <i>waiver</i> was granted to the <i>firm</i>;</p> <p>(2) the <i>waiver</i> was current as respects the <i>firm</i> immediately before 31 December 2006; and</p> <p>(3) there is no specific transitional <i>rule</i> relating to the <i>waiver</i>.</p>
11.6	R	GENPRU TP 11.4 does not have effect if, and to the extent that, it would be inconsistent with any <i>EU</i> law obligation of the <i>United Kingdom</i> .	
11.7	R	A <i>firm</i> which has the benefit of a <i>waiver</i> to which GENPRU TP 11.4R applies must:	
		(1)	notify the <i>PRA</i> immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the <i>waiver</i> ;
		(2)	maintain a written record of the <i>rule</i> in <i>GENPRU</i> to which it considers the <i>waiver</i> applies; and
		(3)	make the record available to the <i>PRA</i> on request.

## General Prudential sourcebook

### GENPRU TP 12 Table: PRU waivers

PRA

12.1	R	This table belongs to GENPRU TP 11.
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PRA

Rules in GENPRU	Corresponding rules in PRU
1.2.1R(2)	1.2.1R
1.2.2R(1)	1.2.3R(3)
1.2.2R(2)	1.2.3R(5)
1.2.6R	1.2.6R
1.3.4R	1.3.5R
2.1	2.1
2.1.3R	2.1.3R
2.1.13R	2.1.9R
2.1.17R	2.1.14R
2.1.24R	2.1.21R
2.1.25R	2.1.22R
2.1.29R	2.1.25R
2.1.30R	2.1.26R
2.1.30R	2.1.27R
2.1.34R	2.1.30R
2.1.38R	2.1.34R
2.2	2.2
2 Ann 1R	2.2.14R
2.2.32R	2.2.16R
2.2.33R	2.2.17R
2.2.34R	2.2.18R
2.2.118R	2.2.58R

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Rules in GENPRU	Corresponding rules in PRU
2.2.64R(2)	2.2.40R
2.2.159R(7)	2.2.108R(7)
2.2.159R(8)	2.2.108R(8)
2.2.159R(9)	2.2.108R(9)
2.2.159R(10)	2.2.108R(10)
2.2.159R(12)	2.2.108R(11)
2.2.181R	2.2.105R
2.2.255R	2.2.89R

General Prudential sourcebook

GENPRU TP 13  
EEA pure reinsurers

PRA

		<b>Application</b>	
13.1	R		<p>GENPRU TP 13 applies to a <i>pure reinsurer</i>:</p> <p>(1) <i>realistic value of liabilities</i> whose head office is in an <i>EEA State</i> other than the <i>United Kingdom</i>; and</p> <p>(2) which is not an <i>incoming Treaty firm</i>.</p>
		<b>Duration of transitional</b>	
13.2	R		<p>GENPRU TP 13 has effect in relation to a <i>firm</i> until 10 December 2008 or, if earlier, the date on which it becomes:</p> <p>(1) an <i>incoming EEA firm</i> by reason of having exercised its right to carry on the <i>regulated activity of effecting or carrying out contracts of insurance</i> in the <i>United Kingdom</i> in accordance with Schedule 3 to the <i>Act</i> (EEA Passport Rights); or</p> <p>(2) an <i>incoming Treaty firm</i> by reason of having exercised its right to carry on the <i>regulated activity of effecting or carrying out contracts of insurance</i> in the <i>United Kingdom</i> in accordance with Schedule 4 to the <i>Act</i> (Treaty Rights).</p>

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**Capital resources and discounting of technical provisions**

13.3

R

GENPRU 2.2.107 R does not apply to a *firm*.

## General Prudential sourcebook

### GENPRU TP 14 Continued use of IPRU expenditure requirements by BIPRU investment firms

FCA

		Application
14.1	R	This section applies to a <i>BIPRU investment firm</i> .
		<b>Transitional rule</b>
14.2	R	If a <i>firm</i> : (1) is subject to the <i>fixed overheads requirement</i> ; and (2) was on 31 December 2006 subject to one of the expenditure based requirements under <i>IPRU</i> listed in the table in <i>GENPRU TP 14.3R</i> ;  the <i>firm</i> may treat that expenditure based requirement as being its <i>fixed overheads requirement</i> .
14.3	R	Table: Continuing IPRU expenditure requirements This table belongs to <i>GENPRU TP 14.2R</i>

FCA

<i>IPRU</i> expenditure requirement	Remarks
Expenditure based requirement under Chapter 5 of <i>IPRU(INV)</i>	If the <i>firm</i> is subject to an expenditure based requirement of 6/52 of its annual audited expenditure, the <i>firm</i> must, for the purposes of this section, use the requirement of one quarter of its annual audited expenditure under <i>rule 5.2.3(4)(c)(i)</i>
The capital requirement of 13/52 of annual audited expenditure under <i>rule 7.2.3R(1)</i> of Chapter 7 of <i>IPRU(INV)</i>	
The expenditure requirement under <i>rule 10-73(1)(b)</i> of Chapter 10 of <i>IPRU(INV)</i>	

IPRU expenditure requirement	Remarks
Financial Resources Test 2 for Category A firms under section 13.5 of Chapter 13 of <i>IPRU(INV)</i> (Expenditure-based requirement)	A <i>firm</i> must, for the purposes of this section, calculate its requirement as 13/52 of its relevant annual expenditure even if the fraction that applies to it under Chapter 13 would otherwise be 4/52 or 8/52.
<p>Note (1): A reference to annual expenditure covers expenditure based on a forecast, pro-rated expenditure based on a period shorter than twelve months or any other expenditure figures for which the <i>IPRU rules</i> in this table provide.</p>	
<p>Note (2): Any <i>waiver</i> that a <i>firm</i> has in relation to the <i>rules</i> in <i>IPRU</i> in this table has effect for the purposes of this section. Any condition, limitation or requirement to which such a <i>waiver</i> is subject also continues to apply.</p>	

**FCA**

		<b>Duration</b>
14.4	R	A <i>firm</i> must stop applying this section at the date when, under the <i>IPRU</i> expenditure requirements that apply to it as described in <i>GENPRU TP 14.3R</i> , it would have had to start using figures for the period following the one on which the expenditure requirements to which it was subject on 31 December 2006 were based.
14.5	G	Say for example that a <i>firm's accounting reference date</i> is 31 December. As at 31 December 2006 the <i>firm's IPRU</i> expenditure requirement was based on its annual accounts for the year ended 31 December 2005. Its annual accounts for the year ending 31 December 2006 are completed on 15 March 2007. From 1 January 2007 to 14 March 2007 the <i>firm</i> may treat its <i>IPRU</i> expenditure requirements as being its <i>fixed overheads requirement</i> . On 15 March 2007 the <i>firm</i> should switch to calculating its <i>fixed overheads requirement</i> under <i>GENPRU 2.1</i>

14.6	G	<p>(Calculation of capital resources requirement).</p> <p>Capital resources</p> <p>The expenditure requirement under <i>IPRU</i> is measured against the <i>firm's capital resources</i> as calculated under GENPRU 2.2 (Capital resources) and not capital resources calculated under <i>IPRU</i>.</p>
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## General Prudential sourcebook

### GENPRU TP 15 Admissible assets

	<b>Application</b>	
15.1	R	GENPRU TP 15 applies to an <i>insurer</i> which is not a pure <i>reinsurer</i> .
	<b>Duration of transitional</b>	
15.2	R	GENPRU TP 15 applies until 30 December 2007.
	<b>GENPRU 2 Annex 7R</b>	
15.3	R	(1) In determining whether its assets are <i>admissible assets</i> , instead of applying GENPRU 2 Annex 7 R, a <i>firm</i> may elect to treat as an <i>admissible asset</i> an asset that would have been an <i>admissible asset</i> for the purposes of the Integrated Prudential Sourcebook (PRU) as it was in force on 30 December 2006.
		(2) (1) does not apply when determining whether a <i>derivative</i> or <i>quasi-derivative</i> is an <i>approved derivative</i> or <i>approved quasi-derivative</i> .
		(3) If a <i>firm</i> applies (1) to any of its assets, it must do so for all of its assets except <i>derivatives</i> and <i>quasi-derivatives</i> .



## General Prudential sourcebook

### Schedule 1 Record keeping requirements

#### G

**FCA** **PRA**

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

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

3 Table

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



## General Prudential sourcebook

### Schedule 2 Notification and reporting requirements

#### G

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

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

3 Table

Handbook reference	Matter to be notified	Contents of notification	Trigger events	Time allowed
GENPRU 1.5.19 R [PRA]	Intention to change maximum amount of <i>callable contribution</i>	Fact of intention and details of the change	Intention to change the maximum amount	Adequate advance notice, normally not less than 6 months
GENPRU 2.1.11 R [FCA] [PRA]	Breach or expected breach of GENPRU 2.1.13 R or <i>main BIPRU firm Pillar 1 rules</i>	Fact of breach or expectation of breach	Breach or expectation of breach	Immediately
GENPRU 2.2.19 R [FCA] [PRA]	Intention to deduct <i>illiquid assets</i> rather than <i>material holdings</i>	Fact of intention	Intention to start or stop using method in column 2	One month prior to change of method
GENPRU 2.2.61B R [FCA] [PRA]	Intention to issue a <i>capital instrument</i> for inclusion in <i>capital resources</i>	Fact of intention and details of intended amount, issue date, type of investor, stage of capital, features of instrument and confirmation of compliance with <i>rules</i>	Intention to issue	One <i>month</i> prior to issue, unless exceptional circumstances prevent a <i>firm</i> adhering to a one-month period
GENPRU 2.2.61C R [FCA] [PRA]	Proposed changes to details of the issue of a <i>capital instrument</i> notified under GENPRU 2.2.61B R	Proposed change and all information required under GENPRU 2.2.61B R (1) to GENPRU 2.2.61B R (4)	Intention to change any details of the issue previously notified to the <i>appropriate regulator</i>	As soon as the changes are proposed
GENPRU 2.2.61D R [FCA] [PRA]	Proposed establishment of a debt securities program	All information required under	Intention to establish	One month prior to first drawdown

Handbook reference	Matter to be notified	Contents of notification	Trigger events	Time allowed
GENPRU 2.2.61F R [FCA] [PRA]	Issue of <i>capital instruments</i> for inclusion in <i>capital resources</i> where instrument or facility previously notified to the appropriate regulator	GENPRU 2.2.61B R (1) to GENPRU 2.2.61B R (4) All information required under GENPRU 2.2.61B R (1) to GENPRU 2.2.61B R (3) and confirmation no changes have been made to the terms of the instrument since a previous similar issue	Intention to issue	No later than date of issue
GENPRU 2.2.74 R [FCA] [PRA]	Intention to redeem <i>tier one instrument</i> included in <i>tier one capital resources</i>	Fact of intention and details of the <i>firm's</i> position after such redemption in order to show how it will meet the <i>capital resources requirement</i> , how it will have sufficient financial resources to meet the <i>overall financial adequacy rule</i> and, in the case of a <i>BIPRU firm</i> , how it will not otherwise suffer any undue effects to its financial or solvency conditions	Intention to redeem	At least one month prior to becoming committed to redeem
GENPRU 2.2.79G R [FCA] [PRA]	Intention to purchase a <i>tier one instrument</i> in accordance with GENPRU 2.2.79A R	Fact of intention and details of the <i>firm's</i> position after the purchase in order to show how, over an appropriate timescale, adequately stressed, and without planned recourse to the capital markets, it will meet its <i>capital resources requirement</i> and have sufficient financial resources to meet the <i>overall financial adequacy rule</i>	Intention to purchase	At least one month prior to becoming committed to purchase
GENPRU 2.2.83B R [FCA] [PRA]	Intention to include in stage A of the <i>cap-</i>	Fact of intention.	Intention to include in stage A of the <i>cap-</i>	At least one month before the <i>shares</i> are issued or (in the case

Handbook reference	Matter to be notified	Contents of notification	Trigger events	Time allowed
	<i>ital resources table</i> different classes of the same <i>share</i> type that meet the conditions in GENPRU 2.2.83 R and GENPRU 2.2.83A R but have differences in voting rights.		<i>ital resources table</i> classes of the same <i>share</i> type that have different voting rights.	of existing issued <i>shares</i> ) the differences in voting rights take effect.
GENPRU 2.2.83F R [PRA]	Intention by a <i>building society</i> to issue a <i>capital instrument</i> that includes a <i>coupon</i> limit in its terms of issuance in accordance with GENPRU 2.2.83E R.	Fact of intention.	Intention to issue a <i>capital instrument</i> that includes a <i>coupon</i> limit.	At least one month before the intended date of issue.
GENPRU 2.2.135 R [FCA] [PRA]	Intention to include an unusual transaction in capital under GENPRU 2.2.124 R	Fact of intention.	Intention to include in capital	At least one month prior to inclusion of that capital in <i>capital resources</i>
GENPRU 2.2.171 R [FCA] [PRA]	Proposal to amend a tier two instrument	Details of the proposed amendment	Proposal to amend	One month before amendment is due to take effect
GENPRU 2.2.174 R [FCA] [PRA]	Intention to repay (other than on contractual repayment date) <i>tier two instrument</i>	Fact of intention and details of the <i>firm's</i> position after such repayment in order to show how it will meet the <i>capital resources requirement</i> and how it will have sufficient financial resources to meet the <i>overall financial adequacy rule</i>	Intention to repay	Six <i>Months</i> (in the case of an <i>insurer</i> ) or one <i>Month</i> (in the case of a <i>BIPRU</i> firm) prior to becoming committed to repayment
GENPRU 2.2.243 R [FCA] [PRA]	Intention to pay interest or principal on subordinated debt included in <i>tier three capital resources</i> if the <i>firm's capital resources</i> are less than 120% of its <i>capital resources requirement</i>	Fact of intention	Intention to pay	One month prior to any payment of interest or principal
GENPRU 2.2.245 R [FCA] [PRA]	Intention to repay (other than on contractual repayment date) <i>tier three capital resources</i>	Fact of intention and details of how the <i>firm</i> will meet its <i>capital resources requirement</i> after such repayment	Intention to repay	One month prior to repayment



## General Prudential sourcebook

### Schedule 3 Fees and other requirement payments

G

FCA PRA

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



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## General Prudential sourcebook

### Schedule 4 Powers exercised

#### Sch 4.1 G

The following powers and related provisions in the *Act* have been exercised by the *FSA* to make the *rules* in *GENPRU*:

- Section 138 (General rule-making power);
- Section 149 (Evidential provisions);
- Section 150(2) (Actions for damages);
- Section 156 (General supplementary powers); and
- Section 316(1) (Direction by Authority)

#### Sch 4.2 G

The following power in the *Act* has been exercised by the *FSA* to give the *guidance* in *GENPRU*:

- Section 157(1) (Guidance).



## General Prudential sourcebook

### Schedule 5 Rights of action for damages

**G**

**FCA**

1. The table below sets out the rules in *GENPRU* contravention of which by an *authorised person* may be actionable under section 138D of the *Act* (Actions for damages) by a person who suffers loss as a result of the contravention.
2. If a "Yes" appears in the column headed "For private person", the rule may be actionable by a private person under section 138D (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001/2256)). A "Yes" in the column headed "Removed" indicates that the *FCA* has removed the right of action under section 138D(3) of the *Act*. If so, a reference to the rule in which it is removed is also given.
3. The column headed "For other person" indicates whether the rule may be actionable by a person other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of person by whom the rule may be actionable is given.

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



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## General Prudential sourcebook

### Schedule 6 Rules that can be waived

#### G

FCA PRA

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

# Prudential sourcebook for Banks, Building Societies and Investment Firms

# Prudential sourcebook for Banks, Building Societies and Investment Firms

<b>BIPRU 1</b>	<b>Application</b>
1.1	Application
1.2	Definition of the trading book
1.3	Applications for advanced approaches and waivers
1.4	Actions for damages
1 Annex 1D	Application form to apply the advanced measurement approach
1 Annex 2D	Application form to apply the IRB approach
1 Annex 3D	Application form to apply the CCR internal model method approach
<b>BIPRU 2</b>	<b>Capital</b>
2.1	Solo consolidation
2.2	Internal capital adequacy standards
2.3	Interest rate risk in the non-trading book
<b>BIPRU 3</b>	<b>Standardised credit risk</b>
3.1	Application and purpose
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# Chapter 1

# Application

## 1.1 Application

### 1.1.1

**FCA** **PRA**

**G**

There is no overall application statement for *BIPRU*. Each chapter or section has its own application statement. Broadly speaking however, *BIPRU* applies to:

- (1) a *bank*;
- (2) a *building society*;
- (3) a *BIPRU investment firm*; and
- (4) groups containing such *firms*.

### 1.1.2

**FCA** **PRA**

**R**

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

### 1.1.3

**FCA** **PRA**

**G**

In the main *BIPRU* only applies to a *UCITS investment firm* in respect of *designated investment business* (excluding *scheme management activity*). 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.

#### Purpose

### 1.1.4

**FCA** **PRA**

**G**

**■** BIPRU 1.1 implements in part 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

**FCA** **PRA**

**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).

#### The definition of a BIPRU firm

### 1.1.6

**FCA** **PRA**

**R**

Subject to **■** BIPRU 1.1.7 R, 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*.

## 1.1.7

FCA PRA

R

None of the following is a *BIPRU firm* and each of the following is excluded from each of the categories of *BIPRU investment firm* listed in

■ BIPRU 1.1.6 R (3) to ■ BIPRU 1.1.6R (5) and ■ BIPRU 1.1.18 R (2) to ■ (4):

- (1) an *incoming EEA firm*;
- (2) an *incoming Treaty firm*;
- (3) any other *overseas firm*;
- (4) an *ELMI*;
- (5) an *insurer*; and
- (6) an *ICVC*.

## 1.1.8

FCA PRA

R

A *firm* falling within ■ BIPRU 1.1.6 R (3) to ■ BIPRU 1.1.6R (5) is a *BIPRU investment firm*. A *BIPRU investment firm* includes a *UCITS investment firm* that is not excluded under ■ BIPRU 1.1.7 R.

## 1.1.9

FCA PRA

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.

## 1.1.10

FCA PRA

G

- (1) This paragraph applies to an *undertaking* that would be a *third country BIPRU firm* if it were *authorised* under the *Act*.
- (2) Except in exceptional circumstances, it is the *appropriate regulator's* policy that it will not give an overseas applicant a *Part 4A permission* unless the *appropriate regulator* is satisfied that the applicant will be subject to prudential regulation by its home state *regulatory body* that is broadly equivalent to that provided for in the *Handbook* and the applicable *EEA prudential sectoral legislation*. The *appropriate regulator* will take into account not only the requirements to which the *firm* is subject but how they are enforced. The *appropriate regulator* will also take into account the laws, regulations and administrative provisions to which it is subject in its home state. The reasons for that policy include:
  - (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;
  - (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*.
- (3) If an *undertaking* is not subject to equivalent supervision in its home state and it wishes to carry on in the *United Kingdom regulated activities* coming within the scope of the activities that define a *BIPRU firm* it should establish a *subsidiary undertaking* in the *United Kingdom*. Such a *subsidiary undertaking* should be able to show, amongst other things, how it would comply with the *threshold conditions* (and in particular *threshold conditions* 3 (Close links) and 5 (Suitability)).
- (4) If in exceptional circumstances the *appropriate regulator* does grant a *Part 4A permission* to an *undertaking* that is not subject to equivalent prudential regulation the *appropriate regulator* is likely to take measures under the *regulatory system* to compensate for the lack of equivalent supervision. These may include applying the prudential requirements for *BIPRU firms* to the *firm*.
- (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*.

### Types of investment firm: Limited activity firms

1.1.11

FCA PRA

R

A *limited activity firm* means (as specified by Article 20(3) of the *Capital Adequacy Directive* (Exemptions from operational risk)) a *CAD investment firm* that satisfies the following conditions:

- (1) it meets the criteria in (a) or the criteria in (b):
  - (a) it *deals on own account* only:
    - (i) for the purpose of fulfilling or executing a client order; or
    - (ii) for the purpose of gaining entrance to a clearing and settlement system or a *recognised investment exchange* or *designated investment exchange* when acting in an agency capacity or executing a client order; or
  - (b) it satisfies the following conditions:
    - (i) it does not hold client money or securities in relation to *investment services* that it provides and is not authorised to do so;

- (ii) the only *investment service* it undertakes is *dealing on own account*;
  - (iii) it has no external customers in relation to *investment services* it provides; and
  - (iv) the execution and settlement of its transactions in relation to *investment services* it provides takes place under the responsibility of a clearing institution and are guaranteed by that clearing institution;
- (2) (in the case of a *CAD investment firm* that is a *BIPRU investment firm*) its *base capital resources requirement* is €730,000;
  - (3) (in the case of a *CAD investment firm* that is an *EEA firm*) it is subject to the *CRD implementation measures* of its *Home State* for Article 9 of the *Capital Adequacy Directive* (Initial capital requirement of €730,000); and
  - (4) (in the case of any other *CAD investment firm*) its *base capital resources requirement* would be €730,000 if it had been a *BIPRU investment firm* on the basis of the assumptions in
    - BIPRU 1.1.14 R (3)(a) and ■ BIPRU 1.1.14 R (3)(b).

#### Types of investment firm: Limited licence firms

1.1.12

FCA PRA

R

A *limited licence firm* means (as specified by Article 20(2) of the *Capital Adequacy Directive* (Exemptions from operational risk)) a *CAD investment firm* that is not authorised to:

- (1) *deal on own account*; or
- (2) provide the investment services of underwriting or placing *financial instruments* (as referred to in point 6 of Section A of Annex I of *MiFID*) on a firm commitment basis.

#### Types of investment firm: CAD full scope firm

1.1.13

FCA PRA

R

A *CAD full scope firm* means a *CAD investment firm* that is not a *limited activity firm* or a *limited licence firm*.

#### Types of investment firm: CAD investment firm

1.1.14

FCA PRA

R

- (1) In accordance with Article 3(1)(b) of the *Capital Adequacy Directive*, a *person* is a *CAD investment firm* if it falls into (2) or (3).
- (2) A *person* whose head office is in an *EEA State* is a *CAD investment firm* if it is an *investment firm* that is subject to the requirements imposed by *MiFID* but excludes the following:
  - (a) a *bank*, a *building society* or an *ELMI*;

- (b) a *credit institution*;
- (c) a *local*; and
- (d) an *exempt CAD firm*.

(3) An *investment firm* whose head office is not in an *EEA State* is a *CAD investment firm* if it would have fallen into (2) 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 are required under *MiFID*.

## 1.1.15

FCA PRA

G

The following are excluded from the definition of a *CAD investment firm* and hence from the definition of *BIPRU investment firm* :

- (1) an *investment firm* to which *MiFID* does not apply under Article 2(1); and
- (2) an *investment firm* with the benefit of an exemption pursuant to Article 3 of *MiFID*.

**Types of investment firm: Exempt CAD firm**

## 1.1.16

FCA PRA

R

In accordance with Article 3(1)(b)(iii) of the *Capital Adequacy Directive* (Definitions), an *exempt CAD firm* means an *investment firm* that satisfies the following conditions:

- (1) it would have been a *CAD investment firm* if *exempt CAD firms* were not excluded from the definition; and
- (2) it is only authorised to provide the service of investment advice and/or receive and transmit orders from investors (as referred to in Section A of Annex I of *MiFID*) without in both cases holding money or securities belonging to its clients and which for that reason may not at any time place itself in debit with its clients.

**Types of BIPRU investment firm**

## 1.1.17

FCA PRA

R

- (1) A *BIPRU limited licence firm* means a *limited licence firm* that falls into (4).
- (2) A *BIPRU limited activity firm* means a *limited activity firm* that falls into (4).
- (3) A *full scope BIPRU investment firm* means a *CAD full scope firm* that falls into (4).
- (4) A *limited licence firm*, *limited activity firm* or *CAD full scope firm* falls into (4) if:

- (a) it is a *firm*; and
- (b) its head office is in the *United Kingdom* and it is not otherwise excluded from the definition of *BIPRU firm* under
  - BIPRU 1.1.7 R.

#### Alternative classification of BIPRU investment firms

1.1.18

FCA PRA

R

*BIPRU investment firm* are divided into the following classes for the purposes of the calculation of the *base capital resources requirement* and for the purpose of any other provision of the *Handbook* that applies this classification:

- (1) a *UCITS investment firm*;
- (2) a *BIPRU 50K firm*;
- (3) a *BIPRU 125K firm*; and
- (4) a *BIPRU 730K firm*.

#### Types of investment firm: BIPRU 125K firm

1.1.19

FCA PRA

R

A *BIPRU 125K firm* means a *BIPRU 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 in Section A of Annex I of *MiFID*) on a firm commitment basis;
- (2) it holds clients' money or securities in relation to *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 *UCITS investment firm* and;
- (5) it does not operate a *multilateral trading facility*.

1.1.20

FCA PRA

R

**Types of investment firm: BIPRU 50K firm**

A *BIPRU 50K firm* means a *BIPRU investment firm* that satisfies the following conditions:

- (1) it satisfies the conditions in ■ BIPRU 1.1.19 R (1) and ■ (3);
- (2) it does not hold clients' money or securities in relation to *investment services* it provides and it is not authorised to do so;
- (3) it is not a *UCITS investment firm*; and
- (4) it does not operate a *multilateral trading facility*.

1.1.21

FCA PRA

R

**Types of investment firm: 730K firm**

A *BIPRU investment firm* that is not a *UCITS investment firm*, a *BIPRU 50K firm* or a *BIPRU 125K firm* is a *BIPRU 730K firm*. A *BIPRU investment firm* that operates a *multilateral trading facility* is a *BIPRU 730K firm*.

1.1.22

FCA PRA

R

**Types of investment firm: Part 4A permission**

A *firm* also falls into one of the categories of *BIPRU investment firm* listed in ■ BIPRU 1.1.6 R (3) to ■ (5) or ■ BIPRU 1.1.18 R if its *Part 4A permission* contains a *requirement* that it comply with the *rules* in *GENPRU* and *BIPRU* 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 *BIPRU investment firm* it does not fall into that other category.

1.1.23

FCA PRA

R

**Meaning of dealing on own account**

- (1) *Dealing on own account* means (for the purpose of *GENPRU* and *BIPRU*) 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 5(2) of the *Capital Adequacy Directive* (Definition of dealing on own account), a *CAD 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 *CAD 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 *CAD investment firm's initial capital*;
  - (c) (in the case of a *BIPRU investment firm*) it complies with the *main BIPRU firm Pillar 1 rules* and ■ BIPRU 10 (Large exposures requirements);

- (d) (in the case of a *CAD investment firm* that is an *EEA firm*) it complies with the *CRD implementation measures* of its *Home State* for Articles 18 and 20 (Minimum capital requirements) and 28 (Large exposures) of the *Capital Adequacy Directive*;
  - (e) (in the case of any other *CAD investment firm*) it would comply with the *rules* in (2)(c) if it had been a *BIPRU investment firm* on the basis of the assumptions in ■ BIPRU 1.1.14 R (3)(a) and ■ BIPRU 1.1.14R (3)(b); and
  - (f) 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 5(2) of the *Capital Adequacy Directive*, the holding of *non-trading book positions* in *financial instruments* in order to invest *capital resources* is not *dealing on own account* for the purposes referred to in ■ BIPRU 1.1.18 R.

#### Interpretation of the definition of types of firm and undertaking

1.1.24

FCA PRA

R

For the purposes of the definitions in ■ BIPRU 1.1, a *person* does any of the activities referred to in ■ BIPRU 1.1 if:

- (1) it does that activity anywhere in the world; or
- (2) if its *permission* includes that activity; or
- (3) (in the case of 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.

1.1.25

FCA PRA

R

For the purposes of the definitions in ■ BIPRU 1.1, a *person* offers any of the services referred to in ■ BIPRU 1.1.19 R (3)if:

- (1) it offers that service anywhere in the world; or
- (2) any of ■ BIPRU 1.1.24 R (1) to ■ BIPRU 1.1.24R (4) apply.

1.1.26

FCA PRA

R

For the purposes of the definitions in ■ BIPRU 1.1, a *person* has an authorisation to do any of the activities referred to in ■ BIPRU 1.1 if any of ■ BIPRU 1.1.24 R (2) to ■ (4) apply.

## 1.2 Definition of the trading book

### Application

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

**FCA** **PRA**

### Purpose

1.2.2 **G** This section implements certain provisions of the *Capital Adequacy Directive* and the *Banking Consolidation Directive* relating to the *trading book*. The precise provisions being implemented are listed as a note after each *rule*.

**FCA** **PRA**

### Definition of the trading book: General

1.2.3 **R** The *trading book* of a *firm* consists of all *position* in *CRD financial instrument* and *commodities* held either with trading intent or in order to hedge other elements of the *trading book* and which are either free of any restrictive covenants on their tradability or able to be hedged.

**FCA** **PRA**

[Note: CAD Article 11(1)]

### Definition of the trading book: Positions

1.2.4 **R** The term *position* includes proprietary positions and positions arising from client servicing and market making.

**FCA** **PRA**

[Note: CAD Article 11(2) second sentence]

1.2.5 **G** *Positions* arising from client servicing include those arising out of contracts where a *firm* acts as principal (even in the context of activity described as 'broking' or 'customer business'). Such *positions* should be allocated to a *firm's trading book* if the intent is trading (see ■ BIPRU 1.2.10 R). This applies even if the nature of the business means that generally the only risks incurred by the *firm* are counterparty risks (i.e. no market risk charges apply). If the nature of the business means that generally the only risks incurred by the *firm* are counterparty risks, the *position* will generally still meet the trading intent requirement in ■ BIPRU 1.2.10 R if the *position* would meet the trading intent requirement if *position* risk did arise. The *appropriate regulator* understands that business carried out under International Uniform Brokerage Execution ("Give-Up") Agreements involve back to back trades as principal. Thus *positions* arising out of business carried out under such agreements should be allocated to a *firm's trading book*.

**FCA** **PRA**

**Definition of the trading book: Repos**

1.2.6

FCA PRA

R

Term trading-related repo-style transactions that a *firm* accounts for in its *non-trading book* may be included in the *trading book* for capital requirement purposes so long as all such repo-style transactions are included. For this purpose, trading-related repo-style transactions are defined as those that meet the requirements of ■ BIPRU 1.2.4 R, ■ BIPRU 1.2.10 R and ■ BIPRU 1.2.12 R, and both legs are in the form of either cash or securities includable in the *trading book*. Regardless of where they are booked, all repo-style transactions are subject to a *non-trading book* counterparty credit risk charge.

[Note: CAD Annex VII Part D point 4]

1.2.6A

FCA PRA

G

Capital requirements for term trading-related repo-style transactions are the same whether the risks arise in the *trading book* as counterparty credit risk or in the *non-trading book* as credit risk.

**CRD financial instruments**

1.2.7

FCA PRA

R

A *CRD financial instrument* means any contract that gives rise to both a financial asset of one party and a financial liability or equity instrument of another party.

[Note: CAD Article 3(1)(e)]

1.2.8

FCA PRA

R

*CRD financial instruments* include both primary *CRD financial instrument* or cash instruments, and derivative *CRD financial instruments* the value of which is derived from the price of an underlying *CRD financial instrument*, a rate, an index or the price of another underlying item and include as a minimum the instruments specified in Section C of Annex I to the *MIFID*.

[Note: CAD Article 3(1) last paragraph]

1.2.9

FCA PRA

G

Generally, for the purpose of the definition of *CRD financial instrument*:

- (1) a financial asset means cash, the right to receive cash or another financial asset, the contractual right to exchange financial assets on potentially favourable terms or an equity instrument; and
- (2) a financial liability means the contractual obligation to deliver cash or another financial asset or to exchange financial liabilities under conditions that are potentially unfavourable.

**Trading intent**

1.2.10

FCA PRA

R

*Positions* held with trading intent for the purpose of the definition of the *trading book* are those held intentionally for short-term resale and/or with the intention of benefiting from actual or expected short-term price

1 differences between buying and selling prices, or from other price or interest rate variations.

[Note: CAD Article 11(2) first sentence]

**1.2.11****FCA** **PRA****R**

Trading intent must be evidenced on the basis of the strategies, policies and procedures set up by the *firm* to manage the *position* or portfolio in accordance with ■ BIPRU 1.2.12 R.

[Note: CAD 11(3)]

**1.2.12****FCA** **PRA****R**

*Positions*/portfolios held with trading intent must comply with the following requirements:

- (1) there must be a clearly documented trading strategy for the *position*/instrument or portfolios, approved by senior management, which must include the expected holding horizon;
- (2) there must be clearly defined policies and procedures to monitor the *position* against the *firm's* trading strategy including the monitoring of turnover and stale *position* in the *firm's trading book*; and
- (3) there must be clearly defined policies and procedures for the active management of the *position*, which must include the following:
  - (a) *position* entered into on a trading desk;
  - (b) *position* limits are set and monitored for appropriateness;
  - (c) dealers have the autonomy to enter into/manage the *position* within agreed limits and according to the approved strategy;
  - (d) *positions* are reported to senior management as an integral part of the *firm's* risk management process; and
  - (e) *positions* are actively monitored with reference to market information sources and an assessment made of the marketability or hedge-ability of the *position* or its component risks, including the assessment of, the quality and availability of market inputs to the valuation process, level of market turnover, sizes of *positions* traded in the market.

[Note: CAD Annex VII Part A]

**Internal hedges**

1.2.13

FCA PRA

R

Internal hedges may be included in the *trading book*, in which case  
 ■ BIPRU 1.2.14 R to ■ BIPRU 1.2.16 R apply.

[Note: CAD Article 11(5)]

1.2.14

FCA PRA

R

(1) An internal hedge is a *position* that materially or completely offsets the component risk element of a *non-trading book position* or a set of *position*. *Positions* arising from internal hedges are eligible for *trading book* capital treatment, provided that they are held with trading intent and that the general criteria on trading intent and prudent valuation specified in ■ BIPRU 1.2.12 R and the *trading book systems and controls rules*. In particular:

- (a) internal hedges must not be primarily intended to avoid or reduce capital requirements;
- (b) internal hedges must be properly documented and subject to particular internal approval and audit procedures;
- (c) the internal transaction must be dealt with at market conditions;
- (d) the bulk of the market risk that is generated by the internal hedge must be dynamically managed in the *trading book* within the authorised limits; and
- (e) internal transactions must be carefully monitored.

(2) Monitoring must be ensured by adequate procedures.

[Note: CAD Annex VII Part C point 1]

1.2.15

FCA PRA

R

The treatment referred to in ■ BIPRU 1.2.14 R applies without prejudice to the capital requirements applicable to the "*non-trading book leg*" of the internal hedge.

[Note: CAD Annex VII Part C point 2]

1.2.16

FCA PRA

R

By way of derogation from ■ BIPRU 1.2.14 R to ■ BIPRU 1.2.15 R, when a *firm* hedges a *non-trading book* credit risk exposure using a credit derivative booked in its *trading book* (using an internal hedge), the *non-trading book* exposure is not deemed to be hedged for the purposes of calculating capital requirements unless the *firm* purchases from an eligible third party protection provider a credit derivative meeting the requirements set out in ■ BIPRU 5.7.13 R (Additional requirements for credit derivatives) with regard to the *non-trading book* exposure. Without prejudice to the second sentence of ■ BIPRU 14.2.10 R, where such third party protection is purchased and is recognised as a hedge of a *non-trading book* exposure for the purposes of calculating capital requirements, neither the internal nor external credit

derivative hedge must be included in the *trading book* for the purposes of calculating capital requirements.

[Note: CAD Annex VII Part C point 3]

#### Size thresholds

1.2.17

FCA PRA

R

- (1) Subject to (3), a *firm* may calculate its capital requirements for its *trading book* business in accordance with the *standardised approach* to credit risk (or, if it has an *IRB permission*, the *IRB approach*) as it applies to the *non-trading book* where the size of the *trading book* business meets the following requirements:
  - (a) the *trading book* business of the *firm* does not normally exceed 5% of its total business;
  - (b) its total *trading book position* do not normally exceed €15 million; and
  - (c) the *trading book* business of the *firm* never exceeds 6% of its total business and its total *trading book positions* never exceed €20 million.
  
- (2) Subject to (3), if (1) applies, the following are disapplied:
  - (a) the *rules* relating to the *interest rate PRR*, the *equity PRR*, the *CIU PRR* and the *PRR* calculated under ■ BIPRU 7.11 (Credit derivatives in the trading book);
  - (b) the *rules* relating to the *option PRR* (but only in relation to *positions* which under ■ BIPRU 7.6.5 R (Table: Appropriate calculation for an option or warrant) may be subject to one of the other *PRR charges* listed in (2)(a) or which would be subject to such a *PRR charge* if ■ BIPRU 7.6.5 R did not require an *option PRR* to be calculated);
  - (c) ■ ■ BIPRU 7.10 (Use of a Value at Risk Model) so far as ■ BIPRU 7.10 relates to the risks covered by the requirements in (a) and (b); and
  - (d) ■ BIPRU 14 (Capital requirements for settlement and counterparty risk).
  
- (3) If (1) applies, the following continue to apply:
  - (a) the *rules* relating to the *commodity PRR* and the *foreign currency PRR*;
  - (b) the *rules* relating to the *option PRR* (so far as not disapplied under (2)(b));
  - (c) ■ BIPRU 7.10 (so far as not disapplied under (2)(c));
  - (d) ■ BIPRU 14.2.3 R to ■ BIPRU 14.2.8 R (Credit derivatives); and

- (e) ■ BIPRU 14.2.15 R to ■ BIPRU 14.2.16 R (Collateral for *repurchase transactions* and other products).

[Note: CAD Article 18(2)]

1.2.18

FCA PRA

R

In order to calculate the proportion that *trading book* business bears to total business for the purpose of ■ BIPRU 1.2.17 R (1)(a) to ■ BIPRU 1.2.17R (1)(c) the *firm* must refer to the size of the combined on- and off-balance-sheet business. For this purpose, debt instruments must be valued at their market prices or their principal values, equities at their market prices and derivatives according to the nominal or market values of the instruments underlying them. Long *positions* and short *positions* must be summed regardless of their signs.

[Note: CAD Article 18(3)]

1.2.19

FCA PRA

R

If a *firm* should happen for more than a short period to exceed either or both of the limits imposed in ■ BIPRU 1.2.17 R (1)(a) and ■ BIPRU 1.2.17R (1)(b) or either or both of the limits imposed in ■ BIPRU 1.2.17 R (1)(c):

- (1) ■ BIPRU 1.2.17 R ceases to apply; and
- (2) the *firm* must notify the *appropriate regulator*.

[Note: CAD Article 18(4)]

1.2.20

FCA PRA

G

As required by ■ BIPRU 8.7.21 R (Special rules for the consolidated market risk requirement), a *firm* should consider whether it meets the threshold conditions in ■ BIPRU 1.2.17 R on both an unconsolidated (or solo) basis and a consolidated basis. If a *firm's* trading activities on both an unconsolidated (or solo) basis and a consolidated basis are below the threshold size, it may be appropriate for the *firm* not to adopt the *trading book* treatment. However, even if the *firm* does not apply the *trading book* treatment it should still adopt a *trading book policy statement*. That statement may be restricted to identifying the activities the *firm* normally considers to be trading and that would constitute part of its *trading book*. The *firm* should use this policy statement to help it to decide whether or not adopting the *trading book* treatment is appropriate.

### Systems and controls for the trading book

1.2.21

FCA PRA

R

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

[Note: BCD Annex V, Part 7 point 10]

1.2.22

FCA PRA

R

A *firm* must establish and maintain systems and controls to manage its *trading book*, in accordance with the *trading book systems and controls rules*, ■ BIPRU 1.2.6 R (Definition of the trading book: Repos) and the *overall financial adequacy rule* to ■ BIPRU 1.2.27 R (Trading book policy statements).

1.2.23

FCA PRA

R

[Note: CAD Article 11(4)]

A *firm* must establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates.

[Note: CAD Annex VII Part B point 1]

1.2.24

FCA PRA

R

Systems and controls must include at least the following elements:

- (1) documented policies and procedures for the process of valuation (including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month end and ad-hoc verification procedures); and
- (2) reporting lines for the department accountable for the valuation process that are clear and independent of the front office.

[Note: CAD Annex VII Part B point 2]

1.2.25

FCA PRA

R

The reporting line in relation to the matters covered by ■ BIPRU 1.2.21 R to ■ BIPRU 1.2.24 R must ultimately be to an executive *director* on the *firm's governing body*.

[Note: CAD Annex VII Part B point 2 (last sentence)]

#### Trading book policy statements

1.2.26

FCA PRA

R

A *firm* must have clearly defined policies and procedures for determining which *positions* to include in the *trading book* for the purposes of calculating its capital requirements, consistent with the criteria set out in ■ BIPRU 1.2.3 R to ■ BIPRU 1.2.4 R, ■ BIPRU 1.2.10 R to ■ BIPRU 1.2.11 R, ■ BIPRU 1.1.13 R and ■ BIPRU 1.2.22 R and taking into account the *firm's* risk management capabilities and practices. Compliance with these policies and procedures must be fully documented and subject to periodic internal audit.

[Note: CAD Annex VII Part D point 1]

1.2.27

FCA PRA

R

A *firm* must have clearly defined policies and procedures for overall management of the *trading book*. At a minimum these policies and procedures must address:

- (1) the activities the *firm* considers to be trading and as constituting part of the *trading book* for capital requirement purposes;
- (2) the extent to which a *position* can be marked-to-market daily by reference to an active, liquid two-way market;

- (3) for *positions* that are marked-to-model, the extent to which the *firm* can:
  - (a) identify all material risks of the *position*;
  - (b) hedge all material risks of the *position* with instruments for which an active, liquid two-way market exists; and
  - (c) derive reliable estimates for the key assumptions and parameters used in the model;
- (4) the extent to which the *firm* can, and is required to, generate valuations for the *position* that can be validated externally in a consistent manner;
- (5) the extent to which legal restrictions or other operational requirements would impede the *firm's* ability to effect a liquidation or hedge of the *position* in the short term;
- (6) the extent to which the *firm* can, and is required to, actively risk manage the *position* within its trading operation; and
- (7) the extent to which the *firm* may transfer risk or *positions* between the *non-trading book* and *trading book* and the criteria for such transfers.

[Note: CAD Annex VII Part D point 2]

## 1.2.28

FCA PRA

G

The policies and procedures referred to in ■ BIPRU 1.2.27 R (1) should cover:

- (1) the *CRD financial instrument* and *commodities* that the *firm* proposes to trade in, including the currencies, maturities, issuers and quality of issues; and
- (2) any instruments to be excluded from its *trading book*.

## 1.2.29

FCA PRA

R

- (1) The policies and procedures referred to in the *overall financial adequacy rule* and ■ BIPRU 1.2.27 R must be recorded in a single written document. A *firm* may record those policies and procedures in more than one written document if the *firm* has a single written document that identifies:
  - (a) all those other documents; and
  - (b) the parts of those documents that record those policies and procedures.
- (2) A *trading book policy statement* means the single document referred to in this *rule*.

1.2.30

FCA PRA

R

- (1) A *firm* must notify the *appropriate regulator* as soon as is reasonably practicable when it adopts a *trading book policy statement*.
- (2) A *firm* must notify the *appropriate regulator* as soon as is reasonably practicable if the *trading book policy statement* is subject to significant changes.

1.2.31

FCA PRA

G

A significant change for the purpose of the *overall Pillar 2 rule* includes new types of customers or business requiring different funding or provisioning.

1.2.32

FCA PRA

G

There is likely to be an overlap between what the *trading book policy statement* should contain and other documents such as dealing or treasury manuals. A cross reference to the latter in the *trading book policy statement* is adequate and material in other documents need not be set out again in the *trading book policy statement*. However where this is the case the matters required to be included in the *trading book policy statement* should be readily identifiable.

1.2.33

FCA PRA

G

The *trading book policy statement* may be prepared on either a consolidated or a solo (or solo-consolidated) basis. It should be prepared on a consolidated basis when a group either manages its trading risk centrally or employs the same risk management techniques in each group member. A *trading book policy statement* prepared on a consolidated basis should set out how it applies to each *firm* in the group and should be approved by each such *firm's governing body*.

#### Treatments common to the trading book and the non-trading book

1.2.34

FCA PRA

G

Capital requirements for *foreign currency risk* and *commodity position risk* are the same whether the risk arises in the *trading book* or the *non-trading book*. The calculation of capital requirements for *foreign currency risk* is set out in ■ BIPRU 7.5. The calculation of capital requirements for *commodity position risk* is set out in ■ BIPRU 7.4.

#### Trading book treatments

1.2.35

FCA PRA

G

All *positions* that are in a *firm's trading book* require capital to cover *position risk* and may require capital to cover counterparty credit risk and to cover large exposures. Counterparty credit risk in the *trading book* is dealt with by ■ BIPRU 14 and capital for *large exposures* is covered by ■ BIPRU 10.

#### Non-trading book treatments

1.2.36

FCA PRA

G

All *positions* that are not in a *firm's trading book* are included in its *non-trading book* and subject capital requirements for the *non-trading book* unless they are deducted from *capital resources* under GENPRU 2.2 (Capital resources).

## 1.3 Applications for advanced approaches and waivers

### Application

1.3.1

FCA PRA

R

This section of the *Handbook* applies to every *BIPRU firm* that wishes to apply for a permission to use any of the approaches set out in ■ BIPRU 1.3.2 G.

### Purpose

1.3.2

FCA PRA

G

- (1) A *firm* may apply for an *Article 129 permission* or a *waiver* in respect of:
  - (a) the *IRB approach*;
  - (b) the *advanced measurement approach*;
  - (c) the *CCR internal model method*; and
  - (d) the *VaR model approach*.
- (2) A *firm* should apply for a *waiver* if it wants to:
  - (a) apply the *CAD 1 model approach*; or
  - (b) apply the *master netting agreement internal models approach*; or
  - (c) disapply consolidated supervision under ■ BIPRU 8 for its *UK consolidation group* or *non-EEA sub-group*; or
  - (d) apply the treatment in ■ BIPRU 2.1 (Solo-consolidation waiver); or
  - (da) apply the treatment for a *core UK group* in ■ BIPRU 3.2.25 R (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
  - (f) apply the treatment in ■ BIPRU 10.6.35 R (Sovereign large exposure waiver).

### Article 129

1.3.3

FCA PRA

G

An *EEA parent institution* and its *subsidiary undertakings* or the *subsidiary undertakings* of its *EEA parent financial holding company* that wish to use any of the approaches listed in ■ BIPRU 1.3.2 G (1) in respect of its group, including members of its group that are *BIPRU firms*, may apply for an *Article 129 permission*.

**1.3.4** FCA PRA G The *Article 129 procedure* allows an *EEA parent institution* and its *subsidiary undertakings* or the *subsidiary undertakings* of its *EEA parent financial holding company* to apply for permission to use the approaches in ■ BIPRU 1.3.2 G (1) without making separate applications to the *competent authority* of each *EEA State* where members of a *firm's* group are authorised.

**1.3.5** FCA PRA G The *Capital Requirements Regulations 2006* set out the *Article 129 procedure*.

**1.3.6** FCA PRA G Where a *firm* or its group has been granted an *Article 129 permission*, each *competent authority*, including the lead *competent authority*, will need to take action to apply that *Article 129 permission* to the *institutions* that they authorise. Part 3 of the *Capital Requirements Regulations 2006* governs how the *appropriate regulator* will take that action, whether or not the *appropriate regulator* is the lead *competent authority*.

### Article 129 permissions and waivers - specific conditions

**1.3.7** FCA PRA D When an *advanced measurement approach* is intended to be used by an *EEA parent institution* and its *subsidiary undertakings* or the *subsidiary undertakings* of an *EEA parent financial holding company*, the application of a *firm* in accordance with ■ BIPRU 1.3.14 D must include the elements listed in ■ BIPRU 6.5.5 R (Minimum standards for the advanced measurement approach).

[Note:BCD Article 105(2)]

**1.3.8** FCA PRA D When an *advanced measurement approach* is intended to be used by an *EEA parent institution* and its *subsidiary undertakings* or the *subsidiary undertakings* of an *EEA parent financial holding company*, the application of a *firm* must include a description of the methodology used for allocating *operational risk* capital between the different entities of the group.

[Note: BCD annex X Part 3 point 30]

**1.3.9** FCA PRA D For the purposes of ■ BIPRU 1.3.8 D, the application of a *firm* must indicate whether and how diversification effects are intended to be factored in the risk measurement system.

[Note: BCD annex X Part 3 point 31]

### Waiver - general

**1.3.10** FCA PRA G As explained in ■ SUP 8, under sections 138A and 138B of the *Act*, the *appropriate regulator* may not grant a *waiver* to a *firm* unless it is satisfied that:

- (1) compliance by the *firm* with the *rules*, or with the *rules* as modified, would be unduly burdensome or would not achieve the purpose for which the *rules* were made; and
- (2) the *waiver* would not result in undue risk to *persons* whose interests the *rules* are intended to protect.

**1.3.11** FCA PRA G The conditions relating to the use of an approach listed in ■ BIPRU 1.3.2 G referred to in the relevant chapter of *BIPRU* are minimum standards. Satisfaction of those conditions does not automatically mean the *appropriate regulator* will grant a *waiver*

referred to in those paragraphs. The *appropriate regulator* will in addition also apply the tests in section 138A of the *Act*.

## 1.3.12

FCA PRA

G

In the *appropriate regulator's* view, if the minimum standards referred to in ■ BIPRU 1.3.11 G are satisfied, the conditions referred to in ■ BIPRU 1.3.10 G (1) will generally be met.

### Forms and method of application

## 1.3.13

FCA PRA

D

Subject to ■ BIPRU 1.3.14 D to ■ BIPRU 1.3.20 D, if a *firm* wishes to apply for a *waiver* to apply an approach set out in ■ BIPRU 1.3.2 G, it must comply with ■ SUP 8.3.3 D.

## 1.3.14

FCA PRA

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.

## 1.3.15

FCA PRA

D

If a *firm* wishes to apply for a *waiver* or an *Article 129 permission* to use the *IRB approach*, it must complete and submit the form in ■ BIPRU 1 Annex 2D D.

## 1.3.16

FCA PRA

D

If a *firm* wishes to apply for a *waiver* or an *Article 129 permission* to use the *CCR internal model method*, it must complete and submit the form in ■ BIPRU 1 Annex 3D D.

## 1.3.17

FCA PRA

D

Where a *firm* makes an application in accordance with ■ BIPRU 1.3.14 D, ■ BIPRU 1.3.15 D or ■ BIPRU 1.3.16 D, the *firm* must state on the application whether it is making an application for a *waiver* or an *Article 129 permission*.

## 1.3.18

FCA PRA

D

Where a *firm* applies for a *VaR model permission*, the *firm* must state whether it is making an application for a *waiver* or an *Article 129 permission*.

## 1.3.19

FCA PRA

G

In respect of the application for *waivers* to apply the approaches set out in ■ BIPRU 1.3.2 G (1), the *appropriate regulator* will aim to give decisions on applications as soon as practicable. However, the *appropriate regulator* expects that it will take a significant period to determine and give a decision due to the complexity of the issues raised by the applications. Details of timelines for applications for waivers to use advanced approaches and under the *Article 129 procedure* are set out on the *appropriate regulator* website.

## 1.3.20

FCA PRA

D

Where a *firm* applies for a *solo consolidation waiver*, it must demonstrate how each of the conditions set out in ■ BIPRU 2.1.20 R to ■ BIPRU 2.1.24 R are met and address the criteria set out in the *guidance* in ■ BIPRU 2.1.25 G as part of its application in accordance with ■ BIPRU 1.3.13 D.

## 1.3.21

FCA PRA

G

Before sending in an application for a *waiver* or *Article 129 permission*, a *firm* may find it helpful to discuss the application with its usual supervisory contact at the *appropriate regulator*. However, the *firm* should still ensure that all relevant information is included in the application.



## 1.4 Actions for damages

1.4.1

FCA PRA

R

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

## Application form to apply the advanced measurement approach

**FCA** **PRA**

This annex consists only of one or more forms.

Forms



## Application form to apply the IRB approach

**FCA** **PRA**

This annex consists only of one or more forms. Forms are to be found through the 'Forms' link at [web address tbc] or through the Handbook section of the CD-ROM under Forms.



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## Application form to apply the CCR internal model method approach

**FCA** **PRA**

This annex consists only of one or more forms. Forms are to be found through the 'Forms' link at [web address tbc] or through the Handbook section of the CD-ROM under Forms.



# Chapter 2

# Capital

## 2.1 Solo consolidation

### Application

**2.1.1** **R** This section applies to a *BIPRU firm* that has a *solo consolidation waiver*.  
**FCA** **PRA**

### Purpose

**2.1.2** **G** The purpose of this section is to implement Articles 70 and 118 of the *Banking Consolidation Directive*. 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*.  
**FCA** **PRA**

**2.1.3** **G** The *rules* in *GENPRU* and *BIPRU* do not allow a *firm* that is a *parent undertaking* to incorporate the capital and requirements of a *subsidiary undertaking* in the calculation of that *firm's capital resources* and *capital resources requirement*. A *firm* that wishes to incorporate a *subsidiary undertaking* for this purpose should therefore apply for a *solo consolidation waiver*.  
**FCA** **PRA**

### Applying for a solo consolidation waiver

**2.1.4** **G** ■ **BIPRU 1.3** (Applications for advanced approaches) explains how to apply for a *solo consolidation waiver*.  
**FCA** **PRA**

### General

**2.1.5** **G** The *appropriate regulator* will not grant a *firm* a *solo consolidation waiver* with respect to a *subsidiary undertaking* unless the *firm* and the *subsidiary undertaking* meet the standards in ■ **BIPRU 2.1.19 R** to ■ **BIPRU 2.1.24 R**.  
**FCA** **PRA**

**2.1.6** **G** A *solo consolidation waiver* will modify the relevant parts of *GENPRU*, *BIPRU* and *SYSC* referred to in ■ **BIPRU 2.1.7 R** to ■ **BIPRU 2.1.8 R** to apply ■ **BIPRU 2.1** to a *firm*.  
**FCA** **PRA**

### The basic rules for solo consolidation

**2.1.7** **R** A *firm* that has a *solo consolidation waiver* must incorporate in the calculation of its requirements under the *main BIPRU firm Pillar 1 rules* and ■ **BIPRU 10** (Large exposure requirements) each *subsidiary undertaking* to which the *solo consolidation waiver* applies. This does not apply to the *base capital resources requirement*.  
**FCA** **PRA**

2.1.8

FCA PRA

R

- (1) A *firm* that has a *solo consolidation waiver* must meet the obligations in ■ SYSC 12.1.13 R (Application of certain systems and controls *rules* on a consolidated basis) on a consolidated basis with respect to the *firm* and each *subsidiary undertaking* to which the *firm's solo consolidation waiver* applies.
- (2) If (1) applies, ■ SYSC 12.1.13 R applies to the group made up of the *firm* and its *subsidiary undertakings* referred to in (1) in the same way as it applies to a *UK consolidation group* or *non-EEA sub-group*.
- (3) If (1) applies, the provisions of SYSC and BIPRU listed in ■ SYSC 12.1.13 R do not apply to the *firm* on a solo basis.

#### Solo consolidation and capital and concentration risk requirements

2.1.9

FCA PRA

R

■ BIPRU 2.1.10 R to ■ BIPRU 2.1.18 R apply for the purposes of ■ BIPRU 2.1.7 R.

2.1.10

FCA PRA

R

A *firm* must treat itself and each *subsidiary undertaking* referred to in ■ BIPRU 2.1.7 R as a single *undertaking* and must apply, on that basis, ■ BIPRU 8 (Group risk - consolidation) to the group made up of the *firm* and such *subsidiary undertakings* in the same way as ■ BIPRU 8 applies to a *UK consolidation group* or *non-EEA sub-group*.

2.1.11

FCA PRA

R

Subject to ■ BIPRU 2.1.13 R, a *firm* must calculate its *capital resources* in accordance with ■ BIPRU 8.6 (Consolidated capital resources).

2.1.12

FCA PRA

R

A *firm* must calculate its *capital resources requirement* in accordance with ■ BIPRU 8.7.13 R (3) (Treating group members as a single undertaking for consolidation purposes).

2.1.13

FCA PRA

R

Where GENPRU applies a different method of calculating *capital resources* or *capital resources requirements* depending on the category into which the *firm* in question falls, the method that applies is the one that would apply to the *firm* on a solo basis.

2.1.14

FCA PRA

G

For example, the effect of ■ BIPRU 2.1.13 R is that if a *firm* that is applying ■ BIPRU 2.1 is a *limited licence firm* it should continue to apply the *capital resources* and *capital resources requirement* applicable to a *limited licence firm*.

2.1.15

FCA PRA

R

A *firm* must continue to calculate its *base capital resources requirement* and the requirement in ■ GENPRU 2.1.42 R (Calculation of capital resources requirement on authorisation) on a solo basis.

2.1.16

FCA PRA

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 2.1.7 R in the same way as ■ BIPRU 8.9A applies to a *UK consolidation group* or *non-EEA sub-group*.

<p>2.1.17 FCA PRA</p>	<p>G</p>	<p>One effect of ■ BIPRU 2.1.16 R 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.</p>
<p>2.1.18 FCA PRA</p>	<p>R</p>	<p>A <i>firm</i> must include in full any <i>subsidiary undertaking</i> in respect of which the <i>firm</i> applies ■ BIPRU 2.1 in the calculations under ■ BIPRU 2.1.7 R.</p>
<p><b>Minimum standards</b></p> <p>.....</p>		
<p>2.1.19 FCA PRA</p>	<p>R</p>	<p>A <i>firm</i> must not apply ■ BIPRU 2.1 to a <i>subsidiary undertaking</i> to which the <i>firm's solo consolidation waiver</i> applies ■ BIPRU 2.1 unless in addition it meets the conditions in ■ BIPRU 2.1.20 R to ■ BIPRU 2.1.24 R.</p>
<p>2.1.20 FCA PRA</p>	<p>R</p>	<p>The risk evaluation, measurement and control procedures of the <i>firm</i> must cover the <i>subsidiary undertaking</i> referred to in ■ BIPRU 2.1.19 R.</p>
<p>2.1.21 FCA PRA</p>	<p>R</p>	<p>The <i>firm</i> must hold more than 75% of the voting rights attaching to the <i>shares</i> in the capital of the <i>subsidiary undertaking</i> referred to in ■ BIPRU 2.1.19 R and must have the right to appoint or remove a majority of the members of the <i>governing body</i> of the <i>subsidiary undertaking</i>.</p>
<p>2.1.22 FCA PRA</p>	<p>R</p>	<p>The material <i>exposures</i> or material liabilities of the <i>subsidiary undertaking</i> referred to in ■ BIPRU 2.1.19 R must be to the <i>firm</i>.</p>
<p>2.1.23 FCA PRA</p>	<p>R</p>	<p>Where the <i>firm</i> is a <i>parent institution in a Member State</i>, it must have measures in place that ensure the satisfactory allocation of risks within the group consisting of the <i>firm</i> and each <i>subsidiary undertaking</i> to which ■ BIPRU 2.1 is applied.</p>
<p>2.1.24 FCA PRA</p>	<p>R</p>	<p>A <i>firm</i> must be able to demonstrate fully to the <i>appropriate regulator</i> 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 the <i>capital resources</i> of the <i>subsidiary undertaking</i> referred to in ■ BIPRU 2.1.19 R or repayment of liabilities when due by the <i>subsidiary undertaking</i> to the <i>firm</i>.</p>
<p>2.1.25 FCA PRA</p>	<p>G</p>	<p>The following are the criteria that the <i>appropriate regulator</i> will take into account when considering whether the condition in ■ BIPRU 2.1.24 R is going to be met:</p> <ol style="list-style-type: none"> <li>(1) the speed with which funds can be transferred or liabilities repaid to the <i>firm</i> and the simplicity of the method for the transfer or repayment;</li> <li>(2) whether there are any interests other than those of the <i>firm</i> in the <i>subsidiary undertaking</i> and what impact those other interests may have on the <i>firm's</i> control over the <i>subsidiary undertaking</i> and on the ability of the <i>firm</i> to require a transfer of funds or repayment of liabilities;</li> </ol>

- (3) whether the prompt transfer of funds or repayment of liabilities to the *firm* might harm the reputation of the *firm* or its *subsidiary undertakings*;
- (4) whether there are any tax disadvantages for the *firm* or the *subsidiary undertaking* 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 undertaking* 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 undertaking* to transfer funds or repay liabilities promptly;
- (8) whether the purpose of the *subsidiary undertaking* prejudices the prompt transfer of funds or repayment of liabilities;
- (9) whether the legal structure of the *subsidiary undertaking* prejudices the prompt transfer of funds or repayment of liabilities;
- (10) whether the contractual relationships of the *subsidiary undertaking* 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 undertaking* and the *firm* demonstrate the ability to make prompt transfer of funds or repayment of liabilities; and
- (12) whether the degree of solo consolidation by the *firm* undermines the *appropriate regulator's* ability to assess the soundness of the *firm* as a legal entity (taking into account any other *subsidiary undertakings* to which ■ BIPRU 2.1 is being applied).

**2.1.26**

FCA PRA

G

The effect of ■ BIPRU 2.1.19 R is that even though a *firm's solo consolidation waiver* applies ■ BIPRU 2.1 with respect to a *subsidiary undertaking*, the *firm* should not apply ■ BIPRU 2.1 with respect to that *subsidiary undertaking* unless in addition it meets the conditions in ■ BIPRU 2.1.20 R to ■ BIPRU 2.1.24 R.

**2.1.27**

FCA PRA

G

A *firm* should not apply ■ BIPRU 2.1 to a *subsidiary undertaking* to which the *firm's solo consolidation waiver* applies if it ceases to be a *subsidiary undertaking* of the *firm* even if the *solo consolidation waiver* is not varied by removing the *subsidiary undertaking*.

**2.1.28**

FCA PRA

G

If a *subsidiary undertaking* referred to in ■ BIPRU 2.1.27 G later becomes a *subsidiary undertaking* again the *firm* should not apply ■ BIPRU 2.1 to it unless the *solo consolidation waiver* is varied to re-apply it with respect to the *subsidiary undertaking*.

## 2.2 Internal capital adequacy standards

### Application

2.2.1

FCA PRA

G

■ BIPRU 2.2 applies to a *BIPRU firm*.

### Purpose

2.2.2

FCA PRA

G

(1) ■ BIPRU 2.2 sets out *guidance* on ■ GENPRU 1.2 (Adequacy of financial resources) so far as it applies to a *BIPRU firm*. In particular it sets out *guidance* on how a *firm* should carry out its *ICAAP*, as well as some factors the *appropriate regulator* will take into consideration when undertaking a *SREP*. The terms *ICAAP* and *SREP* are explained in ■ BIPRU 2.2.4 G.

■ BIPRU 2.2.41 R- ■ BIPRU 2.2.43 R are *rules* that apply to a *firm* with an *IRB permission*.

(2) ■ BIPRU 2.2 is for the most part written on the basis that ■ GENPRU 1.2 (Adequacy of financial resources) applies to a *firm* on a solo basis. However it is still relevant when ■ GENPRU 1.2 applies on a consolidated basis. When ■ GENPRU 1.2 applies on a consolidated basis, ■ BIPRU 2.2 should be read with appropriate adjustments.

### Meaning of capital

2.2.3

FCA PRA

G

For the purpose of ■ BIPRU 2.2, "capital" refers to a *firm's* financial resources, *capital resources* and internal capital, all as referred to in the *overall Pillar 2 rule*.

### The ICAAP and the SREP: Introduction

2.2.4

FCA PRA

G

The adequacy of a *firm's* capital needs to be assessed both by a *firm* and the *appropriate regulator*. 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 *appropriate regulator*.

## 2.2.5

FCA PRA

G

**The ICAAP and the SREP: The ICAAP**

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, *capital resources* and internal capital that it considers adequate to cover the nature and level of the risks to which it is or might be exposed (■ GENPRU 1.2.30 R to ■ GENPRU 1.2.41 G (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*), taking into account, in the case of a *firm* with an *IRB permission*, the stress test required by ■ BIPRU 4.3.39 R to ■ BIPRU 4.3.40 R (Stress tests used in assessment of capital adequacy for a *firm* with an *IRB permission*);
- (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 (■ GENPRU 1.2.35 R); and
- (5) document its *ICAAP* (■ GENPRU 1.2.60 R).

## 2.2.6

FCA PRA

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* (■ GENPRU 1.2.44 G to ■ GENPRU 1.2.56 G (Application of ■ GENPRU 1.2 on a solo and consolidated basis: Processes and tests)). A *firm* may, instead of preparing the *ICAAP* itself, adopt as its *ICAAP* an assessment prepared by other group members.

## 2.2.7

FCA PRA

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**

## 2.2.8

FCA PRA

G

The *appropriate regulator* will review a *firm's ICAAP*, including the results of the *firm's* stress tests carried out under *GENPRU* and *BIPRU*, as part of its *SREP*. Provided that the *appropriate regulator* is satisfied with the appropriateness of a *firm's* capital assessment, the *appropriate regulator* 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 ■ BIPRU 2.2.41 R to ■ BIPRU 2.2.45 G.

## 2.2.9

FCA PRA

G

The *SREP* is a process under which the *appropriate regulator* :

- (1) reviews the arrangements, strategies, processes and mechanisms implemented by a *firm* to comply with *GENPRU*, *BIPRU* and *SYSC* and with requirements imposed by or under the *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 referred to in (1).

## 2.2.10

FCA PRA

G

As part of its *SREP*, the *appropriate regulator* 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 *appropriate regulator* will ask for additional information on the *ICAAP*.

## 2.2.11

FCA PRA

G

As part of its *SREP*, the *appropriate regulator* will consider whether the amount and quality of capital which a *firm* should hold to meet its *CRR* in ■ [GENPRU 2.1](#) (Calculation of capital resources requirements) is sufficient for that *firm* to comply with the *overall financial adequacy rule*.

## 2.2.12

FCA PRA

G

After completing a review as part of the *SREP*, the *appropriate regulator* 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*.

## 2.2.12A

FCA PRA

G

As part of its *SREP*, the *appropriate regulator* will also consider whether a *firm* should hold a *capital planning buffer* and, in that case, the amount and quality of such *capital planning buffer*. In making these assessments, the *appropriate regulator* 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*. 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.

## 2.2.12B

FCA PRA

G

After completing a review as part of the *SREP*, the *appropriate regulator* 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 *appropriate regulator* may set a *firm's* *capital planning buffer* either as an amount and quality of capital which it should hold now (that is, at the time of the *appropriate regulator's* notification following the *firm's* *SREP*) or, in exceptional cases, as a forward looking target that the *firm* should build up over time.

## 2.2.12C

FCA PRA

G

Where the amount or quality of capital which the *appropriate regulator* 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 *appropriate regulator* usually expects to discuss any such difference with the *firm*. Where necessary,

the *appropriate regulator* may consider the use of its powers under section 166 of the *Act* (Reports by skilled persons) to assist in such circumstances.

2.2.13

FCA PRA

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 *appropriate regulator* that it disagrees with that *guidance*. The *appropriate regulator* may reissue *individual capital guidance* if, after discussion with the *firm*, the *appropriate regulator* 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 *appropriate regulator*.

2.2.13A

FCA PRA

G

If a *firm* disagrees with the *appropriate regulator'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 *appropriate regulator* of its disagreement. The *appropriate regulator* may reconsider its initial assessment if, after discussion with the *firm*, the *appropriate regulator* 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.

2.2.14

FCA PRA

G

The *appropriate regulator* 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 *CRR*.

2.2.15

FCA PRA

G

If, after discussion, the *appropriate regulator* and a *firm* still do not agree on an adequate level of capital, the *appropriate regulator* may consider using its powers under section 55J of the *Act* to vary on its own initiative a *firm's Part 4A permission* so as to require it to hold capital in accordance with the *appropriate regulator'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 *appropriate regulator* will take into account the amount and quality of the *capital planning buffer* which the *firm* should hold as referred to in ■ BIPRU 2.2.12A G and ■ BIPRU 2.2.12B G. ■ SUP 7 provides further information about the *appropriate regulator's* powers under section 45.

### The drafting of individual capital guidance and capital planning buffer

2.2.16

FCA PRA

G

If the *appropriate regulator* gives *individual capital guidance* to a *firm*, the *appropriate regulator* will state what amount and quality of capital the *appropriate regulator* 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 *capital resources* of an amount which is at least equal to a specified percentage of that *firm's capital resources requirement* plus one or more static add-ons in relation to specific risks in accordance with the *overall Pillar 2 rule*.

2.2.17

FCA PRA

G

- (1) *Individual capital guidance* may refer to two types of *capital resources*.
- (2) The first type is referred to as general capital. It refers to total *tier one capital resources* and *tier two capital resources* after deductions.
- (3) The second type is referred to as total capital. It refers to total *tier one capital resources*, *tier two capital resources* and *tier three capital resources* after deductions.

## 2.2.18

FCA PRA

G

- (1) In both of the cases in ■ BIPRU 2.2.17 G *capital resources* should be calculated in the same way as they are in GENPRU 2.2 (Capital resources). This includes the *rules* limiting the amount of capital that can be included in the various tiers of capital when *capital resources* are being calculated.
- (2) ■ GENPRU 2.2.42 R does not allow *innovative tier one capital* to count as *tier one capital resources* for certain purposes. This restriction does not apply for the purposes in ■ BIPRU 2.2.17 G.

## 2.2.19

FCA PRA

G

- (1) *Individual capital guidance* may also be given with respect to group capital resources. This paragraph explains how such *guidance* should be interpreted unless the *individual capital guidance* specifies another interpretation.
- (2) If ■ BIPRU 8.2.1 R (General consolidation *rule* for a *UK consolidation group*) applies to the *firm* the *guidance* relates to its *UK consolidation group*. If ■ BIPRU 8.3.1 R (General consolidation *rule* for a *non-EEA sub-group*) applies to the *firm* the *guidance* relates to its *non-EEA sub-group*. If both apply to the *firm* the *guidance* relates to its *UK consolidation group* and to its *non-EEA sub-group*.
- (3) The *guidance* will be on the *overall financial adequacy rule* as it applies on a consolidated basis under ■ GENPRU 1.2.59 R (Application of ■ GENPRU 1.2 on a solo and consolidated basis: Adequacy of resources) and insofar as it refers to capital resources.
- (4) ■ BIPRU 2.2.16 G to ■ BIPRU 2.2.18 G apply for the purpose of this paragraph as they apply to *guidance* given on a solo basis. References to *capital resources* should be read as being to *consolidated capital resources*.

## 2.2.19A

FCA PRA

G

Where the *appropriate regulator* notifies a *firm* that it should hold a *capital planning buffer*, the notification will state what amount and quality of capital the *appropriate regulator* considers that 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 *capital resources* that the *firm* should hold in excess of the amount of *capital resources* indicated as its *individual capital guidance*.

## 2.2.19B

FCA PRA

G

For the purposes of ■ BIPRU 2.2.19A G, ■ BIPRU 2.2.17 G to ■ BIPRU 2.2.19 G apply as they apply to *individual capital guidance*. References in those provisions to *individual capital guidance* or *guidance* should be read as if they were references to *capital planning buffer*. In relation to ■ BIPRU 2.2.19G (3) and ■ GENPRU 1.2.59 R, where the *general stress and scenario testing rule*, as part of the *ICAAP rules*, applies to a *firm* on a consolidated basis, the *appropriate regulator* 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

## 2.2.20

FCA PRA

G

A *firm's* 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 *appropriate regulator's*

supervision of that *firm*. Therefore if a *firm's capital resources* 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 *appropriate regulator* 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 capital resources or to reduce its risks and hence its capital requirements; or
- (2) what modification the *firm* considers should be made to the *individual capital guidance* which it has been given.

## 2.2.21

FCA PRA

G

In the circumstance set out in ■ BIPRU 2.2.20 G, the *appropriate regulator* 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 *appropriate regulator* will seek to agree with the *firm* appropriate timescales and scope for any such additional work, in light of the circumstances which have arisen.

## 2.2.22

FCA PRA

G

If a *firm* has not accepted *individual capital guidance* given by the *appropriate regulator* it should, nevertheless, inform the *appropriate regulator* as soon as practicable if its capital resources have fallen, or are expected to fall, below the level suggested by that *individual capital guidance*.

## 2.2.23

FCA PRA

G

Monitoring the use of a *firm's capital planning buffer* is also a fundamental part of the *appropriate regulator* supervision of that *firm*. A *firm* should only use its *capital planning buffer* to absorb losses or meet increased capital 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.

## 2.2.23A

FCA PRA

G

Consistent with *Principle 11* (Relations with regulators), a *firm* should notify the *appropriate regulator* 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*.

## 2.2.23B

FCA PRA

G

Following discussions with the *firm* on the items listed in ■ BIPRU 2.2.23AG (1) to ■ BIPRU 2.2.23AG (3), the *appropriate regulator* 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 ■ BIPRU 2.2.23AG (3). The *appropriate regulator* 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.

**2.2.23C** **G** Where a *firm's capital planning buffer* is being drawn down due to circumstances other than those referred to in ■ BIPRU 2.2.23 G, such as poor planning or mismanagement, the *appropriate regulator* may ask the *firm* for more detailed plans for it to restore its *capital planning buffer*. In the light of the relevant circumstances, the *appropriate regulator* 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*.  
**FCA** **PRA**

**2.2.23D** **G** A *firm* should inform the *appropriate regulator* where its *capital planning buffer* is likely to start being drawn down even if it has not accepted the *appropriate regulator's* assessment as to the amount or quality of its *capital planning buffer*.  
**FCA** **PRA**

**2.2.23E** **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 *appropriate regulator* and provide the information referred to in ■ BIPRU 2.2.23A G as soon as practicable afterwards.  
**FCA** **PRA**

**2.2.23F** **G** ■ BIPRU 2.2.20 G to ■ BIPRU 2.2.23E G also apply to *individual capital guidance* and to *capital planning buffer* on a consolidated basis as referred to in ■ BIPRU 2.2.19 G.  
**FCA** **PRA**

### Proportionality of an ICAAP

**2.2.24** **G** ■ BIPRU 2.2.25 G to ■ BIPRU 2.2.27 G set out what the *appropriate regulator* considers to be a proportional approach to preparing an *ICAAP* as referred to in ■ GENPRU 1.2.35 R (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 *appropriate regulator* more easily to review a *firm's ICAAP* when the *appropriate regulator* undertakes its *SREP*. The *appropriate regulator* is also likely to place more reliance on an *ICAAP* which takes the appropriate form described in ■ BIPRU 2.2.25 G to ■ BIPRU 2.2.27 G than would otherwise be the case although there may also be circumstances in which the *appropriate regulator* will be able to rely on an *ICAAP* that is not drawn up in that form.  
**FCA** **PRA**

- 2.2.25** **G**
- (1) This paragraph applies to a small *firm* 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 3 to 5 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 CRR* might alter under the scenarios in (c) and how its *CRR* might alter in line with its business plans for the next 3 to 5 years;
- FCA** **PRA**

- (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) (in order to determine the amount of capital that would be absorbed in the circumstances detailed 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 in respect of 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). If the *firm* chooses however 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 ■ GENPRU 1.2.42 R to assess how that *firm's* capital and CRR 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, *capital resources* and *capital resources requirement*, 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.

## 2.2.26

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In relation to a *firm* whose activities are moderately complex, in carrying out its ICAAP, ■ BIPRU 2.2.25 G (3) 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* CRR adequately captures the risks identified in (1) and (2);
- (4) for areas in which the CRR 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;

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- (6) project that *firm's* business activities forward in detail for one year and in less detail for the next 3 to 5 years and estimate how that *firm's* capital and CRR 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 CRR would alter and what that *firm's* reaction to a range of adverse economic scenarios might be (see ■ GENPRU 1.2.30 R to ■ GENPRU 1.2.43 G (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).
- (1) This paragraph applies to a proportional ICAAP in the case of a *firm* whose activities are complex.
  - (2) A proportional approach to that *firm's* ICAAP should cover the matters identified in ■ BIPRU 2.2.26 G, 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 sort 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 ■ BIPRU 7.10), advanced modelling approaches for credit risk (see ■ BIPRU 4) and, possibly, *advanced measurement approaches* for *operational risk* (see ■ BIPRU 6.5). 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 *appropriate regulator* 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. It may be that those amounts are not equal. Where they are not equal, the *appropriate regulator* will expect a *firm* to discuss any differences with the *appropriate regulator*. However,

it may prove difficult to reconcile the outcome of a *firm's* modelling with the *appropriate regulator's* own assessment of the adequacy of that *firm's* capital. This may be the case when, for instance, matters of judgment are involved in arriving at a *firm's* capital assessment, or the *appropriate regulator* relies on information which cannot be fully disclosed to the *firm* (for example 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 *appropriate regulator* 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 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 therefore 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

■ BIPRU 2.2.30 G to ■ BIPRU 2.2.40 G set out *guidance* on some of the sources of risk identified in the *overall Pillar 2 rule*. ■ BIPRU 2.2.41 R to ■ BIPRU 2.2.45 G have material relating to a *firm* with an *IRB permission*.

- (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.

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However, a *firm* should be able to distinguish, for the purpose of its dialogue with the *appropriate regulator*, between capital it holds in order to comply with the *overall financial adequacy rule*, capital that it holds as a *capital planning buffer* and capital held for other purposes.

- (2) The calibration of the *CRR* 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 *CRR* to arrive at an adequate level of *capital resources*.

### Interest rate risk arising from non-trading book activities

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A *firm* should assess its exposure to changes in interest rates, in particular risks arising from the effect of interest rate changes on *non-trading book* activities that are not captured by the *CRR*. 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

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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

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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 *CRR* against its assumptions which underlie any risk mitigation measures it may have in place.

### Concentration risk

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A *firm* should assess, and monitor, in detail its exposure to sectoral, geographic, liability and asset concentrations. The *appropriate regulator* 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 *CRR*.

### Liquidity risk

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In accordance with the *overall Pillar 2 rule* a *firm* should consider its exposure to *liquidity risk* and assess its response should that risk materialise.

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When assessing *liquidity risk*, a *firm* should consider the extent to which there is a mismatch between assets and liabilities.

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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*.

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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

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A *firm's CRR*, being risk-sensitive, may vary as business cycles and economic conditions fluctuate over time. A 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.

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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.

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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 as to the state of 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 *CRR* 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 ■ GENPRU 1.2.73A G (Capital planning).

### Business risk: Stress tests for firms using the IRB approach

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A *firm* with an *IRB permission* must ensure that there is no significant risk that it will not be able to meet its capital resource requirements for credit risk under ■ GENPRU 2.1 (Calculation of capital resources requirements) at all times throughout an economic cycle, including the capital resources requirements for credit risk indicated by any stress test carried out under ■ BIPRU 4.3.39 R to ■ BIPRU 4.3.40 R (Stress tests used in assessment of capital adequacy for a *firm* with an *IRB permission*) as being likely to apply in the scenario tested. For the purpose of deciding what *capital resources* are or will be available to meet those credit risk requirements from time to time a *firm* must exclude *capital resources* that are likely to be required to meet its other capital requirements under ■ GENPRU 2.1 at the relevant

time. A *firm* must also be able to demonstrate to the *appropriate regulator* at any time that it is complying with this *rule*.

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■ BIPRU 2.2.41 R applies to a *firm* on a solo basis if ■ BIPRU 4 (IRB approach) applies to it on a solo basis and applies on a consolidated basis if ■ BIPRU 4 does.

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If ■ BIPRU 2.2.41 R applies to a *firm* on a consolidated basis the following adjustments are made to ■ BIPRU 2.2.41 R in accordance with the general principles of ■ BIPRU 8 (Group risk - consolidation):

- (1) references to *capital resources* are to the *consolidated capital resources* of the *firm's UK consolidation group* or, as the case may be, its *non-EEA sub-group*; and
- (2) references to the capital requirements in ■ GENPRU 2.1 (Calculation of capital resources requirements) are to the consolidated capital requirements with respect to the *firm's UK consolidation group* or, as the case may be, its *non-EEA sub-group* under ■ BIPRU 8 (Group risk - consolidation).

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If a *firm's* current available *capital resources* are less than the capital resources requirement indicated by the stress test that need not be a breach of ■ BIPRU 2.2.41 R. The *firm* may wish to set out any countervailing effects and off-setting actions that can be demonstrated to the satisfaction of the *appropriate regulator* as being likely to reduce the difference referred to in the first sentence. The *appropriate regulator* 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 ■ GENPRU 1.2.73A G (Capital planning) and including a plan of the type referred to in ■ GENPRU 1.2.73A G (5) that has been approved by the *firm's* senior management or *governing body*.

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The countervailing factors and off-setting actions that a *firm* may rely on as referred to in ■ BIPRU 2.2.44 G include, but are not limited to, projected balance sheet shrinkage, growth in *capital resources* 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

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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.

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In considering if there are any systems and control weaknesses and their effect on the adequacy of the *CRR*, a *firm* should be able to demonstrate to the *appropriate regulator* 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

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(1) ■ BIPRU 2.2.49 G to ■ BIPRU 2.2.70 G set out *guidance* for:

- (a) a *bank* or *building society*;
- (b) an asset management *firm*; and
- (c) a securities *firm*;

whose activities are either simple or moderately complex.

(2) ■ BIPRU 2.2.49 G to ■ BIPRU 2.2.70 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*.

### Banks and building societies

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The *appropriate regulator* considers that the concentration risk resulting from concentrated portfolios is significant for most *banks* and *building societies*.

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If a *bank* or *building society* chooses to use the *CRR* as a starting point for its capital assessment, it should remember that, when assessing its exposure to concentration risk, the calculation of the *CRR* is based on the assumption that a *firm* is well-diversified.

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In assessing the degree of credit concentration, a *bank* or *building society* should consider its degree of credit concentration in a particular economic or geographic area. Where the business of a *firm* is, by its nature, concentrated (for example, a specialised *firm* lending to one sector only), a *firm* should consider the impact of adverse economic factors, such as a rise in unemployment in the area in which it has a concentration of *exposures*, and its impact on asset quality. A gradual change of cultural environment could also affect a *bank* or *building society* and a *firm* should consider whether this issue should be the subject of scenario analysis.

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Typically, a *building society's* portfolio is concentrated. The extent to which a *building society* can diversify its business is limited. A *building society* should, nevertheless, consider the impact of geographic concentrations on its capital by, for instance, analysing the effect of local economic factors such as unemployment and its impact on arrears, house prices and loan-to-value ratios.

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Similarly, a *building society* should consider the concentration in its portfolio of certain product types that have, inherently, a more than average risk (for example, lifetime mortgages). It should, through scenario analyses in relation to its portfolio, assess the potential impact on its profitability and capital of those scenarios.

- 2.2.54** **PRA** **G** In relation to ■ BIPRU 10 (Large exposures requirements), a *bank* or *building society* should take into account factors such as future business growth and cyclicalities when it assesses the amount of capital which it will need to remain in compliance with those *rules*. A *firm* may also consider in its assessment whether any *large exposures* that it has identified are positively correlated.
- 2.2.55** **PRA** **G** Where a *bank* or *building society* lends to a *counterparty* which it assesses as representing a high credit risk, it should assess whether compliance with the *rules* in BIPRU in relation to credit risk is sufficient for it to manage that risk prudently.
- 2.2.56** **PRA** **G** The performance of specialised portfolios may, in some instances, depend on key individuals. This factor exacerbates concentration risk because the skill of those individuals in part limits the risk arising from a concentrated portfolio. The impact of those individuals is likely to be correspondingly greater in small *firms*. In developing its stress tests and scenario analyses, a *bank* or *building society* should therefore consider the impact of losing key individuals on its ability to operate normally, as well as the direct impact on its revenues.
- 2.2.57** **PRA** **G** A *bank* or *building society* should assess the sensitivity of its financial position to adverse movements in interest rates. For instance, a *bank* or *building society* should assess its sensitivity to interest rate risk arising from interest rate mismatches between assets and liabilities. A *building society* is exposed to interest rate risk to the extent that it borrows on a short term basis but lends over a longer period.
- 2.2.58** **PRA** **G** When assessing the adequacy of its capital, a *bank* or *building society* should not only consider the vulnerability of its revenue, but also the sensitivity of its funding and, in particular, its ability to raise additional funding in time of economic stress. A *bank* or *building society* should therefore consider whether its funding pool is sufficiently diversified. For example, where a *bank* is reliant solely on its parent to provide funding, its access to funds may be suddenly restricted should the parent's creditworthiness be downgraded. Similarly, a *bank* or *building society* may consider the impact of an increase in bond rates or a rating downgrade, if relevant, on its capital cost and its subsequent ability to raise capital.
- 2.2.59** **PRA** **G** A *bank* or *building society* should assess the impact of its business plans on its capital over the time horizon which it uses in its business plans. A *bank* or *building society* should assess the impact on its capital of diversifying its activities and the risk it runs of failing to manage that new business successfully. For that purpose, it may consider the cost of a price war to enter a new competitive market or the risk of mis-pricing some products as a result of not having sufficient expertise in its new area of business.
- 2.2.60** **PRA** **G** A *bank* or *building society* is also exposed to reputational risk, as its ability to underwrite new business is heavily reliant on the standing of the reputation of the *firm*. A *bank* or *building society* may consider the impact on its financial position of legal disputes which damage its reputation.

### **An asset management firm**

- 2.2.61** **FCA** **G** An asset manager is primarily exposed to *operational risk* and reputational risk.

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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.

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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 *appropriate regulator* 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 should *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 3 to 5 years.

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In relation to the issues identified in ■ BIPRU 2.2.63 G, 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 that *firm* for failing to advise correctly on a certain type of product; the relevance of such scenarios 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.

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The *appropriate regulator* expects an asset manager to consider the impact of economic factors on its ability to meet its liabilities as they fall due. An asset manager should therefore develop scenarios which relate to its strategic and business plan. An asset manager might therefore consider:

- (1) the effect of a market downturn affecting 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

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- (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

- (1) A securities *firm* may consider the impact of the situations listed in (a) to (c) 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 the analysis in (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. It may therefore like to assess the impact of losses arising from a failure to place the securities successfully.

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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. A securities *firm* may therefore consider the impact of *liquidity risk* on its exposure to:

- (1) credit risk; and
- (2) *market risk*.

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Counterparty risk *rules* 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.

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- (1) 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 questions in (2) to (7).
- (2) Whether it plans to participate in a one-off transaction that might strain temporarily or permanently its capital.
- (3) 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.
- (4) 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.
- (5) 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.

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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

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A *firm* may approach its assessment of adequate capital by developing a model, including an ECM (see ■ BIPRU 2.2.27 G), 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.

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A *firm* should not expect the *appropriate regulator* 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 *appropriate regulator* 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* (see ■ GENPRU 1.2.19 G (Outline of provisions related to ■ GENPRU 2.1 (Adequacy of financial resources))).

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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.

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In relation to the use of an ECM (see ■ BIPRU 2.2.27 G), the *appropriate regulator* 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 *CRR* before aggregation with the corresponding components of the *CRR* calculation; and
- (2) evidence that the *guidance* in ■ BIPRU 2.2.71 G to ■ BIPRU 2.2.78 G has been followed.

## 2.2.75

FCA PRA

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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. In relation to a *firm* which is a member of a group, ■ GENPRU 1.2.53 R (Application of ■ GENPRU 1.2 on a solo and consolidated basis: Processes and tests) sets out how internal capital identified as necessary by that *firm's ICAAP* should be allocated.

## 2.2.76

FCA PRA

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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 *appropriate regulator*, with the support of empirical evidence, the basis of those assumptions.

## 2.2.77

FCA PRA

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A *firm's* model should also reflect the past experience of both the *firm* and the sectors in which it operates.

## 2.2.78

FCA PRA

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.

## 2.3 Interest rate risk in the non-trading book

### Application

This section of the *Handbook* applies to a *BIPRU firm*.

#### 2.3.1

FCA PRA

R

#### 2.3.2

FCA PRA

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- (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.
- (2) However it will not normally be a significant risk for any other *BIPRU investment firm*.
- (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 1.2.17 R (Definition of the trading book).
- (4) Where ■ BIPRU 2.3 is applied on a consolidated basis (see ■ BIPRU 2.3.13 R) the test in (1)(c) should be carried out in the same way as it is under ■ BIPRU 8.7.24 R (Trading book size for the purposes of consolidation).

#### 2.3.3

FCA PRA

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Interest rate risk in the *non-trading book* may arise from a number of sources for example:

- (1) risks related to the mismatch of repricing of assets and liabilities and off balance sheet short and long-term positions;
- (2) risks arising from hedging exposure to one interest rate with exposure to a rate which reprices under slightly different conditions;
- (3) risk related to the uncertainties of occurrence of transactions e.g. when expected future transactions do not equal the actual transactions; and
- (4) risks arising from consumers redeeming fixed rate products when market rates change.

2.3.4

FCA PRA

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■ BIPRU 2.3 sets out more detail on how the systems and controls requirements in SYSC and ■ GENPRU 1.2.30 R (Processes, strategies and systems for risks) and the requirements about stress and scenario testing in ■ GENPRU 1.2.36 R apply to interest rate risk in the *non-trading book*.

2.3.5

FCA PRA

G

■ BIPRU 2.3 implements Article 124(5) of the *Banking Consolidation Directive*.

### Proportionality

2.3.6

FCA PRA

G

The *guidance* on proportionality in ■ BIPRU 2.2 applies to ■ BIPRU 2.3.

### Stress testing for interest rate risk: General requirement

2.3.7

FCA PRA

R

- (1) As part of its obligations under ■ GENPRU 1.2.30 R (Processes, strategies and systems for risks) and ■ GENPRU 1.2.36 R (Stress and scenario tests) 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 *appropriate regulator* 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 *capital resources*.

2.3.8

FCA PRA

G

A *firm* should, under ■ BIPRU 2.3.7 R (2), apply a 200 basis point shock to each major currency exposure.

2.3.9

FCA PRA

G

For a larger and/or more complex *firm*, appropriate systems to evaluate and manage interest rate risk in the *non-trading book* should include:

- (1) the ability to measure the exposure and sensitivity of the *firm's* activities, if material, to repricing risk, yield curve risk, basis risk and risks arising from embedded optionality (for example, pipeline risk, prepayment risk) as well as changes in assumptions (for example those about customer behaviour);
- (2) consideration as to whether a purely static analysis of the impact on their current portfolio of a given shock or shocks should be supplemented by a more dynamic simulation approach; and
- (3) scenarios in which different interest rate paths are computed and in which some of the assumptions (e.g. about behaviour, contribution to risk and balance sheet size and composition) are themselves functions of interest rate level.

## 2.3.10

FCA PRA

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Under ■ GENPRU 1.2.60 R, a *firm* is required to make a written record of its assessments made under ■ GENPRU 1.2. A *firm's* record of its approach to evaluating and managing interest rate risk as it affects the *firm's* non-trading activities should cover the following issues:

- (1) the internal definition of and boundary between "banking book" and "trading activities" (see ■ BIPRU 1.2);
- (2) the definition of economic value and its consistency with the method used to value assets and liabilities (e.g. discounted cashflows);
- (3) the size and the form of the different shocks to be used for internal calculations;
- (4) the use of a dynamic and / or static approach in the application of interest rate shocks;
- (5) the treatment of commonly called "pipeline transactions" (including any related hedging);
- (6) the aggregation of multicurrency interest rate exposures;
- (7) the inclusion (or not) of non-interest bearing assets and liabilities (including capital and reserves);
- (8) the treatment of current and savings accounts (i.e. the maturity attached to exposures without a contractual maturity);
- (9) the treatment of fixed rate assets (liabilities) where customers still have a right to repay (withdraw) early;
- (10) the extent to which sensitivities to small shocks can be scaled up on a linear basis without material loss of accuracy (i.e. covering both convexity generally and the non-linearity of pay-off associated with explicit option products);
- (11) the degree of granularity employed (for example offsets within a time bucket); and
- (12) whether all future cash flows or only principal balances are included.

## 2.3.11

FCA PRA

G

The *appropriate regulator* will periodically review whether the level of the shock referred to in ■ BIPRU 2.3.7 R (2) is appropriate in the light of changing circumstances, in particular the general level of interest rates (for instance periods of very low interest rates) and their volatility. A *firm's* internal systems should therefore be flexible enough to compute its sensitivity to any standardised shock that is prescribed. If a 200 basis point shock would imply negative interest rates or if such a shock would otherwise be considered inappropriate, the *appropriate regulator* will consider adjusting the requirements accordingly.

### Stress testing for interest rate risk: Frequency

## 2.3.12

FCA PRA

R

- (1) A *firm* must carry out the evaluations required by ■ BIPRU 2.3.7 R 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 that *rule* and the nature of that exposure. In any case it must carry out those evaluations no less frequently than required by (2) or (3).

- (2) The minimum frequency of the evaluation in ■ BIPRU 2.3.7 R (1) is once each year.
- (3) The minimum frequency of the evaluation in ■ BIPRU 2.3.7 R (2) is once each quarter.

#### Consolidation

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2.3.13

FCA PRA

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■ GENPRU 1.2.45 R to ■ GENPRU 1.2.59 R (Application of ■ GENPRU 1.2 on a solo and consolidated basis) apply to ■ BIPRU 2.3 as they apply to ■ GENPRU 1.2.30 R and ■ GENPRU 1.2.36 R.

## Chapter 3

# Standardised credit risk

## 3.1 Application and purpose

### Application

3.1.1 **R** ■ BIPRU 3 applies to a *BIPRU firm*.

**FCA** **PRA**

### Purpose

3.1.2 **G** ■ BIPRU 3 implements:

**FCA** **PRA**

- (1) Articles 78 to 80, paragraph (1) of Article 81, Article 83, Annex II and Parts 1 and 3 of Annex VI of the *Banking Consolidation Directive*;
- (2) Article 18 of the *Capital Adequacy Directive* so far as it applies Articles 78 to 80, paragraph (1) of Article 81, Article 83 and Parts 1 and 3 of Annex VI of the *Banking Consolidation Directive* to *investment firms*; and
- (3) Article 40 of the *Capital Adequacy Directive* for the purposes of the calculation of credit risk under the *Banking Consolidation Directive*.

3.1.3 **G** ■ BIPRU 3.1 sets out how a *firm* should calculate the *credit risk capital component*, which is one of the elements that make up the *credit risk capital requirement* under ■ GENPRU 2.1.51 R. Part of that calculation involves calculating *risk weighted exposure amounts* for *exposures* in the *firm's non-trading book*. The rest of ■ BIPRU 3 sets out how the *firm* should carry out that calculation.

**FCA** **PRA**

3.1.4 **G** ■ BIPRU 5 deals with the effect of *credit risk mitigation* on the calculation of *risk weighted exposure amounts*. ■ BIPRU 13 deals with the calculation of *exposure* values for certain kinds of products. ■ BIPRU 14.3 deals with the calculation of the *counterparty risk capital component* for unsettled transactions in the *trading book* and *non-trading book*. ■ BIPRU 14.4 deals with *capital resources* with respect to *free deliveries*.

**FCA** **PRA**

### Calculation of the credit risk capital component

3.1.5 **R** The *credit risk capital component* of a *firm* is 8% of the total of its *risk weighted exposure amounts* for *exposures* falling into ■ BIPRU 3.1.6 R, calculated in accordance with ■ BIPRU 3.

**FCA** **PRA**

3.1.6 **R** An *exposure* falls into this *rule* if:

**FCA** **PRA**

- (1) it is in a *firm's non-trading book*; and

- 
- (2) it has not been deducted from the *firm's capital resources* under  
■ GENPRU 2.2.

## 3.2 The central principles of the standardised approach to credit risk

### 3.2.1

FCA PRA

**R** Subject to ■ BIPRU 13:

- (1) the *exposure* value of an asset item must be its balance-sheet value, subject to any value adjustments required by ■ GENPRU 1.3; and
- (2) the *exposure* value of an off-balance sheet item listed in the table in ■ BIPRU 3.7.2 R must be the percentage of its value set out in that table.

[Note: BCD Article 78(1) part]

### 3.2.2

FCA PRA

**R** The off-balance sheet items listed in the table in ■ BIPRU 3.7.2 R must be assigned to the risk categories as indicated in that table.

[Note: BCD Article 78(1) part]

### 3.2.3

FCA PRA

**R** Where an *exposure* is subject to *funded credit protection*, a firm may modify the *exposure* value applicable to that item in accordance with ■ BIPRU 5.

[Note: BCD Article 78(3)]

### 3.2.4

FCA PRA

**G** ■ BIPRU 13 sets out the method for determination of the *exposure* value of a *financial derivative instrument*, with the effects of contracts of novation and other netting agreements taken into account for the purposes of that method in accordance with ■ BIPRU 13.7.

[Note: reference to BCD Article 78(2) first sentence. Implementation in ■ BIPRU 13]

### 3.2.5

FCA PRA

**G** ■ BIPRU 13.3 and ■ BIPRU 13.8 set out the provisions applying to the treatment and determination of the *exposure* value of *repurchase transactions*, *securities or commodities lending or borrowing transactions*, *long settlement transactions* and *margin lending transactions* (SFTs).

[Note: reference to BCD Article 78(2) second sentence. Implementation in ■ BIPRU 13]

## 3.2.6

FCA PRA

G

■ BIPRU 13 also sets out the methods for the determination of *exposure* values for *long settlement transactions*.

## 3.2.7

FCA PRA

G

■ BIPRU 13.8 provides that, in the case of a *firm* using the *financial collateral comprehensive method* under ■ BIPRU 5, where an *exposure* takes the form of an *SFT*, the *exposure* value should be increased by the volatility adjustment appropriate to such *securities* or *commodities* set out in ■ BIPRU 5.4.30 R to ■ BIPRU 5.4.65 R (Supervisory volatility adjustments approach and the own estimates of volatility adjustments approach).

[Note: reference to *BCD* Article 78(1), part. Implementation in ■ BIPRU 13]

## 3.2.8

FCA PRA

G

■ BIPRU 13.3.13 R and ■ BIPRU 13.8.8 R set out the provisions relating to determination of the *exposure* value of certain credit risk *exposures* outstanding with a *central counterparty*, where the *central counterparty* credit risk *exposures* with all participants in its arrangements are fully collateralised on a daily basis.

[Note: reference to *BCD* Article 78(4). Implementation in ■ BIPRU 13]

### Exposure Classes

## 3.2.9

FCA PRA

R

A *firm* must assign each *exposure* to one of the following *exposure* classes:

- (1) claims or contingent claims on central governments or *central banks*;
- (2) claims or contingent claims on regional governments or local authorities;
- (3) claims or contingent claims on administrative bodies and non-commercial *undertakings*;
- (4) claims or contingent claims on *multilateral development banks*;
- (5) claims or contingent claims on *international organisation*;
- (6) claims or contingent claims on *institutions*;
- (7) claims or contingent claims on corporates;
- (8) retail claims or contingent retail claims;
- (9) claims or contingent claims secured on real estate property;
- (10) past due items;
- (11) items belonging to regulatory high-risk categories;
- (12) claims in the form of *covered bonds*;

- (13) *securitisation* positions;
- (14) short-term claims on *institutions* and corporates;
- (15) claims in the form of *CIUs*; or
- (16) other items.

[Note: *BCD* Article 79(1)]

3.2.10

FCA PRA

R

To be eligible for the *retail exposure* class, an *exposure* must meet the following conditions:

- (1) the *exposure* must be either to an individual *person* or *persons*, or to a small or medium sized entity;
- (2) the *exposure* must be one of a significant number of *exposures* with similar characteristics such that the risks associated with such lending are substantially reduced; and
- (3) the total amount owed to the *firm*, its *parent undertakings* and its *subsidiary undertakings*, including any past due *exposure*, by the obligor client or *group of connected clients*, but excluding claims or contingent claims secured on residential real estate collateral, must not, to the knowledge of the *firm*, exceed €1 million.

[Note: *BCD* Article 79(2)]

3.2.11

FCA PRA

R

A *firm* must take reasonable steps to acquire the knowledge referred to in ■ BIPRU 3.2.10 R (3).

[Note: *BCD* Article 79(2)(c) last sentence]

3.2.12

FCA PRA

R

*Securities* are not eligible for the *retail exposure* class.

[Note: *BCD* Article 79(2) last sentence]

3.2.13

FCA PRA

R

The present value of retail minimum lease payments is eligible for the *retail exposure* class.

[Note: *BCD* Article 79(3)]

3.2.14

FCA PRA

G

#### **Retail exposures: Significance**

A key driver of the preferential *risk weight* afforded *retail exposures* is the lower correlation and systematic risk associated with such *exposures*. This aspect is unrelated to the absolute number of *retail exposures*. Accordingly in defining what constitutes a significant number of *retail exposures* for the purpose of ■ BIPRU 3.2.10 R (2), a *firm* need only satisfy itself that the number of *retail exposures* is sufficiently large to diversify away idiosyncratic risk. This assessment will be subject to supervisory review

and part of a *firm's* SREP. It will be looked at as one of the issues relating to overall diversification.

### Retail exposures: Aggregation: Reasonable steps

3.2.15

FCA PRA

G

In deciding what steps are reasonable for the purposes of ■ BIPRU 3.2.11 R, a *firm* may take into account complexity and cost, as well as the materiality of the impact upon its capital calculation. A *firm* should be able to demonstrate to the *appropriate regulator* that it has complied with the obligation to take reasonable steps under ■ BIPRU 3.2.11 R in the way it takes these factors into account.

### Retail exposures: Aggregation: Single risk

3.2.16

FCA PRA

G

- (1) The definition of *group of connected clients* is set out in the *Glossary*. Paragraph (2) of that definition is "two or more *persons* ... who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties".
- (2) Say that a *firm* has *exposures* to A and B. When deciding whether A and B come within paragraph (2) of the definition two conditions should be satisfied. Firstly the connections between A and B should mean that if A experiences financial problems, B should be likely to encounter repayment difficulties. Secondly, the connections between A and B should mean that if B experiences financial problems, A should be likely to encounter repayment difficulties.
- (3) The *guidance* in ■ BIPRU 3.2.16 G is provided for the purpose of ■ BIPRU 3.2.10 R only and not for the purposes of any other provision in the Handbook that uses the defined term *group of connected clients*.

### Retail exposures: Aggregation: Personal and business exposures

3.2.17

FCA PRA

G

If a *firm* has *exposures* to an owner of a *retail SME* in his personal capacity and *exposures* to the *retail SME* the *firm* should aggregate the two types of *exposure* for the purpose of ■ BIPRU 3.2.10 R (3), although it should not include claims secured on residential real estate collateral. In deciding what steps are reasonable for the purposes of ■ BIPRU 3.2.11 R in aggregating these two types of *exposure*, a *firm* may take into account the materiality of those personal *exposures*. A *firm* should be able to demonstrate to the *appropriate regulator* that it has complied with the obligation to take reasonable steps under ■ BIPRU 3.2.11 R when taking into account materiality in this way.

### Retail exposures: Exchange rate

3.2.18

FCA PRA

G

Where an exposure is denominated in a currency other than the euro, a *firm* may calculate the euro equivalent for purposes of ■ BIPRU 3.2.10 R using any appropriate set of exchange rates provided its choice has no obvious bias and that the *firm* is consistent in its approach to choosing rates.

### Retail exposures: Frequency of monitoring

3.2.19

FCA PRA

G

A *firm* may monitor compliance with the €1m threshold in ■ BIPRU 3.2.10 R on the basis of approved limits provided it has internal control procedures that are sufficient to ensure

that amounts owed cannot diverge from approved limits to such an extent as to give rise to a material breach of the €1m threshold.

3.2.20

FCA PRA

R

- (1) To calculate *risk weighted exposure amounts*, *risk weights* must be applied to all *exposures*, unless deducted from *capital resources*, in accordance with the provisions of ■ BIPRU 3.4.
- (2) The application of *risk weights* must be based on the *standardised credit risk exposure class* to which the *exposure* is assigned and, to the extent specified in ■ BIPRU 3.4, its credit quality.
- (3) Credit quality may be determined by reference to:
  - (a) the credit assessments of *eligible ECAs* in accordance with the provisions of ■ BIPRU 3; or
  - (b) the credit assessments of export credit agencies as described in ■ BIPRU 3.4.

[Note: BCD Article 80(1)]

3.2.21

FCA PRA

R

For the purposes of applying a *risk weight*, as referred to in ■ BIPRU 3.2.20 R, the *exposure* value must be multiplied by the *risk weight* specified or determined in accordance with the *standardised approach*.

[Note: BCD Article 80(2)]

3.2.22

FCA PRA

R

Notwithstanding ■ BIPRU 3.2.20 R, where an *exposure* is subject to credit protection the *risk weight* applicable to that item may be modified in accordance with ■ BIPRU 5.

[Note: BCD Article 80(4)]

3.2.23

FCA PRA

R

*Risk weighted exposure amounts* for *securitised exposures* must be calculated in accordance with ■ BIPRU 9.

[Note: BCD Article 80(5)]

3.2.24

FCA PRA

R

*Exposures* the calculation of *risk weighted exposure amounts* for which is not otherwise provided for under the *standardised approach* must be assigned a *risk weight* of 100%.

[Note: BCD Article 80(6)]

#### Zero risk-weighting for intra-group exposures: core UK group

3.2.25

FCA PRA

R

- (1) Subject to ■ BIPRU 3.2.35 R, and with the exception of *exposures* giving rise to liabilities in the form of the items referred to in ■ BIPRU 3.2.26 R, a *firm* is not required to comply with

■ BIPRU 3.2.20 R (Calculation of risk weighted exposures amounts under the standardised approach) in the case of the *exposures* of the *firm* to a counterparty which is its *parent undertaking*, its *subsidiary undertaking* or a *subsidiary undertaking* of its *parent undertaking* provided that the following conditions are met:

- (a) the counterparty is
  - (i) a *core concentration risk group counterparty*; and
  - (ii) an *institution*, *financial holding company*, *financial institution*, *asset management company* or *ancillary services undertaking* subject to appropriate prudential requirements;
- (b) [deleted]
- (ba) (in relation to a *subsidiary undertaking*) 100% of the voting rights attaching to the *shares* in the counterparty's capital is held by the *firm* or a *financial holding company* (or a *subsidiary undertaking* of the *financial holding company*), whether individually or jointly, and that the *firm* or *financial holding company* (or its *subsidiary undertaking*) must have the right to appoint or remove a majority of the members of the board of *directors*, committee of management or other governing body of the counterparty;
- (c) the counterparty is subject to the same risk evaluation, measurement and control procedures as the *firm*;
- (d) the counterparty is incorporated in the *United Kingdom*; and
- (e) there is no current or foreseen material practical or legal impediment to the prompt transfer of *capital resources* or repayment of liabilities from the counterparty to the *firm*.

(2) Where a *firm* chooses under (1) not to apply ■ BIPRU 3.2.20 R, it must assign a *risk weight* of 0% to the *exposure*.

(3) A *firm* need not apply the treatment in (1) and (2) to every *exposure* that is eligible for that treatment.

[Note: BCD Article 80(7)]

- (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 3.2.25 R.
- (2) Therefore, a *firm* that is applying for a *core UK group waiver* should demonstrate that it meets the conditions in ■ BIPRU 3.2.25 R 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*

3.2.25A

FCA PRA

G

*UK group* and for the purpose of exempting the *exposures* within the *core UK group* from the 25% *large exposure* limit.

3.2.26

FCA PRA

R

A *firm* must not apply the treatment in ■ BIPRU 3.2.25 R to *exposures* giving rise to liabilities in the form of any of the following items:

- (1) in the case of a *BIPRU firm*, any *tier one capital* or *tier two capital*; and
- (2) in the case of any other *undertaking*, any item that would be *tier one capital* or *tier two capital* if the *undertaking* were a *BIPRU firm*.

[Note: BCD Article 80(7), part]

3.2.27

R

- (1) [deleted]
  - (a) [deleted]
  - (b) [deleted]
  - (c) [deleted]
- (2) [deleted]

3.2.27A

FCA PRA

R

- (1) For the purpose of ■ BIPRU 3.2.25R (1)(e), a *firm* must be able on an ongoing basis to demonstrate fully to the *appropriate regulator* the circumstances and arrangements, including legal arrangements, by virtue of which there are no material practical or legal impediments, and none are foreseen, to the prompt transfer of *capital resources* or repayment of liabilities from the counterparty to the *firm*.
- (2) In relation to a counterparty that is not a *firm*, the arrangements referred to in (1) must include a legally binding agreement with each *firm* that is a member of the *core UK group* that it will promptly on demand by the *firm* increase the *firm's capital resources* by an amount required to ensure that the *firm* complies with ■ GENPRU 2.1 (Calculation of capital resources requirements), ■ BIPRU 10 (Large exposures) and any other requirements relating to *capital resources* or concentration risk imposed on a *firm* by or under the *regulatory system*.

3.2.28

FCA PRA

G

For the purpose of ■ BIPRU 3.2.25 R (1)(c) it is the risk management functions of the group that should be integrated, rather than the group's operational management. A *firm* should ensure that if risk management functions are integrated in this way it should be possible for the *appropriate regulator* to undertake qualitative supervision of the management of the integrated risk management function.

## 3.2.29

FCA PRA

G

In relation to a *core concentration risk group counterparty*, an *undertaking* is included within the scope of consolidation of a group on a full basis if it is at the head of the group or if its assets and liabilities are taken into account in full as referred to in ■ BIPRU 8.5.2 G (Basis of inclusion of undertakings in consolidation).

## 3.2.29A

FCA PRA

G

- (1) In relation to ■ BIPRU 3.2.25 R (1)(ba), a *subsidiary undertaking* should generally be 100% owned and controlled by a single shareholder. However, if a *subsidiary undertaking* has more than one shareholder, that *undertaking* may be a member of the *core UK group* if all its shareholders are also members of the same *core UK group*.
- (2) For the purpose of ■ BIPRU 3.2.25R (1)(d) (Incorporation in the UK), if a counterparty is of a type that falls within the scope of the Council Regulation of 29 May 2000 on insolvency proceedings (Regulation 1346/2000/EC) and it is established in the *United Kingdom* other than by incorporation, a *firm* wishing to include that counterparty in its *core UK group* may apply to the *appropriate regulator* for a *waiver* of this condition if it can demonstrate fully to the *appropriate regulator* that the counterparty's centre of main interests is situated in the *United Kingdom* within the meaning of that Regulation.

## 3.2.30

FCA PRA

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.2 R (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.6 G 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.7 G (2) in respect of the counterparty's obligation to increase the *firm's capital resources* and the limitations that may be permitted.

## 3.2.31

FCA PRA

G

The requirement in ■ BIPRU 3.2.25 R (1)(e) for the prompt repayment of liabilities refers to the prompt repayment of liabilities when due.

## 3.2.32

FCA PRA

G

The *guidance* in ■ BIPRU 3.2.30 G - ■ BIPRU 3.2.31 G does not apply to ■ BIPRU 2.1 (Solo consolidation) even though the provisions have similar wording. This is because the purpose of the provisions in ■ BIPRU 2.1 is to define the conditions under which two *undertakings* should be treated as a single *undertaking*. The purpose of ■ BIPRU 3.2.25 R (1) is to define the circumstances in which it is appropriate to apply a *zero risk weight*.

## 3.2.33

FCA PRA

G

A *firm* that has chosen to apply the treatment in ■ BIPRU 3.2.25 R should monitor the *exposures* to which a 0% *risk weight* is applied under that treatment and report these to the *appropriate regulator* as required.

3.2.34

FCA PRA

G

If a *firm* has an *IRB permission* and *exposures* are exempted from the *IRB approach* under ■ BIPRU 4.2.26 R (6) the *firm* may apply a 0% *risk weight* to them under ■ BIPRU 3.2.25 R (2) (Zero risk weighting for intra-group exposures) if the conditions in ■ BIPRU 3.2.25 R (1) are satisfied.

3.2.35

FCA PRA

R

- (1) A *firm* may not apply ■ BIPRU 3.2.25 R unless it has a *core UK group waiver*.
- (2) [deleted]
- (3) A *firm* may stop applying ■ BIPRU 3.2.25 R or may stop applying it to some *exposures*.
- (4) [deleted]
- (5) A *firm* must notify the *appropriate regulator* if it becomes aware that any *exposure* that it has treated as exempt under ■ BIPRU 3.2.25 R has ceased to meet the conditions for exemption or if the *firm* ceases to treat an *exposure* under that *rule*.

3.2.36

G

[deleted]

3.2.37

FCA PRA

G

■ BIPRU 3 Annex 1 G is a flow chart guide to assessing whether an intra-group *exposure* can be zero *risk weighted* using the *standardised approach* subject to the conditions set out in ■ BIPRU 3.2.25 R - ■ BIPRU 3.2.35 R.

### Exposures to recognized third-country investment firms, clearing houses and investment exchanges

3.2.38

FCA PRA

R

For the purposes of the *standardised approach* (including as it applies for the purposes of ■ BIPRU 14) and without prejudice to ■ BIPRU 13.3.13 R and ■ BIPRU 13.8.8 R (Exposure to a central counterparty), *exposures to recognised third country investment firms* and *exposures to recognised clearing houses, designated clearing houses, recognised investment exchanges* and *designated investment exchanges* must be treated as exposures to *institutions*.

[Note: CAD Article 40]



### 3.3 The use of the credit assessments of ratings agencies

**3.3.1** FCA PRA R An external credit assessment may be used to determine the *risk weight* of an *exposure* in accordance with ■ BIPRU 3.2.20 R to ■ BIPRU 3.2.26 R only if the *ECAI* which provides it is recognised by the *appropriate regulator* as an *eligible ECAI* for the purposes of the *standardised approach to credit risk*.

[Note: BCD Article 81(1)]

#### Recognition of ratings agencies

**3.3.2** FCA PRA G The *appropriate regulator* will recognise an *ECAI* as an *eligible ECAI* for the purposes of ■ BIPRU 3, or will refuse to recognise an *ECAI* or will revoke its recognition of an *ECAI* as an *eligible ECAI* in accordance with the *Capital Requirements Regulations 2006*.

**3.3.3** FCA PRA G Regulation 22 of the *Capital Requirements Regulations 2006* deals with recognition by the *appropriate regulator* of *eligible ECAIs* for *exposure risk weight* purposes. Regulation 25 deals with revoking recognition.

**3.3.4** FCA PRA G The criteria which the *appropriate regulator* must apply when assessing *ECAIs* for recognition for *exposure risk weighting* purposes are set out in Regulation 22 and Schedule 1 to the *Capital Requirements Regulations 2006*. In making an assessment against those criteria and in carrying out the mapping process described in ■ BIPRU 3.3.7 G to ■ BIPRU 3.3.9 G the *appropriate regulator* will have regard to the approach set out in the Committee of European Banking Supervisors' "Guidelines on the recognition of External Credit Assessment Institutions" dated 20 January 2006. The *appropriate regulator* does not expect to recognise an *ECAI* unless the information set out in those guidelines has been submitted to it.

**3.3.5** FCA PRA G The list of *eligible ECAIs* is published on the *appropriate regulator* website. When the *appropriate regulator* recognises an *ECAI* as an *eligible ECAI*, it publishes that decision by amending the list of *eligible ECAIs* on the *appropriate regulator* website to include the name of the *eligible ECAI*. When the *appropriate regulator* determines that the recognition of an *ECAI* should be revoked, it publishes that decision by deleting the name of the *ECAI* from the list on the *appropriate regulator* website

**3.3.6** FCA PRA G The list of *eligible ECAIs* includes those who have been recognised as eligible for *exposure risk weighting* purposes by a *competent authority* of another *EEA State* and are subsequently recognised as *eligible ECAIs* by the *appropriate regulator* without carrying

out its own evaluation process under Regulation 22(2) of the *Capital Requirements Regulations 2006*.

### Mapping of credit assessments

3.3.7

FCA PRA

G

Under Regulation 22(3) of the *Capital Requirements Regulations 2006* the *appropriate regulator* is obliged to determine, taking into account the requirements set out in Schedule 2 to the *Capital Requirements Regulations 2006*, with which of the *credit quality steps* set out in Part 1 of Annex VI of the *Banking Consolidation Directive* the relevant credit assessments of an *eligible ECAI* are to be associated. Those determinations should be objective and consistent.

3.3.8

FCA PRA

R

The *credit quality step* with which a relevant credit assessment of an *eligible ECAI* is to be associated is that in the table mapping the credit assessments of *eligible ECAIs* to *credit quality steps* published by the *appropriate regulator* under Regulation 22(3) of the *Capital Requirements Regulations 2006*.

3.3.9

FCA PRA

G

The table mapping the credit assessments of *eligible ECAIs* to *credit quality steps* is published on the *appropriate regulator's* website and amended from time to time in line with additions to and deletions from the list of *eligible ECAIs*. The table includes mappings made by a *competent authority* of another *EEA State* which are subsequently recognised by the *appropriate regulator* without carrying out its own determination process under Regulation 22(5) of the *Capital Requirements Regulations 2006*.

[Note: For the most recent version of the table, refer to: <http://www.fca.org.uk/your-fca/documents/fsa-ecais-standardised> for the *FCA* and <http://www.bankofengland.co.uk/publications/Documents/prabankingpolicy/2013/ecaisstandardised.pdf> for the *PRA*]



### 3.4 Risk weights under the standardised approach to credit risk

**Risk weights: Exposures to central governments or central banks: Treatment**

3.4.1  
FCA PRA

R

Without prejudice to ■ BIPRU 3.4.2 R to ■ BIPRU 3.4.9 R, exposures to central governments and central banks must be assigned a 100% *risk weight*.

[Note: BCD Annex VI Part 1 point 1]

3.4.2  
FCA PRA

R

Subject to ■ BIPRU 3.4.4 R, *exposures* to central governments and *central banks* for which a credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* according to the table in ■ BIPRU 3.4.3 R in accordance with the assignment by the *appropriate regulator* in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of *eligible ECAIs* to six steps in a *credit quality assessment scale*.

[Note: BCD Annex VI Part 1 point 2]

**Table: Exposures to central governments and central banks for which a credit assessment by a nominated ECAI is available**

3.4.3  
FCA PRA

R

This table belongs to ■ BIPRU 3.4.2 R.

<i>Credit quality step</i>	1	2	3	4	5	6
<i>Risk weight</i>	0 %	20 %	50 %	100 %	100 %	150 %

3.4.4  
FCA PRA

R

*Exposures* to the European Central Bank must be assigned a 0% *risk weight*.

[Note: BCD Annex VI Part 1 point 3]

**Exposures in the national currency of the borrower**

PAGE 15

3.4.5  
FCA PRA

R

*Exposures* to *EEA States'* central governments and *central banks* denominated and funded in the domestic currency of that central government and *central bank* must be assigned a *risk weight* of 0%.

[Note: BCD Annex VI Part 1 point 4]

3.4.6

FCA PRA

R

When the *competent authorities* of a third country which apply supervisory and regulatory arrangements at least equivalent to those applied in the *EEA* assign a *risk weight* which is lower than that indicated in ■ BIPRU 3.4.1 R to ■ BIPRU 3.4.3 R to *exposures* to their central government and *central bank* denominated and funded in the domestic currency, a *firm* may *risk weight* such *exposures* in the same manner.

[Note: BCD Annex VI Part 1 point 5]

#### Use of credit assessments by export credit agencies

3.4.7

FCA PRA

R

An export credit agency credit assessment may be recognised by a *firm* for the purpose of determining the *risk weight* to be applied to an *exposure* under the *standardised approach* if either of the following conditions is met:

- (1) the credit assessment is a consensus risk score from export credit agencies participating in the OECD "Arrangement on Guidelines for Officially Supported Export Credits"; or
- (2) the export credit agency publishes its credit assessments, and the export credit agency subscribes to the OECD agreed methodology, and the credit assessment is associated with one of the eight minimum export insurance premiums (MEIP) that the OECD agreed methodology establishes.

[Note: BCD Annex VI Part 1 point 6]

3.4.8

FCA PRA

R

*Exposures* for which a credit assessment by an export credit agency is recognised for *risk weighting* purposes must be assigned a *risk weight* according to the table in ■ BIPRU 3.4.9 R.

[Note: BCD Annex VI Part 1 point 7]

#### Table: Exposure for which a credit assessment by an export credit agency is recognised

3.4.9

FCA PRA

R

This table belongs to ■ BIPRU 3.4.8 R.

MEIP	0	1	2	3	4	5	6	7
<i>Risk weight</i>	0%	0%	20%	50%	100%	100%	100%	150%

#### Exposures to regional governments or local authorities: General

3.4.10

FCA PRA

R

Without prejudice to ■ BIPRU 3.4.15 R to ■ BIPRU 3.4.19 R:

- (1) a *firm* must *risk weight exposures* to regional governments and local authorities in accordance with ■ BIPRU 3.4.11 R to ■ BIPRU 3.4.14 R and ■ BIPRU 3.4.19A R; and

- (2) the preferential treatment for short-term *exposures* specified in ■ BIPRU 3.4.37 R, ■ BIPRU 3.4.39 R and ■ BIPRU 3.4.44 R must not be applied.

[Note: BCD Annex VI Part 1 point 8]

**Exposures to regional governments or local authorities: Central government risk weight based method**

3.4.11

FCA PRA

R

- (1) *Exposures* to regional governments and local authorities must be assigned a *risk weight* according to the *credit quality step* to which *exposures* to the central government of the jurisdiction in which the regional government or local authority is established are assigned in accordance with the table in ■ BIPRU 3.4.12 R.

- (2) *Exposures* to an unrated regional government or local authority must not be assigned a *risk weight* lower than that applied to *exposures* to its central government.

[Note: BCD Annex VI Part 1 points 25 and 26]

**Table: Central government risk weight based method**

3.4.12

FCA PRA

R

This table belongs to ■ BIPRU 3.4.11 R.

<i>Credit quality step</i> to which central gov-ernment is assigned	1	2	3	4	5	6
<i>Risk weight of exposure</i>	20%	50%	100%	100%	100%	150%

3.4.13

FCA PRA

R

For *exposures* to regional governments and local authorities established in countries where the central government is unrated, the *risk weight* must be not more than 100%.

[Note: BCD Annex VI Part 1 point 27]

3.4.14

FCA PRA

R

For *exposures* to regional governments and local authorities with an original effective maturity of three months or less, the *risk weight* must be 20%.

[Note: BCD Annex VI Part 1 point 28]

3.4.15

FCA PRA

R

A *firm* must treat an *exposure* to a regional government or local authority of the *United Kingdom* listed in ■ BIPRU 3 Annex 2 R as an *exposure* to the central government of the *United Kingdom*.

[Note: BCD Annex VI Part 1 point 9]

3.4.16

FCA PRA

G

The *appropriate regulator* will include a regional government or local authority in the list in ■ BIPRU 3 Annex 2 R where there is no difference in risk between *exposures* to that body and *exposures* to the central government of the *United Kingdom* because of the specific revenue-raising powers of the regional government or local authority, and the existence of specific institutional arrangements the effect of which is to reduce the risk of default.

[Note: BCD Annex VI Part 1 point 9]

3.4.17

FCA PRA

R

A *firm* must treat an *exposure* to a regional government or local authority of an *EEA State* other than the *United Kingdom* as an *exposure* to the central government in whose jurisdiction that regional government or local authority is established if that regional government or local authority is included on the list of regional governments and local authorities drawn up by the *competent authority* in that *EEA State* under a *CRD implementation measure* with respect to point 9 of Part 1 of Annex VI of the *Banking Consolidation Directive*.

[Note: BCD Annex VI Part 1 point 9]

3.4.18

FCA PRA

R

*Exposures* to churches or religious communities constituted in the form of a legal *person* under public law must, in so far as they raise taxes in accordance with legislation conferring on them the right to do so, be treated as *exposures* to regional governments and local authorities, except that ■ BIPRU 3.4.15 R and ■ BIPRU 3.4.17 R do not apply.

[Note: BCD Annex VI Part 1 point 10]

3.4.19

FCA PRA

R

When competent authorities of a third country jurisdiction which apply supervisory and regulatory arrangements at least equivalent to those applied in the *EEA* treat *exposures* to regional governments and local authorities as *exposures* to their central government, a *firm* may *risk weight exposures* to such regional governments and local authorities in the same manner.

[Note: BCD Annex VI Part 1 point 11]

3.4.19A

FCA PRA

R

Without prejudice to ■ BIPRU 3.4.17 R to ■ BIPRU 3.4.19 R, an *exposure* to a regional government or local authority of an *EEA State* denominated and funded in the domestic currency of that regional government or local authority must be assigned a risk weight of 20%.

[Note: BCD Annex VI Part 2(b)]

#### Exposures to administrative bodies and non-commercial undertakings

3.4.20

FCA PRA

R

■ BIPRU 3.4.21 R to ■ BIPRU 3.4.26 R set out the provisions applying to *exposures* to administrative bodies and non-commercial *undertakings*.

**Treatment**

3.4.21

FCA PRA

R

Without prejudice to ■ BIPRU 3.4.22 R to ■ BIPRU 3.4.26 R, *exposures* to administrative bodies and non-commercial *undertakings* must be assigned a 100% *risk weight*.

[Note: BCD Annex VI Part 1 point 12]

**Public sector entities**

3.4.22

FCA PRA

R

Without prejudice to ■ BIPRU 3.4.23 R to ■ BIPRU 3.4.26 R, *exposures* to *public sector entities* must be assigned a 100% *risk weight*.

[Note: BCD Annex VI Part 1 point 13]

3.4.23

FCA PRA

R

A *firm* may treat an *exposure* to a *public sector entity* as an *exposure* to a regional government or local authority in accordance with ■ BIPRU 3.4.11 R to ■ BIPRU 3.4.14 R.

[Note: BCD Annex VI Part 1 point 14]

3.4.24

FCA PRA

R

In exceptional circumstances a *firm* may treat an *exposure* to a *public sector entity* established in the *United Kingdom* as an *exposure* to the central government of the *United Kingdom* if there is no difference in risk between *exposures* to that body and *exposures* to the central government of the *United Kingdom* because of the existence of an appropriate guarantee by the central government.

[Note: BCD Annex VI Part 1 point 15]

3.4.25

FCA PRA

R

Where a *competent authority* of another *EEA State* implements points 14 or 15 of Part 1 of Annex VI of the *Banking Consolidation Directive* by exercising the discretion to treat *exposures* to *public sector entities* as *exposures* to *institutions* or as *exposures* to the central government of the *EEA State* concerned, a *firm* may *risk weight exposures* to the relevant *public sector entities* in the same manner.

[Note: BCD Annex VI Part 1 point 16]

3.4.26

FCA PRA

R

When *competent authorities* of a third country jurisdiction, which apply supervisory and regulatory arrangements at least equivalent to those applied in the *EEA*, treat *exposures* to *public sector entities* as *exposures* to *institutions*, a *firm* may *risk weight exposures* to the relevant *public sector entities* in the same manner.

[Note: BCD Annex VI Part 1 point 17]

**Exposures to multilateral development banks: Treatment**

3.4.27

FCA PRA

R

Without prejudice to ■ BIPRU 3.4.28 R to ■ BIPRU 3.4.29 R:

- (1) a *firm* must treat *exposures to multilateral development banks* in the same manner as *exposures to institutions* in accordance with ■ BIPRU 3.4.34 R to ■ BIPRU 3.4.39 R (Exposures to institutions: credit assessment based method); and
- (2) the preferential treatment for short-term *exposures* specified in ■ BIPRU 3.4.37 R, ■ BIPRU 3.4.39 R and ■ BIPRU 3.4.44 R must not be applied.

[Note: BCD Annex VI Part 1 point 19]

3.4.28

FCA PRA

R

An *exposure to a multilateral development bank* listed in point (1) of the definition in the *Glossary* must be assigned a 0% *risk weight*.

[Note: BCD Annex VI Part 1 point 20]

3.4.29

FCA PRA

R

A *risk weight* of 20% must be assigned to the portion of unpaid capital subscribed to the European Investment Fund.

[Note: BCD Annex VI Part 1 point 21]

**Exposures to international organisations**

3.4.30

FCA PRA

R

*Exposures to the following international organisations* must be assigned a 0% *risk weight*:

- (1) the *EU*;
- (2) the International Monetary Fund; and
- (3) the Bank for International Settlements.

[Note: BCD Annex VI Part 1 point 22]

**Exposures to institutions: General**

3.4.31

FCA PRA

R

■ BIPRU 3.4.32 R to ■ BIPRU 3.4.48 R set out the treatment to be accorded to *exposures to institutions*.**Exposures to institutions: Treatment**

3.4.32

FCA PRA

R

Without prejudice to ■ BIPRU 3.4.33 R to ■ BIPRU 3.4.47 R, *exposures to financial institutions* authorised and supervised by the *competent authorities* responsible for the authorisation and supervision of *credit institutions* and subject to prudential requirements equivalent to those applied to credit *institutions* must be *risk weighted* as *exposures to institutions*.

[Note: BCD Annex VI Part 1 point 24]

**Exposures to institutions: Risk weight floor on exposures to unrated institutions**

3.4.33

FCA PRA

R

*Exposures to an unrated institution must not be assigned a risk weight lower than that applied to exposures to its central government.*

[Note: BCD Annex VI Part 1 point 25]

**Exposures to institutions: Credit assessment based method**

3.4.34

FCA PRA

R

*Exposures to institutions with a residual maturity of more than three months for which a credit assessment by a nominated ECAI is available must be assigned a risk weight according to the table in ■ BIPRU 3.4.35 R in accordance with the assignment by the appropriate regulator in accordance with the Capital Requirements Regulations 2006 of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale.*

[Note: BCD Annex VI Part 1 point 29]

**Table: Exposures to institutions with a residual maturity of more than three months for which a credit assessment by a nominated ECAI is available**

3.4.35

FCA PRA

R

This table belongs to ■ BIPRU 3.4.34 R.

<i>Credit quality step</i>	1	2	3	4	5	6
<i>Risk weight</i>	20%	50%	50%	100%	100%	150%

3.4.36

FCA PRA

R

Without prejudice to ■ BIPRU 3.4.33 R, *exposures to unrated institutions must be assigned a risk weight of 50%.*

[Note: BCD Annex VI Part 1 point 30]

3.4.37

FCA PRA

R

*Exposures to an institution with a residual maturity of three months or less for which a credit assessment by a nominated ECAI is available must be assigned a risk weight according to the table in ■ BIPRU 3.4.38 R in accordance with the assignment by the appropriate regulator in accordance with the Capital Requirements Regulations 2006 of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale.*

[Note: BCD Annex VI Part 1 point 31]

**Table: Exposures to an institution with a residual maturity of three months or less for which a credit assessment by a nominated ECAI is available**

3.4.38

FCA PRA

R

This table belongs to ■ BIPRU 3.4.37 R.

<i>Credit quality step</i>	1	2	3	4	5	6
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Risk weight	20%	20%	20%	50%	50%	150%
-------------	-----	-----	-----	-----	-----	------

3.4.39

FCA PRA

R

Without prejudice to ■ BIPRU 3.4.33 R, *exposures* to unrated *institutions* having an original effective maturity of three months or less must be assigned a 20% *risk weight*

[Note: BCD Annex VI Part 1 point 32]

#### **Exposures to institutions: Interaction with short-term credit assessments**

3.4.40

FCA PRA

R

If there is no short-term credit assessment as set out in ■ BIPRU 3.4.112 R, the general preferential treatment for short-term *exposures* as specified in ■ BIPRU 3.4.37 R applies to all *exposures* to *institutions* of up to three months residual maturity.

[Note: BCD Annex VI Part 1 point 34]

3.4.41

FCA PRA

R

If there is a short-term credit assessment as set out in ■ BIPRU 3.4.112 R and such an assessment determines the application of a more favourable or identical *risk weight* than the use of the general preferential treatment for short-term *exposures*, as specified in ■ BIPRU 3.4.37 R, then the short-term assessment and *risk weighting* specified in ■ BIPRU 3.4.112 R must be used for that specific *exposure* only. Other short-term *exposures* must follow the general preferential treatment for short-term *exposures*, as specified in ■ BIPRU 3.4.37 R.

[Note: BCD Annex VI Part 1 point 35]

3.4.42

FCA PRA

R

If there is a short-term credit assessment as set out in ■ BIPRU 3.4.112 R and such an assessment determines a less favourable *risk weight* than the use of the general preferential treatment for short-term *exposures*, as specified in ■ BIPRU 3.4.37 R, then the general preferential treatment for short-term *exposures* must not be used and all unrated short-term claims must be assigned the same *risk weight* as that applied by the specific short-term assessment.

[Note: BCD Annex VI Part 1 point 36]

3.4.43

FCA PRA

G

■ BIPRU 3 Annex 4 G contains a flow diagram guide to determining the *risk weight* to be applied to short-term *exposures* to *institutions* according to whether a short-term credit assessment is available.

#### **Exposures to institutions: Short-term exposures in the national currency of the borrower**

3.4.44

FCA PRA

R

A *firm* may assign to an *exposure* to an *institution* formed under the law of the *United Kingdom* of a residual maturity of 3 months or less denominated and funded in pounds sterling a *risk weight* that is one category less favourable than the preferential *risk weight*, as described

in ■ BIPRU 3.4.5 R (Exposures in the national currency of the borrower), assigned to *exposures* to the central government of the *United Kingdom*.

[Note: BCD Annex VI Part 1 point 37]

3.4.45

FCA PRA

R

(1) Where a *competent authority* of another *EEA State* implements point 37 of Part 1 of Annex VI of the *Banking Consolidation Directive* by exercising the discretion to allow the treatment in that point, a *firm* may assign to the relevant national currency *exposures* the *risk weight* permitted by that *CRD implementation measure*.

(2) When the *competent authority* of a third country which applies supervisory and regulatory arrangements at least equivalent to those applied in the *EEA* assigns to an *exposure* to an *institution* formed under the law of that third country of a residual maturity of 3 months or less denominated and funded in the national currency a *risk weight* that is one category less favourable than the preferential *risk weight*, as described in ■ BIPRU 3.4.6 R (Exposures in the national currency of the borrower), assigned to *exposures* to the central government of that third country, a *firm* may *risk weight* such *exposures* in the same manner.

[Note: BCD Annex VI Part 1 point 37]

3.4.46

FCA PRA

R

No *exposures* of a residual maturity of 3 months or less denominated and funded in the national currency of the borrower may be assigned a *risk weight* less than 20%.

[Note: BCD Annex VI Part 1 point 38]

#### Exposures to institutions: Investments in regulatory capital instruments

3.4.47

FCA PRA

R

Investments in *equity* or regulatory capital instruments issued by *institutions* must be *risk weighted* at 100%, unless deducted from *capital resources*.

[Note: BCD Annex VI Part 1 point 39]

#### Exposures to institutions: Minimum reserves required by the ECB

3.4.48

FCA PRA

R

Where an *exposure* to an *institution* is in the form of minimum reserves required by the European Central Bank or by the *central bank* of an *EEA State* to be held by the *firm*, a *firm* may assign the *risk weight* that would be assigned to *exposures* to the *central bank* of the *EEA State* in question provided:

- (1) the reserves are held in accordance with Regulation (EC) No. 1745/2003 of the European Central Bank of 12 September 2003 or a subsequent replacement regulation or in accordance with national requirements in all material respects equivalent to that Regulation; and

- (2) in the event of the bankruptcy or insolvency of the *institution* where the reserves are held, the reserves will be fully repaid to the *firm* in a timely manner and will not be available to meet other liabilities of the *institution*.

[Note: BCD Annex VI Part 1 point 40]

#### Exposures to corporates: General

3.4.49

FCA PRA

G

■ BIPRU 3.4.50 R to ■ BIPRU 3.4.52 R set out the treatment to be accorded to *exposures* to *corporates*.

#### Exposures to corporates: Treatment

3.4.50

FCA PRA

R

*Exposures* for which a credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* according to the table in ■ BIPRU 3.4.51 R in accordance with the assignment by the *appropriate regulator* in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of *eligible ECAIs* to six steps in a *credit quality assessment scale*.

[Note: BCD Annex VI Part 1 point 41]

#### Table: Exposures for which a credit assessment by a nominated ECAI is available

3.4.51

FCA PRA

R

This table belongs to ■ BIPRU 3.4.50 R.

Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	100%	100%	150%	150%

3.4.52

FCA PRA

R

Unrated *exposures* must be assigned a 100% *risk weight* or the *risk weight* of its central government, whichever is the higher.

[Note: BCD Annex VI Part 1 point 42]

#### Retail exposures

3.4.53

FCA PRA

R

*Exposures* that comply with the criteria listed in ■ BIPRU 3.2.10 R must be assigned a *risk weight* of 75%. However a *firm* may treat such an *exposure* under ■ BIPRU 3.2.24 R (100% *risk weight*).

[Note: BCD Annex VI Part 1 point 43]

#### Exposures secured by real estate property

3.4.54

FCA PRA

R

■ BIPRU 3.4.55 R to ■ BIPRU 3.4.94 R set out the treatment to be accorded to *exposures* secured by real estate property.

3.4.55

FCA PRA

R

Without prejudice to ■ BIPRU 3.4.56 R to ■ BIPRU 3.4.94 R, *exposures* fully secured by real estate property must be assigned a *risk weight* of 100%.

[Note: BCD Annex VI Part 1 point 44]

**Exposures secured by mortgages on residential property**

3.4.56

FCA PRA

R

Without prejudice to ■ BIPRU 3.4.85 R, an *exposure* or any part of an *exposure* fully and completely secured, to the satisfaction of the *firm*, by mortgages on residential property which is or shall be occupied or let by the owner or the beneficial owner in the case of personal investment companies must be assigned a *risk weight* of 35%.

[Note: BCD Annex VI Part 1 point 45]

3.4.56A

FCA PRA

R

- (1) A *firm* must not treat a *lifetime mortgage* as an *exposure* fully and completely secured on residential property for the purposes of ■ BIPRU 3.4.56 R unless the amount of the *exposure* is calculated according to the following formula:

*exposure* amount =

$$\frac{P(1+i)^T}{(1+d)^T}$$

where:

- (a) *P* is the current outstanding balance on the *lifetime mortgage*;
  - (b) *i* is the interest rate charged on the *lifetime mortgage*, which for the purposes of this calculation must not be lower than the discount rate referred to in (c);
  - (c) *d* is the discount rate which is the risk-free rate as represented by the yield on 10-year UK government bonds; and
  - (d) *T* is the projected number of years to maturity of the *exposure*.
- (2) Notwithstanding (1)(c), a *firm* may calculate an annual average discount rate provided there is no obvious bias in its calculation and it is consistent in its approach.

## 3.4.56B

FCA PRA

G

- (1) This paragraph provides *guidance* on ■ BIPRU 3.4.56A R.
- (2) For the purposes of ■ BIPRU 3.4.56A R (2), a *firm* may use the FTSE UK gilt 10-year yield index which the Council of Mortgage Lenders makes available to its members.
- (3) If a *firm* offers a variable interest rate on a *lifetime mortgage*, it should calculate an average interest rate in a way which is consistent with the calculation of the discount rate.
- (4) To determine the projected number of years to maturity of the *exposure*, a *firm* may use the standard mortality tables published by the Institute of Actuaries or the Faculty of Actuaries. For internal risk management purposes, the *firm* should use factual data or seek actuarial advice to determine how the information in these tables may be adjusted to take account of regional and other relevant variations.

## 3.4.57

FCA PRA

R

***Exposures fully and completely secured, to the satisfaction of the firm, by shares in Finnish residential housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of residential property which is or shall be occupied or let by the owner must be assigned a risk weight of 35%.***

[Note: BCD Annex VI Part 1 point 46]

## 3.4.58

FCA PRA

R

**Without prejudice to ■ BIPRU 3.4.85 R, an *exposure* or any part 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, must be assigned a *risk weight* of 35% provided that the *firm* is satisfied that the *exposure* of the *firm* is fully and completely secured by its ownership of the property.**

[Note: BCD Annex VI Part 1 point 47]

## 3.4.59

FCA PRA

G

An Ijara mortgage is an example of an *exposure* described in ■ BIPRU 3.4.58 R.

## 3.4.60

FCA PRA

R

- (1) In the exercise of its judgement for the purposes of ■ BIPRU 3.4.56 R to ■ BIPRU 3.4.58 R, a *firm* may be satisfied only if the conditions in (2) to (6) are met.
- (2) The value of the property does not materially depend upon the credit quality of the obligor. This requirement does not preclude situations where purely macroeconomic factors affect both the value of the property and the performance of the borrower.
- (3) The risk of the borrower does not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt

from other sources. As such, repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral.

- (4) The minimum requirements about:
- (a) legal certainty in ■ BIPRU 3.4.64 R;
  - (b) monitoring of property values in ■ BIPRU 3.4.66 R;
  - (c) documentation in ■ BIPRU 3.4.72 R; and
  - (d) insurance in ■ BIPRU 3.4.73 R;
- are met.
- (5) The valuation *rules* set out in ■ BIPRU 3.4.77 R to ■ BIPRU 3.4.80 R are met.
- (6) The value of the property exceeds the *exposures* by a substantial margin as set out in ■ BIPRU 3.4.81 R, ■ BIPRU 3.4.83 R, ■ BIPRU 3.4.84 R or ■ BIPRU 3.4.85 R (as applicable).

[Note: BCD Annex VI Part 1 point 48]

3.4.61

FCA PRA

R

■ BIPRU 3.4.60 R (3) does not apply to *exposures* fully and completely secured by mortgages on residential property which is situated within the *United Kingdom*.

[Note: BCD Annex VI Part 1 point 49]

3.4.62

FCA PRA

G

The *Banking Consolidation Directive* permits a *competent authority* to disapply the condition in ■ BIPRU 3.4.60 R (3), if it has evidence that a well-developed and long-established residential real estate market is present in its territory with loss rates which are sufficiently low to justify such treatment. ■ BIPRU 3.4.61 R implements that option. However, if the evidence changes so that these conditions are no longer satisfied, the *appropriate regulator* may be obliged to revoke ■ BIPRU 3.4.61 R.

3.4.63

FCA PRA

R

If a *CRD implementation measure* of another *EEA State* exercises the discretion in point 49 of Part 1 of Annex VI of the *Banking Consolidation Directive* to dispense with the condition corresponding to ■ BIPRU 3.4.60 R (3) (The risk of the borrower should not materially depend upon the performance of the underlying property or project) , a *firm* may apply a *risk weight* of 35% to such *exposures* fully and completely secured by mortgages on residential property situated in that *EEA State*.

[Note: BCD Annex VI Part 1 point 50]

3.4.64

FCA PRA

R

The requirements about legal certainty referred to in ■ BIPRU 3.4.60 R (4)(a) are as follows:

- (1) the mortgage or charge must be enforceable in all relevant jurisdictions which are relevant at the time of conclusion of the credit agreement, and the mortgage or charge must be properly filed on a timely basis;
- (2) the arrangements must reflect a perfected lien (i.e. all legal requirements for establishing the pledge shall have been fulfilled); and
- (3) the protection agreement and the legal process underpinning it must enable the *firm* to realise the value of the protection within a reasonable timeframe.

[Note: BCD Annex VIII Part 2 point 8(a)]

3.4.65

FCA PRA

G

The term protection agreement in ■ BIPRU 3.4.64 R (3) refers to the contract or deed by which the mortgage or charge is established.

3.4.66

FCA PRA

R

- (1) The requirements about monitoring of property values referred to in ■ BIPRU 3.4.60 R (4)(b) are as follows:
  - (a) the value of the property must be monitored on a frequent basis and at a minimum once every three years for residential real estate;
  - (b) more frequent monitoring must be carried out where the market is subject to significant changes in conditions;
  - (c) statistical methods may be used to monitor the value of the property and to identify property that needs revaluation;
  - (d) the property valuation must be reviewed by an independent valuer when information indicates that the value of the property may have declined materially relative to general market prices; and
  - (e) for loans exceeding €3 million or 5% of the *capital resources* of the *firm*, the property valuation must be reviewed by an independent valuer at least every three years.
- (2) For the purposes of (1), 'independent valuer' means a person who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process.

[Note: BCD Annex VIII Part 2 point 8(b)]

- 3.4.67** FCA PRA G A property will need to be revalued over time to ensure that the original purchase price does not overstate the degree of security provided by the property. Ijara providers should undertake revaluations in the same way as providers of conventional mortgages.
- 3.4.68** FCA PRA G For the purposes of ■ BIPRU 3.4.66 R (1)(a), the monitoring of property values should be an inherent part of risk managing and tracking the portfolio. The requirement to monitor property values does not include the physical assessment of each property in the portfolio.
- 3.4.69** FCA PRA G For the purposes of ■ BIPRU 3.4.66 R (1)(d) and ■ (e), the review of a property valuation is more in-depth than the normal monitoring process required by ■ BIPRU 3.4.66 R (1)(a). This requirement is likely to include a review of the property value on an individual *exposure* basis. Where an *exposure* is secured by multiple properties, the review can be undertaken at the level of the *exposure*, rather than at the level of each individual property.
- 3.4.70** FCA PRA G The review of property values required by ■ BIPRU 3.4.66 R (1)(e) may lead to an amendment of the value assigned to the property under by ■ BIPRU 3.4.80 R.
- 3.4.71** FCA PRA G For the purposes of ■ BIPRU 3.4.66 R (2), necessary qualifications need not be professional qualifications but the firm should be able to demonstrate that he or she has the necessary ability and experience to undertake the review.
- 3.4.72** FCA PRA R **The requirements about documentation referred to in ■ BIPRU 3.4.60 R (4)(c) are that the types of residential real estate accepted by the *firm* and its lending policies in this regard must be clearly documented.**
- [Note: BCD Annex VIII Part 2 point 8(c)]
- 3.4.73** FCA PRA R **The requirements about insurance referred to in ■ BIPRU 3.4.60 R (4)(d) are that the *firm* must have procedures to monitor that the property taken as protection is adequately insured against damage.**
- [Note: BCD Annex VIII Part 2 point 8(d)]
- 3.4.74** FCA PRA G For the purposes of ■ BIPRU 3.4.73 R a *firm* should, as a minimum, ensure that it is a requirement of each loan that the property taken as collateral must have adequate buildings insurance at all times, which should be reviewed when any new loan is extended against the property.
- 3.4.75** FCA PRA G A *firm* may deal with the risk that insurance on properties taken as protection may be inadequate by taking out insurance at the level of the portfolio.
- 3.4.76** FCA PRA R **The valuation *rules* referred to in ■ BIPRU 3.4.60 R (5) are set out in ■ BIPRU 3.4.77 R to ■ BIPRU 3.4.80 R.**
- 3.4.77** FCA PRA R **The property must be valued by an independent valuer at or less than the market value. In those *EEA States* that have laid down rigorous criteria**

for the assessment of the mortgage lending value in statutory or regulatory provisions the property may instead be valued by an independent valuer at or less than the mortgage lending value.

[Note: BCD Annex VIII Part 3 point 62]

3.4.78

FCA PRA

R

Market value means the estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value must be documented in a transparent and clear manner.

[Note: BCD Annex VIII Part 3 point 63]

3.4.79

FCA PRA

R

Mortgage lending value means the value of the property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property. Speculative elements must not be taken into account in the assessment of the mortgage lending value. The mortgage lending value must be documented in a transparent and clear manner.

[Note: BCD Annex VIII Part 3 point 64]

3.4.80

FCA PRA

R

The value of the collateral must be the market value or mortgage lending value reduced as appropriate to reflect the results of the monitoring required under ■ BIPRU 3.4.60 R (4)(b) and ■ BIPRU 3.4.66 R and to take account of any prior claims on the property.

[Note: BCD Annex VIII Part 3 point 65]

3.4.81

FCA PRA

R

A *firm* may not treat an *exposure* as fully and completely secured by residential property located in the *United Kingdom* for the purpose of ■ BIPRU 3.4.56 R or ■ BIPRU 3.4.58 R unless the amount of the *exposure* or of the secured part of the *exposure* referred to in ■ BIPRU 3.4.56 R or ■ BIPRU 3.4.58 R, as the case may be, is 80% or less of the value of the residential property on which it is secured.

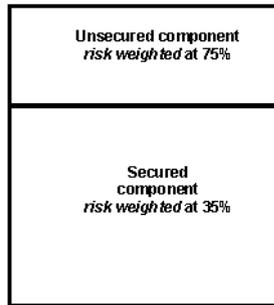
3.4.82

FCA PRA

G

- (1) The application of ■ BIPRU 3.4.81 R may be illustrated by an example. If a *firm* has a mortgage *exposure* of £100,000 secured on residential property in the *United Kingdom* that satisfies the criteria listed in ■ BIPRU 3.4.56 R to ■ BIPRU 3.4.80 R and the value of that property is £100,000, then £80,000 of that *exposure* may be treated as fully and completely secured and *risk weighted* at 35%. The remaining £20,000 may be *risk weighted* at 75% provided the *exposure* meets the criteria in ■ BIPRU 3.2.10 R. The portion *risk weighted* at 75% should be treated as a *retail exposure* for the purposes of the aggregation calculations specified in ■ BIPRU 3.2.10 R (3). A diagrammatic illustration of this example is in (2).

(2)



EXAMPLE

- £100,000 loan secured on property valued at £100,000
- First £80,000 (80% LTV) *risk weighted at 35%*
- Remaining £20,000 *risk weighted at 75%* if meets retail criteria: counts to retail aggregation calculation
- Overall *risk weight* = 43%

(3) The same approach applies to *exposures* described in ■ BIPRU 3.4.58 R. On initiation a 35% *risk weight* should be applied to the first 80% of the principal/"purchase price" outstanding, with a 75% *risk weight* being applied to the remainder of the principal (assuming that the *exposure* meets the requirements in ■ BIPRU 3.2 to be treated as a *retail exposure*).

3.4.83

FCA PRA

R

A *firm* may only treat an *exposure* as fully and completely secured by residential property situated in another *EEA State* for the purposes of ■ BIPRU 3.4.56 R or ■ BIPRU 3.4.58 R if it would be treated as fully and completely secured by the relevant *CRD implementation measures* in that *EEA State* implementing points 45 and 47 of Part 1 of Annex VI of the *Banking Consolidation Directive*.

3.4.84

FCA PRA

R

For the purposes of ■ BIPRU 3.4.56 R or ■ BIPRU 3.4.58 R, a *firm* may only treat an *exposure* as fully and completely secured by residential property situated in the territory of a *third-country competent authority* that is listed as equivalent for credit risk in ■ BIPRU 8 Annex 6 R if it would be treated as fully and completely secured under the applicable requirements of that *third-country competent authority* (including any applicable loan-to-value ceiling).

3.4.85

FCA PRA

R

For the purposes of ■ BIPRU 3.4.56 R or ■ BIPRU 3.4.58 R, where the residential property in question is situated in the territory of a *third-country competent authority* that is not listed as equivalent for credit risk in ■ BIPRU 8 Annex 3 R:

- (1) a *firm* must not treat an *exposure* as fully and completely secured by the residential property in question unless the value of the property exceeds the *exposures* by a substantial margin, which must be at least 20%;
- (2) the *firm* must apply a *risk weight* of 50% to the *exposure*.

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3.4.86

FCA PRA

G

For the purposes of ■ BIPRU 3.4.85 R (1) and in order to satisfy itself that an *exposure* is fully and completely secured by the relevant property, a *firm* should make its own assessment of the appropriate margin in each case, using its knowledge of the market in the relevant country and of its own portfolio.

3.4.87

FCA PRA

G

If a *firm* has more than one *exposure* secured on the same property they should be aggregated and treated as if they were a single *exposure* secured on the property for the purposes of ■ BIPRU 3.4.56 R and ■ BIPRU 3.4.58 R and ■ BIPRU 3.4.81 R, ■ BIPRU 3.4.83 R and ■ BIPRU 3.4.84 R.

3.4.88

FCA PRA

G

If an *exposure* is secured on property that is used in part for residential purposes in accordance with ■ BIPRU 3.4.56 R and partly for commercial purposes (such as a farm, public house, guest house or shop) it may be treated as secured by residential real estate if the *firm* can demonstrate that the property's main use is, or will be, residential and that the value of the property is not significantly affected by its commercial use.

#### Exposures secured by mortgages on commercial real estate

3.4.89

FCA PRA

R

*Exposures* or any part of an *exposure* secured by mortgages on offices or other commercial premises which cannot properly be considered to fall within any other *standardised credit risk exposure class* or to qualify for a lower *risk weight* under ■ BIPRU 3 must be assigned a *risk weight* of 100%.

[Note: BCD Annex VI Part 1 point 51]

3.4.90

FCA PRA

R

*Exposures* fully and completely secured by shares in Finnish housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of offices or other commercial premises may be assigned a *risk weight* of 50%.

[Note: BCD Annex VI Part 1 point 52]

3.4.91

FCA PRA

R

If a *CRD implementation measure* in another *EEA State* implements the discretion in point 51 of Part 1 of Annex VI of the *Banking Consolidation Directive*, a *firm* may apply the same treatment as that *CRD implementation measure* to *exposures* falling within the scope of that *CRD implementation measure* which are fully and completely secured by mortgages on offices or other commercial premises situated in that *EEA State*.

[Note: BCD Annex VI Part 1 points 51 and 57]

3.4.92

FCA PRA

R

If a *CRD implementation measure* in another *EEA State* implements the discretion in point 53 of Part 1 of Annex VI of the *Banking Consolidation Directive*, a *firm* may apply the same treatment as that *CRD implementation measure* to *exposures* related to property leasing transactions concerning offices or other commercial premises situated in that *EEA State* and governed by statutory provisions whereby the lessor retains full ownership of the rented assets until the tenant exercises his option to purchase, as long as that *exposure* falls within the scope of that *CRD implementation measure*.

[Note: BCD Annex VI Part 1 points 53 and 57]

3.4.93

FCA PRA

R

In particular, if a *firm* applies ■ BIPRU 3.4.91 R or ■ BIPRU 3.4.92 R, it must comply with the corresponding *CRD implementation measures* in relation to points 54-56 of Part 1 of Annex VI of the *Banking Consolidation Directive*.

[Note: *BCD* Annex VI Part 1 points 54 to 56]

3.4.94

FCA PRA

R

- (1) If a *CRD implementation measure* in another *EEA State* implements the discretion in point 58 of Part 1 of Annex VI of the *Banking Consolidation Directive* to dispense with the condition in point 54(b) for *exposures* fully and completely secured by mortgages on commercial property situated in that *EEA State*, a *firm* may apply the same treatment as that *CRD implementation measure* to *exposures* fully and completely secured by mortgages on commercial property situated in that *EEA State* falling within the scope of that *CRD implementation measure*.
- (2) However a *firm* may not apply the treatment in (1) if the eligibility to use that treatment under the *CRD implementation measure* referred to in (1) ceases as contemplated under point 59 of Annex VI of the *Banking Consolidation Directive* (condition in point 54(b) must apply where conditions in point 58 are not satisfied).

[Note: *BCD* Annex VI Part 1 points 58, 59 and 60]

#### Past due items

3.4.95

FCA PRA

G

■ BIPRU 3.4.96 R to ■ BIPRU 3.4.101 R set out the treatment to be accorded to past due items.

3.4.96

FCA PRA

R

Without prejudice to the provisions contained in ■ BIPRU 3.4.97 R to ■ BIPRU 3.4.101 R, the unsecured part of any item that is past due for more than 90 days (irrespective of the amount of that item or of the unsecured portion of that item) must be assigned a *risk weight* of:

- (1) 150% if value adjustments are less than 20% of the unsecured part of the *exposure* gross of value adjustments; and
- (2) 100% if value adjustments are no less than 20% of the unsecured part of the *exposure* gross of value adjustments.

[Note: *BCD* Annex VI Part 1 point 61]

3.4.97

FCA PRA

R

For the purpose of defining the secured portion of the past due item, eligible collateral and guarantees must be those eligible for *credit risk mitigation* purposes under ■ BIPRU 5.

[Note: *BCD* Annex VI Part 1 point 62]

3.4.98

FCA PRA

G

For the purposes of ■ BIPRU 3.4.97 R, the secured portion of a past due item is dealt with under ■ BIPRU 5 (Credit risk mitigation). A *firm* may treat the secured portion of an *exposure* covered by a mortgage indemnity product that meets the relevant CRM eligibility criteria as secured for the purposes of ■ BIPRU 3.4.97 R. The *risk weight* to be applied to the secured portion is determined under ■ BIPRU 5.7.21 R to ■ BIPRU 5.7.24 R. The *risk weight* of the unsecured portion is determined in accordance with ■ BIPRU 3.4.96 R.

3.4.99

FCA PRA

R

**Exposures indicated in ■ BIPRU 3.4.56 R to ■ BIPRU 3.4.63 R (Exposures secured by mortgages on residential property) must be assigned a *risk weight* of 100% net of value adjustments if they are past due for more than 90 days. If value adjustments are no less than 20% of the *exposure* gross of value adjustments, the *risk weight* to be assigned to the remainder of the *exposure* is 50%.**

[Note: BCD Annex VI Part 1 point 64]

3.4.100

FCA PRA

G

The application of ■ BIPRU 3.4.96 R and ■ BIPRU 3.4.99 R may be illustrated on the basis of a £110,000 loan on a property valued at £100,000, where £80,000 of the loan is secured and £30,000 of the exposure is unsecured and provisions of £20,000 are taken:

- (1) Option 1 (application of ■ BIPRU 3.4.96 R):
  - (a) provision of £20,000 taken on £80,000 secured *exposure*;
  - (b) provision exceeds 20%, so the *firm* should *risk weight* the remaining £60,000 secured *exposure* at 50%;
  - (c) the *risk weight* to be applied to the unsecured *exposure* of £30,000 is 150%;
  - (d) the average *risk weight* to be assigned to the net *exposure* of £90,000 is 83%.
- (2) Option 2 (application of ■ BIPRU 3.4.99 R):
  - (a) provision of £20,000 taken on £30,000 unsecured *exposure*;
  - (b) provision exceeds 20%, so the *firm* should *risk weight* the remaining £10,000 unsecured *exposure* at 100%;
  - (c) the *risk weight* to be applied to the secured *exposure* of £80,000 is 100%;
  - (d) the average *risk weight* to be assigned to the net *exposure* of £90,000 is 100%.

3.4.101

FCA PRA

R

**Exposures indicated in ■ BIPRU 3.4.89 R to ■ BIPRU 3.4.94 R (Exposures secured by mortgages on commercial real estate) must be assigned a *risk weight* of 100% if they are past due for more than 90 days.**

[Note: BCD Annex VI Part 1 point 65]

3.4.102

FCA PRA

R

Non past due items to be assigned a 150% *risk weight* under ■ BIPRU 3.4 and for which value adjustments have been established may be assigned a *risk weight* of:

- (1) 100% if value adjustments are no less than 20% of the *exposure* value gross of value adjustments; and
- (2) 50%, if value adjustments are no less than 50% of the *exposure* value gross of value adjustments.

[Note: BCD Annex VI Part 1 point 67]

#### Items belonging to regulatory high-risk categories

3.4.103

FCA PRA

R

■ BIPRU 3.4.104 R sets out the treatment to be accorded to items belonging to regulatory high-risk categories.

3.4.104

FCA PRA

R

*Exposures* listed in ■ BIPRU 3 Annex 3 R must be assigned a *risk weight* of 150%.

[Note: BCD Annex VI Part 1 point 66]

3.4.105

FCA PRA

G

For the purposes of point 66 of Part 1 of Annex VI of the *Banking Consolidation Directive*, the *exposures* listed in ■ BIPRU 3 Annex 3 R are in the view of the *appropriate regulator* associated with particularly high risk.

#### Exposures in the form of covered bonds

3.4.106

FCA PRA

R

■ BIPRU 3.4.107 R to ■ BIPRU 3.4.110 R set out the treatment to be accorded to *exposures* in the form of *covered bonds*.

3.4.107

FCA PRA

R

- (1) *Covered bonds* means covered bonds as defined in paragraph (1) of the definition in the *glossary* (Definition based on Article 22(4) of the *UCITS Directive*) and collateralised by any of the following eligible assets:
  - (a) *exposures* to or guaranteed by central governments, *central bank*, *public sector entities*, regional governments and local authorities in the *EEA*;
  - (b) (i) *exposures* to or guaranteed by non-*EEA* central governments, non-*EEA* *central banks*, *multilateral development banks*, *international organisations* that qualify for the *credit quality step 1*;
  - (ii) *exposures* to or guaranteed by non-*EEA* *public sector entities*, non-*EEA* regional governments and non-*EEA* local authorities that are *risk weighted* as *exposures* to *institutions* or central governments and *central banks* according to ■ BIPRU 3.4.23 R, ■ BIPRU 3.4.24 R, ■ BIPRU 3.4.10 R or ■ BIPRU 3.4.16 G to ■ BIPRU 3.4.17 R

- respectively and that qualify for the *credit quality step 1*; and
- (iii) *exposures* in the sense of this point (b) that qualify as a minimum for the *credit quality step 2*, provided that they do not exceed 20% of the nominal amount of outstanding *covered bonds* of issuing *institutions*;
- (c) *exposures* to *institutions* that qualify for the *credit quality step 1* but so that:
- (i) the total exposure of this kind must not exceed 15% of the nominal amount of the outstanding *covered bonds* of the issuing *credit institution*;
  - (ii) *exposures* caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by real estate to the holders of *covered bonds* must not be comprised by the 15% limit; and
  - (iii) *exposures* to *institutions* in the *EEA* with a maturity not exceeding 100 days are not comprised by the step 1 requirement but those *institutions* must as a minimum qualify for *credit quality step 2*;
- (d) loans secured:
- (i) by residential real estate or shares in Finnish residential housing companies as referred to in ■ BIPRU 3.4.57 R up to the lesser of the principal amount of the liens that are combined with any prior liens and 80% of the value of the pledged properties; or
  - (ii) by senior units issued by French Fonds Communs de Créances or by equivalent *securitisation* entities governed by the laws of an *EEA State securitising* residential real estate *exposures* provided that the special public supervision to protect bond holders as provided for in Article 52(4) of Directive 2009/65/EC of the European Parliament and of the Council ensures that the assets underlying such units must, at any time while they are included in the cover pool, be at least 90% composed of residential mortgages that are combined with any prior liens up to the lesser of the principal amounts due under the units, the principal amounts of the liens, and 80% of the value of the pledged properties, that the units qualify for *credit quality step 1* and that such units do not exceed 10% of the nominal amount of the outstanding issue; or

- (e) (i) loans secured by commercial real estate or shares in Finnish housing companies as referred to in ■ BIPRU 3.4.57 R up to the lesser of the principal amount of the liens that are combined with any prior liens and 60% of the value of the pledged properties; or
  - (ii) loans secured by senior units issued by French Fonds Communs de Créances or by equivalent *securitisation* entities governed by the laws of an *EEA State securitising* commercial real estate *exposures* provided that the special public supervision to protect bond holders as provided for in Article 52(4) of Directive 2009/65/EC of the European Parliament and of the Council ensures that the assets underlying such units must, at any time while they are included in the cover pool, be at least 90% composed of commercial mortgages that are combined with any prior liens up to the lesser of the principal amounts due under the units, the principal amounts of the liens, and 60% of the value of the pledged properties, that the units qualify for *credit quality step 1* and that such units do not exceed 10% of the nominal amount of the outstanding issue; or
  - (iii) a *firm* may recognise loans secured by commercial real estate as eligible where the loan to value ratio of 60% is exceeded up to a maximum level of 70% if the value of the total assets pledged as collateral for the *covered bonds* exceed the nominal amount outstanding on the *covered bond* by at least 10%, and the bondholders' claim meets the legal certainty requirements set out in ■ BIPRU 3 and ■ BIPRU 5; the bondholders' claim must take priority over all other claims on the collateral; or
  - (f) loans secured by ships where only liens that are combined with any prior liens within 60% of the value of the pledged ship.
- (2) For the purposes of ■ BIPRU 3.4.107 R (1)(d)(ii) and ■ BIPRU 3.4.107 R (1)(e)(ii) *exposures* caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged properties of the senior units or debt *securities* must not be comprised in calculating the 90% limit.
  - (3) For the purposes of ■ BIPRU 3.4.107 R to ■ BIPRU 3.4.110 R "collateralised" includes situations where the assets described in subpoints (1)(a) to (1)(f) are exclusively dedicated in law to the protection of the bond-holders against losses.
  - (4) [deleted]

(4A) Until 31 December 2013, the 10% limit for senior units issued by French Fonds Communs de Créances or by equivalent *securitisation* entities as specified in (1)(d)(ii) and (1)(e)(ii) does not apply, provided that:

- (a) the *securitised* residential or commercial real estate *exposures* were originated by a member of the same consolidated group of which the *issuer* of the *covered bonds* is also a member or by an entity affiliated to the same central body to which the *issuer* of the *covered bonds* is also affiliated (that common group membership or affiliation to be determined at the time the senior units are made collateral for *covered bonds*); and
- (b) a member of the same consolidated group of which the *issuer* of the *covered bonds* is also a member or an entity affiliated to the same central body to which the *issuer* of the *covered bonds* is also affiliated retains the whole first loss tranche supporting those senior units.

(5) Until 31 December 2010 the figure of 60% in (1)(f) can be replaced with a figure of 70%.

[Note: BCD Annex VI Part 1 point 68]

3.4.108

FCA PRA

R

A *firm* must for real estate collateralising *covered bonds* meet the minimum requirements set out in ■ BIPRU 3.4.64 R to ■ BIPRU 3.4.73 R and the valuation rules set out in ■ BIPRU 3.4.77 R to ■ BIPRU 3.4.80 R.

[Note: BCD Annex VI Part 1 point 69]

3.4.109

FCA PRA

R

Notwithstanding ■ BIPRU 3.4.107 R to ■ BIPRU 3.4.108 R, *covered bonds* meeting the definition of Article 22(4) of the *UCITS Directive* and issued before 31 December 2007 are also eligible for the preferential treatment until their maturity.

[Note: BCD Annex VI Part 1 point 70]

3.4.110

FCA PRA

R

*Covered bonds* must be assigned a *risk weight* on the basis of the *risk weight* assigned to senior unsecured *exposures* to the *credit institution* which issues them. The following correspondence between *risk weights* applies:

- (1) if the *exposures* to the *institution* are assigned a *risk weight* of 20%, the *covered bond* must be assigned a *risk weight* of 10%;
- (2) if the *exposures* to the *institution* are assigned a *risk weight* of 50%, the *covered bond* must be assigned a *risk weight* of 20%;

- (3) if the *exposures* to the *institution* are assigned a *risk weight* of 100%, the *covered bond* must be assigned a *risk weight* of 50%; and
- (4) if the *exposures* to the *institution* are assigned a *risk weight* of 150%, the *covered bond* must be assigned a *risk weight* of 100%.

[Note: BCD Annex VI Part 1 point 71]

**Items representing securitisation positions**

3.4.111  
FCA PRA

**R** *Risk weighted exposure* amounts for *securitisation* positions must be determined in accordance with ■ BIPRU 9.

[Note: BCD Annex VI Part 1 point 72]

**Exposures to institutions and corporates with a short-term credit assessment**

3.4.112  
FCA PRA

**R** *Exposures to institutions* where ■ BIPRU 3.4.34 R to ■ BIPRU 3.4.39 R apply, and *exposures to corporates* for which a short-term credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* according to the table in ■ BIPRU 3.4.113 R in accordance with the mapping by the *appropriate regulator* in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of *eligible ECAs* to six steps in a *credit quality assessment scale*.

[Note: BCD Annex VI Part 1 point 73]

**Table: Exposures to institutions where BIPRU 3.4.34 R to BIPRU 3.4.39 R apply, and exposures to corporates for which a short-term credit assessment by a nominated ECAI is available**

3.4.113  
FCA PRA

**R** This table belongs to ■ BIPRU 3.4.112 R.

<i>Credit quality</i>	1	2	3	4	5	6
<i>step</i>						
<i>Risk weight</i>	20%	50%	100%	150%	150%	150%

**Exposures in the form of collective investment undertakings (CIUs)**

3.4.114  
FCA PRA

**R** ■ BIPRU 3.4.115 R to ■ BIPRU 3.4.125 R set out the treatment to be accorded to *exposures* in the form of *CIUs*.

3.4.115  
FCA PRA

**R** Without prejudice to ■ BIPRU 3.4.116 R to ■ BIPRU 3.4.125 R, *exposures* in *CIUs* must be assigned a *risk weight* of 100%.

[Note: BCD Annex VI Part 1 point 74]

3.4.116  
FCA PRA

**R** *Exposures* in the form of *CIUs* for which a credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* according to the table in ■ BIPRU 3.4.117 R in accordance with the assignment by the *appropriate regulator* in accordance with the *Capital Requirements*

*Regulations 2006 of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale.*

[Note: BCD Annex VI Part 1 point 75]

3.4.117

FCA PRA

R

Table: Exposures in the form of CIUs for which a credit assessment by a nominated ECAI is available

This table belongs to ■ BIPRU 3.4.116 R.

Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	100%	100%	150%	150%

3.4.118

FCA PRA

R

Where a *firm* considers that a position in a *CIU* is associated with particularly high risks it must assign that position a *risk weight* of 150%.

[Note: BCD Annex VI Part 1 point 76]

3.4.119

FCA PRA

G

A *firm* should consider a *CIU* as being high risk where there is no external credit assessment from an *eligible ECAI* and where the *CIU* has specific features (such as high levels of leverage or lack of transparency) that prevent it from meeting the eligibility criteria laid out in ■ BIPRU 3.4.121 R.

3.4.120

FCA PRA

G

Other examples of high risk *CIUs* are: one in which a substantial element of the *CIU's* property is made up of items that would attract a *risk weight* of over 100%; or one whose mandate (as referred to in ■ BIPRU 3.4.124 R) would permit it to invest in a substantial amount of such items.

3.4.121

FCA PRA

R

Where ■ BIPRU 3.4.116 R does not apply, a *firm* may determine the *risk weight* for a *CIU* as set out in ■ BIPRU 3.4.123 R to ■ BIPRU 3.4.125 R, if the following eligibility criteria are met:

- (1) one of the following conditions is satisfied:
  - (a) the *CIU* is managed by a company which is subject to supervision in an *EEA State*; or
  - (b) the following conditions are satisfied:
    - (i) the *CIU* is managed by a company which is subject to supervision that is equivalent to that laid down in *EU* law; and
    - (ii) cooperation between *competent authorities* is sufficiently ensured; and
- (2) the *CIU's* prospectus or equivalent document includes:

- (a) the categories of assets in which the *CIU* is authorised to invest; and
  - (b) if investment limits apply, the relative limits and the methodologies to calculate them; and
- (3) the business of the *CIU* is reported on at least an annual basis to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period.

[Note: *BCD* Annex VI Part 1 point 77]

3.4.122

FCA PRA

R

If another *EEA competent authority* approves a third country *CIU* as eligible under a *CRD implementation measure* with respect to point 77(a) of Part 1 of Annex VI of the *Banking Consolidation Directive* then a *firm* may make use of this recognition.

[Note: *BCD* Annex VI Part 1 point 78]

3.4.123

FCA PRA

R

Where a *firm* is aware of the underlying *exposures* of a *CIU*, it may look through to those underlying *exposures* in order to calculate an average *risk weight* for the *CIU* in accordance with the *standardised approach*.

[Note: *BCD* Annex VI Part 1 point 79]

3.4.124

FCA PRA

R

Where a *firm* is not aware of the underlying *exposures* of a *CIU*, it may calculate an average *risk weight* for the *CIU* in accordance with the *standardised approach* subject to the following rules: it will be assumed that the *CIU* first invests, to the maximum extent allowed under its mandate, in the *standardised credit risk exposure classes* attracting the highest capital requirement, and then continues making investments in descending order until the maximum total investment limit is reached.

[Note: *BCD* Annex VI Part 1 point 80]

3.4.125

FCA PRA

R

A *firm* may rely on a third party to calculate and report, in accordance with the methods set out in ■ BIPRU 3.4.123 R to ■ BIPRU 3.4.124 R, a *risk weight* for the *CIU* provided that the correctness of the calculation and report is adequately ensured.

[Note: *BCD* Annex VI Part 1 point 81]

#### Other items

.....  
 ■ BIPRU 3.4.127 R to ■ BIPRU 3.4.133 R set out the treatment to be accorded to other items as referred to in ■ BIPRU 3.2.9 R (16).

3.4.126

FCA PRA

R

## Treatment

3.4.127

FCA PRA

R

Tangible assets within the meaning of Article 4(10) of the *Bank Accounts Directive* must be assigned a *risk weight* of 100%.

[Note: BCD Annex VI Part 1 point 82]

3.4.128

FCA PRA

R

Prepayments and accrued income for which a *firm* is unable to determine the counterparty in accordance with the *Bank Accounts Directive*, must be assigned a *risk weight* of 100%.

[Note: BCD Annex VI Part 1 point 83]

3.4.129

FCA PRA

R

Cash items in the process of collection must be assigned a 20% *risk weight*. Cash in hand and equivalent cash items must be assigned a 0% *risk weight*.

[Note: BCD Annex VI Part 1 point 84]

3.4.130

FCA PRA

R

Holdings of equity and other participations except where deducted from *capital resources* must be assigned a *risk weight* of at least 100%.

[Note: BCD Annex VI Part 1 point 86]

3.4.131

FCA PRA

R

Gold bullion held in own vaults or on an allocated basis to the extent backed by bullion liabilities must be assigned a 0% *risk weight*.

[Note: BCD Annex VI Part 1 point 87]

3.4.132

FCA PRA

R

In the case of asset sale and *repurchase agreements* and outright forward purchases, the *risk weight* must be that assigned to the assets in question and not to the counterparties to the transactions.

[Note: BCD Annex VI Part 1 point 88]

3.4.133

FCA PRA

R

Where a *firm* provides credit protection for a number of *exposures* under terms that the *n*th default among the *exposures* triggers payment and that this credit event terminates the contract, and where the product has an external credit assessment from an *eligible ECAI* the *risk weights* prescribed in ■ BIPRU 9 must be assigned. If the product is not rated by an *eligible ECAI*, the *risk weights* of the *exposures* included in the basket must be aggregated, excluding *n-1 exposures*, up to a maximum of 1250% and multiplied by the nominal amount of the protection provided by the credit derivative to obtain the *risk weighted* asset amount. The *n-1 exposures* to be excluded from the aggregation must be determined on the basis that they include those *exposures* each of which produces a lower *risk weighted exposure amount* than the *risk weighted exposure amount* of any of the *exposures* included in the aggregation.

[Note: BCD Annex VI Part 1 point 89]

3.4.134

R

FCA PRA

The *exposure* value for leases must be the discounted minimum lease payments. Minimum lease payments are the payments over the lease term that the lessee is or can be required to make and any bargain option (i.e. an option the exercise of which is reasonably certain). Any guaranteed residual value fulfilling the set of conditions in ■ BIPRU 5.7.1 R (Eligibility), regarding the eligibility of protection providers as well as the minimum requirements for recognising other types of guarantees provided in ■ BIPRU 5.7.6 R (Minimum requirements: General) to ■ BIPRU 5.7.12 R (Additional requirements for guarantees) must also be included in the minimum lease payments. These *exposures* must be assigned to the relevant *exposure* class in accordance with ■ BIPRU 3.2.9 R, ■ BIPRU 3.2.10 R, ■ BIPRU 3.2.11 R, ■ BIPRU 3.2.12 R, ■ BIPRU 3.2.13 R and ■ BIPRU 3.2.14 G. When the *exposure* is a residual value of leased properties, the *risk weighted exposure amounts* must be calculated as follows:

$$1/t * 100\% * \textit{exposure value};$$

where t is the greater of 1 and the nearest number of whole years of the lease term remaining.

[Note: BCD Annex VI Part 1, point 90]

## 3.5 Simplified method of calculating risk weights

### 3.5.1

FCA PRA

G

This section (■ BIPRU 3.5) sets out a simplified approach to calculating *risk weights*. This approach is only relevant to an *exposure* class for which *risk weights* are determined by the ratings of a *nominated ECAI* or an export credit agency. For other *exposure* classes a *firm* should use the normal approach under the *standardised approach*.

### 3.5.2

FCA PRA

G

The approach in this section is only likely to be relevant for a *limited licence firm* or a *limited activity firm* that has only incidental credit *exposures* and for whom it would be prohibitively costly to establish the systems needed to include the credit assessments of *ECAIs* and export credit agencies in its regulatory capital calculations. However the approach may be used by other *firms* if appropriate. A *firm* should notify the *appropriate regulator* if it adopts the approach in this section.

### 3.5.3

FCA PRA

G

Rather than *risk weighting exposures* individually, a *firm* eligible to apply the simplified approach should apply a single *risk weight* to all *exposures* in each *exposure* class. The simplified *risk weight* for *exposures* in a particular class will be the *risk weighting* for unrated entities for each *exposure* class in which the external credit assessments influence *risk weights*.

### 3.5.4

FCA PRA

G

The table in ■ BIPRU 3.5.5 G has a summary of the *risk weights* that a *firm* should use if it uses the simplified method of calculating *risk weights* referred to in ■ BIPRU 3.5.1 G.

### 3.5.5

FCA PRA

G

Table : Simplified method of calculating risk weights

This table belongs to ■ BIPRU 3.5.4 G.

Exposure class	Exposure sub-class	Risk weights	Comments
Central government	<i>Exposures to United Kingdom government or Bank of England in sterling</i>	0%	
	<i>Exposures to United Kingdom government or Bank of England in the currency of another EEA State</i>	0%	See Note 2.

Exposure class	Exposure sub-class	Risk weights	Comments
Regional/local governments	<i>Exposures to EEA State's central government or central bank in currency of that state</i>	0%	
	<i>Exposures to EEA State's central government or central bank in the currency of another EEA State</i>	0%	See Notes 2 and 3.
	<i>Exposures to central governments or central banks of certain countries outside the EEA in currency of that country</i>	See next column	The risk weight is whatever it is under local law. See BIPRU 3.4.6 R for precise details.
	<i>Exposures to European Central Bank</i>	0%	
	<i>Other exposures</i>	100%	
	<i>Exposures to the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly in sterling</i>	0%	
	<i>Exposures to the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly in the currency of another EEA State</i>	0%	See Note 2.
	<i>Exposures to EEA States' equivalent regional/local governments in currency of that state</i>	0%	See BIPRU 3.4.17 R for details of type of local/regional government covered.
	<i>Exposures to EEA States' equivalent regional/local governments in the currency of another EEA State</i>	0%	See BIPRU 3.4.17 R for details of type of local/regional government covered.
	<i>Exposures to local or regional governments of certain countries outside the EEA in currency of that country</i>	0%	See Notes 2 and 3. See BIPRU 3.4.19 R for details of type of local/regional government covered. See Note 1.

Exposure class	Exposure sub-class	Risk weights	Comments
PSE	<i>Exposures to United Kingdom or EEA States' local/regional government in currency of that state if the exposure has original effective maturity of 3 months or less</i>	20%	
	<i>Exposures to United Kingdom or EEA States' local/regional government in the currency of another EEA State if the exposure has original effective maturity of 3 months or less</i>	20%	See Note 2. See Note 3 for local/regional government of an EEA State other than the United Kingdom
	<i>Exposures to local or regional governments of countries outside the EEA in currency of that country if the exposure has original effective maturity of 3 months or less</i>	20%	See Note 1.
	<i>Other exposures</i>	100%	
	<i>Exposures to a PSE of the United Kingdom or of an EEA State if that PSE is guaranteed by its central government and if the exposure is in currency of that PSE's state.</i>	0%	BIPRU 3.4.24 R describes the United Kingdom PSEs covered and BIPRU 3.4.25 R describes the EEA PSEs covered.
	<i>Exposures to PSE of a country outside the EEA if that PSE is guaranteed by the country's central government and if the exposure is in currency of that country.</i>	0%	See BIPRU 3.4.26 R and Note 1.
	<i>Exposures to a PSE of the United Kingdom or of an EEA State in currency of that state if the exposure has original effective maturity of 3 months or less</i>	20%	

Exposure class	Exposure sub-class	Risk weights	Comments
	<i>Exposures to a PSE of the United Kingdom or of an EEA State in the currency of another EEA State if the exposure has original effective maturity of 3 months or less</i>	20%	See Notes 2 and 3.
	<i>Exposures to PSE of a country outside the EEA in currency of that country if the exposure has original effective maturity of 3 months or less</i>	20%	See Note 1.
	<i>Other exposures</i>	100%	
<i>Multilateral development banks</i>	<i>Exposures to multilateral development banks listed in paragraph (1) of the Glossary definition</i>	0%	Simplified approach does not apply. Normal rules apply.
	<i>Other exposures</i>	Various	Treated as an <i>institution</i>
<i>EU, the International Monetary Fund and the Bank for International Settlements</i>		0%	Simplified approach does not apply. Normal rules apply.
<i>Institutions</i>	<i>Exposures to United Kingdom institution in sterling with original effective maturity of three months or less</i>	20%	
	<i>Exposures to United Kingdom institution in the currency of another EEA State with original effective maturity of three months or less</i>	20%	See Note 2.
	<i>Exposures to institution whose head office is in another EEA State in the currency of that state with original effective maturity of three months or less</i>	20%	
	<i>Exposures to institution whose head office is in another EEA State in the currency of another EEA State with</i>	20%	See Notes 2 and 3.

Exposure class	Exposure sub-class	Risk weights	Comments
	original effective maturity of three months or less		
	<i>Exposures to institution with a head office in a country outside the EEA in the currency of that country with original effective maturity of three months or less</i>	20%	See Note 1.
	<i>Exposures to United Kingdom institution in sterling with original effective maturity of over three months</i>	50%	
	<i>Exposures to United Kingdom institution in the currency of another EEA State with original effective maturity of over three months</i>	50%	See Note 2.
	<i>Exposures to an EEA institution with a head office in another EEA State in the currency of that state with original effective maturity of over three months</i>	50%	
	<i>Exposures to an EEA institution with a head office in another EEA State in the currency of another EEA State with original effective maturity of over three months</i>	50%	See Notes 2 and 3.
	<i>Exposures to institution with a head office in a country outside the EEA in the currency of that country with original effective maturity of over three months</i>	50%	See Note 1.
	Other exposures	100%	
Corporates		100%	

Exposure class	Exposure sub-class	Risk weights	Comments
<i>Retail exposures</i>		75%	Simplified approach does not apply. Normal rules apply.
Mortgages on residential or commercial property		Various	Simplified approach does not apply. Normal rules apply.
Past due items		Various	Simplified approach does not apply. Normal rules apply.
High risk items		150%	Simplified approach does not apply. Normal rules apply.
<i>Covered bonds</i>		Various	<i>Risk weights</i> are based on the <i>risk weight</i> of issuer as described in BIPRU 3.4.110 R. The <i>risk weight</i> of the issuer for this purpose should be calculated under the simplified approach.
<i>Securitisation exposures</i>		Generally 1250%. May look through to underlying exposures if BIPRU 9 allows.	Use the BIPRU 9 rules for unrated exposures under the standardised approach
Short term exposures with rating			See BIPRU 3.4.112 R. Not applicable as uses ECAI ratings.
CIUs	May look through to underlying under BIPRU 3.4.123 R	Various	Simplified approach does not apply. Normal rules apply. May use simplified approach to underlying if simplified approach applies to underlying.
	May use average risk weight under BIPRU 3.4.124 R	Various	Simplified approach does not apply. Normal rules apply. May use simplified approach to underlyings if simplified approach applies to underlying.
	High risk under BIPRU 3.4.118 R	150%	Simplified approach does not apply. Normal rules apply.
	Others	100%	
Other items under BIPRU 3.2.9 R (16)		Various	Simplified approach does not apply. Normal rules apply.

Exposure class	Exposure sub-class	Risk weights	Comments
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Note 1: The *risk weight* should not be lower than the *risk weight* that applies for national currency *exposures* of the central government of the third country in question under BIPRU 3.5. That means that this *risk weight* only applies if the third country is one of those to which BIPRU 3.4.6 R (Preferential *risk weight* for *exposures* of the central government of countries outside the *EEA* that apply equivalent prudential standards) applies.

Note 2: This is a transitional measure. It lasts until 31 December 2012.

Note 3: The *risk weight* should not be lower than the *risk weight* that applies for *exposures* of the central government of the *EEA State* in question in the currency of another *EEA State* under BIPRU 3.5.

## 3.5.6

FCA PRA

G

If an *exposure* is guaranteed and if under ■ BIPRU 5 the *firm* may treat the *exposure* as being to the guarantor, the simplified approach may be used for the guarantor. The key provisions are ■ BIPRU 5.7.23 R to ■ BIPRU 5.7.25 R.

## 3.5.7

FCA PRA

G

If an *exposure* is collateralised and if under ■ BIPRU 5 the *firm* may recognise the collateral, the simplified approach may be used to determine the *risk weight* to be applied to the collateralised *exposure*. The key provisions are ■ BIPRU 5.4.18 R to ■ BIPRU 5.4.21 R.

## 3.5.8

FCA PRA

R

If a *firm* does not nominate one or more *eligible ECAIs* as referred to in ■ BIPRU 3.6.4 R the *firm* must not use the *financial collateral comprehensive method*.



## 3.6

## Use of rating agencies' credit assessments for the determination of risk weights under the standardised approach to credit risk

## 3.6.1

FCA PRA

R

The use of *ECAI* credit assessments for the calculation of a *firm's risk weighted exposure amounts* must be consistent and in accordance with ■ BIPRU 3.6. Credit assessments must not be used selectively.

[Note: BCD Article 83(1)]

## 3.6.2

FCA PRA

R

Where the *appropriate regulator's* recognition of an *ECAI* is not limited to its solicited credit assessments, a *firm* may use an unsolicited credit assessment of an *eligible ECAI* for the calculation of a *firm's risk weighted exposure amounts*.

[Note: BCD Article 83(2)]

## 3.6.3

FCA PRA

G

The *appropriate regulator's* recognition of an *ECAI* may be limited to its solicited credit assessments. Where this is the case a *firm* should not use unsolicited assessments. The *appropriate regulator* may indicate that the unsolicited ratings of an *eligible ECAI* are not to be used for the purposes of ■ BIPRU 3 if those assessments are considered to be inferior in quality to the general quality of solicited assessments or if it considers that the *ECAI's* strategy in relation to the issuing of unsolicited assessments is founded in the placing of undue pressure on the rated entity to pay for a rating.

### Treatment

## 3.6.4

FCA PRA

R

A *firm* may nominate one or more *eligible ECAIs* to be used for the determination of *risk weights* to be assigned to asset and off-balance sheet items.

[Note: BCD Annex VI Part 3 point 1]

## 3.6.5

FCA PRA

R

A *firm* which decides to use the credit assessments produced by an *eligible ECAI* for a certain class of items must use those credit assessments consistently for all *exposures* belonging to that class.

[Note: BCD Annex VI Part 3 point 2]

3.6.6

FCA PRA

R

A *firm* which decides to use the credit assessments produced by an *eligible ECAI* must use them in a continuous and consistent way over time.

[Note: BCD Annex VI Part 3 point 3]

3.6.7

FCA PRA

R

A *firm* can only use *ECAIs'* credit assessments that take into account all amounts both in principal and in interest owed to it.

[Note: BCD Annex VI Part 3 point 4]

3.6.8

FCA PRA

R

If only one credit assessment is available from a *nominated ECAI* for a rated item, that credit assessment must be used to determine the *risk weight* for that item.

[Note: BCD Annex VI Part 3 point 5]

3.6.9

FCA PRA

R

If two credit assessments are available from *nominated ECAIs* and the two correspond to different *risk weights* for a rated item, the higher *risk weight* must be applied.

[Note: BCD Annex VI Part 3 point 6]

3.6.10

FCA PRA

R

If more than two credit assessments are available from *nominated ECAIs* for a rated item, the two assessments generating the two lowest *risk weights* must be referred to. If the two lowest *risk weights* are different, the higher *risk weight* must be assigned. If the two lowest *risk weights* are the same, that *risk weight* must be assigned.

[Note: BCD Annex VI Part 3 point 7]

3.6.11

FCA PRA

R

- (1) If a *firm* has decided to make use of the credit assessments of export credit agencies, when *risk weighting exposures* to central governments or *central banks*, if two or more credit assessments are available to a *firm* from export credit agencies or if credit assessments are available to a *firm* from both *nominated ECAIs* and export credit agencies, the *firm* must adopt the approach in this *rule*.
- (2) If two credit assessments are available and correspond to different *risk weights* for a rated item, the higher *risk weight* must be applied.
- (3) If more than two credit assessments are available for a rated item, the assessments generating the two lowest *risk weights* must be referred to:
  - (a) if the two lowest *risk weights* are the same, that *risk weight* must be applied; or

(b) if the two lowest *risk weights* are different, the higher of the two must be applied.

(4) If a *firm* does not for the purposes of ■ BIPRU 3 make any use of the consensus risk scores referred to in ■ BIPRU 3.4.7 R (1) it may treat those scores as not being available to it for the purpose of this *rule*. Likewise, if a *firm* does not for the purposes of ■ BIPRU 3 make any use of the credit assessments of a particular export credit agency as referred to in ■ BIPRU 3.4.7 R (2) it may treat those assessments as not being available to it for the purpose of this *rule*.

#### Issuer and issue credit assessment

3.6.12

FCA PRA

R

Where a credit assessment exists for a specific issuing program or facility to which the item constituting the *exposure* belongs, this credit assessment must be used to determine the *risk weight* to be assigned to that item.

[Note: BCD Annex VI Part 3 point 8]

3.6.13

FCA PRA

R

Where no directly applicable credit assessment exists for a certain item, but a credit assessment exists for a specific issuing program or facility to which the item constituting the *exposure* does not belong or a general credit assessment exists for the issuer, then that credit assessment must be used if it produces a higher *risk weight* than would otherwise be the case or if it produces a lower *risk weight* and the *exposure* in question ranks *pari passu* or senior in all respects to the specific issuing program or facility or to senior unsecured *exposures* of that issuer as relevant.

[Note: BCD Annex VI Part 3 point 9]

3.6.14

FCA PRA

R

■ BIPRU 3.6.12 R and ■ BIPRU 3.6.13 R are not to prevent the application of ■ BIPRU 3.4.107 R to ■ BIPRU 3.4.110 R (Exposures in the form of covered bonds).

[Note: BCD Annex VI Part 3 point 10]

3.6.15

FCA PRA

R

Credit assessments for issuers within a corporate group cannot be used as credit assessment of another issuer within the same corporate group.

[Note: BCD Annex VI Part 3 point 11]

#### Long-term and short-term credit assessments

3.6.16

FCA PRA

R

Short-term credit assessments may only be used for short-term asset and off-balance sheet items constituting *exposures to institutions and corporates*.

[Note: BCD Annex VI Part 3 point 12]

3.6.17

FCA PRA

R

Any short-term credit assessment may only apply to the item the short-term credit assessment refers to, and it must not be used to derive *risk weights* for any other item.

[Note: BCD Annex VI Part 3 point 13]

3.6.18

FCA PRA

R

Notwithstanding ■ BIPRU 3.6.17 R, if a short-term rated facility is assigned a 150% *risk weight*, then all unrated unsecured *exposures* on that obligor whether short-term or long-term must also be assigned a 150% *risk weight*.

[Note: BCD Annex VI Part 3 point 14]

3.6.19

FCA PRA

R

Notwithstanding ■ BIPRU 3.6.17 R, if a short-term rated facility is assigned a 50% *risk weight*, no unrated short-term *exposure* may be assigned a *risk weight* lower than 100%.

[Note: BCD Annex VI Part 3 point 15]

#### Domestic and foreign currency items

3.6.20

FCA PRA

R

A credit assessment that refers to an item denominated in the obligor's domestic currency cannot be used to derive a *risk weight* for another *exposure* on that same obligor that is denominated in a foreign currency.

[Note: BCD Annex VI Part 3 point 16]

3.6.21

FCA PRA

R

Notwithstanding ■ BIPRU 3.6.20 R, when an *exposure* arises through a *firm's* participation in a loan that has been extended by a *multilateral development bank* whose preferred creditor status is recognised in the market, the credit assessment on the obligors' domestic currency item may be used for *risk weighting* purposes.

[Note: BCD Annex VI Part 3 point 17]



## 3.7 Classification of off-balance-sheet items

### 3.7.1

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In accordance with ■ BIPRU 3.2.1 R (2) and ■ BIPRU 3.2.2 R, a *firm* must:

- (1) assign an off-balance sheet item listed in the table in ■ BIPRU 3.7.2 R to the risk category indicated in column 1 of that table; and
- (2) determine the *exposure* value of that item as the percentage of its value for the appropriate risk category as set out in column 3 of the table in ■ BIPRU 3.7.2 R.

3.7.2

FCA PRA

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**Table: Classification of off-balance-sheet items**

This table belongs to ■ BIPRU 3.7.1 R

[Note: *BCD Annex II*]

Category	Item	Percentage
<b>Full risk</b>	<b>Guarantees having the character of credit substitutes</b>	<b>100%</b>
	<b>Credit derivatives</b>	
	<b>Acceptances</b>	
	<b>Endorsements on bills not bearing the name of another <i>credit institution</i></b>	
	<b>Transactions with recourse</b>	
	<b>Irrevocable standby letters of credit having the character of credit substitutes</b>	
	<b>Assets purchased under outright forward purchase agreements</b>	
	<b>Forward deposits</b>	
	<b>The unpaid portion of partly-paid <i>shares and securities</i></b>	
	<b>Asset sale and repurchase agreements as defined in Article 12(3) and (5) of the <i>Bank Accounts Directive</i></b>	
	<b>Other items also carrying full risk</b>	
<b>Medium risk</b>	<b>Documentary credits issued and confirmed (see also medium/low risk).</b>	<b>50%</b>
	<b>Warranties and indemnities (including tender, performance, customs and tax bonds) and guarantees not having the character of credit substitutes.</b>	
	<b>Irrevocable standby letters of credit not having the character of credit substitutes.</b>	

Category	Item	Percentage
Medium/low risk	Undrawn credit facilities (agreements to lend, purchase <i>securities</i> , provide guarantees or acceptance facilities) with an original maturity of more than one year.	20%
	Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs). Documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions.	
Low risk	Undrawn credit facilities (agreements to lend, purchase <i>securities</i> , provide guarantees or acceptance facilities) with an original maturity of up to and including one year which may not be cancelled unconditionally at any time without notice or that do not effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness.	0%
	Undrawn credit facilities (agreements to lend, purchase <i>securities</i> , provide guarantees or acceptance facilities) which may be cancelled unconditionally at any time without notice, or that do effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness. Retail credit lines may be considered as unconditionally cancellable if the terms permit the <i>firm</i> to cancel them to the full extent allowable under consumer protection and related legislation.	

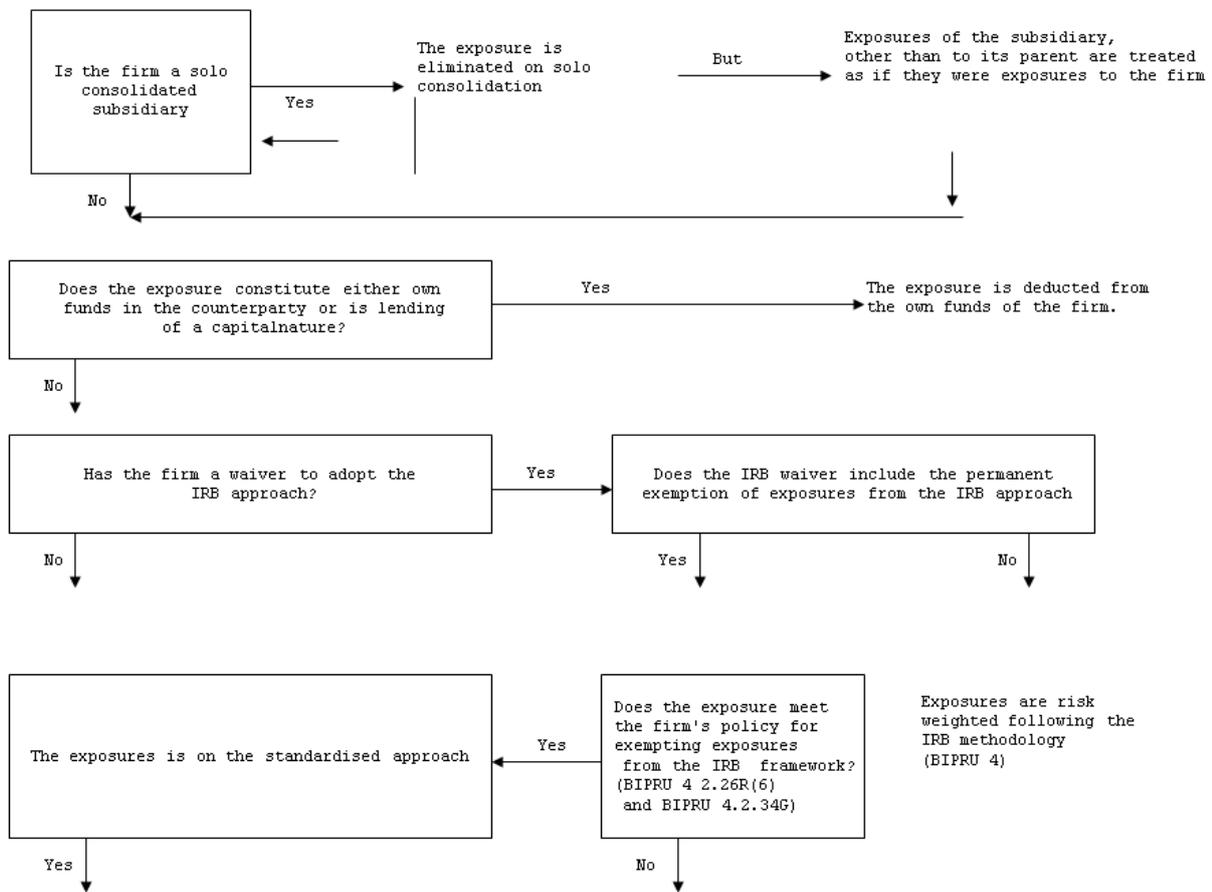


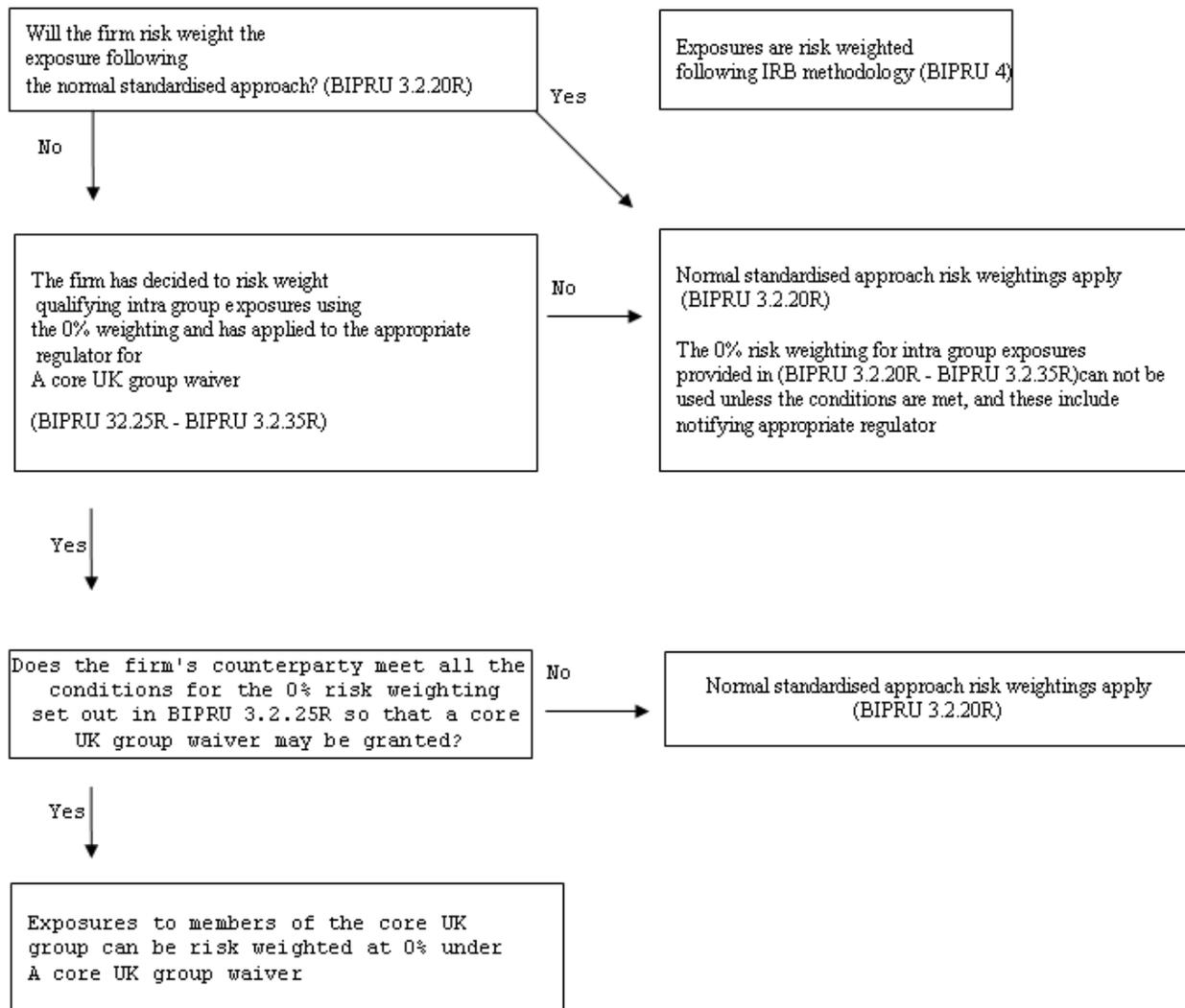
Guidance on the standardised approach zero risk weighting for intra-group exposures

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This flow chart belongs to ■ BIPRU 3.2.25 R - ■ BIPRU 3.2.35 R.

Flowchart - zero risk weighting for intra-group exposures





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## Regional governments and local authorities eligible for the treatment in BIPRU 3.4.15R

**FCA** **PRA**

- (1) The Scottish Parliament**
- (2) National Assembly for Wales**
- (3) Northern Ireland Assembly**



## High risk exposures

**FCA** **PRA**

- (1) *Exposures arising out of venture capital business (whether or not the firm itself carries on the venture capital business).*
- (2) **Any exposure of the type referred to in BIPRU 3.4.118 R (High risk position in a CIU) that is illiquid and held with a view to long-term sale or realisation.**

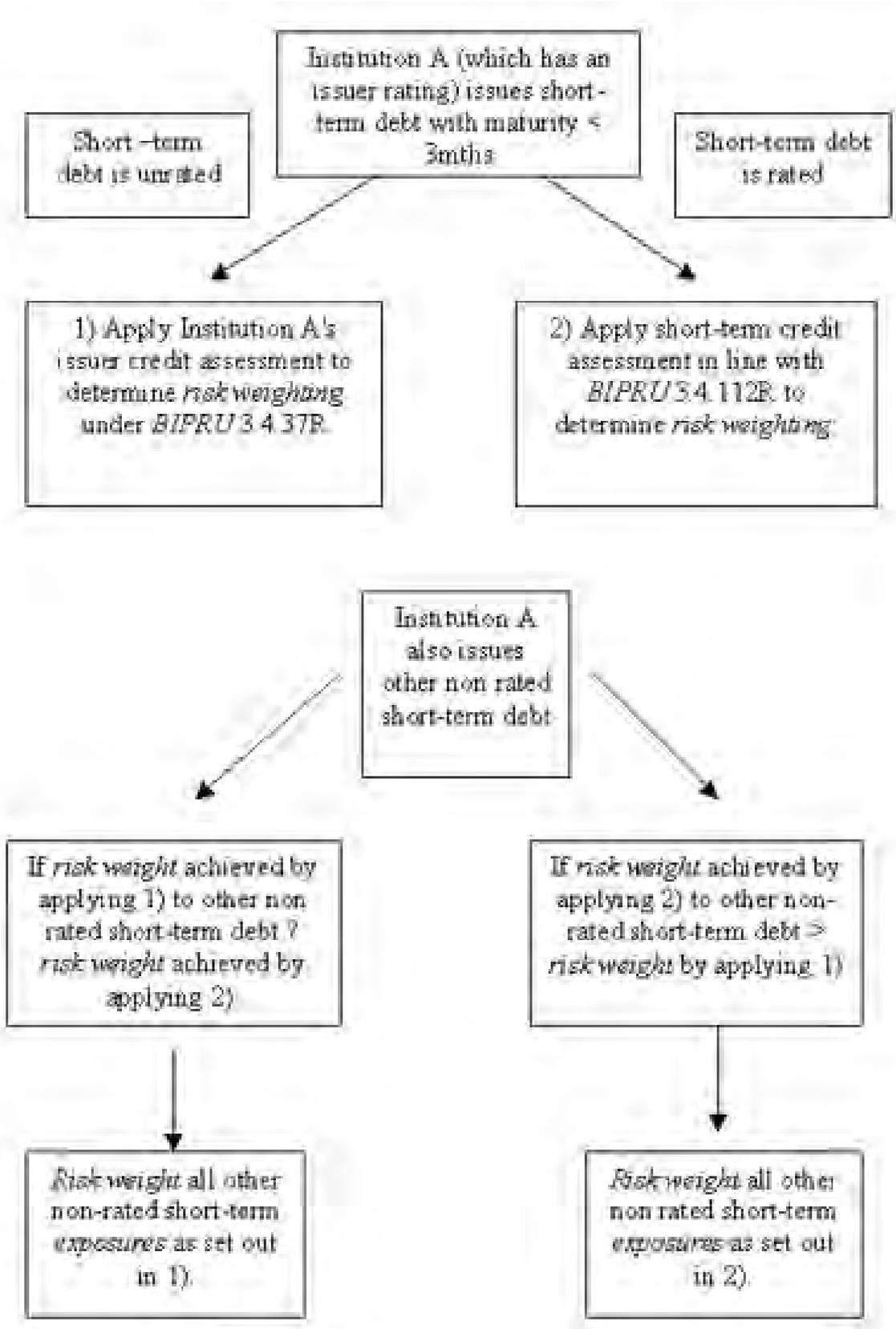


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**Exposures to institutions: Interaction with short-term credit assessments in BIPRU  
3.4.40R**

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3



## Chapter 4

# The IRB approach

## 4.1 The IRB approach: Application, purpose and overview

### Application

**4.1.1** **R** ■ BIPRU 4 applies to a *firm* with an *IRB permission*.

**FCA** **PRA**

### Purpose

**4.1.2** **G** ■ BIPRU 4 implements the following provisions of the *Banking Consolidation Directive*:

**FCA** **PRA**

- (1) Articles 84 - 89; and
- (2) Annex VII.

**4.1.3** **G** ■ 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):

**FCA** **PRA**

- (1) from Part 1 of that Annex, points 12-16, 19-22, 26(g)(ii) and 27;
- (2) from Part 2 of that Annex, points 8-11; and
- (3) from Part 3 of that Annex, points 1, 11, 20, 23-24, 58(h), 61, 64-79 and 90-93.

**4.1.4** **G** ■ BIPRU 4 also implements article 40 of the *Capital Adequacy Directive* as it applies to the *IRB approach*.

**FCA** **PRA**

**4.1.5** **G** Other material on the *IRB approach* can be found in ■ BIPRU 8 (Group risk), ■ BIPRU 9 (Securitisation), ■ BIPRU 13 (The calculation of exposure values for financial derivatives, securities financing transactions and long settlement transactions) and ■ BIPRU 14 (Capital requirements for settlement and counterparty risk). ■ BIPRU 5 (Credit risk mitigation) also contains material applicable to the *IRB approach*.

**FCA** **PRA**

### Overview

**4.1.6** **G** The *IRB approach* is an alternative to the *standardised approach* for calculating a *firm's* credit risk capital requirements. It may be applied to all a *firm's exposures* or to some of them, subject to various limitations on partial use as set out in ■ BIPRU 4.2. Under the *IRB approach* capital requirements are based on a *firm's* own estimates of certain parameters together with other parameters set out in the *Banking Consolidation Directive*.

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- 4.1.7** FCA PRA G *Exposures* are divided into a number of distinct *exposure* classes. These are listed in ■ BIPRU 4.3.2 R. There is a special treatment for purchased receivables, although they do not form an *exposure* class on their own.
- 4.1.8** FCA PRA G For *exposures* in the *sovereign, institution and corporate IRB exposure class*, there is a *foundation IRB approach* under which a *firm* provides its own estimates of *PD* and an *advanced IRB approach* under which a *firm* additionally provides its own estimates of *LGD* and *conversion factors*. The distinction between the *foundation IRB approach* and the *advanced IRB approach* only applies to this *IRB exposure class*.
- 4.1.9** FCA PRA G For *retail exposures*, a *firm* provides its own estimates of *PD*, *LGD* and *conversion factors*.
- 4.1.10** FCA PRA G For the *corporate exposure* class there is a separate sub-class of *specialised lending exposure*. A *firm* may calculate *risk weights* for these *exposures*, where it is able to do so, in the same way as it does for the rest of its *corporate exposure* class, i.e. using the *foundation IRB approach* or the *advanced IRB approach*. Where a *firm* is not able to use this approach it may calculate *risk weights* for *specialised lending exposures* by slotting them into predetermined *risk weights*.
- 4.1.11** FCA PRA G For *equity exposures* there are two approaches based on market based measures and a third under which a *firm* uses its own estimates of *PD* only.
- IRB permissions: general**
- 4.1.12** FCA PRA G The *rules* in *GENPRU* and *BIPRU* do not allow a *firm* to use the *IRB approach*. A *firm* that wishes to use the *IRB approach* should therefore apply for permission to use the *IRB approach* using the application procedure explained in ■ BIPRU 1.3. If a *firm's* application is granted, its terms will be set out in an *IRB permission*.
- 4.1.13** FCA PRA G The *appropriate regulator* recognises that the nature of *IRB approaches* will vary between *firms*. The scope of and the requirements and conditions set out in an *IRB permission* may therefore differ in substance or detail from ■ BIPRU 4 in order to address individual circumstances adequately. However any differences will only be allowed if they are compliant with the *Banking Consolidation Directive*. An *IRB permission* will implement any such variation by modifying the relevant provisions of *GENPRU* and *BIPRU*. An *IRB permission* may also include additional conditions to meet the particular circumstances of the *firm*.
- 4.1.14** FCA PRA G
- (1) The *appropriate regulator* will only grant an *IRB permission* if it is satisfied that the *firm's* systems for the management and rating of credit risk *exposures* are sound and implemented with integrity and, in particular, that they meet the standards in ■ BIPRU 4.2.2 R in accordance with the *minimum IRB standards*.
  - (2) Under ■ BIPRU 4.2.11 R, a *firm* applying for an *IRB permission* is required to demonstrate that it has been using for the *IRB exposure classes* in question *rating systems* that were broadly in line with the *minimum IRB standards* for internal risk measurement and management purposes for at least three years prior to the date of its *IRB permission*.

- (3) Under ■ BIPRU 4.2.13 R, a *firm* applying for the use of own estimates of *LGDs* and/or *conversion factors* should demonstrate that it has been estimating and employing own estimates of *LGDs* and/or *conversion factors* in a manner that was broadly consistent with the *minimum IRB standards* for use of own estimates for at least three years prior to the date of its *IRB permission* or of a variation of its *IRB permission* that, in either case, entitles the *firm* to use own estimates of *LGDs* and/or *conversion factors*.

### Link to standard rules: Incorporation of the IRB output into the capital calculation

4.1.15

FCA PRA

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An *IRB permission* will modify ■ GENPRU 2.1.51 R (Calculation of the credit risk capital requirement) by amending, to the extent set out in the *IRB permission*, the calculation of the *credit risk capital requirement* in accordance with ■ BIPRU 4 and the other provisions of the *Handbook* relating to the *IRB approach*.

4.1.16

FCA PRA

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A *firm* must calculate its *credit risk capital component* as the sum of:

- (1) (for *exposures* to which the *standardised approach* is applied) the *credit risk capital component* as calculated under ■ BIPRU 3.1.5 R; and
- (2) (for *exposures* to which the *IRB approach* is applied to which the *standardised approach* would otherwise apply in accordance with ■ BIPRU 3.1.5 R (Credit risk capital component)), 8% of the total of the *firm's risk weighted exposure amounts* calculated in accordance with the *IRB approach*.

4.1.17

FCA PRA

G

For *exposures* covered by an *IRB permission*, ■ BIPRU 5 (Credit risk mitigation) is modified by ■ BIPRU 4.10.

4.1.18

FCA PRA

G

Under ■ BIPRU 4.9, a *firm* is required to deal with *securitisation positions* under those provisions of ■ BIPRU 9 applicable to a *firm* using the *IRB approach*.

4.1.19

FCA PRA

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*Exposures* treated under ■ BIPRU 13 are required to be dealt with in accordance with the *IRB approach* to the extent set out in ■ BIPRU 13.

4.1.20

FCA PRA

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By modifying ■ GENPRU 2.1.51 R to allow the *firm* to use the *IRB approach* to calculate all or part of its *risk weighted exposure amounts*, the *appropriate regulator* is treating it like an *application rule*. The modification means that the provisions of BIPRU relating to the *IRB approach* supersede the *rules* relating to the *standardised approach* for *exposures* coming within the scope of the *IRB permission*.

4.1.21

FCA PRA

R

A reference in the *Handbook* to a provision of the *IRB approach*, in the case of a *firm*:

- (1) excludes any provision of the *IRB approach* set out in the *Handbook* that is not applied to that *firm* by its *IRB permission*;

- (2) includes any additional provision contained in the *firm's IRB permission*; and
- (3) takes into account any other amendments made to the provisions in the *Handbook* relating to the *IRB approach* made by the *firm's IRB permission*.

4.1.22

FCA PRA

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To the extent that a *firm's IRB permission* does not allow it to use a particular approach in the *Handbook* relating to the *IRB approach* the *Handbook* provision in question does not apply to the *firm*.

4.1.23

FCA PRA

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If a provision of the *Handbook* relating to the *IRB approach* says that a *firm* may do something if its *IRB permission* allows it, a *firm* may do that thing unless its *IRB permission* expressly says that it may not do so except that:

- (1) ■ BIPRU 4.2.18 R - ■ BIPRU 4.2.19 R (Sequential implementation of IRB approach) and ■ BIPRU 4.2.26 R (1)-■ BIPRU 4.2.26R (5) (Combined use of standardised approach with IRB approach) only apply if expressly permitted by a *firm's IRB permission*;
- (2) a *firm* may not use the *advanced IRB approach* for the *sovereign, institution and corporate IRB exposure class* except to the extent expressly permitted by the *firm's IRB permission*;
- (3) if a *firm* uses its own estimates of *LGD* and *conversion factors* it may only take into account *unfunded credit protection* to reduce *LGD* in the manner set out in its *IRB permission*;
- (4) if a *firm* uses its own estimates of *LGD* and *conversion factors* it may only recognise the effects of financial collateral under ■ BIPRU 10.2.19 R (Firms using own estimates of *LGD* and *conversion factors* under the *IRB approach*) in the manner set out in its *IRB permission*;
- (5) a *firm* must deal with *equity exposures* in the manner set out in its *IRB permission*; and
- (6) (in the case of *collateral* that is only eligible for recognition under paragraph 21 of Part 1 of Annex VIII of the *Banking Consolidation Directive* (Other physical collateral)) a *firm* may not recognise as eligible collateral an item of a type referred to in ■ BIPRU 4.10.16 R (Other physical collateral) unless that item is of a type specified as permitted in its *IRB permission*.

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4.1.24

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An *IRB permission* will set out *firm-specific* material. This will generally include:

- (1) details about the *firm's* methodology for carrying out the *IRB approach*, including the models and *rating systems* that a *firm* should use;

- (2) reporting requirements; and
- (3) requirements about internal control structure.

### Compliance

4.1.25

FCA PRA

R

If a *firm* ceases to comply with the requirements of the *IRB approach*, it must either present to the *appropriate regulator* a plan for a timely return to compliance or demonstrate that the effect of non-compliance is immaterial.

[Note: BCD Article 84(5)]

4.1.26

FCA PRA

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If a *firm* ceases to comply with the requirements of the *IRB approach*, the *appropriate regulator* may revoke the *IRB permission* or take other appropriate supervisory action.

4.1.27

FCA PRA

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For the purposes of ■ BIPRU 4.1.25 R, the *appropriate regulator* will expect a *firm* to demonstrate that, taking into account all instances where the *firm* has not complied with the requirements of the *IRB approach*, the effect of non-compliance is immaterial.

## 4.2 The IRB approach: High level material

### Application

4.2.1

R

This section applies to all *exposures* treated under the *IRB approach*.

FCA PRA

### General approach to granting an IRB permission

4.2.2

R

A *firm's* systems for the management and rating of credit risk *exposures* must be sound and implemented with integrity and, in particular, they must meet the following standards in accordance with the *minimum IRB standards*:

FCA PRA

- (1) the *firm's rating systems* provide for a meaningful assessment of obligor and transaction characteristics, a meaningful differentiation of risk and accurate and consistent quantitative estimates of risk;
- (2) internal ratings and *default* and *loss* estimates used in the calculation of capital requirements and associated systems and processes play an essential role in the risk management and decision-making process, and in the credit approval, internal capital allocation and corporate governance functions of the *firm*;
- (3) the *firm* has a credit risk control unit responsible for its *rating systems* that is appropriately independent and free from undue influence;
- (4) the *firm* collects and stores all relevant data to provide effective support to its credit risk measurement and management process; and
- (5) the *firm* documents its *rating systems*, the rationale for their design and validates its rating systems.

[Note: BCD Article 84(2) (part)]

4.2.3

R

Where an *EEA parent institution* and its *subsidiary undertakings* or an *EEA parent financial holding company* and its *subsidiary undertakings* use the *IRB approach* on a unified basis, the question whether the *minimum IRB standards* are met is answered by considering the *parent undertaking*

FCA PRA

and its *subsidiary undertakings* together unless the *firm's IRB permission* specifies otherwise.

[Note: BCD Article 84(2) (part)]

### Outsourcing

4.2.4

FCA PRA

G

- (1) This *guidance* sets out the basis on which a *firm* may rely upon a *rating system* or data provided by another member of its *group*.
- (2) A *firm* may rely upon a *rating system* or data provided by another member of its *group* if the following conditions are satisfied:
  - (a) 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*;
  - (b) the *group* is an *EEA banking and investment group*;
  - (c) the integrity of the *firm's* systems and controls is not adversely affected;
  - (d) the outsourcing of these functions meets the requirements of SYSC; and
  - (e) (if the provision of the *rating system* or data is not carried out in the *United Kingdom* or in the jurisdiction of the *competent authority* that is the lead regulator of the *group*) the *firm* can demonstrate to the *appropriate regulator* that the ability of the *appropriate regulator* and that lead regulator to carry out their responsibilities under the *Handbook*, the *Banking Consolidation Directive* and the *Capital Adequacy Directive* are not adversely affected.
- (3) If a *firm* does use a *rating system* or data provided by another member of its *group*, the requirements in ■ BIPRU 4 continue to apply to that *firm* in respect of that *rating system* and data. A *firm* cannot absolve itself of the responsibility for complying with those requirements by claiming that any breach is caused by the actions of a third party to which the *firm* has delegated tasks. The *rating system* and data provision are still those of the *firm*, even though personnel elsewhere in the *firm's* group are carrying out these functions on its behalf. So any references in BIPRU to what a *firm*, its personnel and its management should and should not do still apply.
- (4) If a *firm* does use a *rating system* or data provided by another *group* member, the *firm's governing body* should formally delegate those functions to the *persons* or bodies that are to carry them out.
- (5) Before delegating the provision of a *rating system* or data to another *group* member, the *firm's governing body* should have explicitly considered the arrangement and decided that it is appropriate and that it enables the *firm* to meet the conditions in (2).

### Assessment and estimation

4.2.5

FCA PRA

G

- (1) This paragraph provides *guidance* on ■ BIPRU 4.2.2 R and in particular ■ BIPRU 4.2.2 R (1).
- (2) The information that a *firm* produces or uses for the purpose of 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).
- (3) A *firm* should establish quantified and documented targets and standards, against which it should test the accuracy of data used in its *rating systems*.
  - (4) Tests under (3) might include:
    - (a) report and accounts reconciliation, including completeness in relation to (b);
    - (b) whether every *exposure* has a *PD*, *LGD* and, if applicable, *conversion factor* for reporting purposes;
    - (c) whether the *firm's* risk control environment has key risk indicators for the purpose of monitoring and ensuring data accuracy;
    - (d) whether the *firm* has an adequate business and information technology infrastructure with fully documented processes;
    - (e) 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
    - (f) whether the *firm* has a comprehensive quantitative audit programme.
  - (5) The reconciliation referred to in 4(a) should be reasonably fit for purpose. In particular it should meet the standards in (6) and (7).
  - (6) For data inputs, testing for accuracy of data, including the reconciliation referred to in 4(a), 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. Input data fails the required standard if it gives rise to a serious risk of material misstatement in the capital requirement either immediately or subsequently.
  - (7) For data outputs, the *firm*, as part of the reconciliation referred to in 4(a), 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 in relation to areas that address similar concepts in different ways (for example *expected loss* on the one hand and accounting provisions on the other).
  - (8) 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:
    - (a) data access and security;
    - (b) data integrity, including the accuracy, completeness, appropriateness and testing of data; and
    - (c) data availability.

### Further requirements concerning the use test

4.2.6

FCA PRA

R

If a *firm* uses separate models for the purpose of the *IRB approach* and for its internal purposes as referred to in ■ BIPRU 4.2.2 R (2) it must be able to demonstrate the reasonableness of any differences between those models.

4.2.7

FCA PRA

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- (1) This paragraph provides *guidance* on ■ BIPRU 4.2.2 R and in particular ■ BIPRU 4.2.2 R (2).
- (2) The *IRB approach* as applicable to a *firm* should be an integral part of its business and risk management processes and procedures to the extent that credit risk is relevant to them. It should also have a substantial influence on its decision-making and actions.
  - (a) particular regard should be had to the use of the *IRB approach* in:
    - (i) credit approval;
    - (ii) individual and portfolio limit setting;
    - (iii) reporting of credit risk information; and
    - (iv) provisioning;
  - (b) other relevant aspects include:
    - (i) assessment of economic capital;
    - (ii) internal capital allocation so far as related to credit risk;
    - (iii) risk appetite;
    - (iv) strategy and acquisitions;
    - (v) profitability and performance; and
    - (vi) performance-related remuneration;
  - (c) the carrying out of the *firm's* obligations under the *overall Pillar 2 rule*; and
  - (d) matters relating to the *firm's* infrastructure, including information technology, skills and resources and organisational culture.

4.2.8

FCA PRA

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This paragraph provides further *guidance* on ■ BIPRU 4.2.2 R and in particular ■ BIPRU 4.2.2 R (2). In the *appropriate regulator's* view risk management has an essential role in informing risk decisions. However, an essential role does not necessarily mean an exclusive role or even always a primary role. There may be justifiable differences between the *IRB approach* and the *firm's* use of *rating systems* for its internal purposes as referred to in ■ BIPRU 4.2.2 R (2). For example, internal standards and policies may refer to estimates of *PD* and *LGD* for the length of the asset rather than to estimates based on a one-year period (in the case of *PD* estimates) or on an economic downturn (in the case of *LGD* estimates) required by the *IRB approach*.

4.2.9

FCA PRA

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If a *firm* uses scorecards for its internal credit approval process and the models it uses for the purpose of the *IRB approach* are fundamentally different from those scorecards, a *firm's* demonstration of how this is compatible with ■ BIPRU 4.2.2 R (2) might include

demonstrating that estimates calculated under the *IRB approach* are used to change sanctioning decisions at an individual or portfolio level. Examples of this might include amending cut-offs, the application of policy rules, the revision of an existing scorecard or the introduction of a new one or taking strategic decisions on which segments of the market to target.

4.2.10

FCA PRA

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To the extent that a *firm* uses *LGD* estimates in its internal risk management processes that differ from the downturn *LGDs* used in the calculation of *risk weighted* assets (see ■ BIPRU 4.3.103 R), the reasons for the difference should be documented in accordance with ■ BIPRU 4.3.109 R.

### Requirements concerning the experience requirement

4.2.11

FCA PRA

R

A *firm* must be able to demonstrate that it has been using for the *IRB exposure classes* in question *rating systems* that were broadly in line with the *minimum IRB standards* for internal risk measurement and management purposes for at least three years prior to the date of its *IRB permission*.

[Note: BCD Article 84(3)]

4.2.12

FCA PRA

G

In meeting the experience requirement under ■ BIPRU 4.2.11 R, the *appropriate regulator* would expect a *firm* to be able to demonstrate that it has been:

- (1) operating an internal *rating system* with estimates of *PD*;
- (2) meeting the standards in ■ BIPRU 4 for senior management knowledge and reporting; and
- (3) meeting the standards in ■ BIPRU 4 relating to the use of *rating systems* in its business;

for the required minimum 3 year period.

4.2.13

FCA PRA

R

A *firm* that has applied for the use of own estimates of *LGDs* and/or *conversion factors* must be able to demonstrate to the *appropriate regulator* that it has been estimating and employing own estimates of *LGDs* and/or *conversion factors* in a manner that was broadly consistent with the *minimum IRB standards* for use of own estimates of those parameters for at least three years prior to the date of its *IRB permission* or of a variation of its *IRB permission* that, in either case, entitled the *firm* to use own estimates of *LGDs* and/or *conversion factors*.

[Note: BCD Article 84(4)]

4.2.14

FCA PRA

G

In meeting the experience requirement under ■ BIPRU 4.2.13 R, the *appropriate regulator* would expect a *firm* to be able to demonstrate that it has been:

- (1) operating an internal *rating system* with estimates of *LGD* and with *conversion factors*; and

(2) compliant with ■ BIPRU 4.2.11 R as applied to the *advanced IRB approach*.

for the required minimum 3 year period.

4.2.15

FCA PRA

G

In the *appropriate regulator's* view the standard required by ■ BIPRU 4.2.11 R and ■ BIPRU 4.2.13 R is for a *rating system* to be improved in the light of experience during the three year period so that it meets the minimum requirements more fully for the last year than for the two prior years, provided that the *rating system* has not changed so profoundly that experience from the first or second years becomes of marginal relevance in assessing the reliability of the changed *rating system*.

### Implementation of the internal ratings based approach

4.2.16

FCA PRA

R

A *firm* must comply with any requirements in its *IRB permission* relating to the matters described in ■ BIPRU 4.2.17 R - ■ BIPRU 4.2.35 G.

4.2.17

FCA PRA

R

Without prejudice to ■ BIPRU 4.2.26 R, a *firm* and any *parent undertaking* and its *subsidiary undertakings* must implement the *IRB approach* for all *exposures*.

[Note: BCD Article 85(1) (part)]

4.2.18

FCA PRA

R

To the extent that a *firm's IRB permission* permits this, implementation may be carried out sequentially across the different *IRB exposure classes* within the same business unit, across different business units in the same group or for the use of own estimates of *LGDs* or *conversion factors* for the calculation of *risk weights* for the *sovereign, institution and corporate IRB exposure class*.

[Note: BCD Article 85(1) (part)]

4.2.19

FCA PRA

R

In the case of the *retail exposures*, implementation may (but only to the extent provided for in the *firm's IRB permission*) be carried out sequentially across the categories of *exposures* to which the different correlations in ■ BIPRU 4.6.41 R-■ BIPRU 4.6.44 R correspond.

[Note: BCD Article 85(1) (part)]

4.2.20

FCA PRA

R

- (1) Implementation of the *IRB approach* as referred to in ■ BIPRU 4.2.18 R must be carried out within a reasonable period of time as set out in the *IRB permission*.
- (2) The implementation must be carried out subject to strict conditions determined by the *appropriate regulator* and set out in the *IRB permission*.
- (3) A *firm* must not use the flexibility under ■ BIPRU 4.2.18 R selectively with the purpose of achieving reduced minimum capital requirements in respect of those *IRB exposure classes*

or business units that are yet to be included in the *IRB approach* or in the use of own estimates of *LGDs* and *conversion factors*.

[Note: BCD Article 85(2)]

4.2.21

FCA PRA

G

- (1) A *firm* should achieve full roll-out of the *IRB approach* to all its *exposures*, subject to the exemptions outlined in ■ BIPRU 4.2.26 R, within the period specified in its *IRB permission*. A *firm* should not retain a permanent mix of portfolios on the *standardised approach* and the *IRB approach*, on the *foundation IRB approach* and the *advanced IRB approach* or on a mixture of all approaches with the exception of portfolios covered by those exemptions.
- (2) This applies to a move:
  - (a) from the *standardised approach* to the *IRB approach*;
  - (b) from the *foundation IRB approach* to the *advanced IRB approach*; and
  - (c) from the *transitional rules and guidance for BIPRU* to the *IRB approach*.
- (3) The period referred to in ■ BIPRU 4.2.20 R (1) will generally be not more than three years of starting use of the *IRB approach* or the *advanced IRB approach* as applicable.

4.2.22

FCA PRA

R

A *firm* using the *IRB approach* for any *IRB exposure class* must at the same time use the *IRB approach* for the *equity exposure class*.

[Note: BCD Article 85(3)]

4.2.23

FCA PRA

R

Subject to ■ BIPRU 4.2.17 R - ■ BIPRU 4.2.20 R, ■ BIPRU 4.2.22 R and ■ BIPRU 4.2.26 R, a *firm* that has an *IRB permission* must not use the *standardised approach* for the calculation of *risk weighted exposure amounts* for the *exposures* to which the *IRB approach* applies under the *IRB permission*.

[Note: BCD Article 85(4)]

4.2.24

FCA PRA

R

Subject to ■ BIPRU 4.2.17 R - ■ BIPRU 4.2.22 R and ■ BIPRU 4.2.26 R, a *firm* whose *IRB permission* provides for the use of the *advanced IRB approach* for the calculation of *LGDs* and *conversion factors* for the *sovereign, institution and corporate IRB exposure class* must not use the *LGD values* and *conversion factors* applicable to the *foundation IRB approach* for the *exposures* to which the *advanced IRB approach* applies under the *IRB permission*.

[Note: BCD Article 85(5)]

4.2.25

FCA PRA

G

The *appropriate regulator* will not agree to a *firm's* request to revoke or vary its *IRB permission* so as to permit the *firm* to revert to the *standardised approach* except for demonstrated good cause. Likewise, the *appropriate regulator* will not agree to a *firm's* request to revoke or vary its *IRB permission* so as to permit the *firm* to revert to the

*foundation IRB approach* if the *IRB permission* provides for it to use the *advanced IRB approach*, except for demonstrated good cause.

### Combined use of methodologies: Basic provisions

4.2.26

FCA PRA

R

- (1) To the extent that its *IRB permission* permits this, a *firm* permitted to use the *IRB approach* in the calculation of *risk weighted exposure amounts* and *expected loss* amounts for one or more *IRB exposure classes* may apply the *standardised approach* in accordance with this *rule*.
- (2) A *firm* may apply the *standardised approach* to the *IRB exposure class* referred to in ■ BIPRU 4.3.2 R (1) (Sovereigns) where the number of material counterparties is limited and it would be unduly burdensome for the *firm* to implement a *rating system* for these counterparties. A *firm* may include in this treatment an *exposure* of the type described in ■ BIPRU 3.4.18 R (Exposures to churches or religious communities) that would fall within ■ BIPRU 3.4.15 R or ■ BIPRU 3.4.17 R (Exposure to a regional government or local authority) if those provisions had not been excluded by ■ BIPRU 3.4.18 R.
- (3) A *firm* may apply the *standardised approach* to the *IRB exposure class* referred to in ■ BIPRU 4.3.2 R (2) (Institutions), where the number of material counterparties is limited and it would be unduly burdensome for the *firm* to implement a *rating system* for these counterparties.
- (4) A *firm* may apply the *standardised approach* to *exposures* in non-significant business units as well as *IRB exposure classes* that are immaterial in terms of size and perceived risk profile.
- (5) A *firm* may apply the *standardised approach* to *exposures* to the central governments of *EEA States* and their regional governments, local authorities and administrative bodies, provided that:
  - (a) there is no difference in risk between the *exposures* to the central government and those other *exposures* because of specific public arrangements; and
  - (b) *exposures* to the central government are assigned a 0% *risk weight* under the *standardised approach*.
- (6) A *firm* may apply the *standardised approach* to *exposures* of a *firm* to a counterparty which is its *parent undertaking*, its *subsidiary undertaking* or a *subsidiary undertaking* of its *parent undertaking* provided that the counterparty is an *institution*, a *financial holding company*, a *financial institution*, an *asset*

*management company* or an *ancillary services undertaking* subject to appropriate prudential requirements.

- (7) A *firm* may apply the *standardised approach* to *equity exposures* to entities whose credit obligations qualify for a 0% *risk weight* under the *standardised approach* (including those publicly sponsored entities where a zero *risk weight* can be applied).
- (8) A *firm* may apply the *standardised approach* to *equity exposures* incurred under legislative programmes to promote specified sectors of the economy that provide significant subsidies for the investment to the *firm* and involve some form of government oversight and restrictions on the *equity* investments. This exclusion is limited to an aggregate of 10% of *capital resources*.
- (9) A *firm* may apply the *standardised approach* to the *exposures* identified in ■ BIPRU 3.4.48 R (Exposures in the form of minimum reserves required by the European Central Bank or by the central bank of an *EEA State*) meeting the conditions specified therein.
- (10) A *firm* may apply the *standardised approach* to state and state-reinsured guarantees pursuant to ■ BIPRU 5.7.12 R (Conditions for state and state-reinsured guarantees).

[Note: BCD Article 89(1)]

#### Combined use of methodologies: Documentation

4.2.27

FCA PRA

G

As part of the application for an *IRB permission*, a *firm* should have a well documented policy explaining the basis on which *exposures* are to be selected for permanent exemption from the *IRB approach* and for treatment under the *standardised approach*. The *firm's* roll out plan should also contain provisions for the continuing application of that policy on a consistent basis over time.

#### Combined use of methodologies: Sovereign and institutional, exposures

4.2.28

FCA PRA

G

A *firm* intending to make use of ■ BIPRU 4.2.26 R (2) or ■ BIPRU 4.2.26 R (3) should demonstrate to the *appropriate regulator* when applying for an *IRB permission* that it meets the requirements of those provisions with respect to its sovereign or, as the case may be, institutional, *exposures*.

#### Combined use of methodologies: Meaning of non-significance and immateriality

4.2.29

FCA PRA

R

For the purposes of ■ BIPRU 4.2.26 R (4), the *equity exposure IRB exposure class* of a *firm* must be considered material if its aggregate value, excluding *equity exposures* incurred under legislative programmes as referred to in ■ BIPRU 4.2.26 R (8) but including *exposures* in a *CIU* treated as *equity exposures* in accordance with ■ BIPRU 4.9.11 R to ■ BIPRU 4.9.15 R, exceeds, on average over the preceding year, 10% of the *firm's capital resources*.

If the number of those *equity exposures* is less than 10 individual holdings, that threshold is 5% of the *firm's capital resources*.

[Note: BCD Article 89(2)]

4.2.30

FCA PRA

R

- (1) This *rule* sets out what must be treated as being non-significant business or immaterial for the purposes of ■ BIPRU 4.2.26 R (4), for *exposures* that do not fall within the *equity exposure IRB exposure class*.
- (2) A *firm* may elect permanently to exclude *exposures* from the *IRB approach* and apply the *standardised approach*. However a *firm* may only make use of this exemption to the extent that:
  - (a) the *consolidated credit risk requirement* (adjusted under (6)) so far as it is attributable to the excluded *exposures*; would be no more than 15% of:
  - (b) the *consolidated credit risk requirement* (adjusted under (6)) with respect to all *exposures* (including the ones dealt with under (a)).
- (3) *Exposures* excluded under ■ BIPRU 4.2.29 R or ■ BIPRU 4.2.26 R (2), ■ BIPRU 4.2.26 R (3) and ■ BIPRU 4.2.26 R (5)-■ BIPRU 4.2.26 R (7) must not be included in (a) or (b).
- (4) The calculation in (2)(a) is based on the *standardised approach*.
- (5) The calculation in (2)(b) is based on whichever of the *standardised approach* and the *IRB approach* would apply to the *exposures* referred to in (2)(b) at the time when the calculation is being made.
- (6) The *consolidated credit risk requirement* is adjusted for the purposes of this *rule* as follows:
  - (a) the element based on the *concentration risk capital component* is excluded, with only the elements based on the *credit risk capital component* and the *counterparty risk capital component* being taken into account; and
  - (b) the calculation is carried out with respect to the group of *undertakings* referred to in ■ BIPRU 4.2.17 R.
- (7) If a group with respect to which the calculation in this *rule* is being carried out is not required to calculate the *consolidated credit risk requirement*, the calculations in this *rule* must be carried out as if it were.

4.2.31

FCA PRA

R

If a *firm* applies to use the *advanced IRB approach* for the *sovereign, institution and corporate IRB exposure class*, ■ BIPRU 4.2.26 R (4) also applies with respect to *exposures* in that class. For these purposes, to the extent permitted in the *firm's IRB permission*, a *firm* may:

- (1) exclude some *exposures* from the *IRB approach* and apply the *standardised approach* to those *exposures*; and
- (2) exclude other *exposures* from the *advanced IRB approach* and apply the *foundation IRB approach* to those *exposures*.

4.2.32

FCA PRA

G

Where ■ BIPRU 4.2.31 R applies:

- (1) the 15% limit in ■ BIPRU 4.2.30 R (2) is a combined limit for excluded *exposures* remaining on the *standardised approach* and excluded *exposures* remaining on the *foundation IRB approach*; and
- (2) the calculation in ■ BIPRU 4.2.30 R (2)(a) is carried out under whichever method of calculation would be applicable to the *exposure* in question.

#### Combined use of methodologies: Territorial aspects

4.2.33

FCA PRA

G

- (1) This *guidance* sets out at what level the tests in ■ BIPRU 4.2.30 R- ■ BIPRU 4.2.32 G will be applied in the case of a *firm* that is a member of a group that is part of a bigger group.
- (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 4.2.30 R- ■ BIPRU 4.2.32 G apply with respect to that wider group.
- (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 4.2.26 R (4) applies with respect to that wider group but the requirements of that lead regulator will generally apply in place of ■ BIPRU 4.2.30 R- ■ BIPRU 4.2.32 G.
- (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 4.2.26 R (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 4.2.30 R- ■ BIPRU 4.2.32 G. The question of whether supervision is equivalent is decided in accordance with ■ GENPRU 3.2 (Third country groups).
- (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 4.2.30 R- ■ BIPRU 4.2.32 G will apply. ■ BIPRU 4.2.30 R- ■ BIPRU 4.2.32 G will apply to the whole group if ■ GENPRU 3.2.9 R (Supervision by analogy) applies. If ■ GENPRU 3.2.4 G (Alternative measures)

applies, ■ BIPRU 4.2.30 R- ■ BIPRU 4.2.32 G will apply to the *EEA banking and investment group*.

- (6) In the case of a group described in (2) or (3) in respect of which the *Article 129 procedure* applies then ■ BIPRU 4.2.26 R (4) applies with respect to that wider group. The detailed requirements that apply will be decided in accordance with that procedure.

### Combined use of methodologies: Intra-group exposures

4.2.34

FCA PRA

G

- (1) Generally, the *appropriate regulator* will consider excluding, through a *firm's IRB permission*, exposures falling into ■ BIPRU 4.2.26 R (6) from the *IRB approach*. The degree to which this exclusion applies will be set out in the *firm's IRB permission*.
- (2) Exposures excluded under (1) will be eligible for a 0% *risk weight* under the *standardised approach* if they satisfy the conditions in ■ BIPRU 3.2.25 R to ■ BIPRU 3.2.27A R (Zero risk weight for certain intra-group exposures).
- (3) Exposures to or holdings in any non-financial *undertakings* in a *firm's group* are not eligible for permanent exemption from the *IRB approach* under ■ BIPRU 4.2.26 R (6), as they are not subject to consolidated supervision. It is also the *appropriate regulator's* policy that exposures to or holdings in any *insurance undertaking* are ineligible. Such exposures should remain on the *IRB approach* unless excluded under another part of ■ BIPRU 4.2.26 R.
- (4) If a *firm* uses the exemption in (1) it should have a policy that:
- provides for the identification of connected counterparties excluded under (1);
  - identifies exposures that would be permanently exempted from the *IRB approach* under (1); and
  - identifies the connected counterparty exposures that are not permitted to be permanently exempted from the *IRB approach* under (1).
- (5) The policy in (4) should be applied consistently to all exposures excluded under (1).

### Combined use of methodologies: Purchase of a new businesses

4.2.35

FCA PRA

G

- (1) This *guidance* deals with some possible effects of acquiring a major new business after the grant of an *IRB permission*.
- (2) A *firm* should if possible ensure that the exposures arising through the acquisition are dealt with in accordance with the *firm's IRB permission*.
- (3) If the acquisition is made during the currency of a roll out plan under ■ BIPRU 4.2.18 R, a *firm* should ensure that the exposures arising through the acquisition are dealt with in accordance with that plan. For these purposes the existing and the acquired business should be considered together. The whole of the *firm's* business, including the newly acquired business, should be included in both the denominator and numerator of the fraction in ■ BIPRU 4.2.30 R.

- (4) If a *firm* cannot comply with (2) the *appropriate regulator* will consider an application to vary the *firm's IRB permission* in order to deal with the acquisition. For example the *appropriate regulator* may agree to extend the time by which the roll out should be completed (see ■ BIPRU 4.2.20 R). However any such variation should be consistent with the provisions of ■ BIPRU 4.2 that would have applied if the acquisition had been included in the *firm's* original application for an *IRB permission*.
- (5) If the acquisition is made after a *firm* has completed its roll out under ■ BIPRU 4.2.18 R the *appropriate regulator* will not in general agree to an application to treat an *exposure*:
  - (a) under the *standardised approach* if it would otherwise be treated under the *IRB approach* under the *firm's IRB permission*; or
  - (b) under the *foundation IRB approach* if it would otherwise be treated under the *advanced IRB approach* under the *firm's IRB permission*.
- (6) Any application to disapply the policy in (5) will be treated in accordance with the approach set out in ■ BIPRU 4.2.25 G.
- (7) The *appropriate regulator* will also adopt the approach in (5) while a roll out plan is in progress if, in relation to an *exposure* of a particular type, the period for completion of the roll out for those *exposures* under that plan has ended.

## 4.3 The IRB approach: Provisions common to different exposure classes

### Application

4.3.1

FCA PRA

R

This section applies to all *exposures* treated under the *IRB approach*.

### Exposure classes

4.3.2

FCA PRA

R

Each *exposure* must be assigned to one of the following *exposure* classes:

- (1) claims or contingent claims on central governments and *central banks*;
- (2) claims or contingent claims on *institutions*;
- (3) claims or contingent claims on corporates;
- (4) retail claims or contingent retail claims;
- (5) equity claims;
- (6) *securitisation* positions; and
- (7) *non credit-obligation assets*.

[Note: BCD Article 86(1)]

4.3.3

FCA PRA

R

The methodology used by a *firm* for assigning *exposures* to different *IRB exposure classes* must be appropriate and consistent over time.

[Note: BCD Article 86(9)]

### Calculation of risk weighted exposure amounts

4.3.4

FCA PRA

R

The *risk weighted exposure amounts* for credit risk for *exposures* belonging to one of the *exposure* classes referred to in (1) to (4) must, unless deducted from *capital resources*, be calculated in accordance with the following provisions:

- (1) for *exposures* in the *sovereign, institution and corporate IRB exposure class*, ■ BIPRU 4.4.57 R to ■ BIPRU 4.4.60 R,

- BIPRU 4.4.79 R, ■ BIPRU 4.5.8 R to ■ BIPRU 4.5.10 R (for *specialised lending exposures*), ■ BIPRU 4.9.3 R and ■ BIPRU 4.8.16 R to ■ BIPRU 4.8.17 R (for purchased *corporate exposure* receivables);
- (2) for *exposures in the retail exposure class*, ■ BIPRU 4.6.41 R to ■ BIPRU 4.6.44 R, ■ BIPRU 4.6.57 R and ■ BIPRU 4.8.18 R to ■ BIPRU 4.8.20 R (for purchased *retail exposure* receivables);
- (3) for *exposures in the equity exposure class*, ■ BIPRU 4.7.5 R to ■ BIPRU 4.7.6 R, ■ BIPRU 4.7.9 R to ■ BIPRU 4.7.11 R, ■ BIPRU 4.7.14 R to ■ BIPRU 4.7.16 R and ■ BIPRU 4.7.24 R to ■ BIPRU 4.7.25 R; and
- (4) for *exposures in the non credit-obligation assets exposure class*, ■ BIPRU 4.9.6 R.

[Note: BCD Article 87(1)]

## 4.3.5

FCA PRA

R

The calculation of *risk weighted exposure amounts* for credit risk and *dilution risk* must be based on the relevant parameters associated with the *exposure* in question. These include *probability of default (PD)*, *loss given default (LGD)*, maturity (M) and the *exposure* value of the *exposure*. *PD* and *LGD* may be considered separately or jointly, in accordance with the provisions relating to *PD* and *LGD* in ■ BIPRU 4.4, ■ BIPRU 4.6, ■ BIPRU 4.7 and ■ BIPRU 4.8 at:

- (1) for *exposures in the sovereign, institution and corporate IRB exposure class*, ■ BIPRU 4.4.34 R - ■ BIPRU 4.4.35 R, ■ BIPRU 4.4.42 R to ■ BIPRU 4.4.43 R, ■ BIPRU 4.4.63 R - ■ BIPRU 4.4.66 R, ■ BIPRU 4.4.80 R and, for *PD* and *LGD* for *dilution risk* of purchased *corporate exposure* receivables, ■ BIPRU 4.8.23 R and ■ BIPRU 4.8.26 R;
- (2) for *exposures in the retail exposure class*, ■ BIPRU 4.6.50 R - ■ BIPRU 4.6.54 R, ■ BIPRU 4.6.58 R, and, for *PD* and *LGD* for *dilution risk* of purchased *retail exposure* receivables, ■ BIPRU 4.8.24 R and ■ BIPRU 4.8.27 R; and
- (3) for *exposures in the equity exposure class*, ■ BIPRU 4.7.18 R and ■ BIPRU 4.7.20 R - ■ BIPRU 4.7.21 R.

[Note: BCD Article 87(3)]

4.3.6

FCA PRA

R

**Calculation of expected loss amounts**

The *expected loss* amounts for *exposures* belonging to one of the *IRB exposure classes* referred to in (1) to (3) must be calculated in accordance with the methods set out in the following provisions:

- (1) for *exposures* in the *sovereign, institution and corporate IRB exposure class*, ■ BIPRU 4.4.61 R to ■ BIPRU 4.4.62 R and (for *specialised lending exposures*) ■ BIPRU 4.5.13 R to BIPRU 4.5.15R;
- (2) for *exposures* in the *retail exposure class*, ■ BIPRU 4.6.47 R to ■ BIPRU 4.6.48 R;
- (3) for *exposures* in the *equity exposure class*, ■ BIPRU 4.7.12 R, ■ BIPRU 4.7.17 R and ■ BIPRU 4.7.26 R; and
- (4) (for purchased receivables falling into one of the *IRB exposure classes* in (1) to (3)) ■ BIPRU 4.8.30 R.

[Note: BCD Article 88(1)]

4.3.7

FCA PRA

R

The calculation of *expected loss* amounts in accordance with ■ BIPRU 4.3.6 R must be based on the same input figures of *PD*, *LGD* and the *exposure* value for each *exposure* as being used for the calculation of *risk weighted exposure amounts* in accordance with ■ BIPRU 4. For *defaulted exposures*, where a *firm* uses its own estimate of *LGDs*, *EL* must be the *firm's* best estimate of expected loss ( $EL_{BE}$ ), for the *defaulted exposure* in accordance with ■ BIPRU 4.3.122 R.

[Note: BCD Article 88(2)]

**Treatment of expected loss amounts**

4.3.8

FCA PRA

R

The *expected loss* amounts calculated in accordance with ■ BIPRU 4.3.6 R (1), ■ BIPRU 4.3.6 R (2) and ■ BIPRU 4.3.6 R (4) must be subtracted from the sum of value adjustments and provisions related to these *exposures*. Discounts on balance sheet *exposures* purchased when in *default* according to ■ BIPRU 4.4.71 R must be treated in the same manner as value adjustments. *Expected loss* amounts for *securitised exposures* and value adjustments and provisions related to these *exposures* must not be included in this calculation.

[Note: BCD Annex VII Part 1 point 36]

**Corporate governance**

4.3.9

FCA PRA

R

All material aspects of the rating and estimation processes must be approved by the *firm's governing body* or a designated committee thereof and senior management. These parties must possess a general

understanding of the *firm's rating systems* and detailed comprehension of its associated management reports.

[Note: BCD Annex VII Part 4 point 124]

4.3.10

FCA PRA

G

- (1) A *firm's governing body* or *designated committee* may choose to approve only material aspects of the *firm's rating systems* and material changes to the *firm's rating systems*.
- (2) Where a *firm's governing body* or *designated committee* chooses to approve only material aspects of the *firm's rating systems* and material changes to the *firm's rating systems*:
  - (a) the *firm's governing body* or *designated committee* should define the *firm's* overall approach to material aspects of rating and estimation processes for all *rating systems*, including non-material *rating systems* and approve a policy statement defining that approach; and
  - (b) the *firm* should define and document the process for approval of non-material aspects of the *firm's rating systems*.

4.3.11

FCA PRA

R

Senior management must provide notice to the *governing body* or a *designated committee* thereof of material changes or exceptions from established policies that will materially impact the operations of the *firm's rating systems*.

[Note: BCD Annex VII Part 4 point 125]

4.3.12

FCA PRA

G

Where the *firm's rating systems* are used on a unified basis for the *parent undertaking* and its *subsidiary undertakings* under ■ BIPRU 4.2.3 R, and approval and reporting of the *ratings systems* are carried out at the group level, the governance requirements in ■ BIPRU 4.3.9 R and ■ BIPRU 4.3.11 R may be met if:

- (1) the *subsidiary undertakings* have delegated to the *governing body* or *designated committee* of the *EEA parent institution* or *EEA parent financial holding company* responsibility for approval of the *firm's rating systems*;
- (2) the *governing body* or *designated committee* of the *EEA parent institution* or *EEA parent financial holding company* approves either:
  - (a) all aspects of the *firm's rating systems*, and material changes; or
  - (b) all aspects of the *firm's rating systems* that are material in the context of the group, and material changes to those, and a policy statement defining the overall approach to material aspects of rating and estimation processes for all *rating systems*, including non-material *rating systems*.

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23

4.3.13

FCA PRA

R

Senior management must have a good understanding of the *rating system's* designs and operations. Senior management must ensure on an ongoing basis that the *rating systems* are operating properly. Senior management must be regularly informed by the credit risk control units about the

performance of the rating process, areas needing improvement, and the status of efforts to improve previously identified deficiencies.

[Note: BCD Annex VII Part 4 point 126]

4.3.14

FCA PRA

R

Internal ratings-based analysis of the *firm's* credit risk profile must be an essential part of the management reporting required under ■ BIPRU 4.3.9 R, ■ BIPRU 4.3.11 R and ■ BIPRU 4.3.13 R. Reporting must include at least risk profile by grade, migration across grades, estimation of the relevant parameters per grade, and comparison of realised *default* rates and, to the extent that own estimates are used, of realised *LGDs* and realised *conversion factors* against expectations and stress-test results. Reporting frequencies must depend on the significance and type of information and the level of the recipient.

[Note: BCD Annex VII Part 4 point 127]

#### Credit risk control

4.3.15

FCA PRA

R

The credit risk control unit must be independent from the personnel and management functions responsible for originating or renewing *exposures* and report directly to senior management. The unit must be responsible for the design or selection, implementation, oversight and performance of the *rating systems*. It must regularly produce and analyse reports on the output of the *rating systems*.

[Note: BCD Annex VII Part 4 point 128]

4.3.16

FCA PRA

R

The areas of responsibility for the credit risk control unit(s) must include the following:

- (1) testing and monitoring grades and pools;
- (2) production and analysis of summary reports from the *firm's rating systems*;
- (3) implementing procedures to verify that grade and pool definitions are consistently applied across departments and geographic areas;
- (4) reviewing and documenting any changes to the rating process, including the reasons for the changes;
- (5) reviewing the rating criteria to evaluate if they remain predictive of risk (and changes to the rating process, criteria or individual rating parameters must be documented and retained);
- (6) active participation in the design or selection, implementation and validation of models used in the rating process;

- (7) oversight and supervision of models used in the rating process; and
- (8) ongoing review and alterations to models used in the rating process.

[Note: BCD Annex VII Part 4 point 129]

4.3.17

FCA PRA

R

Notwithstanding ■ BIPRU 4.3.16 R, a *firm* using pooled data according to ■ BIPRU 4.3.92 R - ■ BIPRU 4.3.94 R (Overall requirements for estimation) may outsource the following tasks:

- (1) production of information relevant to testing and monitoring grades and pools;
- (2) production of summary reports from the *firm's rating systems*;
- (3) production of information relevant to review of the rating criteria to evaluate if they remain predictive of risk;
- (4) documentation of changes to the rating process, criteria or individual rating parameters; and
- (5) production of information relevant to ongoing review and alterations to models used in the rating process.

[Note: BCD Annex VII Part 4 point 130 (part)]

4.3.18

FCA PRA

R

A *firm* making use of ■ BIPRU 4.3.17 R must ensure that the *appropriate regulator* has access to all relevant information from the third party that is necessary for examining compliance with the *minimum IRB standards* and the *firm's IRB permission* and that the *appropriate regulator* may perform on-site examinations to the same extent as within the *firm*.

[Note: BCD Annex VII Part 4 point 130 (part)]

#### Documentation of rating systems

4.3.19

FCA PRA

R

A *firm* must document the design and operational details of its *rating systems*. The documentation must evidence compliance with the *minimum IRB standards* and the *firm's IRB permission*, and address topics including portfolio differentiation, rating criteria, responsibilities of parties that rate obligors and *exposures*, frequency of assignment reviews, and management oversight of the rating process.

[Note: BCD Annex VII Part 4 point 31]

4.3.20

FCA PRA

R

A *firm* must ensure that all documentation relating to its *rating systems* or otherwise required by the *rules* governing the *IRB approach* are stored, arranged and indexed in such a way that the *firm* would be able to make them all available to the *appropriate regulator*, or to make any class or description of them specified by the *appropriate regulator* available to the

*appropriate regulator*, immediately on demand or within a short time thereafter.

4.3.21

FCA PRA

R

A *firm* must document the rationale for and analysis supporting its choice of rating criteria. A *firm* must document all major changes in the risk rating process, and such documentation must support identification of changes made to the risk rating process subsequent to the last review by the *appropriate regulator*. The organisation of rating assignment including the rating assignment process and the internal control structure must also be documented.

[Note: BCD Annex VII Part 4 point 32]

4.3.22

FCA PRA

R

A *firm* must document the specific definitions of default and loss used internally and demonstrate consistency with the definitions of *default* and *loss* set out in the *glossary* and ■ BIPRU 4.

[Note: BCD Annex VII Part 4 point 33]

4.3.23

FCA PRA

G

A *firm's* documentation relating to data should include clear identification of responsibility for data quality. A *firm* should set standards for data quality and aim to improve them over time. A *firm* should measure its performance against those standards. 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.

4.3.24

FCA PRA

R

Where a *firm* employs statistical models in the rating process, the *firm* must document its methodologies. This material must:

- (1) provide a detailed outline of the theory, assumptions and/or mathematical and empirical basis of the assignment of estimates to grades, individual obligors, *exposures*, or pools, and the data source(s) used to estimate the model;
- (2) establish a rigorous statistical process (including out-of-time and out-of-sample performance tests) for validating the model; and
- (3) indicate any circumstances under which the model does not work effectively.

[Note: BCD Annex VII Part 4 point 34]

### Rating systems

4.3.25

FCA PRA

R

A *rating system* comprises all of the methods, processes, controls, data collection and IT systems that support the assessment of credit risk, the assignment of *exposures* to grades or pools (rating), and the quantification of *default* and *loss* estimates for a certain type of *exposure*.

[Note: BCD Annex VII Part 4 point 1]

4.3.26

FCA PRA

R

If a *firm* uses multiple *rating systems*, the rationale for assigning an obligor or a transaction to a *rating system* must be documented and applied in a manner that appropriately reflects the level of risk.

[Note: BCD Annex VII Part 4 point 2]

4.3.27

FCA PRA

R

Assignment criteria and processes must be periodically reviewed to determine whether they remain appropriate for the current portfolio and external conditions.

[Note: BCD Annex VII Part 4 point 3]

4.3.28

FCA PRA

R

Where a *firm* uses direct estimates of risk parameters these may be seen as the outputs of grades on a continuous rating scale.

[Note: BCD Annex VII Part 4 point 4]

#### Validation of internal estimates

4.3.29

FCA PRA

R

A *firm* must have robust systems in place to validate the accuracy and consistency of *rating systems*, processes, and the estimation of all relevant risk parameters (*PD*, *LGD*, *conversion factors* and *EL*). A *firm* must be able to demonstrate to the *appropriate regulator* that the internal validation process enables it to assess the performance of internal rating and risk estimation systems consistently and meaningfully.

[Note: BCD Annex VII Part 4 point 110]

4.3.30

FCA PRA

R

- (1) A *firm* must validate its *rating systems*. Its validation process must include, as a minimum, the elements set out in (2) - (8).
- (2) A *firm* must establish and define standards of objectivity, accuracy, stability and conservatism that it designs its *ratings systems* to meet. It must have processes that establish whether its *rating systems* meet those standards.
- (3) A *firm* must establish and define standards of accuracy of calibration (i.e. whether outcomes are consistent with estimate) and discriminative power (i.e. the ability to rank-order risk) that it designs its *rating systems* to meet. It must have processes that establish whether its *rating systems* meet those standards.
- (4) A *firm* must have policies and standards that specify the actions to be taken when a *rating system* fails to meet the standards of accuracy and discriminative power referred to in (2) and (3).
- (5) A *firm's* validation process must include a mix of developmental evidence, benchmarking and process verification. A *firm's* validation process must include policies on how this mixture varies between different *rating systems*.

- (6) A *firm's* validation process must include the use of both quantitative and qualitative techniques.
- (7) A *firm's* validation process must include policies on how validation procedures are expected to vary over time.
- (8) A *firm's* validation process must include independent input into and review of its *rating systems*.
- (9) The standards set under (2) and (3) must meet the *minimum IRB standards*.
- (10) For the purpose of (5):
  - (a) 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
  - (b) 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*.

4.3.31

FCA PRA

G

A *firm* should have regard to the involvement of management at an appropriately senior level in the validation process.

4.3.32

FCA PRA

G

The approach to validation may vary with the significance of the *exposures* covered by a *rating system*.

4.3.33

FCA PRA

R

A *firm* must regularly compare realised *default* rates with estimated *PDs* for each grade and where realised *default* rates are outside the expected range for that grade a *firm* must specifically analyse the reasons for the deviation. A *firm* using its own estimates of *LGDs* and/or *conversion factors* must also perform analogous analysis for own estimates of *LGDs* and *conversion factors*. Such comparisons must make use of historical data that cover as long a period as possible. A *firm* must document the methods and data used in such comparisons. This analysis and documentation must be updated at least annually.

[Note: BCD Annex VII Part 4 point 111]

4.3.34

FCA PRA

G

- (1) This paragraph sets out *guidance* on assessing the adequacy of a *rating system's* discriminative power (see ■ BIPRU 4.3.30 R (3) on the meaning of discriminative power).

- (2) A *firm* should 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, a *firm* should be able to explain:
  - (a) the extent of any potential inaccuracy in these measures, caused in particular by small sample size; and
  - (b) the potential for divergence in the future, whether caused by changing economic conditions or other factors.
- (3) The assessment of discriminative power should include appropriate use of external benchmarks where available.
- (4) The *appropriate regulator* will, in assessing the *firm's* performance, take into consideration the sophistication of the measure of discrimination chosen.
- (5) In the case of a portfolio for which there is insufficient *default* experience to provide any confidence in statistical measures of discriminative power a *firm* need not carry out the procedure in (2) and may instead use other methods. For example, it may make use of comparison with an external measurement approach by analysing whether the *firm's rating systems* and the external approach rank common obligors in broadly similar ways. A *firm* should be able to explain the methodology it uses and the rationale for its use.

4.3.35

FCA PRA

R

A *firm* must also use other appropriate quantitative validation tools and comparisons with relevant external data sources. The analysis must be based on data that is appropriate to the portfolio, is updated regularly, and covers a relevant observation period. A *firm's* internal assessments of the performance of its *rating systems* must be based on as long a period as possible.

[Note: BCD Annex VII Part 4 point 112]

4.3.36

FCA PRA

R

The methods and data used for quantitative validation must be consistent through time. Changes in estimation and validation methods and data (both data sources and periods covered) must be documented.

[Note: BCD Annex VII Part 4 point 113]

4.3.37

FCA PRA

R

A *firm* must have sound internal standards for situations where deviations in realised *PDs*, *LGDs*, *conversion factors* and, where *EL* is used, total losses, from expectations become significant enough to call the validity of the estimates into question. These standards must take account of business cycles and similar systematic variability in *default* and *loss* experience. Where realised values continue to be higher than expected values, a *firm* must revise estimates upward to reflect its *default* and *loss* experience.

[Note: BCD Annex VII Part 4 point 114]

**Internal audit**

4.3.38

FCA PRA

R

Internal audit or another comparable independent auditing unit must review at least annually the *firm's rating systems* and its operations, including the operations of the *firm* and the estimation of *PDs*, *LGDs*, *ELs* and *conversion factors*. Areas of review must include adherence to all applicable minimum requirements.

[Note: BCD Annex VII Part 4 point 131]

**Stress tests used in assessment of capital adequacy**

4.3.39

FCA PRA

R

A *firm* must have in place sound stress testing processes for use in the assessment of its capital adequacy. Stress testing must involve identifying possible events or future changes in economic conditions that could have unfavourable effects on the *firm's credit exposures* and assessment of the *firm's* ability to withstand such changes.

[Note: BCD Annex VII Part 4 point 40]

4.3.39A

FCA PRA

G

The *appropriate regulator* expects that *firms* will routinely make use of stress testing and scenario analysis as a tool in the calibration and/or validation of their *IRB approach* parameters in order to increase the accuracy or, at least, the conservatism of the estimates. Stress testing should include a thorough exploration of various outturns different to the *firm's* normal expectations in order to give the *firm* a clear view of the potential for the forward-looking estimate to be different from that indicated by the primary data source(s). *Firms* should consider this as an integral part of their quantification process, and should have clear standards for how the results of the stress tests affect the final estimates used for the *IRB approach* parameters.

4.3.40

FCA PRA

R

- (1) A *firm* must regularly perform a credit risk stress test to assess the effect of certain specific conditions on its total capital requirements for credit risk. The test to be employed must be one chosen by the *firm*. The test to be employed must be meaningful and reasonably conservative. Stressed portfolios must contain the vast majority of a *firm's* total *exposures* covered by the *IRB approach*.
- (2) The stress test must be designed to assess the *firm's* ability to meet its capital requirements for credit risk under ■ GENPRU 2.1 during all stages of the economic cycle and during an economic downturn scenario based on forward looking hypothetical events calibrated against the most adverse movements in individual risk drivers experienced over a long historical period.
- (3) In particular the stress test must address the impact (including by ratings migration) of changes in the credit quality of its credit risk counterparties including its protection providers. A *firm* using the treatment set out in ■ BIPRU 4.4.79 R must in particular consider the impact of protection providers falling outside the eligibility criteria.

- (4) The stress test must be conducted on the basis of the *firm's exposures* (on- and off-balance sheet) as they stand at the time of the stress test.
- (5) The stress test must be carried out at least annually and also in the event of a significant change in the state of the economy.
- (6) A *firm* need not assume that the recession referred to in (2) will occur in the 12 months immediately following the stress test. Instead, the stress test must incorporate a plausible time horizon for the occurrence of the cyclical deterioration of the severity tested for. A *firm* need not assume that the downturn will occur for all portfolios in all jurisdictions simultaneously.

[Note: BCD Annex VII Part 4 points 41 and 42]

4.3.41

FCA PRA

G

To the extent that the economic conditions assumed in the stress tests required under ■ BIPRU 4.3.39 R or ■ BIPRU 4.3.40 R coincide with the conditions assumed in the production of economic downturn *LGDs* (see ■ BIPRU 4.3.103 R), the *LGDs* to be used might be expected to be similar.

4.3.42

FCA PRA

G

The requirement in ■ BIPRU 4.3.40 R (2) is to identify, in a forward-looking manner, severe but plausible downturn conditions relevant to business lines and jurisdictions and to determine the likely impact of those conditions on a *firm's* credit risk regulatory capital requirements. The description of the economic recession contained in ■ BIPRU 4.3.40 R (2) should not be taken as stipulating one approach (e.g. statistical) over other approaches (e.g. scenario analysis) in the identification of the relevant recessionary circumstances.

#### Rating systems: Assignment to grades or pools

4.3.43

FCA PRA

R

A *firm* must have specific definitions, processes and criteria for assigning *exposures* to grades or pools within a *rating system*.

[Note: BCD Annex VII Part 4 point 17 (part)]

4.3.44

FCA PRA

R

The grade or pool definitions and criteria must be sufficiently detailed to allow those charged with assigning ratings consistently to assign obligors or facilities posing similar risk to the same grade or pool. This consistency must exist across lines of business, departments and geographic locations within each *rating system*.

[Note: BCD Annex VII Part 4 point 17 (part)]

4.3.45

FCA PRA

G

In meeting ■ BIPRU 4.3.44 R a *firm* should have regard to its application to each *rating system*.

4.3.46

FCA PRA

R

The documentation of the rating process must allow third parties to understand the assignments of *exposures* to grades or pools, to replicate

grade and pool assignments and to evaluate the appropriateness of the assignments to a grade or a pool.

[Note: BCD Annex VII Part 4 point 17 (part)]

4.3.47

FCA PRA

R

The criteria referred to in ■ BIPRU 4.3.43 R must also be consistent with the *firm's* internal lending standards and its policies for handling troubled obligors and facilities.

[Note: BCD Annex VII Part 4 point 17 (part)]

4.3.48

FCA PRA

R

A *firm* must take all relevant information into account in assigning obligors and facilities to grades or pools. Information must be current and must enable the *firm* to forecast the future performance of the *exposure*. The less information a *firm* has, the more conservative must be its assignments of *exposures* to obligor and *facility grades* or pools. If a *firm* uses an external rating as a primary factor determining an internal rating assignment, the *firm* must ensure that it considers other relevant information.

[Note: BCD Annex VII Part 4 point 18]

#### Rating systems: General governance

4.3.49

FCA PRA

G

- (1) This paragraph contains *guidance* on ■ BIPRU 4.3.43 R and more general *guidance* about the governance of *rating systems*.
- (2) In determining the assignment referred to in ■ BIPRU 4.3.43 R, a *firm* should have regard to the sensitivity of the rating to movements in fundamental risk drivers.
- (3) A *firm* should, for any *rating system*, be able to demonstrate that it acts appropriately or has an appropriate policy, as applicable, with respect to:
  - (a) any deficiencies caused by its not being sensitive to movements in fundamental risk drivers or for any other reason;
  - (b) periodic review and action in the light of such review;
  - (c) provision of 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;
  - (d) dealing with potential weaknesses of the *rating system*;
  - (e) identifying appropriate and inappropriate uses of the *rating system* and acting on that identification;
  - (f) novel or narrow rating approaches; and
  - (g) ensuring the appropriate level of stability over time of the *rating system*.

**Rating systems: Overrides**

4.3.50

FCA PRA

R

For grade and pool assignments a *firm* must document the situations in which human judgement may override the inputs or outputs of the assignment process and the personnel responsible for approving these overrides. A *firm* must document these overrides and the personnel responsible. A *firm* must analyse the performance of the *exposures* whose assignments have been overridden. This analysis must include assessment of the performance of *exposures* whose rating has been overridden by a particular *person*, accounting for all the responsible personnel.

[Note: BCD Annex VII Part 4 point 25]

**Rating systems: Use of models**

4.3.51

FCA PRA

R

- (1) This paragraph applies to the use of statistical models and/or other mechanical methods to assign *exposures* to *obligor grades*, *obligor pools*, *facility grades* or *facility pools*.
- (2) A *firm* must be able to demonstrate to the *appropriate regulator* that the model has good predictive power and that capital requirements are not distorted as a result of its use.
- (3) The input variables to the model must form a reasonable and effective basis for the resulting predictions. The model must not have material biases.
- (4) A *firm* must have in place a process for vetting data inputs into the model, which includes an assessment of the accuracy, completeness and appropriateness of the data.
- (5) A *firm* must be able to demonstrate to the *appropriate regulator* that the data used to build the model is representative of the population of the *firm's* actual obligors or *exposures*.
- (6) A *firm* must have a regular cycle of model validation that includes monitoring of model performance and stability, review of model specification and testing of model outputs against outcomes.
- (7) A *firm* must complement the statistical model by human judgement and human oversight to review model-based assignments and to ensure that the models are used appropriately. Review procedures must aim at finding and limiting errors associated with model weaknesses. Human judgements must take into account all relevant information not considered by the model. A *firm* must document how human judgement and model results are to be combined.
- (8) Use of a model obtained from a third-party vendor that claims proprietary technology is not a justification for exemption from documentation or any other of the requirements in ■ BIPRU 4 or a *firm's* IRB permission for rating systems. A *firm* must be able to

satisfy the *appropriate regulator* that all those requirements are satisfied if it uses such a model.

[Note: BCD Annex VII Part 4 points 30 and 35 (part)]

4.3.52

FCA PRA

G

- (1) This paragraph contains guidance on ■ BIPRU 4.3.51 R (7).
- (2) ■ BIPRU 4.3.51 R (7) does not require that each individual assignment of an *exposure* to a pool or grade should be the subject of an open-ended review by reference to factors not covered by the model if:
  - (a) that is not necessary in order to meet the requirements of ■ BIPRU 4 about the ability of the *rating system* to predict and to discriminate (as referred to in ■ BIPRU 4.3.29 R to ■ BIPRU 4.3.30 R (Validation of internal estimates)); and
  - (b) the outputs of the model are not designed to be supplemented by such a review.

4.3.53

FCA PRA

G

- (1) This paragraph contains *guidance* on ■ BIPRU 4.3.51 R for the use of external models.
- (2) ■ BIPRU 4.3.51 R (2) - ■ BIPRU 4.3.51 R (8) also apply to mechanical methods to assign *exposures* or obligors to facility grades or pools and to a combination of models and mechanical methods.
- (3) The standards which a *firm* applies to an external model should not be lower than those for internal models.
- (4) The *appropriate regulator* will not accredit any individual model or vendor. The burden is on a *firm* to satisfy itself that external models are fit for purpose and meet the relevant requirements of the *IRB approach*.
- (5) Notwithstanding that commercial confidentiality may limit the willingness of vendors of external models to disclose all details, a *firm* should ensure that it is able to obtain sufficiently detailed information to be able to satisfy the requirements of the *IRB approach*.
- (6) A *firm* should have a clear understanding of responsibilities for support and maintenance of external models. This should include how new developments will be brought in and what entitlement the *firm* has to receive and/or request specific enhancements. A *firm* should ensure that the requirements of ■ BIPRU 4.3.51 R and other provisions of the *IRB approach* are complied with on an ongoing basis.
- (7) If a *firm* uses an external model it should have regard to the following:
  - (a) the adequacy of the information it has about the population on which the model is built;
  - (b) the comparability of the population referred to in (a) to the *exposures* with respect to which it is using that model;
  - (c) what the drivers of the model are and their relevance to the *exposures* with respect to which it is using the model; and

- (d) how the *firm* satisfies itself that the standards required by the *IRB approach* for an internal model are met by the external model.

#### Rating systems: Data maintenance

4.3.54

R

FCA PRA

A *firm* must collect and store data on aspects of its internal ratings as required under ■ BIPRU 11 (Disclosure).

[Note: BCD Annex VII Part 4 point 36]

#### Rating systems: IT systems

4.3.55

G

FCA PRA

A *firm* should ensure that IT systems relevant to the operation of its *rating systems* are sound and robust. A *firm's* IT systems should provide rapid availability of databases and appropriate archiving. Adequate controls should be in place to prevent unauthorised changes to data being made. Contingency processes and plans should be in place to deal with events of system failure. A *firm* should document work-flows and procedures related to data collection and storage.

#### Definition of default: Main provisions

4.3.56

R

FCA PRA

A *default* must be considered to have occurred with regard to a particular obligor when either or both of the two following events has taken place:

- (1) the *firm* considers that the obligor is unlikely to pay its credit obligations to the *firm*, the *parent undertaking* or any of its *subsidiary undertakings* in full, without recourse by the *firm* to actions such as realising security (if held); and
- (2) the obligor is past due more than 90 days on any material credit obligation to the *firm*, the *parent undertaking* or any of its *subsidiary undertakings*.

[Note: BCD Annex VII Part 4 point 44 (part)]

4.3.57

R

FCA PRA

The following provisions also apply with respect to the definition of *default*:

- (1) for overdrafts, days past due commence once an obligor has breached an advised limit, has been advised a limit smaller than current outstandings, or has drawn credit without authorisation and the underlying amount is material;
- (2) an advised limit means a limit which has been brought to the knowledge of the obligor;
- (3) days past due for credit cards commence on the minimum payment due date;
- (4) in the case of *retail exposures* and *exposures to public sector entities* the number of days past due is as set out in ■ BIPRU 4.4.22 R and ■ BIPRU 4.6.20 R; and

- (5) in all cases for the purposes of the definition of *default*, a credit obligation or, for overdrafts, the underlying amount, is material if, when added to the other *exposures* of the obligor, the total exceeds the amount which the *firm* treats as a material default for its internal risk measurement and management purposes.

[Note: BCD Annex VII Part 4 point 44 (part)]

#### Definition of default: Materiality

4.3.58

FCA PRA

R

Where a *firm* applies the definition of *default* at facility level in accordance with ■ BIPRU 4.6.21 R, it should define materiality for the purposes of ■ BIPRU 4.3.57 R (5) by reference to the facility amount only, disregarding other *exposures* of the obligor.

4.3.59

FCA PRA

R

A *firm* must have a policy which sets out how it will determine whether a credit obligation or, for overdrafts, the underlying amount, is material for the purposes of the definition of *default* in ■ BIPRU 4.3.56 R (2) and ■ BIPRU 4.3.57 R (5).

#### Definition of default: Identification of obligor

4.3.60

FCA PRA

G

- (1) This paragraph contains *guidance* on the definition of *default*.
- (2) If:
  - (a) a *firm* ordinarily assigns *exposures* in the *sovereign, institution and corporate IRB exposure class* to a member of a group substantially on the basis of membership of that group and a common group rating; and
  - (b) the *firm* does so in the case of a particular group;
- (3) the *firm* should consider whether members of that group should be treated as a single obligor for the purpose of the definition of *default*.
- (4) The *appropriate regulator* would not expect a *firm* to treat an obligor as part of a single obligor under (2) if the *firm* rates its *exposures* on a stand alone basis or if its rating is notched. 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.
- (5) Accordingly if a group has two members who are separately rated the *default* of one does not necessarily imply the *default* of the other.

#### Definition of default: Days past due

4.3.61

FCA PRA

G

- (1) This paragraph contains *guidance* on the meaning of days past due for the purposes of the definition of *default*.
- (2) If an amount is overdue by the relevant number of days past due because of administrative oversight on the part of the obligor or the *firm*, a *firm* with sufficient information may, retrospectively if necessary, treat that as not involving a *default* if:

- (a) that failure is not associated with any increase in the risk referred to in ■ BIPRU 4.3.56 R (1); and
  - (b) treating it as not being in *default* is consistent with the way that the *firm* treated the failure in its relationship with the obligor.
- (3) If a *firm* takes advantage of this provision it should have a policy about the circumstances in which it can apply the treatment in (2). That policy should be documented and consistently applied.

4.3.62

FCA PRA

G

Days past due is only one part of the definition of *default* and should be treated as a back-stop. A *firm* should not rely solely on the number of days past due set by ■ BIPRU 4 but should also consider all other indicators of unlikelihood to pay when assessing whether a *default* has occurred.

4

#### Definition of default: Unlikelihood to pay

4.3.63

FCA PRA

R

- (1) Elements to be taken as indications of unlikelihood to pay must include the items set out in this *rule*.
- (2) The *firm* putting the credit obligation on non-accrued status must be taken as an indication of unlikelihood to pay.
- (3) The *firm* making a value adjustment resulting from a significant perceived decline in credit quality subsequent to the *firm* taking on the *exposure* must be taken as an indication of unlikelihood to pay.
- (4) The *firm* selling the credit obligation at a material credit-related economic loss must be taken as an indication of unlikelihood to pay.
- (5) The *firm* consenting to a distressed restructuring of the credit obligation must be taken as an indication of unlikelihood to pay where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or (where relevant) fees. This includes in the case of *equity exposures* assessed under a *PD/LGD approach*, distressed restructuring of the equity itself.
- (6) The *firm* having filed for the obligor's bankruptcy or a similar order in respect of an obligor's credit obligation to the *firm*, the *parent undertaking* or any of its *subsidiary undertakings* must be taken as an indication of unlikelihood to pay.
- (7) The obligor seeking or having been placed in bankruptcy or similar protection where this would avoid or delay repayment of a credit obligation to the *firm*, the *parent undertaking* or any of its *subsidiary undertakings* must be taken as an indication of unlikelihood to pay.

[Note: BCD Annex VII Part 4 point 45]

4.3.64

FCA PRA

G

A *firm* may use the amount overdue as an additional indication of unlikelihood to pay. If a *firm* uses this approach, the days past due element of the definition of *default* continues to apply, including the provisions relating to the fixed number of days past due referred to in ■ BIPRU 4.3.57 R (4). A *firm* might make the use of a definition of *default* that takes into account the amount overdue consistent with the days past due element of the definition by setting the amount overdue at such a level that, taking into account:

- (1) the order in which payments are applied against overdue payments; and
- (2) the number of payment dates, the time between them, the amount of the overdue payments that results in a *default* under the definition used by the *firm* and other relevant factors;

it is not possible for any payment to be past due by a number of days exceeding the maximum amount specified in BIPRU for the purposes of the definition of *default* without there being a *default* under the part of the definition of *default* based on the amount overdue.

4.3.65

FCA PRA

G

In the case of a *retail exposure*, a value adjustment resulting from significant perceived decline in credit quality falling within ■ BIPRU 4.3.63 R (3) need not necessarily be taken as an indication of unlikelihood to pay if a *firm* employs formulaic portfolio provisioning based on a number of days overdue for its *retail exposures*. However, if such an *exposure* reaches the compulsory days past due indicator for the purposes of the definition of *default* it should automatically be deemed to be in *default*, regardless of the provisioning situation.

4.3.66

FCA PRA

G

An obligation should be considered a distressed restructuring under ■ BIPRU 4.3.63 R (5) 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.

4.3.67

FCA PRA

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- (1) The realisation or forfeiture of collateral may be taken as an indication of unlikelihood to pay for the purposes of the definition of *default*.
- (2) However, the realisation or forfeiture of collateral may not indicate unlikelihood to pay:
  - (a) in the case of an *exposure* in a market (such as one that involves *retail exposures* involving margin lending) in which it is established practice for collateral to be sold if its value falls below a certain percentage of the *exposure* and the obligor does not restore the margin (but this exception does not apply if the value of the collateral has fallen below the amount outstanding); or
  - (b) if the *firm* is able to demonstrate that for some other reason the realisation or forfeiture of collateral is not a meaningful indication of unlikelihood to pay.

4.3.68

FCA PRA

G

- (1) If an obligor approach is being taken with respect to *retail exposures* (that is, the application of the definition of *default* at an obligor level rather than

at a facility level as set out in ■ BIPRU 4.6.21 R,) a *firm* should ensure that the *PD* associated with unsecured *exposures* is not understated as a result of the presence of any collateralised *exposures*. A *firm* should be able to explain to the *appropriate regulator*, if asked, how it has ensured that its estimate of *PD* is appropriate for both secured and unsecured *exposures* covered by an obligor rating approach.

- (2) In the view of the *appropriate regulator*, *firms* typically find that the *PD* of a residential mortgage is lower than the *PD* of an unsecured loan to the same borrower.

4.3.69

FCA PRA

G

A *firm* may, but without prejudice to ■ BIPRU 4.4.22 R and ■ BIPRU 4.6.20 R (Fixed numbers of days past due), use additional, or stricter, indicators of unlikeliness to pay if it uses these indicators for internal purposes in accordance with ■ BIPRU 4.2.2 R (2) (Use tests) and if the disclosures under ■ BIPRU 11 (Disclosure) are on this basis.

#### Risk quantification: Definition of default: Other provisions

4.3.70

FCA PRA

R

A *firm* must (if it uses external data that is not itself consistent with the definition of *default*) be able to demonstrate to the *appropriate regulator* that appropriate adjustments have been made that achieve broad equivalence with the definition of *default*.

[Note: BCD Annex VII Part 4 point 46]

4.3.71

FCA PRA

R

If a *firm* considers that a previously *defaulted exposure* is such that no trigger of *default* continues to apply, the *firm* must rate the obligor or facility as it would for a non-*defaulted exposure*. Should the definition of *default* subsequently be triggered, another *default* must be deemed to have occurred.

[Note: BCD Annex VII Part 4 point 47]

4.3.72

FCA PRA

G

A *firm* should have a clear and documented policy for determining whether an *exposure* that has been in *default* should subsequently be returned to performing status.

#### Risk quantification: Overall requirements for estimation: General

4.3.73

FCA PRA

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■ BIPRU 4.3.74 R to ■ BIPRU 4.3.131 R apply to a *firm's* own estimates of risk parameters used in the *IRB approach*.

[Note: BCD Annex VII Part 4 point 43]

4.3.74

FCA PRA

R

A *firm's* own estimates of the risk parameters *PD*, *LGD*, *conversion factor* and *EL* must incorporate all relevant data, information and methods. The estimates must be derived using both historical experience and empirical evidence, and must not be based purely on judgemental considerations. The estimates must be plausible and intuitive and must be based on the material drivers of the respective risk parameters. The less data a *firm* has, the more conservative it must be in its estimation.

[Note: BCD Annex VII Part 4 point 49]

4.3.75

FCA PRA

G

- (1) This paragraph provides guidance on ■ BIPRU 4.3.73 R.
- (2) Relevant data and information under ■ BIPRU 4.3.73 R includes external data.
- (3) Where internal *default* and *loss* experience is scarce, a *firm* should consider using material relevant external information. When using external information such as industry averages when determining *LGD* or *conversion factors*, a *firm* should consider whether this data is appropriate to its own experience and whether adjustments are necessary.

4.3.76

FCA PRA

R

- (1) In calculating estimates of *PD*, *LGD* and *conversion factors* a *firm* must adjust the averages of historical experience referred to in the *historical averages rules* in order to ensure that those estimates are accurate estimates of the *default* rate, *loss* rate or *conversion factor* over the long-run.
- (2) The *historical average rules* means the requirements in ■ BIPRU 4 relating to the calculation of *PD*, *LGD* and *conversion factors* using historical averages (and in particular ■ BIPRU 4.4.24 R, ■ BIPRU 4.4.30 R, ■ BIPRU 4.8.7 R, ■ BIPRU 4.8.8 R, ■ BIPRU 4.6.24 R, ■ BIPRU 4.6.27 R, ■ BIPRU 4.3.99 R and ■ BIPRU 4.3.125 R).

4.3.77

FCA PRA

G

Where a *firm* is able to demonstrate that the effect is immaterial in accordance with ■ BIPRU 4.1.25 R (Compliance), it may estimate average *LGDs* and *conversion factors* under the *historical average rules* in a way that does not strictly comply with ■ BIPRU 4.3.94 R (Default weighted average), provided the final estimates of *LGD* and *conversion factors* following the adjustments to averages of historical experience are made on the basis of *default* weighted averages for the *facility grade* or pool in question.

4.3.78

FCA PRA

G

A *firm* may carry out the adjustments under ■ BIPRU 4.3.76 R (Adjustments to averages of historical experience) by adjusting the data from which estimates are made rather than by adjusting the estimates themselves if it can demonstrate that capital requirements are not underestimated as a result.

4.3.79

FCA PRA

G

While the qualitative requirements in ■ BIPRU 4 are important for all portfolios, they are of even greater importance in those cases where a *firm* lacks sufficient historical data to calibrate or validate its estimates of *PD*, *LGD* or *conversion factors* on the basis of proven statistical significance, sometimes referred to as low default portfolios.

4.3.80

FCA PRA

R

- (1) A *firm* must collect data on what it considers to be the main drivers of the risk parameters *PD*, *LGD*, *conversion factor* and *EL* for each group of obligors or facilities.
- (2) A *firm* must document its identification of the main drivers of risk parameters.

(3) A *firm* must be able to demonstrate that its process of identification is reasonable and appropriate.

4.3.81

FCA PRA

R

In its processes for identifying the main drivers of risk parameters, a *firm* must 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 does not require an intensive analysis of all factors.

4.3.82

FCA PRA

G

If a *firm* uses a rating model to assign exposures to the borrower or facility grades, it may reflect the data on main drivers of risk parameters by its inclusion in the model as a risk driver or as part of a subsequent process that adjusts the output of that model to calculate the risk parameters *PD*, *LGD*, *conversion factor* and *EL*.

4.3.83

FCA PRA

R

A *firm* must be able to provide a breakdown of its loss experience in terms of *default* frequency, *LGD*, *conversion factor*, or *loss* where *EL* estimates are used, by the factors it sees as the drivers of the respective risk parameters. A *firm* must be able to demonstrate to the *appropriate regulator* that its estimates are representative of long-run experience.

[Note: BCD Annex VII Part 4 point 50]

4.3.84

FCA PRA

R

Any changes in lending practice or the process for pursuing recoveries over the observation periods referred to in ■ BIPRU 4.4.31 R (Observation period for sovereigns, institutions and corporates for PDs), ■ BIPRU 4.6.28 R (Observation period for retail exposures for PDs), ■ BIPRU 4.4.54 R (Observation period for sovereigns, institutions and corporates for LGDs), ■ BIPRU 4.6.33 R (Observation period for retail exposures for LGDs), ■ BIPRU 4.4.55 R (Observation period for sovereigns, institutions and corporates for conversion factors) and ■ BIPRU 4.6.38 R (Observation period for retail exposures for conversion factors) must be taken into account. A *firm's* estimates must reflect the implications of technical advances and new data and other information, as it becomes available. A *firm* must review its estimates when new information comes to light but at least on an annual basis.

[Note: BCD Annex VII Part 4 point 51]

4.3.85

FCA PRA

R

The population of *exposures* represented in the data used for estimation, the lending standards used when the data was generated and other relevant characteristics must be comparable with those of a *firm's* *exposures* and standards. A *firm* must also be able to demonstrate to the *appropriate regulator* that the economic or market conditions that underlie the data are relevant to current and foreseeable conditions. The number of *exposures* in the sample and the data period used for quantification must be sufficient to provide a *firm* with confidence in the accuracy and robustness of its estimates.

[Note: BCD Annex VII Part 4 point 52]

4.3.86

FCA PRA

G

It may be reasonable for a *firm* to treat foreseeable in ■ BIPRU 4.3.85 R as referring to the most distant date to which it carries out detailed capital planning.

4.3.87

FCA PRA

G

A *firm* should be able to demonstrate to the *appropriate regulator*:

- (1) how, with respect to each *rating system*, both assignment of ratings and estimates of *PD*, *LGD* and *conversion factors* are affected by:
  - (a) movements in the economic cycle; and
  - (b) other cyclical effects which are material to levels of *default*, *loss* or the amount of *exposures* at *default* for the *exposures* covered by the *rating system*; and
- (2) the level of conservatism inherent in its ratings, as provided for by *BIPRU*.

4.3.88

FCA PRA

R

A *firm* must add to its estimates a margin of conservatism that is related to the expected range of estimation errors. Where methods and data are less satisfactory and the expected range of errors is larger, the margin of conservatism must be larger.

[Note: BCD Annex VII Part 4 point 54]

4.3.89

FCA PRA

G

Estimation of *PD* through the use of a technique set out in *BIPRU* does not remove the need to make conservative adjustments, where necessary, related to the expected range of estimation errors so that capital requirements produced by the relevant model or other *rating system* are not understated.

4.3.90

FCA PRA

R

If a *firm* uses different estimates for the calculation of *risk weights* and internal purposes it must be documented. The *firm* must be able to demonstrate to the *appropriate regulator* the reasonableness of such estimates.

[Note: BCD Annex VII Part 4 point 55]

4.3.91

FCA PRA

G

If a *firm* can demonstrate to the *appropriate regulator* that for data that has been collected prior to 31 December 2006, appropriate adjustments have been made to achieve broad equivalence with the definitions of *default* or *loss*, the *appropriate regulator* may in the *IRB permission* allow the *firm* some flexibility in the application of the required standards for data.

[Note: BCD Annex VII Part 4 point 56]

4.3.92

FCA PRA

R

**Risk quantification: Overall requirements for estimation: Pooled data**

If a *firm* uses data that is pooled across *institutions* it must be able to demonstrate to the *appropriate regulator* that:

- (1) the *rating systems* and criteria of other firms in the pool are similar to its own;
- (2) the pool is representative of the portfolio for which the pooled data is used; and
- (3) the pooled data is used consistently over time by the *firm* for its permanent estimates.

[Note: BCD Annex VII Part 4 point 57]

4.3.93

FCA PRA

G

■ BIPRU 4.3.92 R (1) is intended to ensure that data entering a pool is consistent and does not contain distortions as a result of different contributors' practices. It is not intended to constrain the use of pooled data by one *firm* that is contributed by a second *firm* where the differences do not affect the data being contributed.

4.3.94

FCA PRA

R

If a *firm* uses data that is pooled across *institutions* it remains responsible for the integrity of its *rating systems*. If a *firm* uses such data it must be able to demonstrate to the *appropriate regulator* that it has sufficient in-house understanding of its *rating systems*, including effective ability to monitor and audit the rating process.

[Note: BCD Annex VII Part 4 point 58]

**Risk quantification: Overall requirements for estimation: Requirements specific to PD estimates**

4.3.95

FCA PRA

R

(1) If:

- (a) a *firm's* internal experience of *exposures* of a type covered by a model or other *rating system* is 20 *defaults* or fewer; and
- (b) in the *firm's* view, 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*;

the *firm* must estimate *PD* for *exposures* covered by that *rating system* in accordance with this *rule*.

- (2) A *firm* must 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* in order to produce conservative estimates of *PDs* in accordance with ■ BIPRU 4.3.88 R.

- (3) The techniques chosen for the purposes of (2) must take account, as a minimum, of the following modelling issues:
- the number of *defaults* and number of obligor years in the sample;
  - the number of years from which the sample was drawn;
  - the interdependence between *default* events for individual obligors;
  - the interdependence between *default* rates for different years; and
  - the choice of the statistical estimators and the associated distributions and confidence intervals.
- (4) The *firm* must further adjust the statistical PD to the extent necessary to take account of the following:
- 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 in accordance with ■ BIPRU 4.4.24 R and ■ BIPRU 4.6.24 R; and
  - 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.
- (5) This *rule* is in addition to the other requirements in BIPRU about the calculation of PD.
- (6) When a *firm* calculates whether it has 20 *defaults* or fewer under the calculation in (1)(a), it must only take into account *defaults* that occurred during periods that are relevant to the validation under ■ BIPRU 4 of the model or other *rating system* in question.

4.3.96

FCA PRA

G

A *firm* may if appropriate also choose to use the approach in ■ BIPRU 4.3.91 G if the internal experience on *exposures* covered by a *rating system* is greater than 20 *defaults*.

4.3.97

FCA PRA

G

If a *firm* excludes *defaulted exposures* that have been cured (as referred to in ■ BIPRU 4.3.71 R) or restructured (as referred to in ■ BIPRU 4.3.63 R (5)) from estimates of LGD in accordance with ■ BIPRU 4.3.110 G, it may also exclude cures from estimates of PD for these *exposures*.

#### Risk quantification: Overall requirements for estimation: Requirements specific to own-LGD estimates

4.3.98

FCA PRA

R

■ BIPRU 4.3.98 R to ■ BIPRU 4.3.123 R set out requirements specific to own-LGD estimates.

**4.3.99** **R** A *firm* must estimate *LGDs* by *facility grade* or pool on the basis of the average realised *LGDs* by *facility grade* or pool using all observed *defaults* within the data sources (*default weighted average*).

FCA PRA

[Note: BCD Annex VII Part 4 point 73]

**4.3.100** **R** A *firm* must calculate the *default weighted average* on the basis of the number of *defaults* included in the calculations made under the *historical average rules* so far as they relate to the calculation of *PDs* and must not be weighted by the size of *exposures*.

FCA PRA

**4.3.101** **R**

(1) A *firm's* estimates of *LGDs* must take into account:

(a) data in respect of relevant incomplete workouts; and

(b) the possibility that the proportion of *defaulted exposures* which are cured (as referred to in ■ BIPRU 4.3.71 R) or restructured (as referred to in ■ BIPRU 4.3.63 R (5)) or the length of the period over which a *firm* makes recoveries under a *defaulted exposure* may be different from the *firm's* observed historic experience.

FCA PRA

(2) An incomplete workout as referred to in (1)(a) means a *defaulted exposure* included in the data set on which the *firm's LGD* estimates are based, but for which the recovery process is still in progress, with the result that the final realised *losses* in respect of that *exposure* are not yet certain.

**4.3.102** **G** The changes referred to in ■ BIPRU 4.3.101 R (1)(b) may be caused by external factors, such as the economic environment, as well as factors specific to the obligor, the transaction or the policies of the *firm*.

FCA PRA

**4.3.103** **R** A *firm* must use *LGD* estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. To the extent a *rating system* is expected to deliver constant realised *LGDs* by grade or pool over time, a *firm* must make adjustments to its estimates of risk parameters by grade or pool to limit the capital impact of an economic downturn.

FCA PRA

[Note: BCD Annex VII Part 4 point 74]

**4.3.104** **R**

(1) A *firm* must have a rigorous and well documented process for:

(a) assessing the effects, if any, of economic downturn conditions on recovery rates; and

(b) producing *LGD* estimates consistent with downturn conditions as referred to in ■ BIPRU 4.3.103 R.

FCA PRA

(2) That process must include the following, which may be included in an integrated manner:

- (a) identification of appropriate downturn conditions for each *IRB exposure class* within each jurisdiction;
- (b) identification of adverse dependencies, if any, between *default* rates and recovery rates; and
- (c) incorporation of adverse dependencies, if identified, between *default* rates and recovery rates in the *firm's* estimates of *LGD* in a manner that meets the requirements in
  - BIPRU 4.3.103 R relating to an economic downturn.

## 4.3.105

FCA PRA

G

A *firm* may derive the *LGD* in accordance with ■ BIPRU 4.3.104 R (2)(c) either by directly assigning to the *facility grade* or pool an estimate of *LGD* appropriate for downturn conditions, or alternatively by estimating a *default* weighted average *LGD* in accordance with ■ BIPRU 4.3.99 R and ■ BIPRU 4.3.76 R and converting it into an *LGD* appropriate for downturn conditions by the use of a formula. It should be able to demonstrate that that formula produces well-founded estimates of *LGDs* consistent with downturn conditions for the *exposures* in question.

## 4.3.106

FCA PRA

G

A *firm* may combine *IRB exposure classes*, jurisdictions or both for the purpose of ■ BIPRU 4.3.104 R (2)(a) if it can demonstrate that the downturn conditions to which the portfolios are subject will be similar.

## 4.3.107

FCA PRA

G

The adverse dependencies referred to in ■ BIPRU 4.3.104 R (2)(b) will not always exist. However, if a *firm* uses *LGDs* that do not allow for such adverse dependencies, it should be able to justify its decision.

## 4.3.108

FCA PRA

G

Data relating to economic downturn conditions is likely to be scarce. Accordingly, a *firm* should use internal data, external data or a combination of data sources in order to produce appropriate downturn *LGD* estimates in accordance with ■ BIPRU 4.3.103 R.

## 4.3.109

FCA PRA

R

A *firm* must retain sufficient data on both *LGDs* calculated on a economic downturn basis and calculated on a long-run average basis (as referred to in ■ BIPRU 4.3.103 R) to be able to demonstrate to the *appropriate regulator* (if asked) that its estimates based on an economic downturn are no less conservative than the long-run average as referred to in that *rule*.

## 4.3.110

FCA PRA

G

Where a *firm* is able to demonstrate that the effect is immaterial in accordance with ■ BIPRU 4.1.25 R (Compliance), it may exclude *defaulted exposures* that have been cured (as referred to in ■ BIPRU 4.3.67 G (1)) or restructured (as referred to in ■ BIPRU 4.3.63 R (5)) from the data about *default* and *loss* experience on which *LGDs* are calculated provided it can demonstrate that its calculation of capital requirements (including capital requirements resulting from the application of capital floors under the transitional *rules* and *guidance* in BIPRU) are not reduced as a result of this approximation.

## 4.3.111

FCA PRA

R

Irrespective of whether calculated on an economic downturn or long-run average basis, each *LGD* estimate must be at least zero.

**4.3.112** G  
FCA PRA In order to support an *LG*D estimate which is very low or zero, a *firm* should be able to demonstrate that the estimate adequately reflects the expected experience on a *default* weighted average basis or in a downturn as appropriate, taking into account the costs and discount rate associated with realisations and the operation of ■ BIPRU 4.3.118 R.

**4.3.113** R  
FCA PRA The methods that a *firm* uses for discounting cash flows for the purposes of estimating *LG*Ds must take account of the uncertainties associated with the receipt of recoveries with respect to a *defaulted exposure*. If a *firm* intends to use a discount rate that does not take full account of the uncertainty in recoveries, it must be able to explain by what other process it has taken into account that uncertainty for the purposes of calculating *LG*Ds.

**4.3.114** G  
FCA PRA The uncertainty referred to in ■ BIPRU 4.3.113 R can be addressed 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.

**4.3.115** G  
FCA PRA A *firm* may exclude from its calculation of *loss* indirect costs that it incurs for the purpose of making recoveries with respect to a *defaulted exposure* if it would also have incurred those costs if there had not been a *default*.

**4.3.116** R  
FCA PRA A *firm* must consider the extent of any dependence between the risk of the obligor with that of the collateral or collateral provider. Cases where there is a significant degree of dependence must be addressed in a conservative manner.

[Note: BCD Annex VII Part 4 point 75]

**4.3.117** R  
FCA PRA Currency mismatches between the underlying obligation and the collateral must be treated conservatively in the *firm's* assessment of *LG*D.

[Note: BCD Annex VII Part 4 point 76]

**4.3.118** R  
FCA PRA To the extent that *LG*D estimates take into account the existence of collateral, these estimates must not solely be based on the collateral's estimated market value. *LG*D estimates must take into account the effect of the potential inability of the *firm* expeditiously to gain control of its collateral and liquidate it.

[Note: BCD Annex VII Part 4 point 77]

**4.3.119** G  
FCA PRA

- (1) A *firm* may comply with ■ BIPRU 4.3.118 R by reducing the amount of the collateral taken into account for the purposes of calculating *LG*D (applying a haircut to the collateral), basing that reduction on validated realisation experience and using conservatism to reflect the uncertainties.
- (2) If collateral is used to reduce the *LG*D, a *firm* should be able to demonstrate how the risk in ■ BIPRU 4.3.118 R has been accounted for. To the extent that it

is adequately accounted for in that way it need not be reflected again as part of the residual risk in relation to collateral under the *overall Pillar 2 rule*.

4.3.120  
FCA PRA

**R** To the extent that *LGD* estimates take into account the existence of collateral, a *firm* must establish internal requirements for collateral management, legal certainty and risk management that are generally consistent with those set out in ■ BIPRU 5 (Credit risk mitigation) as modified by ■ BIPRU 4.10.

[Note: BCD Annex VII Part 4 point 78]

4.3.121  
FCA PRA

**R** To the extent that a *firm* recognises collateral for determining the exposure value for *counterparty credit risk* according to the *CCR standardised method* or the *CCR internal model method*, any amount expected to be recovered from the collateral must not be taken into account in the *LGD* estimates.

[Note: BCD Annex VII Part 4 point 79]

4.3.122  
FCA PRA

**R** For the specific case of *exposures* already in *default*, a *firm* must use the sum of its best estimate of *expected loss* for each *exposure* given current economic circumstances and *exposure* status and the possibility of additional unexpected *losses* during the recovery period.

[Note: BCD Annex VII Part 4 point 80]

4.3.123  
FCA PRA

**R** To the extent that unpaid late fees have been capitalised in a *firm's* income statement, they must be added to the *firm's* measure of *exposure* and *loss*.

[Note: BCD Annex VII Part 4 point 81]

#### Risk quantification: Overall requirements for estimation: Requirements specific to own-conversion factor estimates

4.3.124  
FCA PRA

**R** ■ BIPRU 4.3.125 R - ■ BIPRU 4.3.131 R set out requirements specific to *own-conversion factor* estimates.

4.3.125  
FCA PRA

**R** A *firm* must estimate *conversion factors* by *facility grade* or pool on the basis of the average expected *conversion factors* by *facility grade* or pool using all observed *defaults* within the data sources (*default weighted average*).

[Note: BCD Annex VII Part 4 point 87]

4.3.126  
FCA PRA

**G** (1) A *firm* using own estimates of *conversion factors* should take into account all facility types that may result in an *exposure* when an obligor *defaults*, including uncommitted facilities.

- (2) A *firm* should treat a facility as an *exposure* from the earliest date at which a customer is able to make drawings under it.
- (3) To the extent that a *firm* makes available multiple facilities, it should be able to demonstrate:
  - (a) how it deals with the fact that *exposures* on one may become *exposures* under another on which the *losses* are ultimately incurred; and
  - (b) the impact of its approach on its capital requirements.

4.3.127

FCA PRA

R

A *firm* must use *conversion factor* estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. To the extent a *rating system* is expected to deliver realised *conversion factors* at a constant level by grade or pool over time, a *firm* must make adjustments to its estimates of risk parameters by grade or pool to limit the capital impact of an economic downturn.

[Note: BCD Annex VII Part 4 point 88]

4.3.128

FCA PRA

R

A *firm's* estimates of *conversion factors* must reflect the possibility of additional drawings by the obligor up to and after the time a *default* event is triggered. The *conversion factor* estimate must incorporate a larger margin of conservatism where a stronger positive correlation can reasonably be expected between the *default* frequency and the magnitude of *conversion factor*.

[Note: BCD Annex VII Part 4 point 89]

4.3.129

FCA PRA

R

In arriving at estimates of *conversion factors* a *firm* must consider its specific policies and strategies adopted in respect of account monitoring and payment processing. A *firm* must also consider its ability and willingness to prevent further drawings in circumstances short of payment *default*, such as covenant violations or other technical *default* events.

[Note: BCD Annex VII Part 4 point 90]

4.3.130

FCA PRA

R

A *firm* must have adequate systems and procedures in place to monitor facility amounts, current outstandings against committed lines and changes in outstandings per obligor and per grade. A *firm* must be able to monitor outstanding balances on a daily basis.

[Note: BCD Annex VII Part 4 point 91]

4.3.131

FCA PRA

R

If a *firm* uses different estimates of *conversion factors* for the calculation of *risk weighted exposure amounts* and internal purposes it must be documented. The *firm* must be able to demonstrate their reasonableness to the *appropriate regulator*.

[Note: BCD Annex VII Part 4 point 92]

4.3.132

FCA PRA

G

**Risk quantification: Overall requirements for estimation: Comparability**

- (1) This paragraph contains *guidance* about the interpretation of the requirements relating to comparability in ■ BIPRU 4.3.85 R. It is also relevant to the requirement for representative data in ■ BIPRU 4.3.51 R (5), to the references to comparability in the additional *guidance* in ■ BIPRU 4.3.53 G (7)(b) and to the requirements for similarity in ■ BIPRU 4.3.92 R.
- (2) In general, comparability should be based on analyses of the population of *exposures* represented in the data, the lending standards used when the data was generated (where relevant) and other relevant characteristics in relation to the corresponding properties of the *firm's* own portfolio. Other relevant characteristics could include the distribution of the obligors across industries, the size distribution of the *exposures* and similarity with respect to the geographic or demographic distribution of the *exposures*.

## 4.4 The IRB approach: Exposures to corporates, institutions and sovereigns

### Application

4.4.1

R

FCA PRA

- (1) This section applies with respect to the *sovereign, institution and corporate IRB exposure class*.
- (2) The *sovereign, institution and corporate IRB exposure class* includes *specialised lending exposures*.
- (3) Both ■ BIPRU 4.4 and ■ BIPRU 4.5 (Specialised lending exposures) apply to *specialised lending exposures*. A firm may calculate *risk weighted exposure amounts* for a *specialised lending exposure* either:
  - (a) (if it is able to do so) in accordance with ■ BIPRU 4.4; or
  - (b) in accordance with ■ BIPRU 4.4 as modified by ■ BIPRU 4.5.

### Definition

4.4.2

R

FCA PRA

The following *exposures* must be treated as *exposures* to central governments and *central banks*:

- (1) *exposures* to regional governments, local authorities or *public sector entities* which are treated as *exposures* to central governments under the *standardised approach*; and
- (2) *exposures* to *multilateral development banks* and international organisations which attract a *risk weight* of 0% under the *standardised approach*.

[Note: BCD Article 86(2)]

4.4.3

R

FCA PRA

The following *exposures* must be treated as *exposures* to *institutions*:

- (1) *exposures* to regional governments and local authorities which are not treated as *exposures* to central governments under the *standardised approach*;

- (2) *exposures to public sector entities* which are treated as *exposures to institutions* under the *standardised approach*;
- (3) *exposures to multilateral development banks* which do not attract a 0% *risk weight* under the *standardised approach*; and
- (4) without prejudice to ■ BIPRU 13.3.13 R and ■ BIPRU 13.8.7 R (*Exposures to a central counterparty*) *exposures to recognised third country investment firms* and *exposures to recognised clearing houses and designated investment exchanges*.

[Note: BCD Article 86(3) and CAD Article 40]

4.4.4

FCA PRA

R

Any credit obligation not assigned to the *IRB exposure classes* referred to in ■ BIPRU 4.3.2 R (1) (Sovereigns), ■ BIPRU 4.3.2 R (2) (Institutions) and ■ BIPRU 4.3.2 R (4) - ■ BIPRU 4.3.2 R (6) (Retail, equity and securitisations) must be assigned to the *corporate exposure class*.

[Note: BCD Article 86(7)]

#### Rating system: Structure of rating system

4.4.5

FCA PRA

R

■ BIPRU 4.4.6 R - ■ BIPRU 4.4.21 R apply in addition to ■ BIPRU 4.3.25 R - ■ BIPRU 4.3.28 R (Rating systems).

4.4.6

FCA PRA

R

A *rating system* must take into account obligor and transaction risk characteristics.

[Note: BCD Annex VII Part 4 point 5]

4.4.7

FCA PRA

R

A *rating system* must have an obligor rating scale which reflects exclusively quantification of the risk of obligor *default*. The obligor rating scale must have a minimum of seven grades for non-*defaulted* obligors and one for *defaulted* obligors.

[Note: BCD Annex VII Part 4 point 6]

4.4.8

FCA PRA

R

An *obligor grade* means for the purpose of ■ BIPRU 4 as it applies to the *sovereign, institution and corporate IRB exposure class* a risk category within a *rating system's* obligor rating scale, to which obligors are assigned on the basis of a specified and distinct set of rating criteria, from which estimates of *PD* are derived. A *firm* must document both the relationship between *obligor grades* in terms of the level of *default risk* each grade implies and the criteria used to distinguish that level of *default risk*.

[Note: BCD Annex VII Part 4 point 7]

4.4.9

FCA PRA

R

A *firm* with portfolios concentrated in a particular market segment and range of *default risk* must have enough *obligor grades* within that range

to avoid undue concentrations of obligors in a particular grade. Significant concentrations within a single grade must be supported by convincing empirical evidence that the *obligor grade* covers a reasonably narrow *PD* band and that the *default* risk posed by all obligors in the grade falls within that band.

[Note: *BCD* Annex VII Part 4 point 8]

#### Rating system: Assignment to grades or pools

4.4.10

G

FCA PRA

Material on assignment to grades or pools can be found in ■ BIPRU 4.3.43 R - ■ BIPRU 4.3.48 R.

#### Rating system: Assignment of exposures

4.4.11

R

FCA PRA

Each obligor must be assigned to an *obligor grade* as part of the credit approval process.

[Note: *BCD* Annex VII Part 4 point 19]

4.4.12

R

FCA PRA

Each separate legal entity to which a *firm* is exposed must be separately rated. A *firm* must be able to demonstrate to the *appropriate regulator* that it has acceptable policies regarding the treatment of individual obligor clients and *groups of connected clients*.

[Note: *BCD* Annex VII Part 4 point 22]

4.4.13

R

FCA PRA

Separate *exposures* to the same obligor must be assigned to the same *obligor grade*, irrespective of any differences in the nature of each specific transaction. Exceptions, where separate *exposures* are allowed to result in multiple grades for the same obligor are:

- (1) country transfer risk, this being dependent on whether the *exposures* are denominated in local or foreign currency;
- (2) where the treatment of associated guarantees to an *exposure* may be reflected in an adjusted assignment to an *obligor grade*; and
- (3) where consumer protection, bank secrecy or other legislation prohibit the exchange of client data.

[Note: *BCD* Annex VII Part 4 point 23]

#### Rating system: Overrides

4.4.14

G

FCA PRA

Material on overrides can be found in ■ BIPRU 4.3.50 R.

**Rating system: Integrity of assignment process**

4.4.15

FCA PRA

R

Assignments and periodic reviews of assignments must be completed or approved by an independent party that does not directly benefit from decisions to extend the credit.

[Note: BCD Annex VII Part 4 point 26]

4.4.16

FCA PRA

R

A *firm* must update assignments at least annually. High risk obligors and problem *exposures* must be subject to more frequent review. A *firm* must undertake a new assignment if material information on the obligor or *exposure* becomes available.

[Note: BCD Annex VII Part 4 point 27]

4.4.17

FCA PRA

G

Although it will not usually be the case that facility ratings and *conversion factors* will have to be updated more frequently than annually, *LGDs* and *exposure* values are subject to more frequent recalculation due to their connection to drawn balances, which can vary on a daily basis.

4.4.18

FCA PRA

R

A *firm* must have an effective process to obtain and update relevant information on obligor characteristics that affect *PDs*, and on transaction characteristics that affect *LGDs* and *conversion factors*.

[Note: BCD Annex VII Part 4 point 28]

**Rating system: Use of models**

4.4.19

FCA PRA

G

Material on the use of models can be found in ■ BIPRU 4.3.51 R - ■ BIPRU 4.3.53 G.

**Rating system: Documentation of rating systems**

4.4.20

FCA PRA

G

Material on the documentation of rating systems can be found in ■ BIPRU 4.3.19 R - ■ BIPRU 4.3.24 R.

**Rating system: Data maintenance**

4.4.21

FCA PRA

R

In addition to complying with the material in ■ BIPRU 4.3.54 R (Data maintenance) a *firm* must collect and store:

- (1) complete rating histories on obligors and recognised guarantors;
- (2) the dates the ratings were assigned;
- (3) the key data and methodology used to derive the rating;
- (4) the person responsible for the rating assignment;
- (5) the identity of obligors and *exposures* that *defaulted*;
- (6) the date and circumstances of such *defaults*;

- (7) data on the *PDs* and realised *default* rates associated with rating grades and ratings migration; and
- (8) (in the case of a *firm* not using the *advanced IRB approach* in the calculation of *LGDs* and/or *conversion factors*) data on comparisons of realised *LGDs* to the values as set out in ■ BIPRU 4.4.34 R and ■ BIPRU 4.8.25 R and realised *conversion factors* to the values as set out in ■ BIPRU 4.4.37 R, ■ BIPRU 4.4.45 R and ■ BIPRU 4.6.44 R.

[Note: BCD Annex VII Part 4 point 37]

#### Risk quantification: Definition of default

4.4.22

FCA PRA

R

- (1) This *rule*, in accordance with ■ BIPRU 4.3.57 R (4) (Definition of default), sets the exact number of days past due that a *firm* should abide by in the case of *exposures* to *PSEs*.
- (2) For counterparts that are *PSEs* situated within the *United Kingdom* the number of days past due is 180.
- (3) For counterparts that are *PSEs* situated in another *EEA State* the number of days past due is the lower of:
  - (a) 180; and
  - (b) the number of days past due fixed under the *CRD implementation measure* with respect to point 48 of Part 4 of Annex VII of the *Banking Consolidation Directive* for that *EEA State* for such *exposures*.
- (4) For counterparts that are *PSEs* in a state outside the *EEA* the number of days past due is the lower of:
  - (a) 180; and
  - (b) (if a number of days past due for such *exposures* has been fixed under any law of that state applicable to *undertakings* in the *banking sector* or the *investment services sector* that implements the *IRB approach*) that number.

[Note: BCD Annex VII Part 4 point 44 (part) and point 48 (part)]

#### Risk quantification: Overall requirements for estimation: Requirements specific to PD estimation

PAGE  
55

4.4.23

FCA PRA

R

■ BIPRU 4.4.24 R - ■ BIPRU 4.4.31 R apply to both the *foundation IRB approach* and the *advanced IRB approach*.

4.4.24

FCA PRA

R

A *firm* must estimate *PDs* by *obligor grade* from long run averages of one-year *default* rates.

[Note: BCD Annex VII Part 4 point 59]

4.4.25

FCA PRA

R

A *firm* must use *PD* estimation techniques only with supporting analysis. A *firm* must recognise the importance of judgmental considerations in combining results of techniques and in making adjustments for limitations of techniques and information.

[Note: BCD Annex VII Part 4 point 62]

4.4.26

FCA PRA

G

Where rating agency experience or the output of a statistical default model are the primary component of *PD* estimation, a *firm* should consider whether it needs to make adjustments for other relevant information, such as internal experience, conservatism and cyclical effects. In making these adjustments, a *firm* should consider the extent to which it needs to take account of the potential for both under-recording of actual *defaults* experienced and divergence of actual experience from the true underlying average *PD*.

4.4.27

FCA PRA

R

To the extent that a *firm* uses data on internal *default* experience for the estimation of *PDs* it must be able to demonstrate in its analysis that the estimates are reflective of underwriting standards and of any differences in the *rating system* that generated the data and the current *rating system*. Where underwriting standards or *rating systems* have changed, a *firm* must add a greater margin of conservatism in its estimate of *PD*.

[Note: BCD Annex VII Part 4 point 63]

4.4.28

FCA PRA

R

To the extent that a *firm* associates or maps its internal grades to the scale used by an *ECAI* or similar organisations and then attributes the *default* rate observed for the external organisation's grades to the *firm's* grades, mappings must be based on a comparison of internal rating criteria to the criteria used by the external organisation and on a comparison of the internal and external ratings of any common obligors. Biases or inconsistencies in the mapping approach or underlying data must be avoided. The external organisation's criteria underlying the data used for quantification must be oriented to *default* risk only and not reflect transaction characteristics. The *firm's* analysis must include a comparison of the *default* definitions used, subject to the requirements in ■ BIPRU 4.3.56 R to ■ BIPRU 4.3.71 R and ■ BIPRU 4.4.22 R (Definition of default). The *firm* must document the basis for the mapping.

[Note: BCD Annex VII Part 4 point 64]

4.4.29

FCA PRA

G

It is unlikely that a *firm* will be able to convince the *appropriate regulator* that it had considered all relevant and available information, as required by ■ BIPRU 4.3.74 R, if it used only data from one *ECAI* or similar organisation, where other relevant information is available.

4.4.30

FCA PRA

R

To the extent that a *firm* uses statistical *default* prediction models it may estimate *PDs* as the simple average of *default*-probability estimates for individual obligors in a given grade. The firm's use of *default* probability models for this purpose must meet the standards specified in

■ BIPRU 4.3.51 R.

[Note: BCD Annex VII Part 4 point 65]

4.4.31

FCA PRA

R

Irrespective of whether a *firm* is using external, internal, or pooled data sources, or a combination of the three, for its *PD* estimation, the length of the underlying historical observation period used must be at least five years for at least one source. If the available observation period spans a longer period for any source, and this data is relevant, this longer period must be used. A *firm* not permitted to use own estimates of *LGDs* or *conversion factors* may have, when it implements the *IRB approach*, relevant data covering a period of two years. The period to be covered must increase by one year each year until relevant data cover a period of five years.

[Note: BCD Annex VII Part 4 point 66 (part)]

#### IRB foundation approach: General

4.4.32

FCA PRA

R

■ BIPRU 4.4.33 R - ■ BIPRU 4.4.39 R set out requirements specific to the *foundation IRB approach*.

4.4.33

FCA PRA

R

Under the *foundation IRB approach* a *firm* must apply the *LGD* values set out in ■ BIPRU 4.4.34 R and ■ BIPRU 4.8.25 R and the *conversion factors* set out in ■ BIPRU 4.4.37 R.

[Note: BCD Article 87(8)]

#### IRB foundation approach: LGDs

4.4.34

FCA PRA

R

A *firm* must use the following *LGD* values:

- (1) senior *exposures* without eligible collateral, 45%;
- (2) subordinated *exposures* without eligible collateral, 75%;
- (3) a *firm* may recognise funded and *unfunded credit protection* in the *LGD* in accordance with ■ BIPRU 5 (Credit risk mitigation), as modified by ■ BIPRU 4.10;
- (4) *covered bonds* may be assigned an *LGD* value of 11.25%; and
- (5) for certain senior *corporate exposure* purchased receivables, for certain subordinated *corporate exposure* purchased receivables and for *dilution risk* of *corporate* purchased receivables the provisions of ■ BIPRU 4.8.25 R (*LGDs* for corporate receivables) apply.

[Note: BCD Annex VII Part 2 point 8 (part)]

4.4.35

R

[deleted]

(1) [deleted]

(2) [deleted]

(3) [deleted]

(4) [deleted]

#### Foundation IRB approach: Exposure value and conversion factors

4.4.36

R

FCA PRA

■ BIPRU 4.4.37 R - ■ BIPRU 4.4.39 R apply in addition to ■ BIPRU 4.4.71 R - ■ BIPRU 4.4.78 R.

4.4.37

R

FCA PRA

- (1) The *exposure* value for the items set out in this *rule* must be calculated as the committed but undrawn amount multiplied by the applicable *conversion factor* set out in this *rule*.
- (2) For credit lines which are uncommitted, that are unconditionally cancellable at any time by the *firm* without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's credit worthiness, a *conversion factor* of 0 % applies. To apply a *conversion factor* of 0% a *firm* must actively monitor the financial condition of the obligor, and its internal control systems must enable it immediately to detect a deterioration in the credit quality of the obligor.
- (3) For short-term letters of credit arising from the movement of goods, a *conversion factor* of 20% applies for both the issuing and confirming *firms*.
- (4) For other credit lines, note issuance facilities (NIFs), and revolving underwriting facilities (RUFs), a *conversion factor* of 75% applies.
- (5) For undrawn purchase commitments for revolving purchased receivables falling under ■ BIPRU 4.8.29 R, the *conversion factor* set out in that *rule* applies.

[Note: BCD Annex VII Part 3 point 9 (part)]

4.4.38

R

FCA PRA

Where a commitment refers to the extension of another commitment, the lower of the two *conversion factors* associated with the individual commitment must be used.

[Note: BCD Annex VII Part 3 point 10]

4.4.39

FCA PRA

R

For all off-balance sheet items other than mentioned in ■ BIPRU 4.4.37 R, ■ BIPRU 4.4.45 R, ■ BIPRU 4.4.71 R - ■ BIPRU 4.4.78 R, ■ BIPRU 4.6.44 R, ■ BIPRU 4.8.28 R and ■ BIPRU 4.8.29 R, the *exposure* value must be the following percentage of its value:

- (1) 100% if it is a full risk item;
- (2) 50% if it is a medium risk item;
- (3) 20% if it is a medium/low risk item; and
- (4) 0% if it is a low risk item.

For the purposes of this *rule* the off-balance sheet items must be assigned to risk categories as indicated in ■ BIPRU 3.7 (Classification of off-balance sheet items).

[Note: BCD Annex VII Part 3 point 11]

#### Advanced IRB approach: General

4.4.40

FCA PRA

R

■ BIPRU 4.4.41 R - ■ BIPRU 4.4.55 R set out requirements specific to the *advanced IRB approach*.

4.4.41

FCA PRA

R

Under the *advanced IRB approach* a *firm* must use its own estimates of *LGDs* and *conversion factors* in accordance with ■ BIPRU 4.

[Note: BCD Article 87(9)]

#### Advanced IRB approach: LGDs and PDs

4.4.42

FCA PRA

R

A *firm* using own *LGD* estimates under the *advanced IRB approach* may recognise *unfunded credit protection* by adjusting *PDs* subject to ■ BIPRU 4.4.43 R.

[Note: BCD Annex VII Part 2 point 6]

4.4.43

FCA PRA

R

Notwithstanding ■ BIPRU 4.4.34 R and ■ BIPRU 4.8.25 R, if a *firm's IRB permission* permits it to use own *LGD* estimates under the *advanced IRB approach* for *exposures* to which ■ BIPRU 4 applies and permits it to use the approach in this *rule*, *unfunded credit protection* may be recognised by adjusting *PD* and/or *LGD* estimates subject to the *minimum IRB standards*. A *firm* must not assign guaranteed exposures an adjusted *PD* or *LGD* such that the adjusted *risk weight* would be lower than that of a comparable, direct *exposure* to the guarantor.

[Note: BCD Annex VII Part 2 point 10]

4.4.44

FCA PRA

G

A *firm* using the *advanced IRB approach* may only recognise *unfunded credit protection* in accordance with ■ BIPRU 4.4.43 R. The other methods for recognising *unfunded credit*

*risk mitigation* under the *standardised approach* and *foundation IRB approach* are not available to a *firm* on the *advanced IRB approach*.

#### Advanced IRB approach: Conversion factors

4.4.45

FCA PRA

R

If a *firm* uses its own estimates of *conversion factors* under the *advanced IRB approach* it must calculate the *exposure* value of off-balance sheet *exposures* calculated with the use of *conversion factors* by using its own estimates of *conversion factors* across different product types as mentioned in ■ BIPRU 4.4.37 R and ■ BIPRU 4.4.39 R (2) to ■ BIPRU 4.4.39 R (4).

[Note: BCD Annex VII Part 3 point 9 (part)]

4.4.46

FCA PRA

G

Under ■ BIPRU 4.4.45 R, a *firm* may calculate *exposure* values by calculating the amount expected to be claimed, instead of the maximum possible amount of the potential claim. The figure for the amount expected to be claimed should not be less than the current outstandings from time to time.

#### Advanced IRB approach: Structure of the rating system

4.4.47

FCA PRA

R

■ BIPRU 4.4.48 R - ■ BIPRU 4.4.50 R are in addition to ■ BIPRU 4.3.25 R - ■ BIPRU 4.3.28 R and ■ BIPRU 4.4.6 R - ■ BIPRU 4.4.9 R.

4.4.48

FCA PRA

R

If a *firm's IRB permission* provides for it to use the *advanced IRB approach* for the calculation of *LGDs*, its *rating system* must incorporate a distinct facility rating scale which exclusively reflects *LGD* related transaction characteristics.

[Note: BCD Annex VII Part 4 point 9]

4.4.49

FCA PRA

R

A *facility grade* means for the purpose of the *advanced IRB approach* a risk category within a *rating system's* facility scale to which *exposures* are assigned on the basis of a specified and distinct set of rating criteria from which own estimates of *LGDs* are derived. The grade definition must include both a description of how *exposures* are assigned to the grade and of the criteria used to distinguish the level of risk across grades.

[Note: BCD Annex VII Part 4 point 10]

4.4.50

FCA PRA

R

Significant concentrations within a single *facility grade* must be supported by convincing empirical evidence that the *facility grade* covers a reasonably narrow *LGD* band, respectively, and that the risk posed by all *exposures* in the grade falls within that band.

[Note: BCD Annex VII Part 4 point 11]

#### Advanced IRB approach: Assignment of exposures

4.4.51

FCA PRA

R

For a *firm* permitted to use own estimates of *LGDs* or *conversion factors* under the *advanced IRB approach*, each *exposure* must be assigned to

a *facility grade* as part of the credit approval process. This is in addition to the requirements in ■ BIPRU 4.4.11 R - ■ BIPRU 4.4.13 R.

[Note: BCD Annex VII Part 4 point 20]

4.4.52

FCA PRA

G

■ BIPRU 4.4.50 R and ■ BIPRU 4.4.51 R should be read in the light of ■ BIPRU 4.3.28 R.

#### Advanced IRB approach: Data maintenance

4.4.53

FCA PRA

R

As well as complying with ■ BIPRU 4.3.54 R and ■ BIPRU 4.4.21 R (Data maintenance), a *firm* using own estimates of *LGDs* and/or *conversion factors* under the *advanced IRB approach* must collect and store:

- (1) complete histories of data on the facility ratings and *LGD* and *conversion factor* estimates associated with each rating scale;
- (2) the dates the ratings were assigned and the estimates were done;
- (3) the key data and methodology used to derive the facility ratings and *LGD* and *conversion factor* estimates;
- (4) the person who assigned the facility rating and the person who provided *LGD* and *conversion factor* estimates;
- (5) data on the estimated and realised *LGDs* and *conversion factors* associated with each *defaulted exposure*;
- (6) data on the *LGD* of the *exposure* before and after evaluation of the effects of a guarantee or credit derivative, for a *firm* that reflects the credit risk mitigating effects of guarantees or credit derivatives through *LGD*; and
- (7) data on the components of *loss* for each *defaulted exposure*.

[Note: BCD Annex VII Part 4 Point 38]

#### Advanced IRB approach: Requirements specific to own-LGD estimates

4.4.54

FCA PRA

R

In addition to the requirements in ■ BIPRU 4.3.74 R - ■ BIPRU 4.3.94 R (General requirements about risk quantification) and ■ BIPRU 4.3.98 R - ■ BIPRU 4.3.123 R (Requirements for risk quantification specific to own-LGD estimates), estimates of *LGD* must be based on data over a minimum of five years, increasing by one year each year after implementation until a minimum of seven years is reached, for at least one data source. If the available observation period spans a longer period for any source, and the data is relevant, this longer period must be used.

[Note: BCD Annex VII Part 4 point 82]

**Advanced IRB approach: Requirements specific to own-conversion factor estimates**

4.4.55  
FCA PRA

**R** In addition to the requirements in ■ BIPRU 4.3.124 R - ■ BIPRU 4.3.131 R (Requirements specific to own-conversion factor estimates), estimates of *conversion factors* must be based on data over a minimum of five years, increasing by one year each year after implementation until a minimum of seven years is reached, for at least one data source. If the available observation period spans a longer period for any source, and the data is relevant, this longer period must be used.

[Note: BCD Annex VII Part 4 point 93]

**Calculations: General**

4.4.56  
FCA PRA

**R** The remainder of this section applies to both the *foundation IRB approach* and the *advanced IRB approach*.

**Calculations: Risk-weighted exposure amounts**

4.4.57  
FCA PRA

**R** Subject to ■ BIPRU 4.4.59 R to ■ BIPRU 4.4.60 R, ■ BIPRU 4.5.6 R, ■ BIPRU 4.5.8 R - ■ BIPRU 4.5.10 R (Risk weights for specialised lending), ■ BIPRU 4.8.16 R, ■ BIPRU 4.8.17 R (Risk weights for corporate exposure purchased receivables) and ■ BIPRU 4.9.3 R (Securitisation: provision of credit protection), *risk weighted exposure amounts* must be calculated according to the formulae in the table in ■ BIPRU 4.4.58 R and the adjustment formula in ■ BIPRU 4.4.79 R (Double default).

[Note: BCD Annex VII Part 1 point 3]

4.4.58  
FCA PRA

**R** Table: Formulae for the calculation of *risk weighted exposure amounts*

This table belongs to ■ BIPRU 4.4.57 R

Correlation (R)	$0.12 \times (1 - \text{EXP}(-50 \cdot PD)) / (1 - \text{EXP}(-50)) + 0.24 \cdot [1 - (1 - \text{EXP}(-50 \cdot PD)) / (1 - \text{EXP}(-50))]$
Maturity factor (b)	$(0.11852 - 0.05478 \cdot \ln(PD))^2$  $(LGD \cdot N[(1-R)^{-0.5} \cdot G(PD) + (R/(1-R))^{0.5} \cdot G(0.999)] - PD \cdot LGD) \cdot (1 - 1.5 \cdot b)^{-1} \cdot (1 + (M - 2.5) \cdot b) \cdot 12.5 \cdot 1.06$
N(x)	denotes the cumulative distribution function for a standard normal random variable (i.e. the probability that a normal random variable with mean zero and variance of one is less than or equal to x). G(z) denotes the inverse cumulative distribution function for a standard normal random variable (i.e. the value x such that N(x) = z).
PD = 0	For PD = 0, RW shall be: 0

**PD = 1** For **PD = 1**:

(i) for *defaulted exposures* where a *firm* applies the *LGD* values set out in BIPRU 4.4.32R and BIPRU 4.8.25R RW shall be: 0;

(ii) for *defaulted exposures* where a *firm* uses its own estimates of *LGDs*, RW shall be:  $\text{Max}\{0, 12.5 * (\text{LGD} - \text{EL}_{\text{BE}})\}$ ;

where  $\text{EL}_{\text{BE}}$  must be the *firm's* best estimate of *expected loss* for the *defaulted exposure* according to BIPRU 4.3.122 R.

[Note: BCD Annex VII Part 1 point 3]

4.4.59

FCA PRA

R

For *exposures* to companies where the total annual sales for the consolidated group of which the firm is a part is less than EUR 50 million a *firm* may use the following correlation formula for the calculation of *risk weights* for *corporate exposures*. In this formula S is expressed as total annual sales in millions of Euros with  $\text{EUR } 5 \text{ million} \leq S \leq \text{EUR } 50 \text{ million}$ . Reported sales of less than EUR 5 million must be treated as if they were equivalent to EUR 5 million. In accordance with ■ BIPRU 4.8.21 R, for purchased receivables the total annual sales are the weighted average by individual *exposures* of the pool. The formula for the calculation of correlation (R) is:

$$0.12 \times (1 - \text{EXP}(-50 * \text{PD})) / (1 - \text{EXP}(-50)) + 0.24 *$$

$$[1 - (1 - \text{EXP}(-50 * \text{PD})) / (1 - \text{EXP}(-50))]$$

$$-0.04 * (1 - (S - 5) / 45)$$

[Note: BCD Annex VII Part 1 point 5 (part)]

4.4.60

FCA PRA

R

A *firm* must for the purpose of ■ BIPRU 4.4.59 R substitute total assets of the consolidated group for total annual sales when total annual sales are not a meaningful indicator of firm size and total assets are a more meaningful indicator than total annual sales.

[Note: BCD Annex VII Part 1 point 5 (part)]

#### Calculations: Expected loss amounts

4.4.61

FCA PRA

R

*Expected loss* amounts must be calculated according to the formulae in the table in ■ BIPRU 4.4.62 R.

[Note: BCD Annex VII Part 1 point 30 (part)]

4.4.62

FCA PRA

R Table: Formulae for the calculation of *expected loss* amounts

This table belongs to ■ BIPRU 4.4.61 R

*Expected loss (EL)* equals  $PD \times LGD$ *Expected loss amount* equals  $EL \times \text{exposure value}$ 

For *defaulted exposures* ( $PD = 1$ ) where a *firm* uses its own estimates of *LGDs*, *EL* must be  $EL_{BE}$ , the *firm's* best estimate of *expected loss* for the *defaulted exposure* according to BIPRU 4.3.122 R.

For exposures subject to the treatment set out in BIPRU 4.4.79 R (Double default) *EL* must be 0.

[Note: BCD Annex VII Part 1 point 30 (part)]

**Calculations: PD**

4.4.63

FCA PRA

R A *firm* must provide its own estimates of *PDs* in accordance with its *IRB permission* and the *minimum IRB standards*.

[Note: BCD Article 87(6) (part)]

4.4.64

FCA PRA

R The *PD* of a *corporate exposure* or an *exposure* in the *IRB exposure class* referred to in ■ BIPRU 4.3.2 R (2) (Institutions) must be at least 0.03%.

[Note: BCD Annex VII Part 2 point 2]

4.4.65

FCA PRA

R The *PD* of obligors in *default* must be 100%.

[Note: BCD Annex VII Part 2 point 4]

4.4.66

FCA PRA

R Subject to ■ BIPRU 4.4.42 R (*Advanced IRB approach: LGDs and PDs*) a *firm* may recognise *unfunded credit protection* in the *PD* in accordance with the provisions of ■ BIPRU 5 (Credit risk mitigation), as modified by ■ BIPRU 4.10. For *dilution risk*, however, a *firm* may also recognise *unfunded credit protection* providers which are specified in its *IRB permission* in addition to those indicated in the *CRM eligibility conditions*.

[Note: BCD Annex VII Part 2 point 5]

**Calculations: Maturity**

4.4.67

FCA PRA

R (1) A *firm* must calculate maturity (*M*) for each of the *exposures* referred to in this *rule* in accordance with this *rule* and subject to ■ BIPRU 4.4.68 R to ■ BIPRU 4.4.70 R. In all cases, *M* must be no greater than 5 years.(2) For an instrument subject to a cash flow schedule *M* must be calculated according to the following formula:

$$M = \text{MAX}\{1; \text{MIN}\{\sum_t t * CF_t / \sum_t CF_t; 5\}\}$$

where  $CF_t$  denotes the cash flows (principal, interest payments and fees) contractually payable by the obligor in period  $t$ .

- (3) For derivatives subject to a master netting agreement  $M$  must be the weighted average remaining maturity of the *exposure*, where  $M$  must be at least 1 year. The notional amount of each *exposure* must be used for weighting the maturity.
- (4) For *exposures* arising from fully or nearly-fully collateralised *financial derivative instruments* transactions and fully or nearly-fully collateralised *margin lending transactions* which are subject to a master netting agreement  $M$  must be the weighted average remaining maturity of the transactions where  $M$  must be at least 10 days. For *repurchase transactions* or securities or commodities lending or borrowing transactions which are subject to a master netting agreement,  $M$  must be the weighted average remaining maturity of transactions, where  $M$  must be at least 5 days. The notional amount of each transaction must be used for weighting the maturity.
- (5) Where a *firm* uses the *CCR internal model method* to calculate the *exposure* values,  $M$  must be calculated for *exposures* to which a *firm* applies this method and for which the maturity of the longest-dated contract contained in the *netting set* is greater than one year according to the following formula:

$$M = \text{MIN} \left( \frac{\sum_{k=1}^{tk \leq 1 \text{ year}} \text{Effective EE}_k * \Delta tk * dfk + \sum_{tk > 1 \text{ year}}^{\text{maturity}} \text{EE}_k * \Delta tk * dfk}{\sum_{k=1}^{tk \leq 1 \text{ year}} \text{Effective EE}_k * \Delta tk * dfk}, 5 \right)$$

where:

$dfk$  = the risk-free discount factor for future time period  $tk$  and the remaining symbols are defined in ■ BIPRU 13.6.

- (6) Notwithstanding (7), a *firm* that uses a *CCR internal model method* model to calculate a *one-sided credit valuation adjustment* (CVA) may use the effective credit duration estimated by the model as  $M$  if permitted to do so by its *CCR internal model method permission*.
- (7) Subject to ■ BIPRU 4.4.68 R, for *netting sets* in which all contracts have an original maturity of less than one year the formula in (2) must be applied.
- (8) If a *firm* is permitted under its *IRB permission* to use own *PD* estimates for *corporate exposure* purchased receivables, for drawn amounts  $M$  must equal the purchased receivables *exposure*

weighted average maturity, where *M* must be at least 90 days. This same value of *M* must also be used for undrawn amounts under a committed purchase facility provided the facility contains effective covenants, early amortisation triggers, or other features that protect the purchasing *firm* against a significant deterioration in the quality of the future receivables it is required to purchase over the facility's term. Absent such effective protections, *M* for undrawn amounts must be calculated as the sum of the longest-dated potential receivable under the purchase agreement and the remaining maturity of the purchase facility, where *M* must be at least 90 days.

- (9) For any other instrument than mentioned in this *rule* or when a *firm* is not in a position to calculate *M* as set out in (2), *M* must be the maximum remaining time (in years) that the obligor is permitted to take fully to discharge its contractual obligations, where *M* must be at least 1 year.
- (10) Notwithstanding (2) and (9), *M* must be at least one-day for:
- (a) import letters of credit (including standby letters of credit issued for similar purposes) and acceptances under them;
  - (b) export letters of credit confirmation and negotiation;
  - (c) pre-shipment and post-shipment acceptances and financing;
  - (d) export and import loans collateralised by underlying goods, up to a maximum maturity of 180 days; and
  - (e) performance guarantees, bid bonds and other guarantees (including standby letters of credit issued for similar purposes) relating to the export and import of goods and services;

provided these *exposures* are not part of the *firm's* ongoing financing of the obligor.

[Note: BCD Annex VII Part 2 point 13 (part)]

4.4.68

FCA PRA

R

Notwithstanding ■ BIPRU 4.4.67 R (2) - ■ (4) and (8)-(9), *M* must be at least one-day for:

- (1) fully or nearly-fully collateralised *financial derivative instruments*;
- (2) fully or nearly-fully collateralised *margin lending transactions*; and
- (3) *repurchase transactions, securities or commodities lending or borrowing transactions*,

provided the documentation requires daily remargining and daily revaluation and includes provisions that allow for the prompt liquidation or setoff of collateral in the event of *default* or failure to re-margin.

[Note: *BCD* Annex VII Part 2 point 14 (part)]

4.4.69

FCA PRA

G

The last paragraph of paragraph 14 of Part 2 of Annex VII of the *Banking Consolidation Directive* says: "In addition, for other short-term exposures specified by the competent authorities which are not part of the credit institution's ongoing financing of the obligor, M shall be at least one-day. A careful review of the particular circumstances shall be made in each case." ■ BIPRU 4.4.67R (10) is currently the only instance where the *appropriate regulator* has specified any such short-term exposures.

[Note: *BCD* Annex VII Part 2 point 14 (part)]

4.4.70

FCA PRA

R

Maturity mismatches must be treated as specified in ■ BIPRU 4.10 and ■ BIPRU 5 (Credit risk mitigation).

[Note: *BCD* Annex VII Part 2 point 16]

#### Calculations: Exposure value

4.4.71

FCA PRA

R

Unless provided otherwise in ■ BIPRU 4 the *exposure* value of on-balance sheet *exposures* must be measured gross of value adjustments. This also applies to assets purchased at a price different than the amount owed. For purchased assets, the difference between the amount owed and the net value recorded on the balance-sheet of the firm is denoted discount if the amount owed is larger, and premium if it is smaller.

[Note: *BCD* Annex VII Part 3 point 1]

4.4.72

FCA PRA

R

A *firm* must not treat the *exposure* value of a facility as being less than current drawings under it. Interest accrued to date on an *exposure* under a facility must be included in current drawings or an allowance for it must be built into the *conversion factor*.

4.4.73

FCA PRA

R

Where a *firm* uses master netting agreements in relation to *repurchase transactions* or *securities or commodities lending or borrowing transactions* the *exposure* value must be calculated in accordance with ■ BIPRU 5 (Credit risk mitigation), as modified by ■ BIPRU 4.10, and ■ BIPRU 13.8.

[Note: *BCD* Annex VII Part 3 point 2]

4.4.74

FCA PRA

R

For on-balance sheet netting of loans and deposits a *firm* must apply for the calculation of the *exposure* value the methods set out in ■ BIPRU 5 (Credit risk mitigation), as modified by ■ BIPRU 4.10.

[Note: *BCD* Annex VII Part 3 point 3]

4.4.75

FCA PRA

R

The *exposure* value for leases must be the discounted minimum lease payments. Minimum lease payments are the payments over the lease term that the lessee is or can be required to make and any bargain option (i.e. option the exercise of which is reasonably certain). Any guaranteed residual value fulfilling the set of conditions in ■ BIPRU 5.7.1 R (Eligibility), as modified by ■ BIPRU 4.10.38 R and ■ BIPRU 4.10.39 R (Unfunded credit protection: Eligibility of providers) regarding the eligibility of protection providers as well as the minimum requirements for recognising other types of guarantees provided in ■ BIPRU 5.7.6 R (Minimum requirements: General) to ■ BIPRU 5.7.12 R (Additional requirements for guarantees) should also be included in the minimum lease payments.

[Note: BCD Annex VII Part 3 point 4]

4.4.76

FCA PRA

R

Where an *exposure* takes the form of *securities* or *commodities* sold, posted or lent under *repurchase transactions* or *securities or commodities lending or borrowing transactions*, *long settlement transactions* and *margin lending transactions*, the *exposure* value must be the value of the *securities* or *commodities* determined in accordance with ■ GENPRU 1.3 (Valuation). Where the *financial collateral comprehensive method* is used, the *exposure* value must be increased by the volatility adjustment appropriate to such *securities* or *commodities* as set out in ■ BIPRU 4.10 and ■ BIPRU 5 (Credit risk mitigation). The *exposure* value of *repurchase transactions*, *securities or commodities lending or borrowing transactions*, *long settlements transactions* and *margin lending transactions* must be determined in accordance with ■ BIPRU 13.

[Note: BCD Annex VII Part 3 point 7]

4.4.77

FCA PRA

R

Notwithstanding ■ BIPRU 4.4.76 R, the *exposure* value of credit risk *exposures* outstanding, as determined by the *firm*, with a *central counterparty* must be determined in accordance with ■ BIPRU 13.3.3 R and ■ BIPRU 13.8.8 R (Exposure to central counterparty), provided that the *central counterparty's CCR exposures* with all participants in its arrangements are fully collateralised on a daily basis.

[Note: BCD Annex VII Part 3 point 8]

4.4.78

FCA PRA

R

In the case of any *financial derivative instrument*, the *exposure* value must be determined by the methods set out in ■ BIPRU 13.

[Note: BCD Annex VII Part 3 point 5]

**Double default**

4.4.79

FCA PRA

R

The *risk weighted exposure amount* for each *exposure* which meets the requirements set out in ■ BIPRU 5.7.2 R and ■ BIPRU 4.4.83 R (Double default) may be adjusted according to the following formula:

- (1) *Risk weighted exposure amount* =  $RW * exposure\ value * (0.15 + 160 * PD_{pp})$
- (2)  $PD_{pp} = PD$  of the protection provider
- (3) RW must be calculated using the relevant *risk weight* formula set out in ■ BIPRU 4.4.57 R for the *exposure*, the *PD* of the obligor and the *LGD* of a comparable direct *exposure* to the protection provider. The maturity factor (b) must be calculated using the lower of the *PD* of the protection provider and the *PD* of the obligor.

[Note: BCD Annex VII Part 1 point 4]

4.4.80

FCA PRA

R

Notwithstanding ■ BIPRU 4.4.34 R and ■ BIPRU 4.4.43 R, for the purposes of ■ BIPRU 4.4.79 R, the *LGD* of a comparable direct *exposure* to the protection provider shall either be the *LGD* associated with an unhedged facility to the guarantor or the unhedged facility of the obligor, depending upon whether in the event both the guarantor and the obligor *default* during the life of the hedged transaction available evidence and the structure of the guarantee indicate that the amount recovered would depend on the financial condition of the guarantor or obligor, respectively

[Note: BCD Annex VII Part 2 point 11]

4.4.81

FCA PRA

R

For the purposes of ■ BIPRU 4.4.79 R, M must be the effective maturity of the credit protection but at least 1 year.

[Note: BCD Annex VII Part 2 point 13 (part)]

4.4.82

FCA PRA

R

■ BIPRU 4.4.83 R applies to the eligibility of protection providers under the *IRB approach* which qualify for the treatment set out in ■ BIPRU 4.4.79 R.

4.4.83

FCA PRA

R

An *institution*, an *insurance undertaking* (including an *insurance undertaking* that carries out *reinsurance*) or an export credit agency which fulfils the following conditions may be recognised as an eligible provider of *unfunded credit protection* which qualifies for the treatment set out in ■ BIPRU 4.4.79 R:

- (1) the protection provider has sufficient expertise in providing *unfunded credit protection*;
- (2) the protection provider is regulated in a manner equivalent to the rules laid down in the *Banking Consolidation Directive* or had,

at the time the credit protection was provided, a credit assessment by an *eligible ECAI* which is associated with *credit quality step 3* or above under the *rules* for the *risk weighting of exposures to corporates* under the *standardised approach*;

- (3) the protection provider had, at the time the credit protection was provided, or for any period of time thereafter, an internal rating with a *PD* equivalent to or lower than that associated with *credit quality step 2* or above under the *rules* for the *risk weighting of exposures to corporates* under the *standardised approach*;
- (4) the protection provider has an internal rating with a *PD* equivalent to or lower than that associated with *credit quality step 3* or above under the *rules* for the *risk weighting of exposures to corporates* under the *standardised approach*;

For the purpose of this *rule*, credit protection provided by an export credit agency must not benefit from any explicit central government counter-guarantee.

[Note: *BCD Annex VIII Part 1 point 29*]

4.4.84

FCA PRA

R

■ BIPRU 4.4.85 R applies to the requirements to qualify for the treatment set out in ■ BIPRU 4.4.79 R.

4.4.85

FCA PRA

R

To be eligible for the treatment set out in ■ BIPRU 4.4.79 R, credit protection deriving from a guarantee or credit derivative must meet the following conditions:

- (1) the underlying obligation must be to:
  - (a) a *corporate exposure*, excluding an *exposure to an insurance undertaking* (including an *insurance undertaking* that carries out *reinsurance*); or
  - (b) an *exposure* to a regional government, local authority or *public sector entity* which is not treated as an *exposure* to a central government or a *central bank* according to ■ BIPRU 4.4.2 R; or
  - (c) an *exposure to retail SME*, classified as a *retail exposure* according to ■ BIPRU 4.6.2 R;
- (2) the underlying obligors must not be members of the same *group* as the protection provider;
- (3) the *exposure* must be hedged by one of the following instruments:

- (a) single name unfunded credit derivatives or single name guarantees;
  - (b) first to *default* basket products, with these the treatment must be applied to the asset within the basket with the lowest *risk weighted exposure amount*;
  - (c)  $n^{\text{th}}$  to *default* basket products, with these the protection obtained is only eligible for consideration under this framework if eligible  $(n-1)^{\text{th}}$  *default* protection has also been obtained or where  $(n-1)$  of the assets within the basket has/have already *defaulted* and where this is the case the treatment must be applied to the asset within the basket with the lowest *risk weighted exposure amount*;
- (4) the credit protection must meet the requirements set out in ■ BIPRU 5.7.6 R - ■ BIPRU 5.7.8 R (Minimum requirements: Operational requirements), ■ BIPRU 5.7.11 R (Additional requirements for guarantees) and ■ BIPRU 5.7.13 R - ■ BIPRU 5.7.14 R (Additional requirements for credit derivatives);
  - (5) the *risk weight* that is associated with the *exposure* prior to the application of the treatment in ■ BIPRU 4.4.79 R does not already factor in any aspect of the credit protection;
  - (6) a *firm* must have the right and expectation to receive payment from the protection provider without having to take legal action in order to pursue the counterparty for payment;
  - (7) the purchased credit protection must absorb all credit losses incurred on the hedged portion of an *exposure* that arise due to the occurrence of credit events outlined in the contract;
  - (8) if the payout structure provides for physical settlement, then there must be legal certainty with respect to the deliverability of a loan, bond or contingent liability and if a *firm* intends to deliver an obligation other than the underlying *exposure*, it must ensure that the deliverable obligation is sufficiently liquid so that the *firm* would have the ability to purchase it for delivery in accordance with the contract;
  - (9) the terms and conditions of credit protection arrangements must be legally confirmed in writing by both the protection provider and the *firm*;
  - (10) a *firm* must have a process in place to detect excessive correlation between the creditworthiness of a protection provider and the obligor of the underlying *exposure* due to their performance being dependent on common factors beyond the systematic risk factor;

- (11) in the case of protection against *dilution risk*, the seller of purchased receivables must not be a member of the same *group* as the protection provider; and
- (12) with reference to (6), to the extent possible, a *firm* must take steps to satisfy itself that the protection provider is willing to pay promptly should a credit event occur.

[Note: *BCD* Annex VIII Part 2 point 22]

## 4.5 The IRB approach: Specialised lending exposures

### Application

4.5.1

R

- BIPRU 4.5 applies with respect to the *exposures* referred to in
- BIPRU 4.5.3 R.

FCA PRA

4.5.2

R

Except for ■ BIPRU 4.5.1 R and ■ BIPRU 4.5.3 R, ■ BIPRU 4.5 only applies to the extent that a *firm* applies the method in ■ BIPRU 4.5 (slotting).

FCA PRA

### Definition of specialised lending

4.5.3

R

Within the *corporate exposure IRB exposure class*, a *firm* must separately identify as *specialised lending exposures*, *exposures* which possess the following characteristics:

FCA PRA

- (1) the *exposure* is to an entity which was created specifically to finance and/or operate physical assets;
- (2) the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate; and
- (3) the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.

[Note: BCD Article 86(6)]

### Treatment of specialised lending

4.5.4

R

If a *firm* is using or is applying to use the *advanced IRB approach* for some or all of its *exposures* in the *sovereign, institution and corporate IRB exposure class*, then *specialised lending exposures* treated under ■ BIPRU 4.5.8 R (Slotting) must be treated as being dealt with under the *advanced IRB approach* for the purposes of the calculations in ■ BIPRU 4.2.30 R and ■ BIPRU 4.2.31 R. If a *firm* is not using or applying to use the *advanced IRB approach* for any of its *exposures* in the *sovereign, institution and corporate IRB exposure class*, in the cases in which it is necessary to distinguish between the *advanced IRB approach* and the *foundation IRB approach*, then *specialised lending exposures* treated under ■ BIPRU 4.5.8 R must be treated as being dealt with under the *foundation*

FCA PRA

*IRB approach* for the purposes of the calculations in ■ BIPRU 4.2.30 R and ■ BIPRU 4.2.31 R.

### Structure of rating system

4.5.5

FCA PRA

R

A *firm* using the methods set out in ■ BIPRU 4.5.8 R (Slotting) for assigning *risk weights* for *specialised lending exposures* is exempt from the requirement to have an obligor rating scale which reflects exclusively quantification of the risk of obligor *default* for these *exposures*. Notwithstanding ■ BIPRU 4.4.7 R (Seven grades for exposures to sovereigns, institutions and corporates), a *firm* must have for these *exposures* four grades for non-*defaulted* obligors and one grade for *defaulted* obligors.

[Note: BCD Annex VII Part 4 point 12 and point 21]

### Assignment of exposures

4.5.6

FCA PRA

R

- (1) A *firm* using the methods set out in ■ BIPRU 4.5.8 R (Slotting) for assigning *risk weights* for *specialised lending exposures* must assign each of these *exposures* to a grade in accordance with ■ BIPRU 4 Annex 1 R, taking into account the following factors:
  - (a) financial strength;
  - (b) political and legal environment;
  - (c) transaction and/or asset characteristics;
  - (d) strength of the sponsor and developer including any public private partnership income stream; and
  - (e) security package.
- (2) A *firm* must slot *exposures* into the five columns in the tables in ■ BIPRU 4.5.9 R and ■ BIPRU 4.5.13 R as follows:
  - (a) a *firm* must slot an *exposure* categorised as strong under Annex X into column 1;
  - (b) a *firm* must slot an *exposure* categorised as good under the Annex X into column 2;
  - (c) a *firm* must slot an *exposure* categorised as satisfactory under Annex X into column 3;
  - (d) a *firm* must slot an *exposure* categorised as weak under Annex X into column 4;
  - (e) in accordance with ■ BIPRU 4.5.5 R a *firm* must slot an *exposure* in *default* into column 5.

[Note: BCD Annex VII Part 1 point 6 (part)]

**Calculation of risk-weighted exposure amounts**

4.5.7

FCA PRA

R

Notwithstanding ■ BIPRU 4.3.5 R (Use of relevant parameters for calculating risk weighted exposure amounts), the calculation of *risk weighted exposure amounts* for credit risk for *specialised lending exposures* may be calculated in accordance with ■ BIPRU 4.5.8 R.

[Note: BCD Article 87(5)]

4.5.8

FCA PRA

R

For *specialised lending exposures* in respect of which a *firm* cannot demonstrate that its *PD* estimates meet the *minimum IRB standards* it must assign *risk weights* to these *exposures* according to the table in ■ BIPRU 4.5.9 R.

[Note: BCD Annex VII Part 1 point 6 (part)]

4.5.9

FCA PRA

R

Table: Risk weights for specialised lending

This table belongs to ■ BIPRU 4.5.8 R

Remain- ing maturi- ty	Category 1 (Strong)	Category 2 (Good)	Category 3 (Satisfac- tory)	Category 4 (Weak)	Category 5
Less than 2.5 years	50%	70%	115%	250%	0%
Equal or more than 2.5 years	70%	90%	115%	250%	0%

The coverage of each of the categories is set out in BIPRU 4.5.6 R

[Note: BCD Annex VII Part 1 point 6 (part)]

4.5.10

FCA PRA

R

A *firm* may generally assign preferential *risk weights* of 50% to *exposures* in category 1, and a 70% *risk weight* to *exposures* in category 2 if:

- (1) its *IRB permission* allows this; and
- (2) the *firm's* underwriting characteristics and other risk characteristics are substantially strong for the relevant category.

[Note: BCD Annex VII Part 1 point 6 (part)]

4.5.11

FCA PRA

G

- (1) If a *firm* applies for an *IRB permission* or for a variation of an *IRB permission* that permits the treatment in ■ BIPRU 4.5.10 R it should demonstrate that its standards exceed those of the slotting criteria provided for in ■ BIPRU 4.5 and result in ratings that are stronger than the benchmarks referred to in (3).

- (2) If a *firm* has an *IRB permission* that permits the treatment in ■ BIPRU 4.5.10 R it should continue to be able to demonstrate the matters in (1) to the *appropriate regulator* if asked.
- (3) Although a *firm* should map its internal ratings to the supervisory categories set out in the table in ■ BIPRU 4.5.9 R using the slotting criteria provided in ■ BIPRU 4.5.6 R, each supervisory category broadly corresponds to a range of external credit assessments of BBB- or better, BB+ or BB, BB- or B+ and B to C- (or their equivalents). The fifth category covers *default*.

### Calculation of expected loss amounts

4.5.12

FCA PRA

R

The *EL* values for *specialised lending exposures* where a *firm* uses the methods set out in ■ BIPRU 4.5.8 R for assigning *risk weights* must be assigned according to the table in ■ BIPRU 4.5.13 R.

[Note: BCD Annex VII Part 1 point 31 (part)]

4.5.13

FCA PRA

R

Table: Expected loss values for specialised lending

This table belongs to ■ BIPRU 4.5.12 R

Remain- ing matu- rity	Category 1 (Strong)	Category 2 (Good)	Category 3 (Satis- factory)	Category 4 (Weak)	Category 5
Less than 2.5 years	0%	0.4%	2.8%	8%	50%
Equal or more than 2.5 years	0.4%	0.8%	2.8%	8%	50%

The coverage of each of the categories is set out in BIPRU 4.5.6 R

[Note: BCD Annex VII Part 1 point 31 (part)]

4.5.14

FCA PRA

R

Where a *firm's IRB permission* authorises it generally to assign preferential *risk weights* as outlined in ■ BIPRU 4.5.10 R of 50% to *exposures* in category 1, and 70% to *exposures* in category 2, the *EL* value for *exposures* in category 1 must be 0%, and for *exposures* in category 2 must be 0.4%.

[Note: BCD Annex VII Part 1 point 31 (part)]

## 4.6 The IRB approach: Retail exposures

### Application

4.6.1

R

FCA PRA

- BIPRU 4.6 applies with respect to the *exposures* referred to in
- BIPRU 4.6.2 R.

### Definition of retail exposures

4.6.2

R

FCA PRA

To be eligible to be treated as a *retail exposure*, *exposures* must meet the following criteria:

- (1) they must be either to an individual person or persons, or to a small or medium sized entity, provided in the latter case that the total amount owed to the *firm* and *parent undertaking* and its *subsidiary undertakings*, including any past due *exposure*, by the obligor client or *group of connected clients*, but excluding claims or contingent claims secured on residential real estate collateral, must not, to the knowledge of the *firm*, which must have taken reasonable steps to confirm the situation, exceed EUR 1 million;
- (2) they are treated by the *firm* in its risk management consistently over time and in a similar manner;
- (3) they are not managed just as individually as *exposures* in the *corporate exposure IRB exposure class*; and
- (4) they each represent one of a significant number of similarly managed *exposures*.

[Note: BCD Article 86(4) (part)]

4.6.3

R

FCA PRA

The present value of retail minimum lease payments is eligible to be treated as a *retail exposure*.

[Note: BCD Article 86(4) (part)]

4.6.4

G

FCA PRA

- (1) This paragraph sets out *guidance* on ■ BIPRU 4.6.2 R so far as it relates to the boundary between *retail exposures* and *corporate exposures*.

- 4
- (2) In deciding what steps are reasonable for the purposes of ■ BIPRU 4.6.2 R (1), a *firm* may take into account complexity and cost, as well as the materiality of the impact upon its capital calculation. A *firm* should be able to demonstrate to the *appropriate regulator* that it has complied with the obligation to take reasonable steps under ■ BIPRU 4.6.2 R (1) in the way it takes these factors into account.
  - (3) If a *firm* has *exposures* to an owner of a *retail SME* in his personal capacity and *exposures* to the *retail SME* the *firm* should aggregate the two types of *exposure* for the purpose of ■ BIPRU 4.6.2 R (1), although it should not include claims secured on residential real estate collateral. In deciding what steps are reasonable for the purposes of ■ BIPRU 4.6.2 R (1) in aggregating these two types of *exposure*, a *firm* may take into account the materiality of those personal *exposures*. A *firm* should be able to demonstrate to the *appropriate regulator* that it has complied with the obligation to take reasonable steps under ■ BIPRU 4.6.2 R (1) when taking into account materiality in this way.
  - (4) The definition of *group of connected clients* is set out in the *glossary*. Paragraph (2) of that definition is "two or more *persons* ... who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties". Say that a *firm* has *exposures* to A and B. When deciding whether A and B come within paragraph (2) of the definition two conditions should be satisfied. Firstly the connections between A and B should mean that if A experiences financial problems, B should be likely to encounter repayment difficulties. Secondly, the connections between A and B should mean that if B experiences financial problems, A should be likely to encounter repayment difficulties
  - (5) A *firm* should have its own documented policy on the types of *exposures* that, in accordance with ■ BIPRU 4.6, qualify as *retail SME exposures*. The *appropriate regulator* would not expect that a definition based on the EUR 1m *exposure* limit would be adequate on its own.
  - (6) The purpose of the definition of *retail exposure* is to separate a non-granular retail and small and medium sized business portfolio from other business so that a separate capital calculation may be applied to that portfolio that takes into account its non-granularity. Where *retail exposures* are assigned to pools it is the statistical characteristics of these pools which are used to derive the *IRB approach* estimates. Therefore pools should be reasonably homogenous and subject to consistent risk management practices.
  - (7) A *firm* should have sufficient controls to ensure that any inadvertent assignment of non-eligible *exposures* to the *retail exposure IRB exposure class* is sufficiently immaterial that it does not result in any significant distortion of the overall statistical characteristics of the sub-sets of that *IRB exposure class* which arise when the *exposures* are assigned to grades or pools. Cost considerations do not justify inclusion of non-eligible *exposures* if the effect would be material. Sample testing could be one method of demonstrating that the impact would be immaterial. ■ BIPRU 4.1.25 R applies to *exposures* treated in accordance with this sub-paragraph (7).
  - (8) If an *exposure* to a small or medium sized business crosses the *retail exposure* size boundary it should be treated as a *corporate*, unless, in accordance with

■ BIPRU 4.1.25 R, the excess is immaterial because of its size or because it is temporary.

- (9) ■ BIPRU 4.6.2 R does not require that *exposures* to *retail SMEs* should never be individually managed. In deciding whether the frequency and extent of individual management does or does not make *exposures* ineligible for the *retail exposure IRB exposure class*, a *firm* should consider whether that individual management is:
- (a) sufficiently insignificant not to disrupt the homogeneity of the pool;
  - (b) consistent with the management of other *exposures* in the same *retail exposure* pool; and
  - (c) significantly different in extent from the individual management that occurs for *corporate exposures*, looked at as a whole.
- (10) Where an *exposure* is denominated in other currencies, a *firm* may calculate the Euro equivalent for the purposes of ■ BIPRU 4.6.2 R (1) using any appropriate set of exchange rates provided its choice has no obvious bias and that the *firm* is consistent in its approach to choosing rates.
- (11) A *firm* may monitor compliance with the €1m threshold in ■ BIPRU 4.6.2 R (1) on the basis of approved limits provided that it has internal control procedures that are sufficient to ensure that amounts owed cannot diverge from those approved limits to such an extent as to give rise to a breach of the €1m threshold or, if the *firm* is relying on provisions relating to reasonable steps in ■ BIPRU 4.6.2 R (1), any material breach of that threshold.

#### Rating system: Structure of rating system

4.6.5

FCA PRA

G

Further material on the structure of rating systems can be found in ■ BIPRU 4.3.25 R - ■ BIPRU 4.3.28 R.

#### Rating system: Assignment to grades or pools

4.6.6

FCA PRA

R

*Rating systems* must reflect both obligor and transaction risk, and must capture all relevant obligor and transaction characteristics.

[Note: BCD Annex VII Part 4 point 13]

4.6.7

FCA PRA

R

The level of risk differentiation must ensure that the number of *exposures* in a given grade or pool is sufficient to allow for meaningful quantification and validation of the *loss* characteristics at the grade or pool level. The distribution of *exposures* and obligors across grades or pools must be such as to avoid excessive concentrations.

[Note: BCD Annex VII Part 4 point 14]

4.6.8

FCA PRA

G

- (1) This paragraph contains *guidance* on the level of differentiation referred to in ■ BIPRU 4.6.7 R.

- (2) It is important that a *firm* achieves adequate segmentation to deliver robust estimates of *LGD* and *conversion factors*, as well as *PD*. Whether the focus should be more on *exposure* size or collateral type is a question of fact for the particular circumstances in which the assignment of *exposures* to grades or pools occurs. Typically the *appropriate regulator* would expect both to be important.
- (3) A *firm* may allocate *retail exposures* to pools based on direct estimates of *PD*, *LGD* and *conversion factors* as well as using an approach under which the *firm* segments first and attributes *PD*, *LGD* and *conversion factors* afterwards. However the result should in either case be that the pools are sufficiently homogenous.
- (4) The number and size of pools should be determined in relation to the objective of establishing homogeneous risk. Pools should be of sufficient size to permit the production of robust risk estimates but should not be so large as to obscure variations in quality.

## 4.6.9

FCA PRA

R

A *firm* must be able to demonstrate to the *appropriate regulator* that the process of assigning *exposures* to grades or pools provides for a meaningful differentiation of risk, provides for a grouping of sufficiently homogenous exposures, and allows for accurate and consistent estimation of loss characteristics at grade or pool level.

[Note: BCD Annex VII Part 4 point 15 (part)]

## 4.6.10

FCA PRA

G

For purchased receivables, ■ BIPRU 4.8 contains material about assignment to grades or pools.

## 4.6.11

FCA PRA

R

- (1) A *firm* must consider the following risk drivers when assigning *exposures* to grades or pools:
  - (a) obligor risk characteristics;
  - (b) transaction risk characteristics, including product or collateral types or both; and
  - (c) delinquency.
- (2) In the case of (1)(b) a *firm* must explicitly address cases where several *exposures* benefit from the same collateral.
- (3) However:
  - (a) a *firm* need not consider delinquency if this is compatible with its *IRB permission*; and
  - (b) (in the case of a *firm* with an *IRB permission* that permits the *firm* not to consider delinquency) it should be able to demonstrate to the *appropriate regulator* that delinquency is not a material risk driver for the *exposures* treated in this way.

[Note: BCD Annex VII Part 4 Point 16]

#### Rating system: Assignment of exposures

4.6.12

R

FCA PRA

Each *exposure* must be assigned to a grade or a pool as part of the credit approval process.

[Note: BCD Annex VII Part 4 point 24]

#### Rating system: Overrides

4.6.13

G

FCA PRA

Material on overrides can be found in ■ BIPRU 4.3.50 R.

#### Rating system: Integrity of assignment process

4.6.14

R

FCA PRA

A *firm* must at least annually update obligor and facility assignments or review the *loss* characteristics and delinquency status of each identified risk pool whichever is applicable. A *firm* must also at least annually review in a representative sample the status of individual *exposures* within each pool as a means of ensuring that *exposures* continue to be assigned to the correct pool.

[Note: BCD Annex VII Part 4 point 29]

4.6.15

G

FCA PRA

Annual rescoring is one method of meeting the requirement in ■ BIPRU 4.6.14 R. However a *firm* need not carry out this update by means of a full re-run of a credit scoring model if it is able to demonstrate that its method is appropriate to the portfolio given its materiality and its impact on its capital requirements and that the *firm* still meets the *minimum IRB standards*.

#### Rating system: Use of models

4.6.16

G

FCA PRA

Material on the use of models can be found in ■ BIPRU 4.3.51 R - ■ BIPRU 4.3.53 G.

#### Rating system: Documentation

4.6.17

G

FCA PRA

Material on documentation can be found in ■ BIPRU 4.3.19 R - ■ BIPRU 4.3.24 R.

#### Rating system: Data maintenance

4.6.18

R

FCA PRA

In addition to complying with ■ BIPRU 4.3.54 R (Data maintenance) a *firm* must collect and store:

- (1) data used in the process of allocating *exposures* to grades or pools;
- (2) data on the estimated *PDs*, *LGDs* and *conversion factors* associated with grades or pools of *exposures*;
- (3) the identity of obligors and *exposures* that *defaulted*;

- (4) for *defaulted exposures*, data on the grades or pools to which the *exposure* was assigned over the year prior to *default* and the realised outcomes on *LGD* and *conversion factor*; and
- (5) data on *loss rates* for *qualifying revolving retail exposures*.

[Note: BCD Annex VII Part 4 point 39]

#### Risk quantification: Definition of default

4.6.19

FCA PRA

G

Material on the definition of *default* can be found in ■ BIPRU 4.3.56 R - ■ BIPRU 4.3.72 G.

4.6.20

FCA PRA

R

- (1) This *rule*, in accordance with ■ BIPRU 4.3.57 R (4) (Definition of default), sets the exact number of days past due that a *firm* must abide by in the case of *retail exposures*.
- (2) For *retail exposures* to counterparts situated within the *United Kingdom* the number of days past due is 180 days with the exception of *retail SME exposures*. For these *exposures* the number is 90 days.
- (3) For *retail exposures* to counterparts situated in another *EEA State* the number of days past due is the lower of:
  - (a) 180; and
  - (b) the number of days past due fixed under the *CRD implementation measure* in that *EEA State* with respect to paragraph 48 of Part 4 of Annex VII of the *Banking Consolidation Directive* for such *exposures*.
- (4) For *retail exposures* to counterparts in a state outside the *EEA* the number of days past due is the lower of:
  - (a) 180; and
  - (b) (if a number of days past due for such *exposures* has been fixed under any national law of that state applicable to *undertakings* in the *banking sector* or the *investment services sector* that implements the *IRB approach*) that number.

[Note: BCD Annex VII Part 4 point 44 (part) and point 48 (part)]

4.6.21

FCA PRA

R

A *firm* may apply the definition of *default* at a facility level.

[Note: BCD Annex VII Part 4 point 44 (part)]

4.6.22

FCA PRA

G

Where a *firm* chooses to apply the definition of *default* at facility level 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 and so should be taken into account.

**Risk quantification: Overall requirements for estimation**

4.6.23

G

FCA PRA

Material on the overall requirements for estimation can be found in ■ BIPRU 4.3.73 R - ■ BIPRU 4.3.94 R.

**Risk quantification: Requirements specific to PD estimation**

4.6.24

R

FCA PRA

A *firm* must estimate *PDs* by obligor grade or pool from long run averages of one-year *default* rates.

[Note: *BCD* Annex VII Part 4 point 67]

4.6.25

R

FCA PRA

Notwithstanding ■ BIPRU 4.6.24 R, *PD* estimates may also be derived from realised *losses* and appropriate estimates of *LGDs*.

[Note: *BCD* Annex VII Part 4 point 68]

4.6.26

R

FCA PRA

A *firm* must regard internal data for assigning exposures to grades or pools as the primary source of information for estimating *loss* characteristics. A *firm* may use external data (including pooled data) or statistical models for quantification provided a strong link can be demonstrated between:

- (1) the *firm's* process of assigning *exposures* to grades or pools and the process used by the external data source; and
- (2) the *firm's* internal risk profile and the composition of the external data.

[Note: *BCD* Annex VII Part 4 point 69]

4.6.27

R

FCA PRA

If a *firm* derives long run average estimates of *PD* and *LGD* for *retail exposures* from an estimate of total *losses*, and an appropriate estimate of *PD* or *LGD*, the process for estimating total *losses* must meet the *minimum IRB standards* for estimation of *PD* and *LGD*, and the outcome must be consistent with the concept of *LGD* as set out in ■ BIPRU 4.3.99 R (Default weighted average).

[Note: *BCD* Annex VII Part 4 point 70]

4.6.28

R

FCA PRA

Irrespective of whether a *firm* is using external, internal, pooled data sources or a combination of the three, for its estimation of *loss* characteristics, the length of the underlying historical observation period used must be at least five years for at least one source. If the available observation spans a longer period for any source, and these data are relevant, this longer period must be used. However:

- (1) a *firm* need not give equal importance to historic data if this is compatible with its *IRB permission*; and

- (2) (in the case of a *firm* with an *IRB permission* that permits this treatment of historic data) the *firm* must be able to convince the *appropriate regulator* that more recent data is a better predictor of *loss rates*.

[Note: *BCD Annex VII Part 4 point 71 (part)*]

4.6.29

FCA PRA

R

A *firm* may have, when implementing the *IRB approach*, relevant data covering a period of two years. The period to be covered must increase by one year each year until relevant data covers a period of five years.

[Note: *BCD Annex VII Part 4 point 71 (part)*]

4.6.30

FCA PRA

R

A *firm* must identify and analyse expected changes of risk parameters over the life of credit *exposures* (seasoning effects).

[Note: *BCD Annex VII Part 4 point 72*]

#### **Risk quantification: Requirements specific to own-LGD estimation**

4.6.31

FCA PRA

R

Notwithstanding ■ BIPRU 4.3.99 R (Default weighted average), *LGD* estimates may be derived from realised *losses* and appropriate estimates of *PDs*.

[Note: *BCD Annex VII Part 4 point 83*]

4.6.32

FCA PRA

R

Notwithstanding ■ BIPRU 4.3.128 R (Additional drawings), a *firm* may reflect future drawings either in its *conversion factor* or in its *LGD* estimates.

[Note: *BCD Annex VII Part 4 point 84*]

4.6.33

FCA PRA

R

Estimates of *LGD* must be based on data over a minimum of five years. Notwithstanding ■ BIPRU 4.3.99 R (Default weighted average):

- (1) a *firm* need not give equal importance to historic data if this is permitted by its *IRB permission*; and
- (2) (in the case of a *firm* with an *IRB permission* that permits this treatment of historic data) the *firm* must be able to convince the *appropriate regulator* that more recent data is a better predictor of *loss rates*.

[Note: *BCD Annex VII Part 4 point 86 (part)*]

4.6.34

FCA PRA

R

A *firm* may have, when it implements the *IRB approach*, relevant data covering a period of two years. The period to be covered must increase by one year each year until relevant data covers a period of five years.

[Note: *BCD Annex VII Part 4 point 86 (part)*]

4.6.35

FCA PRA

G

The *appropriate regulator* does not assume that all portfolios are sensitive to downturns. The *appropriate regulator* also accepts that for some portfolios, particularly in unsecured lending, the impact of the material drivers on *LGD* may be weak. However the burden is on the *firm* to demonstrate that its models are appropriate for the circumstances in which they are applied.

4.6.36

FCA PRA

G

Additional material on requirements specific to own-*LGD* estimation can be found in ■ BIPRU 4.3.98 R - ■ BIPRU 4.3.123 R.

### Risk quantification: Requirements specific to own-conversion factor estimates

4.6.37

FCA PRA

R

Notwithstanding ■ BIPRU 4.3.128 R (Additional drawings), a *firm* may reflect future drawings either in its *conversion factors* or in its *LGD* estimates.

[Note: BCD Annex VII Part 4 point 94]

4.6.38

FCA PRA

R

Estimates of *conversion factors* must be based on data over a minimum of five years. Notwithstanding ■ BIPRU 4.3.125 R:

- (1) a *firm* need not give equal importance to historic data if this is permitted by its *IRB permission*; and
- (2) (in the case of a *firm* with an *IRB permission* that permits this treatment of historic data) the *firm* must be able to convince the *appropriate regulator* if asked that more recent data is a better predictor of loss rates.

[Note: BCD Annex VII Part 4 point 95 (part)]

4.6.39

FCA PRA

R

A *firm* may have, when it implements the *IRB approach*, relevant data covering a period of two years. The period to be covered must increase by one year each year until relevant data cover a period of five years.

[Note: BCD Annex VII Part 4 point 95 (part)]

4.6.40

FCA PRA

G

Additional material on requirements specific to own-*conversion factor* estimation can be found in ■ BIPRU 4.3.124 R - ■ BIPRU 4.3.131 R.

### Calculation of risk weighted exposure amounts for retail exposures: General

4.6.41

FCA PRA

R

Subject to ■ BIPRU 4.6.43 R and ■ BIPRU 4.6.44 R, the *risk weighted exposure amounts* for *retail exposures* must be calculated according to the formulae in the table in ■ BIPRU 4.6.42 R.

[Note: BCD Annex VII Part 1 point 10 1<sup>st</sup> sentence]

4.6.42

FCA PRA

**R** Table: Risk weighted exposure amounts for retail exposures

This table belongs to ■ BIPRU 4.6.41 R

**Correlation (R)**  $0.03 \times (1 - \text{EXP}(-35 \cdot PD)) / (1 - \text{EXP}(-35)) + 0.16 \cdot [1 - (1 - \text{EXP}(-35 \cdot PD)) / (1 - \text{EXP}(-35))]$

**Risk weight (RW)**  $(LGD \cdot N[(1-R)^{-0.5} \cdot G(PD) + (R/(1-R))^{0.5} \cdot G(0.999)] - PD \cdot LGD) \cdot 12.5 \cdot 1.06$

**N(x)** denotes the cumulative distribution function for a standard normal random variable (i.e. the probability that a normal random variable with mean zero and variance of one is less than or equal to x).

**G(z)** denotes the inverse cumulative distribution function for a standard normal random variable (i.e. the value x such that  $N(x) = z$ ).

**PD = 1** For  $PD = 1$  (defaulted exposure), RW must be:

$\text{Max} \{0, 12.5 \cdot (LGD - EL_{BE})\}$

where  $EL_{BE}$  must be the firm's best estimate of expected loss for the defaulted exposure according to BIPRU 4.3.122 R.

**Risk weighted exposure amount** equals  $RW \cdot \text{exposure value}$

[Note: BCD Annex VII Part 1 point 10 (part)]

### Calculation of risk weighted exposure amounts for retail exposures: Retail mortgages

4.6.43

FCA PRA

**R** For *retail exposures* secured by real estate collateral a correlation (R) of 0.15 must replace the correlation formula in the table in ■ BIPRU 4.6.42 R.

[Note: BCD Annex VII Part 1 point 12]

### Calculation of risk weighted exposure amounts for retail exposures: Qualifying revolving retail exposures

4.6.44

FCA PRA

- R**
- (1) For *qualifying revolving retail exposures* a correlation (R) of 0.04 must replace the correlation formula in the table in ■ BIPRU 4.6.42 R.
  - (2) *Retail exposures* qualify as *qualifying revolving retail exposures* if they meet the following conditions:
    - (a) the *IRB permission* of the *firm* in question does not disapply this paragraph;

- (b) the *exposures* are to individuals;
- (c) the *exposures* are revolving, unsecured, and, to the extent they are not drawn, immediately and unconditionally cancellable by the *firm*;
- (d) the maximum *exposure* to a single individual in the sub-portfolio is EUR 100,000 or less;
- (e) the *firm* is able to demonstrate to the *appropriate regulator* that the use of the correlation formula in this paragraph is limited to portfolios that have exhibited low volatility of *loss* rates, relative to their average level of *loss* rates, especially within the low *PD* bands; and
- (f) the *firm* is able to demonstrate to the *appropriate regulator* that treatment as a *qualifying revolving retail exposure* is consistent with the underlying risk characteristics of the sub-portfolio.

- (3) In the context of this *rule* revolving *exposures* are defined as those where customers' outstanding balances are permitted to fluctuate based on their decisions to borrow and repay, up to a limit established by the *firm* in question. Undrawn commitments may be considered as unconditionally cancellable if the terms permit the *firm* to cancel them to the full extent allowable under consumer protection and related legislation.

[Note: BCD Annex VII Part 1 point 13 (part) and Part 3 point 9(a) (part)]

4.6.45

FCA PRA

G

A *firm* should be able to demonstrate the low volatility of *loss* rates mentioned in ■ BIPRU 4.6.44 R (2)(e) at the time of the initial application for an *IRB permission* and thereafter at any time on request. The benchmark level should be 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*. A *firm* should demonstrate low volatility 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.

4.6.46

FCA PRA

G

In the *appropriate regulator's* view a sub-portfolio consisting of credit card or overdraft obligations will usually meet the condition in ■ BIPRU 4.6.44 R (2)(f). In the *appropriate regulator's* view it is unlikely that any other type of *retail exposure* will do so. If a *firm* wishes to apply the treatment in ■ BIPRU 4.6.44 R (1) to product types other than credit card or overdraft obligations it should first discuss this with the *appropriate regulator*.

### Calculation of expected loss amounts

4.6.47

FCA PRA

R

*Expected loss* amounts must be calculated according to the formulae in the table in ■ BIPRU 4.6.48 R.

[Note: BCD Annex VII Part 1 point 30 (part)]

4.6.48

FCA PRA

**R** Table: Formulae for the calculation of expected loss amounts

This table belongs to ■ BIPRU 4.6.47 R

*Expected loss (EL)* equals  $PD \times LGD$ *Expected loss amount* equals  $EL \times \text{exposure value}$ 

For *defaulted exposures* ( $PD = 1$ ) where a *firm* uses its own estimates of *LGDs*, *EL* must be  $EL_{BE}$ , the *firm's* best estimate of *expected loss* for the *defaulted exposure* according to BIPRU 4.3.122 R.

For *exposures* subject to the treatment set out in BIPRU 4.4.79 R (Double default) *EL* must be 0.

[Note: BCD Annex VII Part 1 point 30 (part)]

**Calculation of PDs**

4.6.49

FCA PRA

**R** A *firm* must provide its own estimates of *PDs* in accordance with its *IRB permission* and the *minimum IRB standards*.

[Note: BCD Article 87(6) (part)]

4.6.50

FCA PRA

**R** The *PD* of an *exposure* must be at least 0.03%.

[Note: BCD Annex VII Part 2 point 17]

4.6.51

FCA PRA

**R** The *PD* of obligors in *default* must be 100%. If a *firm* is using the facility level approach described in ■ BIPRU 4.6.21 R, the *PD* of an *exposure* in *default* must be 100%.

[Note: BCD Annex VII Part 2 point 18]

4.6.52

FCA PRA

**R** *Unfunded credit protection* may be recognised by adjusting *PDs* subject to ■ BIPRU 4.6.54 R. For *dilution risk*, where a *firm* does not use its own estimates of *LGDs*, this must be subject to compliance with ■ BIPRU 5 (Credit risk mitigation) modified by ■ BIPRU 4.10 and, for this purpose, a *firm* may recognise *unfunded credit protection* providers other than those indicated in the *CRM eligibility conditions* provided the *firm* is able to demonstrate that the unfunded protection provider giving the undertaking is sufficiently reliable and that the protection agreement is legally effective in accordance with ■ BIPRU 5.2.7 R (Unfunded credit protection).

[Note: BCD Annex VII Part 2 point 20]

**Calculation of LGDs**

4.6.53

FCA PRA

R

A firm must provide its own estimates of LGDs in accordance with its IRB permission and the *minimum IRB standards*.

[Note: BCD Article 87(7) (part)]

4.6.54

FCA PRA

R

*Unfunded credit protection* may be recognised as eligible by adjusting PD or LGD estimates subject to the *minimum IRB standards* as specified in ■ BIPRU 4.10.43 R - ■ BIPRU 4.10.48 R and in accordance with the IRB permission either in support of an individual *exposure* or a pool of *exposures*. A firm must not assign guaranteed *exposures* an adjusted PD or LGD such that the adjusted *risk weight* would be lower than that of a comparable, direct *exposure* to the guarantor.

[Note: BCD Annex VII Part 2 point 22]

**Calculation of exposure values and own conversion factors**

4.6.55

FCA PRA

R

Except where otherwise specified, ■ BIPRU 4.4.37 R - ■ BIPRU 4.4.39 R (Exposure value and conversion factors), ■ BIPRU 4.4.45 R (AIRB conversion factors) and ■ BIPRU 4.4.71 R - ■ BIPRU 4.4.78 R (Calculation of exposure values for sovereigns, institutions and corporates) also apply to *retail exposures*.

4.6.56

FCA PRA

R

A firm must provide its own estimates of *conversion factors* in accordance with its IRB permission and the *minimum IRB standards*.

[Note: BCD Article 87(7) (part)]

**Double default**

4.6.57

FCA PRA

R

The *risk weighted exposure amount* for each *exposure* to *retail SME* as defined in ■ BIPRU 4.6.2 R which meets the requirements set out in ■ BIPRU 4.4.83 R and ■ BIPRU 4.4.85 R may be calculated according to ■ BIPRU 4.4.79 R (Double default).

[Note: BCD Annex VII Part 1 point 11]

4.6.58

FCA PRA

R

Notwithstanding ■ BIPRU 4.6.54 R for the purposes of ■ BIPRU 4.4.80 R the LGD of a comparable direct *exposure* to the protection provider must either be the LGD associated with an unhedged facility to the guarantor or the unhedged facility of the obligor, depending upon whether in the event both the guarantor and obligor *default* during the life of the hedged transaction available evidence and the structure of the guarantee indicate that the amount recovered would depend on the financial condition of the guarantor or obligor, respectively.

[Note: BCD Annex VII Part 2 point 23]

## 4.7 The IRB approach: Equity exposures

### Application

4.7.1

FCA PRA

R

- BIPRU 4.7 applies with respect to the *exposures* referred to in
- BIPRU 4.7.2 R.

### Definition of equity exposures

4.7.2

FCA PRA

R

The following *exposures* must be classed as *equity exposures*:

- (1) non-debt *exposures* conveying a subordinated, residual claim on the assets or income of the issuer; and
- (2) debt *exposures* the economic substance of which is similar to the *exposures* specified in (1).

[Note: BCD Article 86(2)]

### Calculation of risk-weighted exposure amounts

4.7.3

FCA PRA

R

Notwithstanding ■ BIPRU 4.3.5 R (Relevant parameters), the calculation of *risk weighted exposure amounts* for credit risk for all *exposures* belonging to the *equity exposure IRB exposure class* must be calculated in accordance with one of the following ways:

- (1) the simple risk weight approach (see ■ BIPRU 4.7.8 R;
- (2) the *PD/LGD approach* (see ■ BIPRU 4.7.13 R); and
- (3) the internal models approach (see ■ BIPRU 4.7.23 R);

in accordance with ■ BIPRU 4.7 and subject to the *firm's IRB permission*.

[Note: BCD Article 87(4) (part)]

4.7.4

FCA PRA

R

Even if a *firm's IRB permission* would otherwise permit the use of the internal models approach as referred to in ■ BIPRU 4.7.3 R (3), it may only use that approach if it meets the minimum requirements in ■ BIPRU 4.7.27 R - ■ BIPRU 4.7.35 R.

[Note: BCD Article 87(4) (part)]

4.7.5

FCA PRA

R

A *firm* may employ different approaches to different portfolios where the *firm* itself uses different approaches internally. A *firm* must, if it uses different approaches in accordance with the previous sentence, be able to demonstrate to the *appropriate regulator* that the choice is made consistently and is not determined by regulatory arbitrage considerations.

[Note: BCD Annex VII Part 1 point 17]

4.7.6

FCA PRA

R

Notwithstanding ■ BIPRU 4.7.5 R a firm may, if its *IRB permission* permits it to do so, attribute the *risk weighted exposure amounts* for *equity exposures* to *ancillary services undertakings* according to the treatment of *non credit-obligation assets*.

[Note: BCD Annex VII Part 1 point 18]

#### Exposure value

4.7.7

FCA PRA

R

The *exposure* value must be the value presented in the financial statements. Admissible *equity exposure* measures are the following:

- (1) for investments held at fair value with changes in value flowing directly through income and into *capital resources*, the *exposure* value is the fair value presented in the balance sheet;
- (2) for investments held at fair value with changes in value not flowing through income but into a tax-adjusted separate component of equity, the *exposure* value is the fair value presented in the balance sheet; and
- (3) for investments held at cost or at the lower of cost or market value, the *exposure* value is the cost or market value presented in the balance sheet.

[Note: BCD Annex VII Part 3 point 12]

#### The calculation of risk-weighted exposure amounts for equity exposures: The simple risk weight approach: Introduction

4.7.8

FCA PRA

R

■ BIPRU 4.7.9 R to ■ BIPRU 4.7.12 R set out the simple risk weight approach for calculating the *risk weighted exposure amounts* for *equity exposures* as referred to in ■ BIPRU 4.7.3 R (1).

4.7.9

FCA PRA

R

**The calculation of risk-weighted exposure amounts for equity exposures:  
The simple risk weight approach: Risk weighted exposure amounts**

The *risk weighted exposure amounts* must be calculated according to the following formula:

*risk-weighted exposure amounts* = RW \* *exposure value*;

where:

- (1) *risk weight* (RW) = 190% for private *equity exposures* in sufficiently diversified portfolios;
- (2) *risk weight* (RW) = 290% for exchange traded *equity exposures*; and
- (3) *risk weight* (RW) = 370% for all other *equity exposures*.

[Note: BCD Annex VII Part 1 point 19]

4.7.10

FCA PRA

R

Short cash positions and derivative instruments held in the *non-trading book* are permitted to offset long positions in the same individual stocks provided that these instruments have been explicitly designated as hedges of specific *equity exposures* and that they provide a hedge for at least another year. Other short positions must be treated as if they are long positions with the relevant *risk weight* assigned to the absolute value of each position. In the context of maturity mismatched positions, the method is that for *corporate exposures* as set out in ■ BIPRU 4.4.70 R.

[Note: BCD Annex VII Part 1 point 20]

4.7.11

FCA PRA

R

A *firm* may recognise *unfunded credit protection* obtained on an *equity exposure* in accordance with the methods set out in ■ BIPRU 5 (Credit risk mitigation), as modified by ■ BIPRU 4.10.

[Note: BCD Annex VII Part 1 point 21]

**The calculation of risk-weighted exposure amounts for equity exposures:  
The simple risk weight approach: Expected loss**

4.7.12

FCA PRA

R

The *expected loss* amounts for *equity exposures* must be calculated according to the following formula:

- (1) *expected loss* amount = *EL* × *exposure value*; and
- (2) the *EL* values must be the following:
  - (a) *expected loss* (*EL*) = 0.8% for private *equity exposures* in sufficiently diversified portfolios;
  - (b) *expected loss* (*EL*) = 0.8% for exchange traded *equity exposures*; and

(c) *expected loss (EL)* = 2.4% for all other *equity exposures*.

[Note: BCD Annex VII Part 1 point 32]

**The calculation of risk-weighted exposure amounts for equity exposures:  
The PD/LGD approach: Introduction**

4.7.13

FCA PRA

R

■ BIPRU 4.7.14 R to ■ BIPRU 4.7.22 R set out the *PD/LGD approach* for calculating the *risk weighted exposure amounts* for *equity exposures*.

**The calculation of risk-weighted exposure amounts for equity exposures:  
The PD/LGD approach: Risk weighted exposure amounts**

4.7.14

FCA PRA

R

The *risk weighted exposure amounts* must be calculated according to the formulas in ■ BIPRU 4.4.58 R (Risk weighted exposure amounts for sovereigns, institutions and corporates). If a *firm* does not have sufficient information to use the definition of *default* a scaling factor of 1.5 must be assigned to the *risk weights*.

[Note: BCD Annex VII Part 1 point 22]

4.7.15

FCA PRA

R

At the individual *exposure* level the sum of the *expected loss* amount multiplied by 12.5 and the *risk weighted exposure amount* must not exceed the *exposure* value multiplied by 12.5.

[Note: BCD Annex VII Part 1 point 23]

4.7.16

FCA PRA

R

A *firm* may recognise *unfunded credit protection* obtained on an *equity exposure* in accordance with the methods set out in ■ BIPRU 5 (Credit risk mitigation) as modified by ■ BIPRU 4.10. This must be subject to an *LGD* of 90% on the *exposure* to the provider of the hedge. For private *equity exposures* in sufficiently diversified portfolios an *LGD* of 65% may be used.

[Note: BCD Annex VII Part 1 point 24]

**The calculation of risk-weighted exposure amounts for equity exposures:  
The PD/LGD approach: Calculation of expected loss amounts**

4.7.17

FCA PRA

R

The *expected loss* amounts for *equity exposures* must be calculated according to the following formulae:

(1) *expected loss (EL)* =  $PD \times LGD$ ; and

(2) *expected loss amount* =  $EL \times exposure\ value$ .

[Note: BCD Annex VII Part 1 point 33]

### The calculation of risk-weighted exposure amounts for equity exposures: The PD/LGD approach: PDs

4.7.18

FCA PRA

R

PDs must be determined according to the methods for *corporate exposures*. The following minimum PDs must be applied:

- (1) 0.09% for exchange traded *equity exposures* where the investment is part of a long-term customer relationship;
- (2) 0.09% for non-exchange traded *equity exposures* where the returns on the investment are based on regular and periodic cash flows not derived from capital gains;
- (3) 0.40% for exchange traded *equity exposures* including other short positions as set out in ■ BIPRU 4.7.10 R; and
- (4) 1.25% for all other *equity exposures* including other short positions as set out in ■ BIPRU 4.7.10 R.

[Note: BCD Annex VII Part 2 point 24]

4.7.19

FCA PRA

R

■ BIPRU 4.4.29 G (five year observation period) applies to the *PD/LGD approach*.

[Note: BCD Annex VII Part 4 point 66 (part)]

### The calculation of risk-weighted exposure amounts for equity exposures: The PD/LGD approach: LGDs

4.7.20

FCA PRA

R

Private *equity exposures* in sufficiently diversified portfolios may be assigned an *LGD* of 65%.

[Note: BCD Annex VII Part 2 point 25]

4.7.21

FCA PRA

R

All other *exposures* must be assigned an *LGD* of 90%.

[Note: BCD Annex VII Part 2 point 26]

### The calculation of risk-weighted exposure amounts for equity exposures: The PD/LGD approach: Maturity

4.7.22

FCA PRA

R

M (maturity) assigned to all *exposures* must be 5 years.

[Note: BCD Annex VII Part 2 point 27]

### The calculation of risk-weighted exposure amounts for equity exposures: The internal models approach: Introduction

4.7.23

FCA PRA

R

■ BIPRU 4.7.24 R to ■ BIPRU 4.7.35 R set out the internal models approach for calculating the *risk weighted exposure amounts* for *equity exposures* as referred to in ■ BIPRU 4.7.3 R (3).

**The calculation of risk-weighted exposure amounts for equity exposures:  
The internal models approach: Risk weighted exposure amounts**

4.7.24

FCA PRA

R

The *risk weighted exposure amount* is the potential loss on the *firm's equity exposures* as derived using internal value-at-risk models subject to the 99<sup>th</sup> percentile, one-tailed confidence interval of the difference between quarterly returns and an appropriate risk-free rate computed over a long-term sample period, multiplied by 12.5. The *risk weighted exposure amounts* at the *equity exposure* portfolio level must not be less than the total of the sums of the minimum *risk weighted exposure amounts* required under the *PD/LGD approach* and the corresponding *expected loss* amounts multiplied by 12.5 and calculated on the basis of the *PD* values set out in ■ BIPRU 4.7.18 R (1) and the corresponding *LGD* values set out in ■ BIPRU 4.7.20 R and ■ BIPRU 4.7.21 R.

[Note: BCD Annex VII Part 1 point 25]

4.7.25

FCA PRA

R

A *firm* may recognise *unfunded credit protection* obtained on an *equity position*.

[Note: BCD Annex VII Part 1 point 26]

**The calculation of risk weighted exposure amounts for equity exposures:  
The internal models approach: Expected loss amounts**

4.7.26

FCA PRA

R

The *expected loss* amounts for *equity exposures* under the internal models approach must be 0%.

[Note: BCD Annex VII Part 1 point 34]

**The calculation of risk weighted exposure amounts for equity exposures:  
The internal models approach: Capital requirements and risk quantification**

4.7.27

FCA PRA

R

- (1) A *firm* must meet the standards set out in (2) to (9) for the purpose of calculating capital requirements.
- (2) The estimate of potential *loss* must be robust to adverse market movements relevant to the long-term risk profile of the *firm's* specific holdings. The data used to represent return distributions must reflect the longest sample period for which data is available and be meaningful in representing the risk profile of the *firm's* specific *equity exposures*. The data used must be sufficient to provide conservative, statistically reliable and robust loss estimates that are not based purely on subjective or judgmental considerations. A *firm* must be able to demonstrate to the *appropriate regulator* that the shock employed provides a conservative estimate of potential *losses* over a relevant long-term market or business cycle.
- (3) A *firm* must combine empirical analysis of available data with adjustments based on a variety of factors in order to attain model

outputs that achieve appropriate realism and conservatism. In constructing Value at Risk (VaR) models estimating potential quarterly losses, a *firm* may use quarterly data or convert shorter horizon period data to a quarterly equivalent using an analytically appropriate method supported by empirical evidence and through a well-developed and documented thought process and analysis. Such an approach must be applied conservatively and consistently over time. Where only limited relevant data is available a *firm* must add appropriate margins of conservatism.

- (4) The models used must be able to capture adequately all of the material risks embodied in equity returns including both the *general market risk* and *specific risk* exposure of the *firm's equity exposure* portfolio. The internal models must adequately explain historical price variation, capture both the magnitude and changes in the composition of potential concentrations, and be robust to adverse market environments. The population of risk *exposures* represented in the data used for estimation must be closely matched to or at least comparable with those of the *firm's equity exposures*.
- (5) The internal model must be appropriate for the risk profile and complexity of a *firm's equity exposure* portfolio. Where a *firm* has material holdings with values that are highly non-linear in nature the internal models must be designed to capture appropriately the risks associated with such instruments.
- (6) Mapping of individual positions to proxies, market indices, and risk factors must be plausible, intuitive, and conceptually sound.
- (7) A *firm* must be able to demonstrate to the *appropriate regulator* through empirical analyses the appropriateness of risk factors, including their ability to cover both *general market risk* and *specific risk*.
- (8) The estimates of the return volatility of *equity exposures* must incorporate relevant and available data, information, and methods. Independently reviewed internal data or data from external sources (including pooled data) must be used.
- (9) A rigorous and comprehensive stress-testing programme must be in place.

[Note: BCD Annex VII Part 4 point 115]

#### The calculation of risk-weighted exposure amounts for equity exposures: The internal models approach: Risk management and controls

- (1) With regard to the development and use of internal models for capital requirement purposes, a *firm* must establish policies,

4.7.28

FCA PRA

R

procedures, and controls to ensure the integrity of the model and modelling process. These policies, procedures, and controls must include the ones set out in the rest of this paragraph.

- (2) There must be full integration of the internal model into the overall management information systems of the *firm* and in the management of the *non-trading book equity exposure* portfolio. In particular they must be used in:
  - (a) measuring and assessing *equity exposure* portfolio performance (including the risk adjusted performance);
  - (b) allocating economic capital to *equity exposures*; and
  - (c) evaluating overall capital adequacy and the investment management process.
- (3) A *firm* must have established management systems, procedures, and control functions for ensuring the periodic and independent review of all elements of the internal modelling process, including approval of model revisions, vetting of model inputs, and review of model results, such as direct verification of risk computations. These reviews must assess the accuracy, completeness, and appropriateness of model inputs and results and focus on both finding and limiting potential errors associated with known weaknesses and identifying unknown model weaknesses. Such reviews may be conducted by an internal independent unit, or by an independent external third party.
- (4) There must be adequate systems and procedures for monitoring investment limits and the risk exposures of *equity exposures*.
- (5) The units responsible for the design and application of the model must be functionally independent from the units responsible for managing individual investments.
- (6) Parties responsible for any aspect of the modelling process must be adequately qualified. Management must allocate sufficient skilled and competent resources to the modelling function.

[Note: BCD Annex VII Part 4 point 116]

**The calculation of risk-weighted exposure amounts for equity exposures:  
The internal models approach: Validation and documentation**

A *firm* must have a robust system in place to validate the accuracy and consistency of its internal models and modelling processes. All material elements of the internal models and the modelling process and validation must be documented.

[Note: BCD Annex VII Part 4 point 117]

**4.7.30** **R** A *firm* must use the internal validation process to assess the performance of its internal models and processes in a consistent and meaningful way.

**FCA** **PRA**

[Note: BCD Annex VII Part 4 point 118]

**4.7.31** **R** The methods and data used for quantitative validation must be consistent through time. Changes in estimation and validation methods and data (both data sources and periods covered) must be documented.

**FCA** **PRA**

[Note: BCD Annex VII Part 4 point 119]

**4.7.32** **R** A *firm* must regularly compare actual *equity exposure* returns (computed using realised and unrealised gains and losses) with modelled estimates. Such comparisons must make use of historical data that cover as long a period as possible. A *firm* must document the methods and data used in such comparisons. This analysis and documentation must be updated at least annually.

**FCA** **PRA**

[Note: BCD Annex VII Part 4 point 120]

**4.7.33** **R** A firm must make use of other quantitative validation tools and comparisons with external data sources. The analysis must be based on data that are appropriate to the portfolio, are updated regularly, and cover a relevant observation period. A *firm's* internal assessments of the performance of its models must be based on as long a period as possible.

**FCA** **PRA**

[Note: BCD Annex VII Part 4 point 121]

**4.7.34** **R** A *firm* must have sound internal standards for situations where comparison of actual *equity exposure* returns with the models' estimates calls the validity of the estimates or of the models as such into question. These standards must take account of business cycles and similar systematic variability in *equity exposure* returns. All adjustments made to internal models in response to model reviews must be documented and consistent with the *firm's* model review standards.

**FCA** **PRA**

[Note: BCD Annex VII Part 4 point 122]

**4.7.35** **R** The internal model and the modelling process must be documented, including the responsibilities of parties involved in the modelling, and the model approval and model review processes.

**FCA** **PRA**

[Note: BCD Annex VII Part 4 point 123]

## 4.8 The IRB approach: Purchased receivables

### Application

4.8.1

R

■ BIPRU 4.8 applies with respect to purchased receivables.

FCA PRA

4.8.2

G

Purchased receivables do not form an *IRB exposure class* on their own. For any purchased receivable, the provisions of the sections of ■ BIPRU 4 that deal with the *IRB exposure class* to which it belongs also apply, as modified by this section.

FCA PRA

[Note: BCD Annex VII Part 4 point 15 (part)]

### Structure of rating systems

4.8.3

R

For *retail exposure* that are purchased receivables, the grouping referred to in ■ BIPRU 4.6.9 R must reflect the seller's underwriting practices and the heterogeneity of its customers.

FCA PRA

### Risk quantification: Overall requirements for estimation: General

4.8.4

G

Further general material about the requirements for estimation can be found in ■ BIPRU 4.3.73 R - ■ BIPRU 4.3.94 R.

FCA PRA

4.8.5

R

The estimates for determining the risk parameters *PD*, *LGD*, *conversion factor* and *EL* must reflect all relevant information available to the purchasing *firm* regarding the quality of the underlying receivables, including data for similar pools provided by the seller, by the purchasing *firm*, or by external sources. The purchasing *firm* must evaluate any data relied upon which is provided by the seller.

FCA PRA

[Note: BCD Annex VII Part 4 point 53]

### Risk quantification: Overall requirements for estimation: Requirements specific to PD estimation

4.8.6

R

With respect to ■ BIPRU 4.6.26 R (Internal and external data for PD estimation: retail exposures) a *firm* may use external and internal reference data for *PD* estimation. A *firm* must use all relevant data sources as points of comparison.

FCA PRA

[Note: BCD Annex VII Part 4 point 69 (part)]

4.8.7 **R** For *corporate exposure* purchased receivables a *firm* may estimate *ELs* by obligor grade from long run averages of one-year realised *default* rates.

FCA PRA

[Note: BCD Annex VII Part 4 point 60]

4.8.8 **R** If a *firm* derives long run average estimates of *PDs* and *LGDs* for *corporate exposure* purchased receivables from an estimate of *EL*, and an appropriate estimate of *PD* or *LGD*, the process for estimating total losses must meet the overall standards for estimation of *PD* and *LGD* set out in the *minimum IRB standards*, and the outcome must be consistent with the concept of *LGD* as set out in ■ BIPRU 4.3.99 R.

FCA PRA

[Note: BCD Annex VII Part 4 point 61]

**Risk quantification: Overall requirements for estimation: Requirements specific to own-LGD estimates**

4.8.9 **R** A *firm* may use external and internal reference data for its *LGD* estimates in the case of *retail exposures* that are purchased receivables.

FCA PRA

[Note: BCD Annex VII Part 4 point 85]

**Risk quantification: Overall requirements for estimation: Minimum requirements for purchased receivables: General**

4.8.10 **R** ■ BIPRU 4.8.11 R - ■ BIPRU 4.8.15 R set out minimum requirements specific to the treatment of purchased receivables under the *IRB approach*.

FCA PRA

**Risk quantification: Overall requirements for estimation: Minimum requirements for purchased receivables: Legal certainty**

4.8.11 **R** The structure of the facility must ensure that under all foreseeable circumstances a *firm* has effective ownership and control of all cash remittances from the receivables. When the obligor makes payments directly to a seller or servicer a *firm* must verify regularly that payments are forwarded completely and within the contractually agreed terms. Servicer means an entity that manages a pool of purchased receivables or the underlying credit *exposures* on a day-to-day basis. A *firm* must have procedures to ensure that ownership over the receivables and cash receipts is protected against bankruptcy stays or legal challenges that could materially delay the lender's ability to liquidate or assign the receivables or retain control over cash receipts.

FCA PRA

[Note: BCD Annex VII Part 4 point 105]

**Risk quantification: Overall requirements for estimation: Minimum requirements for purchased receivables: Effectiveness of monitoring systems**

4.8.12 **R** (1) A *firm* must monitor both the quality of the purchased receivables and the financial condition of the seller and servicer.

FCA PRA

In particular a *firm* must comply with the remaining provisions of this *rule*.

- (2) A *firm* must assess the correlation among the quality of the purchased receivables and the financial condition of both the seller and servicer, and have in place internal policies and procedures that provide adequate safeguards to protect against such contingencies, including the assignment of an internal risk rating for each seller and servicer.
- (3) A *firm* must have clear and effective policies and procedures for determining seller and servicer eligibility. A *firm* or its agent must conduct periodic reviews of sellers and servicers in order to verify the accuracy of reports from the seller or servicer, detect fraud or operational weaknesses, and verify the quality of the seller's credit policies and servicer's collection policies and procedures. The findings of these reviews must be documented.
- (4) A *firm* must assess the characteristics of the purchased receivables pools including:
  - (a) over-advances;
  - (b) history of the seller's arrears, bad debts, and bad debt allowances;
  - (c) payment terms; and
  - (d) potential contra accounts.
- (4) A *firm* must have effective policies and procedures for monitoring on an aggregate basis single-obligor concentrations both within and across purchased receivables pools.
- (5) A *firm* must ensure that it receives from the servicer timely and sufficiently detailed reports of receivables ageings and dilutions to ensure compliance with the *firm's* eligibility criteria and advancing policies governing purchased receivables, and provide an effective means with which to monitor and confirm the seller's terms of sale and dilution.

[Note: BCD Annex VII Part 4 point 106]

**Risk quantification: Overall requirements for estimation: Minimum requirements for purchased receivables: Effectiveness of work-out systems**

A *firm* must have systems and procedures for detecting deteriorations in the seller's financial condition and purchased receivables quality at an early stage, and for addressing emerging problems proactively. In particular a *firm* must have clear and effective policies, procedures, and information systems to monitor covenant violations, and clear and effective policies

and procedures for initiating legal actions and dealing with problem purchased receivables.

[Note: BCD Annex VII Part 4 point 107]

**Risk quantification: Overall requirements for estimation: Minimum requirements for purchased receivables: Effectiveness of systems for controlling collateral, credit availability and cash**

4.8.14

FCA PRA

R

A *firm* must have clear and effective policies and procedures governing the control of purchased receivables, credit, and cash. In particular, written internal policies must specify all material elements of the receivables purchase programme, including the advancing rates, eligible collateral, necessary documentation, concentration limits, and the way cash receipts are to be handled. These elements must take appropriate account of all relevant and material factors, including the seller's and servicer's financial condition, risk concentrations, and trends in the quality of the purchased receivables and the seller's customer base, and internal systems must ensure that funds are advanced only against specified supporting collateral and documentation.

[Note: BCD Annex VII Part 4 point 108]

**Risk quantification: Overall requirements for estimation: Minimum requirements for purchased receivables: Compliance with the firm's internal policies and procedures**

4.8.15

FCA PRA

R

A *firm* must have an effective internal process for assessing compliance with all internal policies and procedures. The process must include regular audits of all critical phases of the *firm's* receivables purchase programme, verification of the separation of duties between, firstly, the assessment of the seller and servicer and the assessment of the obligor and, secondly, between the assessment of the seller and servicer and the field audit of the seller and servicer and evaluations of back office operations, with particular focus on qualifications, experience, staffing levels, and supporting automation systems.

[Note: BCD Annex VII Part 4 point 109]

**Calculation of risk-weighted asset amounts: Eligibility for different treatments: Corporate exposures**

4.8.16

FCA PRA

R

For its *corporate exposure* purchased receivables a *firm* must comply with the minimum requirements set out in ■ BIPRU 4.8.11 R - ■ BIPRU 4.8.15 R. For *corporate exposure* purchased receivables that comply in addition with the conditions set out in ■ BIPRU 4.8.18 R, and where it would be unduly burdensome for a *firm* to use the risk quantification standards for *corporate exposures* as set out in the *minimum IRB standards* for these receivables, the risk quantification standards for *retail exposures* as set out in the *minimum IRB standards* may be used.

[Note: BCD Annex VII Part 1 point 7]

4.8.17

FCA PRA

R

For *corporate exposure* purchased receivables, refundable purchase discounts, collateral or partial guarantees that provide first-loss protection for *default losses*, *dilution losses*, or both, may be treated as first-loss positions under the provisions in ■ BIPRU 9 (Securitisation) about the *IRB approach*.

[Note: BCD Annex VII Part 1 point 8]

#### Calculation of risk weighted asset amounts: Eligibility for different treatments: Retail exposures

4.8.18

FCA PRA

R

To be eligible for the *retail exposure* treatment purchased receivables must comply with the minimum requirements set out in ■ BIPRU 4.8.11 R - ■ BIPRU 4.8.15 R and the following conditions:

- (1) the *firm* has purchased the receivables from unrelated, third party sellers, and its *exposure* to the obligor of the receivable does not include any *exposures* that are directly or indirectly originated by the *firm* itself;
- (2) the purchased receivables must be generated on an arm's-length basis between the seller and the obligor (and as such, intercompany accounts receivables and receivables subject to contra-accounts between firms that buy and sell to each other are ineligible);
- (3) the purchasing *firm* has a claim on all proceeds from the purchased receivables or a pro-rata interest in the proceeds; and
- (4) the portfolio of purchased receivables is sufficiently diversified.

[Note: BCD Annex VII Part 1 point 14]

4.8.19

FCA PRA

R

With respect to *retail exposures*, for purchased receivables, refundable purchase discounts, collateral or partial guarantees that provide first-loss protection for *default losses*, *dilution losses*, or both, may be treated as first-loss positions under the provisions in ■ BIPRU 9 (Securitisation) about the *IRB approach*.

[Note: BCD Annex VII Part 1 point 15]

4.8.20

FCA PRA

R

For hybrid pools of purchased *retail exposure* receivables where the purchasing *firm* cannot separate *exposures* secured by real estate collateral and *qualifying revolving retail exposures* from other *retail exposures*, the *retail risk weight* function producing the highest capital requirements for those *exposures* must apply.

[Note: BCD Annex VII Part 1 point 16]

4.8.21

FCA PRA

R

**Calculation of risk weighted asset amounts for dilution risk**

The *risk weights* for *dilution risk* for purchased receivables (both *corporate exposures* and *retail exposures*) must be calculated according to this *rule*. The *risk weights* must be calculated according to the formula in ■ BIPRU 4.4.58 R. However, for the purposes of that formula, the total annual sales referred to in ■ BIPRU 4.4.59 R are the weighted average by individual *exposures* of the pool. The input parameters *PD* and *LGD* and the *exposure* value must be determined under the applicable provisions of ■ BIPRU 4 as modified by this section. *M* (maturity) must be 1 year. However:

- (1) a *firm* need not recognise *dilution risk* if its *IRB permission* permits this; and
- (2) (in the case of a *firm* with an *IRB permission* that permits the treatment of *dilution risk* in (1)) the *firm* must be able to convince the *appropriate regulator* that *dilution risk* is immaterial.

[Note: BCD Article 87(2) (part) and Annex VII Part 1 point 28]

4.8.22

FCA PRA

R

**Calculation of risk weighted exposure amounts: PDs**

For purchased *corporate exposure* receivables in respect of which a *firm* cannot demonstrate that its *PD* estimates meet the *minimum IRB standards*, the *PDs* for these *exposures* must be determined according to the following methods:

- (1) for senior claims on purchased *corporate exposure* receivables *PD* must be the *firm's* estimate of *EL* divided by *LGD* for these receivables;
- (2) for subordinated claims on purchased *corporate exposure* receivables *PD* must be the *firm's* estimate of *EL*; and
- (3) if a *firm* is under its *IRB permission* using the *advanced IRB approach* for *LGD* estimates for *corporate exposures* and it can decompose its *EL* estimates for purchased *corporate exposure* receivables into *PDs* and *LGDs* in a reliable manner, the *LGD* estimate may be used.

[Note: BCD Annex VII Part 2 point 3]

4.8.23

FCA PRA

R

In the case of *corporate exposures*, for *dilution risk* of purchased receivables *PD* must be set equal to *EL* estimate for *dilution risk*. If a *firm* is under its *IRB permission* using the *advanced IRB approach* for *LGD* estimates for *corporate exposures* and it can decompose its *EL* estimates for *dilution risk* of purchased *corporate exposure* receivables into *PDs* and *LGDs* in a reliable manner, the *PD* estimate may be used. A *firm* may recognise *unfunded credit protection* in the *PD* in accordance with the provisions of ■ BIPRU 9 and ■ BIPRU 5 as modified by

■ BIPRU 4.10. A *firm* may recognise those *unfunded credit protection* providers set out in its *IRB permission* in addition to those indicated in the *CRM eligibility conditions*. Where a *firm's IRB permission* allows it to use its own *LGD* estimates for *dilution risk* of purchased corporate receivables, the *firm* may recognise *unfunded credit protection* by adjusting *PDs* subject to the provisions of ■ BIPRU 4.4.43 R.

[Note: BCD Annex VII Part 2 point 7]

4.8.24

FCA PRA

R

In the case of *retail exposures*, for *dilution risk* of purchased receivables *PD* must be set equal to *EL* estimates for *dilution risk*. If a *firm* can decompose its *EL* estimates for *dilution risk* of purchased receivables into *PDs* and *LGDs* in a reliable manner, the *PD* estimate may be used.

[Note: BCD Annex VII Part 2 point 19]

#### Calculation of risk weighted asset amounts: LGDs: Corporate exposures

4.8.25

FCA PRA

R

The following *LGD* values apply for purchased *corporate exposure* receivables:

- (1) for senior purchased *corporate exposure* receivables *exposures* where a *firm* cannot demonstrate that its *PD* estimates meet the *minimum IRB standards*, the value is 45%;
- (2) for subordinated purchased *corporate exposure* receivables *exposures* where a *firm* cannot demonstrate that its *PD* estimates meet the *minimum IRB standards*, the value is 100%; and
- (3) for *dilution risk* of purchased *corporate exposure* receivables, the value is 75%.

[Note: BCD Annex VII Part 2 point 8(e) to (g)]

4.8.26

FCA PRA

R

Notwithstanding ■ BIPRU 4.4.34 R and ■ BIPRU 4.8.25 R, for *dilution risk* and *default risk* if a *firm* is under its *IRB permission* using the *advanced IRB approach* for *LGD* estimates for *corporate exposures* and it can decompose its *EL* estimates for purchased *corporate exposure* receivables into *PDs* and *LGDs* in a reliable manner, the *LGD* estimate for purchased *corporate exposure* receivables may be used.

[Note: BCD Annex VII Part 2 point 9]

#### Calculation of risk weighted asset amounts: LGDs: Retail exposures

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105

4.8.27

FCA PRA

R

For *dilution risk* of purchased *retail exposure* receivables an *LGD* value of 75% must be used. If a *firm* can decompose its *EL* estimates for *dilution risk* of purchased receivables into *PDs* and *LGDs* in a reliable manner, the *LGD* estimate may be used.

[Note: BCD Annex VII Part 2 point 21]

**Calculation of risk weighted asset amounts: Exposure value**

4.8.28

FCA PRA

R

The *exposure* value for the calculation of *risk weighted exposure amounts* of purchased receivables must be the outstanding amount minus the capital requirements for *dilution risk* prior to *credit risk mitigation*.

[Note: BCD Annex VII Part 3 point 6]

4.8.29

FCA PRA

R

- (1) The *exposure* value for the items in (2) must be calculated as the committed but undrawn amount multiplied by a *conversion factor*.
- (2) For undrawn purchase commitments for revolving purchased receivables that are unconditionally cancellable or that effectively provide for automatic cancellation at any time by the *firm* without prior notice, a *conversion factor* of 0% applies. To apply a *conversion factor* of 0%, a *firm* must actively monitor the financial condition of the obligor, and its internal control systems must enable it immediately to detect a deterioration in the credit quality of the obligor.

[Note: BCD Annex VII Part 3 point 9 (c)]

**Calculation of expected loss amounts**

4.8.30

FCA PRA

R

The *expected loss* amounts for *dilution risk* of purchased receivables must be calculated according to the following formula:

*expected loss (EL)* =  $PD \times LGD$ ; and  
*expected loss amount* =  $EL \times exposure\ value$ .

[Note: BCD Article 88(5) and Annex VII Part 1 point 35]

## 4.9 The IRB approach: Securitisation, non-credit obligations assets and CIUs

### Application

4.9.1

R

FCA PRA

BIPRU 4.9 applies with respect to *securitisation exposures, non credit-obligation assets and exposures to CIUs*.

### Securitisation exposures

4.9.2

R

FCA PRA

The following must be calculated in accordance with ■ BIPRU 9 (Securitisation):

- (1) *risk-weighted exposure amounts for securitised exposures and for exposures belonging to the IRB exposure class referred to in ■ BIPRU 4.3.2 R (6) (securitisation positions); and*
- (2) *the expected loss amounts for securitised exposures.*

[Note: BCD Article 87(10) and Article 88(3)]

### Provision of credit protection

4.9.3

R

FCA PRA

Where a *firm* provides credit protection for a number of *exposures* under terms that the *n*th default among the *exposures* shall trigger payment and that this credit event shall terminate the contract, if the product has an external credit assessment from an *eligible ECAI* the *risk weights* set out in ■ BIPRU 9 must be applied. If the product is not rated by an *eligible ECAI*, the *risk weights* of the *exposures* included in the basket must be aggregated, excluding *n-1 exposures* where the sum of the *expected loss* amount multiplied by 12.5 and the *risk weighted exposure amount* must not exceed the nominal amount of the protection provided by the credit derivative multiplied by 12.5. The *n-1 exposures* to be excluded from the aggregation must be determined on the basis that they must include those *exposures* each of which produces a lower *risk weighted exposure amount* than the *risk weighted exposure amount* of any of the *exposures* included in the aggregation.

[Note: BCD Annex VII Part 1 point 9]

4.9.4

FCA PRA

R

**Non credit obligation assets: Introduction**

■ BIPRU 4.9.5 R-■ BIPRU 4.9.10 R apply to *non credit-obligation assets*.

4.9.5

FCA PRA

R

**Non credit obligation assets: Inclusion of residual value of leases**

The *non credit obligation asset IRB exposure class* includes the residual value of leased properties, if not included in the lease *exposure* as defined in ■ BIPRU 4.4.75 R.

[Note: BCD Article 86(8)]

4.9.6

FCA PRA

R

**Non credit obligation assets: Risk weighted exposure amount**

The *risk weighted exposure amounts* must be calculated according to the formula:

*Risk-weighted exposure amount* = 100% \* *exposure* value except for when the *exposure* is a residual value of leased properties in which case it must be calculated as follows:

$1/t * 100\% * \textit{exposure}$  value; where t is the greater of 1 and the nearest number of whole years of the lease remaining.

[Note: BCD Annex VII Part 1 point 27]

4.9.7

FCA PRA

G

t should be an integer number reflecting the nearest number of whole years of the lease remaining and should decrease as the lease matures so that the discounted value steps up gradually from a small value to 100% as the end of the lease approaches.

4.9.8

FCA PRA

R

Where a *firm* has full recourse in respect of purchased receivables for *default risk* and for *dilution risk*, to the seller of the purchased receivables, ■ BIPRU 4.8.21 R and ■ BIPRU 4.8.30 R need not be applied. The *exposure* may instead be treated as a collateralised *exposure*.

[Note: BCD Article 87(2) (part)]

4.9.9

FCA PRA

R

**Non credit obligation assets: Exposure value**

The *exposure* value of *non credit-obligation assets* must be the value presented in the financial statements.

[Note: BCD Annex VII Part 3 point 13]

4.9.10

FCA PRA

R

**Non credit obligation assets: Expected loss amounts**

For *non credit-obligation assets* the *expected loss* amount must be zero.

[Note: BCD Article 88(4)]

4.9.11

FCA PRA

R

**Collective investment undertakings**

- (1) Where *exposures* in the form of a *CIU* meet the criteria set out in ■ BIPRU 3.4.121 R to ■ BIPRU 3.4.122 R (Conditions for look through treatment under the standardised approach) and the *firm* is aware of all of the underlying *exposures* of the *CIU*, the *firm* must look through to those underlying *exposures* in order to calculate *risk weighted exposure amounts* and *expected loss* amounts in accordance with the methods set out in ■ BIPRU 4. ■ BIPRU 4.9.12 R applies to the part of the underlying *exposures* of the *CIU* of which the *firm* is not aware or could not reasonably be aware. In particular, ■ BIPRU 4.9.12 R must apply where it would be unduly burdensome for the *firm* to look through the underlying *exposures* in order to calculate *risk weighted exposure amounts* and *expected loss* amounts in accordance with methods set out in this *rule*.
- (2) Where (1) applies but a *firm* does not meet the conditions for using the methods set out in ■ BIPRU 4 for all or part of the underlying *exposures* of the *CIU*, *risk weighted exposure amounts* and *expected loss* amounts must be calculated in accordance with the following approaches.
- (3) For *equity exposures* the approach set out in ■ BIPRU 4.7.9 R - ■ BIPRU 4.7.12 R (Simple risk weights) must be used. If, for those purposes, the *firm* is unable to differentiate between private equity, exchange-traded and other *equity exposures*, it must treat the *exposures* concerned as other *equity exposures*.
- (4) For all other underlying *exposures*, the *standardised approach* must be used, subject to the following modifications:
  - (a) [deleted]
  - (b) [deleted]
  - (c) for *exposures* subject to a specific *risk weight* for unrated *exposures* or subject to the *credit quality step* yielding the highest *risk weight* for a given exposure class, the *risk weight* must be multiplied by a factor of two, but cannot be higher than 1250%; and
  - (d) for all other *exposures*, the *risk weight* must be multiplied by a factor of 1.1 and subject to a minimum of 5%.

[Note: BCD Article 87(11)]

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109

4.9.12

FCA PRA

R

- (1) Where *exposures* in the form of a *CIU* do not meet the criteria set out in ■ BIPRU 3.4.121 R to ■ BIPRU 3.4.122 R (Conditions for look through treatment under the standardised approach) or the *firm* is not aware of all of the underlying *exposures* of the *CIU*, a *firm* must look through to the underlying *exposures* and calculate *risk*

*weighted exposure amounts and expected loss amounts* in accordance with the approach set out in ■ BIPRU 4.7.9 R - ■ BIPRU 4.7.12 R (Simple risk weights). If, for those purposes, the *firm* is unable to differentiate between private equity, exchange-traded and other *equity exposures*, it must treat the *exposures* concerned as other *equity exposures*. For these purposes, non-equity *exposures* must be assigned to one of the classes (private equity, exchange traded equity or other equity) set out in ■ BIPRU 4.7.9 R (Simple risk weight approach) and unknown *exposures* must be assigned to the other equity class.

- (2) Alternatively to the method described in (1), a *firm* may calculate itself or rely on a third party to calculate and report the average *risk weighted exposure amounts* based on the *CIU's* underlying *exposures* and calculated in accordance with the approaches in ■ BIPRU 4.9.11R (3) to ■ BIPRU 4.9.11R (4), provided that the correctness of the calculation and the report is adequately ensured.
- (3) [deleted]
- (4) [deleted]
- (a) [deleted]
- (b) [deleted]

[Note: BCD Article 87(12)]

#### 4.9.13

FCA PRA

G

For the purposes of ■ BIPRU 4.9.12 R (1), in the case of non-equity *exposures* a *firm* should look at the risk profile of the underlying *exposures* and map these to an equivalent equity *risk weight*. For example, if the underlying *exposures* are exchange-traded, the *risk weight* of exchange-traded *equity exposures* will apply. If the underlying *exposures* are unknown, the *risk weight* of the other equity class will apply. Only under exceptional circumstances would supervisors expect to see non-equity *exposures* mapped to the diversified private equity *risk weight*.

#### 4.9.14

FCA PRA

G

For the purposes of ■ BIPRU 4.9.12 R (2), a *firm* should ensure that any third party relied on for the calculations and report possesses the necessary competence and experience to ensure that the calculations and report are correct.

#### 4.9.15

FCA PRA

R

The *expected loss amounts* for *exposures* referred to in ■ BIPRU 4.9.11 R - ■ BIPRU 4.9.12 R must be calculated in accordance with the methods set out in ■ BIPRU 4.4.61 R (Calculation of expected loss for sovereigns, institutions and corporates), ■ BIPRU 4.5.12 R - ■ BIPRU 4.5.14 R (Calculation of expected loss for specialised lending), ■ BIPRU 4.6.47 R - ■ BIPRU 4.6.48 R (Calculation of expected loss for retail exposures), ■ BIPRU 4.7.12 R, ■ BIPRU 4.7.17 R and ■ BIPRU 4.7.26 R (Calculation of

expected loss for equity exposures) and ■ BIPRU 4.8.30 R (Dilution risk of purchased receivables).

[Note: *BCD* Article 88(6)]

## 4.10 The IRB approach: Credit risk mitigation

### Application

4.10.1

G

■ BIPRU 4.10 applies to all *exposures* treated under the *IRB approach*.

FCA PRA

### Purpose

4.10.2

G

■ BIPRU 4.10 sets out modifications to ■ BIPRU 5 (Credit risk mitigation) for those *exposures* for which the *IRB approach* is being used.

FCA PRA

### General

4.10.3

R

A *firm* using the *IRB approach*, but not using its own estimates of *LGD* and *conversion factors*, may recognise *credit risk mitigation* in accordance with ■ BIPRU 5 as modified by ■ BIPRU 4.10 in the calculation of *risk weighted exposure amounts* for the purposes of the calculation of the *credit risk capital component* or as relevant *expected loss* amounts for the purposes of the calculation in ■ GENPRU 2.2.191 R to ■ GENPRU 2.2.193 R or ■ GENPRU 2.2.236 R.

FCA PRA

[Note: *BCD Article 91* (as it applies to the *IRB approach*)]

4.10.4

R

- (1) Where the requirements of ■ BIPRU 5.2.2 R - ■ BIPRU 5.2.8 R are met the calculation of *risk weighted exposure amounts*, and, as relevant, *expected loss* amounts, may be modified in accordance with ■ BIPRU 5 as modified by ■ BIPRU 4.10.
- (2) No *exposure* in respect of which *credit risk mitigation* is obtained must produce a higher *risk weighted exposure amount* or *expected loss* amount than an otherwise identical *exposure* in respect of which there is no *credit risk mitigation*.
- (3) Where the *risk weighted exposure amount* already takes account of credit protection under the *IRB approach* the calculation of the credit protection must not be further recognised under ■ BIPRU 5 or ■ BIPRU 4.10.
- (4) Subject to ■ BIPRU 5.2.8 R (Maturity mismatches), ■ BIPRU 5.2.9 R (Combinations of credit risk mitigation in the standardised

FCA PRA

approach) and ■ BIPRU 5.7.27 R to ■ BIPRU 5.7.28 R (Basket credit risk mitigation techniques), where the *CRM eligibility conditions* and the *CRM minimum requirements* are satisfied, the calculation of *risk weighted exposure amounts* and *expected loss* amounts under the *IRB approach* may be modified in accordance with the provisions of ■ BIPRU 5 and ■ BIPRU 4.10 that deal with calculating the effects of credit risk mitigation.

[Note: BCD Article 93 and Annex VIII Part 3 point 1 (as they apply to the *IRB approach*)]

#### Eligibility of funded credit protection: General

4.10.5

FCA PRA

R

In addition to the collateral set out in ■ BIPRU 5.3.1 R to ■ BIPRU 5.3.2 R, ■ BIPRU 5.4.1 R to ■ BIPRU 5.4.8 R and ■ BIPRU 5.6.1 R (Eligibility of funded credit protection) the provisions of ■ BIPRU 4.10.6 R - ■ BIPRU 4.10.12 R (Eligibility of real estate collateral), ■ BIPRU 4.10.14 R (Eligibility: receivables), ■ BIPRU 4.10.16 R (Eligibility: other physical collateral), and ■ BIPRU 4.10.19 R (Eligibility: leasing), apply where a *firm* calculates *risk weighted exposure amounts* and *expected loss* amounts under the *IRB approach*.

[Note: BCD Annex VIII Part 1 point 12]

#### Real estate collateral: Types of eligible collateral: General

4.10.6

FCA PRA

R

- (1) Residential real estate property which is or will be occupied or let by the owner or the beneficial owner in the case of personal investment companies and commercial real estate property, that is offices and other commercial premises, may be recognised as eligible collateral where the conditions set out in the remaining provisions of this paragraph are met.
- (2) The value of the property must not materially depend upon the credit quality of the obligor. This requirement does not preclude situations where purely macro-economic factors affect both the value of the property and the performance of the borrower.
- (3) The risk of the borrower must not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility must not materially depend on any cash flow generated by the underlying property serving as collateral.

[Note: BCD Annex VIII Part 1 point 13]

## 4.10.7

FCA PRA

R

The condition in ■ BIPRU 4.10.6 R (3) does not apply to *exposures* secured by residential real estate property situated within the *United Kingdom*.

[Note: BCD Annex VIII Part 1 point 16 (part)]

## 4.10.8

FCA PRA

G

- (1) Under paragraph 16 of Part 1 of Annex VIII of the *Banking Consolidation Directive*, a *competent authority* may only disapply the condition in ■ BIPRU 4.10.6 R (3) if the *competent authority* has evidence that the relevant market is well-developed and long-established with loss-rates which are sufficiently low to justify such action.
- (2) If the evidence were to change so that the action was no longer justified the *appropriate regulator* would expect to revoke ■ BIPRU 4.10.7 R.

## 4.10.9

FCA PRA

R

- (1) The condition in ■ BIPRU 4.10.6 R (3) does not apply for *exposures* secured by residential real estate property situated within the territory of another *EEA State*.
- (2) However (1) only applies if and to the extent that the *CRD implementation measures* for that *EEA State* in relation to the *IRB approach* implement the option set out in paragraph 16 of Part 1 of Annex VIII of the *Banking Consolidation Directive* (waiver for residential real estate property) with respect to residential real estate property situated within that *EEA State*. Therefore (1) does not apply if the eligibility to use this treatment under those measures ceases as contemplated under paragraph 18 of Part 1 of Annex VIII of the *Banking Consolidation Directive* (suspension of alternative treatment).

[Note: BCD Annex VIII Part 1 point 16 (part)]

## 4.10.10

FCA PRA

R

- (1) The condition in ■ BIPRU 4.10.6 R (3) does not apply for commercial real estate property situated within the territory of another *EEA State*.
- (2) However (1) only applies if and to the extent that the *CRD implementation measures* for that *EEA State* in relation to the *IRB approach* implement the option set out in paragraph 17 of Part 1 of Annex VIII of the *Banking Consolidation Directive* (waiver for commercial real estate property) with respect to commercial real estate property situated within that *EEA State*. Therefore (1) does not apply if the eligibility to use this treatment under those measures ceases as contemplated under paragraph 18 of Part 1 of Annex VIII of the *Banking Consolidation Directive* (suspension of alternative treatment).

[Note: BCD Annex VIII Part 1 point 19]

4.10.11

FCA PRA

R

**Real estate collateral: Types of eligible collateral: Finnish housing legislation**

A *firm* may also recognise as eligible collateral shares in Finnish residential housing companies operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation in respect of residential property which is or will be occupied or let by the owner, as residential real estate collateral, provided that the conditions in ■ BIPRU 4.10.6 R are met.

[Note: BCD Annex VIII Part 1 point 14]

4.10.12

FCA PRA

R

A *firm* may also recognise as eligible collateral shares in Finnish housing companies operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation as commercial real estate collateral, provided that the conditions in ■ BIPRU 4.10.6 R are met.

[Note: BCD Annex VIII Part 1 point 15]

**Real estate collateral: Minimum requirements for recognition**

4.10.13

FCA PRA

R

For the recognition of real estate collateral: the minimum requirements in ■ BIPRU 3.4.64 R - ■ BIPRU 3.4.73 R must be met with the following adjustments:

- (1) those provisions apply to all real estate collateral eligible under ■ BIPRU 4.10; and
- (2) the minimum frequency of valuation as referred to in ■ BIPRU 3.4.66 R is once every year for commercial real estate.

[Note: BCD Annex VIII Part 2 point 8 (as it applies to the *IRB approach*)]

**Receivables: Types of eligible collateral**

4.10.14

FCA PRA

R

Amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year may be recognised as eligible collateral. Eligible receivables do not include those associated with *securitisations*, sub-participations or credit derivatives or amounts owed by affiliated parties.

[Note: BCD Annex VIII Part 1 point 20]

**Receivables: Minimum requirements for recognition**

4.10.15

FCA PRA

R

- (1) For the recognition of receivables as collateral the requirements in this paragraph must be met.
- (2) The legal mechanism by which the collateral is provided must be robust and effective and ensure that the lender has clear rights over the proceeds.

- (3) A *firm* must take all steps necessary to fulfil local requirements in respect of the enforceability of security interests. There must be a framework which allows the lender to have a first priority claim over the collateral subject to any claims of preferential creditors provided for in applicable insolvency law.
- (4) A *firm* must have conducted sufficient legal review confirming the enforceability of the collateral arrangements in all relevant jurisdictions.
- (5) The collateral arrangements must be properly documented, with a clear and robust procedure for the timely collection of collateral. A *firm's* procedures must ensure that any legal conditions required for declaring the default of the borrower and timely collection of collateral are observed. In the event of the obligor's financial distress or default, a *firm* must have legal authority to sell or assign the receivables to other parties without consent of the receivables obligors.
- (6) A *firm* must have a sound process for determining the credit risk associated with the receivables. Such a process must include, among other things, analyses of the obligor's business and industry and the types of customers with whom the obligor does business. Where a *firm* relies on the obligor to ascertain the credit risk of the customers, the *firm* must review the obligor's credit practices to ascertain their soundness and credibility.
- (7) The margin between the amount of the *exposure* and the value of the receivables must reflect all appropriate factors, including the cost of collection, concentration within the receivables pool pledged by an individual obligor, and potential concentration risk within the *firm's* total *exposures* beyond that controlled by the *firm's* general methodology. A *firm* must maintain a continuous monitoring process appropriate to the receivables. Additionally, compliance with loan covenants, Environmental restrictions, and other legal requirements must be reviewed on a regular basis.
- (8) The receivables pledged by an obligor must be diversified and not be unduly correlated with the obligor. Where there is material positive correlation, the attendant risks must be taken into account in the setting of margins for the collateral pool as a whole.
- (9) Receivables from affiliates of the obligor (including *subsidiary undertakings* and employees) must not be recognised as risk mitigants.

- (10) A *firm* must have a documented process for collecting receivable payments in distressed situations. The requisite facilities for collection must be in place, even when the *firm* normally looks to the obligor for collections.

[Note: BCD Annex VIII Part 2 point 9]

#### Other physical collateral: Types of eligible collateral

4.10.16

**R**

FCA PRA

A *firm* may recognise as eligible collateral a physical item of a type other than those types indicated in ■ BIPRU 4.10.6 R - ■ BIPRU 4.10.12 R (Eligibility of real estate collateral) if its *IRB permission* provides that the *firm* may treat collateral of that type as eligible and if the *firm* is able to demonstrate the following:

- (1) the existence of liquid markets for disposal of the collateral in an expeditious and economically efficient manner;
- (2) the existence of well-established, publicly available market prices for the collateral; and
- (3) there is no evidence that the net prices it receives when collateral is realised deviates significantly from the market prices referred to in (b).

[Note: BCD Annex VIII Part 1 point 21]

4.10.17

**G**

FCA PRA

If a *firm* wishes to recognise other types of collateral in accordance with ■ BIPRU 4.10.16 R (whether as part of its application for an *IRB permission* or under a variation of its *IRB permission*) it should demonstrate to the *appropriate regulator* how the criteria in ■ BIPRU 4.10.16 R (1) - ■ BIPRU 4.10.16 R (3) have been met with respect to that type of collateral.

#### Other physical collateral: Minimum requirements for recognition

4.10.18

**R**

FCA PRA

- (1) If a type of other physical collateral referred to in ■ BIPRU 4.10.16 R is potentially eligible under a *firm's IRB permission* a *firm* must only recognise it as eligible if the minimum requirements in (2) to (10) are met.
- (2) The collateral arrangement must be legally effective and enforceable in all relevant jurisdictions and must enable the *firm* to realise the value of the property within a reasonable timeframe.
- (3) With the sole exception of permissible prior claims referred to in ■ BIPRU 4.10.15 R (3), only first liens on, or charges over, collateral must be permissible. As such, the *firm* must have priority over all other lenders to the realised proceeds of the collateral.

- (4) The value of the property must be monitored on a frequent basis and at a minimum once every year. More frequent monitoring must be carried out where the market is subject to significant changes in conditions.
- (5) The loan agreement (or other agreement documenting the *exposure*) must include detailed descriptions of the collateral plus detailed specifications of the manner and frequency of revaluation.
- (6) The types of physical collateral accepted by the *firm* and policies and practices in respect of the appropriate amount of each type of collateral relative to the *exposure* amount must be clearly documented in internal credit policies and procedures available for examination.
- (7) The *firm's* credit policies with regard to the transaction structure must address appropriate collateral requirements relative to the *exposure* amount, the ability to liquidate the collateral readily, the ability to establish objectively a price or market value, the frequency with which the value can readily be obtained (including a professional appraisal or valuation), and the volatility or a proxy of the volatility of the value of the collateral.
- (8) Both initial valuation and revaluation must take fully into account any deterioration or obsolescence of the collateral. Particular attention must be paid in valuation and revaluation to the effects of the passage of time on fashion- or date-sensitive collateral.
- (9) The *firm* must have the right to inspect the property physically. It must have policies and procedures addressing its exercise of the right to physical inspection.
- (10) The *firm* must have procedures to monitor that the property taken as protection is adequately insured against damage.

[Note: BCD Annex VIII Part 2 point 10]

#### **Leasing: Types of eligible transactions and conditions of eligibility**

- (1) Where the requirements set out in this paragraph are met, *exposures* arising from transactions whereby a *firm* leases property to a third party must be treated the same as loans collateralised by the type of property leased.
- (2) For the *exposures* arising from leasing transactions to be treated as collateralised by the type of property leased, the following conditions must be met:

4.10.19

FCA PRA

R

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- (a) the conditions set out or referred to in ■ BIPRU 4.10.13 R or ■ BIPRU 4.10.18 R as appropriate for the recognition as collateral of the type of property leased are met;
- (b) there is robust risk management on the part of the lessor with respect to the use to which the leased asset is put, its age, and planned duration of its use, including appropriate monitoring of the value of the security;
- (c) there is in place a robust legal framework establishing the lessor's legal ownership of the asset and its ability to exercise its rights as owner in a timely fashion; and
- (d) where this has not already been ascertained in calculating the *LGD* level, the difference between value of the unamortised amount and the market value of the security must not be so large as to overstate the *credit risk mitigation* attributed to the leased assets.

[Note: *BCD* Annex VIII Part 1 point 22 and Part 2 point 11]

#### Calculating risk-weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Introduction

4.10.20

FCA PRA

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■ BIPRU 4.10.21 R - ■ BIPRU 4.10.37 R and ■ BIPRU 4.10.49 R set out how the calculation of *risk weighted exposure amounts* and *expected loss* amounts under ■ BIPRU 4.1 - ■ BIPRU 4.9 may be modified to take into account *credit risk mitigation* that meets the *CRM eligibility conditions* and the *CRM minimum requirements*.

#### Calculating risk weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Valuation: Receivables

4.10.21

FCA PRA

R

The value of receivables for the purpose of calculating the effect of *credit risk mitigation* must be the amount receivable.

[Note: *BCD* Annex VIII Part 3 point 66]

#### Calculating risk weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Valuation: Other physical collateral

4.10.22

FCA PRA

R

Physical collateral recognised as eligible as described in ■ BIPRU 4.10.16 R must be valued for the purpose of calculating the effect of *credit risk mitigation* at its market value. Market value is the estimated amount for which the property would exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction.

[Note: *BCD* Annex VIII Part 3 point 67]

### Calculating risk weighted exposure amounts and expected loss amounts: General treatment

- 4.10.23** **R** ■ BIPRU 4.10.24 R - ■ BIPRU 4.10.29 R apply to collateral in the form of real estate collateral, receivables, other physical collateral and leasing permitted by ■ BIPRU 4.10 and *exposures* secured by such collateral.  
**FCA** **PRA**
- 4.10.24** **R** LGD\* (the effective *loss given default*) calculated as set out in ■ BIPRU 4.10.25 R - ■ BIPRU 4.10.28 R must be taken as the *LGD*.  
**FCA** **PRA**
- [Note: BCD Annex VIII Part 3 point 68]
- 4.10.25** **R** Where the ratio of the value of the collateral (C) to the *exposure* value (E) is below a threshold level of C\* (the required minimum collateralisation level for the *exposure*) as laid down in ■ BIPRU 4.10.28 R, LGD\* must be the *LGD* laid down in the other sections of ■ BIPRU 4 for uncollateralised *exposures* to the counterparty. For this purpose, the *exposure* value of items listed in ■ BIPRU 4.4.37 R to ■ BIPRU 4.4.39 R and ■ BIPRU 4.8.29 R must be calculated using a *conversion factor* or percentage of 100% rather than the *conversion factors* or percentages indicated in those rules.  
**FCA** **PRA**
- [Note: BCD Annex VIII Part 3 point 69]
- 4.10.26** **R** Where the ratio of the value of the collateral to the *exposure* value exceeds a second, higher threshold level of C\*\* (i.e. the required level of collateralisation to receive full *LGD* recognition) as laid down in ■ BIPRU 4.10.28 R, LGD\* must be that prescribed in that table.  
**FCA** **PRA**
- [Note: BCD Annex VIII Part 3 point 70]
- 4.10.27** **R** Where the required level of collateralisation C\*\* is not achieved in respect of the *exposure* as a whole, the *exposure* must be considered to be two *exposures* - that part in respect of which the required level of collateralisation C\*\* is achieved and the remainder.  
**FCA** **PRA**
- [Note: BCD Annex VIII Part 3 point 71]

4.10.28

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Table: Minimum LGD for secured portion of exposures

FCA PRA

This table belongs to ■ BIPRU 4.10.24 R - ■ BIPRU 4.10.27 R

	LGD* for senior claims or contingent claims	LGD* for subordinated claims or contingent claims	Required minimum collateralisation level of the exposure (C*)	Required minimum collateralisation level of the exposure (C**)
Receivables	35%	65%	0%	125%
Residential real estate/commercial real estate	35%	65%	30%	140%
Other collateral	40%	70%	30%	140%

[Note: BCD Annex VIII Part 3 point 72 (part)]

#### Calculating risk weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Alternative treatment for real estate collateral

4.10.29

R

FCA PRA

- (1) A firm may apply the treatment in paragraph 74 of Part 3 of Annex VIII of the *Banking Consolidation Directive* (50% risk weight for exposures secured by real estate) in respect of exposures collateralised by:
  - (a) residential real estate property; or
  - (b) commercial real estate property; located in the territory of another *EEA State*.
- (2) However (1)(a) or (1)(b) only applies if the *CRD implementing measures* for that *EEA State* with respect to the *IRB approach* have implemented the option set out in the provision of the *Banking Consolidation Directive* referred to in (1) with respect to the relevant category of real estate property situated within that *EEA State*.
- (3) The use of the treatment in (1) with respect to property in another *EEA State* must be subject to the same conditions as apply under the relevant *CRD implementation measures* for that *EEA State*.

[Note: BCD Annex VIII Part 3 point 75]

### Calculating risk weighted exposure amounts and expected loss amounts: Mixed pools of collateral

4.10.30

FCA PRA

R

- (1) Where:
- risk weighted exposure amounts* and *expected loss amounts* are calculated under the *IRB approach*; and
  - an *exposure* is collateralised by both financial collateral and other eligible collateral;
- LGD\* to be taken as the *LGD* for the purposes of the *IRB approach* must be calculated in accordance with this *rule*.
- (2) A *firm* must subdivide the volatility-adjusted value of the *exposure* (i.e. the value after the application of the volatility adjustment as set out in ■ BIPRU 5.4.28 R (Volatility adjustments under the financial collateral comprehensive method) into parts each covered by only one type of collateral. That is, the *firm* must divide the *exposure* into the part covered by eligible financial collateral, the part covered by receivables, the parts covered by commercial real estate property collateral and/or residential real estate property collateral, the part covered by other eligible collateral, and the unsecured part, as relevant.
- (3) LGD\* for each part of *exposure* must be calculated separately in accordance with the relevant provisions of ■ BIPRU 5 (Credit risk mitigation) and ■ BIPRU 4.10.

[Note: BCD Annex VIII Part 3 points 76 to 78]

### Calculating risk weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Other modifications of the rules on credit risk mitigation: Financial collateral simple method

4.10.31

FCA PRA

R

The *financial collateral simple method* must not be used under the *IRB approach*.

[Note: BCD Annex VIII Part 3 point 24 (part)]

### Calculating risk weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Other modifications of the rules on credit risk mitigation: Master netting agreements

4.10.32

FCA PRA

R

- (1) This *rule* sets out how the calculations under ■ BIPRU 5.6.11 R (Using the supervisory volatility adjustments or the own estimates volatility adjustments approaches to master netting agreements covering repurchase transactions and/or securities or commodities lending or borrowing transactions and/or other capital market driven transactions) must be modified under the *IRB approach*.

- (2) Where *risk weighted exposure amounts* and *expected loss* amounts are calculated under the *IRB approach*, E is the *exposure* value for each separate *exposure* under the agreement referred to in the provisions listed in (1) that would apply in the absence of the credit protection.

[Note: BCD Annex VIII Part 3 point 11 (as it applies to the *IRB approach*)]

4.10.33

FCA PRA

R

- (1) This *rule* sets out how the calculations under ■ BIPRU 5.6.24 R (Using the internal models approach to master netting agreements covering repurchase transactions and/or securities or commodities lending or borrowing transactions and/or other capital market driven transactions) must be modified under the *IRB approach*.
- (2) Where *risk weighted exposure amounts* and *expected loss* amounts are calculated under the *IRB approach* E is the *exposure* value for each separate *exposure* under the agreement referred to in the provisions listed in (1) that would apply in the absence of the credit protection.

[Note: BCD Annex VIII Part 3 point 20 (as it applies to the *IRB approach*)]

4.10.34

FCA PRA

R

- (1) This *rule* sets out how the calculations under ■ BIPRU 5.6.29 R (Calculating risk-weighted exposure amounts and expected loss amounts for master netting agreements covering repurchase transactions and/or securities or commodities lending or borrowing transactions and/or other capital market driven transactions) must be modified under the *IRB approach*.
- (2) E\* must be taken as the *exposure* value of the *exposure* to the counterparty arising from the transactions subject to the master netting agreement referred to in the provisions listed in (1) for the purposes of ■ BIPRU 4.

[Note: BCD Annex VIII Part 3 point 23 (as it applies to the *IRB approach*)]

**Calculating risk weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Other modifications of the rules on credit risk mitigation: Financial collateral comprehensive method**

4.10.35

FCA PRA

R

- (1) This *rule* sets out how the calculations under ■ BIPRU 5.4.28 R (Calculating adjusted values under the financial collateral comprehensive method) must be modified under the *IRB approach*.
- (2) E as referred to in the provisions listed in (1) is the *exposure* value as would be determined under the *IRB approach* if the *exposure* was not collateralised. For this purpose, where a *firm* calculates *risk weighted exposure amounts* under the *IRB approach*, the *exposure* value of the items listed in ■ BIPRU 4.4.37 R to ■ BIPRU 4.4.39 R, ■ BIPRU 4.4.45 R, ■ BIPRU 4.6.44 R (3) and

4.10.36

FCA PRA

R

■ BIPRU 4.8.29 R must be calculated using a *conversion factor* of 100% rather than the *conversion factors* or percentages indicated in those provisions.

- (1) This *rule* sets out the calculation of *risk weighted exposure amounts* and *expected loss* amounts under the *financial collateral comprehensive method* for a *firm* using the *IRB approach*.
- (2) LGD\* (the effective *loss given default*) calculated as set out in this paragraph must be taken as the *LGD* for the purposes of ■ BIPRU 4.
- (3)  $LGD^* = LGD \times (E^*/E)$  where:
  - (a) *LGD* is the *loss given default* that would apply to the *exposure* under the *IRB approach* if the *exposure* was not collateralised;
  - (b) *E* is the *exposure* value as calculated under ■ BIPRU 4; and
  - (c) *E\** is as calculated under ■ BIPRU 5.4.28 R (3) (Calculation of adjusted values under the financial collateral comprehensive method).

[Note: BCD Annex VIII Part 3 point 61]

4.10.37

FCA PRA

R

- (1) In the case of a *firm* using the *IRB approach* to calculate *risk weighted exposure amounts* and *expected loss* amounts, the *persons* in (2) are added to the list in ■ BIPRU 5.4.64 R (Definition of core market participant).
- (2) The *persons* referred to in (1) are other financial companies (including insurance companies) *exposures* to which do not have a credit assessment by an *eligible ECAI* and are internally rated as having a *probability of default* equivalent to that associated with the credit assessments of *ECAIs* that are associated with *credit quality step 2* or above under the *rules* for the *risk weighting* of *exposures* under the *standardised approach* to credit risk.

[Note: BCD Annex VIII Part 3 point 58(h) (as it applies to the *IRB approach*)]

#### Unfunded credit protection: Eligibility of providers

4.10.38

FCA PRA

R

- (1) In the case of a *firm* using the *IRB approach* in calculating *risk weighted exposure amounts* and *expected loss* amounts, the *persons* in (2) are added to the list in ■ BIPRU 5.7.1 R (List of eligible providers of unfunded credit protection).

- (2) The *persons* referred to in (1) are other corporate entities, including *parent undertakings, subsidiary undertakings* and affiliate corporate entities of the *firm*, that do not have a credit assessment by an *eligible ECAI* and are internally rated as having a *probability of default* equivalent to that associated with the credit assessments of *ECAIs* that are associated with *credit quality step 2* or above under the *rules* for the *risk weighting* of *exposures* under the *standardised approach* to credit risk.

[Note: BCD Annex VIII Part 1 point 26(g)(ii)]

4.10.39

FCA PRA

R

Where *risk weighted exposure amounts* and *expected loss* amounts are calculated under the *IRB approach*, to be eligible a guarantor must be internally rated by a *firm* in accordance with the provisions of the *minimum IRB standards*.

[Note: BCD Annex VIII Part 1 point 27]

#### Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives: Introduction

4.10.40

FCA PRA

R

■ BIPRU 4.10.41 R to ■ BIPRU 4.10.48 R set out the minimum requirements:

- (1) assessing the effect of guarantees and credit derivatives for:
  - (a) *exposures* in the *sovereign, institution and corporate IRB exposure class* where the *advanced IRB approach* is being used to calculate *LGDs*; and
  - (b) *retail exposures*; and
- (2) additionally, in the case of *retail exposure* guarantees, to the assignment of *exposures* to grades or pools, and the estimation of *PD*.

[Note: BCD Annex VII Part 4 point 97]

4.10.41

FCA PRA

R

The requirements in ■ BIPRU 4.10.40 R (2) and ■ BIPRU 4.10.42 R - ■ BIPRU 4.10.48 R do not apply to guarantees provided by *institutions, central governments, central banks* and other *corporate* entities which meet the requirements in ■ BIPRU 5.7.1 R (7) if the *firm* has received approval under ■ BIPRU 4.2 to apply the *standardised approach* for *exposures* to such entities. In this case the requirements of ■ BIPRU 5 (credit risk mitigation) apply.

[Note: BCD Annex VII Part 4 point 96]

### Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives: Eligible guarantors and guarantees

4.10.42

FCA PRA

R

A *firm* must have clearly specified criteria for the types of guarantors it recognises for the calculation of *risk weighted exposure amounts*.

[Note: Annex VII Part 4 point 98]

4.10.43

FCA PRA

R

For recognised guarantors the same requirements as for obligors as set out in ■ BIPRU 4.3.43 R - ■ BIPRU 4.3.48 R (Assignment to grades and pools), ■ BIPRU 4.4.11 R - ■ BIPRU 4.4.18 R and ■ BIPRU 4.4.51 R (Assignment of exposures and rating systems), ■ BIPRU 4.5.6 R (Assignment of exposures) and ■ BIPRU 4.6.11 R and ■ BIPRU 4.6.14 R (Assignment of exposures and rating systems) apply.

[Note: BCD Annex VII Part 4 point 99]

4.10.44

FCA PRA

R

The guarantee must be evidenced in writing, non-cancellable on the part of the guarantor, in force until the obligation is satisfied in full (to the extent of the amount and tenor of the guarantee) and legally enforceable against the guarantor in a jurisdiction where the guarantor has assets to attach and enforce a judgement. Guarantees prescribing conditions under which the guarantor may not be obliged to perform (conditional guarantees) may be recognised if the *IRB permission* permits this. A *firm* must (in the case of a *firm* with an *IRB permission* that permits conditional guarantees) be able to demonstrate to the *appropriate regulator* that the assignment criteria adequately address any potential reduction in the risk mitigation effect.

[Note: BCD Annex VII Part 4 point 100]

### Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives: Adjustment criteria

4.10.45

FCA PRA

R

A *firm* must have clearly specified criteria for adjusting grades, pools or *LGD* estimates, and in the case of *retail exposures* and eligible purchased receivables, the process of allocating *exposures* to grades or pools, to reflect the impact of guarantees for the calculation of *risk weighted exposure amounts*. These criteria must comply with the minimum requirements referred to in ■ BIPRU 4.10.43 R.

[Note: BCD Annex VII Part 4 point 101]

4.10.46

FCA PRA

R

The criteria in ■ BIPRU 4.10.45 R must be plausible and intuitive. They must address the guarantor's ability and willingness to perform under the guarantee, the likely timing of any payments from the guarantor, the degree to which the guarantor's ability to perform under the guarantee is correlated with the obligor's ability to repay, and the extent to which residual risk to the obligor remains.

[Note: BCD Annex VII Part 4 point 102]

**Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives: Credit derivatives**

4.10.47

FCA PRA

R

The minimum requirements for guarantees set out in ■ BIPRU 4.10 also apply for single name credit derivatives. In relation to a mismatch between the underlying obligation and the reference obligation of the credit derivative or the obligation used for determining whether a credit event has occurred the requirements set out under ■ BIPRU 5.7.14 R (Mismatches and credit derivatives) apply. For *retail exposures* and eligible purchased receivables, this paragraph applies to the process of allocating *exposures* to grades or pools.

[Note: BCD Annex VII Part 4 point 103]

4.10.48

FCA PRA

R

The criteria applied by ■ BIPRU 4.10.47 R must address the payout structure of the credit derivative and conservatively assess the impact this has on the level and timing of recoveries. A *firm* must consider the extent to which other forms of residual risk remain.

[Note: BCD Annex VII Part 4 point 104]

**Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives: Calculating risk weighted exposure amounts and expected loss amounts**

4.10.49

FCA PRA

R

- (1) This *rule* relates to the calculation of *risk-weighted exposure amounts* and *expected loss* amounts in the case of *unfunded credit protection*.
- (2) ■ BIPRU 5.7.21 R (Tranching) applies for the purpose in (1).
- (3) The provisions in (4) replace those in ■ BIPRU 5.7.22 R to ■ BIPRU 5.7.25 R (Calculating risk weighted exposure amounts under the standardised approach in the case of unfunded credit protection).
- (4) For the covered portion of the *exposure* value E (based on the adjusted value of the credit protection  $G_A$ ), the *PD* for the purposes of ■ BIPRU 4 may be the *PD* of the protection provider, or a *PD* between that of the borrower and that of the guarantor if a full substitution is deemed not to be warranted. In the case of subordinated *exposures* and non-subordinated unfunded protection, the *LGD* to be applied for the purposes of ■ BIPRU 4 may be that associated with senior claims.
- (5) For any uncovered portion of the *exposure* value E the *PD* must be that of the borrower and the *LGD* must be that of the underlying *exposure*.

- (6)  $G_A$  is the value of  $G^*$  as calculated under ■ BIPRU 5.7.17 R (Valuation of unfunded credit protection) further adjusted for any maturity mismatch as laid down in ■ BIPRU 4.10.51 R (Maturity mismatches).
- (7) E is the *exposure* value as related to the following rules:  
 ■ BIPRU 4.4.38 R, ■ BIPRU 4.4.39 R, ■ BIPRU 4.4.71 R to ■ BIPRU 4.4.78 R, ■ BIPRU 4.7.7 R, ■ BIPRU 4.8.28 R, ■ BIPRU 4.8.29 R and ■ BIPRU 4.9.9 R. For this purpose, the *exposure* value of the items referred to in ■ BIPRU 4.4.37 R to ■ BIPRU 4.4.39 R and ■ BIPRU 4.8.29 R must be calculated using a *conversion factor* or percentage of 100% rather than the *conversion factors* or percentages indicated in those rules.

[Note: BCD Annex VIII Part 3 points 90 to 92]

#### Maturity mismatches

4.10.50

FCA PRA

R

In addition to ■ BIPRU 5.8.2 R, where there is a maturity mismatch the credit protection must not be recognised where the *exposure* is a short term *exposure* specified in the *firm's IRB permission* as being subject to a one-day floor rather than a one-year floor in respect of the maturity value (M) under ■ BIPRU 4.4.68 R.

[Note: BCD Annex VIII Part 4 point 2(b)]

4.10.51

FCA PRA

R

$G_A$  as calculated under ■ BIPRU 5.8.11 R is then taken as the value of the protection for the purposes of calculating the effects of *unfunded credit protection* under the *IRB approach*.

[Note: BCD Annex VIII Part 4 point 8 (part)]

## Supervisory Slotting Criteria for Specialised Lending

**FCA** **PRA**

This Annex outlines the criteria that must be used to slot a *specialised lending exposure* into the categories in **■ BIPRU 4.5.6 R**.

This table belongs to **■ BIPRU 4.5.6 R** and must be used in accordance with that rule only for project finance exposures.

Table 1 - Supervisory Rating Grades for Project Finance Exposures

	Strong	Good	Satisfactory	Weak
<b>Financial strength</b>				
<b>Market conditions</b>	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
<b>Financial ratios (e.g. debt service coverage ratio (DSCR), loan life coverage ratio (LLCR), project life coverage ratio (PLCR), and debt-to-equity ratio)</b>	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
<b>Stress analysis</b>	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

Table 1 - Supervisory Rating Grades for Project Finance Exposures

	Strong	Good	Satisfactory	Weak
<b>Duration of the credit compared to the duration of the project</b>	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
<b>Amortisation schedule</b>	Amortising debt	Amortising debt	Amortising debt repayments with limited bullet payment	Bullet repayment or amortising debt repayments with high bullet repayment
<b>Political and legal environment</b>				
<b>Political risk, including transfer risk, considering project type and mitigants</b>	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
<b>Force majeure risk (war, civil unrest, etc)</b>	Low exposure	Acceptable exposure	Standard protection	Significant risks, not fully mitigated
<b>Government support and project's importance for the country over the long term</b>	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
<b>Stability of legal and regulatory environment (risk of change in law)</b>	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
<b>Acquisition of all necessary supports and approvals for such relief from local content laws</b>	Strong	Satisfactory	Fair	Weak
<b>Enforceability of contracts, collateral and security</b>	Contracts, collateral and security are enforceable	Contracts, collateral and security are enforceable	Contracts, collateral and security are considered enforceable even if certain	There are unresolved key issues in respect if actual enforcement of

Table 1 - Supervisory Rating Grades for Project Finance Exposures

	Strong	Good	Satisfactory	Weak
<b>Transaction characteristics</b>			non-key issues may exist	contracts, collateral and security
<b>Design and technology risk</b>	Fully proven technology and design	Fully proven technology and design	Proven technology and design - start-up issues are mitigated by a strong completion package	Unproven technology and design; technology issues exist and/or complex design
<b>Permitting and siting</b>	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
<b>Type of construction contract</b>	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
<b>Completion guarantees</b>	Substantial liquidated damages supported by financial substance and/or strong completion guarantee from sponsors with excellent financial standing	Significant liquidated damages supported by financial substance and/or completion guarantee from sponsors with good financial standing	Adequate liquidated damages supported by financial substance and/or completion guarantee from sponsors with good financial standing	Inadequate liquidated damages or not supported by financial substance or weak completion guarantees
<b>Track record and financial strength of contractor in constructing similar projects.</b>	Strong	Good	Satisfactory	Weak
<b>Scope and nature of operations and maintenance (O &amp; M) contracts</b>	Strong long-term O&M contract, preferably with contractual performance incentives,	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

Table 1 - Supervisory Rating Grades for Project Finance Exposures

	Strong	Good	Satisfactory	Weak
<b>Operator's expertise, track record, and financial strength</b>	and/or O&M reserve accounts Very strong, or committed technical assistance of the sponsors	Strong	Acceptable	Limited/weak, or local operator dependent on local authorities
<b>(a) If there is a take-or-pay or fixed-price off-take contract:</b>	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>(b) If there is no take-or-pay or fixed-price off-take contract:</b>	Project produces essential services or a commodity sold widely on a world market; output can readily be absorbed at projected prices even at lower than historic market growth rates	Project produces essential services or a commodity sold widely on a regional market that will absorb it at projected prices at historical growth rates	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 market
<b>Price, volume and transportation risk of feed-stocks; supplier's track record and financial strength</b>	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
<b>Reserve risks (e.g. natural resource development)</b>	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 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
<b>Strength of Sponsor</b>				

4

Table 1 - Supervisory Rating Grades for Project Finance Exposures

	Strong	Good	Satisfactory	Weak
<b>Sponsor's track record, financial strength, and country/sector experience</b>	<b>Strong sponsor with excellent track record and high financial standing</b>	<b>Good sponsor with satisfactory track record and good financial standing</b>	<b>Adequate sponsor with adequate track record and good financial standing</b>	<b>Weak sponsor with no or questionable track record and/or financial weaknesses</b>
<b>Sponsor support, as evidenced by equity, ownership clause and incentive to inject additional cash if necessary</b>	<b>Strong. Project is highly strategic for the sponsor (core business - long-term strategy)</b>	<b>Good. Project is strategic for the sponsor (core business - long-term strategy)</b>	<b>Acceptable. Project is considered important for the sponsor (core business)</b>	<b>Limited. Project is not key to sponsor's long-term strategy or core business</b>
<b>Security Package</b>				
<b>Assignment of contracts and accounts</b>	<b>Fully comprehensive</b>	<b>Comprehensive</b>	<b>Acceptable</b>	<b>Weak</b>
<b>Pledge of assets, taking into account quality, value and liquidity of assets</b>	<b>First perfected security interest in all project assets, contracts, permits and accounts necessary to run the project</b>	<b>Perfected security interest in all project assets, contracts, permits and accounts necessary to run the project</b>	<b>Acceptable security interest in all project assets, contracts, permits and accounts necessary to run the project</b>	<b>Little security or collateral for lenders; weak negative pledge clause</b>
<b>Lender's control over cash flow (e.g. cash sweeps, independent escrow accounts)</b>	<b>Strong</b>	<b>Satisfactory</b>	<b>Fair</b>	<b>Weak</b>
<b>Strength of the covenant package (mandatory prepayments, payment deferrals, payment cascade, dividend restrictions...)</b>	<b>Covenant package is strong for this type of project</b>	<b>Covenant package is satisfactory for this type of project</b>	<b>Covenant package is fair for this type of project</b>	<b>Covenant package is Insufficient for this type of project</b>
	<b>Project may issue no additional debt</b>	<b>Project may issue extremely limited additional debt</b>	<b>Project may issue limited additional debt</b>	<b>Project may issue unlimited additional debt</b>
<b>Reserve funds (debt service, O&amp;M, renewal and replacement,</b>	<b>Longer than average coverage period, all reserve funds fully funded in cash or letters</b>	<b>Average coverage period, all reserve funds fully funded</b>	<b>Average coverage period, all reserve funds fully funded</b>	<b>Shorter than average coverage period, reserve funds funded from operating cash flows</b>

Table 1 - Supervisory Rating Grades for Project Finance Exposures

	Strong	Good	Satisfactory	Weak
unforeseen events, of credit from etc) highly rated bank				

This table belongs to ■ BIPRU 4.5.6 R and must be used in accordance with that rule only for income-producing real estate exposures

Table 2 - Supervisory Rating Grades for Income-Producing Real Estate Exposures

	Strong	Good	Satisfactory	Weak
<b>Financial strength</b>				
<b>Market conditions</b>	The supply and demand for the project's type and location are currently in equilibrium. The number of competitive properties coming to market is equal or lower than forecasted demand	The supply and demand for the project's type and location are currently in equilibrium. The number of competitive properties coming to market is roughly equal to forecasted demand	Market conditions are roughly in equilibrium. Competitive 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	Market conditions are weak. It is uncertain when conditions will improve and return to equilibrium. The project is losing tenants at lease expiration. New lease terms are less favourable compared to those expiring
<b>Financial ratios and advance rate</b>	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
<b>Stress analysis</b>	The property's resources, contingencies and liability	The property can meet its financial obligations under	During an economic downturn, the property would	The property's financial condition is strained and is

4

Table 2 - Supervisory Rating Grades for Income-Producing Real Estate Exposures

	Strong	Good	Satisfactory	Weak
	structure allow it to meet its financial obligations during a period of severe financial stress (e.g. interest rates, economic growth)	a sustained period of financial stress (e.g. interest rates, economic growth). The property is likely to default only under severe economic conditions	suffer a decline in revenue that would limit its ability to fund capital expenditures and significantly increase the risk of default	likely to default unless conditions improve in the near term
<b>Cash-flow predictability</b>				
<b>(a) For complete and stabilised property</b>	The property's leases are long-term with credit-worthy 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	Most of the 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	Most of the 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	The property's 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>(b) For complete but not stabilised property</b>	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
<b>(c) For construction phase</b>	The property is entirely pre-leased through the tenor of the loan or pre-sold to an investment grade tenant or buyer, or the	The property is entirely pre-leased or pre-sold to a creditworthy tenant or buyer, or the bank has a binding commit-	Leasing activity is within projections but the building may not be pre-leased and there may not exist a take-out financing.	The property is deteriorating due to cost overruns, market deterioration, tenant cancellations or other factors. There may

Table 2 - Supervisory Rating Grades for Income-Producing Real Estate Exposures

	Strong	Good	Satisfactory	Weak
<b>Asset characteristics</b>	bank has a binding commitment for take-out financing from an investment grade lender	ment for permanent financing from a creditworthy lender	The bank may be the permanent lender	be a dispute with the party providing the permanent financing
<b>Location</b>	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
<b>Design and condition</b>	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
<b>Property is under construction</b>	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
<b>Strength of Sponsor/Developer</b>				
<b>Financial capacity and willingness to support the property</b>	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 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	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

Table 2 - Supervisory Rating Grades for Income-Producing Real Estate Exposures

	Strong	Good	Satisfactory	Weak
	The sponsor/developer's properties are diversified geographically and by property type	cash flow shortfall. The sponsor/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
<b>Security Package</b>				
Nature of lien	Perfect first lien (Note 1)	Perfect first lien (Note 1)	Perfect 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

Table 2 - Supervisory Rating Grades for Income-Producing Real Estate Exposures

Strong	Good	Satisfactory	Weak
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**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.**

This table belongs to **■ BIPRU 4.5.6 R** and must be used in accordance with that rule only for object finance exposures

Table 3 - Supervisory Rating Grades for Object Finance Exposures

Strong	Good	Satisfactory	Weak
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**Financial strength**

<b>Market conditions</b>	<b>Demand is strong and growing, strong entry barriers, low sensitivity to changes in technology and economic outlook</b>	<b>Demand is strong and stable. Some entry barriers, some sensitivity to changes in technology and economic outlook</b>	<b>Demand is adequate and stable, limited entry barriers, significant sensitivity to changes in technology and economic outlook</b>	<b>Demand is weak and declining, vulnerable to changes in technology and economic outlook, highly uncertain environment</b>
<b>Financial ratios (debt service coverage ratio and loan-to-value ratio)</b>	<b>Strong financial ratios considering the type of asset. Very robust economic assumptions</b>	<b>Strong / acceptable financial ratios considering the type of asset. Robust project economic assumptions</b>	<b>Standard financial ratios for the asset type</b>	<b>Aggressive financial ratios considering the type of asset</b>
<b>Stress analysis</b>	<b>Stable long-term revenues, capable of withstanding severely stressed conditions through an economic cycle</b>	<b>Satisfactory short-term revenues. Loan can withstand some financial adversity. Default is only likely under severe economic conditions</b>	<b>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</b>	<b>Revenues subject to strong uncertainties; even in normal economic conditions the asset may default, unless conditions improve</b>
<b>Market liquidity</b>	<b>Market is structured on a worldwide basis; assets are highly liquid</b>	<b>Market is worldwide or regional; assets are relatively liquid</b>	<b>Market is regional with limited prospects in the short term, implying lower liquidity</b>	<b>Local market and/or poor visibility. Low or no liquidity, particularly on niche markets</b>

Table 3 - Supervisory Rating Grades for Object Finance Exposures

	Strong	Good	Satisfactory	Weak
<b>Political and legal environment</b>				
<b>Political risk, including transfer risk</b>	Very low; strong mitigation instruments, if needed	Low; satisfactory mitigation instruments, if needed	Moderate; fair mitigation instruments	High; no or weak mitigation instruments
<b>Legal and regulatory risks</b>	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
<b>Transaction characteristics</b>				
<b>Financing term compared to the economic life of the asset</b>	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
<b>Operating risk</b>				
<b>Permits / licensing</b>	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
<b>Scope and nature of O &amp; M contracts</b>	Strong long-term O&M contract, preferably with contractual performance incentives, and/or O&M reserve accounts (if needed)	Long-term O&M contract, and/or O&M reserve accounts (if needed)	Limited O&M contract or O&M reserve account (if needed)	No O&M contract: risk of high operational cost overruns beyond mitigants
<b>Operator's financial strength, track record in managing the asset type</b>	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

Table 3 - Supervisory Rating Grades for Object Finance Exposures

	Strong	Good	Satisfactory	Weak
<b>and capability to re-market asset when it comes off-lease</b>				
<b>Asset characteristics</b>				
<b>Configuration, size, design and maintenance (i.e. age, size for a plane) compared to other assets on the same market</b>	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
<b>Resale value</b>	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
<b>Sensitivity of the asset value and liquidity to economic cycles</b>	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
<b>Strength of sponsor</b>				
<b>Operator's financial strength, track record in managing the asset type and capability to re-market asset when it comes off-lease</b>	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
<b>Sponsors' track record and financial strength</b>	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
<b>Security Package</b>				
<b>Asset control</b>	Legal documentation provides the lender effective control (e.g. a first	Legal documentation provides the lender effective control (e.g. a per-	Legal documentation provides the lender effective control (e.g. a per-	The contract provides little security to the lender and leaves room to

Table 3 - Supervisory Rating Grades for Object Finance Exposures

	Strong	Good	Satisfactory	Weak
	perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	some risk of losing control on the asset
<b>Rights and means at the lender's disposal to monitor the location and condition of the asset</b>	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
<b>Insurance against damages</b>	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

This table belongs to **■ BIPRU 4.5.6 R** and must be used in accordance with that rule only for commodities finance exposures.

Table 4 - Supervisory Rating Grades for Commodities Finance Exposures

	Strong	Good	Satisfactory	Weak
<b>Financial strength</b>				
<b>Degree of over-collateralisation of trade</b>	Strong	Good	Satisfactory	Weak
<b>Political and legal Environment</b>				
<b>Country risk</b>	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)
<b>Mitigation of country risks</b>	Very strong mitigation:	Strong mitigation:	Acceptable mitigation:	Only partial mitigation:

Table 4 - Supervisory Rating Grades for Commodities Finance Exposures

	Strong	Good	Satisfactory	Weak
	<b>Strong offshore Mechanisms</b>	<b>Offshore mechanisms</b>	<b>Offshore mechanisms</b>	<b>No offshore mechanisms</b>
	<b>Strategic commodity</b>	<b>Strategic commodity</b>	<b>Less strategic commodity</b>	<b>Non-strategic commodity</b>
	<b>1<sup>st</sup> class buyer</b>	<b>Strong buyer</b>	<b>Acceptable buyer</b>	<b>Weak buyer</b>
<b>Asset characteristics</b>				
<b>Liquidity and susceptibility to damage</b>	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
<b>Strength of sponsor</b>				
<b>Financial strength of trader</b>	Very strong, relative to trading philosophy and risks	Strong	Adequate	Weak
<b>Track record, including ability to manage the logistic process</b>	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
<b>Trading controls and hedging policies</b>	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
<b>Quality of financial disclosure</b>	Excellent	Good	Satisfactory	Financial disclosure contains some uncertainties or is insufficient
<b>Security package</b>				

Table 4 - Supervisory Rating Grades for Commodities Finance Exposures

	Strong	Good	Satisfactory	Weak
<b>Asset control</b>	<b>First perfected security interest provides the lender legal control of the assets at any time if needed</b>	<b>First perfected security interest provides the lender legal control of the assets at any time if needed</b>	<b>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</b>	<b>Contract leaves room for some risk of losing control over the assets. Recovery could be jeopardised</b>
<b>Insurance against damages</b>	<b>Strong insurance coverage including collateral damages with top quality insurance companies</b>	<b>Satisfactory insurance coverage (not including collateral damages) with good quality insurance companies</b>	<b>Fair insurance coverage (not including collateral damages) with acceptable quality insurance companies</b>	<b>Weak insurance coverage (not including collateral damages) or with weak quality insurance companies</b>



## Chapter 5

# Credit risk mitigation

## 5.1 Application and purpose

### Application

**5.1.1** **R** ■ BIPRU 5 applies to a *BIPRU firm*.

**FCA** **PRA**

### Purpose

**5.1.2** **G** ■ BIPRU 5 implements, in part, Articles 78(1) and 91 to 93 and Annex VIII of the *Banking Consolidation Directive*.

**FCA** **PRA**

**5.1.3** **G** ■ BIPRU 5 sets out the principles for the recognition of *credit risk mitigation* in the calculation of *risk weighted exposure amounts* for the purposes of the calculation of the *credit risk capital component*.

**FCA** **PRA**

**5.1.4** **G** ■ BIPRU 4.10 implements those parts of Articles 91 to 93 and Annex VIII of the *Banking Consolidation Directive* which are specific to the recognition of *credit risk mitigation* by *firms* using the *IRB approach*, and modifies the application of the provisions in ■ BIPRU 5 to those *firms*.

**FCA** **PRA**

**5.1.5** **G** In certain cases provisions specific to the *IRB approach* have been kept in ■ BIPRU 5 in order to reduce duplication. The main examples are certain references to *expected loss* and references in the *IRB approach* in the provisions in ■ BIPRU 5.7 about basket CRM techniques.

**FCA** **PRA**

## 5.2 The central principles of credit risk mitigation

5.2.1

FCA PRA

R

A *firm* using the *standardised approach* may recognise *credit risk mitigation* in accordance with ■ BIPRU 5 in the calculation of *risk weighted exposure amounts* for the purposes of the calculation of the *credit risk capital component*.

[Note: BCD Article 91]

5.2.2

FCA PRA

R

The technique used to provide the credit protection together with the actions and steps taken and procedures and policies implemented by a *lending firm* must be such as to result in credit protection arrangements which are legally effective and enforceable in all relevant jurisdictions.

[Note: BCD Article 92(1)]

5.2.3

FCA PRA

R

- (1) A *firm* must not recognise credit protection as eligible until it has conducted sufficient legal review confirming that the credit protection arrangements are legally effective and enforceable in all relevant jurisdictions in accordance with ■ BIPRU 5.2.2 R.
- (2) A *firm* must re-conduct legal reviews as necessary to ensure continuing enforceability and effectiveness.

5.2.4

FCA PRA

R

A *lending firm* must take all appropriate steps to ensure the effectiveness of the credit protection arrangement and to address related risks.

[Note: BCD Article 92(2)]

### Funded credit protection

5.2.5

FCA PRA

R

In the case of *funded credit protection*:

- (1) to be eligible for recognition the assets relied upon must be sufficiently liquid and their value over time sufficiently stable to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate *risk weighted exposure amounts* and to the degree of recognition allowed; eligibility is limited to the assets set out in the *CRM eligibility conditions*; and

- (2) the *lending firm* must have the right to liquidate or retain, in a timely manner, the assets from which the protection derives in the event of the default, insolvency or bankruptcy of the obligor - or other credit event set out in the transaction documentation - and, where applicable, of the custodian holding the collateral; the degree of correlation between the value of the assets relied upon for protection and the credit quality of the obligor must not be undue.

[Note: BCD Article 92(3) and (4)]

#### Treatment of credit linked notes

5.2.6

FCA PRA

G

A credit linked note should be treated, to the extent of its cash funding, as *funded credit protection*. Therefore the conditions in ■ BIPRU 5 regulating the eligibility of protection providers for *unfunded credit protection* do not apply. However the other provisions about the requirements for the recognition of *unfunded credit protection* do apply.

#### Unfunded credit protection

5.2.7

FCA PRA

R

In the case of *unfunded credit protection*:

- (1) to be eligible for recognition the party giving the undertaking must be sufficiently reliable, and the protection agreement legally effective and enforceable in the relevant jurisdictions, to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate *risk weighted exposure amounts* and to the degree of recognition allowed; and
- (2) eligibility is limited to the protection providers and types of protection agreement set out in the *CRM eligibility conditions*.

[Note: BCD Article 92(5)]

#### Minimum requirements

5.2.8

FCA PRA

R

The minimum requirements set out in BIPRU 5 must be complied with.

[Note: BCD Article 92(6)]

5.2.9

FCA PRA

R

A *firm* must be able to satisfy the *appropriate regulator* that it has adequate risk management processes to control the risks to which the *firm* may be exposed as a result of carrying out *credit risk mitigation*. Those processes must include appropriate stress tests and scenario analyses relating to those risks, including residual risk and the risks relating to the intrinsic value of the *credit risk mitigation*.

[Note: BCD Annex VIII Part 2 point 1]

5.2.10

FCA PRA

R

Notwithstanding the presence of *credit risk mitigation* taken into account for the purposes of calculating *risk weighted exposure amounts* and as relevant *expected loss* amounts, a *firm* must continue to undertake full credit risk assessment of the underlying *exposure* and must be in a position to demonstrate to the *appropriate regulator* the fulfilment of this requirement. In the case of *repurchase transactions* and/or *securities or commodities lending or borrowing transactions* the underlying *exposure* must, for the purposes of this *rule* only, be deemed to be the net amount of the *exposure*.

[Note: BCD Annex VIII Part 2 point 2]

#### Calculating the effects of the credit risk mitigation

5.2.11

FCA PRA

R

Where the requirements of ■ BIPRU 5.2.2 R to ■ BIPRU 5.2.8 R are met the calculation of *risk weighted exposure amounts*, may be modified in accordance with ■ BIPRU 5.

[Note: BCD Article 93(1)]

5.2.12

FCA PRA

R

No *exposure* in respect of which *credit risk mitigation* is obtained may produce a higher *risk weighted exposure amount* than an otherwise identical *exposure* in respect of which there is no *credit risk mitigation*.

[Note: BCD Article 93(2)]

5.2.13

FCA PRA

R

Where the *risk weighted exposure amount* already takes account of credit protection under the *standardised approach* the calculation of the credit protection must not be further recognised under ■ BIPRU 5.

[Note: BCD Article 93(3)]

5.2.14

FCA PRA

R

Subject to ■ BIPRU 5.8, ■ BIPRU 5.9 and ■ BIPRU 5.7.27 R to ■ BIPRU 5.7.28 R, where the *CRM eligibility conditions* and the *CRM minimum requirements* are satisfied, the calculation of *risk weighted exposure amounts* under the *standardised approach* may be modified in accordance with the provisions of ■ BIPRU 5.

[Note: BCD Annex VIII Part 3 point 1]

5.2.15

FCA PRA

R

Cash, *securities* or *commodities* purchased, borrowed or received under a *repurchase transaction* or *securities or commodities lending or borrowing transaction* must be treated as collateral.

[Note: BCD Annex VIII Part 3 point 2]

## 5.3 On balance sheet netting

### Eligibility

5.3.1

FCA PRA

R

A *firm* may recognise as eligible the on-balance sheet netting of mutual claims between the *firm* and its counterparty.

[Note: BCD Annex VIII Part 1 point 3]

5.3.2

FCA PRA

R

Without prejudice to ■ BIPRU 5.6.1 R, eligibility is limited to reciprocal cash balances between a *firm* and a counterparty. Only loans and deposits of the *lending firm* may be subject to a modification of *risk weighted exposure amounts* and, as relevant, *expected loss* amounts as a result of an on-balance sheet netting agreement.

[Note: BCD Annex VIII Part 1 point 4]

### Minimum requirements

5.3.3

FCA PRA

R

For on-balance sheet netting agreements - other than master netting agreements covering *repurchase transactions, securities or commodities lending or borrowing transactions* and/or other *capital market-driven transactions* - to be recognised for the purposes of ■ BIPRU 5 the following conditions must be satisfied:

- (1) they must be legally effective and enforceable in all relevant jurisdictions, including in the event of the insolvency or bankruptcy of a counterparty;
- (2) the *firm* must be able to determine at any time those assets and liabilities that are subject to the on-balance sheet netting agreement;
- (3) the *firm* must monitor and control the risks associated with the termination of the credit protection; and
- (4) the *firm* must monitor and control the relevant *exposures* on a net basis.

[Note: BCD Annex VIII Part 2 point 3]

**Calculating the effects of credit risk mitigation**

5.3.4

FCA PRA

R

Loans and deposits with a *lending firm* subject to on-balance sheet netting are to be treated as cash collateral.

[Note: BCD Annex VIII Part 3 point 4]

5

## 5.4 Financial collateral

### Eligibility

#### 5.4.1

FCA PRA

R

- (1) Where the *credit risk mitigation* used relies on the right of a *firm* to liquidate or retain assets, eligibility depends upon whether *risk weighted exposure amounts*, and, as relevant, *expected loss amounts*, are calculated under the *standardised approach* or the *IRB approach*.
- (2) Eligibility further depends upon whether the *financial collateral simple method* is used or the *financial collateral comprehensive method*.
- (3) In relation to *repurchase transactions* and *securities or commodities lending or borrowing transactions*, eligibility also depends upon whether the transaction is booked in the *non-trading book* or the *trading book*.

[Note: BCD Annex VIII Part 1 point 6]

#### 5.4.2

FCA PRA

R

The following financial items may be recognised as eligible collateral under all approaches and methods:

- (1) cash on deposit with, or *cash assimilated instruments* held by, the *lending firm*;
- (2) *debt securities* issued by central governments or *central banks* which *securities* have a credit assessment by an *eligible ECAI* or export credit agency recognised as eligible for the purposes of the *standardised approach*, which is associated with *credit quality step 4* or above under the *rules* for the *risk weighting* of *exposures* to central governments and *central banks* under the *standardised approach*;
- (3) *debt securities* issued by *institutions* which *securities* have a credit assessment by an *eligible ECAI* associated with *credit quality step 3* or above under the *rules* for the *risk weighting* of *exposures* to a *credit institution* under the *standardised approach*;

- (4) *debt securities* issued by other entities which *securities* have a credit assessment by an *eligible ECAI* associated with *credit quality step 3* or above under the *rules* for the *risk weighting* of *exposures* to *corporates* under the *standardised approach*;
- (5) *debt securities* with a short-term credit assessment by an *eligible ECAI* associated with *credit quality step 3* or above under the *rules* for the *risk weighting* of *short term exposures* under the *standardised approach*;
- (6) equities or *convertible* bonds that are included in a main index; and
- (7) gold.

[Note: BCD Annex VIII Part 1 point 7 (part)]

5

## 5.4.3

FCA PRA

R

For the purposes of ■ BIPRU 5.4.2 R (2), '*debt securities* issued by central governments or *central banks*' include -

- (1) *debt securities* issued by regional governments or local authorities *exposures* to which are treated as *exposures* to the central government in whose jurisdiction they are established under the *standardised approach*;
- (2) *debt securities* issued by *public sector entities* which are treated as *exposures* to central governments in accordance with ■ BIPRU 3.4.24 R;
- (3) *debt securities* issued by *multilateral development banks* to which a 0% *risk weight* is assigned under the *standardised approach*; and
- (4) *debt securities* issued by *international organisations* which are assigned a 0% *risk weight* under the *standardised approach*.

[Note: BCD Annex VIII Part 1 point 7 (part)]

## 5.4.4

FCA PRA

R

For the purposes of ■ BIPRU 5.4.2 R (3), '*debt securities* issued by *institutions*' include:

- (1) *debt securities* issued by regional governments or local authorities other than those *exposures* to which are treated as *exposures* to the central government in whose jurisdiction they are established under the *standardised approach*;
- (2) *debt securities* issued by *public sector entities*, *exposures* to which are treated as *exposures* to a *credit institution* under the *standardised approach*;

- (3) *debt securities* issued by *multilateral development banks* other than those to which a 0% *risk weight* is assigned under the *standardised approach*.

[Note: BCD Annex VIII Part 1 point 7 (part)]

5.4.5

FCA PRA

R

*Debt securities* issued by *institutions* which *securities* do not have a credit assessment by an *eligible ECAI* may be recognised as eligible collateral if they fulfil the following criteria:

- (1) they are listed on a *recognised investment exchange* or a *designated investment exchange*;
- (2) they qualify as senior debt;
- (3) all other rated issues by the issuing *institution* of the same seniority have a credit assessment by an *eligible ECAI* associated with *credit quality step 3* or above under the *rules* for the *risk weight* of *exposures to institutions* or short term *exposures* under the *standardised approach*;
- (4) the *lending firm* has no information to suggest that the issue would justify a credit assessment below that indicated in (3); and
- (5) the *firm* can demonstrate to the *appropriate regulator* that the market liquidity of the instrument is sufficient for these purposes.

[Note: BCD Annex VIII Part 1 point 8]

5.4.6

FCA PRA

R

- (1) Units in *CIUs* may be recognised as eligible collateral if the following conditions are satisfied:
  - (a) they have a daily public price quote;
  - (b) the *CIU* is limited to investing in instruments that are eligible for recognition under ■ BIPRU 5.4.2 R to ■ BIPRU 5.4.5 R; and
  - (c) if the *CIU* is not limited to investing in instruments that are eligible for recognition under ■ BIPRU 5.4.2 R to ■ BIPRU 5.4.5 R, units may be recognised with the value of the eligible assets as collateral under the assumption that the *CIU* has invested to the maximum extent allowed under its mandate in non-eligible assets. In cases where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, the *firm* must calculate the total value of the non-eligible assets and must reduce the value of the eligible assets by that of the non-eligible assets in case the latter is negative in total.

- (2) The use (or potential use) by a *CIU* of derivative instruments to hedge permitted investments shall not prevent units in that *CIU* from being eligible.

[Note: *BCD* Annex VIII Part 1 point 9]

5.4.7

FCA PRA

R

In relation to ■ BIPRU 5.4.2 R (2) to ■ (5):

- (1) where a *security* has two credit assessments by *eligible ECAIs*, the less favourable assessment must be deemed to apply;
- (2) in cases where a *security* has more than two credit assessments by *eligible ECAIs*:
- (a) the two most favourable assessments must be deemed to apply; or
- (b) if the two most favourable credit assessments are different, the less favourable of the two must be deemed to apply.

[Note: *BCD* Annex VIII Part 1 point 10]

5.4.8

FCA PRA

R

- (1) In addition to the collateral set out in ■ BIPRU 5.4.2 R to ■ BIPRU 5.4.7 R, where a *firm* uses the *financial collateral comprehensive method*, the following financial items may be recognised as eligible collateral:
- (a) equities or *convertible* bonds not included in a main index but traded on a *recognised investment exchange* or a *designated investment exchange*;
- (b) units in *CIUs* if the following conditions are met:
- (i) they have a daily public price quote; and
- (ii) the *CIU* is limited to investing in instruments that are eligible for recognition under ■ BIPRU 5.4.2 R to ■ BIPRU 5.4.5 R and the items mentioned in (a); and
- (c) if the *CIU* is not limited to investing in instruments that are eligible for recognition under ■ BIPRU 5.4.2 R to ■ BIPRU 5.4.5 R and the items mentioned in (a) of this *rule*, units may be recognised with the value of the eligible assets as collateral under the assumption that the *CIU* has invested to the maximum extent allowed under its mandate in non-eligible assets. In cases where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, the *firm* must calculate the total value of the non-eligible assets and must reduce the value of the eligible assets by that of the non-eligible assets, in case the latter is negative in total.

- (2) The use (or potential use) by a *CIU* of derivative instruments to hedge permitted investments shall not prevent units in that *CIU* from being eligible.

[Note: *BCD* Annex VIII Part 1 point 11]

#### Minimum requirements

5.4.9

FCA PRA

R

For the recognition of financial collateral and gold, the following conditions must be met:

- (1) the low correlation conditions in ■ BIPRU 5.4.10 R;
- (2) the legal certainty conditions in ■ BIPRU 5.4.11 R; and
- (3) the operational requirements in ■ BIPRU 5.4.12 R.

[Note: *BCD* Annex VIII Part 2 point 6]

5.4.10

FCA PRA

R

The low correlation conditions referred to in ■ BIPRU 5.4.9 R (1) are as follows:

- (1) (a) the credit quality of the obligor and the value of the collateral must not have a material positive correlation; and  
(b) *securities* issued by the obligor, or any related *group* entity are not eligible.
- (2) notwithstanding (1)(b), the obligor's own issues of *covered bonds* falling within the terms of ■ BIPRU 3.4.107 R to ■ BIPRU 3.4.109 R may be recognised as collateral for *repurchase transactions*, provided that (1)(a) is complied with.

[Note: *BCD* Annex VIII Part 2 point 6(a)]

5.4.11

FCA PRA

R

The legal certainty conditions referred to in ■ BIPRU 5.4.9 R (2) are as follows:

- (1) a *firm* must fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of the collateral arrangements under the law applicable to its interest in the collateral;
- (2) in accordance with the general principle in ■ BIPRU 5.2.2 R, a *firm* must have conducted sufficient legal review confirming the enforceability of the collateral arrangements in all relevant jurisdictions; and
- (3) a *firm* must re-conduct such review as necessary to ensure continuing enforceability.

[Note: BCD Annex VIII Part 2 point 6(b)]

5.4.12

FCA PRA

R

The operational requirements referred to in ■ BIPRU 5.4.9 R (3) are as follows:

- (1) the collateral arrangements must be properly documented, with a clear and robust procedure for the timely liquidation of collateral;
- (2) a *firm* must employ robust procedures and processes to control risks arising from the use of collateral - including risks of failed or reduced credit protection, valuation risks, risks associated with the termination of the credit protection, concentration risk arising from the use of collateral and the interaction with the *firm's* overall risk profile;
- (3) a *firm* must have documented policies and practices concerning the types and amounts of collateral accepted;
- (4) a *firm* must calculate the market value of the collateral, and revalue it accordingly, with a minimum frequency of once every six months and whenever the *firm* has reason to believe that there has occurred a significant decrease in its market value; and
- (5) where the collateral is held by a third party, a *firm* must take reasonable steps to ensure that the third party segregates the collateral from its own assets.

[Note: BCD Annex VIII Part 2 point 6(c)]

5.4.13

FCA PRA

R

In addition to the requirements set out in ■ BIPRU 5.4.9 R, for the recognition of financial collateral under the *financial collateral simple method* the residual maturity of the protection must be at least as long as the residual maturity of the *exposure*.

[Note: BCD Annex VIII Part 2 point 7]

#### The financial collateral simple method: General

5.4.14

FCA PRA

R

■ BIPRU 5.4.17 R - ■ BIPRU 5.4.22 R set out the calculation of the effects of *credit risk mitigation* under the *financial collateral simple method*.

5.4.15

FCA PRA

R

The *financial collateral simple method* is available only where *risk weighted exposure amounts* are calculated under the *standardised approach* to credit risk.

[Note: BCD Annex VIII Part 3 point 24 (part)]

5.4.16

FCA PRA

R

A *firm* must not use both the *financial collateral simple method* and the *financial collateral comprehensive method*, unless such use is for the purposes of ■ BIPRU 4.2.17 R to ■ BIPRU 4.2.19 R and ■ BIPRU 4.2.26 R, and such use is provided for by the *firm's IRB permission*. A *firm* must

demonstrate to the *appropriate regulator* that this exceptional application of both methods is not used selectively with the purpose of achieving reduced minimum capital requirements and does not lead to regulatory arbitrage.

[Note: BCD Annex VIII Part 3 point 24 (part)]

#### The financial collateral simple method: Valuation

5.4.17

FCA PRA

R

Under the *financial collateral simple method*, recognised financial collateral is assigned a value equal to its market value as determined in accordance with ■ BIPRU 5.4.12 R.

[Note: BCD Annex VIII Part 3 point 25]

#### The financial collateral simple method: Calculating risk-weighted exposure amounts

5.4.18

FCA PRA

R

The *risk weight* that would be assigned under the *standardised approach* to credit risk if the *lending firm* had a direct *exposure* to the collateral instrument must be assigned to those portions of *exposure* values collateralised by the market value of recognised collateral. For this purpose, the *exposure* value of an off-balance sheet item listed in ■ BIPRU 3.7.2 R must be 100% of its value rather than the *exposure* value indicated in ■ BIPRU 3.2.1 R. The *risk weight* of the collateralised portion must be a minimum of 20% except as specified in ■ BIPRU 5.4.19 R to ■ BIPRU 5.4.21 R. The remainder of the *exposure* value receives the *risk weight* that would be applied to an unsecured *exposure* to the counterparty under the *standardised approach*.

[Note: BCD Annex VIII Part 3 point 26]

#### The financial collateral simple method: Repurchase transactions and securities lending or borrowing transactions

5.4.19

FCA PRA

R

A *risk weight* of 0% must be assigned to the collateralised portion of the *exposure* arising from transactions which fulfil the criteria enumerated in ■ BIPRU 5.4.62 R or ■ BIPRU 5.4.65 R. If the counterparty to the transaction is not a *core market participant* a *risk weight* of 10% must be assigned.

[Note: BCD Annex VIII Part 3 point 27]

#### The financial collateral simple method: financial derivative instruments subject to daily mark-to-market

5.4.20

FCA PRA

R

A *risk weight* of 0% must, to the extent of the collateralisation, be assigned to the *exposure* values determined under ■ BIPRU 13 for *financial derivative instruments* and subject to daily marking-to-market, collateralised by cash or *cash assimilated instruments* where there is no currency mismatch. A *risk weight* of 10% must be assigned to the extent of the collateralisation to the *exposure* values of such transactions

collateralised by *debt securities* issued by central governments or *central banks* which are assigned a 0% *risk weight* under the *standardised approach*.

[Note: BCD Annex VIII Part 3 point 28 (part)]

5.4.21

FCA PRA

R

A 0% *risk weight* may be assigned where the *exposure* and the collateral are denominated in the same currency, and either:

- (1) the collateral is cash on deposit or a *cash assimilated instrument*; or
- (2) the collateral is in the form of *debt securities* issued by central governments or *central banks* eligible for a 0% *risk weight* under the *standardised approach*, and its market value has been discounted by 20%.

[Note: BCD Annex VIII Part 3 point 29]

5.4.22

FCA PRA

R

For the purposes of ■ BIPRU 5.4.20 R and ■ BIPRU 5.4.21 R '*debt securities* issued by central governments or *central banks*' must include:

- (1) *debt securities* issued by regional governments or local authorities *exposures* to which are treated as *exposures* to the central government in whose jurisdiction they are established under the *standardised approach*;
- (2) *debt securities* issued by *multilateral development banks* to which a 0% *risk weight* is assigned under or by virtue of the *standardised approach*; and
- (3) *debt securities* issued by *international organisations* which are assigned a 0% *risk weight* under the *standardised approach*.

[Note: BCD Annex VIII Part 3 point 28 (part)]

#### The financial collateral comprehensive method: General

5.4.23

FCA PRA

R

■ BIPRU 5.4.24 R - ■ BIPRU 5.4.66 R set out the calculation of the effects of *credit risk mitigation* under the *financial collateral comprehensive method*.

5.4.24

FCA PRA

R

In valuing financial collateral for the purposes of the *financial collateral comprehensive method*, volatility adjustments must be applied to the market value of collateral, as set out in ■ BIPRU 5.4.30 R to ■ BIPRU 5.4.65 R, in order to take account of price volatility.

[Note: BCD Annex VIII Part 3 point 30]

5.4.25

FCA PRA

R

Subject to the treatment for currency mismatches in the case of *financial derivative instrument* set out in ■ BIPRU 5.4.26 R, where collateral is

denominated in a currency that differs from that in which the underlying *exposure* is denominated, an adjustment reflecting currency volatility must be added to the volatility adjustment appropriate to the collateral as set out in ■ BIPRU 5.4.30 R to ■ BIPRU 5.4.65 R.

[Note: BCD Annex VIII Part 3 point 31]

5.4.26

FCA PRA

R

In the case of *financial derivative instrument* covered by netting agreements recognised under ■ BIPRU 13, a volatility adjustment reflecting currency volatility must be applied when there is a mismatch between the collateral currency and the settlement currency. Even in the case where multiple currencies are involved in the transactions covered by the netting agreement, only a single volatility adjustment may be applied.

[Note: BCD Annex VIII Part 3 point 32]

5.4.27

FCA PRA

R

In the case of a *firm* using the *financial collateral comprehensive method*, where an *exposure* takes the form of securities or *commodities* sold, posted or lent under a *repurchase transaction* or under a *securities or commodities lending or borrowing transaction*, and *margin lending transactions* the *exposure* value must be increased by the volatility adjustment appropriate to such securities or *commodities* as prescribed in ■ BIPRU 5.4.30 R to ■ BIPRU 5.4.65 R.

[Note: BCD Article 78(1), third sentence]

#### The financial collateral comprehensive method: Calculating adjusted values

5.4.28

FCA PRA

R

- (1) The volatility-adjusted value of the collateral to be taken into account is calculated as follows in the case of all transactions except those transactions subject to recognised master netting agreements to which the provisions set out in ■ BIPRU 5.6.5 R to ■ BIPRU 5.6.29 R are to be applied:

$$C_{VA} = C \times (1 - H_C - H_{FX})$$

- (2) The volatility-adjusted value of the *exposure* to be taken into account is calculated as follows:

$$E_{VA} = E \times (1 + H_E), \text{ and in the case of } \textit{financial derivative instruments} \ E_{VA} = E.$$

- (3) The fully adjusted value of the *exposure*, taking into account both volatility and the risk-mitigating effects of collateral is calculated as follows:

$$E^* = \max \{0, [E_{VA} - C_{VAM}]\}$$

Where:

- (a)  $E$  is the *exposure* value as would be determined under the *standardised approach* if the *exposure* was not collateralised.
  - (b)  $E_{VA}$  is the volatility-adjusted *exposure* amount.
  - (c)  $C_{VA}$  is the volatility-adjusted value of the collateral.
  - (d)  $C_{VAM}$  is  $C_{VA}$  further adjusted for any maturity mismatch in accordance with the provisions of ■ BIPRU 5.8.
  - (e)  $H_E$  is the volatility adjustment appropriate to the *exposure* ( $E$ ), as calculated under ■ BIPRU 5.4.30 R to ■ BIPRU 5.4.65 R.
  - (f)  $H_C$  is the volatility adjustment appropriate for the collateral, as calculated under ■ BIPRU 5.4.30 R to ■ BIPRU 5.4.65 R.
  - (g)  $H_{FX}$  is the volatility adjustment appropriate for currency mismatch, as calculated under ■ BIPRU 5.4.30 R to ■ BIPRU 5.4.65 R.
  - (h)  $E^*$  is the fully adjusted *exposure* value taking into account volatility and the risk-mitigating effects of the collateral.
- (4) For the purpose of (3)(a), for a *firm* calculating *risk weighted exposure amounts* under the *standardised approach* the *exposure* value of an off-balance sheet items listed in ■ BIPRU 3.7 must be 100% of its value rather than the *exposure* value indicated in ■ BIPRU 3.2.1 R and ■ BIPRU 3.7.2 R.

[Note: BCD Annex VIII Part 3 point 33]

#### The financial collateral comprehensive method: Calculation of volatility adjustments to be applied: General

5.4.29

FCA PRA

R

■ BIPRU 5.4.30 R - ■ BIPRU 5.4.65 R set out the calculation of volatility adjustments under the *financial collateral comprehensive method*.

5.4.30

FCA PRA

R

Volatility adjustments may be calculated in two ways: the *supervisory volatility adjustments approach* and the *own estimates of volatility adjustments approach*.

[Note: BCD Annex VIII Part 3 point 34]

5.4.31

FCA PRA

R

A *firm* may choose to use the *supervisory volatility adjustments approach* or the *own estimates of volatility adjustments approach* independently of the choice it has made between the *standardised approach* and the *IRB approach* for the calculation of *risk weighted exposure amounts*. However, if a *firm* seeks to use the *own estimates of volatility adjustments approach*,

it must do so for the full range of instrument types, excluding immaterial portfolios where it may use the *supervisory volatility adjustments approach*.

[Note: BCD Annex VIII Part 3 point 35 (part)]

5.4.32

FCA PRA

R

Where the collateral consists of a number of recognised items, the volatility adjustment must be

$$(H = \sum_i \alpha_i H_i)$$

where:

- (1)  $a_i$  is the proportion of an item to the collateral as a whole; and
- (2)  $H_i$  is the volatility adjustment applicable to that item.

[Note: BCD Annex VIII Part 3 point 35 (part)]

#### The financial collateral comprehensive method: Supervisory volatility adjustments approach

5.4.33

FCA PRA

R

■ BIPRU 5.4.34 R - ■ BIPRU 5.4.43 R set out the calculation of volatility adjustments under the *supervisory volatility adjustments approach*.

5.4.34

FCA PRA

R

The volatility adjustments to be applied under the *supervisory volatility adjustments approach* (assuming daily revaluation) are those set out in the tables in ■ BIPRU 5.4.35 R - ■ BIPRU 5.4.38 R.

[Note: BCD Annex VIII Part 3 point 36]

**Table: Volatility adjustments for debt securities described in BIPRU 5.4.2R(2) and (3) - (4)**

5.4.35

FCA PRA

R

This table belongs to ■ BIPRU 5.4.34 R.

<i>Credit quality step with which the credit assessment of the debt security is associated</i>	Residual Maturity	Volatility adjustments for <i>debt securities</i> issued by entities described in BIPRU 5.4.2 R (2)			Volatility adjustments for <i>debt securities</i> issued by entities described in BIPRU 5.4.2 R (3) and (4)		
		20 day liquidation period (%)	10 day liquidation period (%)	5 day liquidation period (%)	20 day liquidation period (%)	10 day liquidation period (%)	5 day liquidation period (%)
<b>1</b>	≤ 1 year	0.707	0.5	0.354	1.414	1	0.707
	> 1 ≤ 5 years	2.828	2	1.414	5.657	4	2.828
	> 5 years	5.657	4	2.828	11.314	8	5.657
<b>2-3</b>	≤ 1 year	1.414	1	0.707	2.828	2	1.414
	> 1 ≤ 5 years	4.243	3	2.121	8.485	6	4.243
	> 5 years	8.485	6	4.243	16.971	12	8.485
<b>4</b>	≤ 1 year	21.213	15	10.607	N/A	N/A	N/A
	> 1 ≤ 5 years	21.213	15	10.607	N/A	N/A	N/A
	> 5 years	21.213	15	10.607	N/A	N/A	N/A

5

**Table: Volatility adjustments for debt securities described in BIPRU 5.4.2R(5)**

5.4.36

FCA PRA

R

This table belongs to ■ BIPRU 5.4.34 R.

<i>Credit quality step with which the credit assessment of a short term debt security is associated</i>	Volatility adjustments for <i>debt securities</i> issued by entities described in BIPRU 5.4.2 R (2) with short-term credit assessments			Volatility adjustments for <i>debt securities</i> issued by entities described in BIPRU 5.4.2 R (3) and (4) with short-term credit assessments		
	20 day liquidation period (%)	10 day liquidation period (%)	5 day liquidation period (%)	20 day liquidation period (%)	10 day liquidation period (%)	5 day liquidation period (%)
1	0.707	0.5	0.354	1.414	1	0.707
2-3	1.414	1	0.707	2.828	2	1.414

**Table: Volatility adjustments for other collateral or exposure types**

5.4.37

FCA PRA

R

This table belongs to ■ BIPRU 5.4.34 R.

	Other collateral or <i>exposure</i> types		
	20 day liquidation period (%)	10 day liquidation period (%)	5 day liquidation period (%)
Main index equities, main index convertible bonds	21.213	15	10.607
Other equities or convertible bonds listed on a recognised investment exchange or designated investment exchange	35.355	25	17.678
Cash	0	0	0

Other collateral or <i>exposure</i> types			
	20 day liquidation period (%)	10 day liquidation period (%)	5 day liquidation period (%)
Gold	21.213	15	10.607

**Table: Volatility adjustments for currency mismatch**

5.4.38

FCA PRA

R

This table belongs to ■ BIPRU 5.4.34 R.

Volatility adjustment for currency mismatch		
20 day liquidation period (%)	10 day liquidation period (%)	5 day liquidation period (%)
11.314	8	5.657

5.4.39

FCA PRA

R

- (1) For *secured lending transactions* the liquidation period is 20 business days.
- (2) For *repurchase transactions* (except insofar as such transactions involve the transfer of *commodities* or guaranteed rights relating to title to *commodities*) and *securities lending or borrowing transactions* the liquidation period is 5 business days.
- (3) For other *capital market-driven transactions*, the liquidation period is 10 business days.

[Note: BCD Annex VIII Part 3 point 37]

5.4.40

FCA PRA

R

In the tables in ■ BIPRU 5.4.35 R - ■ BIPRU 5.4.38 R and in ■ BIPRU 5.4.41 R to ■ BIPRU 5.4.43 R, the *credit quality step* with which a credit assessment of the *debt security* is associated is the *credit quality step* with which the external credit assessment is associated under the *standardised approach*. For the purposes of this *rule*, ■ BIPRU 5.4.7 R also applies.

[Note: BCD Annex VIII Part 3 point 38]

5.4.41

FCA PRA

R

For non-eligible *securities* or for *commodities* lent or sold under *repurchase transactions* or *securities or commodities lending or borrowing transactions*, the volatility adjustment is the same as for non-main index equities listed on a *recognised investment exchange* or a *designated investment exchange*.

[Note: BCD Annex VIII Part 3 point 39]

5.4.42

FCA PRA

R

For eligible units in *CIUs* the volatility adjustment is the weighted average volatility adjustments that would apply, having regard to the liquidation period of the transaction as specified in ■ BIPRU 5.4.39 R, to the assets in

which the fund has invested. If the assets in which the fund has invested are not known to the *firm*, the volatility adjustment is the highest volatility adjustment that would apply to any of the assets in which the fund has the right to invest.

[Note: BCD Annex VIII Part 3 point 40]

5.4.43

FCA PRA

R

For unrated *debt securities* issued by *institutions* and satisfying the eligibility criteria in ■ BIPRU 5.4.5 R the volatility adjustments are the same as for *securities* issued by *institutions* or *corporates* with an external credit assessment associated with *credit quality steps* 2 or 3.

[Note: BCD Annex VIII Part 3 point 41]

#### The financial collateral comprehensive method: Own estimates of volatility adjustments approach: General

5.4.44

FCA PRA

R

■ BIPRU 5.4.45 R - ■ BIPRU 5.4.60 R deal with the calculation of volatility adjustments under the *own estimates of volatility adjustments approach*.

5.4.45

FCA PRA

R

A *firm* complying with the requirements set out in ■ BIPRU 5.4.50 R to ■ BIPRU 5.4.60 R may use the *own estimates of volatility adjustments approach* for calculating the volatility adjustments to be applied to collateral and *exposures*.

[Note: BCD Annex VIII Part 3 point 42]

5.4.46

FCA PRA

R

When *debt securities* have a credit assessment from an *eligible ECAI* equivalent to investment grade or better, a *firm* may calculate a volatility estimate for each category of *security*.

[Note: BCD Annex VIII Part 3 point 43]

5.4.47

FCA PRA

R

In determining relevant categories, a *firm* must take into account the type of issuer of the *security* the external credit assessment of the *securities*, their residual maturity, and their modified duration. Volatility estimates must be representative of the *securities* included in the category by the *firm*.

[Note: BCD Annex VIII Part 3 point 44]

5.4.48

FCA PRA

R

For *debt securities* having a credit assessment from an *eligible ECAI* equivalent to below investment grade and for other eligible collateral the volatility adjustments must be calculated for each individual item.

[Note: BCD Annex VIII Part 3 point 45]

5.4.49

FCA PRA

R

A *firm* using the *own estimates of volatility adjustments approach* must estimate volatility of the collateral or foreign exchange mismatch without

taking into account any correlations between the unsecured *exposure*, collateral and/or exchange rates.

[Note: *BCD* Annex VIII Part 3 point 46]

**The financial collateral comprehensive method: Own estimates of volatility adjustments approach: Quantitative Criteria**

5.4.50

FCA PRA

R

In calculating the volatility adjustments, a 99th percentile one-tailed confidence interval must be used.

[Note: *BCD* Annex VIII Part 3 point 47]

5.4.51

FCA PRA

R

The liquidation period is 20 *business days* for *secured lending transactions*; 5 *business days* for *repurchase transactions* except insofar as such transactions involve the transfer of *commodities* or guaranteed rights relating to title to commodities and *securities lending or borrowing transactions*; and 10 *business days* for other *capital market-driven transactions*.

[Note: *BCD* Annex VIII Part 3 point 48]

5.4.52

FCA PRA

R

A *firm* may use volatility adjustment numbers calculated according to shorter or longer liquidation periods, scaled up or down to the liquidation period set out in ■ BIPRU 5.4.51 R for the type of transaction in question, using the square root of time formula:

$$(H_M = H_N) \sqrt{T_M/T_N}$$

where:

- (1)  $T_M$  is the relevant liquidation period;
- (2)  $H_M$  is the volatility adjustment under  $T_M$ ; and
- (3)  $H_N$  is the volatility adjustment based on the liquidation period  $T_N$ .

[Note: *BCD* Annex VIII Part 3 point 49]

5.4.53

FCA PRA

R

A *firm* must take into account the illiquidity of lower-quality assets. The liquidation period must be adjusted upwards in cases where there is doubt concerning the liquidity of the collateral. A *firm* must also identify where historical data may understate potential volatility, e.g. a pegged currency. Such cases must be dealt with by means of stress scenario assessments .

[Note: *BCD* Annex VIII Part 3 point 50]

5.4.54

FCA PRA

R

The historical observation period (sample period) for calculating volatility adjustments must be a minimum length of one year. For a *firm* that uses

a weighting scheme or other methods for the historical observation period, the effective observation period must be at least one year (that is, the weighted average time lag of the individual observations must not be less than 6 months).

[Note: *BCD Annex VIII Part 3 point 51*]

5.4.55

FCA PRA

G

The *appropriate regulator* may also require a *firm* to calculate its volatility adjustments using a shorter observation period if, in the *appropriate regulator's* judgement, this is justified by a significant upsurge in price volatility.

5.4.56

FCA PRA

R

A *firm* must update its data sets at least once every three months and must also reassess them whenever market prices are subject to material changes. This implies that volatility adjustments must be computed at least every three months.

[Note: *BCD Annex VIII Part 3 point 52*]

#### The financial collateral comprehensive method: Own estimates of volatility adjustments approach: Qualitative Criteria

5.4.57

FCA PRA

R

The volatility estimates must be used in the day-to-day risk management process of a *firm* including in relation to its internal *exposure* limits.

[Note: *BCD Annex VIII Part 3 point 53*]

5.4.58

FCA PRA

R

If the liquidation period used by a *firm* in its day-to-day risk management process is longer than that set out in ■ BIPRU 5.4 for the type of transaction in question, the *firm's* volatility adjustments must be scaled up in accordance with the square root of time formula set out in ■ BIPRU 5.4.52 R.

[Note: *BCD Annex VIII Part 3 point 54*]

5.4.59

FCA PRA

R

A *firm* must have established procedures for monitoring and ensuring compliance with a documented set of policies and controls for the operation of its system for the estimation of volatility adjustments and for the integration of such estimations into its risk management process.

[Note: *BCD Annex VIII Part 3 point 55*]

5.4.60

FCA PRA

R

An independent review of a *firm's* system for the estimation of volatility adjustments must be carried out regularly in the *firm's* own internal auditing process. A review of the overall system for the estimation of volatility adjustments and for integration of those adjustments into the *firm's* risk management process must take place at least once a year and must specifically address, at a minimum:

- (1) the integration of estimated volatility adjustments into daily risk management;

- (2) the validation of any significant change in the process for the estimation of volatility adjustments;
- (3) the verification of the consistency, timeliness and reliability of data sources used to run the system for the estimation of volatility adjustments, including the independence of such data sources; and
- (4) the accuracy and appropriateness of the volatility assumptions.

[Note: BCD Annex VIII Part 3 point 56]

#### The financial collateral comprehensive method: Scaling up of volatility adjustments

5.4.61

FCA PRA

R

The volatility adjustments set out in ■ BIPRU 5.4.34 R to ■ BIPRU 5.4.43 R are the volatility adjustments to be applied where there is daily revaluation. Similarly, where a *firm* uses its own estimates of the volatility adjustments in accordance with ■ BIPRU 5.4.45 R to ■ BIPRU 5.4.60 R, these must be calculated in the first instance on the basis of daily revaluation. If the frequency of revaluation is less than daily, larger volatility adjustments must be applied. These must be calculated by scaling up the daily revaluation volatility adjustments, using the following 'square root of time' formula:

$$(H = H_M \sqrt{(N_R + (T_M - 1)) / (T_M)})$$

where:

- (1) H is the volatility adjustment to be applied;
- (2)  $H_M$  is the volatility adjustment where there is daily revaluation;
- (3)  $N_R$  is the actual number of business days between revaluations; and
- (4)  $T_M$  is the liquidation period for the type of transaction in question.

[Note: BCD Annex VIII Part 3 point 57]

#### The financial collateral comprehensive method: Conditions for applying a 0% volatility adjustment

5.4.62

FCA PRA

R

In relation to *repurchase transaction* and *securities lending or borrowing transactions*, where a *firm* uses the *supervisory volatility adjustments approach* or the *own estimates of volatility adjustments approach* and where the conditions set out in (1) - (8) are satisfied, a *firm* may, instead of applying the volatility adjustments calculated under ■ BIPRU 5.4.30 R to ■ BIPRU 5.4.61 R, apply a 0% volatility adjustment:

- (1) both the *exposure* and the collateral are cash or *debt securities* issued by central governments or *central banks* within the meaning of ■ BIPRU 5.4.2 R (2) and eligible for a 0% *risk weight* under the *standardised approach*;
- (2) both the *exposure* and the collateral are denominated in the same currency;
- (3) either the maturity of the transaction is no more than one day or both the *exposure* and the collateral are subject to daily marking-to-market or daily remargining;
- (4) it is considered that the time between the last marking-to-market before a failure to remargin by the counterparty and the liquidation of the collateral is no more than four business days;
- (5) the transaction is settled across a settlement system proven for that type of transaction;
- (6) the documentation covering the agreement is standard market documentation for *repurchase transactions* or *securities lending or borrowing transactions* in the *securities* concerned;
- (7) the transaction is governed by documentation specifying that if the counterparty fails to satisfy an obligation to deliver cash or *securities* or to deliver margin or otherwise defaults, then the transaction is immediately terminable; and
- (8) the counterparty is a *core market participant*.

[Note: BCD Annex VIII Part 3 point 58 (part)]

5.4.63

FCA PRA

R

The option in ■ BIPRU 5.4.62 R is not available in respect of a *firm* using the *master netting agreement internal models approach*.

[Note: BCD Annex VIII Part 3 point 58 (part)]

5.4.64

FCA PRA

R

*Core market participant* means the following entities:

- (1) the entities mentioned in ■ BIPRU 5.4.2 R (2) *exposures* to which are assigned a 0% *risk weight* under the *standardised approach* to credit risk;
- (2) *institutions*;
- (3) other financial companies (including insurance companies) *exposures* which are assigned a 20% *risk weight* under the *standardised approach*;

- (4) regulated *CIUs* that are subject to capital or leverage requirements;
- (5) regulated pension funds; and
- (6) a *recognised clearing house* or *designated clearing house*.

[Note: *BCD* Annex VIII Part 3 point 58 (part)]

5.4.65

FCA PRA

R

If under the *CRD implementation measure* for a particular *EEA State* with respect to point 58 of Part 3 of Annex VIII of the *Banking Consolidation Directive* (Conditions for applying the 0% volatility adjustment) the treatment set out in that point is permitted to be applied in the case of *repurchase transactions* or *securities lending or borrowing transactions* in *securities* issued by the domestic government of that *EEA State*, then a *firm* may adopt the same approach to the same transactions.

[Note: *BCD* Annex VIII Part 3 point 59]

#### Financial collateral comprehensive method: Calculating risk-weighted exposure amounts

5.4.66

FCA PRA

R

Under the *standardised approach*  $E^*$  as calculated under ■ BIPRU 5.4.28 R must be taken as the *exposure* value for the purposes of ■ BIPRU 3.2.20 R to ■ BIPRU 3.2.26 R. In the case of off-balance sheet items listed in ■ BIPRU 3.7,  $E^*$  must be taken as the value to which the percentages indicated in ■ BIPRU 3.2.1 R and ■ BIPRU 3.7.2 R must be applied to arrive at the *exposure* value.

[Note: *BCD* Annex VIII Part 3 point 60]

## 5.5 Other funded credit risk mitigation

### Deposits with third parties: Eligibility

5.5.1

FCA PRA

R

Cash on deposit with, or *cash assimilated instruments* held by, a third party *institution* in a non-custodial arrangement and pledged to a *lending firm* may be recognised as eligible credit protection.

[Note: BCD Annex VIII Part 1 point 23]

### Deposits with third parties: Minimum requirements

5.5.2

FCA PRA

R

To be eligible for the treatment set out at ■ BIPRU 5.5.3 R, the protection referred to in ■ BIPRU 5.5.1 R must satisfy the following conditions:

- (1) the borrower's claim against the third party *institution* is openly pledged or assigned to the *lending firm* and such pledge or assignment is legally effective and enforceable in all relevant jurisdictions;
- (2) the third party *institution* is notified of the pledge or assignment;
- (3) as a result of the notification, the third party *institution* is able to make payments solely to the *lending firm* or to other parties with the *lending firm's* consent; and
- (4) the pledge or assignment is unconditional and irrevocable.

[Note: BCD Annex VIII Part 2 point 12]

### Deposits with third parties: Calculating the effects of the credit risk mitigation

5.5.3

FCA PRA

R

Where the conditions set out in ■ BIPRU 5.5.2 R are satisfied, credit protection falling within the terms of ■ BIPRU 5.5.1 R may be treated as a guarantee by the third party *institution*.

[Note: BCD Annex VIII Part 3 point 79]

5.5.4

FCA PRA

R

**Life insurance policies: Eligibility**

Life insurance policies pledged to a *lending firm* may be recognised as eligible credit protection.

[Note: BCD Annex VIII Part 1 point 24]

5.5.5

FCA PRA

R

**Life insurance policies: Minimum requirements**

For life insurance policies pledged to a *lending firm* to be recognised the following conditions must be met:

- (1) the party providing the life insurance must be subject to Directive 2002/83/EC and Directive 2001/17/EC of the European Parliament and of the Council, or is subject to supervision by a competent authority of a third country which applies supervisory and regulatory arrangements at least equivalent to those applied in the Community;
- (2) the life insurance policy is openly pledged or assigned to the *lending firm*;
- (3) the party providing the life insurance is notified of the pledge or assignment and as a result may not pay amounts payable under the contract without the consent of the *lending firm*;
- (4) the *surrender value* is declared by the company providing the life insurance and is non-reducible;
- (4A) the *surrender value* must be paid in a timely manner upon request;
- (4B) the *surrender value* must not be requested without the consent of the *lending firm*;
- (5) the *lending firm* must have the right to cancel the policy and receive the surrender value in a timely way in the event of the default of the borrower;
- (6) the *lending firm* is informed of any non-payments under the policy by the policyholder;
- (7) the credit protection must be provided for the maturity of the loan. Where this is not possible because the insurance relationship ends before the loan relationship expires, the *lending firm* must ensure that the amount deriving from the insurance contract serves the *lending firm* as security until the end of the duration of the credit agreement; and
- (8) the pledge or assignment must be legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.

[Note: BCD Annex VIII Part 2 point 13 (part)]

5.5.6

FCA PRA

R

Where it is not possible for a *firm* to meet the condition set out in ■ BIPRU 5.5.5 R (7), because the insurance relationship ends before the loan relationship expires, the *firm* must ensure that the amount deriving from the insurance contract serves the *firm* as security until the end of the duration of the credit agreement.

[Note: BCD Annex VIII Part 2 point 13 (part)]

### Life insurance policies: Calculating the effects of the credit risk mitigation

5.5.7

FCA PRA

R

- (1) Where the conditions set out in ■ BIPRU 5.5.5 R are satisfied, the portion of the *exposure* collateralised by the current *surrender value* of credit protection falling within the terms of ■ BIPRU 5.5.4 R must be either:
  - (a) subject to the *risk weights* specified in (3) where the *exposure* is subject to the *standardised approach* to credit risk; or
  - (b) assigned an *LGD* of 40% where the *exposure* is subject to the *IRB approach* but not subject to the *firm's* own estimates of *LGD*.
- (2) In case of a currency mismatch, the current *surrender value* must be reduced according to ■ BIPRU 5.7.17 R and ■ BIPRU 5.7.18R, the value of the credit protection being the current *surrender value* of the life insurance policy.
- (3) For the purpose of (1)(a), the following *risk weights* must be assigned on the basis of the *risk weight* assigned to a senior unsecured *exposure* to the company providing the life insurance:
  - (a) a *risk weight* of 20%, where the senior unsecured *exposure* to the company providing the life insurance is assigned a *risk weight* of 20%;
  - (b) a *risk weight* of 35%, where the senior unsecured *exposure* to the company providing the life insurance is assigned a *risk weight* of 50%;
  - (c) a *risk weight* of 70%, where the senior unsecured *exposure* to the company providing the life insurance is assigned a *risk weight* of 100%; and
  - (d) a *risk weight* of 150%, where the senior unsecured *exposure* to the company providing the life insurance is assigned a *risk weight* of 150%.

[Note: BCD Annex VIII Part 3 point 80]

5.5.8

FCA PRA

R

**Instruments purchased on request: Eligibility**

Instruments issued by third party *institutions* which will be repurchased by that *institution* on request may be recognised as eligible credit protection.

[Note: *BCD* Annex VIII Part 1 point 25]

**Instruments purchased on request: Calculating the effects of the credit risk mitigation**

5.5.9

FCA PRA

R

Instruments eligible under ■ BIPRU 5.5.8 R may be treated as a guarantee by the issuing *institution*.

[Note: *BCD* Annex VIII Part 3 point 81]

5.5.10

FCA PRA

R

For the purposes of ■ BIPRU 5.5.9 R, the value of the credit protection recognised is the following:

- (1) where the instrument will be repurchased at its face value, the value of the protection is that amount; or
- (2) where the instrument will be repurchased at market price, the value of the protection is the value of the instrument valued in the same way as the *debt securities* specified in ■ BIPRU 5.4.5 R.

[Note: *BCD* Annex VIII Part 3 point 82]

**Credit linked notes**

5.5.11

FCA PRA

R

Investments in credit linked notes issued by a *lending firm* may be treated as cash collateral.

[Note: *BCD* Annex VIII Part 3 point 3]

## 5.6 Master netting agreements

### Eligibility

5.6.1

FCA PRA

R

- (1) For a *firm* adopting the *financial collateral comprehensive method*, the effects of bilateral netting contracts covering *repurchase transactions, securities or commodities lending or borrowing transactions*, and/or other *capital market-driven transactions* with a counterparty may be recognised.
- (2) Without prejudice to ■ BIPRU 14 to be recognised the collateral taken and *securities or commodities* borrowed within such agreements must comply with the eligibility requirements for collateral set out at ■ BIPRU 5.4.2 R to ■ BIPRU 5.4.8 R.

[Note: BCD Annex VIII Part 1 point 5]

### Minimum requirements

5.6.2

FCA PRA

R

For master netting agreements covering *repurchase transactions* and/or *securities or commodities lending or borrowing transactions* and/or other *capital market-driven transactions* to be recognised for the purposes of ■ BIPRU 5, they must:

- (1) be legally effective and enforceable in all relevant jurisdictions, including in the event of the bankruptcy or insolvency of the counterparty;
- (2) give the non-defaulting party the right to terminate and close-out in a timely manner all transactions under the agreement upon the event of default, including in the event of the bankruptcy or insolvency of the counterparty; and
- (3) provide for the netting of gains and losses on transactions closed out under a master agreement so that a single net amount is owed by one party to the other.

[Note: BCD Annex VIII Part 2 point 4]

5.6.3

FCA PRA

R

In addition the minimum requirements for the recognition of financial collateral under the *financial collateral comprehensive method* set out in ■ BIPRU 5.4.9 R must be fulfilled.

[Note: BCD Annex VIII Part 2 point 5]

**Calculation of the fully adjusted exposure value: the supervisory volatility adjustments approach and the own estimates of volatility adjustments approach**

5.6.4

FCA PRA

R

■ BIPRU 5.6.5 R to ■ BIPRU 5.6.11 R set out the calculation of the fully adjusted *exposure* value under the *supervisory volatility adjustments approach* and the *own estimates of volatility adjustments approach*.

5.6.5

FCA PRA

R

In calculating the 'fully adjusted *exposure* value' ( $E^*$ ) for the *exposures* subject to an eligible master netting agreement covering *repurchase transactions* and/or *securities or commodities lending or borrowing transactions* and/or other *capital market-driven transactions*, a firm must calculate the volatility adjustments to be applied in the manner set out in ■ BIPRU 5.6.6 R to ■ BIPRU 5.6.11 R either using the *supervisory volatility adjustments approach* or the *own estimates of volatility adjustments approach* as set out in ■ BIPRU 5.4.30 R to ■ BIPRU 5.4.65 R for the *financial collateral comprehensive method*. For the use of the *own estimates of volatility adjustments approach* the same conditions and requirements apply as under the *financial collateral comprehensive method*.

[Note: BCD Annex VIII Part 3 point 5]

5.6.6

FCA PRA

R

A firm must calculate the net position in each type of *security* or *commodity* by subtracting from the total value of the *securities* or *commodities* of that type lent, sold or provided under the master netting agreement, the total value of *securities* or *commodities* of that type borrowed, purchased or received under the agreement.

[Note: BCD Annex VIII Part 3 point 6]

5.6.7

FCA PRA

R

For the purposes of ■ BIPRU 5.6.6 R, type of *security* means *securities* which are issued by the same entity, have the same issue date, the same maturity and are subject to the same terms and conditions and are subject to the same liquidation periods as indicated in ■ BIPRU 5.4.30 R to ■ BIPRU 5.4.65 R.

[Note: BCD Annex VIII Part 3 point 7]

5.6.8

FCA PRA

R

A firm must calculate the net position in each currency other than the settlement currency of the master netting agreement by subtracting from the total value of *securities* denominated in that currency lent, sold or provided under the master netting agreement added to the amount of cash in that currency lent or transferred under the agreement, the total value of *securities* denominated in that currency borrowed, purchased or received

under the agreement added to the amount of cash in that currency borrowed or received under the agreement.

[Note: BCD Annex VIII Part 3 point 8]

5.6.9

FCA PRA

R

A *firm* must apply the volatility adjustment appropriate to a given type of *security* or cash position to the absolute value of the positive or negative net position in the *securities* of that type.

[Note: BCD Annex VIII Part 3 point 9]

5.6.10

FCA PRA

R

A *firm* must apply the foreign exchange risk (fx) volatility adjustment to the net positive or negative position in each currency other than the settlement currency of the master netting agreement.

[Note: BCD Annex VIII Part 3 point 10]

5.6.11

FCA PRA

R

$E^*$  must be calculated according to the following formula:

$$E^* = \max \{0, [(\sum(E) - \sum(C)) + \sum(|\text{net position in each security}| \times H_{\text{sec}}) + (\sum|E_{\text{fx}}| \times H_{\text{fx}})]\}$$

where:

- (1) (where *risk weighted exposure amounts* are calculated under the *standardised approach*) E is the *exposure* value for each separate *exposure* under the agreement that would apply in the absence of the credit protection;
- (2) C is the value of the *securities* or *commodities* borrowed, purchased or received or the cash borrowed or received in respect of each such *exposure*;
- (3)  $\sum(E)$  is the sum of all Es under the agreement;
- (4)  $\sum(C)$  is the sum of all Cs under the agreement;
- (5)  $E_{\text{fx}}$  is the net position (positive or negative) in a given currency other than the settlement currency of the agreement as calculated under ■ BIPRU 5.6.8 R;
- (6)  $H_{\text{sec}}$  is the volatility adjustment appropriate to a particular type of *security*;
- (7)  $H_{\text{fx}}$  is the foreign exchange volatility adjustment; and
- (8)  $E^*$  is the fully adjusted *exposure* value.

[Note: BCD Annex VIII Part 3 point 11]

### Calculation of the fully adjusted exposure value: the master netting agreement internal models approach

5.6.12

FCA PRA

R

■ BIPRU 5.6.16 R to ■ BIPRU 5.6.28 G apply to a *firm* that has a *master netting agreement internal models approach permission* and set out the calculation of the effects of *credit risk mitigation* under the *master netting agreement internal models approach*.

5.6.13

FCA PRA

G

A *firm* that wishes to use the *master netting agreement internal models approach* will need to apply to the *appropriate regulator* for a *master netting agreement internal models approach permission*. ■ BIPRU 1.3 sets out the requirements and procedures relating to those applications.

5.6.14

FCA PRA

G

A *master netting agreement internal models approach permission* will amend, to the extent set out in the *master netting agreement internal models approach permission*, ■ BIPRU 5.6.1 R so as to provide that, with the exceptions provided in ■ BIPRU 5.6, a *firm* must use the *master netting agreement internal models approach* for the purposes of the calculations specified in ■ BIPRU 5.6.

5.6.15

FCA PRA

G

A *firm* which has been granted a *VaR model waiver* will still need to make an application to the *appropriate regulator* for a *master netting agreement internal models approach permission*. However, the application should generally be straightforward as a *firm* which is able to satisfy the requirements for a *VaR model waiver* should usually also be able to satisfy the requirements for a *master netting agreement internal models approach permission*.

[Note: BCD Annex VIII Part 3 point 14]

5.6.16

FCA PRA

R

The *master netting agreement internal models approach* is an alternative to using the *supervisory volatility adjustments approach* or the *own estimates of volatility adjustments approach* in calculating volatility adjustments for the purpose of calculating the 'fully adjusted exposure value' ( $E^*$ ) resulting from the application of an eligible master netting agreement covering *repurchase transactions, securities or commodities lending or borrowing transactions* and/or other *capital market-driven transactions* other than derivative transactions. The *master netting agreement internal models approach* takes into account correlation effects between security positions subject to a master netting agreement as well as the liquidity of the instruments concerned. The internal model used for the *master netting agreement internal models approach* must provide estimates of the potential change in value of the unsecured *exposure* amount ( $\Sigma E - \Sigma C$ ).

[Note: BCD Annex VIII Part 3 point 12 (part)]

5.6.17

FCA PRA

R

A *firm* may also use the internal model used for the *master netting agreement internal models approach* for *margin lending transactions* if

the transactions are covered under the *firm's master netting agreement internal models approach permission* and the transactions are covered by a bilateral master netting agreement that meets the requirements set out in ■ BIPRU 13.7.

[Note: BCD Annex VIII Part 3 point 12 (part)]

5.6.18

FCA PRA

R

A *firm* may use the *master netting agreement internal models approach* independently of the choice it has made between the *standardised approach* and the *IRB approach* for the calculation of *risk weighted exposure amounts*. However, if a *firm* uses the *master netting agreement internal models approach*, it must do so for all counterparties and *securities*, excluding immaterial portfolios where it may use the *supervisory volatility adjustments approach* or the *own estimates of volatility adjustments approach* as set out in ■ BIPRU 5.4.30 R to ■ BIPRU 5.4.65 R.

[Note: BCD Annex VIII Part 3 point 13]

5.6.19

FCA PRA

R

- (1) A *firm* must be able to satisfy the *appropriate regulator* that the *firm's* risk management system for managing the risks arising on the transactions covered by the master netting agreement is conceptually sound and implemented with integrity and that, in particular, the minimum qualitative standards in (2) - (11) are met.
- (2) The internal risk-measurement model used for calculation of potential price volatility for the transactions is closely integrated into the daily risk-management process of the *firm* and serves as the basis for reporting risk *exposures* to senior management of the *firm*.
- (3) The *firm* has a risk control unit that is independent from business trading units and reports directly to senior management. The unit must be responsible for designing and implementing the *firm's* risk-management system. It must produce and analyse daily reports on the output of the risk-measurement model and on the appropriate measures to be taken in terms of position limits.
- (4) The daily reports produced by the risk-control unit are reviewed by a level of management with sufficient authority to enforce reductions of positions taken and of overall risk *exposure*.
- (5) The *firm* has sufficient staff skilled in the use of sophisticated models in the risk control unit.
- (6) The *firm* has established procedures for monitoring and ensuring compliance with a documented set of internal policies and

controls concerning the overall operation of the risk-measurement system.

- (7) The *firm's* models have a proven track record of reasonable accuracy in measuring risks demonstrated through the back-testing of its output using at least one year of data.
- (8) The *firm* frequently conducts a rigorous programme of stress testing and the results of these tests are reviewed by senior management and reflected in the policies and limits it sets.
- (9) The *firm* must conduct, as part of its regular internal auditing process, an independent review of its risk-measurement system. This review must include both the activities of the business trading units and of the independent risk-control unit.
- (10) At least once a year, the *firm* must conduct a review of its risk management system.
- (11) The internal model used for the *master netting agreement internal models approach* must meet the requirements set out in
  - BIPRU 13.6.65 R to ■ BIPRU 13.6.67 R.

[Note: BCD Annex VIII Part 3 point 16]

#### 5.6.19A

FCA PRA

G

This paragraph provides *guidance* in relation to ■ BIPRU 5.6.19R (8). In carrying out the stress testing programme, a *firm* should evaluate the simultaneous impact of individual stress scenarios on its *counterparty exposures*, its *positions* and the aggregate amount of margin calls that it would receive. A *firm's* stress scenarios should take into account the possibility that the liquidation period may be substantially longer than 5 days for *repurchase transactions* and securities lending or borrowing transactions, and 10 days for other types of *securities financing transactions*.

#### 5.6.20

FCA PRA

R

The calculation of the potential change in value must be subject to the following minimum standards:

- (1) at least daily calculation of the potential change in value;
- (2) a 99th percentile, one-tailed confidence interval;
- (3) a 5-day equivalent liquidation period, except in the case of transactions other than securities *repurchase transaction* or *securities lending or borrowing transactions* where a 10-day equivalent liquidation period should be used;
- (4) an effective historical observation period of at least one year except where a shorter observation period is justified by a significant upsurge in price volatility; and

(5) three-monthly data set updates.

[Note: BCD Annex VIII Part 3 point 17]

5.6.21

FCA PRA

R

The internal risk-measurement model must capture a sufficient number of risk factors in order to capture all material price risks.

[Note: BCD Annex VIII Part 3 point 18]

5.6.22

FCA PRA

R

A *firm* may use empirical correlations within risk categories and across risk categories provided that it is able to satisfy the *appropriate regulator* that the *firm's* system for measuring correlations is sound and implemented with integrity.

[Note: BCD Annex VIII Part 3 point 19]

5.6.23

FCA PRA

G

The *appropriate regulator* will not grant a *master netting agreement internal models approach permission* if it is not satisfied that the standards in ■ BIPRU 5.6.19 R to ■ BIPRU 5.6.22 R are met.

5.6.24

FCA PRA

R

The fully adjusted *exposure* value ( $E^*$ ) for a *firm* using the *master netting agreement internal models approach* must be calculated according to the following formula:

$$E^* = \max \{0, [(\sum E - \sum C) + (VaR \text{ output of the internal models})]\}$$

where

- (1) (where *risk weighted exposure amounts* are calculated under the *standardised approach*) E is the *exposure* value for each separate *exposure* under the agreement that would apply in the absence of the credit protection;
- (2) C is the value of the *securities* borrowed, purchased or received or the cash borrowed or received in respect of each such *exposure*;
- (3)  $\sum (E)$  is the sum of all Es under the agreement; and
- (4)  $\sum (C)$  is the sum of all Cs under the agreement.

[Note: BCD Annex VIII Part 3 point 20]

5.6.25

FCA PRA

R

In calculating *risk weighted exposure amounts* using the *master netting agreement internal models approach*, a *firm* must use the previous *business day's* model output.

[Note: BCD Annex VIII Part 3 point 21]

5.6.26

FCA PRA

G

No changes should be made to the internal model used for the *master netting agreement internal models approach* unless the change is not material. Material changes to such a model will require a variation of the *master netting agreement internal models approach permission*. Materiality is measured against the model as it was at the time that the *master netting agreement internal models approach permission* was originally granted or, any later date set out in the *master netting agreement internal models approach permission* for this purpose. If a *firm* is considering making material changes to such a model then it should notify the *appropriate regulator* at once.

5.6.27

FCA PRA

G

If a *firm* ceases to meet the requirements of ■ BIPRU 5 in relation to the *master netting agreement internal models approach*, the *firm* should notify the *appropriate regulator* at once.

5.6.28

FCA PRA

G

The *appropriate regulator* is likely to revoke a *master netting agreement internal models approach permission* if a *firm* ceases to meet the requirements of ■ BIPRU 5 in relation to the *master netting agreement internal models approach*.

### Calculation of risk weighted exposure amounts under the standardised approach

5.6.29

FCA PRA

R

- (1) A *firm* must under the *standardised approach* calculate *risk weighted exposure amounts* for *repurchase transactions* and/or *securities or commodities lending or borrowing transactions* and/or other *capital market-driven transactions* covered by master netting agreements under this *rule*.
- (2)  $E^*$  as calculated under ■ BIPRU 5.6.5 R to ■ BIPRU 5.6.25 R must be taken as the *exposure* value of the *exposure* to the counterparty arising from the transactions subject to the master netting agreement for the purposes of ■ BIPRU 3.2.20 R to ■ BIPRU 3.2.26 R.

[Note: BCD Annex VIII Part 3 point 22]

## 5.7 Unfunded credit protection

### Eligibility

5.7.1

FCA PRA

R

The following parties may be recognised as eligible providers of *unfunded credit protection*:

- (1) central governments and *central banks*;
- (2) regional governments or local authorities;
- (3) *multilateral development banks*;
- (4) *international organisations exposures* which are assigned a 0% *risk weight* under the *standardised approach*;
- (5) *public sector entities, claims* on which are treated as claims on *institutions* or central governments under the *standardised approach*;
- (6) *institutions*;
- (7) other corporate entities, including *parent undertakings, subsidiary undertakings* and affiliate corporate entities of the *firm*, that have a credit assessment by an *eligible ECAI* associated with *credit quality step 2* or above under the *rules* for the *risk weighting of exposures to corporates* under the *standardised approach*.

[Note: BCD Annex VIII Part 1 point 26]

### Types of credit derivatives

5.7.2

FCA PRA

R

The following types of credit derivatives, and instruments that may be composed of such credit derivatives or that are economically effectively similar, may be recognised as eligible;

- (1) credit default swaps;
- (2) total return swaps; and

- (3) credit linked notes to the extent of their cash funding.

[Note: BCD Annex VIII Part 1 point 30]

5.7.3

FCA PRA

R

Where a *firm* buys credit protection through a total return swap and records the net payments received on the swap as net income, but does not record offsetting deterioration in the value of the asset that is protected (either through reductions in fair value or by an addition to reserves), the credit protection must not be recognised as eligible.

[Note: BCD Annex VIII Part 1 point 31]

#### Internal hedges

5.7.4

FCA PRA

R

When a *firm* conducts an internal hedge using a credit derivative - i.e. hedges the credit risk of an *exposure* in the *non-trading book* with a credit derivative booked in the *trading book* - in order for the protection to be recognised as eligible for the purposes of ■ BIPRU 4.10 or ■ BIPRU 5 the credit risk transferred to the *trading book* must be transferred out to a third party or parties. In such circumstances, subject to the compliance of such transfer with the requirements for the recognition of *credit risk mitigation* set out in ■ BIPRU 4.10 or ■ BIPRU 5, the *rules* for the calculation of *risk weighted exposure amounts* and *expected loss* amounts where *unfunded credit protection* is acquired set out in ■ BIPRU 4.10 or ■ BIPRU 5 must be applied.

[Note: BCD Annex VIII Part 1 point 32]

#### Minimum requirements: General

5.7.5

FCA PRA

R

■ BIPRU 5.7.6 R to ■ BIPRU 5.7.10 R deal with requirements common to guarantees and credit derivatives.

5.7.6

FCA PRA

R

Subject to ■ BIPRU 5.7.9 R, for the credit protection deriving from a guarantee or credit derivative to be recognised the following conditions must be met:

- (1) the credit protection must be direct;
- (2) the extent of the credit protection must be clearly defined and incontrovertible;
- (3) the credit protection contract must not contain any clause, the fulfilment of which is outside the direct control of the lender, that:
  - (a) would allow the protection provider unilaterally to cancel the protection;
  - (b) would increase the effective cost of protection as a result of deteriorating credit quality of the protected *exposure*;

(c) could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original obligor fails to make any payments due; or

(d) could allow the maturity of the credit protection to be reduced by the protection provider; and

(4) it must be legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.

[Note: BCD Annex VIII Part 2 point 14]

5.7.7

FCA PRA

G

For the purposes of ■ BIPRU 5.7.6 R (3)(a), payment of premiums and other monies due under the contract is within the control of the *lending firm*. So a clause that allows the protection provider unilaterally to cancel the contract after a reasonable period due to non payment of such monies will not mean that the condition in that *rule* is not met.

#### Minimum requirements: Operational requirements

5.7.8

FCA PRA

R

A *firm* must be able to satisfy the *appropriate regulator* that it has systems in place to manage potential concentration of risk arising from the *firm's* use of guarantees and credit derivatives. The *firm* must be able to demonstrate how its strategy in respect of its use of credit derivatives and guarantees interacts with its management of its overall risk profile.

[Note: BCD Annex VIII Part 2 point 15]

#### Minimum requirements: Sovereign and other public sector counter-guarantees

5.7.9

FCA PRA

R

Where an *exposure* is protected by a guarantee which is counter-guaranteed by a central government or *central bank*, a regional government or local authority or a *public sector entity* claims on which are treated as claims on the central government in whose jurisdiction they are established under the *standardised approach*, a *multilateral development bank* or an *international organisation*, to which a 0% *risk weight* is assigned under or by virtue of the *standardised approach*, or a *public sector entity*, claims on which are treated as claims on *credit institutions* under the *standardised approach*, the *exposure* may be treated as protected by a guarantee provided by the entity in question provided the following conditions are satisfied:

- (1) the counter-guarantee covers all credit risk elements of the claim;
- (2) both the original guarantee and the counter-guarantee meet the requirements for guarantees set out in ■ BIPRU 5.7.6 R, ■ BIPRU 5.7.8 R and ■ BIPRU 5.7.11 R, except that the counter-guarantee need not be direct; and

- (3) the *firm* is able to satisfy the *appropriate regulator* that the cover is robust and that nothing in the historical evidence suggests that the coverage of the counter-guarantee is less than effectively equivalent to that of a direct guarantee by the entity in question.

[Note: BCD Annex VIII Part 2 point 16]

5.7.10

FCA PRA

R

The treatment of ■ BIPRU 5.7.9 R applies, also, to an *exposure* which is not counter-guaranteed by an entity listed in that *rule* if the *exposure's* counter-guarantee is in its turn directly guaranteed by one of the listed entities and the conditions listed in ■ BIPRU 5.7.9 R are satisfied.

[Note: BCD Annex VIII Part 2 point 17]

#### Additional requirements for guarantees

5.7.11

FCA PRA

R

For a guarantee to be recognised the following conditions must also be met:

- (1) on the qualifying default of and/or non-payment by the counterparty, the *lending firm* must have the right to pursue, in a timely manner, the guarantor for any monies due under the claim in respect of which the protection is provided;
- (2) payment by the guarantor must not be subject to the *lending firm* first having to pursue the obligor;
- (3) in the case of *unfunded credit protection* covering residential mortgage loans, the requirements in ■ BIPRU 5.7.6 R (3)(c) and in this *rule* have only to be satisfied within 24 months;
- (4) the guarantee must be an explicitly documented obligation assumed by the guarantor;
- (5) subject to (6), the guarantee must cover all types of payments the obligor is expected to make in respect of the claim; and
- (6) where certain types of payment are excluded from the guarantee, the recognised value of the guarantee must be adjusted to reflect the limited coverage.

[Note: BCD Annex VIII Part 2 point 18]

5.7.12

FCA PRA

R

In the case of guarantees provided in the context of mutual guarantee schemes recognised for these purposes by another EEA *competent authority* under a *CRD implementation measure* with respect to point 19 of Part 2 of Annex VIII of the *Banking Consolidation Directive* or provided by or counter-guaranteed by entities referred to in ■ BIPRU 5.7.9 R, the requirements in ■ BIPRU 5.7.11 R (1) - ■ (3) will be satisfied where either of the following conditions are met:

- (1) the *lending firm* has the right to obtain in a timely manner a provisional payment by the guarantor calculated to represent a robust estimate of the amount of the economic *loss*, including losses resulting from the non-payment of interest and other types of payment which the borrower is obliged to make, likely to be incurred by the *lending firm* proportional to the coverage of the guarantee; or
- (2) the *lending firm* is able to demonstrate to the *appropriate regulator* that the loss-protecting effects of the guarantee, including losses resulting from the non-payment of interest and other types of payments which the borrower is obliged to make, justify such treatment.

[Note: BCD Annex VIII Part 2 point 19]

#### Additional requirements for credit derivatives

5.7.13

FCA PRA

R

For a credit derivative to be met the following conditions must also be met.

- (1) Subject to (2), the credit events specified under the credit derivative must at a minimum include:
  - (a) the failure to pay the amounts due under the terms of the underlying obligation that are in effect at the time of such failure (with a grace period that is closely in line with or shorter than the grace period in the underlying obligation);
  - (b) the bankruptcy, insolvency or inability of the obligor to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and analogous events; and
  - (c) the restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that results in a credit loss event (i.e. value adjustment or other similar debit to the profit and loss account).
- (2) Where the credit events specified under the credit derivative do not include restructuring of the underlying obligation as described in (1)(c), the credit protection may nonetheless be recognised subject to a reduction in the recognised value as specified in ■ BIPRU 5.7.16 R.
- (3) In the case of credit derivatives allowing for cash settlement a robust valuation process must be in place in order to estimate loss reliably. There must be a clearly specified period for obtaining post-credit-event valuations of the underlying obligation.

- (4) If the protection purchaser's right and ability to transfer the underlying obligation to the protection provider is required for settlement, the terms of the underlying obligation must provide that any required consent to such transfer may not be unreasonably withheld.
- (5) The identity of the parties responsible for determining whether a credit event has occurred must be clearly defined. This determination must not be the sole responsibility of the protection provider. The protection buyer must have the right/ability to inform the protection provider of the occurrence of a credit event.

[Note: BCD Annex VIII Part 2 point 20]

5.7.14

FCA PRA

R

A mismatch between the underlying obligation and the reference obligation under the credit derivative (i.e. the obligation used for the purposes of determining cash settlement value or the deliverable obligation) or between the underlying obligation and the obligation used for purposes of determining whether a credit event has occurred is permissible only if the following conditions are met:

- (1) the reference obligation or the obligation used for purposes of determining whether a credit event has occurred, as the case may be, ranks *pari passu* with or is junior to the underlying obligation; and
- (2) the underlying obligation and the reference obligation or the obligation used for purposes of determining whether a credit event has occurred, as the case may be, share the same obligor (i.e., the same legal entity) and there are in place legally enforceable cross-default or cross-acceleration clauses.

[Note: BCD Annex VIII Part 2 point 21]

#### Unfunded credit protection: Valuation

5.7.15

FCA PRA

R

■ BIPRU 5.7.16 R to ■ BIPRU 5.7.19 R set out the provisions applying to the valuation of *unfunded credit protection*.

5.7.16

FCA PRA

R

- (1) The value of *unfunded credit protection* (G) is the amount that the protection provider has undertaken to pay in the event of the default or non-payment of the borrower or on the occurrence of other specified credit events.
- (2) In the case of credit derivatives which do not include as a credit event restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that result in a credit loss event (e.g. value adjustment, the making of a value adjustment or other similar debit to the profit and loss account):

- (a) where the amount that the protection provider has undertaken to pay is not higher than the *exposure* value, the value of the credit protection calculated under (1) must be reduced by 40%; or
- (b) where the amount that the protection provider has undertaken to pay is higher than the *exposure* value, the value of the credit protection must be no higher than 60% of the *exposure* value.

[Note: BCD Annex VIII Part 3 point 83]

5.7.17

FCA PRA

R

Where *unfunded credit protection* is denominated in a currency different from that in which the *exposure* is denominated (a currency mismatch) the value of the credit protection must be reduced by the application of a volatility adjustment  $H_{FX}$  as follows:

$$G^* = G \times (1 - H_{FX})$$

where:

- (1)  $G$  is the nominal amount of the credit protection;
- (2)  $G^*$  is  $G$  adjusted for any *foreign currency* risk; and
- (3)  $H_{FX}$  is the volatility adjustment for any currency mismatch between the credit protection and the underlying obligation.

[Note: BCD Annex VIII Part 3 point 84 (part)]

5.7.18

FCA PRA

R

Where there is no currency mismatch:

$$G^* = G$$

[Note: BCD Annex VIII Part 3 point 84 (part)]

5.7.19

FCA PRA

R

The volatility adjustments to be applied for any currency mismatch may be calculated based on the *supervisory volatility adjustments approach* or the *own estimates of volatility adjustments approach* as set out in ■ BIPRU 5.4.30 R to ■ BIPRU 5.4.65 R.

[Note: BCD Annex VIII Part 3 point 85]

#### Calculating risk weighted exposure amounts and expected loss amounts

5.7.20

FCA PRA

R

■ BIPRU 5.7.21 R to ■ BIPRU 5.7.28 R set out the provisions applying to the calculation of *risk weighted exposure amounts*.

5.7.21

FCA PRA

R

**Calculating risk weighted exposure amounts: Partial protection - tranching**

Where a *firm* transfers a part of the risk of a loan in one or more *tranches*, BIPRU 9 applies. Materiality thresholds on payments below which no payment shall be made in the event of loss are considered to be equivalent to retained first loss positions and to give rise to a *tranching* transfer of risk.

[Note: BCD Annex VIII Part 3 point 86]

5.7.22

FCA PRA

R

**Calculating risk-weighted exposure amounts : The standardised approach**

■ BIPRU 5.7.23 R to ■ BIPRU 5.7.25 R set out the provisions applying to the calculation of *risk weighted exposure amounts* under the *standardised approach* in the case of *unfunded credit protection*.

**Calculating risk weighted exposure amounts: standardised approach: Full protection**

5.7.23

FCA PRA

R

For the purposes of ■ BIPRU 3.2.20 R to ■ BIPRU 3.2.26 R, *g* shall be the *risk weight* to be assigned to an *exposure*, the *exposure* value (*E*) of which is fully protected by *unfunded credit protection* ( $G_A$ ), where:

- (1) *g* is the *risk weight* of *exposures* to the protection provider as specified under the *standardised approach*;
- (2)  $G_A$  is the value of  $G^*$  as calculated under ■ BIPRU 5.7.17 R further adjusted for any maturity mismatch as laid down in ■ BIPRU 5.8; and
- (3) *E* is the *exposure* value according to ■ BIPRU 3.2.1 R to ■ BIPRU 3.2.3 R and ■ BIPRU 13; for this purpose the *exposure* value of an off-balance sheet item listed in ■ BIPRU 3.7.2 R shall be 100% of its value rather than the *exposure* value indicated in ■ BIPRU 3.2.1 R.

[Note: BCD Annex VIII Part 3 point 87]

**Calculating risk weighted exposure amounts: Standardised approach: Partial protection - equal seniority**

5.7.24

FCA PRA

R

Where the protected amount is less than the *exposure* value and the protected and unprotected portions are of equal seniority - i.e. the *firm* and the protection provider share losses on a pro-rata basis, proportional regulatory capital relief is afforded. For the purposes of ■ BIPRU 3.2.20 R to ■ BIPRU 3.2.26 R *risk weighted exposure amounts* must be calculated in accordance with the following formula:

$$(E - G_A) \times r + G_A \times g$$

where:

- (1) E is the *exposure* value; according to ■ BIPRU 3.2.1 R to ■ BIPRU 3.2.3 R and ■ BIPRU 13; for this purpose, the *exposure* value of an off-balance sheet item listed in ■ BIPRU 3.7.2 R shall be 100% of its value rather than the *exposure* value indicated in ■ BIPRU 3.2.1 R;
- (2)  $G_A$  is the value of  $G^*$  as calculated under ■ BIPRU 5.7.17 R further adjusted for any maturity mismatch as laid down in ■ BIPRU 5.8;
- (3) r is the *risk weight* of *exposures* to the obligor as specified under the *standardised approach*; and
- (4) g is the *risk weight* of *exposures* to the protection provider as specified under the *standardised approach*.

[Note: BCD Annex VIII Part 3 point 88]

#### Calculating risk weighted exposure amounts: standardised approach: Sovereign guarantees

5.7.25

FCA PRA

R

A *firm* may apply the treatment provided for in ■ BIPRU 3.4.5 R to ■ BIPRU 3.4.7 R to *exposures* or parts of *exposures* guaranteed by the central government or *central bank*, where the guarantee is denominated in the domestic currency of the borrower and the *exposure* is funded in that currency.

[Note: BCD Annex VIII Part 3 point 89]

#### Calculating risk-weighted exposure amounts and expected loss amounts: Basket CRM techniques

5.7.26

FCA PRA

R

■ BIPRU 5.7.27 R to ■ BIPRU 5.7.28 R set out the provisions applying to the calculation of *risk weighted exposure amount* and *expected loss* amounts where *basket credit risk mitigation* techniques are used.

#### First-to-default credit derivatives

5.7.27

FCA PRA

R

Where a *firm* obtains credit protection for a number of *exposures* under terms that the first default among the *exposures* will trigger payment and that this credit event will terminate the contract, the *firm* may modify the calculation of the *risk weighted exposure amount* and, as relevant, the *expected loss* amount of the *exposure* which would in the absence of the credit protection produce the lowest *risk weighted exposure amount* under the *standardised approach* or the *IRB approach* as appropriate in accordance with ■ BIPRU 4.10 or ■ BIPRU 5, but only if the *exposure* value is less than or equal to the value of the credit protection.

[Note: BCD Annex VIII Part 6 point 1]

5.7.28

FCA PRA

R

**Nth-to-default credit derivatives**

Where the *n*th default among the *exposures* triggers payment under the credit protection provided by a credit derivative, a *firm* purchasing the protection may only recognise the protection for the calculation of *risk weighted exposure amounts* and, as relevant, *expected loss* amounts if protection has also been obtained for defaults 1 to *n*-1 or when *n*-1 defaults have already occurred. In such cases the methodology must follow that set out in ■ BIPRU 5.7.27 R for first-to-default derivatives appropriately modified for *n*th-to-default products.

[Note: BCD Annex VIII Part 6 point 2]

5

## 5.8 Maturity mismatches

5.8.1

FCA PRA

R

For the purposes of calculating *risk weighted exposure amounts*, a maturity mismatch occurs when the residual maturity of the credit protection is less than that of the protected *exposure*. Protection of less than three months residual maturity, the maturity of which is less than the maturity of the underlying *exposure*, must not be recognised.

[Note: BCD Annex VIII Part 4 point 1]

5.8.2

FCA PRA

R

Where there is a maturity mismatch the credit protection must not be recognised where the original maturity of the protection is less than 1 year.

[Note: BCD Annex VIII Part 4 point 2 (part)]

### Definition of maturity

5.8.3

FCA PRA

R

Subject to a maximum of 5 years, the effective maturity of the underlying is the longest possible remaining time before the obligor is scheduled to fulfil its obligations. Subject to ■ BIPRU 5.8.4 R, the maturity of the credit protection is the time to the earliest date at which the protection may terminate or be terminated.

[Note: BCD Annex VIII Part 4 point 3]

5.8.4

FCA PRA

R

Where there is an option to terminate the protection which is at the discretion of the protection seller, the maturity of the protection must be taken to be the time to the earliest date at which that option may be exercised. Where there is an option to terminate the protection which is at the discretion of the protection buyer and the terms of the arrangement at origination of the protection contain a positive incentive for the *firm* to call the transaction before contractual maturity, the maturity of the protection must be taken to be the time to the earliest date at which that option may be exercised; otherwise such an option may be considered not to affect the maturity of the protection.

[Note: BCD Annex VIII Part 4 point 4]

5.8.5

FCA PRA

R

Where a credit derivative is not prevented from terminating prior to expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay the maturity of the protection must be reduced by the amount of the grace period.

[Note: BCD Annex VIII Part 4 point 5]

**Valuation of protection: Transactions subject to funded credit protection - financial collateral simple method**

5.8.6

FCA PRA

R

■ BIPRU 5.8.7 R sets out the calculation for the valuation of transactions subject to *funded credit protection* under the *financial collateral simple method*.

5.8.7

FCA PRA

R

Where there is a mismatch between the maturity of the *exposure* and the maturity of the protection, the collateral must not be recognised.

[Note: BCD Annex VIII Part 4 point 6]

**Valuation of protection: Transactions subject to funded credit protection - financial collateral comprehensive method**

5.8.8

FCA PRA

R

■ BIPRU 5.8.9 R sets out the calculation for the valuation of transactions subject to *funded credit protection* under the *financial collateral comprehensive method*.

5.8.9

FCA PRA

R

- (1) The maturity of the credit protection and that of the *exposure* must be reflected in the adjusted value of the collateral according to the following formula:

$$C_{VAM} = C_{VA} \times (t-t^*) / (T-t^*)$$

where:

- (a)  $C_{VA}$  is the volatility adjusted value of the collateral as specified in ■ BIPRU 5.4.28 R or the amount of the *exposure*, whichever is the lowest;
- (b)  $t$  is the number of years remaining to the maturity date of the credit protection calculated in accordance with ■ BIPRU 5.8.3 R to ■ BIPRU 5.8.5 R, or the value of  $T$ , whichever is the lower;
- (c)  $T$  is the number of years remaining to the maturity date of the *exposure* calculated in accordance with ■ BIPRU 5.8.3 R to ■ BIPRU 5.8.5 R, or 5 years, whichever is the lower; and
- (d)  $t^*$  is 0.25.

- (2)  $C_{VAM}$  must be taken as  $C_{VA}$  further adjusted for maturity mismatch to be included in the formula for the calculation of the fully adjusted value of the *exposure* ( $E^*$ ) set out at ■ BIPRU 5.4.28 R.

[Note: BCD Annex VIII Part 4 point 7]

#### Valuation of protection: Transactions subject to unfunded credit protection

5.8.10

FCA PRA

R

■ BIPRU 5.8.11 R sets out the calculation for the valuation of transactions subject to *unfunded credit protection*.

5.8.11

FCA PRA

R

- (1) The maturity of the credit protection and that of the *exposure* must be reflected in the adjusted value of the credit protection according to the following formula:

$$G_A = G^* \times (t-t^*) / (T-t^*)$$

where:

- (a)  $G^*$  is the amount of the protection adjusted for any currency mismatch;
  - (b)  $G_A$  is  $G^*$  adjusted for any maturity mismatch;
  - (c)  $t$  is the number of years remaining to the maturity date of the credit protection calculated in accordance with ■ BIPRU 5.8.3 R to ■ BIPRU 5.8.5 R, or the value of  $T$ , whichever is the lower;
  - (d)  $T$  is the number of years remaining to the maturity date of the *exposure* calculated in accordance with ■ BIPRU 5.8.3 R to ■ BIPRU 5.8.5 R, or 5 years, whichever is the lower; and
  - (e)  $t^*$  is 0.25.
- (2)  $G_A$  is then taken as the value of the protection for the purposes of ■ BIPRU 5.7.16 R to ■ BIPRU 5.7.25 R.

[Note: BCD Annex VIII Part 4 point 8]



## 5.9 Combinations of credit risk mitigation in the standardised approach

### 5.9.1

FCA PRA

R

In the case where a *firm* calculating *risk weighted exposure amounts* under the *standardised approach* has more than one form of *credit risk mitigation* covering a single *exposure* (e.g. a *firm* has both collateral and a guarantee partially covering an *exposure*), the *firm* must subdivide the *exposure* into parts covered by each type of *credit risk mitigation* tool (e.g. a part covered by collateral and a portion covered by guarantee) and the *risk weighted exposure amount* for each portion must be calculated separately in accordance with the provisions of the *standardised approach* and ■ BIPRU 5.

[Note: BCD Annex VIII Part 5 point 1]

### 5.9.2

FCA PRA

R

When credit protection provided by a single protection provider has differing maturities, a similar approach to that described in ■ BIPRU 5.9.1 R must be applied.

[Note: BCD Annex VIII Part 5 point 2]



## Chapter 6

# Operational risk

## 6.1 Operational risk: Application and purpose

### Application

6.1.1

FCA PRA

R

■ BIPRU 6 applies to a *BIPRU firm* except for:

- (1) a *BIPRU limited licence firm*; and
- (2) a *BIPRU limited activity firm*.

6.1.2

FCA PRA

G

A *BIPRU limited licence firm* or *BIPRU limited activity firm* that wishes to calculate an *operational risk capital requirement* in accordance with this chapter for the purposes of its *capital resources requirement* should apply for a *waiver* to modify ■ GENPRU 1.1 or seek a variation to its *permission* so that it is treated as a *full scope BIPRU investment firm*.

### Purpose

6.1.3

FCA PRA

G

The purpose of ■ BIPRU 6 is:

- (1) to detail the requirement to hold capital to cover *operational risk* losses and have appropriate systems and controls in place to manage *operational risk*; and
- (2) to explain how to calculate the *operational risk capital requirement*, or ORCR.

6.1.4

FCA PRA

G

■ BIPRU 6 implements:

- (1) Articles 102 to 104;
- (2) Article 105, in part; and
- (3) Annex X;

of the *Banking Consolidation Directive*.

## 6.2 Operational risk: Methodologies and systems

### The definition of ORCR

6.2.1

FCA PRA

R

The *operational risk capital requirement (ORCR)* for a *firm* is an amount calculated in accordance with:

- (1) the *basic indicator approach* (see ■ BIPRU 6.3); or
- (2) the *standardised approach* (see ■ BIPRU 6.4).

[Note: BCD Article 102(1)]

6.2.2

FCA PRA

G

The simplest method of calculating the *ORCR* is the *basic indicator approach* and a *firm* should use this approach if it does not, or is not permitted to, use another approach.

6.2.3

FCA PRA

G

A *firm* does not need a *waiver* to use the *standardised approach*. However there are eligibility conditions that a *firm* should satisfy if it is to use this approach. If it does not satisfy them, it should not use this approach.

6.2.4

FCA PRA

G

A *firm* may apply to the *appropriate regulator* for a *waiver* from ■ BIPRU 6.2.1 R in order to use its own *advanced measurement approach* for the calculation of its *ORCR* (see ■ BIPRU 6.5). If the *waiver* is granted, the *ORCR* will be an amount determined in accordance with such *waiver*.

[Note: BCD Article 105(1)]

### Restrictions on changing the approach used for calculating ORCR

6.2.5

FCA PRA

R

A *firm* that calculates its *ORCR* using the *standardised approach* must not change to calculating its *ORCR* using the *basic indicator approach*.

[Note: BCD Article 102(2) (part)]

6.2.6

FCA PRA

G

A *firm* may apply to the *appropriate regulator* for a *waiver* from ■ BIPRU 6.2.5 R where it can demonstrate good cause for changing to the *basic indicator approach*.

[Note: BCD Article 102(2) (part)]

6.2.7

FCA PRA

R

A firm that calculates its ORCR using an *advanced measurement approach* must not change to calculating its ORCR using the *standardised approach* or the *basic indicator approach*.

[Note: BCD Article 102(3) (part)]

6.2.8

FCA PRA

G

A firm may apply to the *appropriate regulator* for a *waiver* from ■ BIPRU 6.2.7 R where it can demonstrate good cause for changing to the *standardised approach* or the *basic indicator approach* as the case may be.

[Note: BCD Article 102(3) (part)]

### Combination of different methodologies

6.2.9

FCA PRA

R

Without prejudice to any other conditions that may be imposed by a firm's *AMA permission*, where a firm's *AMA permission* allows it to use an *advanced measurement approach* in combination with either the *basic indicator approach* or the *standardised approach*, the firm must comply with the following conditions:

- (1) all *operational risks* of the firm are captured;
- (2) the firm must be able to satisfy the *appropriate regulator* with respect to the methodology used to cover different activities, geographical locations or other relevant divisions determined on an internal basis; and
- (3) ■ BIPRU 6.4.1 R and ■ BIPRU 6.5.6 R must be complied with for the part of activities covered by the *standardised approach* and *advanced measurement approaches* respectively.

[Note: BCD Article 102(4) and Annex X, Part 4 point 1]

6.2.10

FCA PRA

G

Where a firm's *AMA permission* allows it to use an *advanced measurement approach* in combination with either the *basic indicator approach* or the *standardised approach*, the *appropriate regulator* may impose additional conditions on a case by case basis as follows:

- (1) on the date of implementation of an *advanced measurement approach*, a significant part of the firm's *operational risks* are captured by the *advanced measurement approach*; and
- (2) the firm is obliged to roll out the *advanced measurement approach* to a material part of its operations within a time schedule set out in its *AMA permission*.

[Note: BCD Annex X, Part 4 point 2]

6.2.11

FCA PRA

R

A *firm* applying for an *AMA permission* to use a combination of different approaches must be able to show that:

- (1) at the date of implementation of the *advanced measurement approach*, approximately 50% (or more) of the *firm's operational risk* is captured under the *AMA*; and
- (2) the *firm* has committed to roll out the *advanced measurement approach* for around 85% (or more) of its *operational risk*, subject to the remaining percentage not being concentrated in a single operation, within a timescale set out in the *AMA permission*.

6.2.12

FCA PRA

R

For the determination of its *ORCR*, a *firm* must not use any of the following combinations of methodologies:

- (1) the *basic indicator approach* with the *standardised approach*;
- (2) the *basic indicator approach* with the *alternative standardised approach*; or
- (3) the *standardised approach* with the *alternative standardised approach* for the same business line.

6.2.13

FCA PRA

G

A *firm* may apply to the *appropriate regulator* for a *waiver* from ■ BIPRU 6.2.12 R (1) and ■ BIPRU 6.2.12 R (2) in exceptional circumstances, such as the recent acquisition of new business, which require a transition period for the roll out of the *standardised approach* (or the *alternative standardised approach*). In this event, a *firm* will need to make a commitment to roll out the *standardised approach* (or the *alternative standardised approach*) within a time schedule agreed with the *appropriate regulator*.

[Note: BCD Annex X, Part 4 points 3 and 4]

## 6.3 Operational risk: Basic indicator approach

### ORCR

6.3.1

FCA PRA

R

The *ORCR* under the *basic indicator approach* is equal to 15% of the relevant indicator defined in this section.

[Note: *BCD* Article 103 and Annex X, Part 1 point 1]

### Relevant indicator: General

6.3.2

FCA PRA

R

- (1) The relevant indicator is the three-year average of the sum of:
  - (a) a *firm's* net interest income; and
  - (b) a *firm's* net non-interest income.
- (2) The three-year average must be calculated on the basis of the last three yearly observations at the end of the financial year. When audited figures are not available, business estimates may be used.
- (3) If for any given observation, the sum of a *firm's* net interest income and net non-interest income is negative or equal to zero, this figure must be excluded from both the numerator and denominator when calculating the three year average. The relevant indicator must be calculated as the sum of the positive figures divided by the number of positive figures.

[Note: *BCD* Annex X, Part 1 points 2 to 4]

### Relevant indicator: An example calculation

6.3.3

FCA PRA

G

If a *firm* has:

- (1) two positive yearly relevant indicators of £20 each; and
- (2) the final yearly observation shows a negative figure of £5; then

the relevant indicator is calculated as £20, being £40 (sum of positive figures) divided by 2 (number of positive figures).

6.3.4

FCA PRA

G

**Relevant indicator: Insufficient income data**

A *firm* that does not have sufficient income data to meet the three-year requirement (e.g. a start-up) may use its forecasted gross income projections for all or part of the three year time period when calculating its relevant indicator.

6.3.5

FCA PRA

R

**Relevant indicator: Application of accounting categories**

- (1) This *rule* applies to a *firm* that is subject to the *Bank Accounts Directive*.
- (2) Based on accounting categories for the profit and loss account of *credit institutions* under Article 27 of the *Bank Accounts Directive*, the relevant indicator in ■ BIPRU 6.3.2 R must be expressed as the sum of the elements listed in the table in ■ BIPRU 6.3.6 R.
- (3) Each element in the table in ■ BIPRU 6.3.6 R must be included in the sum with its positive or negative sign.

[Note: BCD Annex X, Part 1 point 5]

6.3.6

FCA PRA

R

**Table: Relevant indicators** This table belongs to ■ BIPRU 6.3.5 R

1	Interest receivable and similar income
2	Interest payable and similar charges
3	Income from shares and other variable/fixed-yield securities.
4	Commissions/fees receivable
5	Commission/fees payable
6	Net profit or net loss on financial operations
7	Other operating income

6.3.7

FCA PRA

G

Income from a *participation* held in an *undertaking* by the *firm* or a *subsidiary undertaking* of the *firm* should not be included in the relevant indicator calculations, to ensure that intra-group dividends and other intra-group income flows are not double counted.

6.3.8

FCA PRA

G

Income received under an operating lease should be included as gross income less depreciation, not as gross rental income.

6.3.9

FCA PRA

G

- (1) If a *firm* considers that, due to exceptional circumstances, using a three year average to calculate the relevant indicator would lead to a major overestimation of its ORCR, the *firm* may apply for a *waiver* from ■ BIPRU 6.3.2 R.
- (2) Exceptional circumstances might include stopping or selling a major business line.

### Qualifications

6.3.10

FCA PRA

R

- (1) The relevant indicator for the *basic indicator approach* must be calculated before the deduction of any provisions and operating expenses.
- (2) Operating expenses must include fees paid for outsourcing services rendered by third parties which are not a *parent undertaking* or *subsidiary undertaking* of the *firm* or a *subsidiary undertaking* of a *parent undertaking* which is also the *parent undertaking* of the *firm*. Expenditure on the outsourcing of services rendered by third parties may reduce the relevant indicator if the expenditure is incurred by an undertaking subject to supervision under, or equivalent to, the *Banking Consolidation Directive*.

[Note: *BCD Annex X, Part 1 point 7*]

6.3.11

FCA PRA

G

The definition of 'outsourcing' for the purposes of ■ BIPRU 6.3.10 R (2) is set out in detail in a Joint Forum paper of the Basel Committee on Banking Supervision entitled "Outsourcing in Financial Services" dated February 2005 and can be summarised as meaning a *firm's* use of a third party to perform activities on a continuing basis that would normally be undertaken by the *firm*, now or in the future and can be the initial transfer of an activity (or part of that activity) from the *firm* to a third party or a further transfer of an activity (or part thereof) from one third party service provider to another.

6.3.12

FCA PRA

R

The following elements must not be used in the calculation of the relevant indicator:

- (1) realised profits/losses from the sale of *non-trading book* items;
- (2) income from extraordinary or irregular items; and
- (3) income derived from insurance.

[Note: *BCD Annex X, Part 1 point 8 (part)*]

6.3.13

FCA PRA

R

When revaluation of trading items is part of the profit and loss statement, revaluation may be included in the calculation of the relevant indicator.

[Note: *BCD Annex X, Part 1 point 8 (part)*]

6.3.14

FCA PRA

R

When Article 36(2) of the *Bank Accounts Directive* is applied, revaluation booked in the profit and loss account must be included in the calculation of the relevant indicator.

[Note: *BCD Annex X, Part 1 point 8 (part)*]

6.3.15

FCA PRA

R

When a *firm* is subject to an accounting framework different from the one established by the *Bank Accounts Directive*, it must calculate the relevant income indicator on the basis of internal data that best reflect the definition in this section.

[Note: *BCD Annex X, Part 1 points 6 and 9*]

#### General risk management standards

6.3.16

FCA PRA

G

- (1) In common with all *BIPRU firms*, a *firm* calculating its *ORCR* using the *basic indicator approach* is required to meet the general risk management standards set out in ■ SYSC 4.1.1 R to ■ SYSC 4.1.2 R and ■ SYSC 7.1.16 R.
- (2) In meeting those general risk management standards, a *firm* that undertakes market-related activities should be able to demonstrate to the *appropriate regulator* that it has considered the Committee of European Banking Supervisors' Guidelines on the management of operational risk in market-related activities, published in October 2010. These can be found at [http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Management-of-op-risk/CEBS-2010-216-\(Guidelines-on-the-management-of-op-.aspx](http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Management-of-op-risk/CEBS-2010-216-(Guidelines-on-the-management-of-op-.aspx)

6

## 6.4 Operational risk: Standardised approach

### Eligibility

6.4.1

FCA PRA

R

- (1) To be eligible for the *standardised approach*, a *firm* must meet the qualifying criteria set out in this *rule*, in addition to the general risk management standards set out in ■ SYSC 4.1.1 R to ■ SYSC 4.1.2 R and ■ SYSC 7.1.16 R .
- (2) A *firm* must have a well-documented assessment and management system for *operational risk* with clear responsibilities for the system assigned within the *firm*. The system must identify the *firm's* exposures to *operational risk* and track relevant *operational risk* data, including material loss data.
- (3) A *firm's operational risk* assessment and management system must be subject to regular independent review.
- (4) A *firm's operational risk* assessment system must be closely integrated into the *firm's* risk management processes. Its output must be an integral part of the process of monitoring and controlling the *firm's operational risk* profile.
- (5) A *firm* must implement a system of management reporting that provides *operational risk* reports to relevant functions within the *firm*. A *firm* must have procedures in place for taking appropriate action in response to the information contained in such reports.

[Note: BCD Article 104(6) and Annex X, Part 2 point 12 (part)]

6.4.1A

FCA PRA

G

In meeting the general risk management standards referred to in ■ BIPRU 6.4.1 R (1), a *firm* that undertakes market-related activities should be able to demonstrate to the *appropriate regulator* that it has considered the Committee of European Banking Supervisors' Guidelines on the management of operational risk in market-related activities, published in October 2010. These can be found at [http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Management-of-op-risk/CEBS-2010-216-\(Guidelines-on-the-management-of-op-.aspx](http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Management-of-op-risk/CEBS-2010-216-(Guidelines-on-the-management-of-op-.aspx)

6.4.2 **R** A *firm* must comply with the criteria in ■ BIPRU 6.4.1 R having regard to the size and scale of its activities and to the principle of proportionality.

FCA PRA

[Note: BCD Annex X, Part 2 point 12 (part)]

#### Business lines

6.4.3 **R** Under the *standardised approach*, a *firm* must divide its activities into a number of business lines as set out in this section.

FCA PRA

[Note: BCD Article 104(1)]

6.4.4 **G** The list of activities in ■ BIPRU 6.4.15 R is not a complete definition of the activities within a business line and it may be possible for an activity to be allocated to a business line other than the one to which it is attributed in ■ BIPRU 6.4.15 R.

FCA PRA

6.4.5 **R** For each business line, a *firm* must calculate a capital requirement for *operational risk* as a certain percentage of a relevant indicator, in accordance with the *rules* in this section.

FCA PRA

[Note: BCD Article 104(2)]

#### ORCR calculated using the standardised approach

6.4.6 **R** The *ORCR* under the *standardised approach* is calculated as the three-year average of the yearly summations of the capital requirements across the business lines referred to in ■ BIPRU 6.4.15 R.

FCA PRA

[Note: BCD Annex X, Part 2 point 1 (part)]

6.4.7 **R** In any given year, negative capital requirements (resulting from negative gross income) in any business line may offset positive capital requirements in other business lines without limit. However, where the aggregate of the capital requirements across all business lines within a given year is negative, the input to the numerator for that year must be zero.

FCA PRA

[Note: BCD Annex X, Part 2 point 1 (part)]

6.4.8 **G** (1) If a *firm* considers that, due to exceptional circumstances, using a three year average to calculate the relevant indicator would lead to a major overestimation of its *ORCR*, the *firm* may apply for a *waiver* from ■ BIPRU 6.4.5 R.

FCA PRA

(2) Exceptional circumstances might include stopping or selling a major business line.

#### Relevant indicator

6.4.9 **R** The three year average in ■ BIPRU 6.4.6 R must be calculated on the basis of the last three twelve monthly observations at the end of the financial year. When audited figures are not available, business estimates may be used.

FCA PRA

[Note: BCD Annex X, Part 2 point 2]

### Principles for business line mapping

6.4.10

FCA PRA

R

A *firm* must develop and document specific policies and criteria for mapping the relevant indicator for current business lines and activities into the framework for the *standardised approach*. The criteria must be reviewed and adjusted for new or changing business activities and risks as appropriate.

[Note: BCD Annex X, Part 2 point 4 (part)]

6.4.11

FCA PRA

R

- (1) The principles for business line mapping that a *firm* must meet are set out in this *rule*.
- (2) All activities must be mapped into the business lines in a mutually exclusive and jointly exhaustive manner.
- (3) Any activity which cannot be readily mapped into the business line framework, but which represents an ancillary function to an activity included in the framework, must be allocated to the business line it supports. If more than one business line is supported through the ancillary activity, an objective mapping criterion must be used (e.g., proportional allocation of the indicators).
- (4) If an activity cannot be mapped into a particular business line then the business line yielding the highest charge for the *firm* must be used. The same business line equally applies to any associated ancillary activity.
- (5) A *firm* may use internal pricing methods to allocate the relevant indicator between business lines.
- (6) The mapping of activities into business lines for *operational risk* capital purposes must be consistent with the definitions of business lines used by the *firm* for credit and market risks.
- (7) Senior management must be responsible for the mapping policy.
- (8) The mapping process to business lines must be subject to independent review.

[Note: BCD Annex X, Part 2 point 4 (part)]

6.4.12

FCA PRA

G

A *firm* that is mapping activities to a business line should take into account:

- (1) the activities listed in respect of each business line in the table in
  - BIPRU 6.4.15 R; and

(2) the organisation of the *firm's* business in respect of that business line.

6.4.13

G

FCA PRA

A *firm* should take into account its business and organisation when mapping activities to the business lines in the table in ■ BIPRU 6.4.15 R.

6.4.14

R

FCA PRA

For the purposes of ■ BIPRU 6.4.11 R (5), costs generated in one business line which are imputable to a different business line may be reallocated to the business line to which they pertain, for instance by using a treatment based on internal transfer costs between two business lines.

[Note: BCD Annex X, Part 2 point 4 (part)]

6.4.15

R

FCA PRA

**Table: Percentages applying to the income indicator of individual business lines**

This table belongs to ■ BIPRU 6.4.3 R

Business line	List of activities	Percentage
Corporate finance	<ul style="list-style-type: none"> <li>• Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis</li> <li>• Services related to underwriting</li> <li>• Investment advice</li> <li>• Advice to <i>undertakings</i> on capital structure, industrial strategy and related matters and advice and services relating to the mergers and the purchase of <i>undertakings</i></li> <li>• Investment research and financial analysis and other forms of general recommendation relating to transactions in financial instruments</li> </ul>	18%
Trading and sales	<ul style="list-style-type: none"> <li>• Dealing on own account</li> <li>• Money broking</li> <li>• Reception and transmission of orders in relation to one or more financial instruments</li> </ul>	18%

6

Business line	List of activities	Percentage
	<ul style="list-style-type: none"> <li>• Execution of orders on behalf of clients</li> <li>• Placing of financial instruments on a best efforts basis</li> <li>• Operation of <i>multilateral trading facilities</i></li> </ul>	
<b>Retail brokerage</b> (Activities with individual physical persons or with a <i>retail SME</i> as defined under the <i>standardised approach to credit risk</i> )	<ul style="list-style-type: none"> <li>• Reception and transmission of orders in relation to one or more financial instruments</li> <li>• Execution of orders of behalf of clients</li> <li>• Placing of financial instruments without a firm commitment basis</li> </ul>	12%
<b>Commercial banking</b>	<ul style="list-style-type: none"> <li>• Acceptance of deposits and other repayable funds</li> <li>• Lending</li> <li>• Financial leasing</li> <li>• Guarantees and commitments</li> </ul>	15%
<b>Retail banking</b> (Activities with an individual physical persons or with a <i>retail SME</i> as defined under the <i>standardised approach to credit risk</i> )	<ul style="list-style-type: none"> <li>• Acceptance of deposits and other repayable funds</li> <li>• Lending</li> <li>• Financial leasing</li> <li>• Guarantees and commitments</li> </ul>	12%
<b>Payment and settlement</b>	<ul style="list-style-type: none"> <li>• Money transmission services</li> <li>• Issuing and administering means of payment</li> </ul>	18%
<b>Agency services</b>	<ul style="list-style-type: none"> <li>• Safekeeping and administration of financial instruments for the account of clients including custodianship and related services</li> </ul>	15%

Business line	List of activities	Percentage
Asset management	<p>such as cash/collateral management</p> <ul style="list-style-type: none"> <li>• Portfolio management</li> <li>• UCITS management and other forms of asset management</li> </ul>	12%

### The alternative standardised approach

6.4.16

FCA PRA

G

Under the *alternative standardised approach*, a firm using the *standardised approach* may use alternative indicators for retail banking and commercial banking business lines if it complies with ■ BIPRU 6.4.17 R to ■ BIPRU 6.4.21 R.

[Note: BCD Annex X, Part 2 point 3]

### Eligibility for the alternative standardised approach

6.4.17

FCA PRA

R

To be eligible to use the *alternative standardised approach*, a firm must meet the following conditions, in addition to the general risk management standards set out in ■ SYSC 4.1.1 R to ■ SYSC 4.1.2 R and ■ SYSC 7.1.16 R :

- (1) the firm must meet the eligibility criteria for the *standardised approach* in ■ BIPRU 6.4.1 R;
- (2) the firm must be overwhelmingly active in retail and/or commercial banking activities, which must account for at least 90% of its income; and
- (3) the firm must be able to demonstrate that a significant proportion of its retail and/or commercial banking activities comprise loans associated with a high *probability of default*, and that the *alternative standardised approach* provides an improved basis for assessing the *operational risk*.

[Note: BCD Article 104(3) and Annex X, Part 2 points 5 and 8 to 11]

6.4.18

FCA PRA

G

In relation to ■ BIPRU 6.4.17 R (3), the *appropriate regulator's* view is that a high *probability of default* is equal to or greater than 3.5%.

### ORCR calculated using the alternative standardised approach

6.4.19

FCA PRA

R

- (1) The relevant indicators under the *alternative standardised approach* are the same as for the *standardised approach* except for the two following business lines:
  - (a) retail banking; and

(b) commercial banking.

(2) For retail banking and commercial banking, the *ORCR* must be calculated as a normalised income indicator equal to the three-year average of the total nominal amount of loans and advances multiplied:

(a) by 0.035, and then

(b) by the appropriate business line percentage set out in ■ BIPRU 6.4.15 R.

[Note: *BCD* Annex X, Part 2 point 6]

6.4.20

FCA PRA

R

For the retail and/or commercial banking business lines, the loans and advances must consist of the total drawn amounts in the corresponding credit portfolios.

[Note: *BCD* Annex X, Part 2 point 7 (part)]

6.4.21

FCA PRA

R

For the commercial banking business line, the securities held in the *non-trading book* must also be included.

[Note: *BCD* Annex X, Part 2 point 7 (part)]

## 6.5 Operational risk: Advanced measurement approaches

### Application

**6.5.1** **R** ■ BIPRU 6.5 applies to a *BIPRU firm* with an *AMA permission*.

**FCA** **PRA**

### AMA permissions: general

**6.5.2** **G** The rules in *GENPRU* and *BIPRU* do not allow a *firm* to use the *advanced measurement approach*. A *firm* that wishes to use an *advanced measurement approach*, based on the *firm's* own *operational risk* measurement systems, for the calculation of its *ORCR* should therefore apply for *AMA permission* to use the *advanced measurement approach* as explained in ■ BIPRU 1.3.

**FCA** **PRA**

**6.5.3** **G** The *appropriate regulator* will not grant a *firm* an *AMA permission* to use the *advanced measurement approach* if the *firm* does not meet the standards in ■ BIPRU 6.5.5 R.

**FCA** **PRA**

**6.5.4** **G** An *AMA permission* will generally modify ■ BIPRU 6.2.1 R (Calculation of *ORCR*) by amending, to the extent set out in the *AMA permission*, the calculation of the *ORCR* of the *firm* to be calculated in accordance with ■ BIPRU 6.5.

**FCA** **PRA**

### Minimum standards

**6.5.5** **R** A *firm* must be able to satisfy the *appropriate regulator* that it meets:

**FCA** **PRA**

- (1) the general risk management standards in ■ SYSC 4.1.1 R to ■ SYSC 4.1.2 R and ■ SYSC 7.1.16 R;
- (2) the qualitative standards set out in this section; and
- (3) the quantitative standards set out in this section.

[Note: *BCD* Article 105(2) and Annex X Part 3 point 1]

**6.5.5A** **G** In meeting the general risk management standards referred to in ■ BIPRU 6.5.5 R (1), a *firm* that undertakes market-related activities should be able to demonstrate compliance with the Committee of European Banking Supervisors' Guidelines on the management of operational risk in market-related activities, published in October 2010. These can be found at [http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Management-of-op-risk/CEBS-2010-216-\(Guidelines-on-the-management-of-op-.aspx](http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Management-of-op-risk/CEBS-2010-216-(Guidelines-on-the-management-of-op-.aspx)

**FCA** **PRA**

6.5.5B

FCA PRA

G

In meeting the general risk management standards referred to in ■ BIPRU 6.5.5R (1), a *firm* with AMA approval should be able to demonstrate to the *appropriate regulator* that it has considered and complies with Section III of the European Banking Authority's Guidelines on the Advanced Measurement Approach (AMA) - Extensions and Changes published in January 2012. These can be found at [http://eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2012/EBA-BS-2011-209-final-\(EBA-GL-on-AMA-extensions-and-changes\).pdf](http://eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2012/EBA-BS-2011-209-final-(EBA-GL-on-AMA-extensions-and-changes).pdf)

### Qualitative standards

6.5.6

FCA PRA

R

- (1) This *rule* sets out the qualitative standards that a *firm's operational risk* measurement system must meet.
- (2) A *firm's internal operational risk* measurement system must be closely integrated into its day-to-day risk management processes.
- (3) A *firm* must have an independent risk management function for *operational risk*.
- (4) There must be regular reporting of *operational risk* exposures and loss experience. The *firm* must have procedures for taking appropriate corrective action.
- (5) A *firm's* risk management system must be well documented. The *firm* must have a routine in place for ensuring compliance and policies for the treatment of non-compliance.
- (6) A *firm's operational risk* management processes and measurement systems must be subject to regular reviews performed by internal and/or external auditors.
- (7) A *firm* must ensure that in respect of its *operational risk* measurement system:
  - (a) its internal validation processes are operating in a satisfactory manner; and
  - (b) the data flows and processes associated with the risk measurement system are transparent and accessible.

[Note: BCD Annex X Part 3 points 2 to 7]

6.5.7

FCA PRA

G

For the purposes of ■ BIPRU 6.5.6 R (2), a *firm* should be able to show that:

- (1) its *operational risk* measurement systems and processes provide benefits to the *firm* and are not limited to determining regulatory capital;
- (2) the *operational risk* measurement system and framework forms part of the systems and controls it has in place; and

- (3) the *operational risk* measurement system and framework are capable of adapting to the changes in the business of the *firm* and evolving as the *firm* gains experience of risk management techniques.

## 6.5.8

FCA PRA

G

For the purposes of ■ BIPRU 6.5.6 R (3), a *firm* should be able to show that the independent risk management function is sufficiently separate from the business units of the *firm* to allow its professional judgement and recommendations to be effective and impartial.

## 6.5.9

FCA PRA

G

For the purposes of ■ BIPRU 6.5.6 R (4), a *firm* should ensure that:

- (1) its *governing body* or *designated committee* (where one is used) possesses a general understanding of the *firm's AMA*; and
- (2) its senior management possesses a good understanding of the *firm's AMA* and its operation.

## 6.5.10

FCA PRA

G

- (1) A *firm's governing body* or *designated committee* may choose to approve only material aspects of the *firm's AMA* and material changes to the *firm's AMA*.
- (2) Where a *firm's governing body* or *designated committee* chooses to approve only material aspects of the *firm's AMA* and material changes to the *firm's AMA*:
  - (a) the *firm's governing body* or *designated committee* should define the *firm's* overall approach to the *AMA* and approve a policy statement defining that approach; and
  - (b) the *firm* should define and document the process for approval of non-material aspects of the *firm's AMA*.

## 6.5.11

FCA PRA

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For the purposes of ■ BIPRU 6.5.6 R (7), a *firm* should develop and adopt an internal validation methodology of its *operational risk* measurement system and management processes that:

- (1) is proportionate and appropriate to the business of the *firm*;
- (2) takes into account changing market and operating conditions of the *firm*;
- (3) encompasses both quantitative and qualitative methods of the *firm's operational risk* measurement system;
- (4) is periodically assessed by the *firm*;
- (5) is subject to regular independent review to ensure effective implementation; and
- (6) is clearly documented.

6.5.12

FCA PRA

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**Quantitative standards: process**

- (1) This *rule* sets out the quantitative standards that a *firm's operational risk* measurement system must meet with respect to process.
- (2) A *firm* must calculate its capital requirement as comprising both expected loss and unexpected loss, unless the *firm* can demonstrate that expected loss is adequately captured in its internal business practices.
- (3) The *operational risk* measure of a *firm* must capture potentially severe tail events, achieving a soundness standard comparable to a 99.9% confidence interval over a one year period.
- (4) The *operational risk* measurement system of a *firm* must have certain key elements to meet the soundness standard set out in (2) and (3). These elements must include the use of internal data, external data, scenario analysis and factors reflecting the business environment and internal control systems as set out in ■ BIPRU 6.5.21 R to ■ BIPRU 6.5.25 R.
- (5) A *firm* must have a well documented approach for weighting the use of the four elements in (4) in its overall risk measurement system.
- (6) A *firm's* risk measurement system must capture the major drivers of risk affecting the shape of the tail of the loss estimates.
- (7) A *firm* must only recognise correlations in *operational risk* losses across individual *operational risk* estimates to the extent they are set out in its *AMA permission*. The *firm* must validate its correlation assumptions using appropriate quantitative and qualitative techniques.
- (8) A *firm's* risk measurement system must be internally consistent and must avoid the multiple counting of qualitative assessments or risk mitigants recognised in other areas of the capital adequacy framework.

[Note: BCD Annex X Part 3 points 8 to 10, 11 (part) and 12]

6.5.13

FCA PRA

R

For the purposes of ■ BIPRU 6.5.12 R (7), the *firm* must be able to show that its system for measuring correlations is sound, implemented with integrity, and takes into account the uncertainty surrounding any such correlation estimates, particularly in periods of stress.

[Note: BCD Annex X Part 3 point 11 (part)]

## 6.5.14

FCA PRA

G

A *firm* should be able to satisfy the *appropriate regulator* that it has considered the following with respect to its *operational risk* measurement systems:

- (1) whether the choice of distributions used provides both a good fit with the data and an ability adequately to account for rare events;
- (2) whether the estimated parameters and capital numbers used for the simulated inclusion or exclusion of unusually large losses are sufficiently robust;
- (3) the co-dependency, or independency, of assumptions governing the relationships between risk types and between business lines;
- (4) the number of simulations or iterations required during model execution to provide reasonably stable capital results;
- (5) the emergence of different data types, such as the combination of internal and external loss data, based on different degrees of credibility; and
- (6) the methodologies used for the purposes of achieving a soundness standard comparable to a 99.9% confidence interval.

## 6.5.15

FCA PRA

G

For the purposes of ■ BIPRU 6.5.12 R (2), a *firm* should be able to show that its *operational risk* measurement systems that capture expected loss are:

- (1) clearly documented;
- (2) sound, implemented with integrity and consistently applied, and take into account uncertainty surrounding expected loss;
- (3) subject to regular reviews by the *firm* of the reasonableness of the expected loss estimates and comparisons with subsequent outcomes; and
- (4) based on justifiable assumptions for capturing and reviewing the reasonableness of the expected loss estimates.

## 6.5.16

FCA PRA

G

For the purposes of ■ BIPRU 6.5.15 G, the *firm* should use the business management definition it uses for the purposes of identifying an expected loss.

## 6.5.17

FCA PRA

G

Where a *firm* is using a combination of budgeting and pricing for the purposes of the *operational risk* measurement system for capturing expected loss, a *firm* should be able to show that:

- (1) the process is transparent, can be repeated and provides support to the *firm's* management of its business;
- (2) to a reasonable degree of certainty, budgeted resources for the relevant year cover budgeted expected losses;
- (3) its forecasting takes into account both historic performance and drivers which may affect future trends; and

- (4) the forecasting in (3) is monitored on a periodic basis and adjusted as appropriate.

## 6.5.18

FCA PRA

G

For the purposes of ■ BIPRU 6.5.12 R (3), a *firm* should be able to show that in respect of its *operational risk* measurement system:

- (1) the methodology for obtaining a soundness standard comparable to a 99.9% confidence level is practical and appropriate;
- (2) it has assessed its overall model outputs as sufficiently robust; and
- (3) it reviews its methodology on an ongoing basis.

## 6.5.19

FCA PRA

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For the purpose of developing and reviewing its methodology for obtaining a soundness standard comparable to a 99.9% confidence level, a *firm* should consider whether any of the following are appropriate:

- (1) stress testing;
- (2) sensitivity analysis;
- (3) scenario analysis;
- (4) back testing; and
- (5) boot-strapping techniques.

## 6.5.20

FCA PRA

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Where a *firm* is using scaling for the purposes of the *operational risk* measurement system, it should be able to show that the methodology used is robust and based on assumptions that are meaningful and credible.

#### Quantitative standards: internal data

## 6.5.21

FCA PRA

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- (1) This *rule* sets out the quantitative standards that a *firm's operational risk* measurement system must meet with respect to internal data.
- (2) A *firm's* internally generated *operational risk* measures must be based on a minimum historical observation period of five years. When a *firm* first moves to the *advanced measurement approach*, a three year historical observation period may be used.
- (3) A *firm* must be able to map its historical internal loss data into the business lines defined in ■ BIPRU 6.4.15 R and into the event type categories defined in ■ BIPRU 6.5.25 R, and must be able to provide this data to the *appropriate regulator* upon request. Loss events which affect the entire *firm* may be allocated to an additional business line 'corporate items' due to exceptional circumstances. The *firm* must have documented, objective

criteria for allocating losses to the specified business lines and event types. A *firm's operational risk* losses that are related to credit risk and have historically been included in the internal credit risk databases must be recorded in the *operational risk* databases and be separately identified. Such losses will not be subject to the ORCR, as long as they continue to be treated as credit risk for the purposes of calculating the *capital resources requirement*. *Operational risk* losses that are related to market risks must be included in the scope of the capital requirement for *operational risk*.

- (4) A *firm's* internal loss data must be comprehensive in that it captures all material activities and exposures from all appropriate sub-systems and geographic locations. A *firm* must be able to demonstrate that any excluded activities or exposures, both individually and in combination, would not have a material impact on the overall risk estimates. A *firm* must define appropriate minimum loss thresholds for internal loss data collection.
- (5) Aside from information on gross loss amounts, a *firm* must collect information about the date of the event, any recoveries of gross loss amounts, as well as some descriptive information about the drivers or causes of the loss event.
- (6) A *firm* must have specific criteria for assigning loss data arising from an event in a centralised function or an activity that spans more than one business line, as well as from related events over time.
- (7) A *firm* must have documented procedures for assessing the ongoing relevance of historical loss data, including those situations in which judgement overrides, scaling or other adjustments may be used, to what extent they may be used and who is authorised to make such decisions.

[Note: BCD Annex X Part 3 points 13 to 18]

#### Quantitative standards: external data

- (1) This *rule* sets out the quantitative standards that a *firm's operational risk* measurement system must meet with respect to external data.
- (2) A *firm's operational risk* measurement system must use relevant external data, especially when there is reason to believe that the *firm* is exposed to infrequent, yet potentially severe, losses. A *firm* must have a systematic process for determining the situations for which external data should be used and the methodologies used to incorporate the data in its measurement system. The conditions

6.5.22

FCA PRA

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and practices for external data use should be regularly reviewed, documented and subject to periodic independent review.

[Note: BCD Annex X Part 3 point 19]

#### Quantitative standards: scenario analysis

6.5.23

FCA PRA

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- (1) This *rule* sets out the quantitative standards that a *firm's operational risk* measurement system must meet with respect to scenario analysis.
- (2) A *firm* must use scenario analysis of expert opinion in conjunction with external data to evaluate its exposure to high severity events. Over time, such assessments must be validated and re-assessed through comparison to actual loss experience to ensure their reasonableness.

[Note: BCD Annex X Part 3 point 20]

#### Quantitative standards: business environment and internal control factors

6.5.24

FCA PRA

R

- (1) This *rule* sets out the quantitative standards that a *firm's operational risk* measurement system must meet with respect to business environment and internal control factors.
- (2) A *firm's firm-wide* risk assessment methodology must capture key business environment and internal control factors that can change its *operational risk* profile.
- (3) A *firm* must be able to justify the choice of each factor as a meaningful driver of risk, based on experience and involving the expert judgment of the affected business areas.
- (4) The sensitivity of risk estimates to changes in the factors and the relative weighting of the various factors must be well reasoned. In addition to capturing changes in risk due to improvements in risk controls, the framework must also capture potential increases in risk due to greater complexity of activities or increased business volume.
- (5) A *firm* must document this framework and make it subject to independent review within the *firm* and make it available for review by supervisors.
- (6) Over time, a *firm* must validate and re-assess the process and the outcomes through comparison to actual internal loss experience and relevant external data.

[Note: BCD Annex X Part 3 points 21 to 24]

6.5.25

FCA PRA

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**Loss event type classification**

**Table: Loss event type classification**

This table belongs to ■ BIPRU 6.5.21 R (3).

Event-Type Category	Definition
<b>Internal fraud</b>	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/ discrimination events, which involves at least one internal party
<b>External fraud</b>	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party
<b>Employee Practices and Workplace Safety</b>	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity/discrimination events
<b>Clients, Products &amp; Business Practices</b>	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product
<b>Damage to Physical Assets</b>	Losses arising from loss or damage to physical assets from natural disaster or other events
<b>Business disruption and system failures</b>	Losses arising from disruption of business or system failures
<b>Execution, Delivery &amp; Process Management</b>	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors

[Note: BCD Annex X Part 5 Table 3]

**Impact of insurance and risk transfer mechanisms**

- (1) A firm may recognise the impact of insurance for the purposes of its operational risk measurement system subject to the conditions set out in this rule and ■ BIPRU 6.5.27 R.
- (2) The provider must be authorised to provide insurance or re-insurance.

6.5.26

FCA PRA

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- (3) The provider must have a minimum claims paying ability rating by an *eligible ECAI* associated with *credit quality step 3* or above under the rules for the risk weighting of exposures to *firms* under the *standardised approach* to credit risk .

[Note: BCD Annex X Part 3 points 25 to 26]

6.5.27

FCA PRA

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- (1) A *firm* must ensure that its insurance and its insurance framework meet the conditions in this *rule*.
- (2) The insurance policy must have an initial term of no less than one year. For policies with a residual term of less than one year the *firm* must make appropriate haircuts to reflect the declining residual term of the policy, up to a full 100% haircut for policies with a residual term of 90 days or less.
- (3) The insurance policy must have a minimum notice period for cancellation of the contract of 90 days.
- (4) The insurance policy must contain no exclusions or limitations based upon supervisory actions or, in the case of a failed *firm*, that preclude the *firm*, its receiver or liquidator from recovering for damages suffered or expenses incurred by the *firm*, except in respect of events occurring after the initiation of receivership or liquidation proceedings in respect of the *firm*. The insurance policy may exclude coverage for any fine, penalty or punitive damages resulting from actions by a *competent authority* or *third country competent authority*.
- (5) The risk mitigation calculations must reflect the insurance coverage in a manner that is transparent in its relationship to, and consistent with, the actual likelihood and impact of loss used in the overall determination of the *ORCR*.
- (6) The insurance must be provided by a third party entity. In the case of insurance through captives and affiliates, the exposure must be laid off to an independent third party entity, for example through reinsurance that meets the eligibility criteria.
- (7) The framework for recognising insurance must be well reasoned and documented.
- (8) The methodology for recognising insurance must capture the following elements through discounts or haircuts in the amount of insurance recognition:
- (a) the residual term of a policy, where less than one year, as noted in (2);
  - (b) a policy's cancellation terms, where less than one year;

- (c) mismatches in coverage of insurance policies; and
- (d) the uncertainty of payment.

(9) The capital alleviation arising from the recognition of insurances and other risk transfer mechanisms must not exceed 20% of the capital requirement before the recognition of risk mitigation techniques.

[Note: BCD Annex X Part 3 points 27 to 29]

6.5.28

FCA PRA

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For the purposes of ■ BIPRU 6.5.27 R (7), a *firm* should be able to demonstrate that the mitigating effect of the insurance is appropriate and relevant to the *firm's* business.

6.5.29

FCA PRA

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For the purposes of ■ BIPRU 6.5.27 R (9), a *firm* should be able to set out clearly how it made its assessment of the appropriate level of capital alleviation, including any assumptions made by the *firm* and how the insurances and other risk transfer mechanisms have been factored into the *firm's* risk measurement system.

6.5.30

FCA PRA

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A *firm* may recognise a risk transfer mechanism other than insurance to the extent that a noticeable risk mitigating effect is achieved and the risk transfer mechanism is included in the *firm's* AMA permission.

[Note: BCD Annex X Part 3 point 25]

6.5.30A

FCA PRA

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A *firm* that recognises the impact of insurance and operational risk mitigation techniques for the purposes of its *operational risk* measurement system should be able to show that it has considered the Commission of European Banking Supervisors' guidelines on operational risk mitigation techniques published in December 2009. This can be found at <http://www.c-eps.org/documents/Publications/Standards---Guidelines/2009/Operational-risk-mitigation-techniques/Guidelines.aspx>.

#### Use of an advanced measurement approach on a groupwide basis

6.5.31

FCA PRA

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Where an *EEA parent institution* and its *subsidiary undertakings* or an *EEA parent financial holding company* and its *subsidiary undertakings* use an *advanced measurement approach* on a unified basis for the *parent undertaking* and its *subsidiary undertakings*, the qualifying criteria set out in ■ BIPRU 6.5 may be met by the *parent undertaking* and its *subsidiary undertakings* considered together where permitted by the *AMA permission*.

[Note: BCD Article 105(4)]

6.5.32

FCA PRA

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Where the *AMA* is used on a unified basis for the *parent undertaking* and its *subsidiary undertakings*, and approval and reporting of the *AMA* are carried out at the group level, the qualifying criteria in ■ BIPRU 6.5 may be met if:

- (1) the *subsidiary undertakings* have delegated to the *governing body* or *designated committee* of the *EEA parent institution* or *EEA parent financial holding company* responsibility for approval of the *AMA*;

- 
- (2) the *governing body* or *designated committee* of the *EEA parent institution* or *EEA parent financial holding company* approves either:
- (a) all aspects of the *AMA*, and material changes; or
  - (b) all aspects of the *AMA* that are material in the context of the group, and material changes to those, and a policy statement defining the overall approach to the *AMA*.

# Chapter 7

## Market risk

## 7.1 Application, purpose, general provisions and non-standard transactions

### Application

7.1.1 **R** This chapter applies to a *BIPRU firm*.

**FCA** **PRA**

### Purpose

7.1.2 **G** The purpose of this chapter is to implement Annexes I, III, IV and V of the *Capital Adequacy Directive*.

**FCA** **PRA**

### General provisions: Obligation to calculate PRR

7.1.3 **R** A *firm* must calculate a *PRR* in respect of:

**FCA** **PRA**

- (1) all its *trading book positions*;
- (2) all *positions* falling within **■ BIPRU 7.5.3 R** (Scope of the foreign exchange PRR calculation), whether or not in the *trading book*; and
- (3) all *positions in commodities* (including *physical commodities*) whether or not in the *trading book*;

even if no treatment is provided for that *position* in the other sections of this chapter.

7.1.4 **R** A *firm* must calculate a *PRR* for any *position* falling into **■ BIPRU 7.1.3 R** using:

**FCA** **PRA**

- (1) the *PRR* calculations contained in **■ BIPRU 7**; or
- (2) another method provided the *firm* is able to demonstrate that in all circumstances the calculation being employed results in a higher *PRR* for the *position* than would be required under (1).

### General provisions: Non-trading book items

7.1.5 **G** *Positions* in instruments which are *non-trading book* items should be treated under **■ BIPRU 3** (Standardised credit risk), **■ BIPRU 4** (The IRB approach) or **■ BIPRU 13** (Financial derivatives, SFTs and long settlement transactions) unless deducted as an

**FCA** **PRA**

*illiquid asset*. If they fall into ■ BIPRU 7.1.3R(2) or ■ (3) they also give rise to a *PRR charge*.

### General provisions: Frequency of calculation

7.1.6

FCA PRA

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A *firm* must be able to monitor its total *PRR* on an intra-day basis, and, before executing any trade, must be able to re-calculate *PRR* to the level of detail necessary to establish whether or not the *firm's capital resources* exceed its *capital resources requirement*.

7.1.7

FCA PRA

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A *firm* may rely on intra-day limits for the purposes of ■ BIPRU 7.1.6R.

### Purpose of rules for non-standard transactions and instruments for which no PRR treatment has been specified

7.1.8

FCA PRA

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The methodologies which have been developed for calculating *PRR charges* have been based on existing instruments and assume instruments with standard characteristics. However, as a result of innovation and because there are instruments which, although based on a standard contract, contain structural features which would make the *rules* in the rest of this chapter inappropriate, flexible *rules* are required. The *rules* in this section about transactions for which no *PRR* treatment has been specified and non-standard transactions are designed to address this.

### Instruments for which no PRR treatment has been specified

7.1.9

FCA PRA

R

Where a *firm* has a *position* for which no *PRR* treatment has been specified, it must calculate the *PRR* for that *position* in accordance with ■ BIPRU 7.1.12R-■ BIPRU 7.1.13R.

7.1.10

FCA PRA

R

If ■ BIPRU 7.1.9 R applies, a *firm* must document its policies and procedures for calculating the *PRR* for that *position* of that type in its *trading book policy statement*.

7.1.11

FCA PRA

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Under ■ BIPRU 1.2.30 R (2) a *firm* should notify the *appropriate regulator* as soon as is reasonably practicable if its *trading book policy statement* is subject to significant changes. Therefore if a *firm* makes a change in accordance with ■ BIPRU 7.1.10R it should consider whether it is necessary to report it to the *appropriate regulator*.

7.1.12

FCA PRA

R

A *firm* may calculate the *PRR* for a *position* falling into ■ BIPRU 7.1.9R by applying by analogy the *rules* relating to the calculation of the *interest rate PRR*, the *equity PRR*, the *commodity PRR*, the *foreign currency PRR*, the *option PRR* or the *collective investment undertaking PRR* if doing so is appropriate and if the *position* and *PRR item* are sufficiently similar to those that are covered by those *rules*.

7.1.13

FCA PRA

R

Where a *firm* has a *position* for which no *PRR* treatment has been specified and it is not applying ■ BIPRU 7.1.12R, it must calculate a *PRR* of an appropriate percentage of the current value of the *position* calculated under ■ GENPRU 1.3 (Valuation).

**Instruments in non-standard form**

7.1.14

FCA PRA

R

- (1) If a *firm* has a *position*:
- (a) in a *PRR item* in non-standard form; or
  - (b) that is part of a non-standard arrangement; or
  - (c) that, taken together with other *positions* (whether or not they are subject to *PRR charges* under ■ BIPRU 7), gives rise to a non-standard *market risk*;
- the *firm* must notify the *appropriate regulator* of that fact and of details about the *position*, *PRR item*, arrangements and type of risk concerned.
- (2) Except as (1) provides to the contrary, (1) applies to a *position* that is subject to a *PRR* under ■ BIPRU 7.1.3R.
- (3) The question of what is non-standard for the purposes of (1) must be judged by reference to the standards:
- (a) prevailing at the time the *rule* is being applied; and
  - (b) of *firms* generally who carry on business which gives rise to *PRRs* under ■ BIPRU 7 rather than merely by reference to the *firm's* own business.

7.1.15

FCA PRA

R

If a *firm* has a *position* or combination of *positions* falling into ■ BIPRU 7.1.14R and the *PRR* relating to that *position* or *positions* materially underestimates the *market risk* incurred by the *firm* to which they give rise, the *firm* must calculate the *PRR* for that *position* or *positions* under ■ BIPRU 7.1.13R.

**Meaning of appropriate percentage for non-standard transactions**

7.1.16

FCA PRA

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- (1) In ■ BIPRU 7.1.13R and, to the extent that that *rule* applies ■ BIPRU 7.1.13R, ■ BIPRU 7.1.15R, an "appropriate percentage" is:
- (a) 100%; or
  - (b) a percentage which takes account of the characteristics of the *position* concerned and of discussions with the *appropriate regulator* or a predecessor regulator under the Banking Act 1987 or the Financial Services Act 1986.
- (2) Compliance with (1) may be relied on as tending to establish compliance with ■ BIPRU 7.1.13R or, insofar as it incorporates the requirements relating to an appropriate percentage, ■ BIPRU 7.1.15R.

- (3) Contravention of (1) may be relied on as tending to establish contravention with ■ BIPRU 7.1.13 R or, insofar as it incorporates the requirements relating to an appropriate percentage, ■ BIPRU 7.1.15 R.

### Stress testing and scenario analyses of trading book positions

7.1.17

FCA PRA

R

A *firm* must conduct 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. The results of these tests must be reviewed by senior management and reflected in the policies and limits the *firm* sets.

7.1.17A

FCA PRA

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The *firm's* stress testing programme should be comprehensive in terms of both risk and *firm* coverage, and appropriate to the size and complexity of *trading book positions* held.

7.1.18

FCA PRA

R

In carrying out the stress tests and scenario analyses required by ■ BIPRU 7.1.17 R, a *firm* must incorporate and take into account any other relevant stress tests and scenario analyses that it is required to carry out under any other provision of the *Handbook*, and in particular under ■ BIPRU 7.10.72 R where the *firm* has a *VaR model permission*.

7.1.19

FCA PRA

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This paragraph gives *guidance* in relation to the stress testing programme that a *firm* must carry out in relation to its *trading book positions*.

- (1) The frequency of the stress testing of *trading book positions* should be determined by the nature of the *positions*.
- (2) 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.
- (3) 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.
- (4) As part of its stress testing programme, the *firm* should consider how prudent valuation principles (see ■ GENPRU 1.3) will be met in a stressed scenario.

7.1.20

FCA PRA

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The stress testing and scenario analysis under ■ BIPRU 7.1.17 R should be taken into account under the *overall Pillar 2 rule*.

## 7.2 Interest rate PRR

### General rule

7.2.1

FCA PRA

R

- (1) A *firm* must calculate its *interest rate PRR* under ■ BIPRU 7.2 by:
  - (a) identifying which *positions* must be included within the *interest rate PRR* calculation;
  - (b) deriving the net *position* in each debt *security* in accordance with ■ BIPRU 7.2.36R-■ BIPRU 7.2.41R;
  - (c) including these net *positions* in the *interest rate PRR* calculation for *general market risk* and the *interest rate PRR* calculation for *specific risk*; and
  - (d) summing all *PRRs* calculated for *general market risk* and *specific risk*.
- (2) A *firm* must calculate its *interest rate PRR* by adding the amount calculated under (1) to the amount calculated under the basic *interest rate PRR* calculation under ■ BIPRU 7.3.45R.
- (3) All net *positions*, irrespective of their signs, must be converted on a daily basis into the *firm's base currency* at the prevailing spot exchange rate before their aggregation.
- (4) Net *positions* must be classified according to the currency in which they are denominated. A *firm* must calculate the capital requirement for *general market risk* and *specific risk* in each individual currency separately.

7.2.2

FCA PRA

G

The *interest rate PRR* calculation divides the interest rate risk into the risk of loss from a general move in market interest rates, and the risk of loss from an individual debt *security's* price changing for reasons other than a general move in market interest rates. These are called *general market risk* and *specific risk* respectively.

7.2.3

FCA PRA

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**Scope of the interest rate PRR calculation**

A firm's interest rate PRR calculation must:

- (1) include all *trading book positions* in *debt securities*, *preference shares* and *convertibles*, except:
  - (a) *positions* in *convertibles* which have been included in the firm's *equity PRR* calculation;
  - (b) *positions* fully deducted as a *material holding* under the calculations under the *capital resources table*, in which case the firm may exclude them; or
  - (c) *positions* hedging an *option* which is being treated under ■ BIPRU 7.6.26R (Table: Appropriate treatment for equities, debt securities or currencies hedging options);
- (2) include notional *positions* arising from *trading book positions* in the instruments listed in the table in ■ BIPRU 7.2.4R; and
- (3) (if the firm is the transferor of *debt securities* or guaranteed rights relating to title to *debt securities* in a *repurchase agreement* or the lender of *debt securities* in a *debt securities* lending agreement) include such *debt securities* if those *debt securities* meet the criteria for inclusion in the *trading book*.

7.2.4

FCA PRA

R

Table: Instruments which result in notional positions

This table belongs to ■ BIPRU 7.2.3R(2)

Instrument	See
<i>Futures, forwards or synthetic futures on debt securities</i>	BIPRU 7.2.13 R
<i>Futures, forwards or synthetic futures on debt indices or baskets</i>	BIPRU 7.2.14R
<i>Interest rate futures or forward rate agreements (FRAs)</i>	BIPRU 7.2.18 R
<i>Interest rate swaps or foreign currency swaps</i>	BIPRU 7.2.21R
<i>Deferred start interest rate swaps or foreign currency swaps</i>	BIPRU 7.2.24R
<i>The interest rate leg of an equity swap (unless the firm calculates the interest rate PRR on the instrument using the basic interest rate PRR calculation in BIPRU 7.3 (Equity PRR and basic interest rate PRR for equity derivatives))</i>	BIPRU 7.2.27R

Instrument	See
<b>The cash leg of a <i>repurchase agreement</i> or a <i>reverse repurchase agreement</i></b>	<b>BIPRU 7.2.30R</b>
<b>Cash borrowings or deposits</b>	<b>BIPRU 7.2.31 R</b>
<b><i>Options</i> on a <i>debt security</i>, a basket of <i>debt securities</i>, a <i>debt security index</i>, an <i>interest rate</i> or an <i>interest rate future</i> or <i>swap</i> (including an <i>option on a future on a debt security</i>) (unless the <i>firm</i> calculates a <i>PRR</i> on the <i>option</i> under <b>BIPRU 7.6</b> (Option PRR))</b>	<b>BIPRU 7.2.32R</b>
<b>Dual currency bonds</b>	<b>BIPRU 7.2.33R</b>
<b><i>Foreign currency futures</i> or <i>forwards</i></b>	<b>BIPRU 7.2.34R</b>
<b><i>Gold futures</i> or <i>forwards</i></b>	<b>BIPRU 7.2.34R</b>
<b><i>Forwards, futures</i> or <i>options</i> (except <i>cliquets</i>) on an <i>equity</i>, basket of <i>equities</i> or <i>equity index</i> (unless the <i>firm</i> calculates the <i>interest rate PRR</i> on the instrument using the basic <i>interest rate PRR</i> calculation in <b>BIPRU 7.3</b>)</b>	<b>BIPRU 7.2.34R</b>
<b>Credit derivatives</b>	<b>BIPRU 7.11</b>
<b><i>A warrant</i> must be treated in the same way as an <i>option</i></b>	

## 7.2.5

FCA PRA

G

■ BIPRU 7.2.3R(1) includes a *trading book position* in *debt security*, *preference share* or *convertible* that is subsequently repo'd under a *repurchase agreement* or lent under a stock lending agreement. Clearly, if the *security* had initially been obtained via a *reverse repurchase agreement* or stock borrowing agreement, the *security* would not have been included in the *PRR* calculation in the first place.

## 7.2.6

FCA PRA

G

■ BIPRU 7.2.3R(1) includes *net underwriting positions* or *reduced net underwriting position* in *debt securities*.

## 7.2.7

FCA PRA

G

*Firms* are reminded that the table in ■ BIPRU 7.6.5R (Table: Appropriate PRR calculation for an option or warrant) divides *options* and *warrants* on interest rates, *debt securities* and interest rate *futures* and *swaps* into:

- (1) those which must be treated under ■ BIPRU 7.6 (Option PRR); and
- (2) those which must be treated under either ■ BIPRU 7.2 or ■ BIPRU 7.6, the *firm* being able to choose whether ■ BIPRU 7.2 or ■ BIPRU 7.6 is used.

## 7.2.8

FCA PRA

G

Cliquets on *equities*, baskets of *equities* or *equity* indices do not attract an *interest rate PRR*. The table in ■ BIPRU 7.2.4R excludes them from the scope of the *interest rate PRR* calculation in ■ BIPRU 7.2 and ■ BIPRU 7.3.45R excludes them from the basic *interest rate PRR* calculation in ■ BIPRU 7.3 (Equity PRR and basic interest rate PRR for equity derivatives).

## 7.2.9

FCA PRA

G

The table in ■ BIPRU 7.2.4R shows that *equity derivatives* are excluded from ■ BIPRU 7.2's *PRR* calculation if they have been included in the basic *interest rate PRR* calculation in ■ BIPRU 7.3 (see ■ BIPRU 7.3.45R).

### Derivation of notional positions: General approach

## 7.2.10

FCA PRA

G

■ BIPRU 7.2.11 R - ■ BIPRU 7.2.35R convert the instruments listed in the table in ■ BIPRU 7.2.4R into notional *positions* in:

- (1) the underlying debt *security*, where the instrument depends on the price (or yield) of a specific debt *security*; or
- (2) notional debt *securities* to capture the pure interest rate risk arising from future payments and receipts of cash (including notional payments and receipts) which, because they are designed to represent pure *general market risk* (and not *specific risk*), are called *zero-specific-risk securities*; or
- (3) both (1) and (2).

## 7.2.11

FCA PRA

R

- (1) For the purposes of calculating *interest rate PRR*, unless specified otherwise, a *firm* must derive the value of notional *positions* as follows:
  - (a) notional *positions* in actual debt *securities* must be valued as the nominal amount underlying the contract at the current market price of the debt *security*; and
  - (b) *positions* in *zero-specific-risk securities* must be valued using one of the two methods in (2).
- (2) A *firm* must use one of the following two methods for all *positions* arising under (1)(b) and must use the same method for all *positions* denominated in the same currency:
  - (a) the present value approach, under which the *zero-specific-risk security* is assigned a value equal to the present value of all the future cash flows that it represents; or
  - (b) the alternative approach, under which the *zero-specific-risk security* is assigned a value equal to:
    - (i) the market value of the underlying notional *equity position* in the case of an *equity derivative*;
    - (ii) the notional principal amount in the case of an interest rate or *foreign currency swap*; or

- (iii) the notional amount of the future cash flow that it represents in the case of any other *CRD financial instrument*.

7.2.12

FCA PRA

R

A *firm* must use ■ BIPRU 7.2.11R(2)(a) in respect of any *positions* that it includes in the *interest rate duration method*.

#### Derivation of notional positions: Futures, forwards or synthetic futures on a debt security

7.2.13

FCA PRA

R

*Futures, forwards or synthetic futures* on a single debt *security* must be treated as follows:

- (1) a purchased *future, synthetic future or forward* is treated as:
  - (a) a notional long *position* in the underlying debt *security* (or the cheapest to deliver (taking into account the conversion factor) where the contract can be satisfied by delivery of one from a range of *securities*); and
  - (b) a notional short *position* in a zero coupon *zero-specific-risk security* with a maturity equal to the expiry date of the *future or forward*; and
- (2) a sold *future, synthetic future or forward* is treated as:
  - (a) a notional short *position* in the underlying *security* (or the cheapest to deliver (taking into account the conversion factor) where the contract can be satisfied by delivery of one from a range of *securities*); and
  - (b) a notional long *position* in a zero coupon *zero-specific-risk security* with a maturity equal to the expiry date of the *future, synthetic future or forward*.

#### Derivation of notional positions: Futures, forwards or synthetic futures on a basket or index of debt securities

7.2.14

FCA PRA

R

*Futures, forwards or synthetic futures* on a basket or index of debt *securities* must be converted into *forwards* on single debt *securities* as follows (and then the resulting *positions* must be treated under ■ BIPRU 7.2.13R):

- (1) *futures, synthetic futures or forwards* on a single currency basket or index of debt *securities* must 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* must be treated as either:
  - (a) a series of *forwards* (using the method described 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.

7.2.15  
FCA PRA

**G** Under ■ BIPRU 7.2.14R(2)(b), a *forward* on basket of three Euro denominated debt *securities* and two Dollar denominated debt *securities* would be treated as a *forward* on a single notional Euro denominated debt *security* and a *forward* on a single notional Dollar denominated debt *security*.

7.2.16  
FCA PRA

**R** The notional debt *securities* in ■ BIPRU 7.2.14R are 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.

7.2.17  
FCA PRA

**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* . ■ BIPRU 7.2.16R requires a *firm* to 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.

**Derivation of notional positions: Interest rate futures and forward rate agreements (FRAs)**

7.2.18  
FCA PRA

**R** Interest rate *futures* or *FRAs* must be treated as the two notional *positions* (one long, one short) shown in the table in ■ BIPRU 7.2.19R.

7.2.19  
FCA PRA

**R** Table: Interest rate futures and FRAs

This table belongs to ■ BIPRU 7.2.18R

	A short <i>position</i> in a zero coupon zero-specific-risk <i>security</i>	A long <i>position</i> in a zero coupon zero-specific-risk <i>security</i>
Where the <i>firm</i> buys an interest rate <i>future</i> or sells an <i>FRA</i>	Maturity equals the expiry date of the <i>future</i> (or settlement date of the <i>FRA</i> )	Maturity equals the expiry date of the <i>future</i> (or settlement date of the <i>FRA</i> ) plus the maturity of the notional borrowing/deposit

	A short <i>position</i> in a zero coupon <i>zero-specific-risk security</i>	A long <i>position</i> in a zero coupon <i>zero-specific-risk security</i>
Where the <i>firm</i> sells an interest rate <i>future</i> or buys an <i>FRA</i>	Maturity equals the expiry date of the <i>future</i> (or settlement date of the <i>FRA</i> ) plus the maturity of the notional borrowing/deposit	Maturity equals the expiry date of the <i>future</i> (or settlement date of the <i>FRA</i> )

7.2.20

FCA PRA

G

- (1) The following example illustrates ■ BIPRU 7.2.18R and ■ BIPRU 7.2.19R in conjunction with ■ BIPRU 7.2.11R (the last *rule* determines the value of notional *positions*). A *firm* sells £1mn notional of a 3v6 *FRA* at 6%. This results in:
- (a) a short *position* in a *zero-specific-risk security* with a zero coupon, three month maturity, and a nominal amount of £1million; and
  - (b) a long *position* in a *zero-specific-risk security* with a zero coupon, six month maturity, and nominal amount of £1,015,000 (i.e. notional plus interest at 6% over 90 days).
- (2) If a *firm* were to apply the approach in ■ BIPRU 7.2.11R(2)(a) the two nominal amounts would have to be present valued.

**Derivation of notional positions: Interest rate swaps or foreign currency swaps**

7.2.21

FCA PRA

R

Interest rate *swaps* or *foreign currency swaps* without deferred starts must be treated as the two notional *positions* (one long, one short) shown in the table in ■ BIPRU 7.2.22R.

7.2.22

FCA PRA

R

Table: Interest rate and foreign currency swaps

This table belongs to ■ BIPRU 7.2.21R

	Paying leg (which must be treated as a short <i>position</i> in a <i>zero-specific-risk security</i> )	Receiving leg (which must be treated as a long <i>position</i> in a <i>zero-specific-risk security</i> )
Receiving fixed and paying floating	Coupon equals the floating rate and maturity equals the reset date	Coupon equals the fixed rate of the <i>swap</i> and maturity equals the maturity of the <i>swap</i>
Paying fixed and receiving floating	Coupon equals the fixed rate of the <i>swap</i> and maturity equals	Coupon equals the floating rate and maturity equals the reset date

	Paying leg (which must be treated as a short <i>position in a zero-specific-risk security</i> )	Receiving leg (which must be treated as a long <i>position in a zero-specific-risk security</i> )
	<b>the maturity of the swap</b>	
<b>Paying floating and receiving floating</b>	<b>Coupon equals the floating rate and maturity equals the reset date</b>	<b>Coupon equals the floating rate and maturity equals the reset date</b>

7.2.23

FCA PRA

G

For a *foreign currency swap*, the two notional *zero-specific-risk securities* would be denominated in different currencies. A *foreign currency swap* is also included in the *foreign currency PRR* calculation.

**Derivation of notional positions: Deferred start interest rate swaps or foreign currency swaps**

7.2.24

FCA PRA

R

Interest rate *swaps* or *foreign currency swaps* with a deferred start must be treated as the two notional *positions* (one long, one short) shown in the table in ■ BIPRU 7.2.25R.

7.2.25

FCA PRA

R

Table: Deferred start interest rate and foreign currency swaps

This table belongs to ■ BIPRU 7.2.24R

	Paying leg (which must be treated as a short <i>position in a zero-specific-risk security with a coupon equal to the fixed rate of the swap</i> )	Receiving leg (which must be treated as a long <i>position in a zero-specific-risk security with a coupon equal to the fixed rate of the swap</i> )
<b>Receiving fixed and paying floating</b>	<b>maturity equals the start date of the swap</b>	<b>maturity equals the maturity of the swap</b>
<b>Paying fixed and receiving floating</b>	<b>maturity equals the maturity of the swap</b>	<b>maturity equals the start date of the swap</b>

7.2.26

FCA PRA

G

An example of ■ BIPRU 7.2.24R is as follows. A *firm* enters into a five year *swap* which starts in two year's time. The *firm* has contracted to receive 6% and pay six month Libor on a principal amount of £1 million. This results in a long *position* in a 7 year debt *security* and a short *position* in a 2 year debt *security*. Both have a coupon of 6%. ■ BIPRU 7.2.24R deals with the capital treatment of the delayed start date; once the *swap* has started, ■ BIPRU 7.2.21R applies.

### Derivation of notional positions: Swaps where only one leg is an interest rate leg (e.g. equity swaps)

7.2.27

FCA PRA

R

A *firm* must treat a *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.

7.2.28

FCA PRA

G

■ BIPRU 7.2.27R includes *equity swaps*, *commodity swaps* and any other *swap* where only one leg is an interest rate leg.

### Derivation of notional positions: Cash legs of repurchase agreements and reverse repurchase agreements

7.2.29

FCA PRA

G

*Firms* are reminded that for the purposes of ■ BIPRU 7.2.30R, a *repurchase agreement* includes a sell/buy back or stock lending; and a *reverse repurchase agreement* includes a buy/sell back or a stock borrowing.

7.2.30

FCA PRA

R

The forward cash leg of a *repurchase agreement* or *reverse repurchase agreement* must be treated as a notional position in a *zero-specific-risk security* which:

- (1) is a short notional *position* in the case of a *repurchase agreement*; and a long notional *position* in the case of a *reverse repurchase agreement*;
- (2) has a value equal to the market value of the cash leg;
- (3) has a maturity equal to that of the *repurchase agreement* or *reverse repurchase agreement*; and
- (4) has a coupon equal to:
  - (a) zero, if the next interest payment date coincides with the maturity date; or
  - (b) the interest rate on the contract, if any interest is due to be paid before the maturity date.

7.2.31

FCA PRA

R

**Derivation of notional positions: Cash borrowings and deposits**

A cash borrowing or deposit must be treated as a notional *position* in a zero coupon *zero-specific-risk security* which:

- (1) is a short *position* in the case of a borrowing and a long *position* in the case of a deposit;
- (2) has a value equal to the market value of the borrowing or deposit;
- (3) has a maturity equal to that of the borrowing or deposit, or the next date the interest rate is reset (if earlier); and
- (4) has a coupon equal to:
  - (a) zero, if the next interest payment date coincides with the maturity date; or
  - (b) the interest rate on the borrowing or deposit, if any interest is due to be paid before the maturity date.

**Derivation of notional positions: Options and warrants**

7.2.32

FCA PRA

R

- (1) Where included in the *PRR* calculation in ■ BIPRU 7.2 (see the table in ■ BIPRU 7.2.4R), *options* and *warrants* must be treated in accordance with this *rule*.
- (2) An *option* or *warrant* on a debt *security*, a basket of debt *securities* or a debt *security* index must be treated as a *position* in that debt *security*, basket or index.
- (3) An *option* on an interest rate must be treated as a *position* in a zero coupon *zero-specific-risk security* with a maturity equal to the sum of the time to expiry of the *option* and the length of the period for which the interest rate is fixed.
- (4) An *option* on a *future* - where the *future* is based on an interest rate or debt *security* - must be treated as:
  - (a) a long *position* in that *future* for purchased call *options* and written put *options*; and
  - (b) a short *position* in that *future* for purchased put *options* and written call *options*.
- (5) An *option* on a *swap* must be treated as a deferred starting *swap*.

### Derivation of notional positions: Bonds where the coupons and principal are paid in different currencies

7.2.33

FCA PRA

R

Where a debt *security* pays coupons in one currency, but will be redeemed in a different currency, it must 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*.

### Derivation of notional positions: Interest rate risk on other futures, forwards and options

7.2.34

FCA PRA

R

Other *futures, forwards, options* and *swaps* treated under ■ BIPRU 7.2 must 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 ■ BIPRU 7.2.35R.

7.2.35

FCA PRA

R

Table: Interest rate risk on other futures, forwards, options and swaps

This table belongs to ■ BIPRU 7.2.34R.

Instrument	Notional positions		
<i>foreign currency forward or future</i>	a long <i>position</i> denominated in the currency purchased	and	a short <i>position</i> denominated in the currency sold
<i>Gold forward or future</i>	a long <i>position</i> if the <i>forward or future</i> involves an actual (or notional) sale of gold	or	a short <i>position</i> if the <i>forward or future</i> involves an actual (or notional) purchase of gold
<i>Equity forward or future, or option</i>	A long <i>position</i> if the contract in-	or	A short <i>position</i> if the contract in-

Instrument	Notional <i>positions</i>	
(unless the <i>interest rate PRR</i> is calculated under the basic <i>interest rate PRR</i> calculation in BIPRU 7.3)	volves an actual (or notional) sale of the underlying <i>equity</i>	volves an actual (or notional) purchase of the underlying <i>equity</i>

#### Deriving the net position in each debt security: General

7.2.36

FCA PRA

R

The net *position* in a debt *security* is the difference between the value of the *firm's* long *positions* (including notional *positions*) and the value of its short *positions* (including notional *positions*) in the same debt *security*.

#### Deriving the net position in each debt security: Netting positions in the same debt security

7.2.37

FCA PRA

R

- (1) A *firm* must not net *positions* (including notional *positions*) unless those *positions* are in the same debt *security*. This *rule* sets out the circumstances in which debt *securities* may be treated as the same for these purposes.
- (2) Subject to (3) long and short *positions* are in the same debt *security*, and a debt *security* is the same as another if and only if:
  - (a) they enjoy the same rights in all respects; and
  - (b) are fungible with each other.
- (3) Long and short *positions* in different tranches of the same debt *security* may be treated as being in the same debt *security* for the purpose of (1) where:
  - (a) the tranches enjoy the same rights in all respects; and
  - (b) the tranches become fungible within 180 days and thereafter the debt *security* of one tranche can be delivered in settlement of the other tranche.

#### Deriving the net position in each debt security: Netting the cheapest to deliver security with other deliverable securities

7.2.38

FCA PRA

R

A *firm* may net a short notional *position* in the cheapest to deliver *security* arising from a short *future* or *forward* (see ■ BIPRU 7.2.13R(2)(a)) under which the seller has a choice of which debt *security* it may use to settle its obligations against a long *position* in any deliverable *security* up to a maximum of 90% of the common nominal amounts. The residual long and short nominal amounts must be treated as separate long and short *positions*.

7.2.39

FCA PRA

R

The netting permitted by ■ BIPRU 7.2.38R only relates to where the *firm* has sold the *future* or *forward*. It does not relate to where the *firm* has bought a *future* or *forward*.

#### Deriving the net position in each debt security: Netting zero-specific-risk securities with different maturities

7.2.40

FCA PRA

R

A *firm* may net a notional long *position* in a *zero-specific-risk security* against a notional short *position* in a *zero-specific-risk security* if:

- (1) they are denominated in the same currency;
- (2) their coupons do not differ by more than 15 basis points; and
- (3) they mature:
  - (a) on the same day, if they have residual maturities of less than one month;
  - (b) within 7 days of each other, if they have residual maturities of between one month and one year; and
  - (c) within 30 days of each other, if they have residual maturities in excess of one year.

#### Deriving the net position in each debt security: Reduced net underwriting positions in debt securities

7.2.41

FCA PRA

R

A *firm* must not net a *reduced net underwriting position* in a debt *security* with any other debt *security position*.

7.2.42

FCA PRA

G

■ BIPRU 7.2.41R only relates to *reduced net underwriting position*.

#### Deriving the net position in the correlation trading portfolio

7.2.42A

FCA PRA

R

A *correlation trading portfolio* may only consist of *securitisation positions* and *nth-to-default credit derivatives* that meet the following criteria:

- (1) the *positions* are neither *resecuritisation positions*, nor *options* on a *securitisation position*, nor any other derivatives of *securitisation exposures* that do not provide a pro-rata share in the proceeds of a *securitisation tranche*;
- (2) all reference instruments are either single-name instruments, including single-name credit derivatives, for which a liquid two-way market exists, or commonly traded indices based on reference entities which meet this criterion;
- (3) the *positions* do not fall under the exposure classes outlined in ■ BIPRU 3.2.9 R (8) (retail claims or contingent retail claims) and

■ BIPRU 3.2.9 R (9) (claims or contingent claims secured on real estate property); and

(4) the *positions* do not reference a claim on a *special purpose vehicle*.

7.2.42B

R

FCA PRA

*Positions* which are not *securitisation positions* or nth-to-default credit derivatives may be included in the *correlation trading portfolio* only if they hedge other such *positions* in this portfolio and a liquid two-way market exists for the relevant *position* or its reference entities.

7.2.42C

R

FCA PRA

For the purposes of ■ BIPRU 7.2.42A R (2) and ■ BIPRU 7.2.42B R, a two-way market may be deemed to exist only where there are independent, bona fide offers to buy and sell, so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one *business day* and settled at that price within a relatively short time conforming to trade custom.

7.2.42D

R

FCA PRA

A *firm* must calculate both the net long and the net short *positions* in the *correlation trading portfolio* by applying ■ BIPRU 7.2.36 R and ■ BIPRU 7.2.37 R or, where applicable, ■ BIPRU 7.11.13 R to ■ BIPRU 7.11.17 R.

#### Specific risk calculation

7.2.43

R

FCA PRA

- (1) A *firm* must calculate the *specific risk* portion of the *interest rate PRR* for each debt *security* by multiplying the market value of the individual net *position* (ignoring the sign) by the *appropriate position risk adjustment* from the table in ■ BIPRU 7.2.44R or as specified by ■ BIPRU 7.2.45R - ■ BIPRU 7.2.48L R or by ■ BIPRU 7.11.13 R - ■ BIPRU 7.11.17 R.
- (2) Notional *positions* in *zero-specific-risk securities* do not attract *specific risk*.
- (3) For the purpose of (1), a *firm* may cap the product of multiplying the individual net *position* by the *appropriate position risk adjustment* at the maximum possible default-risk-related loss. For a short *position* in a credit derivative, a *firm* may calculate the maximum possible default-risk-related loss as a change in value due to the underlying names immediately becoming default-risk-free.

7.2.44

FCA PRA

**R** Table: specific risk position risk adjustments

This table belongs to ■ BIPRU 7.2.43R.

Issuer	Residual maturity	Position risk adjustment
Debt securities issued or guaranteed by central governments, issued by <i>central banks, international organisations, multilateral development banks</i> or <i>EEA States'</i> regional governments or local authorities which would qualify for <i>credit quality step 1</i> or which would receive a 0% risk weight under the <i>standardised approach</i> to credit risk.	Any	0%
(A) Debt securities issued or guaranteed by central governments, issued by <i>central banks, international organisations, multilateral development banks</i> or <i>EEA States'</i> regional governments or local authorities which would qualify for <i>credit quality step 2</i> or 3 under the <i>standardised approach</i> to credit risk.	Zero to six months over 6 and up to and including 24 months Over 24 months	0% 1% 1%
(B) Debt securities issued or guaranteed by <i>institutions</i> which would qualify for <i>credit quality step 1</i> or 2 under the <i>standardised approach</i> to credit risk.		
(C) Debt securities issued or guaranteed by <i>institution</i> which would qualify for <i>credit quality step 3</i> under BIPRU 3.4.34 R (Exposures to institutions: Credit assessment based method) or which would do so if it had an original effective maturity of three months or less.		
(D) Debt securities issued or guaranteed by <i>corporates</i> which would qualify for <i>credit quality step 1</i> , 2 or 3 under the <i>standardised approach</i> to credit risk.		
(E) Other <i>qualifying debt securities</i> (see BIPRU 7.2.49R)		
(A) Debt securities issued or guaranteed by central governments, issued by <i>central banks</i> ,	Any	8%

Issuer	Residual maturity	Position risk adjustment
<p><i>international organisations, multilateral development banks or EEA States' regional governments or local authorities or institutions which would qualify for credit quality step 4 or 5 under the standardised approach to credit risk.</i></p> <p>(B) Debt securities issued or guaranteed by corporates which would qualify for credit quality step 4 under the standardised approach to credit risk.</p> <p>(C) Exposures for which a credit assessment by a nominated ECAI is not available.</p>		
<p>(A) Debt securities issued or guaranteed by central governments, issued by central banks, international organisations, multilateral development banks or EEA States' regional governments or local authorities or institution which would qualify for credit quality step 6 under the standardised approach to credit risk.</p>	Any	12%
<p>(B) Debt securities issued or guaranteed by corporate which would qualify for credit quality step 5 or 6 under the standardised approach to credit risk.</p> <p>(C) An instrument that shows a particular risk because of the insufficient solvency of the issuer of liquidity. This paragraph applies even if the instrument would otherwise qualify for a lower position risk adjustment under this table.</p>		
<p>Note: The question of what a corporate is and of what category a debt security falls into must be decided under the rules relating to the standardised approach to credit risk.</p>		

[Note: CAD Annex I point 14 Table 1]

To the extent that a firm applies the IRB approach, to qualify for a credit quality step for the purpose of the table in ■ BIPRU 7.2.44R the obligor of the exposure must have an internal rating with a PD equivalent to or lower than that associated with the appropriate credit quality step under the standardised approach to credit risk.

7.2.46

FCA PRA

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A *debt security* issued by a non-qualifying issuer must receive a *specific risk position risk adjustment* of 8% or 12% according to the table in ■ BIPRU 7.2.44R. However a *firm* must apply a higher *specific risk position risk adjustment* to such a *debt security* and/or not recognise offsetting for the purposes of defining the extent of *general market risk* between such a *security* and any other *debt securities* to the extent that doing otherwise would not be a prudent treatment of *specific risk* or *general market risk*.

7.2.46A

FCA PRA

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■ BIPRU 7.2.43 R includes both actual and notional *positions*. However, notional *positions* in a *zero-specific-risk security* do not attract *specific risk*. For example:

- (1) interest-rate *swaps*, *foreign-currency swaps*, *FRAs*, interest-rate *futures*, *foreign-currency forwards*, *foreign-currency futures*, and the cash leg of *repurchase agreements* and *reverse repurchase agreements* create notional *positions* which will not attract *specific risk*; while
- (2) *futures*, *forwards* and *swaps* which are based on the price (or yield) of one or more *debt securities* will create at least one notional *position* that attracts *specific risk*.

#### Specific risk: securitisations and resecuritisations

7.2.47

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[deleted]

7.2.47A

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[deleted]

7.2.47B

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[deleted]

7.2.47C

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[deleted]

7.2.48

G

[deleted]

7.2.48A

FCA PRA

R

- (1) Subject to (3), a *firm* must calculate the *specific risk* portion of the *interest rate PRR* for each *securitisation* and *resecuritisation position* by multiplying the market value of the individual net *position* (ignoring the sign) by the *appropriate position risk adjustment* from the table in ■ BIPRU 7.2.48D R or ■ BIPRU 7.2.48E R, or in accordance with ■ BIPRU 7.2.48F R, as applicable.
- (2) In calculating the *specific risk* capital charge of an individual net *securitisation* or *resecuritisation position*, a *firm* may cap the product of the weight and the individual net position at the maximum possible default-risk-related loss. For a short position, that limit may be calculated as a change in value due to the underlying names immediately becoming default-risk-free.

- (3) For a transitional period ending on 31 December 2013, where a *firm* holds *securitisation* and *resecuritisation positions*, other than *positions* included in the *correlation trading portfolio*, it must calculate:
  - (a) the total *specific risk* capital charges that would apply just to the net long *positions*; and
  - (b) the total *specific risk* capital charges that would apply just to the net short *positions*.

The total *specific risk* capital charge for *securitisation* and *resecuritisation positions* will be the higher of (3)(a) and (3)(b).

7.2.48B  
FCA PRA

**R** The *firm* must report to the *appropriate regulator* the total sum of its weighted net long and net short *securitisation* and *resecuritisation positions*, broken down by types of underlying assets.

7.2.48C  
FCA PRA

**R** When calculating the PRR of a *protection seller* in *securitisation* and *resecuritisation* credit derivatives, a *firm* must apply **■** BIPRU 7.11.3 R.

7.2.48D  
FCA PRA

**R** Table: specific risk position risk adjustments - standardised approach

Credit quality step	1	2	3	4 (only for credit assessments other than short-term credit assessments)	All other credit quality steps
---------------------	---	---	---	--	--------------------------------

<i>Securitisations</i>	1.6%	4%	8%	28%	100%
<i>Resecuritisations</i>	3.2%	8%	18%	52%	100%

A *firm* may only apply the *position risk adjustments* in this table where it would have to calculate a *risk weighted exposure amount* in accordance with the *standardised approach to securitisation and resecuritisation positions* if such *positions* were in its *non-trading book* under BIPRU 9. The *appropriate position risk adjustment* is calculated as 8% of the *risk weight* that would apply to the *position* under the *standardised approach* in BIPRU 9.11.2 R, subject to the requirements of BIPRU 9.9 to BIPRU 9.11, where appropriate.

7

7.2.48E

FCA PRA

R

Table: specific risk Position Risk Adjustments - IRB approach

Credit Quality Step		Securitisation positions			Resecuritisation positions	
Credit assessments other than short term	Short-term credit assessments	A	B	C	D	E
1	1	0.56%	0.96%	1.6%	1.6%	2.4%
2		0.64%	1.20%	2%	2%	3.2%
3		0.8%	1.44%	2.8%	2.8%	4%
4	2	0.96%	1.6%		3.2%	5.2%
5		1.60%	2.8%		4.8%	8%
6		2.8%	4%		8%	12%
7	3	4.8%	6%		12%	18%
8		8%			16%	28%
9		20%			24%	40%
10		34%			40%	52%
11		52%			60%	68%
all other unrated		100%				

A firm may only apply the *position risk adjustments* in this table where it would have to calculate a *risk weighted exposure amount* in accordance with the *IRB approach to securitisation and resecuritisation positions* if such positions were in its *non-trading book* under BIPRU 9. The *appropriate position risk adjustment* is calculated as 8% of the *risk weight* that would apply to the *position* under the *IRB approach* in BIPRU 9.12.11 R, subject to the requirements in BIPRU 9.12 where appropriate.

7.2.48F

FCA PRA

R

- (1) A firm may use the *supervisory formula method* to calculate the *appropriate position risk adjustment* for *specific risk* where:
- the firm is permitted to apply the *supervisory formula method* to the same *position* if it was held in its *non-trading book* in accordance with ■ BIPRU 9.12; or
  - otherwise, the firm is expressly permitted by its *VaR model permission* to apply the *supervisory formula method* to calculate the *appropriate position risk adjustment* for *specific risk*.

- (2) The *appropriate position risk adjustment* under the *supervisory formula method* must be calculated by multiplying the *risk weight* calculated according to ■ BIPRU 9.12.21 R by 8%.
- (3) Where relevant, estimates of *PDs* and *LGDs* as inputs to the *supervisory formula method* must be determined in accordance with ■ BIPRU 4.
- (4) Where expressly permitted by its *VaR model permission*, a *firm* may use the approach outlined in ■ BIPRU 7.10.55A R to ■ BIPRU 7.10.55S G (Incremental Risk Charge) to determine *PDs* and *LGDs* as inputs to the *supervisory formula method*.

7.2.48G

FCA PRA

R

Where a *securitisation position* in the *trading book* is subject to an increased *risk weight* in accordance with ■ BIPRU 9.15, the *appropriate position risk adjustment* must be calculated as 8% of the *risk weight* that would apply to the *position* in accordance with ■ BIPRU 9.15.

7.2.48H

FCA PRA

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*Originators*, *investors* and *sponsors* of *securitisations* in the *trading book* will have to meet the requirements of ■ BIPRU 9.3.1A R, ■ BIPRU 9.3.15 R to ■ BIPRU 9.3.20 R and ■ BIPRU 9.15.

7.2.48I

FCA PRA

G

- (1) Subject to ■ BIPRU 7.2.48J G, ■ BIPRU 9.15.9 R and ■ BIPRU 9.15.10 R, where the investor, *originator* or *sponsor* of a *securitisation* fails to meet any of the requirements in ■ BIPRU 9.3.18 R to ■ BIPRU 9.3.20 R (Disclosure requirements) and ■ BIPRU 9.15.11 R to ■ BIPRU 9.15.16 R (investor due diligence requirements) in any material respect by reason of its negligence or omission, the *appropriate regulator* will use its powers under section 55J (Variation etc. on the Authority's own initiative) of the *Act* to impose an additional capital charge in accordance with ■ BIPRU 7.2.48 GR. The additional capital charge imposed will be progressively increased with each relevant, subsequent infringement of the requirements in ■ BIPRU 9.3.18 R to ■ BIPRU 9.3.20 R and ■ BIPRU 9.15.11 R to ■ BIPRU 9.15.16A R, up to a maximum of 1250% *risk weight*.
- (2) Subject to ■ BIPRU 9.3.22 G, ■ BIPRU 9.15.9 R and ■ BIPRU 9.15.10 R, where a *credit institution* fails to meet in any material respect the requirements in ■ BIPRU 9.15.16A R (Group level requirements), the *appropriate regulator* may consider using its powers under section 55J (Variation etc on the Authority's own initiative) of the *Act* in the manner described in (1). In order to calculate the *risk weights* that would apply to the *credit institution*, the *appropriate regulator* may treat the *securitisation* investments of the *subsidiary undertaking* as if they were *securitisation positions* held directly by the *credit institution*.

7.2.48J

FCA PRA

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When calculating the additional capital charge it will impose under ■ BIPRU 7.2.48G R, the *appropriate regulator* will take into account the exemption of certain *securitisations* from the scope of ■ BIPRU 9.15.3 R under ■ BIPRU 9.15.9 R and ■ BIPRU 9.15.10 R and, if those exemptions are relevant, it will reduce the capital charge it would otherwise impose.

7.2.48K

FCA PRA

R

A *securitisation exposure* in the *trading book* that would be subject to deduction in accordance with ■ GENPRU 2.2. (Capital resources) or to a 1250% *risk weight* in accordance with ■ BIPRU 9 (Securitisation) is subject to a capital charge that is no less than that set out under those provisions, capped at the maximum possible default-risk-related loss. Unrated liquidity facilities are subject to a capital charge that is no less than that set out in ■ BIPRU 9.

#### Specific risk: correlation trading portfolio

7.2.48L

FCA PRA

R

- (1) Where a *firm* holds a *position* in the *correlation trading portfolio*, it must calculate:
  - (a) The total *specific risk* capital charges that would apply just to the net long *positions* of the *correlation trading portfolio*; and
  - (b) The total *specific risk* capital charges that would apply just to the net short *positions* of the *correlation trading portfolio*.
- (2) The higher of (1)(a) and (1)(b) will be the *specific risk* capital charge for the *correlation trading portfolio*.
- (3) In calculating the *specific risk* capital charge of an individual net *position* in the *correlation trading portfolio*, a *firm* may cap the product of multiplying the individual net *position* by the *appropriate position risk adjustment* at the maximum possible default-risk-related loss. For a short *position*, a *firm* may calculate the maximum possible default-risk-related loss as a change in value due to the underlying names immediately becoming default-risk-free.

#### Definition of a qualifying debt security

7.2.49

FCA PRA

R

A *debt security* is a *qualifying debt security* if:

- (1) it qualifies for a *credit quality step* under the *standardised approach* to credit risk corresponding at least to investment grade; or
- (2) it has a *PD* which, because of the solvency of the issuer, is not higher than that of the *debt securities* referred to under (1) under the *IRB approach*; or
- (3) it is a *debt security* for which a credit assessment by a *nominated ECAI* is unavailable and which meets the following conditions:
  - (a) it is considered by the *firm* to be sufficiently liquid;

- (b) it is of investment quality, according to the *firm's* own discretion, at least equivalent to that of the *debt securities* referred to under (1); and
  - (c) it is listed on at least one *regulated market* or *designated investment exchange*; or
- (4) it is a *debt security* issued by an *institution* subject to the capital adequacy requirements set out in the *Banking Consolidation Directive* that satisfies the following conditions:
- (a) it is considered by the *firm* to be sufficiently liquid;
  - (b) its investment quality is, according to the *firm's* own discretion, at least equivalent to that of the assets referred to under (1) above; or
- (5) it is a *debt security* issued by an *institution* that is deemed to be of equivalent or higher credit quality than that associated with *credit quality step 2* under the *standardised approach* to credit risk and that is subject to supervision and regulatory arrangements comparable to those under the *Capital Adequacy Directive*.

7.2.50

FCA PRA

R

A *firm* must not treat a *debt security* as a *qualifying debt security* if it would be prudent to consider that the *debt security* concerned is subject to too high a degree of *specific risk* for it to be treated as a *qualifying debt security*.

7.2.51

FCA PRA

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The manner in which a *firm* assesses a *debt security* for the purpose of treatment as a *qualifying debt security* will be subject to scrutiny by the *appropriate regulator*. The *appropriate regulator* may take action to overturn the *firm's* judgement if it considers that the *debt security* should not be treated as a *qualifying debt security*.

#### General market risk calculation: General

7.2.52

FCA PRA

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A *firm* must calculate the *general market risk* portion of the *interest rate PRR* for each currency using either:

- (1) the *interest rate simplified maturity method*;
- (2) the *interest rate maturity method*; or
- (3) the *interest rate duration method*.

7.2.53

FCA PRA

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■ BIPRU 7.2.52R(3) is subject to ■ BIPRU 7.2.54R.

7.2.54

FCA PRA

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A *firm* must not use the *interest rate duration method* for index-linked *securities*. Instead, these *securities* must:

- (1) be attributed a coupon of 3%; and

- (2) be treated separately under either the *interest rate simplified maturity method* or the *interest rate maturity method*.

### General market risk calculation: Simplified maturity method

7.2.55

FCA PRA

G

The *interest rate simplified maturity method* weights individual net *positions* to reflect their price sensitivity to changes in interest rates. The weights are related to the coupon and the residual maturity of the instrument (or the next interest rate re-fix date for floating rate items).

7.2.56

FCA PRA

R

Under the *interest rate simplified maturity method*, the portion of the *interest rate PRR* for *general market risk* equals the sum of each individual net *position* (long or short) multiplied by the *appropriate position risk adjustment* in the table in ■ BIPRU 7.2.57R. A *firm* must assign its net *positions* to the appropriate maturity bands in the table in ■ BIPRU 7.2.57R on the basis of residual maturity in the case of fixed-rate instruments and on the basis of the period until the interest rate is next set in the case of instruments on which the interest rate is variable before final maturity.

7.2.57

FCA PRA

R

Table: general market risk Position Risk Adjustments

This table belongs to ■ BIPRU 7.2.56R.

Zone	Maturity band		<i>position risk adjustment</i>
	Coupon of 3% or more	Coupon of less than 3%	
One	0 ; 1 month	0 ; 1 month	0.00%
	> 1 ; 3 months	> 1 ; 3 months	0.20%
	> 3 ; 6 months	> 3 ; 6 months	0.4%
	> 6 ; 12 months	> 6 ; 12 months	0.7%
Two	> 1 ; 2 years	> 1.0 ; 1.9 years	1.25%
	> 2 ; 3 years	> 1.9 ; 2.8 years	1.75%
	> 3 ; 4 years	> 2.8 ; 3.6 years	2.25%
Three	> 4 ; 5 years	> 3.6 ; 4.3 years	2.75%
	> 5 ; 7 years	> 4.3 ; 5.7 years	3.25%
	> 7 ; 10 years	> 5.7 ; 7.3 years	3.75%
	> 10 ; 15 years	> 7.3 ; 9.3 years	4.5%
	> 15 ; 20 years	> 9.3 ; 10.6 years	5.25%
	> 20 years	> 10.6 ; 12.0 years	6.00%
		> 12.0 ; 20.0 years	8.00%

Zone	Maturity band		<i>position risk adjustment</i>
	Coupon of 3% or more	Coupon of less than 3%	
	> 20 years		12.50%

### General market risk calculation: The maturity method

7.2.58

FCA PRA

G

The *interest rate maturity method* builds on the *interest rate simplified maturity method* by partially recognising offsetting *positions*. ■ BIPRU 7.2.61G provides an illustration of the *interest rate maturity method*.

7.2.59

FCA PRA

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Under the *interest rate maturity method*, the portion of the *interest rate PRR* for *general market risk* is calculated as follows:

- (1) Step 1: each net *position* is allocated to the appropriate maturity band in the table in ■ BIPRU 7.2.57R and multiplied by the corresponding *position risk adjustment*;
- (2) Step 2: weighted long and short *positions* are matched within:
  - (a) the same maturity band;
  - (b) the same zone (using unmatched *positions* from (a)); and
  - (c) different zones (using unmatched *positions* from (b) and matching between zones 1 and 2 and 2 and 3 before zone 1 and 3); and
- (3) Step 3: the portion of the *interest rate PRR* for *general market risk* is the sum of:
  - (a) 10% of the total amount matched within maturity bands;
  - (b) 40% of the amount matched within zone 1 under (2)(b);
  - (c) 30% of the amount matched within zones 2 & 3 under (2)(b);
  - (d) 40% of the amounts matched between zones 1 and 2, and between zones 2 and 3;
  - (e) 150% of the amount matched between zones 1 and 3; and
  - (f) 100% of the weighted *positions* remaining unmatched after (2)(c).

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29

7.2.60

FCA PRA

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The table in ■ BIPRU 7.2.57R distinguishes between debt *securities* with a coupon of less than 3% and those with coupon in excess of 3%. However, this does not mean that the *firm* has to do a separate *general market risk* calculation for each; it merely ensures that when allocating debt *securities* to a particular band, their coupons are taken into account as well as their maturities. So for example, a 21 year 6% debt *security* falls into the same band as an 11 year 2% debt *security*. They are both weighted at 6%, and can be matched

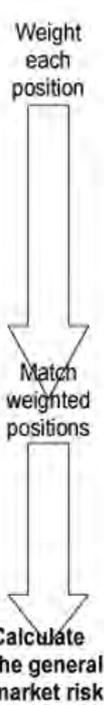
under ■ BIPRU 7.2.59R(2)(a) (the first part of step two of the *interest rate maturity method* calculation) because they fall within the same band.

7.2.61

FCA PRA

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This paragraph sets out an example of a calculation under the *interest rate maturity method*. In this example, a firm with a £ sterling base currency is processing its euro denominated positions.



Zone	Totals of		PRA	Weighted longs within each band	Weighted shorts within each band
	net longs within the band	net shorts within the band			
1	€100	€50	0.00%	0	0
	€250	€0	0.20%	0.50	0
	€200	€0	0.40%	0.80	0
	€0	€0	0.70%	0	0
2	€140	€0	3.25%	1.75	0
	€200	€100	7.75%	3.50	5.25
	€0	€400	2.25%	0	9
3	€0	€0	2.75%	0	0
	€200	€200	3.25%	6.50	6.50
	€300	€0	3.75%	11.25	0
	€200	€200	4.50%	9	13.90
	€0	€14.50	5.25%	0	0.75
	€300	€0	6.00%	18.00	0
	€0	€0	8.00%	0	0
	€0	€0	12.50%	0	0

same band		same zones		different zones	
Long	Short	Long	Short	Long	Short
0.50		0.50		1.30	
0.80		0.80			
1.75		1.75			
3.50	5.25		1.75		5.00
			9		
6.50	6.50				
11.25		11.25			
9	13.90		4.50		
13.00	0.75	18.00	0.75		
19 matched		7 matched		9 matched	

Matched within bands	19	@	10%	=	1.9
Matched within zone 1	0	@	40%	=	0
Matched within zones 2&3	7	@	30%	=	2.1
Matched between zones 1&2 and 2&3	9	@	40%	=	3.6
Matched between zones 1&3	0	@	150%	=	0
Unmatched after 2(c)	16.80	@	100%	=	16.80
					<b>total = € 23.90</b>
					<i>general market risk PRR (if €1=£0.60) = £14.34</i>

**General market risk calculation: Duration method**

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The *interest rate duration method* produces a more accurate measure of interest rate risk than the maturity methods but it is also more complex to calculate.

7.2.62

FCA PRA

7.2.63

FCA PRA

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- (1) A firm must use the following formula to calculate modified duration for the purpose of the *interest rate duration method*:

$$\text{Modified duration} = \frac{D}{(1 + r)}$$

(2)

For the purposes of the formula in (1):

$$D = \frac{\sum_{t=1}^m \frac{tC_t}{(1+r)^t}}{\sum_{t=1}^m \frac{C_t}{(1+r)^t}}$$

(3) For the purpose of the formulae in (1) and (2):

- (a)  $C_t$ =cash payment at time  $t$
- (b)  $m$ =total maturity
- (c)  $r$ =yield to maturity. In the case of a fixed-rate debt *security* a *firm* must take the current mark to market of the debt *security* and thence calculate its yield to maturity, which is the implied discount rate for that instrument. In the case of a floating rate instrument, a *firm* must take the current mark to market of the debt *security* and thence calculate its yield on the assumption that the principal is due on the date that the interest rate can next be changed.
- (d)  $t$ =time

7.2.64

FCA PRA

R

Under the *interest rate duration method*, the portion of the *interest rate PRR* for *general market risk* is calculated as follows:

- (1) Step 1: allocate each net *position* to the appropriate duration zone in the table in ■ BIPRU 7.2.65R and multiply it by:
  - (a) its modified duration (using the formula in ■ BIPRU 7.2.63R); and
  - (b) the appropriate assumed interest rate change in the table in ■ BIPRU 7.2.65R;
- (2) Step 2: match weighted long and short *positions*:
  - (a) within zones; and
  - (b) across zones (using unmatched *positions* from (2)(a) and following the process in ■ BIPRU 7.2.59R (2)(c)); and
- (3) Step 3: calculate the portion of the *interest rate PRR* for *general market risk* as the sum of:
  - (a) 100% of the weighted *positions* remaining unmatched after (2)(b);
  - (b) 2% of the matched weighted *position* in each zone;
  - (c) 40% of the matched weighted *position* between zones 1 and 2, and between zones 2 and 3; and

(d) 150% of the matched weighted *position* between zones 1 and 3.

7.2.65

FCA PRA

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Table: Assumed interest rate change in the interest rate duration method

This table belongs to ■ BIPRU 7.2.64R

Zone	Modified Duration	Assumed interest rate change (percentage points)
1	0 ; 12 months	1.00
2	> 12 months ; 3.6 years	0.85
3	> 3.6 years	0.70

7.2.66

FCA PRA

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If a *firm* uses the *interest rate duration method* it must do so on a consistent basis.

## 7.3 Equity PRR and basic interest rate PRR for equity derivatives

### General rule

7.3.1

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FCA PRA

- (1) A *firm* must calculate its *equity PRR* by:
- (a) identifying which *positions* must be included within the *PRR* calculation (see ■ BIPRU 7.3.2R);
  - (b) deriving the net *position* in each *equity* in accordance with ■ BIPRU 7.3.23R;
  - (c) including each of those net *positions* in either the *simplified equity method* (see ■ BIPRU 7.3.29R) or, subject to ■ BIPRU 7.3.27R, the *standard equity method* (see ■ BIPRU 7.3.32R); and
  - (d) summing the *PRR* on each net *position* as calculated under the *simplified equity method* and *standard equity method*.
- (2) All net *positions*, irrespective of their signs, must be converted on a daily basis into the *firm's base currency* at the prevailing spot exchange rate before their aggregation.

### Scope of the equity PRR calculation

7.3.2

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FCA PRA

A *firm's equity PRR* calculation must:

- (1) include all *trading book positions* in *equities*, unless:
  - (a) the *position* is fully deducted as a *material holding* under the calculations under the *capital resources table*, in which case the *firm* may exclude it; or
  - (b) the *position* is hedging an *option* or *warrant* which is being treated under ■ BIPRU 7.6.26R (Table: Appropriate treatment for equities, debt securities or currencies hedging options);
- (2) include notional *positions* arising from *trading book positions* in the instruments listed in the table in ■ BIPRU 7.3.3R; and

- (3) (if the *firm* is the transferor of *equities* or guaranteed rights relating to title to *equities* in a *repurchase agreement* or the lender of *equities* in an *equities* lending agreement) include such *equities* if those *equities* meet the criteria for inclusion in the *trading book*.

7.3.3

FCA PRA

R

Table: Instruments which result in notional positions

This table belongs to ■ BIPRU 7.3.2R(2)

Instrument	See
Depository receipts	BIPRU 7.3.12R
<i>Convertibles</i> where:	
(a) the <i>convertible</i> is trading at a market price of less than 110% of the underlying <i>equity</i> ; and the first date at which conversion can take place is less than three months ahead, or the next such date (where the first has passed) is less than a year ahead; or	BIPRU 7.3.13R
(b) the conditions in (a) are not met but the <i>firm</i> includes the <i>convertible</i> in its <i>equity PRR</i> calculation rather than including it in its <i>interest rate PRR</i> calculation set out in BIPRU 7.2 (Interest rate PRR).	
<i>Futures, forwards, CFDs and synthetic futures on a single equity</i>	BIPRU 7.3.14R
<i>Futures, forwards, CFDs and synthetic futures on a basket of equities or equity index</i>	BIPRU 7.3.15R
<i>equity legs of an equity swap</i>	BIPRU 7.3.19R
<i>Options or warrants on a single equity, an equity future, a basket of equities or an equity index (unless the firm calculates a PRR on the option or warrant under BIPRU 7.6).</i>	BIPRU 7.3.21R

7.3.4

FCA PRA

G

■ BIPRU 7.3.2R(1) includes a *trading book position* in an *equity* that is subsequently repo'd under a *repurchase agreement* or lent under a stock lending agreement. Clearly, if the *equity* had initially been obtained via a *reverse repurchase agreement* or stock

borrowing agreement, the *equity* would not have been included in the *trading book* in the first place.

## 7.3.5

FCA PRA

G

■ BIPRU 7.3.2R(1) includes *net underwriting positions* or *reduced net underwriting positions* in *equities*. ■ BIPRU 7.3.27R requires a *firm* to use the *simplified equity method* in the case of *reduced net underwriting positions*. In the case of *net underwriting positions* that have not been reduced according to ■ BIPRU 7.8.27R (Calculating the reduced net underwriting position), there is no such restriction; a *firm* can choose which of the two *equity* methods to use.

## 7.3.6

FCA PRA

G

*Firms* are reminded that the table in ■ BIPRU 7.6.5R (Table: Appropriate PRR calculation for an option or warrant) divides *equity options* and *warrants* into:

- (1) those which must be treated under ■ BIPRU 7.6 (Option PRR); and
- (2) those which must be treated under either ■ BIPRU 7.3 or ■ BIPRU 7.6, the *firm* being able to choose whether ■ BIPRU 7.3 or ■ BIPRU 7.6 is used.

## 7.3.7

FCA PRA

G

The table in ■ BIPRU 7.3.3R does not require every *convertible* to be included in ■ BIPRU 7.3's PRR calculation. Where a *convertible* is not included in this PRR calculation, ■ BIPRU 7.2.3R (1) (Scope of the interest rate PRR calculation) requires that it be included in the ■ BIPRU 7.2 PRR calculation.

## 7.3.8

FCA PRA

G

Some of the instruments listed in the table in ■ BIPRU 7.3.3R are also included in a *firm's interest rate PRR* calculation. For simplicity, a *firm* may use the *interest rate PRR* calculation in ■ BIPRU 7.3 rather than the calculation in ■ BIPRU 7.2 (Interest rate PRR). ■ BIPRU 7.3.44G explains this in more detail.

### Derivation of notional positions: General approach

## 7.3.9

FCA PRA

G

■ BIPRU 7.3.10R - ■ BIPRU 7.3.21R convert the instruments listed in the table in ■ BIPRU 7.3.3R into notional *positions* in individual *equities*, *equity* baskets or *equity* indices.

## 7.3.10

FCA PRA

R

Unless specified otherwise, the value of each notional *equity position* equals the quantity of that *equity* underlying the instrument multiplied by the current market value of the *equity*.

## 7.3.11

FCA PRA

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- (1) An example of ■ BIPRU 7.3.10R is as follows. The current market value of a particular *equity* is £2.50. If a *firm* contracts to sell this *equity* in five year's time for £3 it would treat the notional short *equity position* as having a value of £2.50 when calculating the *equity* PRR.
- (2) In effect, the forward *position* has been treated as being equivalent to a spot *position* for the purposes of calculating *equity* PRR. To capture the risk that the forward price changes relative to the spot price, forward *equity positions* are included in the *firm's interest rate PRR* calculation (see ■ BIPRU 7.3.45R or the table in ■ BIPRU 7.2.4R (Table: Instruments which result in notional positions)).

7.3.12

FCA PRA

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**Derivation of notional positions: Depository receipts**

A depository receipt must be treated as a notional *position* in the underlying *equity*.

7.3.13

FCA PRA

R

**Derivation of notional positions: Convertibles**

Where a *convertible* is included in ■ BIPRU 7.3's PRR calculation (see the table in ■ BIPRU 7.3.3R):

- (1) it must be treated as a *position* in the *equity* into which it converts; and
- (2) the *firm's equity PRR* must 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 PRR on the notional *position* underlying the *convertible*).

**Derivation of notional positions: Futures, forwards and CFDs on a single equity**

7.3.14

FCA PRA

R

A *future* (including a *synthetic future*), *forward* or *CFD* on a single *equity* must be treated as a notional *position* in that *equity*.

**Derivation of notional positions: Futures, forwards and CFDs on equity indices or baskets**

7.3.15

FCA PRA

R

A *future* (including a *synthetic future*), *forward* or *CFD* on an *equity* index or basket must be treated as either:

- (1) a *position* in each of the underlying *equities*; or
- (2) the *positions* shown in the table in ■ BIPRU 7.3.16R.

7.3.16

FCA PRA

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Table: Instruments which result in notional positions

This table belongs to ■ BIPRU 7.3.15R(2)

	Under the <i>simplified equity method</i> (BIPRU 7.3.29R)	Under the <i>standard equity method</i> (BIPRU 7.3.32R)
Only one country in the index or	One <i>position</i> in the index or basket	One <i>position</i> in the index or basket

	Under the <i>simplified equity method</i> (BIPRU 7.3.29R)	Under the <i>standard equity method</i> ( BIPRU 7.3.32R)
<b>basket (see BIPRU 7.3.32R)</b>		
<b>More than one country in the index or basket</b>	<b>One <i>position</i> in the index or basket</b>	<b>Several notional- or al basket <i>positions</i>, one for each country</b>
		<b>One notional basket <i>position</i> in a separate, notional country</b>

7.3.17

FCA PRA

G

An example of ■ BIPRU 7.3.16R is as follows. A *firm* decides to treat a FTSE Eurotop 300 *future* under the *standard equity method*, and furthermore, chooses to treat it as one notional *position*. The table in ■ BIPRU 7.3.16R requires that this notional *position* be treated as if it were from a separate notional country rather than any of the countries to which the underlying *equities* are from.

7.3.18

FCA PRA

R

The notional *positions* created under ■ BIPRU 7.3.15R have the following values:

- (1) where only one notional *position* is created, it has a value equal to the total market value of the *equities* underlying the contract; or
- (2) where more than one notional *position* is created, each one has a value which reflects the relevant *equity's* or country's contribution to the total market value of the *equities* underlying the contract.

**Derivation of notional positions: Equity legs of equity swaps**

7.3.19

FCA PRA

R

The *equity* leg of an *equity swap* must be treated as a *position* in the underlying *equity, equity basket* or *equity index*, which is:

- (1) long, if the *firm* has contracted to receive any increase and pay any decrease in the value of the underlying *equities* or *equity index*; and
- (2) short, if the *firm* has contracted to receive any decrease and pay any increase in the value of the underlying *equities* or *equity index*.

7.3.20

FCA PRA

G

The interest rate leg of an *equity swap* is included in a *firm's interest rate PRR* calculation (see the table in ■ BIPRU 7.2.4R (Table: Instruments which result in notional positions)) unless it is treated under ■ BIPRU 7.3.45R.

7.3.21

FCA PRA

R

**Derivation of notional positions: Options**

If included in ■ BIPRU 7.3's PRR calculation (see the table in ■ BIPRU 7.3.3R), *options* must be treated as follows:

- (1) an *option* on a single *equity* must be treated as a notional *position* in that *equity*;
- (2) an *option* on a basket of *equities* or *equity* index must be treated as a *future* on that basket or index; and
- (3) an *option* on an *equity future* must be treated as:
  - (a) a long *position* in that *future*, for purchased call *options* and written put *options*; and
  - (b) a short *position* in that *future*, for purchased put *options* and written call *options*.

7.3.22

FCA PRA

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**Deriving the net position in each equity**

The net *position* in each *equity* is the difference between the value of the *firm's* long *positions* (including notional *positions*) and the value of its short *positions* (including notional *positions*) in the same *equity*.

7.3.23

FCA PRA

R

- (1) When deriving the net *position* in each *equity*, a *firm* must not net long and short *positions* except in accordance with this *rule*.
- (2) Subject to (3), a *firm* may net long and short *positions* in the same *equity*. Two *equities* are the same if and only if they:
  - (a) enjoy the same rights in all respects; and
  - (b) are fungible with each other.
- (3) Long and short *positions* in different tranches of the same *equity* may be treated as being in the same *equity* for the purpose of (1), where:
  - (a) the tranches enjoy the same rights in all respects; and
  - (b) the tranches become fungible with each other within 180 days, and thereafter the *equity* of one tranche can be delivered in settlement of the other tranche.

7.3.24

FCA PRA

R

A *firm* must not net a *reduced net underwriting position* with any other *equity position*.

7.3.25

FCA PRA

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■ BIPRU 7.3.24R only relates to *reduced net underwriting position*.

**Simplified and standard equity methods**

7.3.26

FCA PRA

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■ BIPRU 7.3.1R (1) requires that the net *position* in each *equity* be included in either the *simplified equity method* or the *standard equity method*, subject to the restriction in ■ BIPRU 7.3.27R. A *firm* does not have to use the same method for all *equities*.

7.3.27

FCA PRA

R

A *firm* must use the *simplified equity method* for *reduced net underwriting positions*.

7.3.28

FCA PRA

G

A *firm* may use either method for a *net underwriting position*; ■ BIPRU 7.3.27R only relates to *reduced net underwriting positions*.

**Simplified equity method**

7.3.29

FCA PRA

R

Under the *simplified equity method*, the PRR for each *equity*, *equity index*, or *equity basket* equals the market value of the net *position* (ignoring the sign) multiplied by the *appropriate position risk adjustment* from the table in ■ BIPRU 7.3.30R. The result must be converted into the *firm's base currency* at current spot *foreign currency* rates.

7.3.30

FCA PRA

R

Table: simplified equity method *position risk adjustments*

This table belongs to ■ BIPRU 7.3.29R

Instrument	Position risk adjustment
Single equities	16%
Qualifying equity indices (see BIPRU 7.3.38R)	8%
All other equity indices or baskets	16%

If it is necessary to distinguish between the *specific risk position risk adjustment* and the *general market risk position risk adjustment*, the *specific risk position risk adjustment* for the first and third rows is 8% and that for the second row is 0%. The rest of the *position risk adjustment* in the second column is the *general market risk position risk adjustment*

**Standard equity method**

7.3.31

FCA PRA

G

The *standard equity method* divides the risk of loss from a *firm's equity positions* into the risk of loss from a general move in a country's *equity* market and the risk of loss from an individual *equity's* price changing relative to that country's *equity* market. These are called *general market risk* and *specific risk* respectively.

7.3.32

FCA PRA

R

Under the *standard equity method*, a *firm* must:

- (1) group *equity positions* into country portfolios as follows:
  - (a) a *position* in an individual *equity* belongs to:
    - (i) the country it is listed in;

- (ii) any of the countries it is listed in, if more than one; or
- (iii) the country it was issued from, if unlisted;

(b) a *position* in an *equity* basket or index that is treated under ■ BIPRU 7.3.15R(2), is allocated to one or more country portfolios based on the countries to which the underlying *equities* belong to under (a) or a notional country provided for in the table in ■ BIPRU 7.3.16R; and

(2) sum:

- (a) the *PRRs* for *specific risk* calculated under ■ BIPRU 7.3.33R; and
- (b) the *PRRs* for *general market risk* for each country portfolio as calculated under ■ BIPRU 7.3.41R and ■ BIPRU 7.3.42R.

**Standard equity method: Specific risk**

7.3.33

FCA PRA

R

Under the *standard equity method*, a *firm* must calculate a *PRR* for *specific risk* based on the net *position* in each *equity*, *equity* index or *equity* basket by multiplying its market value (ignoring the sign) by the *appropriate position risk adjustment* from the table in ■ BIPRU 7.3.34R.

7.3.34

FCA PRA

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Table: *position risk adjustment* for specific risk under the standard equity method

This table belongs to ■ BIPRU 7.3.33R

Instrument	<i>Position risk adjustment</i>
<i>Qualifying equity indices</i> (see BIPRU 7.3.38R)	0%
All <i>equities</i> , and other <i>equity</i> indices or <i>equity</i> baskets	8%

**Definition of a qualifying equity**

7.3.35

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[deleted]

7.3.36

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[deleted]

7.3.37

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[deleted]

**Definition of a qualifying equity index**

7.3.38

FCA PRA

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A *qualifying equity index* is one which is traded on a *recognised investment exchange* or a *designated investment exchange* and:

- (1) is listed in the table in ■ BIPRU 7.3.39R; or

- (2) is not listed in the table in ■ BIPRU 7.3.39R, but is constructed in such a way that:
- (a) it contains at least 20 *equities*;
  - (b) no single *equity* represents more than 20% of the total index; and
  - (c) no five *equities* combined represent more than 60% of the total index.

7.3.39

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Table: Qualifying equity indices

FCA PRA

This table belongs to ■ BIPRU 7.3.38R

Country or territory	Name of index
Australia	All Ordinaries
Austria	Austrian Traded Index
Belgium	BEL 20
Canada	TSE 35, TSE 100, TSE 300
France	CAC 40, SBF 250
Germany	DAX
European	Dow Jones Stoxx 50 Index, FTSE Eurotop 300, MSCI Euro Index
Hong Kong	Hang Seng 33
Italy	MIB 30
Japan	Nikkei 225, Nikkei 300, TOPIX
Korea	Kospi
Netherlands	AEX
Singapore	Straits Times Index
Spain	IBEX 35
Sweden	OMX
Switzerland	SMI
UK	FTSE 100, FTSE Mid 250, FTSE All Share
US	S&P 500, Dow Jones Industrial Average, NASDAQ Composite, Russell 2000

**Standard equity method: General market risk: General**.....

7.3.40

R

Under the *standard equity method*, a *firm* must apply approach one, as set out in ■ BIPRU 7.3.41R, to each country portfolio (or part portfolio) unless the conditions in ■ BIPRU 7.3.42R(3) are met, in which case the *firm*

FCA PRA

may instead apply approach two, as set out in ■ BIPRU 7.3.42R, to the relevant country portfolios (or part portfolios).

**Standard equity method: General market risk: Approach One: No offset between different country portfolios**

7.3.41  
FCA PRA

R

Under approach one as referred to in ■ BIPRU 7.3.40R, the *PRR* for *general market risk* equals the net value (ignoring the sign) of the country portfolio multiplied by 8%.

**Standard equity method: General market risk: Approach Two: Limited offset between different country portfolios**

7.3.42  
FCA PRA

R

(1) Under approach two as referred to in ■ BIPRU 7.3.40R, the *PRR* for *general market risk* is calculated using the following formula:

$$\sqrt{(8\% * CP_1)^2 + (8\% * CP_2)^2 + (8\% * CP_3)^2 + \dots + (8\% * CP_n)^2}$$

- (2) In the formula in (1)  $CP_i$  denotes the net value of  $i$ th country portfolio (converted to the *firm's base currency* using current spot *foreign currency* rates).
- (3) The conditions referred to in ■ BIPRU 7.3.40R that must be met for a *firm* to be able to use approach two as referred to in ■ BIPRU 7.3.40R are as follows:
  - (a) at least four country portfolios are included (that is:  $n \geq 4$ );
  - (b) only country portfolios for countries which are full members of the *OECD*, Hong Kong or Singapore are included;
  - (c) no individual country portfolio comprises more than 30% of the total gross value of country portfolios included; and
  - (d) the total net value of country portfolios included equals zero, that is:

$$\sum_i CP_i = 0$$

7.3.43  
FCA PRA

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In order to meet ■ BIPRU 7.3.42R(3)(d), it is likely that part of a country portfolio will have to be excluded from approach two under ■ BIPRU 7.3.42R (and therefore included in approach one under ■ BIPRU 7.3.41R), even if that country portfolio meets ■ BIPRU 7.3.42R(3)(a) - ■ (c).

**Basic interest rate calculation for equity instruments**

7.3.44  
FCA PRA

G

A *basic interest rate PRR* calculation is included in ■ BIPRU 7.3 for a *firm* that does not wish to use the calculation in ■ BIPRU 7.2 (Interest rate PRR). However, it tends to result in higher charges than the methods in ■ BIPRU 7.2, largely because the *interest rate PRR* is calculated on each notional *equity position* separately and then summed without offsetting long and short *positions*.

7.3.45

FCA PRA

R

This rule applies to a *firm* that does not include a *forward*, *future*, *option* or *swap* on an *equity*, basket of *equities* or *equity* index in the calculation of its *interest rate PRR* calculation under ■ BIPRU 7.2 (Interest rate PRR). However it does not apply to cliquet as defined in ■ BIPRU 7.6.18R (Table: Option PRR: methods for different types of option). A *firm* must calculate the *interest rate PRR* for a *position* being treated under this rule as follows:

- (1) multiply the market value of the notional *equity position* underlying the instrument by the appropriate percentage from the table in ■ BIPRU 7.3.47R; and
- (2) sum the results from (1), ignoring the sign.

7.3.46

FCA PRA

G

Cliquets on *equities*, baskets of *equities* or *equity* indices do not attract an *interest rate PRR*. ■ BIPRU 7.3.45R excludes them from the basic *interest rate PRR* calculation and the table in ■ BIPRU 7.2.4R (Table: Instruments which result in notional positions) excludes them from the scope of the *interest rate PRR* calculation in ■ BIPRU 7.2 (Interest rate PRR).

7.3.47

FCA PRA

R

Table: Percentages used in the basic interest rate PRR calculation for equity instruments

This table belongs to ■ BIPRU 7.3.45R(1)

Time to expiration	Percentage (%)
0 ; 3 months	0.20
> 3 ; 6 months	0.40
> 6 ; 12 months	0.70
> 1 ; 2 years	1.25
> 2 ; 3 years	1.75
> 3 ; 4 years	2.25
> 4 ; 5 years	2.75
> 5 ; 7 years	3.25
> 7 ; 10 years	3.75
> 10 ; 15 years	4.50
> 15 ; 20 years	5.25
> 20 years	6.00

#### Additional capital charge in relation to equity indices

7.3.48

FCA PRA

R

If a *firm* nets off *positions* in one or more of the *equities* constituting an *equity* index *future*, *forward* or *CFD* against one or more *positions* in the *equity* index *future*, *forward* or *CFD* itself, the *firm* must apply an additional *equity PRR* to the netted *position* to cover the risk of loss caused by the value of the *future*, *forward* or *CFD* not moving fully in line with

that of its constituent *equities*. The same applies if a *firm* holds opposite *positions* in a *future, forward* or *CFD* on an *equity* index that are not identical in respect of either their maturity or their composition or both.

## 7.4 Commodity PRR

### General rule

7.4.1

FCA PRA

R

A *firm* must calculate its *commodity PRR* by:

- (1) identifying which *commodity position* must be included within the scope of the *PRR* calculation (see ■ BIPRU 7.4.2R);
- (2) expressing each such *position* in terms of the standard unit of measurement of the *commodity* concerned;
- (3) expressing the spot price in each *commodity* in the *firm's base currency* at current spot foreign exchange rates;
- (4) calculating an individual *PRR* for each *commodity* (see ■ BIPRU 7.4.20R); and
- (5) summing the resulting individual *PRRs*.

### Scope of the commodity PRR calculation

7.4.2

FCA PRA

R

A *firm's commodity PRR* calculation must, regardless of whether the *positions* concerned are *trading book* or *non-trading book positions*:

- (1) include *physical commodity positions*;
- (2) (if the *firm* is the transferor of *commodities* or guaranteed rights relating to title to *commodities* in a *repurchase agreement* or the lender of *commodities* in a *commodities* lending agreement) include such *commodities*;
- (3) include notional *positions* arising from *positions* in the instruments listed in the table in ■ BIPRU 7.4.4R; and
- (4) exclude *positions* constituting a *stock financing* transaction.

7.4.3

FCA PRA

R

Gold *positions* are excluded from the scope of the *commodity PRR*. Instead, they are included within the scope of the foreign exchange *PRR* (■ BIPRU 7.5).

7.4.4

FCA PRA

**R** Table: Instruments which result in notional positions

This table belongs to ■ BIPRU 7.4.2R(3)

Instrument	See
<i>Forwards, futures, CFDs, synthetic futures and options on a single commodity (unless the firm calculates a PRR on the option under BIPRU 7.6 (Option PRR))</i>	BIPRU 7.4.8R
<b>A commitment to buy or sell a single commodity at an average of spot prices prevailing over some future period</b>	BIPRU 7.4.10R
<i>Forwards, futures, CFDs, synthetic futures and options on a commodity index (unless the firm calculates a PRR on the option under BIPRU 7.6)</i>	BIPRU 7.4.13R - BIPRU 7.4.14R
<i>Commodity swaps</i>	BIPRU 7.4.16R - BIPRU 7.4.17R
<b>A warrant relating to a commodity must be treated as an option on a commodity.</b>	

7.4.5

FCA PRA

**G**

■ BIPRU 7.4.2R includes a *trading book position* in a *commodity* that is subsequently repo'd under a *repurchase agreement* or lent under a stock lending agreement. Clearly, if the *commodity* had initially been obtained via a *reverse repurchase agreement* or stock borrowing agreement, the *commodity* would not have been included in the *trading book* in the first place.

7.4.6

FCA PRA

**G**

*Firms* are reminded that the table in ■ BIPRU 7.6.5R (Table: Appropriate PRR calculation for an option or warrant) divides *commodity options* into:

- (1) those which must be treated under ■ BIPRU 7.6; and
- (2) those which must be treated under either ■ BIPRU 7.4 or ■ BIPRU 7.6 (Option PRR), the *firm* being able to choose whether ■ BIPRU 7.4 or ■ BIPRU 7.6 is used.

**Derivation of notional positions: General**

7.4.7

FCA PRA

**G**

■ BIPRU 7.4.8R - ■ BIPRU 7.4.19G convert the instruments listed in the table in ■ BIPRU 7.4.4R into notional *positions* in the relevant *commodities*. These notional *positions* are expressed in terms of quantity (tonnes, barrels, etc), not value. The maturity of the *position* is only relevant where the *firm* is using the *commodity maturity ladder approach* or the *commodity extended maturity ladder approach*.

7.4.8

FCA PRA

R

### Derivation of notional positions: Futures, forwards, CFDs and options on a single commodity

Where a *forward, future, CFD, synthetic future* or *option* (unless already included in the *firm's option PRR* calculation) settles according to:

- (1) the difference between the price set on trade date and that prevailing at contract expiry, the notional *position*:
  - (a) equals the total quantity underlying the contract; and
  - (b) has 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, there is a notional *position* 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.

7.4.9

FCA PRA

G

- (1) The following example illustrates ■ BIPRU 7.4.8R (2).
- (2) A *firm* buys a Traded Average Price Option (TAPO - a type of Asian option) allowing it to deliver 100 tonnes of Grade A copper and receive \$1,750 in June. If there were 20 *business days* in June the short notional *positions* will each:
  - (a) equal 5 tonnes per day (1/20 of 100 tonnes); and
  - (b) have a maturity equal to one of the *business days* in June (one for each day).
- (3) In this example as each *business day* in June goes by the quantity per day for the remaining days does not change (5 tonnes per day) only the days remaining changes. Therefore, halfway through June there are ten, 5 tonne short notional *positions* remaining each for the ten remaining *business days* in June.

### Derivation of notional positions: Buying or selling a single commodity at an average of spot prices prevailing in the future

7.4.10

FCA PRA

R

Commitments to buy or sell at the average spot price of the *commodity* prevailing over some period between trade date and maturity must 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 is:
  - (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:
  - (a) is long if the *position* under (1) is short, or short if the *position* under (1) is long;
  - (b) equals a fractional share of the total quantity underlying the contract; and
  - (c) has a maturity date of the relevant reference date.

7.4.11  
FCA PRA

G

The following guidance provides an example of ■ BIPRU 7.4.10R. In January, a *firm* agrees to buy 100 tonnes of copper for the average spot price prevailing during the 20 *business days* in February, and will settle on 30 June. After entering into this agreement, the *firm* faces the risk that the average price for February increases relative to that for 30 June. Therefore, as highlighted in the table below:

- (1) the short *positions* reflect the fact that this could occur because any one of the remaining forward prices for February increase; and
- (2) the long *position* reflects the fact that this loss could occur because the forward price for 30 June falls.

7.4.12  
FCA PRA

G

Table: Example of buying at the average spot price prevailing in the future

This table belongs to ■ BIPRU 7.4.11G

	Application of BIPRU 7.4.10R(1)	Application of BIPRU 7.4.10R(2)
From trade date to start of averaging period	Long <i>position</i> in 100 tonnes of copper with a maturity of 30 June.	A series of 20 notional short <i>positions</i> each equal to 5 tonnes of copper. Each <i>position</i> is allocated a maturity equal to one of the <i>business days</i> in February (one for each day).
During averaging period	Long <i>position</i> in 100 tonnes of copper with a maturity of 30 June.	As each <i>business day</i> goes by in February the price for 5 tonnes of copper is fixed and so there will be one less notional short <i>position</i> .
After averaging period	Long <i>position</i> in 100 tonnes of copper with a maturity of 30 June.	No short <i>positions</i> .

7.4.13  
FCA PRA

R

**Derivation of notional positions: CFDs and options on a commodity index**  
*Commodity index futures* and *commodity index options* (unless the *option* is included in the *firm's option PRR* calculation), must be treated as follows:

- (1) Step 1: the total quantity underlying the contract must be either:

- (a) treated as a single notional *commodity position* (separate from all other *commodities*); or
  - (b) divided into notional *positions*, one for each of the constituent *commodities* in the index, of an amount which is a proportionate part of the total underlying the contract according to the weighting of the relevant *commodity* in the index;
- (2) Step 2: each notional *position* determined in Step 1 must then be included:
- (a) when using the *commodity simplified approach* (■ BIPRU 7.4.24R), without adjustment; or
  - (b) when using the *commodity maturity ladder approach* (■ BIPRU 7.4.25R) or the *commodity extended maturity ladder approach* (■ BIPRU 7.4.32R), with the adjustments in ■ BIPRU 7.4.14R.

7.4.14

FCA PRA

R

Table: Treatment of commodity index futures and commodity index options

This table belongs to ■ BIPRU 7.4.13R(2)(b)

Construction of index	Notional <i>position</i> (or <i>positions</i> ) and maturity
Spot level of index is based on the spot price of each constituent <i>commodity</i>	Each quantity determined in Step 1 as referred to in BIPRU 7.4.13R is assigned a maturity equal to the expiry date of the contract.
Spot level of index is based on an average of the forward prices of each constituent <i>commodity</i>	Each quantity determined in Step 1 as referred to in BIPRU 7.4.13R is divided (on a pro-rata basis) into a series of forward <i>positions</i> to reflect the impact of each forward price on the level of the index. The maturity of each forward <i>position</i> equals the maturity of the relevant forward price determining the level of the index when the contract expires.

7.4.15

FCA PRA

G

- (1) An example of using ■ BIPRU 7.4.13R and the table in ■ BIPRU 7.4.14R is as follows.
- (2) A *firm* is long a three-month *commodity index future* where the spot level of the index is based on the one, two and three month forward prices of aluminium, copper, tin, lead, zinc and nickel (18 prices in total).
- (3) Step 1: the *firm* should decide whether to treat the full quantity underlying the contract as a single notional *commodity position* or disaggregate it into notional *positions* in aluminium, copper, tin, lead, zinc and nickel. In this case the *firm*

decides to disaggregate the contract into notional *positions* in aluminium, copper, tin, lead, zinc and nickel.

- (4) Step 2: if the *firm* uses the *commodity simplified approach*, nothing more need be done to arrive at the notional *position*. In this case the *firm* uses the *commodity maturity ladder approach* and so subdivides each *position* in each metal into three because the level of the index is based on the prevailing one, two and three month forward prices. Since the *future* will be settled in three months' time at the prevailing level of the index, the three *positions* for each metal will have maturities of four, five and six months respectively.

**Derivation of notional positions: Commodity swaps**

7.4.16  
FCA PRA

R

A *firm* must treat a *commodity swap* as a series of notional *positions*, one *position* for each payment under the *swap*, each of which:

- (1) equals the total quantity underlying the contract;
- (2) has a maturity corresponding to the payment date; and
- (3) is long or short according to ■ BIPRU 7.4.17R.

7.4.17  
FCA PRA

R

Table: Treatment of commodity swaps

This table belongs to ■ BIPRU 7.4.16R

	Receiving amounts which are unrelated to any <i>commodity's</i> price	Receiving the price of <i>commodity 'b'</i>
Paying amounts which are unrelated to any <i>commodity's</i> price	N/A	Long <i>positions</i> in <i>commodity 'b'</i>
Paying the price of <i>commodity 'a'</i>	Short <i>positions</i> in <i>commodity 'a'</i>	Short <i>positions</i> in <i>commodity 'a'</i> and long <i>positions</i> in <i>commodity 'b'</i>

7.4.18  
FCA PRA

G

The table in ■ BIPRU 7.4.17R shows that where the legs of the *swap* are in different *commodities*, a series of forward *positions* are created for each *commodity* (that is, a series of short *positions* in *commodity 'a'* and a series of long *positions* in *commodity 'b'*).

7.4.19  
FCA PRA

G

The table in ■ BIPRU 7.4.17R also covers the case where one leg is unrelated to any *commodity's* price. This leg may be subject to a *PRR* under another part of ■ BIPRU 7; for example, an interest rate based leg would have to be included in a *firm's interest rate PRR* calculation.

**Calculating the PRR for each commodity: General**

7.4.20

FCA PRA

R

A *firm* must calculate a *commodity PRR* for each *commodity* separately using either the *commodity simplified approach* (■ BIPRU 7.4.24R), the *commodity maturity ladder approach* (■ BIPRU 7.4.25R) or the *commodity extended maturity ladder approach* (■ BIPRU 7.4.32R).

7.4.21

FCA PRA

R

A *firm* must use the same approach for a particular *commodity* but need not use the same approach for all *commodities*.

7.4.22

FCA PRA

R

(1) A *firm* must treat *positions* in different grades or brands of the same *commodity-class* as different *commodities* unless they:

- (a) can be delivered against each other; or
- (b) are close substitutes and have price movements which have exhibited a stable correlation coefficient of at least 0.9 over the last 12 months.

(2) If a *firm* relies on (1)(b) it must then monitor compliance with the conditions in that paragraph on a continuing basis.

7.4.23

FCA PRA

R

If a *firm* intends to rely on the approach in ■ BIPRU 7.4.22R(1)(b):

- (1) it must notify the *appropriate regulator* in writing at least 20 *business days* prior to the date the *firm* starts relying on it; and
- (2) the *firm* must, as part of the notification under (1), provide to the *appropriate regulator* the analysis of price movements on which it relies.

**Calculating the PRR for each commodity: Simplified approach**

7.4.24

FCA PRA

R

A *firm* which calculates a *commodity PRR* using the *commodity simplified approach* must do so by summing:

- (1) 15% of the net *position* multiplied by the spot price for the *commodity*; and
- (2) 3% of the gross *position* (long plus short, ignoring the sign) multiplied by the spot price for the *commodity*;

(and for these purposes the excess of a *firm's* long (short) *positions* over its short (long) *positions* in the same *commodity* (including notional *positions* under ■ BIPRU 7.4.4R) is its net *position* in each *commodity*).

**Calculating the PRR for each commodity: Maturity ladder approach**

7.4.25

FCA PRA

R

A *firm* using the *commodity maturity ladder approach* must calculate the *commodity PRR* following the steps in ■ BIPRU 7.4.26R and then sum all spread charges, carry charges and outright charges that result. A *firm* must use a separate maturity ladder for each *commodity*.

7.4.26

FCA PRA

R

- (1) A *firm* must calculate the charges referred to in ■ BIPRU 7.4.25R as follows.
- (2) Step 1: offset long and short *positions* maturing:
  - (a) on the same day; or
  - (b) (in the case of *positions* arising under contracts traded in markets with daily delivery dates) within 10 *business days* of each other.
- (3) Step 2: allocate the *positions* remaining after step 1 to the appropriate maturity band in the table in ■ BIPRU 7.4.28R (*physical commodity positions* are allocated to band 1).
- (4) Step 3: match long and short *positions* within each band. In each instance, calculate a spread charge equal to the matched amount multiplied first by the spot price for the *commodity* and then by the spread rate of 3%.
- (5) Step 4: carry unmatched *positions* remaining after step 3 to another band where they can be matched, then match them. Do this until all matching possibilities are exhausted. In each instance, calculate:
  - (a) a carry charge equal to the carried *position* multiplied by the spot price for the *commodity*, the carry rate of 0.6% and the number of bands by which the *position* is carried; and
  - (b) a spread charge equal to the matched amount multiplied by the spot price for the *commodity* and the spread rate of 3%.
- (6) Step 5: calculate the outright charge on the remaining *positions* (which will either be all long *positions* or all short *positions*). The outright charge equals the remaining *position* (ignoring the sign) multiplied by the spot price for the *commodity* and the outright rate of 15%.

7.4.27

FCA PRA

G

The matched amount in ■ BIPRU 7.4.26R is the lesser (ignoring the sign) of either the total long *position* or the total short *position*. For example, a band with 1000 long and 700 short results in a matched amount of 700. The unmatched amount would be 300.

7.4.28

FCA PRA

R

Table: Maturity bands for the maturity ladder approach

This table belongs to ■ BIPRU 7.4.26R

Band	Maturity of <i>position</i>
Band 1	0 ; 1 month

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Band	Maturity of <i>position</i>
Band 2	> 1 month ; 3 months
Band 3	> 3 months ; 6 months
Band 4	> 6 months ; 1 year
Band 5	> 1 year ; 2 years
Band 6	> 2 years ; 3 years
Band 7	> 3 years

7.4.29

FCA PRA

G

■ BIPRU 7.4.30G is an example illustrating the calculation of the *commodity PRR* on an individual *commodity* using the *commodity maturity ladder approach* ( ■ BIPRU 7.4.26R). After the *firm* has carried out the pre-processing required by ■ BIPRU 7.4.26R(2) (that is, step 1), it follows steps 2 to 5 as shown below. Because the *firm* is using the *commodity maturity ladder approach* the spread rate is 3%, the carry rate is 0.6% and the outright rate is 15%. The example assumes that the spot price for the *commodity* is £25.

7.4.30

FCA PRA

G

Table: Example illustrating the commodity maturity ladder approach

This table belongs to ■ BIPRU 7.4.29G

Band	Step 2 Allocate remaining positions to appropriate maturity bands	Step 3 Match within bands. Each matched amount incurs a spread charge.	Step 4a Carry across bands. Each carried amount incurs a carry charge.	Step 4b Match within band. Each matched amount incurs a spread charge.	Step 6 Remaining position(s) incur an outright charge.
0 ≤ 1 month					
>1 month ≤ 3 months	1000 long 700 short	700 matched	300 carried		
>3 months ≤ 6 months					
>6 months ≤ 1 year					
>1 year ≤ 2 years	600 short	Nothing matched	100 carried	400 matched	200 short remains
>2 years ≤ 3 years					
> 3 years	100 long	Nothing matched			
Spread charges	700*£25*3% + 400*£25*3%			=	£825
Carry charges	300*£25*0.6%*3 + 100*£25*0.6%*2			=	£165
Outright charge	200*£25*15%			=	£750
					<u>£1740</u>

### Calculating the PRR for each commodity: Extended maturity ladder approach

7.4.31

FCA PRA

R

A *firm* may use the *commodity extended maturity ladder approach* to calculate the *commodity PRR* for a particular *commodity* provided the *firm*:

- (1) has a diversified *commodities* portfolio;
- (2) undertakes significant *commodities* business;
- (3) is not yet in a position to use the *VaR model approach* to calculate *commodity PRR*; and
- (4) at least twenty *business days* before the date the *firm* uses that approach notifies the *appropriate regulator* in writing of:
  - (a) its intention to use the *commodity extended maturity ladder approach*; and
  - (b) the facts and matters relied on to demonstrate that the *firm* meets the criteria in (1) - (3).

7.4.32

FCA PRA

R

A *firm* using the *commodity extended maturity ladder approach* must calculate its *commodity PRR* by:

- (1) following the same steps as in ■ BIPRU 7.4.26R but using the rates from the table in ■ BIPRU 7.4.33R rather than those in ■ BIPRU 7.4.26R; and
- (2) summing all spread charges, carry charges and outright charge that result.

7.4.33

FCA PRA

R

Table: Alternative spread, carry and outright rates

This table belongs to ■ BIPRU 7.4.32R

	Precious metals (excluding gold)	Base metals	Softs (agricultural)	Other (including energy)
Spread rate (%)	2	2.4	3	3
Carry rate (%)	0.3	0.5	0.6	0.6
Outright rate (%)	8	10	12	15

7.4.34

FCA PRA

G

For the purposes of ■ BIPRU 7.4.31R(1) a *firm* has a diversified *commodity* portfolio where it holds *positions* in more than one *commodity* in each of the categories set out in the table in ■ BIPRU 7.4.33R and holds *positions* across different maturities in those individual *commodities*. A *firm* would not have a diversified *commodity* portfolio if it held *positions* in only one *commodity* in each of the categories set out in the table in ■ BIPRU 7.4.33R. This is because the rates in the table in ■ BIPRU 7.4.33R assume *firms* have *positions* in more than one of that category's *commodities*. Different *commodities* within a given category are likely to exhibit different volatilities, so where a *firm* does not have a diversified *commodity* portfolio in that category, the rates applying to that category might underestimate the regulatory capital required for a certain *commodity* at certain times.

7.4.35

FCA PRA

G

What constitutes significant business in ■ BIPRU 7.4.31R(2) will vary from *firm* to *firm*. The more regularly the *firm* undertakes trades in *commodities* and the more consistently it has *positions* in the relevant *commodity*, the more likely it is to be undertaking significant business for the purposes of ■ BIPRU 7.4.31R(2).

7.4.36

FCA PRA

R

Where a *firm* is:

- (1) treating a *commodity* index *derivative* as if it was based on a single separate *commodity* (see ■ BIPRU 7.4.13R(1)(a)); and
- (2) using the *commodity* extended maturity ladder approach to calculate the *commodity* PRR for that *commodity*;

it must determine which index constituent incurs the highest rate in the table in ■ BIPRU 7.4.33R and apply that rate to the notional *position* for the purposes of ■ BIPRU 7.4.32R.

7.4.37

FCA PRA

G

Where an index is only based on precious metals, ■ BIPRU 7.4.13R and ■ BIPRU 7.4.36R allow the *firm* to treat the single notional *position* as precious metal for the purposes of ■ BIPRU 7.4.32R. However, if the index contained a mix of precious metals and base metals the *firm* would have to treat the notional *position* under ■ BIPRU 7.4.36R as a base metal because base metals attract a higher rate than precious metals in the table in ■ BIPRU 7.4.33R.

### Liquidity and other risks

7.4.38

FCA PRA

R

If a short *position* to which ■ BIPRU 7.4 applies falls due before a long *position* to which ■ BIPRU 7.4 applies, a *firm* must also guard against the risk of a shortage of liquidity which may exist in some markets.

7.4.39

FCA PRA

G

In particular, where ■ BIPRU 7.4.38R applies and the short *position* constitutes a material *position* compared to a *firm's* total *commodity* *positions*, it should consider a further *commodity* PRR charge in respect of that *position* depending on the likelihood of a shortage of liquidity in that market.

7.4.40

FCA PRA

R

A *firm* must safeguard against other risks, apart from the delta risk, associated with *commodity* options.

7.4.41

FCA PRA

R

The interest-rate and foreign-exchange risks not covered by other provisions of ■ BIPRU 7.4 or by the provisions of ■ BIPRU 7.2 (Interest rate PRR) or ■ BIPRU 7.5 (Foreign currency PRR) must be included in the calculation of *general market risk* for traded debt securities and in the calculation of *foreign currency PRR*.

## 7.5 Foreign currency PRR

### General rule

7.5.1

FCA PRA

R

A *firm* must calculate its *foreign currency PRR* by:

- (1) identifying which *foreign currency* and *gold positions* to include in the *PRR* calculation;
- (2) calculating the net open *position* in each currency in accordance with this section (including where necessary the *base currency* calculated in the same way as it is for *foreign currencies*) and in gold;
- (3) calculating the *open currency position* for *foreign currencies* as calculated under ■ BIPRU 7.5.19R and the net gold position (see ■ BIPRU 7.5.20R); and
- (4) multiplying the sum of the absolutes of that *open currency position* and that net gold *position* by 8%.

7.5.2

FCA PRA

G

An example of the operation of ■ BIPRU 7.5.1R is as follows. A *firm* has an *open currency position* of £100 and a net gold *position* of £50. The sum (ignoring the sign) is £150, and so the *foreign currency PRR* is £12.

### Scope of the foreign currency PRR calculation

7.5.3

FCA PRA

R

A *firm's foreign currency PRR* calculation must include the following items regardless of whether they are *trading book* or *non-trading book positions*:

- (1) all gold *positions*;
- (2) all spot *positions* in *foreign currency* (that is, all asset items less all liability items, including accrued interest, in the *foreign currency* in question);
- (3) all forward *positions* in *foreign currency*;
- (4) all *CRD financial instruments* and other items which are denominated in a *foreign currency*;

(5) irrevocable guarantees (and similar instruments) that are certain to be called and likely to be irrecoverable to the extent they give rise to a *position* in gold or *foreign currency*; and

(6) notional *positions* arising from the instruments listed in the table in ■ BIPRU 7.5.5R.

## 7.5.4

FCA PRA

R

(1) The following are excluded from a *firm's foreign currency PRR* calculation:

(a) *foreign currency* assets which have been deducted in full from the *firm's capital resources* under the calculations under the *capital resources table*;

(b) *positions* hedging (a);

(c) *positions* that a *firm* has deliberately taken in order to hedge against the adverse effect of the exchange rate on the ratio of its *capital resources* to its *capital resources requirement*; and

(d) transactions to the extent that they fully hedge net future *foreign currency* income or expenses which are known but not yet accrued.

(2) If a *firm* uses an exclusion under (1) it must:

(a) notify the *appropriate regulator* before it makes use of it;

(b) include in the notification in (a) the terms on which the relevant item will be excluded;

(c) not change the terms of the exclusion under (b); and

(d) document its policy on the use of that exclusion in its *trading book policy statement*.

(3) A *position* may only be excluded under (1)(b) or (c) if it is of a non-trading or structural nature.

## 7.5.5

FCA PRA

R

Table: instruments which result in notional foreign currency positions

This table belongs to ■ BIPRU 7.5.3R(6).

Instruments	See
<i>Foreign currency futures, forwards, synthetic futures and CFDs</i>	BIPRU 7.5.11R
<i>Foreign currency swaps</i>	BIPRU 7.5.13R
<i>Foreign currency options or warrants (unless the firm calculates a</i>	BIPRU 7.5.15R

Instruments	See
<b><i>PRR on the option or warrant under BIPRU 7.6 (Option PRR).</i></b>	
<b><i>Gold futures, forwards, synthetic futures and CFDs</i></b>	<b>BIPRU 7.5.16R</b>
<b><i>Gold options (unless the firm calculates a PRR on the option under BIPRU 7.6).</i></b>	<b>BIPRU 7.5.17R</b>
<b><i>Positions in CIUs</i></b>	<b>BIPRU 7.5.18R</b>

7.5.6  
FCA PRA

**G** Firms are reminded that the table in ■ BIPRU 7.6.5R (Table: Appropriate PRR calculation for an option or warrant) divides *foreign currency options* and *warrants* into:

- (1) those which must be treated under ■ BIPRU 7.6 (Option PRR); and
- (2) those which must be treated under either ■ BIPRU 7.5 or ■ BIPRU 7.6, the *firm* being able to choose whether ■ BIPRU 7.5 or ■ BIPRU 7.6 is used.

7.5.7  
FCA PRA

**R** When determining the currency of denomination *firms* must:

- (1) use the currency in which the *firm* accounts for the instrument where an instrument is quoted in more than one currency; and
- (2) treat depository receipts as *positions* in the underlying *security*.

7.5.8  
FCA PRA

**G** Instruments denominated in a foreign currency include, amongst other things, assets and liabilities (including accrued interest); *non-foreign currency derivative; net underwriting positions; reduced net underwriting positions*; and irrevocable guarantees (or similar instruments) that are certain to be called.

7.5.9  
FCA PRA

**R** Where a contract is based on a basket of currencies, the *firm* can choose either to derive notional *positions* in each of the constituent currencies or treat it as a single notional *position* in a separate notional currency.

**Derivation of notional positions: General**

7.5.10  
FCA PRA

**G** ■ BIPRU 7.5.11R - ■ BIPRU 7.5.18R derive notional currency *positions* for the instruments listed in the table in ■ BIPRU 7.5.5R.

**Derivation of notional positions: Foreign exchange forwards, futures, CFDs and synthetic futures**

7.5.11  
FCA PRA

- R**
- (1) A *firm* must 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* have a value equal to either:
- (a) the contracted amount of each currency to be exchanged in the case of 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 the case of a *forward, future, synthetic future* or *CFD* held in the *trading book*.

## 7.5.12

FCA PRA

G

- (1) The following example illustrates ■ BIPRU 7.5.11R. In this example, a *firm* contracts to sell \$106 for €108 in one year's time and the present values of each cash flow are \$100 and €100 respectively.



- (2) In the *non-trading book*, this *forward* would be treated as a combination of a €108 long *position* and a \$106 short *position*.
- (3) In the *trading book*, this *forward* would be treated as a combination of a €100 long *position* and a \$100 short *position*.
- (4) *Firms* are reminded that *foreign currency forwards* held in the *trading book* should also be included in the *firm's interest rate PRR* calculation (see ■ BIPRU 7.2.4R (Instruments which result in notional *positions* for the purpose of the *interest rate PRR*)).

### Derivation of notional positions: Foreign currency swaps

## 7.5.13

FCA PRA

R

- (1) A *firm* must 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* 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*.

7.5.14

FCA PRA

G

- (1) The following example illustrates ■ BIPRU 7.5.13R. In this example a *firm* enters into a five year *foreign currency swap* where it contracts to pay six month US\$ Libor on \$100 in return for receiving 6% fixed on €100. The present values of each leg are \$100 and €98 respectively.
- (2) In the *non-trading book*, this *swap* would be treated as a combination of a €100 long *position* and a \$100 short *position*.
- (3) In the *trading book*, this *swap* would be treated as a combination of a €98 long *position* and a \$100 short *position*.
- (4) *Firms* are reminded that *foreign currency swaps* held in the *trading book* should also be included in the *firm's interest rate PRR* calculation (see ■ BIPRU 7.2.4R (Instruments which result in notional *positions* for the purpose of the *interest rate PRR*)).

#### Derivation of notional positions: Foreign currency options and warrants

7.5.15

FCA PRA

R

Where included in ■ BIPRU 7.5's *PRR* calculation (see the table in ■ BIPRU 7.5.5R), a *foreign currency option* or *warrant* must be treated as a *foreign currency forward*.

#### Derivation of notional positions: Gold forwards, futures, synthetic futures and CFDs

7.5.16

FCA PRA

R

A *forward*, *future*, *synthetic future* or *CFD* on gold must be treated as a notional *position* in gold with a value equal to the amount of gold underlying multiplied by the current spot price for gold.

#### Derivation of notional positions: Gold options

7.5.17

FCA PRA

R

If included in the *PRR* calculation under ■ BIPRU 7.5 (see the table in ■ BIPRU 7.5.5R), a *gold option* must be treated as a *gold forward*.

#### Derivation of notional positions: CIUs

7.5.18

FCA PRA

R

- (1) This *rule* deals with *positions* in *CIUs*.
- (2) The actual *foreign currency positions* of a *CIU* must be included in a *firm's foreign currency PRR* calculation under ■ BIPRU 7.5.1 R.
- (3) A *firm* may rely on third party reporting of the *foreign currency positions* in the *CIU*, where the correctness of this report is adequately ensured.
- (4) If a *firm* is not aware of the *foreign currency positions* in a *CIU*, the *firm* must assume that the *CIU* is invested up to the maximum extent allowed under the *CIUs* mandate in *foreign currency* and the *firm* must, for *trading book positions*, take account of the maximum indirect exposure that it could achieve by taking leveraged *positions* through the *CIU* when calculating its *foreign currency PRR*. This must be done by proportionally increasing the

*position* in the *CIU* up to the maximum exposure to the underlying investment items resulting from the investment mandate.

- (5) The assumed *position* of the *CIU* in *foreign currency* calculated in accordance with ■ BIPRU 7.5.18R(4) must be treated as a separate currency according to the treatment of investments in gold, subject to the modification that, if the direction of the *CIUs* investment is available, the total long *position* may be added to the total long open *foreign currency position* and the total short *position* may be added to the total short open *foreign currency position*. No netting is allowed between such *positions* prior to this calculation.

#### Open currency position

7.5.19

FCA PRA

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A *firm* must calculate its *open currency position* by:

- (1) calculating the net *position* in each *foreign currency*;
- (2) converting each such net *position* into its *base currency* equivalent at current spot rates;
- (3) summing all short net *positions* and summing all long net *positions* calculated under (1) and (2); and
- (4) selecting the larger sum (ignoring the sign) from (3).

#### Net gold position

7.5.20

FCA PRA

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A *firm* must calculate its net gold *position* by:

- (1) valuing all gold *positions* using the prevailing spot price for gold (regardless of the maturity of the *positions*);
- (2) offsetting long and short *positions*; and
- (3) converting the resulting net *position* into the *base currency* equivalent using the current spot *foreign currency* rate.

## 7.6 Option PRR

### Option PRR calculation

#### 7.6.1

FCA PRA

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A *firm* must calculate its *option PRR* by:

- (1) identifying which *option positions* must be included within the scope of the *option PRR* calculation under ■ BIPRU 7.6.3R - ■ BIPRU 7.6.5R;
- (2) calculating the derived *position* in each *option* in accordance with ■ BIPRU 7.6.9R - ■ BIPRU 7.6.15R;
- (3) calculating the *PRR* for each derived *position* in accordance with ■ BIPRU 7.6.16R - ■ BIPRU 7.6.31R;
- (4) summing all of the *PRRs* calculated in accordance with (3).

#### 7.6.2

FCA PRA

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*Firms* are reminded that the table in ■ BIPRU 7.2.4R (Instruments which result in notional *positions* for the purposes of the *interest rate PRR*) and the table in ■ BIPRU 7.3.3R (Instruments which result in notional *positions* for the purposes of the *equity PRR*) also require an *interest rate PRR* to be calculated for *options* on *equities*, baskets of *equities* or *equities* indices. The interaction between ■ BIPRU 7.6 and the rest of Chapter 7 is illustrated in ■ BIPRU 7.6.33G.

### Scope of the option PRR calculation

#### 7.6.3

FCA PRA

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Except as permitted under ■ BIPRU 7.6.5R, a *firm's option PRR* calculation must include:

- (1) each *trading book position* in an *option* on an *equity*, interest rate or debt *security*;
- (2) each *trading book position* in a *warrant* on an *equity* or debt *security*;
- (3) each *trading book position* in a *CIU*; and
- (4) each *trading book* and *non-trading book position* in an *option* on a *commodity*, currency or gold.

7.6.4

FCA PRA

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■ BIPRU 7.6.3R(2) includes *net underwriting positions* or *reduced net underwriting positions* in warrants.

7.6.5

FCA PRA

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Table: Appropriate PRR calculation for an option or warrant

This table belongs to ■ BIPRU 7.6.3R

<i>Option type (see BIPRU 7.6.18R) or warrant</i>	<i>PRR calculation</i>
<p>American option, European option, Bermudan option, Asian option or warrant for which the <i>in the money</i> percentage (see BIPRU 7.6.6R) is equal to or greater than the <i>appropriate position risk adjustment</i> (see BIPRU 7.6.7R and BIPRU 7.6.8R)</p>	<p>Calculate either an <i>option PRR</i>, or the most appropriate to the underlying position of:</p> <ul style="list-style-type: none"> <li>(a) an <i>equity PRR</i>; or</li> <li>(b) an <i>interest rate PRR</i>; or</li> <li>(c) a <i>commodity PRR</i>; or</li> <li>(d) a <i>foreign currency PRR</i>; or</li> <li>(e) a <i>collective investment undertaking PRR</i>.</li> </ul>
<p>American option, European option, Bermudan option, Asian option or warrant:</p> <ul style="list-style-type: none"> <li>(a) for which the <i>in the money</i> percentage (see BIPRU 7.6.6R) is less than the <i>appropriate position risk adjustment</i> (see BIPRU 7.6.7R and BIPRU 7.6.8R); or</li> <li>(b) that is <i>at the money</i>; or</li> <li>(c) that is <i>out of the money</i>.</li> </ul>	<p>Calculate an <i>option PRR</i></p>
<p>All other types of <i>option</i> listed in BIPRU 7.6.18R (regardless of whether <i>in the money, at the money</i> or <i>out of the money</i>).</p>	<p>Calculate an <i>option PRR</i></p>

**The in the money percentage**

7.6.6

FCA PRA

R

(1) The *in the money* percentage is calculated in accordance with this rule.

(2) For a call option:

$$* 100$$

Strike price of the option

(3) For a put option:

$$* 100$$

Strike price of the *option*

- (4) In the case of an *option* on a basket of *securities* a *firm* may not treat the *option* as being *in the money* by the relevant percentage so as to enable the *firm* not to apply an *option PRR* under ■ BIPRU 7.6.5R unless the conditions in ■ BIPRU 7.6.5R are satisfied with respect to each kind of underlying investment.
- (5) (4) also applies to an *option* on a *CIU* if a *firm* is using one of the *CIU look through methods*.

**The appropriate position risk adjustment**

7.6.7

FCA PRA

R

- (1) The *appropriate position risk adjustment* for a *position* is that listed in the table in ■ BIPRU 7.6.8R against the relevant underlying *position*.
- (2) If the *firm* uses the *commodity extended maturity ladder approach* or the *commodity maturity ladder approach* for a particular *commodity* under ■ BIPRU 7.4 (Commodity PRR) the *appropriate position risk adjustment* for an *option* on that *commodity* is the outright rate applicable to the underlying *position* (see ■ BIPRU 7.4.26R (Calculating the PRR for each commodity: Maturity ladder approach) and ■ BIPRU 7.4.33R (Table: Alternative spread, carry and outright rates)).
- (3) If a *firm* does not have *commodity positions* treated under ■ BIPRU 7.4 or does not have *positions* in the *commodity* in question treated under ■ BIPRU 7.4 the restrictions in ■ BIPRU 7.4 that regulate when a *firm* can and cannot use a particular method of calculating the *commodity PRR* apply for the purpose of establishing the *appropriate position risk adjustment* for the purposes of ■ BIPRU 7.6.
- (4) If a *firm* is using one of the *CIU look through methods* for an *option* on a *CIU* the leveraging requirements in ■ BIPRU 7.7 (Position risk requirements for collective investment undertakings) apply (see ■ BIPRU 7.7.11R). For this purpose the amount of the *appropriate position risk adjustments* under ■ BIPRU 7.6.6R(5) is increased by the amount of that leveraging (expressed as a percentage) as calculated under ■ BIPRU 7.7, subject to a maximum *appropriate position risk adjustment* of 32%.

7.6.8

FCA PRA

**R** Table: Appropriate position risk adjustment

This table belongs to ■ BIPRU 7.6.7R

Underlying <i>position</i>	Appropriate <i>position risk adjustment</i>
<i>Equity</i>	The <i>position risk adjustment</i> applicable to the underlying <i>equity</i> or <i>equity</i> index in the table in BIPRU 7.3.30R (Simplified equity method)
<i>Interest rate</i>	The sum of the <i>specific risk position risk adjustment</i> (see BIPRU 7.2.43R to BIPRU 7.2.51G (Specific risk calculation)) and the <i>general market risk position risk adjustment</i> (as set out in BIPRU 7.2.57R (General market risk position risk adjustments)) applicable to the underlying <i>position</i>
<i>Debt securities</i>	The sum of the <i>specific risk position risk adjustment</i> (see BIPRU 7.2.43R to BIPRU 7.2.51G (Specific risk calculation)) and the <i>general market risk position risk adjustment</i> (as set out in the table in BIPRU 7.2.57R (General market risk position risk adjustments)) applicable to the underlying <i>position</i>
<i>Commodity</i>	18% (unless BIPRU 7.6.7R requires otherwise)
<i>Currency</i>	8%
<i>Gold</i>	8%
<i>CIU</i>	32% (subject to BIPRU 7.6.6R and BIPRU 7.6.7R)

**Calculating derived positions**

7.6.9

FCA PRA

**R** A *firm* must calculate the derived *position* specified in the table in ■ BIPRU 7.6.13R for each *position* included in its *option PRR* calculation.**Netting positions**

7.6.10

FCA PRA

**R** A *firm* may calculate a derived *position* for its net *position* in an *option* or a *warrant*, if the relevant *options* or *warrants* are identical or may be treated as identical under ■ BIPRU 7.6.11R or ■ BIPRU 7.6.12R.

7.6.11

FCA PRA

**R** A *firm* may treat *options* or *warrants* as identical if they have the same strike price, maturity (except for an interest rate cap or floor - see ■ BIPRU 7.6.12R) and underlying.

7.6.12

FCA PRA

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A *firm* may treat as identical a purchased interest rate cap (or floor) and a written interest rate cap (or floor) only if they mature within 30 days of each other and all other terms are identical (a cap may not be netted against a floor).

**Derived positions**

7.6.13

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Table: Derived positions

This table belongs to ■ BIPRU 7.6.9R

Underlying	Option (or warrant)	Derived <i>position</i>
<i>Equity</i>	<i>Option (warrant) on a single equity or option on a future/forward on a single equity</i>	A notional <i>position</i> in the actual <i>equity</i> underlying the contract valued at the current market price of the <i>equity</i> .
	<i>Option (warrant) on a basket of equities or option on a future/forward on a basket of equities</i>	A notional <i>position</i> in the actual <i>equities</i> underlying the contract valued at the current market price of the <i>equities</i> .
	<i>Option (warrant) on an equity index or option on a future/forward on an equity index</i>	A notional <i>position</i> in the index underlying the contract valued at the current market price of the index.
Interest rate	<i>Option on an interest rate or an interest rate future/FRA</i>	A zero coupon <i>zero-specific-risk security</i> in the currency concerned with a maturity equal to the sum of the time to expiry of the contract and the length of the period on which the settlement amount of the contract is calculated valued at the notional amount of the contract.
	<i>Option on an interest rate swap</i>	A zero coupon <i>zero-specific-risk security</i> in the currency concerned with a maturity equal to the length of the <i>swap</i> valued at the notional principal amount.
	Interest rate cap or floor	A zero coupon <i>zero-specific-risk security</i> in the

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Underlying	Option (or warrant)	Derived <i>position</i>
Debt securities		currency concerned with a maturity equal to the remaining period of the cap or floor valued at the notional amount of the contract.
	<i>Option (warrant) on a debt security or option on a future/forward on a debt security</i>	The underlying debt security with a maturity equal to the time to expiry of the <i>option</i> valued as the nominal amount underlying the contract at the current market price of the debt security.
	<i>Option (warrant) on a basket of debt securities or option on a future/forward on a basket of debt securities</i>	A notional <i>position</i> in the actual debt securities underlying the contract valued at the current market price of the debt securities.
Commodity	<i>Option (warrant) on an index of debt securities or option on a future/forward on an index of debt securities</i>	A notional <i>position</i> in the index underlying the contract valued at the current market price of the index.
	<i>Option on a commodity or option on a future/forward on a commodity</i>	An amount equal to the tonnage, barrels or kilos underlying the <i>option</i> with (in the case of a <i>future/forward</i> on a <i>commodity</i> ) a maturity equal to the expiry date of the <i>forward</i> or <i>Futures</i> contract underlying the <i>option</i> . In the case of an <i>option</i> on a <i>commodity</i> the maturity of the <i>position</i> falls into Band 1 in the table in BIPRU 7.4.28R (Table: Maturity bands for the maturity ladder approach).

Underlying	Option (or warrant)	Derived <i>position</i>
	<i>Option on a commodity swap</i>	An amount equal to the tonnage, barrels or kilos underlying the <i>option</i> with a maturity equal to the length of the <i>swap</i> valued at the notional principal amount.
<i>CIU</i>  (These provisions about <i>CIUs</i> are subject to BIPRU 7.6.35R)	<i>Option (warrant) on a single CIU or option on a future/forward on a single CIU</i>	A notional <i>position</i> in the actual <i>CIU</i> underlying the contract valued at the current market price of the <i>CIU</i> .
	<i>Option (warrant) on a basket of CIUs or option on a future/forward on a basket of CIUs</i>	A notional <i>position</i> in the actual <i>CIUs</i> underlying the contract valued at the current market price of the <i>CIUs</i> .
Gold	<i>Option on gold or option on a future/forward on gold</i>	An amount equal to the troy ounces underlying the <i>option</i> with (in the case of a <i>future/forward</i> on gold) a maturity equal to the expiry date of the <i>forward</i> or <i>futures</i> contract underlying the <i>option</i> .
Currency	Currency <i>option</i>	The amount of the underlying currency that the <i>firm</i> will receive if the <i>option</i> is exercised converted at the spot rate into the currency that the <i>firm</i> will sell if the <i>option</i> is exercised.

**Combinations of options which can be treated as one option**

A *firm* may treat (for the purpose of calculating an *option PRR* under ■ BIPRU 7.6) an *option* strategy listed in the table in ■ BIPRU 7.6.15R as the single *position* in a notional *option* specified against that strategy in the table in ■ BIPRU 7.6.15R, if:

- (1) each element of the strategy is transacted with the same *counterparty*;
- (2) the strategy is documented as a single structure;

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- (3) the underlying for each part of the composite *position* (including any actual holding of the underlying) is the same under the *PRR identical product netting rules*;
- (4) the netting achieved does not result overall in a greater degree of netting in the calculation of the *market risk capital requirement* than would be permitted under the other *standard market risk PRR rules*;
- (5) each *option* in the structure has the same maturity and underlying; and
- (6) the constituent parts of the structure form an indivisible single contract, so that neither party can unwind or default on one part of the structure without doing so for the contract as a whole;

except that (1) and (6) only apply to the extent possible with respect to any part of the composite *position* held by the *firm* that consists of an actual holding of the underlying.

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Table: Option strategies

This table belongs to ■ BIPRU 7.6.14R

Option strategy (and an example)	Notional option (and rule it must be treated under)
<b>Bull Spread</b> (e.g. buy 100 call and sell 101 call)	<b>One purchased option</b> (treat under BIPRU 7.6.20R)
<b>Bear Spread</b> (e.g. sell 100 put and buy 101 put)	<b>One written option</b> (treat under BIPRU 7.6.21R)
<b>Synthetic Long Call</b> (e.g. long underlying and buy 100 put)	<b>One purchased option</b> (treat under BIPRU 7.6.20R or BIPRU 7.6.24R)
<b>Synthetic Short Call</b> (e.g. short underlying and sell 100 put)	<b>One written option</b> (treat under BIPRU 7.6.21R or BIPRU 7.6.24R)
<b>Synthetic Long Put</b> (e.g. short underlying and buy 100 call)	<b>One purchased option</b> (treat under BIPRU 7.6.20R or BIPRU 7.6.24R)

Option strategy (and an example)	Notional option (and rule it must be treated under)
<b>Synthetic Short Put</b> (e.g. buy underlying and sell 100 call)	<b>One written option</b> (treat under BIPRU 7.6.21R or BIPRU 7.6.24R)
<b>Long Straddle</b> (e.g. buy 100 call and buy 100 put)	<b>One purchased option</b> (treat under BIPRU 7.6.20R)
<b>Short Straddle</b> (e.g. sell 100 call and sell 100 put)	<b>One written option</b> (treat under BIPRU 7.6.21R but with no reduction for the amount the option is out of the money)
<b>Long Strangle</b> (e.g. buy 101 call and buy 99 put)	<b>One purchased option</b> (treat under BIPRU 7.6.20R)
<b>Short Strangle</b> (e.g. sell 99 call and sell 101 put)	<b>One written option</b> (treat under BIPRU 7.6.21R but with no reduction for the amount the option is out of the money)
<b>Long Butterfly</b> (e.g. buy one 100 call, sell two 101 calls, and buy one 102 call)	<b>One purchased option</b> (treat under BIPRU 7.6.20R)
<b>Short Butterfly</b> (e.g. sell one 100 put, buy two 101 puts, and sell one 102 put)	<b>One written option</b> (treat under BIPRU 7.6.21R but with no reduction for the amount the option is out of the money)

**The option PRR for an individual positions**

7.6.16

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A firm must calculate the *option PRR* for each individual derived *option position* using the method specified in the table in ■ BIPRU 7.6.18R, or, if more than one method is permitted, using one of those methods.

7.6.17

FCA PRA

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A firm must convert its *positions* into its *base currency* in accordance with the procedures that apply for whichever of the other *PRR charges* is appropriate (see ■ BIPRU 7.2.1R(3), ■ BIPRU 7.3.1R(2), ■ BIPRU 7.4.1R(3), ■ BIPRU 7.5.19R(2), ■ BIPRU 7.5.20R(3) and ■ BIPRU 7.7.1R(3)).

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R Table: Option PRR: methods for different types of option

This table belongs to ■ BIPRU 7.6.16R

Option	Description	Method
<i>American option</i>	An <i>option</i> that may be exercised at any time over an extended period up to its expiry date.	<i>Option standard method or option hedging method if appropriate</i>
<i>European option</i>	An <i>option</i> that can only be exercised at expiry.	
<i>Bermudan option</i>	A cross between an <i>American option</i> and <i>European option</i> . The <i>Bermudan option</i> can only be exercised at specific dates during its life.	
<i>Asian option</i>	The buyer has the right to exercise at the average rate or price of the underlying over the period (or part of the period) of the <i>option</i> . One variant is where the payout is based on the average of the underlying against a fixed strike price; another variant is where the payout gives at expiry the price of the underlying against the average price over the <i>option</i> period.	<i>Option standard method or option hedging method if appropriate</i>
<i>Barrier option</i>	An <i>option</i> which is either cancelled or activated if the price of the underlying reaches a pre-set level regardless of the price at which the underlying may be trading at the expiry of the <i>option</i> . The knock-out type is cancelled if the underlying price or rate trades through the trigger; while the	

Option	Description	Method
<b>Corridor option</b>	knock-in becomes activated if the price moves through the trigger. Provides the holder with a pay-out for each day that the underlying stays within a defined range chosen by the investor.	
<b>Ladder option</b>	Provides the holder with guaranteed pay-outs if the underlying trades through a pre-agreed price(s) or rate(s) at a certain point(s) in time, regardless of future performance.	
<b>Lock-in option</b>	An option where the pay-out to the holder is locked in at the maximum (or minimum) value of the underlying that occurred during the life of the option.	
<b>Look-back option</b>	A European style option where the strike price is fixed in retrospect, that is at the most favourable price (i.e. the lowest (highest) price of the underlying in the case of a call (put)) during the life of the option.	
<b>Forward starting option</b>	An option that starts at a future date.	
<b>Compound option</b>	An option where the underlying is itself an option (i.e. an option on an option).	Option standard method or option hedging method if appropriate
<b>Interest rate cap</b>	An interest rate option or series of options under which a counterparty contracts to pay any interest costs arising as	Option standard method, but no reduction for the amount the option is out of the money is permitted

Option	Description	Method
<p><b>Interest rate floor</b></p>	<p>a result of an increase in rates above an agreed rate: the effect being to provide protection to the holder against a rise above that agreed interest rate.</p> <p>An interest rate <i>option</i> or series of <i>options</i> under which a counterparty contracts to pay any lost income arising as a result of a fall in rates below an agreed rate: the effect being to provide protection to the holder against a fall below that agreed interest rate.</p>	
<p><b>Performance option</b></p>	<p>An <i>option</i> based on a reference basket comprising any number of assets, where the payout to the holder could be one of the following: the maximum of the worst performing asset, or 0; the maximum of the best performing asset, or 0; the maximum of the spreads between several pairs of the assets, or 0.</p>	<p><i>Option standard method</i> or <i>option hedging method</i> - using the highest <i>position risk adjustment</i> of the individual assets in the basket</p>
<p><b>Quanto</b></p>	<p>Quanto stands for "Quantity Adjusted Option". A quanto is an instrument where two currencies are involved. The payoff is dependent on a variable that is measured in one of the currencies and the payoff is made in the other currency.</p>	<p>Subject to BIPRU 7.6.31R, the <i>option standard method</i></p>

Option	Description	Method
<b>Cliquet option</b>	A cliquet <i>option</i> consists of a series of forward starting <i>options</i> where the strike price for the next exercise date is set equal to a positive constant times the underlying price as of the previous exercise date. It initially acts like a vanilla <i>option</i> with a fixed price but as time moves on, the strike is reset and the intrinsic value automatically locked in at pre-set dates. If the underlying price is below the previous level at the reset date no intrinsic value is locked in but the strike price will be reset to the current price attained by the underlying. If the underlying price exceeds the current level at the next reset the intrinsic value will again be locked in.	<b>Option standard method</b> for a purchased cliquet, or the method specified in <b>BIPRU 7.6.30R</b> for a written cliquet
<b>Digital option</b>	A type of <i>option</i> where the pay-out to the holder is fixed. The most common types are all-or-nothing and one-touch <i>options</i> . All-or-nothing will pay out the fixed amount if the underlying is above (call) or below (put) a set value at expiry. The one-touch will pay the fixed amount if the underlying reaches a fixed point any time before expiry.	The method specified in <b>BIPRU 7.6.29 R</b>
<b>Any other option or warrant</b>		The method specified for the type of instrument whose description

Option	Description	Method
		it most closely resembles.

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- (1) The *option standard method* is described in ■ BIPRU 7.6.20R - ■ BIPRU 7.6.22R.
- (2) The *option hedging method* is described in ■ BIPRU 7.6.23G - ■ BIPRU 7.6.28R.

#### The standard method: Purchased options and warrants

7.6.20

FCA PRA

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Under the *option standard method*, the PRR for a purchased *option* or *warrant* is the lesser of:

- (1) the market value of the derived *position* (see ■ BIPRU 7.6.9R) multiplied by the *appropriate position risk adjustment* (see ■ BIPRU 7.6.8R); and
- (2) the market value of the *option* or *warrant*.

#### The standard method: Written options and warrants

7.6.21

FCA PRA

R

Under the *option standard method*, the PRR for a written *option* or *warrant* is the market value of the derived *position* (see ■ BIPRU 7.6.9R) multiplied by the *appropriate position risk adjustment* (see ■ BIPRU 7.6.8R). This result may be reduced by the amount the *option* or *warrant* is *out of the money* (subject to a maximum reduction to zero).

#### The standard method: Underwriting or sub-underwriting an issue of warrants

7.6.22

FCA PRA

R

Under the *option standard method*, the PRR for *underwriting* or *sub-underwriting* an issue of *warrants* is the *net underwriting position* (or *reduced net underwriting position*) multiplied by the current market price of the underlying *securities* multiplied by the *appropriate position risk adjustment*, but the result can be limited to the value of the *net underwriting position* (or *reduced net underwriting position*) calculated using the issue price of the *warrant*.

#### The hedging method

7.6.23

FCA PRA

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The *option hedging method* involves the *option PRR* being calculated on a combination of the *option* and its hedge.

7.6.24

FCA PRA

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Under the *option hedging method* a *firm* must calculate the *option PRR* for individual *positions* as follows:

- (1) for an *option* or *warrant* on an *equity*, basket of *equities* or *equity* index and its *equity* hedge(s), the *firm* must, to the extent

specified or permitted in the table in ■ BIPRU 7.6.26R, use the calculation in the table in ■ BIPRU 7.6.27R;

- (2) for an *option* or *warrant* on a debt *security*, basket of debt *securities* or debt *security* index and its debt *security* hedge(s), the *firm* must, to the extent specified or permitted in the table in ■ BIPRU 7.6.26R, use the calculation in the table in ■ BIPRU 7.6.27R;
- (3) for an *option* on gold and its gold hedge, the *firm* must, to the extent specified or permitted in the table in ■ BIPRU 7.6.26R, use the calculation in the table in ■ BIPRU 7.6.27R; and
- (4) for an *option* on a currency and its currency hedge, the *firm* must, to the extent specified or permitted in the table in ■ BIPRU 7.6.26R, use the calculation in the table in ■ BIPRU 7.6.28R.

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FCA PRA

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- (1) A *firm* may not use the *option hedging method* for:
  - (a) an interest rate *option* and its hedge; or
  - (b) a *commodity option* and its hedge; or
  - (c) a *CIU option* and its hedge.
- (2) A *firm* may only use the *option hedging method* if the item underlying the *option* or *warrant* is the same as the hedge of the *option* or *warrant* under the *PRR identical product netting rules*.

7.6.26

FCA PRA

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Table: Appropriate treatment for equities, debt securities or currencies hedging options

This table belongs to ■ BIPRU 7.6.24R

Hedge	PRR calculation for the hedge	Limits (if hedging method is used)	Naked <i>position</i>
An <i>equity</i> (hedging an <i>option</i> or <i>warrant</i> )	The <i>equity</i> must be treated in either BIPRU 7.3 (equity <i>PRR</i> ) or the <i>option hedging method</i> (see the table in BIPRU 7.6.27R)	The <i>option hedging method</i> must only be used up to the amount of the hedge that matches the notional amount underlying the <i>option</i> or <i>warrant</i>	To the extent that the amount of the hedge (or <i>option</i> or <i>warrant</i> ) exceeds the notional amount underlying the <i>option</i> or <i>warrant</i> (or hedge), a <i>firm</i> must apply an <i>equity PRR</i> , interest rate <i>PRR</i> or <i>foreign currency PRR</i> (or the <i>op-</i>

Hedge	PRR calculation for the hedge	Limits (if hedging method is used)	Naked <i>position</i> <i>standard method</i> )
A debt security (hedging an option or warrant)	The debt security must be treated in BIPRU 7.2 (interest rate PRR) or the option hedging method (see the table in BIPRU 7.6.27R)	As for the first row	As for the first row
Gold (hedging a gold option)	The gold must be treated in either BIPRU 7.5 (Foreign currency PRR) or the option hedging method (see the table in BIPRU 7.6.27R)	As for the first row	As for the first row
A currency or currencies (hedging a currency option)	The currency must be treated in either BIPRU 7.5 (Foreign currency PRR) or the option hedging method (see the table in BIPRU 7.6.28R)	As for the first row	As for the first row

7.6.27

FCA PRA

R

Table: The hedging method of calculating the PRR (equities, debt securities and gold)

This table belongs to ■ BIPRU 7.6.24R(1) - ■ (3)

PRR				
	Option or warrant position	In the money by more than the position risk adjustment	In the money by less than the position risk adjustment	Out of the money or at the money
Long in security or gold	Long put	Zero	Wp	X
	Short call	Y	Y	Z

		PRR		
Short in <i>security</i> or gold	Long call	Zero	Wc	X
	Short put	Y	Y	Z
Where:				
Wp means	{ ( <i>position risk adjustment</i> -100%) x The underlying <i>position</i> valued at strike price}		+	The market value of the underlying <i>position</i>
Wc means	{(100% + <i>position risk adjustment</i> x The underlying <i>position</i> valued at strike price}		-	The market value of the underlying <i>position</i>
X means	The market value of the underlying <i>position</i> multiplied by the <i>appropriate position risk adjustment</i>			
Y means	The market value of the underlying <i>position</i> multiplied by the <i>appropriate position risk adjustment</i> . This result may be reduced by the market value of the <i>option</i> or <i>warrant</i> , subject to a maximum reduction to zero.			
Z means	The <i>option hedging method</i> is not permitted; the <i>option standard method</i> must be used.			

7.6.28

FCA PRA

R

Table: The hedging method of calculating the PRR (currencies)

This table belongs to ■ BIPRU 7.6.24R(4)

PRR			
<i>Option position</i>	<i>In the money by more than 8%</i>	<i>In the money by less than 8%</i>	<i>Out of the money or at the money</i>
Long calls & long puts	Zero	W <sub>L</sub>	X
Short calls & short puts	Zero	Y	X
Where:			
W <sub>L</sub> means	(1.08% x U)	-	The market value of the underlying <i>position</i>
U means	The amount of the underlying currency that the <i>firm</i> will receive if the <i>option</i> is exercised, converted at the strike price into the currency that the <i>firm</i> will sell if the <i>option</i> is exercised		
X means	The market value of the underlying <i>position</i> multiplied by 8%.		

7

### PRR

**Y means** The market value of the underlying *position* multiplied by 8%. This result may be reduced by the market value of the *option*, subject to a maximum reduction to zero.

#### Specific methods and treatments: Digital options

7.6.29

FCA PRA

R

The *option PRR* for a digital *option* is the maximum loss of the *option*.

#### Specific methods and treatments: Written cliquet options

7.6.30

FCA PRA

R

The *option PRR* for a written cliquet *option* is the market value of the derived *position* (see ■ BIPRU 7.6.9R) multiplied by the *appropriate position risk adjustment* (see ■ BIPRU 7.6.8R) multiplied by F+1 (see the following provisions of this paragraph). This result may be reduced by the amount the *option* is *out of the money* (subject to a maximum reduction to zero). The *option PRR* for a written cliquet *option* is therefore defined by the following formula:

[ *position risk adjustment* \* underlying \* (F + 1)] - OTM

where:

$$(1) \quad F = \min \left[ FR, \max \left( \frac{FR}{2}, Y \right) \right]$$

(2) FR= Number of forward re-sets

(3) Y= Years to maturity

(4) OTM= the amount by which the *option* is *out of the money*

#### Specific methods and treatments: Quantos

7.6.31

FCA PRA

R

If the pay-out to the holder of a quanto *option* is fixed at the inception of the transaction a *firm* must add 8% to the *position risk adjustment* when applying the *option standard method*.

#### Interaction with other chapters

7.6.32

FCA PRA

G

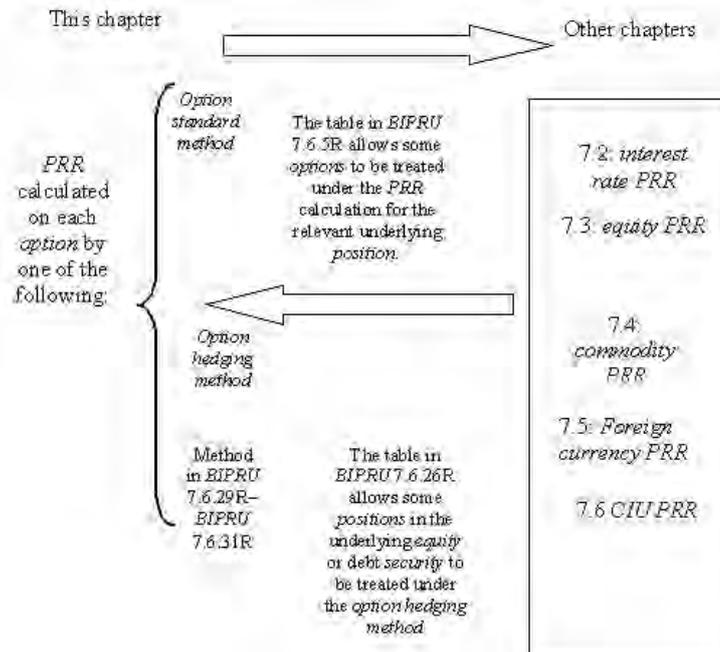
The application of an *option PRR* to a *position* does not prevent any of the other *PRR charges* from applying if they would otherwise do so. In particular if a *firm* applies an *option PRR* to an *equity derivative* an *interest rate PRR* will also generally apply.

7.6.33

FCA PRA

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The following diagram illustrates the relationship between ■ BIPRU 7.6 and the rest of ■ BIPRU 7.



**Options on a commodity**

7.6.34

FCA PRA

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■ BIPRU 7.4.38R to ■ BIPRU 7.4.41R (Liquidity and other risks) apply to *commodity options* treated under ■ BIPRU 7.6 as well as to those treated under ■ BIPRU 7.4 (Commodity PRR).

**Options on a CIU**

7.6.35

FCA PRA

R

For the purpose of identifying the appropriate treatment for the purpose of ■ BIPRU 7.6.5R, the underlying *position* for the purpose of ■ BIPRU 7.6.8R and the derived *position* under ■ BIPRU 7.6.13R a *firm* may choose between treating an *option* on a *CIU* as being:

- (1) a *position* in the *CIU* itself; or
- (2) (if the conditions in ■ BIPRU 7.7 (Position risk requirements for collective investment undertakings) for the use of the method in question are satisfied) *positions* in the underlying investments or assumed *positions* arising through the use of the *standard CIU look through method* or the *modified CIU look through method*.

7.6.36

FCA PRA

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- (1) This paragraph gives an example of how the *appropriate position risk adjustment* should be calculated for the purpose of deciding whether or not an *option* on a *CIU* is sufficiently *in the money* for the *firm* to have a choice whether or not to apply an *option PRR*. This example assumes that there is no leveraging (see ■ BIPRU 7.7.11R (CIU modified look through method)).
- (2) Say that the *CIU* contains underlying *equity position* and the *firm* is using one of the *CIU look through methods*. The *appropriate position risk adjustment* for some is 8% and for the others is 12%. The *firm* should identify the highest

*appropriate position risk adjustment* for the underlyings. In this case it is 12%. Therefore in this case the *option* would need to be *in the money* by more than 12% in order for the *firm* to have a choice between applying the *option PRR* or one of the other *PRR charges*.

- (3) However if the *firm* is not using one of the *CIU look through methods* the *option* would need to be *in the money* by more than 32% in order for the *firm* to have a choice between applying the *option PRR* or the *CIU PRR*.

7.6.37

FCA PRA

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■ BIPRU 7.6.10R - ■ BIPRU 7.6.12R are subject to ■ BIPRU 7.7.3R (netting). ■ BIPRU 7.7.4R (use of third party) applies for the purpose of ■ BIPRU 7.6.

## 7.7 Position risk requirements for collective investment undertakings

### Collective investment undertaking PRR calculation

7.7.1

R

FCA PRA

A *firm* must calculate its *CIU PRR* by:

- (1) identifying which *CIU positions* must be included within the scope of the *PRR* calculation (see ■ BIPRU 7.7.2R);
- (2) identifying which *CIU positions* are to be subject to the *CIU PRR* and which *positions* are to be subject to one of the other *PRR charges*;
- (3) converting on a daily basis net *positions* into the *firm's base currency* at the prevailing spot exchange rate before their aggregation;
- (4) calculating an individual *PRR* for each *position* in a *CIU* (see ■ BIPRU 7.7.5R);
- (5) summing the resulting individual *PRRs*.

### Scope of the PRR calculation for collective investment undertakings

7.7.2

R

FCA PRA

- (1) A *firm's PRR* calculation must include all *trading book positions* in *CIUs*.
- (2) A *firm's CIU PRR* calculation must include all *trading book positions* in *CIUs* unless they are treated under one of the *CIU look through methods* and included in the *PRR* calculations for the relevant underlying investments or subject to an *option PRR*.
- (3) A *firm's PRR* calculation for *CIUs* must include notional *positions* arising from *trading book positions* in *options* or *warrants* on *collective investment undertakings*.

### General rules

7.7.3

R

FCA PRA

Unless noted otherwise, no netting is permitted between the underlying investments of a *CIU* and other *positions* held by a *firm* for the purposes of calculating the *PRR charge* for a *position* in a *CIU*.

7.7.4

FCA PRA

R

A firm may rely on a third party to calculate and report PRR capital requirements for position risk (general market risk and specific risk) for positions in CIUs falling within ■ BIPRU 7.7.9R and ■ BIPRU 7.7.11R, in accordance with the methods set out in ■ BIPRU 7.7, provided that the correctness of the calculation and the report is adequately ensured.

#### Calculation of the collective investment undertaking PRR

7.7.5

FCA PRA

R

Without prejudice to other provisions in ■ BIPRU 7.7, a position in a CIU is subject to a collective investment undertaking PRR (general market risk and specific risk) of 32%. Without prejudice to provisions in ■ BIPRU 7.5.18R (Foreign currency PRR for CIUs) or, if the firm has a VaR model permission, ■ BIPRU 7.10.44R (Commodity risks and VaR models) taken together with ■ BIPRU 7.5.18R, where the modified gold treatment set out in those rules is used, a position in a CIU is subject to a securities PRR requirement for position risk (general market risk and specific risk) and a foreign currency PRR of no more than 40%.

#### Look through methods: General criteria

7.7.6

FCA PRA

R

A firm may determine the securities PRR requirement for positions in CIUs which meet the criteria set out in ■ BIPRU 7.7.7R, by one of the following methods:

- (1) the standard CIU look through method ( ■ BIPRU 7.7.4R and ■ BIPRU 7.7.7R - ■ BIPRU 7.7.10R); or
- (2) the modified CIU look through method ( ■ BIPRU 7.7.4R, ■ BIPRU 7.7.7R - ■ BIPRU 7.7.8R and ■ BIPRU 7.7.11R - ■ BIPRU 7.7.12R).

7.7.7

FCA PRA

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The general eligibility criteria for using the methods in ■ BIPRU 7.7.4R and ■ BIPRU 7.7.9R - ■ BIPRU 7.7.11R, for CIUs issued by companies supervised or incorporated within the EEA are that:

- (1) the CIU's prospectus or equivalent document must include:
  - (a) the categories of assets the CIU is authorised to invest in;
  - (b) if investment limits apply, the relative limits and the methodologies to calculate them;
  - (c) if leverage is allowed, the maximum level of leverage; and
  - (d) if investment in OTC financial derivatives or repo-style transactions are allowed, a policy to limit counterparty risk arising from these transactions;
- (2) the business of the CIU must be reported in half-yearly and annual reports to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period;

- (3) the units/shares of the *CIU* are redeemable in cash, out of the *undertaking's* assets, on a daily basis at the request of the unit holder;
- (4) investments in the *CIU* must be segregated from the assets of the *CIU* manager; and
- (5) there must be adequate risk assessment, by the investing *firm*, of the *CIU*.

7.7.8

FCA PRA

R

Third country *CIUs* are eligible if the requirements in ■ BIPRU 7.7.7R (1) - ■ BIPRU 7.7.7R (5) are met.

#### Standard CIU look through method: General

7.7.9

FCA PRA

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- (1) Where a *firm* is aware of the underlying investments of the *CIU* on a daily basis the *firm* may look through to those underlying investments in order to calculate the *securities PRR* for *position* risk (*general market risk* and *specific risk*) for those *positions* in accordance with the methods set out in the *securities PRR* requirements or, if the *firm* has a *VaR model permission*, in accordance with the methods set out in ■ BIPRU 7.10 (Use of a Value at Risk Model).
- (2) Under this approach, *positions* in *CIUs* must be treated as *positions* in the underlying investments of the *CIU*. Netting is permitted between *positions* in the underlying investments of the *CIU* and other *positions* held by the *firm*, as long as the *firm* holds a sufficient quantity of units to allow for redemption/creation in exchange for the underlying investments.

#### Standard CIU look through method: Index or basket funds

7.7.10

FCA PRA

R

- (1) A *firm* may calculate the *securities PRR* for *position* risk (*general market risk* and *specific risk*) for *positions* in *CIUs* in accordance with the methods set out in the *securities PRR* requirements or, if the *firm* has a *VaR model permission*, in accordance with the methods set out in ■ BIPRU 7.10 (Use of a Value at Risk Model), to assumed *positions* representing those necessary to replicate the composition and performance of the externally generated index or fixed basket of *equities* or *debt securities* referred to in (a), subject to the following conditions:
  - (a) the purpose of the *CIU's* mandate is to replicate the composition and performance of an externally generated index or fixed basket of *equities* or *debt securities*; and
  - (b) a minimum correlation of 0.9 between daily price movements of the *CIU* and the index or basket of *equities* or *debt securities* it tracks can be clearly established over a minimum period of six months.

- (2) Correlation as referred to in (1)(b) means the correlation coefficient between daily returns on the *CIU* and the index or basket of *equities* or *debt securities* it tracks.

#### CIU modified look through method

7.7.11

FCA PRA

R

Where a *firm* is not aware of the underlying investments of the *CIU* on a daily basis, the *firm* may calculate the *securities PRR* for *position risk* (*general market risk* and *specific risk*) in accordance with the methods set out in the *securities PRR* requirements, subject to the following conditions:

- (1) it must be assumed that the *CIU* first invests to the maximum extent allowed under its mandate in the asset classes attracting the highest *securities PRR* for *position risk* (*general market risk* and *specific risk*), and then continues making investments in descending order until the maximum total investment limit is reached;
- (2) the *firm* must take account of the maximum indirect exposure that it could achieve by taking leveraged *positions* through the *CIU* when calculating its *securities PRR* for *position risk*, by proportionally increasing the *position* in the *CIU* up to the maximum exposure to the underlying investment items resulting from the investment mandate; and
- (3) should the *securities PRR* for *position risk* (*general market risk* and *specific risk*) under this approach exceed that set out in ■ BIPRU 7.7.5R, the *PRR charge* must be capped at that level.

7.7.12

FCA PRA

R

For the purpose of ■ BIPRU 7.7.11R (1) the *position* in the *CIU* must be treated as a direct holding in the assumed *position*.

#### CAD 1 models and VaR models

7.7.13

FCA PRA

G

Where ■ BIPRU 7.7 permits a *firm* to calculate the *PRR charge* for a *position* in a *CIU* using the *rules* in ■ BIPRU 7 relating to the underlying investment, a *firm* that has:

- (1) a *CAD 1 model waiver* that covers *positions* in *CIUs* may use the *rules* as modified by that *waiver*; and
- (2) a *VaR model permission* that covers *positions* in *CIUs* may use its *VaR model*.

#### Options on a CIU

7.7.14

FCA PRA

G

An *option* on a *CIU* should be treated in accordance with ■ BIPRU 7.6.35R to ■ BIPRU 7.6.37G (Options on a *CIU*).

## 7.8 Securities underwriting

### General rules

7.8.1

FCA PRA

G

■ BIPRU 7.8 sets out the method for calculating a *net underwriting position* or *reduced net underwriting position*, which is then included in the *PRR* calculation in other parts of ■ BIPRU 7. It also deals with concentration risk. ■ BIPRU 7.8 only relates to new *securities*, which is defined in ■ BIPRU 7.8.12R.

7.8.2

FCA PRA

R

A *firm* which *underwrites* or *sub-underwrites* an issue of *securities* must, for the purposes of calculating its *market risk capital component* and its *concentration risk capital component*:

- (1) identify commitments to *underwrite* or *sub-underwrite* which give rise to an *underwriting position* (see ■ BIPRU 7.8.8R);
- (2) identify the time of *initial commitment* (see ■ BIPRU 7.8.13R); and
- (3) calculate the *net underwriting position* (set out in ■ BIPRU 7.8.17R), *reduced net underwriting position* or the *net underwriting exposure*.

7.8.3

FCA PRA

R

A *firm* must include the *net underwriting position* or *reduced net underwriting position* in whichever one or more of the following is or are relevant:

- (1) ■ BIPRU 7.2.3R (1) where *debt securities* are being underwritten;
- (2) ■ BIPRU 7.3.2R (1) where *equities* are being underwritten;
- (3) ■ BIPRU 7.6.22R where *warrants* are being underwritten; and
- (4) ■ BIPRU 7.5.3R where the *equities*, *debt securities* or *warrants* being underwritten are denominated in a *foreign currency*.

7.8.4

FCA PRA

R

A *firm* must comply with ■ BIPRU 7.8.3R from *initial commitment* (as determined under ■ BIPRU 7.8.8R) until the end of the fifth *business day* after *working day 0* (as determined under ■ BIPRU 7.8.23R).

7.8.5

FCA PRA

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Sub-*underwriting* is a commitment given by one *firm* to someone other than the issuer or seller of the *securities* to sub-underwrite all or part of an issue of *securities*.

7.8.6

FCA PRA

G

The *net underwriting position* calculated in ■ BIPRU 7.8.17R will also be used in calculating the *net underwriting exposure* under ■ BIPRU 7.8.34R.

7.8.7

FCA PRA

G

The *net underwriting position* or *reduced net underwriting position* arising from *underwriting* or sub-*underwriting* a rights or *warrants* issue should be calculated using the current market price of the underlying *security* for the purposes of the *equity PRR* or *option PRR*. However, the *PRR* will be limited to the value of the *net underwriting position* calculated using the initial issue price of the rights or *warrants*. Where there is no market price because the rights or *warrants* are in relation to a new class of *securities* and the initial price has not been set the *net underwriting position* or *reduced net underwriting* is the amount of the commitment.

### Commitment to underwriting securities

7.8.8

FCA PRA

R

- (1) For the purpose of ■ BIPRU 7.8.2R (1), a *firm* has a commitment to *underwrite* or sub-*underwrite* an issue of *securities* where:
  - (a) it gives a commitment to an issuer of *securities* to *underwrite* an issue of *securities*; or
  - (b) (where ■ BIPRU 7.8.12R (2) applies) it gives a commitment to a seller of *securities* to *underwrite* a sale of those *securities*; or
  - (c) it gives a commitment to a *person*, other than the issuer of *securities* or, if ■ BIPRU 7.8.12R (2) applies, the seller of the *securities*, to sub-*underwrite* an issue of *securities*; or
  - (d) it is a member of a syndicate or group that gives a commitment of the type described in (1)(a)-(c).
- (2) Unless a *rule* deals with them separately or the context otherwise requires, a provision of ■ BIPRU 7.8 that deals with *underwriting* also applies to sub-*underwriting*.

### Exclusions from BIPRU 7.8

7.8.9

FCA PRA

G

- (1) Block trades, including bought deals, and private placements are not within the scope of ■ BIPRU 7.8 because they involve an outright purchase by the *firm* of the relevant *securities*.
- (2) For the purpose of ■ BIPRU 7.8 *securities* include debt and *equity* instruments and *convertibles* but excludes loans.

### Grey market transactions

7.8.10

FCA PRA

R

- (1) A *firm* that buys and sells *securities* before issue is dealing in the grey market for the purposes of ■ BIPRU 7.8.

- (2) ■ BIPRU 7.8 does not apply to a *firm* with respect to its dealings in the grey market unless the *firm*:
  - (a) has an *underwriting* commitment to the issuer in respect of those *securities*; or
  - (b) has a sub-*underwriting* commitment in respect of those *securities* and is using the grey market solely for the purpose of reducing that sub-*underwriting* commitment.
- (3) ■ BIPRU 7.8 does not apply to a *firm* with respect to its dealings in the grey market if the transaction is undertaken by the proprietary trading part of the *firm* or is undertaken for proprietary trading purposes.
- (4) ■ BIPRU 7.8 does not apply to a *firm* with respect to its dealings in the grey market except as described in ■ BIPRU 7.8.17R.

7.8.11

FCA PRA

G

In ■ BIPRU 7.8 the grey market is the market in which dealers "buy" and "sell" *securities* ahead of issue. In reality the dealers are buying and selling promises to deliver the *securities* when issued.

#### New securities

7.8.12

FCA PRA

R

For the purposes of ■ BIPRU 7.8, a *firm* must treat *securities* as being new for the purposes of the definition of *underwriting* if they are:

- (1) *securities* that, prior to the allotment following the *underwriting*, were not in issue; or
- (2) *securities* that do not fall within (1) but that have not previously been offered for sale or subscription to the public and have not been admitted to trading on a market operated by a *recognised investment exchange* or an *overseas investment exchange*.

#### Time of initial commitment

7.8.13

FCA PRA

R

Subject to ■ BIPRU 7.8.14R, the time of *initial commitment* is the earlier of:

- (1) (in the case of *underwriting*) the time the *firm* agrees with the issuer of *securities* to *underwrite* those *securities*; or
- (2) (in the case of *underwriting* falling under ■ BIPRU 7.8.12R (2)) the time the *firm* agrees with the seller of *securities* to *underwrite* those *securities*; or
- (3) (in the case of sub-*underwriting*) the time the *firm* agrees with the *person* referred to ■ BIPRU 7.8.8R (1)(c) to sub-*underwrite* those *securities*; or

- (4) (in the case of ■ BIPRU 7.8.8R (1)(d)) the time the group or syndicate in question (or a member of that group or syndicate on behalf of the others) agrees with the issuer or other *person* to whom the commitment is given as referred to in ■ BIPRU 7.8.8R (1)(d) to *underwrite* or *sub-underwrite* the *securities* in question; or
- (5) (if the *firm* at that time has a commitment, whether legally or binding or not) the time the price and allocation of the issue or offer are set.

7.8.14

FCA PRA

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If a *firm* has an irrevocable and unfettered right to withdraw from an *underwriting* commitment, exercisable within a certain period, the commitment commences (and thus the time of *initial commitment* occurs) when that right expires.

7.8.15

FCA PRA

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Subject to the existence of a right described in ■ BIPRU 7.8.14R an *underwriting* commitment commences even if it is subject to formal, legal or other conditions that would normally be expected to be satisfied.

7.8.16

FCA PRA

G

A force majeure or material adverse change clause would not be a right of the sort referred to in ■ BIPRU 7.8.14R.

#### Calculating the net underwriting position

7.8.17

FCA PRA

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A *firm* must calculate a *net underwriting position* by adjusting the gross amount it has committed to *underwrite* for:

- (1) any sales or *sub-underwriting* commitments received that have been confirmed in writing at the time of *initial commitment* (but excluding any sales in the grey market as defined in ■ BIPRU 7.8.10R (1));
- (2) any *underwriting* or *sub-underwriting* commitments obtained from others since the time of *initial commitment*;
- (3) any purchases or sales of the *securities* since the time of *initial commitment* (other than purchases or sales in the grey market as defined in ■ BIPRU 7.8.10R (1));
- (4) (in the case of sales in the grey market as defined in ■ BIPRU 7.8.10R (1)) any sales of the *securities* as at the time of *initial commitment* or since the time of *initial commitment* subject, in both cases, to the following conditions:
  - (a) any sales of the *securities* as at the time of *initial commitment* must be confirmed in writing at the time of *initial commitment*; and

(b) sales must be net of any purchases in the grey market as defined in ■ BIPRU 7.8.10R (1); and

(5) any allocation of *securities* granted or received, arising from the commitment to *underwrite* the *securities*, since the time of *initial commitment*.

7.8.18

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FCA PRA

If the allocation of *securities* has not been fixed a *firm* must calculate the gross amount of its commitment, for the purposes of ■ BIPRU 7.8.17R, by reference to the maximum amount it has committed to *underwrite* until the time the allocation is set.

7.8.19

R

FCA PRA

An *underwriting* commitment may only be reduced under ■ BIPRU 7.8.17R on the basis of a formal agreement.

7.8.20

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FCA PRA

Allocations may arise, after date of *initial commitment*, from the agreement to *underwrite*. For example obligations or rights may be allocated to or from the issuer, the *underwriting* group or syndicate.

#### Over-allotment options

7.8.21

R

FCA PRA

(1) This *rule* deals with the treatment of short *positions* that arise when a *firm* commits to distribute *securities* that it is *underwriting* in an amount that exceeds the allocation to the *firm* made by the issuer of the *securities* being *underwritten*.

(2) When calculating its *net underwriting position*, a *firm* may use an over-allotment option granted to it by the issuer of the *securities* being *underwritten* to reduce the short *positions* in (1).

(3) A *firm* may also use an over-allotment option granted to another member of the *underwriting* syndicate for the purpose in (2).

(4) (2) and (3) only apply from *working day 0*.

(5) (2) and (3) only apply to the extent that the treatment is consistent with the terms of the over-allotment option.

7.8.22

R

FCA PRA

Except as provided in ■ BIPRU 7.8.21R, a *firm* must not take into account an over-allotment option granted to it or another member of the *underwriting* syndicate in calculating its *net underwriting position*.

#### Working day 0

7.8.23

R

FCA PRA

For the purposes of ■ BIPRU 7.8 *working day 0* is the *business day* on which a *firm* that is *underwriting* or sub-*underwriting* becomes unconditionally committed to accepting a known quantity of *securities* at a specified price.

7.8.24

FCA PRA

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For debt issues and *securities* which are issued in a similar manner, *working day 0* is the later of the date on which the *securities* are allotted and the date on which payment for them is due.

7.8.25

FCA PRA

G

For *equity* issues and *securities* which are issued in a similar manner, *working day 0* is the later of the date on which the offer becomes closed for subscriptions and the date on which the allocations are made public.

7.8.26

FCA PRA

G

For rights issues, *working day 0* is the first day after the date on which the offer becomes closed to acceptances for subscription.

### Calculating the reduced net underwriting position

7.8.27

FCA PRA

R

To calculate the *reduced net underwriting position* a firm must apply the reduction factors in the table in ■ BIPRU 7.8.28R to the *net underwriting position* (calculated under ■ BIPRU 7.8.17R) as follows:

- (1) in respect of debt *securities*, a firm must calculate two *reduced net underwriting positions*; one for inclusion in the firm's *interest rate PRR specific risk* calculation (■ BIPRU 7.2.43R), the other for inclusion in its *interest rate PRR general market risk* calculation (■ BIPRU 7.2.52R); and
- (2) in respect of *equities*, a firm must calculate only one *reduced net underwriting position*, and then include it in the *simplified equity method* (see ■ BIPRU 7.3.29R).

7.8.28

FCA PRA

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Table: Net underwriting position reduction factors

This table belongs to ■ BIPRU 7.8.27R

Underwriting timeline	Debt		Equity
	<i>General market risk</i>	<i>Specific risk</i>	
<b>Time of initial commitment until working day 0</b>	<b>0%</b>	<b>100%</b>	<b>90%</b>
<i>Working day 1</i>	0%	90%	90%
<i>Working day 2</i>	0%	75%	75%
<i>Working day 3</i>	0%	75%	75%
<i>Working day 4</i>	0%	50%	50%
<i>Working day 5</i>	0%	25%	25%
<i>Working day 6 and onwards</i>	0%	0%	0%

## 7.8.29

FCA PRA

G

The table in ■ BIPRU 7.8.30G gives an example of the *reduced net underwriting position* calculation. The example is based on the *firm* starting with a commitment to underwrite £100 million of a new *equity* issue. *Firms* are reminded that in the case of an *equity*, the *reduced net underwriting position* should be treated under the *simplified equity method* (see ■ BIPRU 7.8.27R (Simplified and standard equity methods) and ■ BIPRU 7.8.27R).

## 7.8.30

FCA PRA

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Table: Example of the reduced net underwriting position calculation

This table belongs to ■ BIPRU 7.8.29G

Time	<i>Net underwriting position</i> (see BIPRU 7.8.17R)		£	Percentage reduction (see BIPRU 7.8.28R)	<i>Reduced net underwriting position</i>
At <i>initial commitment</i> 9.00am Monday	£100m gross amount is reduced by £20m due to sales/sub-underwriting commitments confirmed in writing at the time of initial commitment (see BIPRU 7.8.17R (1) and (4)).	=	£80m	90%	£8m
Post initial commitment 9.02am Monday	Remaining £80m is reduced by £40m due to further sales, sub-underwriting commitments obtained and allocations granted (see BIPRU 7.8.17R (2) - (5)).	=	£40m	90%	£4m
At the end of <i>working day 1</i>	Remaining £40m is reduced to £20m due to further sales.	=	£20m	90%	£2m
End of <i>working day 3</i>	Remaining £20m is reduced to £5m due to further sales.	=	£5m	75%	£1.25 m
End of <i>working day 4</i>	Remaining £5m is re-	=	£2m	50%	£1m

Time	Net underwriting position (see BIPRU 7.8.17R)	Percentage reduction (see BIPRU 7.8.28R)	Reduced net underwriting position
	duced to £2m due to further sales.		
End of working day 5	Remaining £2m is reduced to £1m due to further sales.	25%	£0.75 m
Start of working day 6	£1m remaining	0%	£1m

**Large exposure risk from underwriting securities: Calculating the net underwriting exposure**

7.8.31  
FCA PRA

**R** For the purposes of calculating the total amount of its *trading book exposures* to a *person* for concentration risk purposes, a *firm* must include *net underwriting exposure* to that *person*.

7.8.32  
FCA PRA

**R** A *firm* must include any other *exposures* arising out of *underwriting* (including any counterparty *exposures* to any sub-underwriters) for the purposes of calculating the total amount of its *trading book exposures* to a *person* for concentration risk purposes.

7.8.33  
FCA PRA

**R** A *firm*, before entering into a new *underwriting* commitment, must be able to recalculate the *concentration risk capital component* to the level of detail necessary to ensure that the *firm's capital resources requirement* does not exceed the *firm's capital resources*.

7.8.34  
FCA PRA

**R** Except where otherwise specified by a *requirement* on its *Part 4A permission*, a *firm* must calculate the *net underwriting exposure* to an issuer by applying the relevant reduction factors in the table in ■ BIPRU 7.8.35R to its *net underwriting position* calculated under ■ BIPRU 7.8.17R.

7.8.35  
FCA PRA

**R** Table: Calculation of net underwriting exposure

This table belongs to ■ BIPRU 7.8.34R

Time	Reduction factor to be applied to net underwriting position
<i>Initial commitment to working day 0</i>	100%
<i>Working day 0</i>	100%

Time	Reduction factor to be applied to net underwriting position
<i>Working day 1</i>	<b>90%</b>
<i>Working day 2</i>	<b>75%</b>
<i>Working day 3</i>	<b>75%</b>
<i>Working day 4</i>	<b>50%</b>
<i>Working day 5</i>	<b>25%</b>
<i>Working day 6 onwards</i>	<b>0%</b>

7.8.36

FCA PRA

G

The effect of ■ BIPRU 7.8.34R is that there is no concentration limit for *net underwriting exposures* between *initial commitment* and the end of *working day 0*, except where specified by a *requirement* on a *firm's Part 4A permission*.

### Large exposure risk from underwriting securities: Monitoring and reporting concentration risk

7.8.37

FCA PRA

R

For the purposes of concentration risk monitoring only, a *firm* must report its *net underwriting exposure* both before and after the application of the reduction factors in the table in ■ BIPRU 7.8.35R.

### Risk management

7.8.38

FCA PRA

R

A *firm* must take reasonable steps to establish and maintain such systems and controls to monitor and manage its *underwriting* and *sub-underwriting* business as are appropriate to the nature, scale and complexity of its *underwriting* and *sub-underwriting* business. In particular, a *firm* must have systems to monitor and control its *underwriting exposures* between the time of the *initial commitment* and *working day one* in the light of the nature of the risks incurred in the markets in question.

7.8.39

FCA PRA

G

A *firm* should take reasonable steps to:

- (1) allocate responsibility for the management of its *underwriting* and *sub-underwriting* business;
- (2) allocate adequate resources to monitor and control its *underwriting* and *sub-underwriting* business;
- (3) satisfy itself that its systems to monitor *exposure* to counterparties will calculate, revise and update its *exposure* to each counterparty arising from its *underwriting* or *sub-underwriting* business;
- (4) satisfy itself of the suitability of each *person* who performs functions for it in connection with the *firm's underwriting* and *sub-underwriting* business having regard to the *person's* skill and experience; and
- (5) satisfy itself that its procedures and controls to monitor and manage its *underwriting* business address, on an on-going basis, the capacity of *sub-underwriters* to meet *sub-underwriting* commitments.

## 7.9 Use of a CAD 1 model

### Introduction

#### 7.9.1

FCA PRA

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A *firm* is required under ■ GENPRU 2.1.52 R (Calculation of the *market risk* capital requirement) to calculate its *market risk capital requirement* using the rules in ■ BIPRU 7. However, the *appropriate regulator* may at the *firm's* request modify ■ GENPRU 2.1.52 R to allow the *firm* to calculate all or part of the *PRR* for the *positions* covered by that model by using a *CAD 1 model* (for *options* risk aggregation and/or interest rate pre-processing) or a *VaR model* (value at risk model) instead. ■ BIPRU 7.10 (Use of a Value at Risk Model) deals with *VaR model permissions*.

#### 7.9.2

FCA PRA

G

The purpose of ■ BIPRU 7.9 is to provide *guidance* on the *appropriate regulator's* policy for granting *CAD 1 model waivers* under section 138A of the *Act* (Modification or waiver of rules). The policy recognises that *CAD 1 models* may vary across *firms* but, as a minimum, the *appropriate regulator* will need to be satisfied:

- (1) about the quality of the internal controls and risk management relating to the model (see ■ BIPRU 7.9.19G - ■ BIPRU 7.9.23G for further details);
- (2) about the quality of the model standards; and
- (3) that the *CAD 1 model* captures and produces an accurate measure of the risks inherent in the portfolio covered by the *CAD 1 model* (see ■ BIPRU 7.9.25G - ■ BIPRU 7.9.53G for further details).

#### 7.9.3

FCA PRA

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■ BIPRU 7.9 also explains how the output from the *CAD 1 model* is fed into the *market risk capital requirement* calculation.

#### 7.9.4

FCA PRA

G

If a *CAD 1 model waiver* is granted by the *appropriate regulator*, the *waiver* will contain certain requirements. In order adequately to address individual circumstances, these may differ from what is set out in ■ BIPRU 7.9. The *waiver* will also identify the *rules* to which the *waiver* applies and the scope of model recognition granted to the *firm*.

#### 7.9.5

FCA PRA

G

*Waivers* permitting the use of models in the calculation of *PRR* will not be granted if that would be contrary to the *CAD*. Any *waiver* which is granted will only be granted on terms that are compatible with the *CAD*. Accordingly, the only *waivers* permitting the use of models in calculating *PRR* that the *appropriate regulator* is likely to grant are *CAD 1 model waivers* and *VaR model permissions*.

7.9.6

FCA PRA

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**Scope of CAD 1 models**

The *appropriate regulator* recognises two types of *CAD 1 model*. The table in ■ BIPRU 7.9.7G describes them.

7.9.7

FCA PRA

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Table: Types of CAD 1 model

This table belongs to ■ BIPRU 7.9.6G

	Options risk aggregation models	Interest rate pre-processing models
Brief description and eligible instruments	Analyse and aggregate <i>options</i> risks for: <ul style="list-style-type: none"> <li>• interest rate <i>options</i>;</li> <li>• equity <i>options</i>;</li> <li>• foreign currency <i>options</i>;</li> <li>• commodity <i>options</i>; and</li> <li>• <i>CIU options</i>.</li> </ul>	May be used to calculate duration weighted <i>positions</i> for: <ul style="list-style-type: none"> <li>• interest rate <i>futures</i>;</li> <li>• forward rate agreements (<i>FRAs</i>);</li> <li>• forward commitments to buy or sell debt <i>securities</i>;</li> <li>• <i>options, swaps</i> or <i>warrants</i> on interest rates or debt <i>securities</i> and <i>options</i> on such <i>swaps</i>;</li> <li>• amortising bonds;</li> <li>• equity <i>futures, forwards, warrants</i> and <i>options</i> (but only in relation to the interest rate risk inherent in these products); and</li> <li>• foreign currency <i>futures, forwards, swaps</i> and <i>options</i>, but only in relation to the interest rate risk inherent in these products.</li> </ul>
The output and how it is used in the <i>PRR</i> calculation	Depending on the type of model and the requirements in the <i>CAD 1 model waiver</i> granted, the outputs from an <i>options</i> risk aggregation model are used as an input to the <i>market risk capital requirement</i> calculation.	Depending on the type of model and the requirements in the <i>CAD 1 model waiver</i> granted, the individual sensitivity figures produced by this type of <i>CAD 1 model</i> are either input into the calculation of <i>interest rate PRR</i> under the <i>interest rate duration method</i> (see BIPRU 7.2.63R) or are converted into notional <i>position</i> and input into the calculation of <i>interest rate PRR</i> under the <i>interest rate maturity method</i> (see BIPRU 7.2.59R).

7

7.9.8

FCA PRA

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Currently the *appropriate regulator* only envisages allowing recognition for *options* on *CIUs* if the *CIU* satisfies one of the following conditions:

- (1) it is a *regulated collective investment scheme*; or

- (2) the *firm* can demonstrate that it has characteristics that are similar to or better than an *undertaking* in (1) from the point of view of transparency and liquidity.

### The CAD 1 model waiver application and review process

7.9.9

FCA PRA

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Details of the general *waiver* process are set out in ■ SUP 8 (Waiver and modification of rules). Further details of the *waiver* process applicable to certain *waivers* relating to BIPRU (including *CAD 1 model waivers*) can be found in ■ BIPRU 1.3 (Applications for advanced approaches). Because of the complexity of a *CAD 1 model waiver*, it is recommended that, as set out in ■ SUP 8.3.4 G and ■ BIPRU 1.3.21 G, a *firm* contact its usual contact at the *appropriate regulator* to discuss its proposed application. It should also be noted that the *waiver* recognition process in the case of a *CAD 1 model* may take longer than the timescales indicated in ■ SUP 8.3.5 G.

7.9.10

FCA PRA

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In order to consider a *CAD 1 model waiver* request, the *appropriate regulator* may undertake a review to ensure that it is adequate and appropriate for the *PRR* calculation.

7.9.11

FCA PRA

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The model review process may be conducted through a series of visits covering various aspects of the *firm's* control and IT environment. Before these visits the *appropriate regulator* may ask the *firm* to provide some information relating to its *waiver* request accompanied by some specified background material. The model review visits are organised on a timetable that allows a *firm* being visited sufficient time to arrange the visit and provide the appropriate pre-visit information.

7.9.12

FCA PRA

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As part of the model review process, the following may be reviewed: organisational structure and personnel; details of the *firm's* market position in the relevant products; profit and risk information; valuation and reserving policies; operational controls; IT systems; model release and control procedures; risk management and control framework; risk appetite and limit structure and future developments relevant to model recognition.

7.9.13

FCA PRA

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The *appropriate regulator* will normally require meetings with senior management and staff from the front office, financial control, risk management, operations, systems development, information technology and audit areas.

7.9.14

FCA PRA

G

A review by a *skilled person* may be used before a *CAD 1 model waiver* is granted to supplement the *waiver* process or after the *waiver* has been granted to review the *CAD 1 model*.

7.9.15

FCA PRA

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If the *appropriate regulator* grants a *CAD 1 model waiver*, the *waiver* direction will specify the particular *rule* which has been modified, and set out the requirements subject to which the *waiver* has been granted. These requirements may include:

- (1) the details of the calculation of *PRR*;
- (2) the *CAD 1 model waiver* methodology to be employed;

- (3) the products covered by the model (e.g. *option* type, maturity, currency); and
- (4) any notification requirements relating to the *CAD 1 model waiver*.

7.9.16

FCA PRA

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Where a *firm* operates any part of its *CAD 1 model* outside the *United Kingdom*, the *appropriate regulator* may take into account the results of any review of that model carried out by any overseas regulator concerned. The *appropriate regulator* may wish to receive information directly from that regulator.

### Maintenance of model recognition

7.9.17

FCA PRA

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No changes should be made to a *CAD 1 model* unless the change is not material. Material changes to a *CAD 1 model* will require a renewed *waiver* to be issued. Materiality is measured from the time that the *waiver* is granted or, if the *waiver* has been varied in accordance with section 138A of the *Act*, any later time that may be specified in the *waiver* for these purposes. If a *firm* is considering making material changes to its *CAD 1 model*, then it should notify the *appropriate regulator* at once. If a *firm* wishes to change the products covered by the model it should apply for a variation of its *CAD 1 model waiver*.

7.9.18

FCA PRA

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If the *CAD 1 model* ceases to meet the requirements of the *waiver*, the *firm* should notify the *appropriate regulator* at once. The *appropriate regulator* may then revoke the *waiver* unless it is varied in accordance with section 138A of the *Act*. If the *CAD 1 model waiver* contains conditions it is a condition of using the *CAD 1 model approach* that the *firm* should continue to comply with those conditions.

### Risk management standards

7.9.19

FCA PRA

G

A *firm* with a complex portfolio is expected to demonstrate more sophistication in its modelling and risk management than a *firm* with a simple portfolio.

7.9.20

FCA PRA

G

A *firm* should be able to demonstrate that the risk management standards set out in ■ BIPRU 7.9 are satisfied by each legal entity with respect to which the *CAD 1 model approach* is being used (even though they are expressed to refer only to a *firm*). This is particularly important for *subsidiary undertakings* in *groups* subject to matrix management where the business lines cut across legal entity boundaries.

7.9.21

FCA PRA

G

- (1) A *firm* should have a conceptually sound risk management system which is implemented with integrity and should meet the minimum standards set out in this paragraph.
- (2) A *firm* should have a risk control unit that is independent of business trading units and reports directly to senior management. The unit should be responsible for designing and implementing the *firm's* risk management system. It should produce and analyse daily reports on the risks run by the business and on the appropriate measures to be taken in terms of the trading limits.
- (3) A *firm's* senior management should be actively involved in the risk control process and the daily reports produced by the risk control unit should be reviewed by a level of management with sufficient authority to enforce reductions of *positions* taken by individual traders as well as in the *firm's* overall risk exposure.

- (4) The risk control group should have a sufficient number of staff with appropriate skills in the use of models.
- (5) A *firm* should have established procedures for monitoring and ensuring compliance with a documented set of appropriate internal policies and controls concerning the overall operation of the risk measurement and control framework. This should take into account the front, middle and back office functions.
- (6) A *firm* should conduct, as part of its regular internal audit process, a review of the systems and controls relating to its *CAD 1 model*. This review should include the valuation process, compliance with the *CAD 1 model waiver's* scope and the activities of the business trading units and the risk control units. This review should be undertaken by staff independent of the areas being reviewed.

## 7.9.22

FCA PRA

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In assessing whether the risk management and control framework is implemented with integrity, the *appropriate regulator* will consider the IT systems used to run the *CAD 1 model* and associated calculations. The assessment will include, where appropriate:

- (1) feeder systems; risk aggregation systems; the integrity of the data (i.e. whether it is complete, coherent and correct); reconciliations and checks on completeness of capture; and
- (2) system development, change control and documentation; security and audit trails; system availability and contingency procedures; network adequacy.

## 7.9.23

FCA PRA

G

A *firm* should take appropriate steps to ensure that it has adequate controls relating to:

- (1) the derivation of the *PRR* from the *CAD 1 model* output;
- (2) *CAD 1 model* development, including independent validation;
- (3) reserving;
- (4) valuation (see ■ GENPRU 1.3 (Valuation)), including independent validation; and
- (5) the adequacy of the IT infrastructure.

### Model standards

## 7.9.24

FCA PRA

G

A *firm* should take appropriate steps to ensure that its *CAD 1 model* captures and produces an accurate measure of the risks inherent in the portfolio covered by the *CAD 1 model*. These risks may include, but are not limited to, gamma, vega and rho.

### Options risk aggregation models

## 7.9.25

FCA PRA

G

For a *firm* to obtain a *CAD 1 model waiver* for its *options* risk aggregation model, it should have in place an appropriate *options* valuation model.

## 7.9.26

FCA PRA

G

The *appropriate regulator* does not specify the methodology that a *firm* should employ in order to produce the appropriate outputs from its *options* risk aggregation CAD 1 model. However, ■ BIPRU 7.9.27G - ■ BIPRU 7.9.43G provide details of how a *firm* could meet the requirement to capture gamma, vega and rho risks using a scenario matrix approach. Where a *firm* adopts the scenario matrix approach then the standards set out in ■ BIPRU 7.9.27G - ■ BIPRU 7.9.43G should be followed. The *firm* should also take into account other risks not captured by the scenario matrix approach. If a *firm* does not use the scenario matrix approach it should use an equivalent methodology. If a *firm* uses an equivalent methodology it should be able to demonstrate that the approach used meets the requirements of ■ BIPRU 7.9.

## 7.9.27

FCA PRA

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A scenario matrix is an approach by which an *options* portfolio is revalued given a number of simultaneous shifts in both the spot level of the underlying and the implied volatility.

## 7.9.28

FCA PRA

G

The scenario matrix approach may be employed for all types of *options* on all types of underlying asset.

## 7.9.29

FCA PRA

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- (1) This paragraph provides an outline of the initial steps to be taken when using the scenario matrix approach.
- (2) A value for an *option* should be obtained using the *firm's options* valuation model.
- (3) The inputs into the *options* valuation model for implied volatility of the underlying asset and the price of the underlying asset should then be altered so that a new value for the *option* is obtained (details of the amount by which the implied volatility and the price of the underlying should be amended are set out in ■ BIPRU 7.9.30G - ■ BIPRU 7.9.36G).
- (4) The difference between the original value of the *option* and the new value obtained following the alterations should be input into the appropriate cell in the matrix. The value in the central cell where there is no change in implied volatility or price of the underlying should therefore be zero.
- (5) The process of obtaining a new price for the *option* should be repeated until the matrix is completed.

## 7.9.30

FCA PRA

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The alteration to the implied volatility (known as the implied volatility shift) referred to in ■ BIPRU 7.9.29G (3) may be a proportional shift. The size of the shift depends on the remaining life of the *option* and the asset class of the underlying. The table in ■ BIPRU 7.9.32G sets out the shifts that should be applied where a proportional shift is used. Alternatively, a *firm* may use a single shift across all maturities or use an absolute rather than a proportional implied volatility shift. Where a single shift or an absolute shift is used it should be at least as conservative as the proportional shifts. Any use of a single shift or an absolute shift should be reviewed and, if necessary updated, on a regular basis.

## 7.9.31

FCA PRA

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A *firm* may choose to use a less detailed term structure than that in the table in ■ BIPRU 7.9.32G, but the shifts used should be no less conservative than those set out in that table. For example, a *firm* that uses one <3 month band, rather than the two bands (< 1 month and 1-3 months) set out in the table, should use the most conservative shift set out in the table for the bands covered. In this example that shift is 30%.

## 7.9.32

FCA PRA

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Table: proportional implied volatility shifts

This table belongs to ■ BIPRU 7.9.30G

Remaining life of option	Proportional shift	
	<i>Equities, foreign currency and commodities</i>	Interest rates and <i>CIUs</i>
≤ 1 month	30%	30%
> 1 ≤ 3 months	20%	20%
> 3 ≤ 6 months	15%	15%
> 6 ≤ 9 months	12%	12%
> 9 ≤ 12 months	9%	9%
> 1 ≤ 2 years	6%	9%
> 2 ≤ 4 years	4.5%	9%
> 4 years	3%	9%

## 7.9.33

FCA PRA

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The size of the underlying price/rate shift depends on the asset class of the underlying as referred to in ■ BIPRU 7.9.29G (3) and is set out in the table in ■ BIPRU 7.9.34 G.

## 7.9.34

FCA PRA

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Table: underlying price/rate shifts

This table belongs to ■ BIPRU 7.9.33G

Underlying asset class	Shift
<i>Equities</i>	±8%
<i>Foreign currency</i>	±8%
<i>Commodities</i>	±15%, (but a <i>firm</i> may use the percentages applicable under the <i>commodity extended maturity ladder approach</i> if it would qualify under BIPRU 7.4 (Commodity PRR) to use that approach).
Interest rates	±100bp (but a <i>firm</i> may use the sliding scale of shifts by maturity as applicable to the <i>interest rate duration method</i> ).
<i>CIU</i>	±32%, (but a <i>firm</i> may use the percentages applicable to the underlyings if the <i>firm</i> applies one of the <i>CIU look through methods</i> under BIPRU 7.7 (Position risk requirements for collective investment undertakings)).

## 7.9.35

FCA PRA

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The shifts outlined in the table in ■ BIPRU 7.9.34G are the maximum shifts required; in addition there will be a number of intermediate shifts as a result of the minimum matrix size criteria set out in ■ BIPRU 7.9.36G.

## 7.9.36

FCA PRA

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The minimum size of the scenario matrix should be 3x7, that is, three observations for implied volatility (including the actual implied volatility) and seven observations for the price of the underlying (including the actual price of the underlying). A *firm* should be able to justify its choice of granularity. Greater granularity may be required where the portfolio contains, for example, a large proportion of barrier *options*.

## 7.9.37

FCA PRA

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- (1) A different scenario matrix should be set up for each underlying asset type in accordance with this paragraph.
- (2) For *equities* (including single *equities*, baskets and indices) there should be a separate matrix for each national market or non-decomposed basket or non-decomposed multi-national index.
- (3) For *foreign currency* products there should be a separate matrix for each currency pair where appropriate.
- (4) For *commodity* products there should be a separate matrix for each *commodity*. The question whether two items are the same *commodity* should be decided in accordance with ■ BIPRU 7.4 (Commodity PRR).
- (5) For interest rate products there should be a separate matrix for each currency. In addition, a *firm* should not offset the gamma and vega exposures (except in the circumstances set out in ■ BIPRU 7.9.38G) arising from any one of the following types of product with the gamma and vega exposures arising from any of the other products in the list:
  - (a) swaptions (*options* on interest rates);
  - (b) interest rate *options* (including *options* on exchange-traded deposit or bill *futures*);
  - (c) bond *options* (including *options* on exchange-traded bond *futures*); and
  - (d) other types of *options* required by the CAD 1 model *waiver* to form their own separate class of underlying asset.
- (6) The other types of *options* referred to in (5)(d) will generally be exotic *options* that do not fall easily into (5)(a) - (c).
- (7) For *CIUs* there should be a separate matrix for each *CIU* fund. If the *firm* applies one of the *CIU look through methods* under ■ BIPRU 7.7 (Position risk requirements for collective investment undertakings), then (1) - (6) apply based on what the underlyings are.

## 7.9.38

FCA PRA

G

A *firm* may offset gamma and vega exposures arising from the products listed in ■ BIPRU 7.9.37G (5) where it can demonstrate that it trades different types of interest rate-related *options* as a portfolio and takes steps to control the basis risk between different types of implied volatility. To the extent that this is the case an individual matrix is not required for each of the products listed in ■ BIPRU 7.9.37G (5) and a combined scenario matrix may be used.

## 7.9.39

FCA PRA

G

Where it is imprudent fully to offset long-dated and short-dated vega exposure owing to the risk of non-parallel shifts in the yield curve, a *firm* should use an appropriate number

of scenario matrices to take account of non-parallel shifts in the yield curve according to the maturity of the *option* or underlying.

7.9.40

FCA PRA

G

Following the steps outlined in ■ BIPRU 7.9.29G, a *firm* then removes the portion of the values in the matrix that can be attributed to the effect that delta has had on the change in the value of the *option* (a process known as delta-stripping).

7.9.41

FCA PRA

G

Once the effect of delta has been removed from the matrix, the values left in the matrix relate to gamma and vega risk. A *firm's* PRR in relation to gamma and vega risk on the individual *option* is the absolute of the most negative cell in the scenario matrix produced. Where all cells are positive the PRR is zero. The total PRR for the gamma and vega risk on the portfolio of *options* is a simple sum of the individual requirements. This amount should then be fed into a *firm's* PRR calculation.

7.9.42

FCA PRA

G

The values that have been obtained for the delta-equivalent *positions* of instruments included in the scenario matrix should then be treated in the same way as *positions* in the underlying. Where the delta obtained relates to interest rate *position* risk, the delta equivalent *positions* may be fed into the *firm's* interest rate pre-processing model to the extent that the *positions* fall within the scope of interest rate pre-processing models as set out in ■ BIPRU 7.9.7G and provided that the *firm's* CAD 1 model waiver allows the *firm's* CAD 1 model to be used in this way. Alternatively, the delta obtained should be fed into the standard PRR calculations in ■ BIPRU 7.2 (Interest rate PRR), ■ BIPRU 7.3 (Equity PRR and basic interest rate PRR for equity derivatives), ■ BIPRU 7.4 (Commodity PRR) or ■ BIPRU 7.5 (Foreign currency PRR) as appropriate.

7.9.43

FCA PRA

G

In using the scenario matrix approach, none of the steps followed will take specific account of a *firm's* exposure to rho risk. Where a *firm* can demonstrate that for interest rate-related *options* the rho sensitivity is effectively included in the delta sensitivities produced, there is no separate capital requirement relating to rho. For all other *options* except *commodity options*, a *firm* should calculate a rho sensitivity ladder by currency using its CAD 1 model and either feed this into the *interest rate maturity method* or *interest rate duration method* calculation or, where the *firm's* CAD 1 model waiver allows the *firm's* CAD 1 model to be used in this way, feed that ladder into an interest rate pre-processing model. Generally a CAD 1 model does not need to deal specifically with rho risk for *commodity options*.

### Interest rate pre-processing models

7.9.44

FCA PRA

G

To the extent that a *firm's* CAD 1 model waiver is for the use of an interest rate pre-processing model the *firm* should use it for the pre-processing of the instruments set out in ■ BIPRU 7.9.7G, from which the residual *positions* are fed into the *interest rate maturity method* or *interest rate duration method* calculation.

7.9.45

FCA PRA

G

There are a number of different methods of constructing pre-processing models but all should comply with ■ BIPRU 7.9.45G - ■ BIPRU 7.9.53G. All pre-processing models should generate *positions* that have the same sensitivity to defined interest rate changes as the underlying cash flows.

7.9.46

FCA PRA

G

In an interest rate pre-processing model each transaction is converted into its constituent cash flows. The cash flows are discounted using zero coupon rates derived from the *firm's* own yield curves.

7.9.47

FCA PRA

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The cash flows are then calculated again using the *firm's* own yield curve shifted by the amount set out in ■ BIPRU 7.9.49G.

7.9.48

FCA PRA

G

The difference between the present values calculated using the *firm's* own yield curve and those calculated using the *firm's* curve shifted under ■ BIPRU 7.9.47G are known as the sensitivity figures. Alternatively, a *firm* may shift the yield curve by one basis point and multiply up the sensitivity figures by the appropriate amount in order to achieve the shifts set out in ■ BIPRU 7.9.47G. These sensitivity figures are then allocated to each of the 15 maturity bands set out in ■ BIPRU 7.9.49G.

7.9.49

FCA PRA

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Table: yield curve shifts

This table belongs to ■ BIPRU 7.9.47G

Zone	Modified duration	Assumed interest rate change (percentage points)
1	0 ĩ 1 months	1.00
	> 1 ĩ 3 months	1.00
	> 3 ĩ 6 months	1.00
	> 6 ĩ 12 months	1.00
2	> 1.0 ĩ 1.9 years	0.90
	> 1.9 ĩ 2.8 years	0.85
	> 2.8 ĩ 3.6 years	0.85
3	> 3.6 ĩ 4.3 years	0.75
3	> 4.3 ĩ 5.7 years	0.70
	> 5.7 ĩ 7.3 years	0.70
	> 7.3 ĩ 9.3 years	0.70
	> 9.3 ĩ 10.6 years	0.70
	> 10.6 ĩ 12 years	0.70
	> 12.0 ĩ 20 years	0.70
	> 20 years	0.70

7.9.50

FCA PRA

G

Sensitivity figures calculated by a *firm* using an interest rate pre-processing model are usually produced in the format of a net sensitivity by maturity bucket or by discrete gridpoint. These maturity buckets or gridpoints should then be allocated to the 15 bands set out in ■ BIPRU 7.9.49G. The number of maturity buckets or gridpoints used to represent a yield curve can be referred to as granularity. The granularity should always be adequate to capture the material curve risk in the portfolio. Curve risk can be defined as the risk associated with holding long and short *positions* at different points along the yield curve.

7.9.51

FCA PRA

G

Positive and negative amounts placed in each of the different maturity bands in ■ BIPRU 7.9.49G under the sensitivity calculation in ■ BIPRU 7.9.50G should then be netted off to produce one figure for each of the bands. There is no capital requirement for this netting process.

7.9.52

FCA PRA

G

The individual sensitivity figures produced should then be input into the *interest rate duration method* calculation. The individual sensitivity figures for each band should be included with the other *positions* in the appropriate column in the table in ■ BIPRU 7.2.65R (Table: Assumed interest rate change in the interest rate duration method).

7.9.53

FCA PRA

G

Instead of using the approach in ■ BIPRU 7.9.52G a *firm* may use an approach based on the *interest rate maturity method*, making appropriate adjustments to the sensitivity figures.

## 7.10 Use of a Value at Risk Model

### Application

**7.10.1** **R** ■ BIPRU 7.10 applies to a *firm* with a *VaR model permission*.

**FCA** **PRA**

### Introduction and purpose

**7.10.2** **G** ■ BIPRU 7.10 provides details of when the *appropriate regulator* expects to allow a *firm* to use a *VaR model* (value at risk model) for the purpose of calculating part or all of its *PRR*. It introduces the concept of a *VaR model*, the methodology behind it and the link to the *standard market risk PRR rules*. It then goes on to detail the application and review process. The bulk of ■ BIPRU 7.10 specifies the model standards and risk management standards that *firms* will be required to meet in order to use a *VaR model*. It further stipulates requirements for stress testing, backtesting, capital calculations and finally the reporting standards expected by the *appropriate regulator*.

**7.10.3** **G** The models described in ■ BIPRU 7.10 are described as VaR models in order to distinguish them from *CAD 1 models*, which are dealt with in ■ BIPRU 7.9 (Use of a CAD 1 model). A *VaR model* is a risk management model which uses a statistical measure to predict profit and loss movement ranges with a confidence interval. From these results *PRR charges* can be calculated. The standards described in ■ BIPRU 7.10, and which will be applied by the *appropriate regulator*, are based on and implement Annex V of the *Capital Adequacy Directive*.

**7.10.4** **G** The aim of the *VaR model approach* is to enable a *firm* with adequate risk management systems to be subject to a *PRR* requirement that is more closely aligned with the risks to which it is subject than the *PRR* requirements generated by the *standard market risk PRR rules*. This provides a *firm* with an incentive to measure market risks as accurately and comprehensively as possible. It is crucial that those responsible for managing *market risk* at a *firm* should be aware of the assumptions and limitations of the *firm's VaR model*.

**7.10.5** **G** There are a number of general methodologies for calculating *PRR* using a *firms*. The *appropriate regulator* does not prescribe any one method of computing *VaR measures*. Moreover, it does not wish to discourage any *firm* from developing alternative risk measurement techniques. A *firm* should discuss the use of any alternative techniques used to calculate *PRR* with the *appropriate regulator*.

**7.10.6** **G** A *firm* should not use the *VaR model approach* to calculate *PRR* unless it has a *VaR model permission*. If a *firm* does not have such a permission it should use the *standard market risk PRR rules*. Therefore, a *firm* needs to apply for a *VaR model permission* in

order to calculate its *PRR* using a *VaR model* instead of (or in combination with) the *standard market risk PRR rules*.

### Conditions for granting a VaR model permission

7.10.7

FCA PRA

G

A *waiver* or other permission allowing the use of models in the calculation of *PRR* will not be granted if that would be contrary to the *Capital Adequacy Directive* and any *VaR model permission* which is granted will only be granted on terms that are compatible with the *Capital Adequacy Directive*. Accordingly, the *appropriate regulator* is likely only to grant a *waiver* or other permission allowing the use of models in the calculation of *PRR* if it is a *VaR model permission* or a *CAD 1 model waiver*.

7.10.8

FCA PRA

G

■ BIPRU 7.10 sets out the minimum standards that the *appropriate regulator* expects *firms* to meet before granting a *VaR model permission*. The *appropriate regulator* will not grant a *VaR model permission* unless it is satisfied that the requirements of ■ BIPRU 7.10 are met and it is satisfied about the procedures in place at a *firm* to calculate the *model PRR*. In particular the *appropriate regulator* will not normally grant a *VaR model permission* unless it is satisfied about the quality of:

- (1) the internal controls and risk management relating to the *VaR model* (see ■ BIPRU 7.10.56G - ■ BIPRU 7.10.82R);
- (2) the *VaR model* standards (see ■ BIPRU 7.10.24R- ■ BIPRU 7.10.55G); and
- (3) stress testing and backtesting procedures relating to a *VaR model* (see, in addition to (2), ■ BIPRU 7.10.83R - ■ BIPRU 7.10.112G).

7.10.9

FCA PRA

G

The *appropriate regulator* recognises that the nature of *VaR models* will vary between *firms*. The scope of and the requirements and conditions set out in a *VaR model permission* may therefore differ in substance or detail from ■ BIPRU 7.10 in order to address individual circumstances adequately. However any differences will only be allowed if they are compliant with the *Capital Adequacy Directive*. A *VaR model permission* will implement any such variation by modifying ■ BIPRU 7.10. A *VaR model permission* may also include additional conditions to meet the particular circumstances of the *firm* or the model.

### The VaR model permission application and review process

7.10.10

FCA PRA

G

Details of the general process for applying for a *VaR model permission* are set out in ■ BIPRU 1.3 (Applications for advanced approaches). Because of the complexity of a *VaR model permission*, it is recommended that a *firm* discuss its proposed application with its usual contact at the *appropriate regulator* before it makes the application.

7.10.11

FCA PRA

G

In order for a *VaR model permission* to be granted, the *appropriate regulator* is likely to undertake a review to ensure that it is adequate and appropriate for the *PRR* calculation.

7.10.12

FCA PRA

G

The *VaR model* review process may be conducted through a series of visits covering various aspects of a *firm's* control and IT environment. Before these visits the *appropriate regulator* may ask the *firm* to provide some information relating to the *firm's VaR model permission* request accompanied by some specified background

material. The *VaR model* review visits are organised on a timetable that allows the *firm* being visited sufficient time to arrange the visit and provide the appropriate pre-visit information.

7.10.13

FCA PRA

G

As part of the process for dealing with an application for a *VaR model permission* the following may be reviewed: organisational structure and personnel; details of the *firm's* market position in the relevant products; revenue and risk information; valuation and reserving policies; operational controls; information technology systems; model release and control procedures; risk management and control framework; risk appetite and limit structure; future developments relevant to model recognition.

7.10.14

FCA PRA

G

A visit will usually involve the *appropriate regulator* wishing to meet *senior management* and staff from the front office, financial control, risk management, operations, systems development, information technology and internal audit areas.

7.10.15

FCA PRA

G

The *appropriate regulator* may complement its own review of a *VaR model permission* request with one or more reviews by a *skilled person* under section 166 of the *Act* (Reports by skilled persons). Such a review may also be used where a *VaR model permission* has been granted to ensure that the requirements ■ BIPRU 7.10 and of the *VaR model permission* continue to be met.

#### Conditions for a VaR model outside the United Kingdom

7.10.16

FCA PRA

G

Where a *VaR model* used outside the *United Kingdom* differs from that used in the *United Kingdom* the *appropriate regulator* may request details of the reasons for using different models.

7.10.17

FCA PRA

G

Where a *firm* operates any part of its *VaR model* outside the *United Kingdom*, the *appropriate regulator* may take into account the results of the home supervisor's review of that model. The *appropriate regulator* may wish to receive information directly from the home supervisor.

#### Scope of VaR models

7.10.18

FCA PRA

R

A *firm* must use the *VaR model approach* to calculate the *PRR* for a *position*:

- (1) to the extent that the risks in relation to that *position* are within the scope of the *VaR model permission* (see ■ BIPRU 7.10.136R (Link to standard *PRR* rules: Incorporation of the model output into the capital calculation)); and
- (2) if the *position* is of a type that comes within the scope of the *VaR model permission*.

7.10.19

FCA PRA

G

In accordance with ■ BIPRU 7.10.18R (1) a *VaR model permission* will set out the risk categories that it covers, which are expected to be one or more of the following types:

- (1) interest rate *general market risk*;

- (2) interest rate *specific risk* (in conjunction with interest rate *general market risk*);
- (3) *equity general market risk*;
- (4) *equity specific risk* (in conjunction with *equity general market risk*);
- (5) *CIU risk*;
- (6) *foreign currency risk*; and
- (7) *commodity risk*.

## 7.10.20

FCA PRA

G

A *VaR model permission* will generally set out the broad classes of *position* within its scope. It may also specify how individual products within one of those broad classes may be brought into or taken out of the scope of the *VaR model permission*.

## 7.10.21

FCA PRA

G

The broad classes of *position* referred to in ■ BIPRU 7.10.20G are as follows:

- (1) linear products, which comprise *securities* with linear pay-offs (e.g. bonds and *equities*) and *derivative* products which have linear pay-offs in the underlying risk factor (e.g. interest rate *swaps*, *FRAs*, total return *swaps*);
- (2) European, American and Bermudan put and call *options* (including caps, floors and swaptions) and *investments* with these features (see ■ BIPRU 7.6.18R (Table: Option PRR: methods for different types of option) for an explanation of some of these terms);
- (3) Asian *options*, digital *options*, single barrier *options*, double barrier *options*, lookback *options*, forward starting *options*, compound *options* and *investments* with these features (see ■ BIPRU 7.6.18R for an explanation of some of these terms); and
- (4) all other *option* based products (e.g. basket *options*, quantos, outperformance *options*, timing *options*) and *investments* with these features (see ■ BIPRU 7.6.18R for an explanation of some of these terms).

## 7.10.22

FCA PRA

G

The categorisation described in ■ BIPRU 7.10.21G may be amended or replaced in the case of a particular *firm's VaR model permission*.

## 7.10.23

FCA PRA

G

It is the *appropriate regulator's* view that, where a *firm* uses a *VaR model* for one risk category as described in ■ BIPRU 7.10.19G, it is good practice to extend its model over time to calculate all of its *PRR* risk categories. A *firm* will typically be expected to have a realistic plan in place to do this.

### Model standards: General

## 7.10.24

FCA PRA

R

A *firm* must comply with the minimum standards set out in ■ BIPRU 7.10.26R - ■ BIPRU 7.10.53R in calculating the *model PRR*.

7.10.25

FCA PRA

G

The *appropriate regulator* accepts that the scope and nature of *VaR models* varies across *firms*. This means that different *firms* are likely to calculate different estimates of *market risk* for the same portfolio. Systematic differences are due to length of data series, choice of methodology (historical or Monte Carlo simulation or variance-covariance method or a hybrid of these), differences in aggregating risks within and across broad risk factors, the treatment of *options* and other non-linear products and the specification of risk factors.

#### Model standards: Frequency of calculations and confidence level

7.10.26

FCA PRA

R

The *model PRR* must be computed at least once every *business day*, using a 99% one-tailed confidence limit.

7.10.27

FCA PRA

G

A *firm* may meet the requirement in ■ BIPRU 7.10.26R by using different model parameters and employing a suitable adjustment mechanism to produce a figure which is equivalent to the figure produced using the parameters set out in ■ BIPRU 7.10.26R. For example, a *firm's* model may use a 95% one-tailed confidence limit if the *firm* has a mechanism to convert the output of the model to reflect a 99% one-tailed confidence limit.

7.10.27A

FCA PRA

R

*Stressed VaR* must be calculated at least weekly, using a 99% one-tailed confidence limit.

#### Model standards: Holding period

7.10.28

FCA PRA

R

In calculating the *VaR number*, a *firm* must either use a ten *business day* holding period, or use a holding period converted to a ten *business day* holding period. However if the *firm's VaR model permission* specifies that the *firm* must use a specific method, the *firm* must do so.

7.10.29

FCA PRA

G

If a *firm* uses a holding period other than 10 *business days* and converts the resulting *VaR measure* to a ten *business day* equivalent measure, it should be able to justify the choice of conversion technique. For example, the square root of time method will usually be justifiable. The *appropriate regulator* considers it good practice ultimately to move towards the application of an actual ten *business day* holding period, rather than using different holding periods.

#### Model standards: Observation period

7.10.30

FCA PRA

R

Subject to ■ BIPRU 7.10.31R, the calculation of *VaR numbers* must be based on an effective historical observation period that is the longest possible consistent with a prudent *VaR number*. That period must be at least one year or such longer period as may be set out in the *firm's VaR model permission*. However if using that prescribed observation period does not result in a sufficiently prudent way of calculating a *VaR measure* or a component of a *VaR measure* the *firm* must shorten this observation period until the observation period is consistent with a prudent *VaR number*.

7.10.30A

FCA PRA

R

The *stressed VaR* measure must be based on inputs calibrated to historical data from a continuous twelve-month period of significant financial stress relevant to the *firm's* portfolio. The choice of that historical period will be subject to the *appropriate regulator's* approval and will form part of a *firm's VaR model permission*.

7.10.30B  
FCA PRA

R

A *firm* must review the selection of the *stressed VaR* historical observation period at least annually.

#### Model standards: Data series

7.10.31  
FCA PRA

R

A *firm* must 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 technique must be used. A *firm* must be able to demonstrate that the technique is appropriate and does not materially understate the modelled risks.

7.10.32  
FCA PRA

G

A data series is unreliable if it has, for example, missing data points, or data points which contain stale data. Reliable data series may be difficult to obtain for new products (for example an instrument of longer dated tenor that did not previously trade) and for less liquid risk factors or *positions*. With regard to less liquid risk factors or *positions*, a *firm* may use 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*.

7.10.33  
FCA PRA

R

- (1) If a weighting scheme or other similar method is used to calculate *VaR numbers*, then the effective observation period must be at least one year. Where a weighting scheme is used, the weighted average time lag of the individual observations must not be less than six *Months*.
- (2) If a specific observation period or weighted average time lag is specified in a *firm's VaR model permission*, the *firm* must comply with that if it is longer than the period specified in (1).
- (3) However, if a weighting scheme in (1) or (2) would result in imprudent *VaR numbers* then the weighting scheme must be adjusted so that it is consistent with a prudent *VaR number*.

7.10.34  
FCA PRA

R

A *firm* must update data sets in accordance with the frequency set out in its *VaR model permission*. If volatility in market prices or rates necessitates more frequent updating in order to ensure a prudent calculation of the *VaR measure* the *firm* must do so.

7.10.35  
FCA PRA

G

The minimum updating frequency for the current *VaR measure* that can be specified in a *VaR model permission* is monthly.

#### Model standards: Aggregation across risk categories

7.10.36  
FCA PRA

R

The process for determining and implementing correlations within and across risk categories must be sound, implemented with integrity and consistent with the terms of the *firm's VaR model permission*.

7.10.37  
FCA PRA

R

In aggregating *VaR measures* across risk or product categories, a *firm* must not use the square root of the sum of the squares approach 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 must simply be added in order to determine its aggregate *VaR measure*. But to the extent that a *firm's VaR model permission* provides for a different way of aggregating *VaR measures*:

- (1) that method applies instead of this *rule*; and
- (2) if the correlations between risk categories used for that purpose cease to be empirically justified then the *firm* must notify the *appropriate regulator* at once.

#### Model standards: Risk factors: Introduction

7.10.38

FCA PRA

G

Subject to ■ BIPRU 7.10.53R (Model standards: Materiality), a *VaR model* should capture and accurately reflect all material risks arising on the underlying portfolio on a continuing basis insofar as those risks are within the scope of the *VaR model permission*. This should encompass *general market risk* and, to the extent that this comes within the scope of the *VaR model permission*, *specific risk*. A *firm* should ensure that the *VaR model* has sufficient risk factor granularity to be able to capture all such material risks and that these are properly documented and specified.

#### Model standards: Risk factors: General

7.10.39

FCA PRA

R

In the case of *general market risk* and risks with respect to which the *standard market risk PRR rules* do not distinguish between *general market risk* and *specific risk*, a *firm's VaR model* must capture a sufficient number of risk factors in relation to the level of activity of the *firm* and in particular the risks set out in ■ BIPRU 7.10.40R - ■ BIPRU 7.10.44R.

7.10.39A

FCA PRA

R

A *firm* must incorporate risk factors that are included in its pricing model in its *VaR model*. A *firm's VaR model* must capture nonlinearities for *options* and other products, as well as correlation risk and *basis risk*. Where proxies for risk factors are used they must show a good track record for the actual *position* held. In addition, ■ BIPRU 7.10.40 R to ■ BIPRU 7.10.44 R apply for individual risk types.

7.10.39B

FCA PRA

R

A *firm* with a *VaR model permission* must justify to the *appropriate regulator* any omissions of risk factors from its *VaR model*, if they are included in its pricing model.

7.10.40

FCA PRA

R

For interest rate risk, a *VaR model* must incorporate a set of risk factors corresponding to the interest rate curves in each currency in which the *firm* has interest rate sensitive *positions*. A *firm* must ensure that it captures the variations of volatility of rates along the yield curve. In order to achieve this, a *firm* must divide the yield curves of, at a minimum, the major currencies and markets in which it has material interest rate exposures into a minimum of six maturity segments. The *VaR model* must also capture the risk of less than perfectly correlated movements between different yield curves.

- 7.10.41** **R** For *equity* risk, a *VaR model* must use a separate risk factor at least for each of the *equity* markets in which the *firm* has material *positions*.  
**FCA** **PRA**
- 7.10.42** **R** For *foreign currency* risk, a *VaR model* must incorporate risk factors corresponding to the individual *foreign currencies*, including gold, in which the *firm's positions* are denominated.  
**FCA** **PRA**
- 7.10.43** **R** For *commodity* risk, the *VaR model* must use a separate risk factor at least for each *commodity* in which the *firm* has material *positions*. The *VaR model* must also capture the risk of less than perfectly correlated movements between similar, but not identical, *commodities* and the exposure to changes in forward prices arising from maturity mismatches. It must also take account of market characteristics, notably delivery dates and the scope provided to traders to close out positions.  
**FCA** **PRA**
- 7.10.44** **R**
- (1) For *CIUs* the actual *foreign currency positions* of the *CIU* must be taken into account.
  - (2) A *firm* may rely on third party reporting of the *foreign currency position* of the *CIU*, where the correctness of this report is adequately ensured.
  - (3) If a *firm* is not aware of the *foreign currency positions* in a *CIU*, this *position* must be carved out and treated in **■ BIPRU 7.5.18R** (Derivation of notional *positions* in *CIUs* for the *foreign currency PRR*).
- 7.10.45** **G**
- (1) This paragraph contains *guidance* on the inclusion of *CIUs* in a *VaR model*.
  - (2) The *appropriate regulator* may allow all types of *CIU* to be included within the scope of a *firm's VaR model permission*.
  - (3) **■ BIPRU 7.10** does not distinguish between *specific risk* and *general market risk* for *positions* in *CIUs*. Therefore even if *specific risk* is not otherwise included within the scope of a *firm's VaR model permission*, a *firm* should be able to demonstrate that its *VaR model* captures *specific risk*.
  - (4) A *firm* should also be able to demonstrate that its *VaR model* adequately captures correlations, concentration risk and risks associated with the illiquidity of the *CIU* itself should this be deemed necessary (see **■ BIPRU 7.10.32G**).
  - (5) A *firm* may use a look-through approach, under which the *VaR model* estimates are based on the underlying *positions*. If a *firm* uses a look through approach it should also ensure that all the relevant risk factors relating to the underlying *positions* are captured. **■ BIPRU 7.7** (Position risk requirements for collective investment undertakings) sets out *rules* relating to the look through approach when a *firm* is using the *VaR model approach*.

**Model standards: Risk factors: Specific risk**

7.10.46

**R**

FCA PRA

- (1) If a *firm's VaR model* covers the calculation of *PRR* with respect to *specific risk* the *firm* must meet the *VaR specific risk minimum requirements* in addition to the other requirements of ■ BIPRU 7.10.
- (2) The *VaR model* must explain the historical price variation in the portfolios concerned.
- (3) The *VaR model* must capture concentration in terms of magnitude and changes of composition of the portfolios concerned.
- (4) The *VaR model* must be robust to an adverse environment.
- (5) The *VaR model* must capture name-related basis risk. That is the *firm* must be able to demonstrate that the *VaR model* is sensitive to material idiosyncratic differences between similar but not identical *positions*.
- (6) The *VaR model* must capture event risk.
- (7) In addition to the other requirements in ■ BIPRU 7.10, a *firm* must have an approach in place to capture, in the calculation of its capital requirements, the *incremental risk charge* of its *trading book positions* that is incremental to the default and migration risk captured by the *VaR measures*, as specified in ■ BIPRU 7.10.55A R to ■ BIPRU 7.10.55S G and ■ BIPRU 7.10.107R (Backtesting: Specific risk backtesting).
- (8) [deleted]

7.10.47

**G**

FCA PRA

This paragraph provides *guidance* on ■ BIPRU 7.10.46R (3). Take as an example a *VaR model* based on a factor model or on a historical simulation model. The ability of the model to explain price variation could be demonstrated by a statistical comparison over the same period of time between actual price changes on the portfolio and the profit and loss impact of risk factors included within the model. A *firm* may wish to include an estimate of residual variation not explained by the model.

7.10.48

**R**

FCA PRA

- (1) [deleted]
- (2) A *firm's VaR model* must conservatively assess the risk arising from less liquid *positions* and *positions* with limited price transparency under realistic market scenarios. In addition, the *VaR model* must meet minimum data standards. Proxies must be appropriately conservative and may be used only where available data is insufficient or is not reflective of the true volatility of a *position* or portfolio.

7.10.49

**R**

FCA PRA

As techniques and best practices evolve, a *firm* must avail itself of these advances.

7.10.50 **R** [deleted]

7.10.51 **R** [deleted]

7.10.52 **R** [deleted]

#### Model standards: Materiality

7.10.53 **R** **FCA** **PRA** A firm's VaR model must capture accurately all material price risks for positions within the scope of its VaR permission, including risks relating to options or option-like positions. The firm must ensure that, if its VaR model does not accurately capture any material risk, the firm has capital resources adequate to cover that risk. These capital resources must be additional to those required to meet its capital resources requirement.

7.10.54 **G** **FCA** **PRA** For example, ■ BIPRU 7.10.53R might involve creating and documenting a prudent incremental PRR charge for the risk not captured in the VaR model and holding sufficient capital resources against this risk. In that case the firm should hold capital resources at least equal to its capital resources requirement as increased by adding this incremental charge to the model PRR. Alternatively the firm may make valuation adjustments through its profit and loss reserves to cover this material risk. These reserves should be transparent to senior management and auditable. The reserves should also be consistent with ■ GENPRU 1.3 (Valuation) while not being excessive in relation to the principles of mark-to-market accounting. Therefore, a firm should be able to satisfy the appropriate regulator that all material risks are adequately addressed, whether this be through the VaR model, through taking an incremental PRR charge or through making an adjustment through profit and loss reserves.

7.10.55 **G** **FCA** **PRA** A firm is expected ultimately to move towards full revaluation of option positions. For portfolios containing path dependent options, an instantaneous price shock applied to a static portfolio will be acceptable provided that the risks not captured by such an approach are not material. Where a risk is immaterial and does not justify further capital resources, that immaterial risk should still be documented.

#### Incremental risk charge: Scope and parameters

7.10.55A **R** **FCA** **PRA** A firm must demonstrate that its incremental risk charge meets soundness standards comparable to those under the IRB approach, assuming a constant level of risk and adjusted, where appropriate, to reflect the impact of liquidity, concentrations, hedging and optionality.

7.10.55B **R** **FCA** **PRA** The incremental risk charge must cover all positions which are subject to a capital charge for interest-rate specific risk in accordance with the firm's VaR model permission, except securitisation positions and nth-to-default credit derivatives. Where permitted by its VaR model permission, a firm may choose consistently to include all listed equity positions and derivatives positions based on listed equities for which that inclusion is consistent with how the firm internally measures and manages risk, but the approach must reflect the impact of correlations between default and migration events, and it must not reflect the impact of diversification between default and migration events and other market risk factors.

7.10.55C **R** The *firm's* approach to capture the *incremental risk charge* must measure losses due to default and internal or external ratings migration at the 99.9% confidence interval over a capital horizon of one year.  
 FCA PRA

7.10.55D **R** The *firm's* correlation assumptions must be supported by the analysis of objective data in a conceptually sound framework. The approach to capture the *incremental risk charge* must appropriately reflect *issuer* concentrations. Concentrations that can arise within and across product classes under stressed conditions must also be reflected.  
 FCA PRA

7.10.55E **R** The *firm's* approach must be based on the assumption of a constant level of risk over the one-year capital horizon, implying that given individual *trading book positions* or sets of *positions* that have experienced default or migration over their liquidity horizon are re-balanced at the end of their liquidity horizon to attain the initial level of risk. Alternatively, a *firm* may choose consistently to use a one-year constant *position* assumption.  
 FCA PRA

#### **Incremental risk charge: Liquidity horizons**

7.10.55F **R** (1) The *firm's* liquidity horizons for calculating *incremental risk charge* must be set according to the time required to sell the *position* or to hedge all material and relevant price risks in a stressed market, having particular regard to the size of the *position*.  
 FCA PRA

(2) Liquidity horizons must reflect actual practice and experience during periods of both systematic and idiosyncratic stresses. The liquidity horizon must be measured under conservative assumptions and must be sufficiently long that the act of selling or hedging, in itself, would not materially affect the price at which the selling or hedging would be executed.

7.10.55G **R** The determination of the appropriate liquidity horizon for a *position* or set of *positions* is subject to a floor of three months. The determination of the appropriate liquidity horizon for a *position* or set of *positions* must take into account a *firm's* internal policies relating to valuation adjustments and the management of stale *positions*.  
 FCA PRA

7.10.55H **R** When a *firm* determines liquidity horizons for sets of *positions* rather than for individual *positions*, the criteria for defining sets of *positions* must be defined in a way that meaningfully reflects differences in liquidity. The liquidity horizons must be greater for *positions* that are concentrated, reflecting the longer period needed to liquidate those *positions*.  
 FCA PRA

7.10.55I **R** The liquidity horizon for a *securitisation* warehouse must reflect the time to build, sell and securitise the assets, or to hedge the material risk factors, under stressed market conditions.  
 FCA PRA

**Incremental risk charge: Hedges**

7.10.55J

FCA PRA

R

- (1) Hedges may be incorporated into the calculation of a *firm's incremental risk charge*. *Positions* may be netted only when long and short *positions* refer to the same financial instrument.
- (2) Hedging or diversification effects associated with long and short *positions* involving different instruments or different securities of the same obligor, as well as long and short *positions* in different *issuers*, may only be recognised by explicitly modelling gross long and short *positions* in the different instruments.
- (3) A *firm* must reflect the impact of material risks that could occur during the interval between the hedge's maturity and the liquidity horizon, as well as the potential for significant basis risks in hedging strategies by product, seniority in the capital structure, internal or external rating, maturity, vintage and other differences in the instruments. A *firm* must reflect a hedge only to the extent that it can be maintained even as the obligor approaches a credit or other event.

7.10.55K

FCA PRA

R

For *trading book positions* that are hedged via dynamic hedging strategies, a rebalancing of the hedge within the liquidity horizon of the hedged position may be recognised only if the *firm*:

- (1) chooses to model rebalancing of the hedge consistently over the relevant set of *trading book positions*;
- (2) demonstrates that the inclusion of rebalancing results in a better risk measurement;
- (3) demonstrates that the markets for the instruments serving as hedges are liquid enough to allow for this rebalancing even during periods of stress; and
- (4) reflects in the capital charge any residual risks resulting from dynamic hedging strategies.

**Incremental risk charge: Nonlinear positions and model risk**

7.10.55L

FCA PRA

R

- (1) The *incremental risk charge* must reflect the nonlinear impact of *options*, structured credit derivatives and other *positions* with material nonlinear behaviour with respect to price changes.
- (2) The *firm* must also consider the amount of model risk inherent in the valuation and estimation of price risks associated with those products.

7.10.55M

FCA PRA

R

The *incremental risk charge* must be based on objective and up-to-date data.

**Incremental risk charge: Validation**

7.10.55N

**R**

FCA PRA

A *firm* must validate its approach to *incremental risk charge*. In particular, a *firm* must:

- (1) validate that its modelling approach for correlations and price changes is appropriate for its portfolio, including the choice and weights of its systematic risk factors;
- (2) perform a variety of stress tests (not limited to the range of events experienced historically), including sensitivity analysis and scenario analysis, to assess the qualitative and quantitative reasonableness of the approach, with particular regard to the treatment of concentrations; and
- (3) apply appropriate quantitative validation including relevant internal modelling benchmarks.

7.10.55O

**R**

FCA PRA

A *firm's* approach for *incremental risk charge* must be consistent with the *firm's* internal risk management methodologies for identifying, measuring, and managing trading risks.

**Incremental risk charge: Documentation and frequency of calculation**

7.10.55P

**R**

FCA PRA

A *firm* must document its approach for the *incremental risk charge* clearly, setting out its correlation and other modelling assumptions.

7.10.55Q

**R**

FCA PRA

A *firm* must calculate its *incremental risk charge* at least weekly.

**Incremental risk charge: Internal approaches based on different parameters**

7.10.55R

**R**

FCA PRA

A *firm* may use an approach for *incremental risk charge* that does not comply with all the requirements in ■ BIPRU 7.10.55A R to ■ BIPRU 7.10.55P R, only if:

- (1) such an approach is consistent with the *firm's* internal methodologies for identifying, measuring, and managing risks; and
- (2) the *firm* can demonstrate that its approach results in a capital requirement that is at least as high as it would be if based on an approach in full compliance with the requirements in ■ BIPRU 7.10.55A R to ■ BIPRU 7.10.55P R.

7.10.55S

**G**

FCA PRA

The *appropriate regulator* will review at least annually any approach taken by the *firm* under ■ BIPRU 7.10.55R R.

**All price risk measure: General requirements**

7.10.55T

**R**

FCA PRA

As part of its *VaR model permission*, the *appropriate regulator* may authorise a *firm* to use the *all price risk measure* to calculate an additional

capital charge in relation to *positions* in its *correlation trading portfolio* if it meets the following minimum standards:

- (1) it adequately captures all price risks at a 99.9% confidence interval over a capital horizon of one year under the assumption of a constant level of risk, and adjusted, where appropriate, to reflect the impact of liquidity, concentrations, hedging and optionality;
- (2) it adequately captures the following risks:
  - (a) the cumulative risk arising from multiple defaults, including the ordering of defaults, in *tranche* products;
  - (b) credit *spread risk*, including the gamma and cross-gamma effects;
  - (c) volatility of implied correlations, including the cross effect between spreads and correlations;
  - (d) *basis risk*, including both:
    - (i) the basis between the spread of an index and those of its constituent single names; and
    - (ii) the basis between the implied correlation of an index and that of bespoke portfolios;
  - (e) recovery-rate volatility, as it relates to the propensity for recovery rates to affect *tranche* prices; and
  - (f) to the extent that the *all price risk measure* incorporates benefits from dynamic hedging, the risk of hedge slippage and the potential costs of rebalancing those hedges.

7.10.55U **R**  
FCA PRA

The amount of the capital charge for the *correlation trading portfolio* calculated in accordance with the *all price risk measure* must not be less than 8% of the capital charge that would result from applying **■ BIPRU 7.2.48L R** to all *positions* in the *correlation trading portfolio* subject to the *all price risk measure*.

7.10.55V **R**  
FCA PRA

A *firm* may include in its *all price risk measure positions* that are jointly managed with *positions* in the *correlation trading portfolio* and would otherwise be included in the *incremental risk charge*. In that case, the *firm* must exclude these *positions* from the calculation of its *incremental risk charge*.

7.10.55W **R**  
FCA PRA

A *firm* must have sufficient market data to ensure that it fully captures the salient risks of the *positions* in its *all price risk measure* in accordance with the standards set out in **■ BIPRU 7.10.55T R**.

**7.10.55X** **R**  
**FCA PRA** A *firm* must demonstrate through backtesting or other appropriate means that its *all price risk measure* can appropriately explain the historical price variation of these *positions*. A *firm* must be able to demonstrate to the *appropriate regulator* that it can identify the *positions* within its *correlation trading portfolio*, in relation to which it is authorised to use the *all price risk measure*, separately from those other *positions* in relation to which it is not authorised to do so.

**7.10.55Y** **R**  
**FCA PRA** A *firm* must calculate the capital charge under the *all price risk measure* at least weekly.

#### All price risk measure: Stress testing

**7.10.55Z** **R**  
**FCA PRA** (1) For *positions* within its *correlation trading portfolio* in relation to which a *firm* may use the *all price risk measure*, a *firm* must regularly apply a set of specific, predetermined stress scenarios. These stress scenarios must examine the effects of stress to default rates, recovery rates, credit spreads, and correlations on the profit and loss of the *correlation trading portfolio*.

(2) A *firm* must apply the stress scenarios in (1) at least weekly and report the results to the *appropriate regulator* in accordance with  
 ■ BIPRU 7.10.129 R.

**7.10.55ZA** **R**  
**FCA PRA** If the results of the stress tests carried out in accordance with  
 ■ BIPRU 7.10.55Z R indicate a material shortfall in the amount of capital required under the *all price risk measure*, a *firm* must notify the *appropriate regulator* of this circumstance by no later than two *business days* after the *business day* on which the material shortfall occurred.

**7.10.55ZB** **G**  
**FCA PRA** The *appropriate regulator* may use its powers under section 55J (Variation etc. on the Authority's own initiative) of the *Act* to impose on the *firm* a capital add-on to cover the material shortfall reported under ■ BIPRU 7.10.55ZA R.

**7.10.55ZC** **G**  
**FCA PRA** The *all price risk measure* is based on the *incremental risk charge*. Therefore, when applying the *all price risk measure*, a *firm* should have regard to the requirements in  
 ■ BIPRU 7.10.55A R to ■ BIPRU 7.10.55R R.

#### Risk management standards: Introduction

**7.10.56** **G**  
**FCA PRA** A *firm* with a complex portfolio is expected to demonstrate greater sophistication in its modelling and risk management than a *firm* with a simple portfolio. For example, a *firm* will be expected to consider, where necessary, varying degrees of liquidity for different risk factors, the complexity of risk modelling across time zones, product categories and risk factors. Some trade-off is permissible between the sophistication and accuracy of the model and the conservatism of underlying assumptions or simplifications.

**7.10.57** **G**  
**FCA PRA** A *firm* should be able to demonstrate that it meets the risk management standards set out in the *VaR model permission* on a legal entity basis. This is particularly important for a *subsidiary undertaking* in a *group* subject to matrix management where the business lines cut across legal entity boundaries.

**Risk management standards: General requirement**

7.10.58

FCA PRA

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A *firm* must have a conceptually sound risk management system surrounding the use of its *VaR model* that is implemented with integrity and that in particular meet the qualitative standards set out in ■ BIPRU 7.10.59R - ■ BIPRU 7.10.82R.

**Risk management standards: Use requirement**

7.10.59

FCA PRA

R

A *firm* must base its *model PRR* calculation on the output of the *VaR model* which is used for its internal risk management rather than one developed specifically to calculate its *PRR*.

7.10.60

FCA PRA

R

The *VaR model* must be fully integrated into the daily risk management process of the *firm*, and serve as the basis for reporting risk exposures to *senior management* of the *firm*.

7.10.61

FCA PRA

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A *firm's VaR model* output should be an integral part of the process of planning, monitoring and controlling a *firm's market risk* profile. The *VaR model* should be used in conjunction with internal trading and exposure limits. The links between these limits and the *VaR model* should be consistent over time and understood by *senior management*. The *firm* should regard risk control as an essential aspect of the business to which significant resources need to be devoted.

**Risk management standards: Risk control unit**

7.10.62

FCA PRA

R

A *firm* must have a risk control unit which is independent from business trading units and which reports directly to *senior management*. It:

- (1) must be responsible for designing and implementing the *firm's* risk management system;
- (2) must produce and analyse daily reports on the output of the *VaR model* and on the appropriate measures to be taken in terms of the trading limits; and
- (3) conduct the initial and on-going validation of the *VaR model*.

**Risk management standards: Senior management**

7.10.63

FCA PRA

R

A *firm's governing body* and *senior management* must be actively involved in the risk control process, and the daily reports produced by the risk control unit must be reviewed by a level of management with sufficient authority to enforce both reductions of *positions* taken by individual traders as well as in the *firm's* overall risk exposure.

7.10.64

FCA PRA

G

It is the responsibility of a *firm's* own management to ensure the accuracy and integrity of its *VaR model*. This responsibility includes obtaining appropriate independent validation of the *VaR model*.

7.10.65

FCA PRA

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**Risk management standards: Skilled staff**

A *firm* must have sufficient numbers of staff skilled in the use of sophisticated models in the trading, risk control, audit and back office areas.

7.10.66

FCA PRA

R

**Risk management standards: Controls and compliance**

A *firm* must establish, document and maintain policies, controls and procedures to an auditable standard:

- (1) concerning the operation of its *VaR model approach*; and
- (2) for monitoring and ensuring compliance with the policies, controls and procedures in (1).

7.10.67

FCA PRA

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**Risk management standards: Documentation**

A *VaR model* must be adequately documented.

7.10.68

FCA PRA

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- (1) An example of documents required by ■ BIPRU 7.10.67R may be a manual that describes the basic principles of the risk management framework, clearly setting out empirical techniques, principles and assumptions used within it.
- (2) This documentation should be of sufficient detail for the *appropriate regulator* to be able to develop a clear understanding of how the *VaR model* works from that documentation on its own.

7.10.69

FCA PRA

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**Risk management standards: Track record**

A *firm's VaR model* must have a proven track record of acceptable accuracy in measuring risk.

7.10.70

FCA PRA

R

**Risk management standards: Development validation**

Adequate procedures must be in place to ensure that model changes are validated before being introduced.

7.10.71

FCA PRA

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The procedures in ■ BIPRU 7.10.70R need not necessarily rely on backtesting using a back-run of recreated data.

7.10.72

FCA PRA

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**Risk management standards: Stress testing**

- (1) A *firm* must frequently conduct a rigorous programme of stress testing. The results of these tests must be reviewed by *senior management* and reflected in the policies and limits the *firm* sets.
- (2) The programme must particularly address:
  - (a) concentration risk;
  - (b) illiquidity of markets in stressed market conditions;
  - (c) one way markets;

- (d) event and jump to default risks;
- (e) non linearity of products;
- (f) deep out of the money *positions*;
- (g) *positions* subject to the gapping of prices;
- (h) full revaluation, or a reliable approximation, of *positions*;
- (i) instant shocks as well as effects of longer term periods of stress;
- (j) calibration changes under stressed conditions;
- (k) secondary risk factors (such as volatility);
- (l) basis risk;
- (m) systemic and localised stresses; and
- (n) other risks that may not be captured appropriately in the *VaR model* (for example, recovery rate uncertainty, implied correlations and skew risk).

- (3) The shocks applied must reflect the nature of the portfolios and the time it could take to hedge out or manage risks under severe market conditions.

7.10.73

FCA PRA

G

The stress testing under ■ BIPRU 7.10.72R should be taken into account under the *overall Pillar 2 rule*.

7.10.73A

FCA PRA

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The *firm's* stress testing programme should be comprehensive in terms of both risk and *firm* coverage, and appropriate to the size and complexity of *trading book positions* held.

#### **Risk management standards: Valuation**

7.10.74

FCA PRA

R

A *firm* must have procedures to ensure that the valuation of assets and liabilities is appropriate, that valuation uncertainty is identified and appropriate reserving is undertaken where necessary.

#### **Risk management standards: Risk review**

7.10.75

FCA PRA

R

At least once a year, a *firm* must conduct, as part of its regular internal audit process, a review of its risk management process. This review must include both the activities of the business trading units and of the independent risk control unit, and must be undertaken by suitably qualified staff independent of the areas being reviewed. This review must consider, at a minimum:

- (1) the adequacy of the documentation of the risk management system and process;

- (2) the organisation of the risk control unit;
- (3) the integration of *market risk* measures into daily risk management;
- (4) the integrity of the management information system;
- (5) the process for approving risk pricing models and valuation systems used in front and back offices;
- (6) the validation of any significant changes in the risk management process;
- (7) the scope of risks and products captured by the *VaR model*;
- (8) the accuracy and completeness of *position* data;
- (9) the process used to ensure the consistency, timeliness, independence and reliability of data sources (including the independence of such data sources);
- (10) the accuracy and appropriateness of volatility and correlation assumptions;
- (11) reserving policies and the accuracy of the valuation procedures and risk sensitivity calculations;
- (12) the process employed to evaluate the *VaR model's* accuracy, including the programme of backtesting;
- (13) the controls surrounding the development of the *VaR model*; and
- (14) the process employed to produce the calculation of the *model PRR*.

#### Risk management standards: Validation and backtesting

7.10.76

FCA PRA

G

The *appropriate regulator* will require a period of initial monitoring or live testing before a *VaR model* can be recognised. This will be agreed on a *firm by firm* basis.

7.10.77

FCA PRA

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In assessing the *firm's VaR model* and risk management, the *appropriate regulator* has regard to the results of internal model validation procedures used by the *firm* to assess the *VaR model*.

7.10.78

FCA PRA

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A *firm* must have processes in place to ensure that its *VaR model* has been adequately validated by suitably qualified parties independent of the development process to ensure that it is conceptually sound and adequately captures all material risks. This validation must be conducted when the *VaR model* is initially developed and when any significant changes are made to the *VaR model*. The validation must also be conducted on a periodic basis but especially where there have been any significant structural

changes in the market or changes to the composition of the portfolio which might lead to the *VaR model* no longer being adequate. As techniques and best practices evolve, a *firm* must avail itself of these advances. Model validation must not be limited to backtesting, but must, at a minimum, also include the following:

- (1) tests to demonstrate that any assumptions made within the *VaR model* are appropriate and do not underestimate or overestimate the risk (including testing of the validity of the assumptions and approximations underlying the *VaR model*);
- (2) in addition to the regulatory backtesting programmes, a *firm* must carry out its own model validation tests in relation to the risks and structures of its portfolios, such as statistical validation techniques and other methods of measuring performance and validity;
- (3) the use of hypothetical portfolios to ensure that the *VaR model* is able to account for particular structural features that may arise, for example material basis risks and concentration risk; and
- (4) investigation of the limitations of the *VaR model* including testing of the accuracy of parts of the *VaR model* as well as of the whole.

7.10.79

FCA PRA

G

- (1) In addition to regulatory backtesting programs, testing for model validation should be carried out using additional tests which may include for example:
  - (a) testing carried out using hypothetical changes in portfolio value that would occur were end of day positions to remain unchanged;
  - (b) testing carried out for longer periods than required for the regular backtesting programme (for example, 3 years);
  - (c) testing carried out using confidence intervals other than the 99 percent interval required under the quantitative requirements in ■ BIPRU 7.10; and
  - (d) testing of parts of portfolios.
- (2) 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.

7.10.80

FCA PRA

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Further material on backtesting can be found in ■ BIPRU 7.10.91G - ■ BIPRU 7.10.112G.

7.10.81

FCA PRA

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### **Risk management standards: Information technology**

In assessing whether the *VaR model* is implemented with integrity as described in ■ BIPRU 7.10.58R (Stress testing), the *appropriate regulator* will consider in particular

the information technology systems used to run the model and associated calculations. The assessment may include:

- (1) feeder systems; risk aggregation systems; time series databases; the *VaR model* system; stress testing system; the backtesting system including profit and loss cleaning systems where appropriate; data quality; reconciliations and checks on completeness of capture;
- (2) system development, change control and documentation; security and audit trails; system availability and contingency procedures; network adequacy; and
- (3) operational statistics relating to the *VaR model* production process, including, for example, statistics relating to timeliness, number of re-runs required and the reliability of data feeds.

### Risk management standards: Controls

7.10.82

FCA PRA

R

A *firm* must ensure that it has adequate controls relating to:

- (1) the derivation of the *model PRR*;
- (2) the integrity of the backtesting programme, including the calculation of the profit and loss account;
- (3) the integrity and appropriateness of the *VaR model*, including the *VaR model's* geographic coverage and the completeness of data sources;
- (4) the *VaR model's* initial and ongoing development, including independent validation;
- (5) the valuation models, including independent validation; and
- (6) the adequacy, security and integrity of the information technology infrastructure.

### Stress testing

7.10.83

FCA PRA

R

■ BIPRU 7.10.84G-■ BIPRU 7.10.90G relate to stress testing of a *VaR model* (see ■ BIPRU 7.10.72R (Risk management standards: Stress testing)).

7.10.84

FCA PRA

G

Stress testing is a way of identifying the risk to a *firm* posed by a breakdown of model assumptions or by low-probability events. Where stress tests reveal unacceptable vulnerability to a given set of circumstances, a *firm* should take prompt steps to manage those risks appropriately, for example by hedging against the outcome or reducing the size of the *firm's* *exposure*.

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7.10.85

FCA PRA

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A *firm* must have the capacity to run daily stress tests.

<p>7.10.86 FCA PRA</p>	<p><b>R</b></p>	<p>Stress testing must involve identifying market scenarios or other low probability events in all types of risks that generate the greatest losses on a <i>firm's</i> portfolio.</p>
<p>7.10.87 FCA PRA</p>	<p><b>R</b></p>	<p>A <i>firm</i> must periodically and actively identify all the worst case scenarios that are relevant to its portfolio. Scenarios used must be appropriate to test the effect of adverse movements in market volatilities and correlations and the effect of any change in the assumptions underlying the <i>VaR model</i>. Scenarios involving low probability market events must nevertheless be plausible.</p>
<p>7.10.88 FCA PRA</p>	<p><b>R</b></p>	<p>Stress testing must capture non-linear effects.</p>
<p>7.10.89 FCA PRA</p>	<p><b>R</b></p>	<p>A <i>firm</i> must have procedures to assess and respond to the results produced from stress testing. In particular, stress testing results must be:</p> <ol style="list-style-type: none"> <li>(1) used to evaluate its capacity to absorb such losses or identify steps to be taken to reduce risk; and</li> <li>(2) communicated routinely to <i>senior management</i> and periodically to the <i>governing body</i>.</li> </ol>
<p>7.10.90 FCA PRA</p>	<p><b>G</b></p>	<p>A <i>firm</i> may want to conduct the more complex stress tests at longer intervals or on an ad hoc basis.</p>
<p>7.10.90A FCA PRA</p>	<p><b>R</b></p>	<p>A <i>firm</i> must also carry out reverse stress tests.</p>
<p><b>Backtesting: Introduction</b> .....</p>		
<p>7.10.91 FCA PRA</p>	<p><b>G</b></p>	<p>Backtesting is the process of comparing value-at-risk risk measures to portfolio performance. It is intended to act as one of the mechanisms for the ongoing validation of a <i>firm's VaR model</i> and to provide incentives for <i>firms</i> to improve their <i>VaR measures</i>.</p>
<p>7.10.92 FCA PRA</p>	<p><b>G</b></p>	<p>It is a condition for granting a <i>VaR model permission</i> that a <i>firm</i> should have a backtesting programme in place and should provide three months of backtesting history.</p>
<p>7.10.93 FCA PRA</p>	<p><b>G</b></p>	<p>Backtesting conducted only at a whole portfolio level using a single measure of profit and loss has limited power to distinguish an accurate <i>VaR model</i> from an inaccurate one. Backtesting should therefore be regarded as an additional safeguard rather than a primary validation tool. Such testing does however form the basis of the <i>appropriate regulator's plus factor</i> system. The test has been chosen as the basis of the backtesting regime because of its simplicity. A <i>firm</i> will therefore be expected to complement this backtesting with more granular backtesting analysis and involving more than one measure of profit and loss (i.e. both a <i>profit and loss figure</i> and a <i>hypothetical profit and loss figure</i>).</p>

**7.10.94** **R** A *firm* must have the capacity to analyse and compare its *profit and loss figures* and *hypothetical profit and loss figures* to the *VaR measure*, both at the level of the whole portfolio covered by the *VaR model permission* and at the level of individual books that contain material amounts of risk.  
**FCA** **PRA**

**7.10.94A** **R** At a minimum, backtesting of *hypothetical profit and loss figures* must be used for regulatory backtesting and also to calculate *plus factors*.  
**FCA** **PRA**

**7.10.95** **G** Backtesting of *hypothetical profit and loss figures* is also used for model validation and for reporting to the *appropriate regulator*.  
**FCA** **PRA**

#### **Backtesting: Basic testing requirements**

**7.10.96** **R** At a minimum, a *firm* must, on each *business day*, compare each of its 250 most recent *business days'* *hypothetical profit and loss figures* (ending with the *business day* preceding the *business day* in question) with the corresponding *one-day VaR measures*.  
**FCA** **PRA**

**7.10.97** **G** Generally the *positions* underlying the profit and loss account and *VaR measures* should not be materially different.  
**FCA** **PRA**

#### **Backtesting: One day VaR measure**

**7.10.98** **R** The *one-day VaR measure* for a particular *business day* is the *VaR number* for that *business day* calibrated to a one *business day* holding period and a 99% one-tailed confidence level.  
**FCA** **PRA**

#### **Backtesting: Calculating the profit and loss**

**7.10.99** **G** The ultimate purpose of backtesting is to assess whether capital is sufficient to absorb actual losses. Actual daily profit and loss means the day's profit and loss arising from trading activities within the scope of the *VaR model permission*. This measure should, however, be 'cleaned' using ■ BIPRU 7.10.100R inclusion in profit and loss of non-modelled factors.  
**FCA** **PRA**

**7.10.100** **R** The *profit and loss figure* for a particular *business day* is the *firm's* actual profit or loss for that day in respect of the trading activities within the scope of the *firm's VaR model permission*, adjusted by stripping out:

- (1) fees and commissions;
- (2) brokerage;
- (3) additions to and releases from reserves which are not directly related to *market risk* (e.g. administration reserves); and
- (4) any inception profit exceeding an amount specified for this purpose in the *firm's VaR model permission* (where inception profit is defined as any profit arising immediately on entering into a new transaction).

**7.10.101** **G** The definition of *profit and loss figure* may be amended or replaced in an individual *VaR model permission* if the *firm* can demonstrate to the *appropriate regulator* that the alternative method meets the spirit and purpose of the provisions in ■ BIPRU 7.10 about the *profit and loss figure*.  
**FCA** **PRA**

**7.10.102** **G** The *appropriate regulator* 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.  
**FCA** **PRA**

### **Backtesting: Definition of backtesting exception**

**7.10.103** **R** A *backtesting exception* is deemed to have occurred for any *business day* if the *hypothetical profit and loss figure* for that *business day* shows a loss, which in absolute magnitude, exceeds the *one-day VaR measure* for that *business day*. The only exception is if that *business day* is identified in the *firm's VaR model permission* as giving rise to an excluded *backtesting exception*.  
**FCA** **PRA**

### **Backtesting: Obligation to notify the appropriate regulator**

**7.10.104** **R** If a *backtesting exception* occurs, the *firm* must notify its usual supervisory contact at the *appropriate regulator* orally by close of business two *business days* after the *business day* for which the *backtesting exception* occurred. Within five *business days* following the end of each *Month*, the *firm* must submit to the *appropriate regulator* a written account of the previous *Month's backtesting exceptions* (if any). This explanation must include the causes of the *backtesting exceptions*, an analysis of whether the *backtesting exception* indicate a deficiency in the *firm's VaR model* and the *firm's* planned response (if any).  
**FCA** **PRA**

### **Backtesting: Summary of the backtesting cycle**

- 7.10.105** **G**
- (1) This paragraph gives *guidance* on the backtesting calculation and reporting process in ■ BIPRU 7.10.96R - ■ BIPRU 7.10.104R.
  - (2) Let the day on which the loss referred to in ■ BIPRU 7.10.100R is made be 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 *backtesting exceptions* by close of business on day *n+2*.
  - (3) Any *backtesting exception* initially counts for the purpose of the calculation of the *plus factor* even if subsequently the *appropriate regulator* agrees to exclude it under the process described in ■ BIPRU 7.10.106G. Thus, where the *firm* experiences a *backtesting exception* and already has four or more *backtesting exceptions* for the previous 250 *business days*, changes to the *multiplication factor* arising from changes to the *plus factor* become effective at *n+3* (using the time-line terminology in (2)).

7.10.106

FCA PRA

G

**Backtesting: Process for disregarding backtesting exceptions**

- (1) This paragraph gives *guidance* on the process for excluding *backtesting exceptions* as referred to in ■ BIPRU 7.10.103R.
- (2) The *appropriate regulator* will respond flexibly to *backtesting exceptions*. However, the *appropriate regulator's* starting assumption will be that a *backtesting exception* should be taken into account for the purpose of the calculation of *plus factors*. If the *firm* believes that a *backtesting exception* should not count for that purpose, then it should seek a variation of its *VaR model permission* in order to exclude that particular *backtesting exception*. The *appropriate regulator* will then decide whether to agree to such a variation.
- (3) One example of when a *firm's backtesting exception* 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 *capital resources* are already held.

7.10.107

FCA PRA

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**Backtesting: Specific risk backtesting**

If a *firm's VaR model permission* covers *specific risk*, the *firm* must validate its *VaR model* through backtesting aimed at assessing whether *specific risk* is being accurately captured. This backtesting must be carried out in accordance with the provisions of its *VaR model permission*. If the *VaR model permission* provides for this backtesting to be performed on the basis of relevant sub-portfolios, these must be chosen in a consistent manner.

7.10.108

FCA PRA

G

*Specific risk* backtesting involves the backtesting of a standalone *specific risk VaR* measure against a profit and loss series determined by reference to exposure risk factors categorised as *specific risk*. Alternatively *specific risk* backtesting may take the form of regular backtesting of trading books and portfolios that are predominantly exposed to risk factors categorised as *specific risk*. The precise requirements for *specific risk* backtesting will be specified in the *firm's VaR model permission* as will the definition of a *specific risk backtesting exception*.

**Backtesting: Multiple exceptions**

7.10.109

FCA PRA

R

If ten or more *backtesting exceptions* or ten or more *specific risk backtesting exceptions* are recorded in a 250 *business day* period, a *firm* must take immediate corrective action.

7.10.110

FCA PRA

G

Where backtesting reveals severe problems with the basic integrity of the *VaR model*, the *appropriate regulator* may withdraw model recognition. In particular, if ten or more *backtesting exceptions* are recorded in a 250 *business day* period, the *appropriate regulator* may apply a *plus factor* greater than one or the *appropriate regulator* may consider revoking a *firm's VaR model permission*. The *appropriate regulator* may also consider revoking a *firm's VaR model permission* if ten or more *specific risk backtesting exceptions* occur in such a period.

**Backtesting: Hypothetical profit and loss**

7.10.111

FCA PRA

R

A *firm* must perform backtesting against a *hypothetical profit and loss figure* with respect to each *business day*. A *hypothetical profit and loss figure* for a *business day* means the *hypothetical profit and loss figure* that

would have occurred for that *business day* if the portfolio on which the *VaR number* for that *business day* is based remained unchanged.

7.10.112

FCA PRA

G

- (1) A *hypothetical profit and loss figure* is based on the day's change in the value of the same portfolio that was used to generate the value-at-risk forecast.
- (2) [deleted]
- (3) The *firm* may also need to calculate a *hypothetical profit and loss figure* in order to produce profit attribution reports and to analyse the cause of *backtesting exceptions*.

7.10.112A

FCA PRA

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The definition of *hypothetical profit and loss figure* may be amended or replaced in an individual *VaR model permission* if the *firm* can demonstrate to the *appropriate regulator* that the alternative method meets the spirit and purpose of the provisions in ■ BIPRU 7.10 about the *hypothetical profit and loss figure*.

#### Capital calculations: General

7.10.113

FCA PRA

R

The *model PRR* is, for any *business day* (the "relevant" *business day*), calculated in accordance with the following formula:

- (1) the higher of:
  - (a) the *VaR number* for the relevant *business day*; and
  - (b) the average of its daily *VaR numbers* for each of the 60 *business days* ending with the relevant *business day*, multiplied by the *multiplication factor* for the relevant *business day*; and
- (2) (in the case of a *VaR model permission* that covers *specific risk*) the higher of:
  - (a) the *incremental risk charge* for the relevant *business day*; and
  - (b) the average of the twelve-week *incremental risk charge*; and
- (3) the higher of:
  - (a) the latest *stressed VaR number*; and
  - (b) the average of the *firm's* daily *stressed VaR number* for the 60 *business days* ending with the relevant *business day*, multiplied by the *multiplication factor* applied to the *stressed VaR measure* for the relevant *business day*; and
- (4) (in the case of a *VaR model permission* that covers *all price risk measure*) the higher of:
  - (a) the *all price risk measure* for the relevant *business day*; and

(b) the average of the twelve-week *all price risk measure*.

7.10.114

R

FCA PRA

For any day that is not a *business day*, the *model PRR* is the amount for the prior *business day*.

7.10.115

R

FCA PRA

The *VaR number* for any *business day* means the *VaR measure*, in respect of the previous *business day's* close-of-business *positions* in products coming within the scope of the *VaR model permission*, calculated by the *VaR model* and in accordance with ■ BIPRU 7.10 and any methodology set out in the *VaR model permission*. The *VaR number* must not be calculated taking into account matters on the *business day* for which it is the *VaR number*.

7.10.116

R

FCA PRA

The *incremental risk charge* for any *business day* means the *incremental risk charge* required under the provisions in ■ BIPRU 7.10 about *specific risk*, in respect of the previous *business day's* close-of-business *positions* with respect to which those provisions apply.

7.10.116A

R

FCA PRA

The *all price risk measure* for any *business day* means the *all price risk measure* required under the provisions in ■ BIPRU 7.10 about *specific risk* for the *correlation trading portfolio*.

7.10.117

G

FCA PRA

The following equation expresses ■ BIPRU 7.10.113R mathematically:

$$PRR_{VaR} = \text{Max} \left\{ VaR_t, f x \frac{1}{60} \sum_{i=0}^{59} VaR_{t-i} \right\} + \text{Max} \left\{ SVaR_t, s x \frac{1}{y} \sum_{i=0}^{y-1} SVaR_{t-i} \right\} + \text{Max} \left\{ IRC_t, \frac{1}{z} \sum_{i=0}^{z-1} IRC_{t-i} \right\} + \text{Max} \left\{ APR_t, \frac{1}{w} \sum_{i=0}^{w-1} APR_{t-i} \right\}$$

where:

- (1)  $PRR_{VaR}$  is a firm's model PRR;
- (2)  $VaR_t$  represents the previous day's value-at-risk figure;
- (3)  $VaR_{t-i}$  represents the value-at-risk calculated for  $i$  business days earlier;
- (4)  $f$  is the *multiplication factor* for VaR;
- (5)  $SVaR_t$  represents the latest *stressed VaR* figure;
- (6)  $SVaR_{t-i}$  represents the *stressed VaR* calculated for  $i$  business days earlier;
- (7)  $s$  is the *multiplication factor* for *stressed VaR*;
- (8)  $y$  is the number of times the *stressed VaR* was calculated in the last 60 *business days*;
- (9)  $IRC_t$  represents the latest *incremental risk charge*;
- (10)  $IRC_{t-i}$  represents the *incremental risk charge* calculated for  $i$  business days earlier;

- (11)  $z$  is the number of times the *incremental risk charge* was calculated in the last 12 weeks;
- (12)  $APR_t$  represents the latest *all price risk measure*;
- (13)  $APR_{t-i}$  represents the *all price risk measure* calculated for  $i$  business days earlier; and
- (14)  $w$  is the number of times the *all price risk measure* was calculated in the last 12 weeks.

### Capital calculations: Multiplication factors

- 7.10.118** **R** The *multiplication factor*, for VaR and *stressed VaR*, for any *business day* is the sum of the *minimum multiplication factor* and the *plus factor* for that day.  
FCA PRA
- 7.10.119** **R** The *minimum multiplication factor*, for VaR and *stressed VaR*, is three or any higher amount the *VaR model permission* defines it as.  
FCA PRA
- 7.10.120** **G** The *minimum multiplication factor*, for VaR and *stressed VaR*, will never be less than three. If the *appropriate regulator* does set the *minimum multiplication factor*, for VaR and *stressed VaR*, above three the *VaR model permission* will have a table that sets out the reasons for that add on and specify how much of the add on is attributable to each reason (see ■ BIPRU 7.10.121R). If there are weaknesses in the *VaR model* that may otherwise be considered a breach of the minimum standards referred to in ■ BIPRU 7.10.24R the *appropriate regulator* may apply such an add on to act as a mitigant for those weaknesses.  
FCA PRA
- 7.10.121** **R** Something that would otherwise be a breach of the minimum standards in ■ BIPRU 7.10.26R - ■ BIPRU 7.10.53R is not a breach to the extent that that thing is identified in the *firm's VaR permission* as a reason for an increase in the *minimum multiplication factor*, for VaR and *stressed VaR*, above 3.  
FCA PRA
- 7.10.122** **G** Typically, any add on will be due to a specific weakness in systems and controls identified during the *appropriate regulator's* review that the *appropriate regulator* does not consider material enough to justify withholding overall model recognition. The *firm* will be expected to take action to address the reasons for any add on. The *appropriate regulator* will then review these periodically and, where satisfactory action has been taken, the add on will be removed through a variation of the *VaR model permission*.  
FCA PRA
- 7.10.123** **G** The *plus factor* system is designed so that the more often a *VaR model* has under-predicted losses in the past, the higher should be the capital requirement based on the *VaR model*. It is intended to provide a capital incentive for the *firm* to continue to improve the accuracy of its *VaR model*.  
FCA PRA
- 7.10.124** **R** The table in ■ BIPRU 7.10.125R sets out the *plus factors* to be added to the *minimum multiplication factor*, for VaR and *stressed VaR*, for any  
FCA PRA

*business day*. It is based on the number of *backtesting exceptions* that occurred during the backtesting period as referred to in ■ BIPRU 7.10.96R (Backtesting: Basic testing requirements) ending three *business days* preceding the *business day* for which the *model PRR* is being calculated.

7.10.125

R

Table: Backtesting plus factors

FCA PRA

This table belongs to ■ BIPRU 7.10.124R

Zone	Number of recorded exceptions	Plus factor
Green	4 or less	0.00
Yellow	5	0.40
	6	0.50
	7	0.65
	8	0.75
	9	0.85
Red	10 or more	1.00

7.10.126

G

FCA PRA

A *VaR model* that correctly predicts a one-tailed 99% confidence level is expected to produce, on average, 2.5 *backtesting exceptions* every 250 days. Random events may cause the number of *backtesting exceptions* actually observed to vary. The *plus factor* system is designed to take this into account. Hence *plus factors* are only imposed on the *firm* if it has five or more recorded *backtesting exceptions*. Therefore, where a *backtesting exception* appears to be caused simply by chance, it will not be appropriate for a *VaR model permission* to be varied to exclude that *backtesting exception* as described in ■ BIPRU 7.10.106G (Backtesting: Process for disregarding backtesting exceptions).

**Capital calculations: Specific risk surcharge: transitional requirements**

7.10.127

G

FCA PRA

*Firms* who gained model recognition before 1 January 2007 will be permitted to calculate *PRR* for *specific risk* in accordance with the methodology they were permitted to use immediately before that date instead of capturing event and default risk in their models (see ■ BIPRU TP 14 (Market risk: VaR models)). This treatment will not be available to a *firm* that gains model recognition after that date.

**Reporting procedures and requirements**

7.10.128

G

FCA PRA

A *VaR model permission* will contain requirements for what the *firm* should report to the *appropriate regulator* and the procedures for reporting. The precise requirements will vary from *VaR model permission* to *VaR model permission*.

■ BIPRU 7.10.129R-■ BIPRU 7.10.130R set out what the *appropriate regulator* regards as the standard requirements.

7.10.129

R

FCA PRA

A *firm* must, no later than the number of *business days* after the end of each quarter specified in the *VaR model permission* for this purpose, submit, in respect of that quarter, a report to the *appropriate regulator* about the operation of the *VaR model*, the systems and controls relating to it and

any changes to the *VaR model* and those systems and controls. Each report must outline as a minimum the following information in respect of that quarter:

- (1) methodological changes and developments to the *VaR model*;
- (2) the introduction of all new pricing models used in connection with the *VaR model* and any changes to any pricing models used in connection with the *VaR model*, including details of any material associated valuation or risk management issues;
- (3) a summary of backtesting performance against *profit and loss figures* (if calculated) and *hypothetical profit and loss figures*, which must be provided in electronic format as stipulated by the *VaR model permission*;
- (4) (if the *VaR model permission* covers *specific risk*) the results of the *specific risk* backtesting including *specific risk backtesting exceptions*;
- (5) any change to any feeder or pre-processing systems in connection with the *VaR model*, including changes to any of the systems set out in the list described in ■ BIPRU 7.10.131G (1) (as it exists at the date of the *VaR model permission*), and any introduction of a new such system;
- (6) any changes to the products coming within the scope of the *VaR model*;
- (7) any material changes or additions to any of the matters referred to in the *firm's* internal documentation in relation to the *VaR model* (as it exists at the date of the *VaR model permission*) or to any matters subsequently notified under (7);
- (8) any changes in *senior management*;
- (9) an up-to-date list of products covered by the *VaR model permission* showing all changes made since the *VaR model permission* was granted;
- (10) where applicable (nil returns are not required), details of:
  - (a) any use of a changed historical observation period in accordance with ■ BIPRU 7.10.30R or any change in the use of any weighting scheme as described in ■ BIPRU 7.10.33R;
  - (b) any data series becoming unreliable as described in ■ BIPRU 7.10.31R and any subsequent use of alternative value-at-risk measurement techniques;

- (c) the frequency of updating data sets being increased in accordance with ■ BIPRU 7.10.34R;
  - (d) any change in the method employed to derive 10-day VaR *measure* (see ■ BIPRU 7.10.28R);
  - (e) to the extent that the use of correlations is permitted by a *firm's VaR model permission*, a summary of any notifications that are required under ■ BIPRU 7.10.37R; and
  - (f) the *VaR model* not accurately capturing risks (as referred to in ■ BIPRU 7.10.53R) and any steps taken under ■ BIPRU 7.10.53R ; and
- (11) the results of the stress tests on the *firm's correlation trading portfolio* under ■ BIPRU 7.10.55Z R, including a comparison to the current capital charge.

7.10.130

FCA PRA

R

A *firm* must provide to, and discuss with, the *appropriate regulator* details of any significant planned changes to the *VaR model* before those changes are implemented. These details must include information about the nature of the change and an estimate of the impact on *VaR numbers* and the *incremental risk charge*.

#### Updating the VaR model permission

7.10.131

FCA PRA

G

The *VaR model permission* will generally contain a list of the following:

- (1) feeder systems and pre-processing systems;
- (2) products covered by the *VaR model permission*; and
- (3) the *firm's* internal documentation in relation to the *VaR model*.

7.10.132

FCA PRA

G

The information in ■ BIPRU 7.10.131G will vary over time. It is therefore not included in a *VaR model permission* as a *rule* but for information only. The *appropriate regulator* will update that information regularly in accordance with information supplied under ■ BIPRU 7.10.129R. That updating will not amount to a variation of the *VaR model permission*.

#### Link to standard PRR rules: Incorporation of the model output into the capital calculation

7.10.133

FCA PRA

G

A *VaR model permission* will modify ■ GENPRU 2.1.52 R (Calculation of the *market risk* capital requirement) to provide that a *firm* should calculate its *market risk capital requirement* in accordance with ■ BIPRU 7.10 to the extent set out in the *VaR model permission*.

7.10.134

FCA PRA

G

By modifying ■ GENPRU 2.1.52 R (Calculation of the *market risk* capital requirement) to allow the *firm* to use the *VaR model* to calculate all or part of its *PRR* for certain positions, the *appropriate regulator* is treating it like an *application rule*. The modification means

that the *PRR* calculation set out in ■ BIPRU 7.10 supersedes the *standard market risk PRR rules* for products and risks coming within the scope of the *VaR model permission*.

7.10.135  
FCA PRA

**R** To the extent that a *position* does not fall within the scope of a *firm's VaR model permission* the *firm* must calculate the *PRR* under the *standard market risk PRR rules* or, as applicable, those provisions as modified by the *firm's CAD 1 waiver*.

7.10.136  
FCA PRA

- R**
- (1) This *rule* applies to a *position* of a type that comes within the scope of a *firm's VaR model permission*.
  - (2) Subject to ■ BIPRU 7.10.136A R, if, where the *standard market risk PRR rules* apply, a *position* is subject to a *PRR charge* and the *firm's VaR model permission* says that it covers the risks to which that *PRR charge* relates, the *firm* must, for those risks, calculate the *PRR* for that *position* under the *VaR model approach* rather than under the *standard market risk PRR rules*.
  - (3) If, where the *standard market risk PRR rules* apply, a *position* is subject to one or more *PRR charges* and the *firm's VaR model permission* does not cover all the risks to which those *PRR charges* relate, the *firm* must calculate the *PRR* for that *position* under the *VaR model approach* (for those risks that are covered) and under the *standard market risk PRR rules* (for those other risks).
  - (4) Where the *standard market risk PRR rules* distinguish between *specific risk* and *general market risk* a *firm's VaR model permission* covers *specific risk* to the extent that it says it does. If the *firm's VaR model permission* does not cover *specific risk*, ■ BIPRU 7.10.143R and ■ BIPRU 7.10.144R apply.
  - (5) If a *firm's VaR model permission* covers *positions* in *CIUs* it covers *specific risk* with respect to those *positions*.

7.10.136A  
FCA PRA

**R** A *firm* must calculate the *market risk capital requirement* for *securitisation positions* and *positions* in the *correlation trading portfolio* in accordance with the *standard market risk PRR rules*, with the exception of those *positions* subject to the *all price risk measure*.

7.10.137  
FCA PRA

**R** A *firm* may exclude from the *VaR model approach* immaterial risks within the scope of its *VaR model approach*. If a *firm* does so it must instead apply the *standard market risk PRR rules* to those risks.

7.10.138  
FCA PRA

- R**
- (1) If a *firm* calculates its *market risk capital requirement* using a combination of the *standard market risk PRR rules* and either the *VaR model approach* or the *VaR model approach* with the *CAD 1 model approach* the *PRR* from each method must be added together.

- (2) A *firm* must take appropriate steps to ensure that all of the approaches are applied in a consistent manner.

7.10.139

G

FCA PRA

An example of the effect of ■ BIPRU 7.10.138R is that where a *firm* normally calculates the PRR for a particular portfolio using a *VaR model*, a *firm* should not switch to the *standard market risk PRR rules* purely to achieve a more attractive PRR.

7.10.140

R

FCA PRA

If:

- (1) the *standard market risk PRR rules* provide for a choice of which of the *PRR charges* to use or specify that one type must be used in some circumstances and that another type must be used in other circumstances;
- (2) one of those types is disapplied under ■ BIPRU 7.10.136R; and
- (3) the other type is not disapplied;

the *firm*:

- (4) must use the *VaR model approach* if under the *standard market risk PRR rules* the *firm* must use the *standard market risk PRR rules* in (2); and
- (5) may use the *VaR model approach* if under the *standard market risk PRR rules* the *firm* may use the *standard market risk PRR rules* in (2).

7.10.141

G

FCA PRA

The treatment of a *convertible* is an example of a situation in which ■ BIPRU 7.10.140R applies. The table in ■ BIPRU 7.3.3R (Table: Instruments which result in notional positions) shows that there are circumstances in which under the *standard market risk PRR rules* a *firm* should calculate an *equity PRR* and that there are circumstances in which a *firm* may choose between calculating an *equity PRR* and an *interest rate PRR*. ■ BIPRU 7.10.140R would be relevant if a *firm's VaR model permission* only covers one of *equity risk* and *interest rate risk*.

7.10.142

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FCA PRA

The *standard market risk PRR rules* for the *option PRR* are only disapplied to the extent that the derived positions arising under ■ BIPRU 7.6.13R (Table: Derived positions) come within the scope of the *VaR model permission*.

#### Link to standard PRR rules: General market risk only

7.10.143

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FCA PRA

If a *firm's VaR model permission* covers *interest rate general market risk* but not *interest rate specific risk*, the *firm* must calculate the *interest rate PRR* so far as it relates to *interest rate specific risk* in accordance with the *standard market risk PRR rules* except that the *firm* must not use the basic *interest rate PRR* calculation in ■ BIPRU 7.3.45R (Basic interest rate calculation for equity instruments).

7.10.144

FCA PRA

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**Link to standard PRR rules: General market risk only**

If a *firm's VaR model permission* covers *equity general market risk* but not *equity specific risk*, the *firm* must calculate the *equity PRR* so far as it relates to *equity specific risk* in accordance with the *standard market risk PRR rules* except that the *PRR for equity specific risk* must be calculated under the *standard equity method*.

7.10.145

FCA PRA

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**Link to standard PRR rules: Miscellaneous**

- (1) To the extent that a *firm's VaR model permission* does not allow it to use an approach set out in ■ BIPRU 7.10 the relevant provisions in ■ BIPRU 7.10 do not apply to that *firm*.
- (2) If a provision of the *Handbook* refers to ■ BIPRU 7.10, that reference must, in the case of a particular *firm* with a *VaR model permission*, be treated as excluding provisions of ■ BIPRU 7.10 that do not apply under the *VaR model permission* and as taking into account any modifications to ■ BIPRU 7.10 made by the *VaR model permission*. Such references also include requirements and conditions contained in the *VaR model permission* but not ■ BIPRU 7.10 and to the *rules* modified by the *VaR model permission*.

7.10.146

FCA PRA

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**Requirement to use value at risk methodology**

A *VaR model* must be a value-at-risk model. It must provide an estimate of the worst expected loss on a portfolio resulting from market movements over a period of time with the specified confidence level.

7.10.147

FCA PRA

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**Ceasing to meet the requirements of BIPRU 7.10**

If a *firm* ceases to meet any of the requirements set out in ■ BIPRU 7.10, the *appropriate regulator's* policy is that the *VaR model permission* should cease to have effect. In part this will be achieved by making it a condition of a *firm's VaR model permission* that it complies at all times with the minimum standards referred to in ■ BIPRU 7.10.26R - ■ BIPRU 7.10.53R. Even if they are not formally included as conditions, the *appropriate regulator* is likely to consider revoking the *VaR model permission* if the requirements are not met.

7.10.148

FCA PRA

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If a *firm* ceases to meet the conditions or requirements in its *VaR model permission* or ■ BIPRU 7.10 it must notify the *appropriate regulator* at once.

**Changes to a VaR model**

7.10.149

FCA PRA

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A *firm* may change its *VaR model* to such extent as it sees fit, except that it must not make a change that (either on its own or together with other changes since the date of *VaR model permission*) would:

- (1) be inconsistent with *VaR model permission* or ■ BIPRU 7.10; or

- 
- (2) mean that backtesting in accordance with ■ BIPRU 7.10 and the *VaR model permission* would result in the use of data that is inappropriate for the purposes of measuring the performance of the *VaR model*.

## 7.11 Credit derivatives in the trading book

### Scope

7.11.1

FCA PRA

R

This section applies to the treatment of credit derivatives in the *trading book*.

### Establishment of positions created by credit derivatives: Treatment of the protection seller

7.11.2

FCA PRA

R

■ BIPRU 7.11.3R - ■ BIPRU 7.11.11R relate to the treatment of the *protection seller* for the purpose of calculating the *securities PRR*. Positions are determined in accordance with ■ BIPRU 7.11.4R - ■ BIPRU 7.11.11R.

7.11.3

FCA PRA

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- (1) When calculating the *PRR* of the *protection seller*, unless specified differently by other *rules* and subject to (2), the notional amount of the credit derivative contract must be used. For the purpose of calculating the *specific risk PRR charge*, other than for total return swaps, the maturity of the credit derivative contract is applicable instead of the maturity of the obligation.
- (2) When calculating the *PRR* of the *protection seller*, a *firm* may choose to replace the notional value of the credit derivative by the notional value adjusted for changes in the *market value* of the credit derivative since trade inception.

7.11.4

FCA PRA

R

A total return swap creates a long *position* in the *general market risk* of the reference obligation and a short *position* in the *general market risk* of a *zero-specific-risk security* with a maturity equivalent to the period until the next interest fixing and which is assigned a 0% *risk weight* under the *standardised approach* to credit risk. It also creates a long *position* in the *specific risk* of the reference obligation.

7.11.5

FCA PRA

R

A credit default swap does not create a *position* for *general market risk*. For the purposes of *specific risk*, a *firm* must record a synthetic long *position* in an obligation of the reference entity, unless the derivative is rated externally and meets the conditions for a *qualifying debt security*, in which case a long *position* in the derivative is recorded. If premium or interest payments are due under the product, these cash flows must be represented as notional *positions* in *zero-specific-risk securities*.

**7.11.6** **R** A single name credit linked note creates a long *position* in the *general market risk* of the note itself, as an interest rate product. For the purpose of *specific risk*, a synthetic long *position* is created in an obligation of the reference entity. An additional long *position* is created in the issuer of the note. Where the credit linked note has an external rating and meets the conditions for a *qualifying debt security*, a single long *position* with the *specific risk* of the note need only be recorded.

**7.11.7** **R** In addition to a long *position* in the *specific risk* of the issuer of the note, a multiple name credit linked note providing proportional protection creates a *position* in each reference entity, with the total notional amount of the contract assigned across the *positions* according to the proportion of the total notional amount that each exposure to a reference entity represents. Where more than one obligation of a reference entity can be selected, the obligation with the highest *risk weighting* determines the *specific risk*.

**7.11.8** **R** Where a multiple name credit linked note has an external rating and meets the conditions for a *qualifying debt security*, a single long *position* with the *specific risk* of the note need only be recorded.

**7.11.9** **R** A first-asset-to-default credit derivative creates a *position* for the notional amount in an obligation of each reference entity. If the size of the maximum credit event payment is lower than the *PRR* requirement under the method in the first sentence of this *rule*, the maximum payment amount may be taken as the *PRR* requirement for *specific risk*.

**7.11.10** **R** A second-asset-to-default credit derivative creates a *position* for the notional amount in an obligation of each reference entity less one (that with the lowest *specific risk PRR* requirement). If the size of the maximum credit event payment is lower than the *PRR* requirement under the method in the first sentence of this *rule*, this amount may be taken as the *PRR* requirement for *specific risk*.

**7.11.11** **R** If an *n*<sup>th</sup>-to-default derivative is externally rated and meets the conditions for a *qualifying debt security*, then the *protection seller* need only calculate one *specific risk* charge reflecting the rating of the derivative. The *specific risk* charge must be based on the *securitisation PRAs* in ■ BIPRU 7.2 as applicable.

#### Establishment of positions created by credit derivatives: Treatment of the protection buyer

**7.11.12** **R** For the *protection buyer*, the *positions* are determined as the mirror principle of the *protection seller*, with the exception of a credit linked note (which entails no short *position* in the issuer). If at a given moment there is a call option in combination with a *step-up*, such moment is treated as the maturity of the protection. In the case of first-to-default credit derivatives and *n*<sup>th</sup> to default credit derivatives, the treatment in ■ BIPRU 7.11.12AR and ■ BIPRU 7.11.12B R applies instead of the mirror principle .

[Note: CAD Annex I point 8.B]

7.11.12A **R**  
FCA PRA

Where a *firm* obtains credit protection for a number of reference entities underlying a credit derivative under the terms that the first default among the assets will trigger payment and that this credit event will terminate the contract, the *firm* may off-set specific risk for the reference entity to which the lowest specific risk percentage charge among the underlying reference entities applies according to the Table in ■ BIPRU 7.2.44R.

[Note: CAD Annex I point 8.B]

7.11.12B **R**  
FCA PRA

Where the  $n^{\text{th}}$  default among the exposures triggers payment under the credit protection, the *protection buyer* may only off-set specific risk if protection has also been obtained for defaults 1 to  $n-1$  or when  $n-1$  defaults have already occurred. In those cases, the methodology set out in ■ BIPRU 7.11.12AR for first-to-default credit derivatives must be followed, appropriately modified for  $n^{\text{th}}$ -to-default products.

[Note: CAD Annex I point 8.B]

#### Deriving the net position in each debt security: Credit derivatives

7.11.12C **R**  
FCA PRA

A *firm* must calculate both the net long and the net short positions in credit derivatives by applying ■ BIPRU 7.2.36 R and ■ BIPRU 7.2.37 R and, where applicable, ■ BIPRU 7.2.42A R to ■ BIPRU 7.2.42C R or ■ BIPRU 7.11.13 R to ■ BIPRU 7.11.17 R.

#### Recognition of hedging provided by credit derivatives

7.11.13 **R**  
FCA PRA

(1) ■ BIPRU 7.11.14R - ■ BIPRU 7.11.17R relate to *specific risk PRR* for *trading book positions* hedged by credit derivatives for the purposes of the calculation of the *securities PRR*.

(2) A *firm* may take an allowance for protection provided by credit derivatives for the purposes in (1) in accordance with the principles set out in the *rules* referred to in (1).

(3) [deleted]

7.11.14 **R**  
FCA PRA

(1) A *firm* may take full allowance when the value of two legs always move in the opposite direction and broadly to the same extent.

(2) This will be the case in the following situations:

- (a) the two legs consist of completely identical instruments; or
- (b) a long cash *position* is hedged by a total rate of return swap (or vice versa) and there is an exact match between the reference obligation and the underlying exposure (i.e., the cash *position*).

- (3) The maturity of the swap itself may be different from that of the underlying exposure for the purposes of (2)(b).
- (4) In these situations, a *firm* must not apply a *specific risk PRR* to either side of the *position*.

## 7.11.15

FCA PRA

R

An 80% offset may be applied when the value of two legs always move in the opposite direction and where there is an exact match in terms of the reference obligation, the maturity of both the reference obligation and the credit derivative, and the currency of the underlying exposure. In addition, key features of the credit derivative contract must not cause the price movement of the credit derivative materially to deviate from the price movements of the cash *position*. To the extent that the transaction transfers risk, an 80% *specific risk* offset may be applied to the side of the transaction with the higher *PRR*, while the *specific risk* requirements on the other side are zero.

## 7.11.16

FCA PRA

R

- (1) A *firm* may take partial allowance when the value of two legs usually move in the opposite direction. This would be the case in the situations set out in (2) - (4).
- (2) The first situation referred to in (1) is that the *position* falls under ■ BIPRU 7.11.16 R (2)(b) but there is an asset mismatch between the reference obligation and the underlying exposure. However, the *positions* meet the following requirements:
  - (a) the reference obligation ranks *pari passu* with or is junior to the underlying obligation; and
  - (b) the underlying obligation and reference obligation share the same obligor and have legally enforceable cross-default or cross-acceleration clauses.
- (3) The second situation referred to in (1) is that the *position* falls under ■ BIPRU 7.11.14 R (2)(a) or ■ BIPRU 7.11.15 R but there is a currency or maturity mismatch between the credit protection and the underlying asset (currency mismatches must be included in the normal reporting with respect to the *foreign currency PRR*).
- (4) The third situation referred to in (1) is that the *position* falls under ■ BIPRU 7.11.15 R but there is an asset mismatch between the cash *position* and the credit derivative. However, the underlying asset is included in the (deliverable) obligations in the credit derivative documentation.
- (5) In each of those situations, rather than adding the *specific risk PRR* requirements for each side of the transaction, only the higher of the two *PRR* requirements applies.

7.11.17 **R** In all situations not falling under ■ BIPRU 7.11.14 R - ■ BIPRU 7.11.16 R, a firm must assess a *specific risk PRR charge* against both sides of the positions.  
**FCA** **PRA**

#### Specific risk calculation

7.11.18 **R** [deleted]

7.11.19 **R** [deleted]

7.11.20 **R** The *specific risk* portion of the *interest rate PRR* for credit derivatives in the *trading book* must be calculated in accordance with ■ BIPRU 7.2.43 R to ■ BIPRU 7.2.46A G (Specific risk calculation), ■ BIPRU 7.2.48A R to ■ BIPRU 7.2.48K R (Specific risk: securitisations and re-securitisations), ■ BIPRU 7.2.48L R (Specific risk: Correlation trading portfolio), ■ BIPRU 7.2.49 R to ■ BIPRU 7.2.51 G (Definition of a qualifying debt security) and the other provisions of ■ BIPRU 7.11, as applicable.

7.11.21 **R** [deleted]

7.11.22 **R** [deleted]

7.11.23 **R** [deleted]

7.11.24 **R** [deleted]

7.11.25 **R** [deleted]

7.11.26 **R** [deleted]

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7.11.45	<b>R</b>	[deleted]
7.11.46	<b>R</b>	[deleted]
7.11.47	<b>G</b>	[deleted]
7.11.48	<b>R</b>	[deleted]
7.11.49	<b>R</b>	[deleted]
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7.11.57	<b>R</b>	[deleted]
7.11.58	<b>R</b>	[deleted]

PAGE  
147**Valuation**

7.11.59	<b>G</b>	■ GENPRU 1.3.29 R - ■ GENPRU 1.3.35 G (General requirements: Valuation adjustments or reserves) are particularly relevant for a <i>firm</i> trading credit derivatives, especially for credit default swaps that are also <i>securitisation positions</i> .
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**FCA** **PRA**

### Other risks relating to credit derivatives

- 7.11.60** **R** **FCA** **PRA** A *firm* must be able to describe, demonstrate and explain to the *appropriate regulator* its trading strategies in relation to credit derivatives both in theory and in practice.
- 7.11.61** **G** **FCA** **PRA** ■ BIPRU 7.11.62 G - ■ BIPRU 7.11.63 G cover risks relating to credit derivatives that may not be captured in this section. This *guidance* is of particular relevance to the *overall financial adequacy rule*, the *overall Pillar 2 rule* and the *general stress and scenario testing rule*.
- 7.11.62** **G** **FCA** **PRA** ■ BIPRU 7.11.5 R requires a *firm* to recognise any premiums payable or receivable under the contract as notional *zero-specific-risk securities*. These *positions* are then entered into the *general market risk* framework. As premium payments paid under such contracts are contingent on no credit event occurring, a credit event could significantly change the *general market risk* capital requirement. A *firm* should consider, under the *overall Pillar 2 rule*, whether this risk means that the capital requirements under this section materially understate the *firm's general market risk* position.
- 7.11.63** **G** **FCA** **PRA** If a *firm* recognises profits on a non-accrual basis it should consider whether the capital requirements for its credit derivatives business adequately cover the risk that any recognised profit may not be achieved due to a credit event occurring. This includes *positions* for which the *firm* may have a perfect hedge in place.
- 7.11.64** **G** [deleted]

## Chapter 8

# Group risk consolidation

## 8.1 Application

### 8.1.1

FCA PRA

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This chapter applies to:

- (1) a *BIPRU firm* that is a member of a *UK consolidation group*;
- (2) a *BIPRU firm* that is a member of a *non-EEA sub-group*; and
- (3) [deleted]
- (4) a *firm* that is not a *BIPRU firm* and is a *parent financial holding company in a Member State in a UK consolidation group*.

### 8.1.2

FCA PRA

R

This chapter does not apply to a *firm* in ■ BIPRU 8.1.1 R (1) to ■ BIPRU 8.1.1R (3) which is a member of the *UK consolidation group* or *non-EEA sub-group* if the interest of the relevant *UK consolidation group* or *non-EEA sub-group* in that *firm* is no more than a *participation*.

#### Purpose

### 8.1.3

FCA PRA

G

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*.

#### How this chapter is organised

### 8.1.4

FCA PRA

G

■ BIPRU 8.2 sets out the definition of *UK consolidation group* and the basic requirement to apply financial resources and concentration risk requirements to that group on a consolidated basis.

### 8.1.5

FCA PRA

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■ BIPRU 8.3 sets out the definition of a *non-EEA sub-group* and the basic requirement to apply financial resources and concentration risk requirements to that group on a consolidated basis.

### 8.1.6

FCA PRA

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■ BIPRU 8.4 sets out how a group of *CAD investment firms* can apply for a *waiver* from consolidated capital requirements although remaining subject to consolidated supervision (including reporting requirements).

- 8.1.7** FCA PRA G ■ BIPRU 8.5 sets out the basis for including and excluding *undertakings* within the group for the purposes of consolidation.
- 8.1.8** FCA PRA G ■ BIPRU 8.6 sets out the calculation of the *consolidated capital resources* of a group and the limits that apply.
- 8.1.9** FCA PRA G ■ BIPRU 8.7 sets out the calculation of the *consolidated capital resources requirement* of a group.
- 8.1.10** FCA PRA G ■ BIPRU 8.8 deals with the application of *advanced prudential calculation approach* on a consolidated basis.
- 8.1.11** FCA PRA G ■ BIPRU 8.9 sets out consolidated concentration risk requirements.
- Consolidation requirements for BIPRU firms elsewhere in the Handbook**
- 8.1.12** FCA PRA G ■ SYSC 12 (Group risk systems and controls requirement) deals with systems and controls requirements for groups.
- 8.1.13** FCA PRA G ■ GENPRU 1.2 (Adequacy of financial resources) deals with the detail about how  
 ■ GENPRU 1.2 applies on a consolidated basis although the underlying requirement to apply it on a consolidated basis is in ■ BIPRU 8.2 and ■ BIPRU 8.3.
- 8.1.14** FCA PRA G ■ BIPRU 11 (Disclosure) itself deals with how that chapter is applied on a consolidated basis.
- 8.1.15** FCA PRA G ■ GENPRU 3.1 (Cross sector groups) deals with *financial conglomerates*.
- 8.1.16** FCA PRA G ■ GENPRU 3.2 (Prudential rules for third country groups) deals, amongst other things, with banking and investment services groups headed by a *parent undertaking* outside the *EEA*.

## 8.2 Scope and basic consolidation requirements for UK consolidation groups

### Main consolidation rule for UK consolidation groups

8.2.1

FCA PRA

R

A *firm* that is a member of a *UK consolidation group* must comply, to the extent and in the manner prescribed in ■ BIPRU 8.5, with the obligations laid down in ■ GENPRU 1.2 (Adequacy of financial resources), the *main BIPRU firm Pillar 1 rules* (but not the *base capital resources requirement*) and ■ BIPRU 10 (Large exposures requirements) on the basis of the consolidated financial position of:

- (1) where either Test 1A or Test 1B in ■ BIPRU 8 Annex 1 R (Decision tree identifying a UK consolidation group) apply, the *parent institution in a Member State in the UK consolidation group*; or
- (2) where either Test 1C or Test 1D in ■ BIPRU 8 Annex 1 R apply, the *parent financial holding company in a Member State*.

8.2.2

FCA PRA

R

Further to ■ BIPRU 8.2.1 R, a *firm* that is a member of a *UK consolidation group* must at all times ensure that the *consolidated capital resources* of the *UK consolidation group* are equal to or exceed its *consolidated capital resources requirement*.

8.2.3

FCA PRA

G

The *base capital resources requirement* does not apply on a consolidated basis.

### Definition of UK consolidation group

8.2.4

FCA PRA

R

A *firm's UK consolidation group* means a group that is identified as a *UK consolidation group* in accordance with the decision tree in ■ BIPRU 8 Annex 1 R (Decision tree identifying a UK consolidation group); the members of that group are:

- (1) where either Test 1A or Test 1B in ■ BIPRU 8 Annex 1 R apply, the members of the *consolidation group* made up of the *sub-group of the parent institution in a Member State* identified in ■ BIPRU 8 Annex 1 R together with any other *person* who is a member of that *consolidation group* because of a *consolidation Article 12(1) relationship* or an *Article 134 relationship*; or

- (2) where either Test 1C or Test 1D in ■ BIPRU 8 Annex 1 R apply, the members of the *consolidation group* made up of the *sub-group* of the *parent financial holding company in a Member State* identified in ■ BIPRU 8 Annex 1 R together with any other *person* who is a member of that *consolidation group* because of a *consolidation Article 12(1) relationship* or an *Article 134 relationship*;

in each case only *persons* included under ■ BIPRU 8.5 (Basis of consolidation) are included in the *UK consolidation group*.

## 8.2.5

FCA PRA

R

For the purposes of this chapter, what would otherwise be a *UK consolidation group* is not a *UK consolidation group* if all the members of that *UK consolidation group* wholly form part of another *UK consolidation group*.

## 8.2.6

FCA PRA

G

■ BIPRU 8 Annex 2 G (Examples of how to identify a UK consolidation group) sets out examples of how to identify a *UK consolidation group*.

## 8.2.7

FCA PRA

G

■ BIPRU 8 Annex 1 R (Decision tree identifying a UK consolidation group) shows that Articles 125 and 126 of the *Banking Consolidation Directive* are important in deciding whether the *appropriate regulator* is obliged to supervise a group or part of a group and hence whether that group or part of a group is a *UK consolidation group*. ■ BIPRU 8 Annex 4 G (Text of Articles 125 and 126 of the *Banking Consolidation Directive*) sets out these articles together with an explanation of how those articles should be read in the case of a group which also contains *CAD investment firms*.

## 8.3 Scope and basic consolidation requirements for non-EEA sub-groups

### Main consolidation rule for non-EEA sub-groups

8.3.1

FCA PRA

R

- (1) A *BIPRU firm* that is a *subsidiary undertaking* of a *BIPRU firm* or of a *financial holding company* must apply the requirements laid down in ■ GENPRU 1.2 (Adequacy of financial resources), the *main BIPRU firm Pillar 1 rules* (but not the *base capital resources requirement*) and ■ BIPRU 10 (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*.
- (2) (1) only applies if the *appropriate regulator* is required by the *Banking Consolidation Directive* or the *Capital Adequacy Directive* to supervise the group established under (1) under Article 73(2) of the *Banking Consolidation Directive* (Non-EEA sub-groups).

8.3.2

FCA PRA

R

Further to ■ BIPRU 8.3.1 R, a *firm* that is a member of a *non-EEA sub-group* must at all times ensure that the *consolidated capital resources* of that *non-EEA sub-group* are equal to or exceed its *consolidated capital resources requirement*.

8.3.3

FCA PRA

G

The *base capital resources requirement* does not apply on a consolidated basis.

8.3.4

FCA PRA

G

The *sub-group* identified in ■ BIPRU 8.3.1 R is called a *non-EEA sub-group*.

### How to identify a non-EEA sub-group

8.3.5

FCA PRA

G

■ BIPRU 8 Annex 3 G (Examples of how to identify a non-EEA sub-group) sets out examples of how to identify a *non-EEA sub-group*.

8.3.6

FCA PRA

G

The remainder of this section sets out a process for identifying a *non-EEA sub-group* in straightforward cases.

## 8.3.7

FCA PRA

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, financial institution* or *asset management company* whose head office is outside the EEA (a *third country banking or investment services undertaking*);
- (2) one of the following applies:
  - (a) it is a *subsidiary undertaking* of a *BIPRU firm* in that *UK consolidation group*; or
  - (b) a *BIPRU firm* in that *UK consolidation group* holds a *participation* in it; and
- (3) that *BIPRU firm* is not a *parent institution in a Member State*.

## 8.3.8

FCA PRA

G

The *sub-group* of the *BIPRU firm* identified in ■ BIPRU 8.3.7 G (2)(a) or ■ BIPRU 8.3.7 G (2)(b) is a potential *non-EEA sub-group*.

## 8.3.9

FCA PRA

G

If more than one *BIPRU firm* is a direct or indirect *parent undertaking* in accordance with ■ BIPRU 8.3.7 G (2)(a) then the *sub-groups* of each of them are all potential *non-EEA sub-groups*. This is illustrated in example three in ■ BIPRU 8 Annex 3 G (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

FCA PRA

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

FCA PRA

G

The effect of ■ BIPRU 8.3.7 G (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 3 G (Examples of how to identify a non-EEA sub-group).

## 8.3.12

FCA PRA

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, financial institution* or *asset management company* whose head office is outside the EEA (a *third country banking or investment services undertaking*);
- (2) one of the following applies:
  - (a) it is a *subsidiary undertaking* of a *financial holding company* in that *UK consolidation group*; or
  - (b) a *financial holding company* in that *UK consolidation group* holds a *participation* in it;

- (3) the head office of that *financial holding company* is in the *United Kingdom*; and
- (4) that *financial holding company* has a *subsidiary undertaking* that is a *BIPRU firm*.

8.3.13

FCA PRA

G

The *sub-group* of the *financial holding company* identified in ■ BIPRU 8.3.12 G (2)(a) or ■ BIPRU 8.3.12 G (2)(b) is a potential *non-EEA sub-group*.

8.3.14

FCA PRA

G

The *financial holding company* identified in ■ BIPRU 8.3.12 G may be a *parent financial holding company in a Member State*. This is illustrated by example 2 of ■ BIPRU 8 Annex 3 G (Examples of how to identify a non-EEA sub-group).

8.3.15

FCA PRA

G

If more than one *financial holding company* is a direct or indirect *parent undertaking* in accordance with ■ BIPRU 8.3.12 G (2)(a) then the *sub-groups* of each of them are all potential *non-EEA sub-groups*.

8.3.16

FCA PRA

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 8.3.12 G (2)(b) then the *sub-group* of each such *financial holding company* is a potential *non-EEA sub-group*.

8.3.17

FCA PRA

G

The *firm* should apply the process in ■ BIPRU 8.3.12 G 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 8.3.7 G.

8.3.18

FCA PRA

G

Having identified potential *non-EEA sub-groups* for each *third country banking or investment services undertaking* in its *UK consolidation group* the *firm* should then eliminate overlapping potential *non-EEA sub-groups* in the following way. If:

- (1) one potential *non-EEA sub-group* is contained within a wider potential *non-EEA sub-group*; and
- (2) the *third country banking or investment services undertakings* in the two potential *non-EEA sub-groups* are the same;

then the smaller potential *non-EEA sub-group* is eliminated.

8.3.19

FCA PRA

G

If there is a chain of three or more potential *non-EEA sub-groups*, each with the same *third country banking or investment services undertakings*, the elimination process may remove all but the highest. This is illustrated in example three in ■ BIPRU 8 Annex 3 G (Examples of how to identify a non-EEA sub-group). In this example there are four potential *non-EEA sub-groups* and the elimination process results in just one remaining (the one headed by the *UK parent financial holding company in a Member State*).

8.3.20

FCA PRA

G

Each remaining potential *non-EEA sub-group* is a *non-EEA sub-group*, even though it may be part of a wider *non-EEA sub-group*.

## 8.3.21

FCA PRA

G

Examples four and five in ■ BIPRU 8 Annex 3 G (Examples of how to identify a *non-EEA sub-group*) show how the same group may contain two *non-EEA sub-groups* even though the smaller potential *non-EEA sub-group* is part of a bigger one. The reason for there being two *non-EEA sub-groups* in these examples is that one of the *third country banking or investment services undertakings* is not a member of both potential *non-EEA sub-groups*.

## 8.3.22

FCA PRA

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 3 G (Examples of how to identify a *non-EEA sub-group*). The effect of ■ BIPRU 8.3.7 G (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 3 G.

## 8.3.23

FCA PRA

G

Even where the requirements for a *non-EEA sub-group* are absorbed into those for the *UK consolidation group* a *firm* should still make clear in its regulatory reporting that the consolidation figures relate to a *UK consolidation group* and a *non-EEA sub-group* and that they both contain the same members.

## 8.3.24

FCA PRA

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 3 G (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  
FCA

R

This section applies to a *BIPRU investment firm* with an *investment firm consolidation waiver*.

### The effect of an investment firm consolidation waiver and the conditions for getting one

8.4.2  
FCA

G

A *BIPRU investment firm* may apply for a *waiver* of the requirement in this chapter to apply capital requirements on a consolidated basis. Such a *waiver* is called an *investment firm consolidation waiver*.

8.4.3  
FCA

G

An *investment firm consolidation waiver* will waive the application of ■ BIPRU 8.2.1 R and ■ BIPRU 8.2.2 R (if it applies with respect to a *UK consolidation group*) or ■ BIPRU 8.3.1 R and ■ BIPRU 8.3.2 R (if it applies with respect to a *non-EEA sub-group*). The effect will be to switch off this chapter with respect to the group in question apart from this section.

8.4.4  
FCA

G

The *FCA* will not grant an *investment firm consolidation waiver* unless:

- (1) the *UK consolidation group* or *non-EEA sub-group* meets the conditions for being a *CAD Article 22 group*;
- (2) the *FCA* is satisfied that each *BIPRU firm* in the *UK consolidation group* or *non-EEA sub-group* will be able to meet its capital requirements using the calculation of *capital resources* in ■ GENPRU 2 Annex 6 R (Capital resources table for a *BIPRU investment firm* with a waiver from consolidated supervision); and
- (3) the *firm* demonstrates that the requirements in ■ BIPRU 8.4.11 R to ■ BIPRU 8.4.18 R will be met.

8.4.5  
FCA

G

The standards in ■ BIPRU 8.4.4 G are minimum standards. Satisfaction of these conditions does not automatically mean the *FCA* will give an *investment firm consolidation waiver*. The *FCA* will in addition also apply the tests in Section 138A of the *Act* (Modification or waiver of rules).

8.4.6

FCA

G

■ SUP 8 (Waiver and modification of rules) and ■ BIPRU 1.3 (Application for advanced approaches) are also relevant to applications for an *investment firm consolidation waiver*.

#### Meeting the terms of an investment firm consolidation waiver

8.4.7

FCA

R

If a *firm* has an *investment firm consolidation waiver* with respect to its *UK consolidation group* or *non-EEA sub-group* but that *UK consolidation group* or *non-EEA sub-group* ceases to meet the definition of a *CAD Article 22 group* the *firm* must comply with the rest of this chapter rather than this section notwithstanding the *investment firm consolidation waiver*.

8.4.8

FCA

G

Compliance with the capital requirements set out in ■ BIPRU 8.4.11 R is a condition under the *Capital Adequacy Directive* for the exemption from capital requirements. Thus if they are breached the *FCA* is likely to revoke the *investment firm consolidation waiver*.

#### Definition of a CAD Article 22 group

8.4.9

FCA

R

- (1) A *CAD Article 22 group* means a *UK consolidation group* or *non-EEA sub-group* that meets the conditions in this rule.
- (2) There must be no *bank, building society* or *credit institution* in the *UK consolidation group* or *non-EEA sub-group*.
- (3) Each *CAD investment firm* in the *UK consolidation group* or *non-EEA sub-group* which is an *EEA firm* must use the definition of own funds given in the *CRD implementation measure* of its *EEA State* for Article 16 of the *Capital Adequacy Directive*.
- (4) Each *CAD investment firm* in the *UK consolidation group* or *non-EEA sub-group* must be a:
  - (a) *limited activity firm*; or
  - (b) *limited licence firm*.
- (5) Each *CAD investment firm* in the *UK consolidation group* or *non-EEA sub-group* which is an *EEA firm* must:
  - (a) meet the requirements imposed by the *CRD implementation measures* of its *EEA State* for Articles 18 and Article 20 of the *Capital Adequacy Directive* on an individual basis; and
  - (b) deduct from its own funds any contingent liability in favour of other members of 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 Pillar 1 rules* on an individual basis.

8.4.10

FCA

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 6 R (Capital resources table for a BIPRU investment firm with a waiver from consolidated supervision). ■ GENPRU 2 Annex 6 R 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 8.4.9 R (5)(b) only imposes the requirement to deduct them on *EEA firms*.

#### Capital adequacy obligations relating to a CAD Article 22 group: General rule

8.4.11

FCA

R

If a *firm* has an *investment firm consolidation waiver*, it must ensure that any *financial holding company* in the *UK consolidation group* or the *non-EEA sub-group* that is the *UK parent financial holding company in a Member State* of a *CAD investment firm* in the *UK consolidation group* or *non-EEA sub-group* has capital resources, calculated under ■ BIPRU 8.4.12 R, in excess of the sum of the following (or any higher amount specified in the *investment firm consolidation waiver*):

- (1) the sum of the solo notional capital resources requirements for each *CAD investment firm*, *financial institution*, *asset management company* and *ancillary services undertaking* in the *UK consolidation group* or the *non-EEA sub-group*, as calculated in accordance with ■ BIPRU 8.4.13 R; and
- (2) the total amount of any contingent liability in favour of *CAD investment firms*, *financial institutions*, *asset management companies* and *ancillary services undertakings* in the *UK consolidation group* or *non-EEA sub-group*.

#### Capital adequacy obligations relating to a CAD Article 22 group: Capital resources

8.4.12

FCA

R

A *firm* must calculate the capital resources of the *parent financial holding company in a Member State* for the purpose of ■ BIPRU 8.4.11 R as follows:

- (1) the capital resources are the sum of *capital resources* calculated at stages D (Total tier one capital before deductions) and I (Total tier two capital) of the version of the *capital resources table* in ■ GENPRU 2 Annex 4 R (Capital resources table for a BIPRU investment firm deducting material holdings) as adjusted in accordance with this *rule*;
- (2) *capital resources* at stage D must not include *innovative tier one capital resources*, but they may be included at stage I if (5) allows this;

- (3) the amount of the items which may be included at stage I must not exceed the amount calculated at stage D of the *capital resources table*;
- (4) the amount of the items which may be included in *lower tier two capital* in stage I must not exceed 50% of the amount calculated at stage D of the *capital resources table*; and
- (5) ■ GENPRU 2.2.25 R (Limits on the use of different forms of capital: Use of higher tier capital in lower tiers) and ■ GENPRU 2.2.27 R (Use of *innovative tier one capital* in lower stages of capital) apply.

#### Capital adequacy obligations relating to a CAD Article 22 group: Capital resources requirement

8.4.13

FCA

R

The solo notional capital resources requirement as referred to in ■ BIPRU 8.4.11 R (1) is calculated in the same way as:

- (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*.

8.4.14

FCA

R

A *firm* must exclude *material holdings* in the notional calculation of the *credit risk capital requirement* for the purposes of ■ BIPRU 8.4.13 R. A *firm* must identify whether it has any *material holdings* and the amount of them in accordance with ■ GENPRU 2.2 (Capital resources) and ■ GENPRU 2 Annex 4 R (Capital resources table for a BIPRU investment firm deducting material holdings).

8.4.15

FCA

G

The notional capital resources requirement calculated under ■ BIPRU 8.4.13 R need not include a credit charge for *material holdings*. However it should include one for *illiquid assets*.

8.4.16

FCA

R

Intra-group *exposures* must not be netted for the purpose of ■ BIPRU 8.4.11 R.

#### Capital adequacy obligations relating to a CAD Article 22 group: Advanced prudential calculation approaches

8.4.17

FCA

R

A *firm* may not use an *advanced prudential calculation approach* for the purpose of ■ BIPRU 8.4.11 R.

**Additional rules that apply to a firm with an investment firm  
consolidation waiver**

8.4.18

FCA

R

If a *firm* has an *investment firm consolidation waiver*, it must:

- (1) ensure that each *CAD investment firm* in the *UK consolidation group* or *non-EEA sub-group* which is a *firm* or an *EEA firm* has in place systems to monitor and control the sources of capital and funding of all the members in the *UK consolidation group* or *non-EEA sub-group*;
- (2) notify the *FCA* of any serious risk that could undermine the financial stability of the *UK consolidation group* or *non-EEA sub-group*, as soon as the *firm* becomes aware of that risk, including those associated with the composition and sources of the capital and funding of members of the *UK consolidation group* or *non-EEA sub-group*;
- (3) report the amount of the *consolidated capital resources* and *consolidated capital resources requirement* of the *UK consolidation group* or *non-EEA sub-group* on a periodic basis as set out in the *investment firm consolidation waiver*;
- (4) report any *large exposures* risks of members of the *UK consolidation group* or *non-EEA sub-group* including any *undertakings* not located in an *EEA State* on a periodic basis set out in the *investment firm consolidation waiver*;
- (5) notify the *FCA* immediately it becomes aware that the *UK consolidation group* or *non-EEA sub-group* has ceased to meet the conditions for being a *CAD Article 22 group*; and
- (6) notify the *FCA* immediately it becomes aware of any breach of  
■ BIPRU 8.4.11 R.

8.4.19

FCA

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

FCA PRA

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:

- (1) a *BIPRU firm*;
- (2) an *institution*;
- (3) a *financial institution*;
- (4) an *asset management company*;
- (5) a *financial holding company*; and
- (6) an *ancillary services undertaking*.

8.5.2

FCA PRA

G

Although an *undertaking* falling outside ■ BIPRU 8.5.1 R will not be included in a *UK consolidation group* or *non-EEA sub-group* it may be relevant in deciding whether one *undertaking* in the *banking sector* or the *investment services sector* is a *subsidiary undertaking* of another with the result that they should be included in the same *UK consolidation group* or *non-EEA sub-group*.

8.5.3

FCA PRA

G

An example of ■ BIPRU 8.5.2 G is as follows. Say that the *undertaking* at the head of a *bank's UK group* is a *parent financial holding company in a Member State*. One of its *subsidiary undertakings* is the *bank*. The *parent financial holding company in a Member State* also has an *insurer* as a *subsidiary undertaking*. That *insurer* has several *investment 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*. It will also include the *investment firms* that are *subsidiary undertakings* of the *insurer*. This is because the *investment 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 undertakings in consolidation

8.5.4

FCA PRA

R

A *firm* must include any *subsidiary undertaking* in the *UK consolidation group* or *non-EEA sub-group* in full in the calculations in this chapter.

8.5.5

FCA PRA

R

In carrying out the calculations for the purposes of this chapter a *firm* must only include the relevant proportion of an *undertaking* that is a member of the *UK consolidation group* or *non-EEA sub-group*:

- (1) by virtue of a *consolidation Article 12(1) relationship*;
- (2) by virtue of an *Article 134 relationship*; or
- (3) because the group holds a *participation* in it.

8.5.6

FCA PRA

R

In ■ BIPRU 8.5.5 R, the relevant proportion is either:

- (1) (in the case of a *participation*) the proportion of *shares* issued by the *undertaking* held by the *UK consolidation group* or the *non-EEA sub-group*; or
- (2) (in the case of a *consolidation Article 12(1) relationship* or an *Article 134 relationship*), such proportion (if any) as stated in the *Part 4A permission* of the *firm*.

#### Basis of inclusion of UCITS investment firms in consolidation

8.5.7

FCA PRA

R

■ GENPRU 2.1.46 R (Adjustment of the variable capital requirement calculation for UCITS investment firms) does not apply for the purpose of this chapter.

8.5.8

FCA PRA

G

In general a *UCITS investment firm* only calculates its capital and concentration risk requirements in relation to its *designated investment business* and does not calculate them with respect to *scheme management activity*. The effect of ■ BIPRU 8.5.7 R 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 *UCITS investment firm*.

#### Exclusion of undertakings from consolidation: Balance sheet size

8.5.9

FCA PRA

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, 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:

- (1) 10 million Euros;
- (2) 1% of the balance sheet total of the *parent undertaking* or the *undertaking* that holds the *participation*.

8.5.10

FCA PRA

R

A *firm* must include *undertakings*, to which ■ BIPRU 8.5.9 R would otherwise apply, if the balance sheet total of those *undertakings* taken together breaches the limit in ■ BIPRU 8.5.9 R.

**Exclusion of undertakings from consolidation: Other reasons**

8.5.11

FCA PRA

G

Article 73(1) of the *Banking Consolidation Directive* allows the *appropriate regulator* to decide to exclude an *institution, 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:

- (1) where the head office of the *undertaking* concerned is situated in a country outside the *EEA* where there are legal impediments to the transfer of the necessary information; or
- (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*; 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* are concerned.

8.5.12

FCA PRA

G

If a *firm* wishes to exclude an *undertaking* on the basis of any of the grounds set out in ■ BIPRU 8.5.11 G it should apply to the *appropriate regulator* for a *waiver*. The *appropriate regulator* will consider such applications in the light of the criteria in Section 138A of the *Act*.

8.5.13

FCA PRA

G

If several *undertakings* meet the criteria in ■ BIPRU 8.5.11 G (2), the *appropriate regulator* will not agree to a *waiver* to exclude them all from consolidation where collectively they are of non-negligible interest with respect to the objectives of the supervision of *institutions*.

**Information about excluded undertakings**

8.5.14

FCA PRA

G

The *appropriate regulator* may require a *firm* to provide information about the *undertakings* excluded from consolidation of the *UK consolidation group* or *non-EEA sub-group* pursuant to this section.

## 8.6 Consolidated capital resources

### General

8.6.1

FCA PRA

R

A *firm* must calculate the *consolidated capital resources* of its *UK consolidation group* or its *non-EEA sub-group* by applying ■ GENPRU 2.2 (Capital resources) to its *UK consolidation group* or *non-EEA sub-group* on an accounting consolidation basis, treating the *UK consolidation group* or *non-EEA sub-group* as a single *undertaking*. The *firm* must adjust ■ GENPRU 2.2 in accordance with this section for this purpose.

### Notification of issuance of capital instruments

8.6.1A

FCA PRA

R

This section applies to a *firm* if another member of its *group* intends to issue a *capital instrument* on or after 1 March 2012 for inclusion in the *firm's capital resources* or *consolidated capital resources* of its *UK consolidation group* or *non-EEA sub-group*.

8.6.1B

FCA PRA

R

A *firm* must notify the *appropriate regulator* in writing of the intention of another member of its *group* which is not a *firm* to issue a *capital instrument* which the *firm* intends to include within its *capital resources* or the *consolidated capital resources* of its *UK consolidation group* or *non-EEA sub-group* as soon as it becomes aware of the intention of the *group undertaking* to issue the *capital instrument*. When giving notice, a *firm* must:

- (1) provide details of the amount of capital to be raised through the intended issue and whether the capital is intended to be issued to external investors or within its *group*;
- (2) identify the stage of the *capital resources table* the *capital instrument* is intended to fall within;
- (3) include confirmation from a *senior manager* of the *firm* responsible for authorising the inclusion of the issue within *capital resources* or *consolidated capital resources* that the *capital instrument* complies with the *rules* applicable to instruments included in the stage of the *capital resources table* identified in (2); and

- (4) provide details of any features of the *capital instrument* which are novel, unusual or different from a *capital instrument* of a similar nature previously issued by the *firm* or widely available in the market or not specifically contemplated by ■ GENPRU 2.2.

This *rule* does not apply to a *firm* if a *group undertaking* intends to issue a *capital instrument* listed in ■ BIPRU 8.6.1E R.

8.6.1C

FCA PRA

R

A *firm* must provide a further notification to the *appropriate regulator* in writing including all the information required in ■ BIPRU 8.6.1BR (1) to ■ (4) as soon as it becomes aware of any changes that are proposed to the intended date of issue, amount of issue, type of investors, stage of capital or any other feature of the *capital instrument* previously notified to the *appropriate regulator*.

8.6.1D

FCA PRA

R

If a *group undertaking* proposes to establish a debt securities program for the issue of *capital instruments* which the *firm* intends to include within its *capital resources* or the *consolidated capital resources* of its UK *consolidation group* or *non-EEA sub-group*, it must:

- (1) notify the *appropriate regulator* of the establishment of the program; and
- (2) provide the information required by ■ BIPRU 8.6.1BR (1) to ■ (4);

as soon as it becomes aware of the proposed establishment. The *appropriate regulator* must be notified of any changes, in accordance with ■ BIPRU 8.6.1C R.

8.6.1E

FCA PRA

R

The *capital instruments* to which ■ BIPRU 8.6.1B R does not apply are:

- (1) ordinary *shares* issued by a *group undertaking* which:
  - (a) are the most deeply subordinated *capital instrument* issued by that *group undertaking*;
  - (b) meet the criteria set out in ■ GENPRU 2.2.83 R (2) and ■ GENPRU 2.2.83 R (3) and ■ GENPRU 2.2.83A R; and
  - (c) are the same as ordinary *shares* previously issued by that *group undertaking*;
- (2) debt instruments issued from a debt securities program established by a *group undertaking*, provided the program was notified to the *appropriate regulator* prior to its first drawdown, in accordance with ■ BIPRU 8.6.1D R; and
- (3) *capital instruments* which are not materially different in terms of their characteristics and eligibility for inclusion in a particular tier of capital to *capital instruments* previously issued by a *group undertaking* for inclusion in the *firm's capital resources* or

*consolidated capital resources of its UK consolidation group or non-EEA sub-group.*

8.6.1F

FCA PRA

R

A *firm* must notify the *appropriate regulator* in writing, no later than the date of issue, of the intention of a *group undertaking* to issue a *capital instrument* listed in ■ BIPRU 8.6.1E R which the *firm* intends to include within its *capital resources* or the *consolidated capital resources* of its *UK consolidation group* or *non-EEA sub-group*. When giving notice a *firm* must:

- (1) provide the information set out at ■ BIPRU 8.6.1BR (1) to ■ (3); and
- (2) confirm that the terms of the *capital instrument* have not changed since the previous issue of that type of *capital instrument* by that *group undertaking*.

#### Limits on the use of different forms of capital

8.6.2

FCA PRA

R

The *capital resources gearing rules* apply for the purposes of calculating *consolidated capital resources*. They apply to the *UK consolidation group* or *non-EEA sub-group* on an accounting consolidation basis, treating the *UK consolidation group* or *non-EEA sub-group* as a single *undertaking*.

8.6.3

FCA PRA

G

As the various components of capital differ in the degree of protection that they offer, the *capital resources gearing rules* as applied on a consolidated basis place restrictions on the extent to which certain types of capital are eligible for inclusion in a *UK consolidation group* or *non-EEA sub-group's consolidated capital resources*.

■ GENPRU 2.2.25 R (Limits on the use of different forms of capital: Use of higher tier capital in lower tiers) also applies.

8.6.4

FCA PRA

G

The prohibition in ■ GENPRU 2.2 (Capital resources) on including *innovative tier one capital* in *tier one capital* for the purposes of meeting capital resources requirements applies under this section. However ■ GENPRU 2.2.27 R (*innovative tier one capital* may be included in *lower stages of capital* when excluded from *tier one capital*) also applies. So, for example, a *firm* should not include *consolidated indirectly issued capital* in *tier one capital* but should generally include it as *upper tier two capital*.

8.6.5

FCA PRA

G

The *rules* in ■ GENPRU 2.2 (Capital resources) on what *tier two capital* and *tier three capital* can be used for also apply under this section.

#### Calculation of consolidated capital resources if there is a building society in the group

8.6.6

FCA PRA

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*.

### Calculation of consolidated capital resources if there is a bank or credit institution in the group

8.6.7

FCA PRA

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*.

### Calculation of consolidated capital resources for an investment firm group

8.6.8

FCA PRA

R

Where a *firm's UK consolidation group* or *non-EEA sub-group* does not include a *bank*, *building society* or *credit institution*, the *firm* must calculate that group's *consolidated capital resources* using the calculation of *capital resources* in ■ GENPRU 2 Annex 4 R (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).

8.6.9

FCA PRA

R

A *firm* must give one *Month's* prior notice to the *appropriate regulator* before starting to use or stopping using the method in ■ GENPRU 2 Annex 5 (Capital resources table for a BIPRU investment firm deducting illiquid assets).

### Treatment of minority interests

8.6.10

FCA PRA

R

- (1) This *rule* sets out how to determine whether minority interests in an *undertaking* in a *UK consolidation group* or *non-EEA sub-group* may be included in *tier one capital*, *tier two capital* or *tier three capital* for the purpose of calculating *consolidated capital resources* (each referred to as a "tier" of capital in this *rule*).
- (2) A *firm* must identify the item of capital of the *undertaking* in question that gives rise to that minority interest.
- (3) A *firm* must include the minority interest in the tier of capital in which that *undertaking* would have to include the capital referred to in (2) if it were a *firm* calculating its *capital resources* on a solo basis under whichever method applies to the group under ■ BIPRU 8.6.6 R to ■ BIPRU 8.6.8 R.
- (4) This *rule* does not apply to a minority interest created by *consolidated indirectly issued capital*.

### Indirectly issued capital and group capital resources

8.6.11

FCA PRA

R

For the purposes of this chapter, ■ GENPRU 2.2.123 R to ■ GENPRU 2.2.137 R (Indirectly issued tier one capital (BIPRU firm only)) do not apply. A *firm* may only include *consolidated indirectly issued capital* in *consolidated capital resources* (whether as a minority interest or otherwise) in accordance with this section.

8.6.12

FCA PRA

R

*Consolidated indirectly issued capital* means any *capital instrument* issued by a member of the *UK consolidation group* or *non-EEA sub-group* where:

- (1) some or all of the following conditions are satisfied:
  - (a) that capital is issued to an *SPV*; or
  - (b) that capital is issued by an *SPV*; or
  - (c) the subscription for the capital issued by the member of the group in question is funded directly or indirectly by an *SPV*; and
- (2) any of the *SPVs* referred to in (1) is a member of the *UK consolidation group* or *non-EEA sub-group* or a *subsidiary undertaking* of any member of the *UK consolidation group* or *non-EEA sub-group*.

8.6.13

FCA PRA

R

A *firm* may only include *consolidated indirectly issued capital* in the *consolidated capital resources* of its *UK consolidation group* or *non-EEA sub-group* if:

- (1) it is issued by an *SPV* that is a member of the *UK consolidation group* or *non-EEA sub-group* to *persons* who are not members of the *UK consolidation group* or *non-EEA sub-group*; and
- (2) the conditions in ■ BIPRU 8.6.16 R to ■ BIPRU 8.6.18 R are satisfied.

8.6.14

FCA PRA

R

*Consolidated indirectly issued capital* that is eligible for inclusion in the *consolidated capital resources* of a *UK consolidation group* or *non-EEA sub-group* may only be included as a minority interest created by the *capital instrument* issued by the *SPV* referred to in ■ BIPRU 8.6.13 R. If it is eligible, it is *innovative tier one capital*.

8.6.15

FCA PRA

R

For the purposes of this section, an *undertaking* is an *SPV* if the main activity of the *SPV* is to raise funds for *undertakings* in:

- (1) (in the case of a *UK consolidation group*) that *UK consolidation group*; or
- (2) (in the case of a *non-EEA sub-group*) that *non-EEA sub-group* or any *UK consolidation group* of which it forms part.

8.6.16

FCA PRA

R

The *SPV* referred to in ■ BIPRU 8.6.13 R must satisfy the conditions in ■ GENPRU 2.2.127 R (Conditions that an *SPV* has to satisfy if indirectly issued capital is to be included in *capital resources* on a solo basis) as modified by the following:

- (1) references in ■ GENPRU 2.2.127 R (1) to being controlled by the *firm* are to being controlled by a member of the *firm's UK consolidation group* or *non-EEA sub-group* as the case may be; and
- (2) references to the *firm's group* are to the *firm's UK consolidation group* or *non-EEA sub-group* as the case may be.

8.6.17

FCA PRA

R

The capital issued by the *SPV* referred to in ■ BIPRU 8.6.13 R must satisfy the conditions in ■ GENPRU 2.2.129 R (Conditions that capital issued by an *SPV* has to satisfy if indirectly issued capital is to be included in *capital resources* on a solo basis) as modified by the following:

- (1) references to the *firm's group* are to the *firm's UK consolidation group* or *non-EEA sub-group* as the case may be;
- (2) the substitution obligation in ■ GENPRU 2.2.129 R (2) need not be the *firm's* but may apply to any member of the *UK consolidation group* or *non-EEA sub-group* as the case may be; and
- (3) that substitution obligation applies if the *consolidated capital resources* of the *UK consolidation group* or *non-EEA sub-group*, as the case may be, fall, or are likely to fall, below its *consolidated capital resources requirement*.

8.6.18

FCA PRA

R

The *SPV* referred to in ■ BIPRU 8.6.13 R must invest the funds raised from the issue of capital by the *SPV* by subscribing for capital resources issued by an *undertaking* that is a member of the *UK consolidation group* or *non-EEA sub-group*. Those capital resources must satisfy the following conditions:

- (1) those capital resources must at least comply with the requirements for *lower tier two capital*; and
- (2) the first call date or fixed maturity date (if any) of those capital resources must not arise before the first call date on the instrument issued by the *SPV*.

8.6.19

FCA PRA

R

In relation to the obligation to substitute described in ■ BIPRU 8.6.17 R (2), a *firm* must take all reasonable steps to ensure that the *undertaking* in question has at all times sufficient authorised and unissued *tier one instruments* other than *innovative tier one instruments* (and authority to issue them) to enable it to discharge the obligation to substitute.

8.6.20

FCA PRA

R

A *firm* must comply with the requirements set out in ■ GENPRU 2.2.135R (Notifying the *appropriate regulator* of unusual transactions in relation to indirectly issued capital) and ■ GENPRU 2.2.137 R (Contents of marketing documents in relation to indirectly issued capital) in relation to *consolidated indirectly issued capital* included in *consolidated capital resources*.

8.6.21

FCA PRA

R

### Venture Capital Investments

Part 2 of stage M in the *capital resources table* for banks in ■ GENPRU 2 Annex 2 R and the *capital resources table* for building societies in ■ GENPRU 2 Annex 3 R is adjusted so as to read as follows in relation to the deduction of investments in *subsidiary undertakings* and *participations*:

Deductions from the totals of tier one and tier two	(M)
...	...
...	(Part 2 of stage M)
<b>Investments in <i>subsidiary undertakings</i> and <i>participations</i> excluding:</b>	
<p>(1) any amount which is already deducted as <i>material holdings</i> or <i>qualifying holdings</i>; and</p> <p>(2) any investment in an <i>undertaking</i> that meets the following conditions:</p> <p>(a) the investment has been made by a Venture Capital Investor and the <i>firm</i> is entitled to ignore (i) the Venture Capital Investor making that investment in accordance with GENPRU 2.2.209 R (2) or (ii) the Venture Capital Holding Company (or a proportion of it) which holds the Venture Capital Investor in accordance with GENPRU 2.2.209 R (3) for the purposes of determining whether there is a <i>material holding</i>;</p> <p>(b) the investment is a <i>venture capital investment</i>; and</p> <p>(c) the <i>undertaking</i> is not (i) a <i>credit institution</i> or (ii) <i>financial institution</i> the principal activity of which is to perform any activity other than the acquisition of holdings in other <i>undertakings</i>.</p>	

## 8.7 Consolidated capital resources requirements

### General approach

#### 8.7.1

FCA PRA

G

The calculation of the *consolidated capital resources requirement* of a firm's UK consolidation group or non-EEA sub-group involves taking the individual components that make up the *capital resources requirement* on a solo basis and applying them on a consolidated basis. Those components are the capital charge for credit risk (the *credit risk capital requirement*), the capital charge for market risk (the *market risk capital requirement*), the capital charge for operational risk (the *operational risk capital requirement*) and the *fixed overheads requirement*.

#### 8.7.2

FCA PRA

G

Each of the capital charges in ■ BIPRU 8.7.1 G, as applied on a consolidated basis, is called a *consolidated requirement component*. The name of each *consolidated requirement component* reflects the solo capital charge on which it is based. Solo capital charges are called *risk capital requirements*. Thus for example the *consolidated requirement component* for market risk is called the *consolidated market risk requirement*. The calculation of the *consolidated market risk requirement* is based on the calculation of the capital charge for market risk that applies on a solo basis (the *market risk capital requirement*). So the *risk capital requirement* applicable to the *consolidated market risk requirement* is the *market risk capital requirement*.

#### 8.7.3

FCA PRA

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 5 R (Decision tree for identifying the consolidated capital resources requirement of a UK consolidation group or a non-EEA sub-group).

■ BIPRU 8 Annex 5 R 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*.

#### 8.7.4

FCA PRA

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 firms, limited activity firms* or *CAD full scope firms*).

#### 8.7.5

FCA PRA

G

In general a firm should calculate each *consolidated requirement component* using the *appropriate regulator's rules*, even in the case of group members who are subject to the

capital requirements of an overseas regulator. However this section sets out certain circumstances in which a *firm* may use the capital requirements of an overseas regulator.

8.7.6

FCA PRA

G

■ BIPRU 8.8 (Advanced prudential calculation approaches) says that a *firm* should not apply an *advanced prudential calculation approach* on a consolidated basis unless the *advanced prudential calculation approach permission* allowing the *firm* to use the *advanced prudential calculation approach* specifically allows it to be used on consolidated basis.

8.7.7

FCA PRA

G

■ BIPRU 8.8 (Advanced prudential calculation approaches) has further details about how capital requirements are calculated on a consolidated basis if a *firm* uses an *advanced prudential calculation approach*.

8.7.8

FCA PRA

G

A *firm* has a choice about how it should apply a *risk capital requirement* to the group. It may do this by treating the whole of the group as a single entity and applying the *risk capital requirement* to the group (a line by line approach), calculating a separate *risk capital requirement* for each group member (an aggregation approach) or a mixture of the two.

8.7.9

FCA PRA

G

A *firm* may make the choice between an aggregation and a line by line approach differently for each *consolidated requirement component*. So for example a *firm* may decide to calculate the *consolidated market risk requirement* on an aggregation basis and the *consolidated fixed overheads requirement* on a line by line basis.

#### Method of calculation to be used

8.7.10

FCA PRA

R

A *firm* must calculate 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 5 R (Decision tree for identifying the consolidated capital resources requirement of a UK consolidation group or a non-EEA sub-group).

#### Calculation of the consolidated requirement components

8.7.11

FCA PRA

R

A *firm* must calculate a *consolidated requirement component* by applying the *risk capital requirement* applicable to that *consolidated requirement component* to the *UK consolidation group* or *non-EEA sub-group* in accordance with ■ BIPRU 8.7.13 R. Except where ■ BIPRU 8.7.34 R to ■ BIPRU 8.7.38 R allow the requirements of another regulator to be used, the *risk capital requirement* must be calculated in accordance with the *appropriate regulator's rules*. The *risk capital requirement* applicable to a *consolidated requirement component* is the one specified in the second column of the table in ■ BIPRU 8.7.12 R.

8.7.12

R

Table: Capital charges relating to consolidated requirement components

FCA PRA

This table belongs to ■ BIPRU 8.7.11 R

<i>Consolidated requirement component</i>	<i>Rules on which the consolidated requirement component are based (the applicable risk capital requirement)</i>
<i>Consolidated credit risk requirement</i>	<i>Credit risk capital requirement</i>
<i>Consolidated fixed overheads requirement</i>	<i>Fixed overheads requirement</i>
<i>Consolidated market risk requirement</i>	<i>Market risk capital requirement</i>
<i>Consolidated operational risk requirement</i>	<i>Operational risk capital requirement</i>

#### Choice of consolidation method

8.7.13

R

FCA PRA

- (1) A *firm* must calculate a *consolidated requirement component* by using one of the methods in this *rule*.
- (2) Under the first method a *firm* must:
  - (a) apply the *risk capital requirement* set out in ■ BIPRU 8.7.12 R to each *undertaking* in the *UK consolidation group* or *non-EEA sub-group*; and
  - (b) add the *risk capital requirements* together.
- (3) Under the second method a *firm* must:
  - (a) treat the whole *UK consolidation group* or *non-EEA sub-group* as a single *undertaking*; and
  - (b) apply the *risk capital requirement* set out in ■ BIPRU 8.7.12 R to the group on an accounting consolidation basis.
- (4) The third method is a mixture of methods one and two. Under the third method a *firm* must:
  - (a) treat one or more parts of the *UK consolidation group* or *non-EEA sub-group* as separate single *undertakings*;
  - (b) apply the *risk capital requirement* set out in ■ BIPRU 8.7.12 R to each such part of the group on an accounting consolidation basis;
  - (c) apply the *risk capital requirement* set out in ■ BIPRU 8.7.12 R to each of the remaining *undertakings* in the *UK consolidation group* or *non-EEA sub-group* (if any); and
  - (d) add the *risk capital requirements* together.

(5) *A firm may use different methods for different consolidated requirement components.*

8.7.14

FCA PRA

G

An accounting consolidation basis means applying the *rules* in ■ BIPRU 8.7.12 R on a line by line consolidation basis rather than an aggregation basis.

8.7.15

FCA PRA

G

The provisions of this section on credit risk and *market risk* restrict the choice given by ■ BIPRU 8.7.13 R in certain circumstances.

### Notifying the appropriate regulator of the choice of consolidation technique

8.7.16

FCA PRA

R

*A firm must notify the appropriate regulator which method under ■ BIPRU 8.7.13 R it applies for which consolidated requirement component and to which parts of the UK consolidation group or non-EEA sub-group it is applying an aggregation approach and to which parts it is applying an accounting consolidation approach.*

### Special rules for the consolidated credit risk requirement

8.7.17

FCA PRA

R

■ BIPRU 8.7.18 G to ■ BIPRU 8.7.23 R relate to the calculation of the *consolidated credit risk requirement*.

8.7.18

FCA PRA

G

The *credit risk capital requirement* (on which the *consolidated credit risk requirement* is based) is split into three capital charges. One relates to credit risk in the *non-trading book* (the *credit risk capital component*). One relates to credit risk in the *trading book* (the *counterparty risk capital component*). The third is a capital charge for *exposures* in the *trading book* that exceed the limits in ■ BIPRU 10.5 (Limits on exposures). This is called the *concentration risk capital component*.

8.7.19

G

[deleted]

8.7.20

FCA PRA

R

*A firm may use a combination of the CCR standardised method, the CCR mark to market method and the CCR internal model method on a permanent basis with respect to the firm's UK consolidation group or non-EEA sub-group for the purposes of calculating the consolidated credit risk requirement. In particular, where the firm is permitted to apply the CCR internal model method on a consolidated basis with respect to its UK consolidation group or non-EEA sub-group, it may combine the use of CCR standardised method and CCR mark to market method on a permanent basis for financial derivative instruments and long settlement transaction not covered by its CCR internal model method permission.*

8.7.21

FCA PRA

R

■ BIPRU 9.4.1 R (Minimum requirements for recognition of significant credit risk transfer) as applied on a consolidated basis requires the transfer to be to a *person* outside the *UK consolidation group* or *non-EEA sub-group*.

8.7.22

FCA PRA

R

A *firm* must not use both the *financial collateral simple method* and the *financial collateral comprehensive method* with respect to its *UK consolidation group* or *non-EEA sub-group*.

8.7.23

FCA PRA

R

(1) A *firm* may only treat an *exposure* as exempt under ■ BIPRU 3.2.25 R (Zero risk-weighting for intra-group exposures) as applied on a consolidated basis if the member of the *UK consolidation group* or *non-EEA sub-group* that has the *exposure*:

- (a) is a *BIPRU firm* and that *exposure* is exempt under ■ BIPRU 3.2.25 R as it applies to that *BIPRU firm* on a solo basis; or
- (b) meets the conditions in ■ BIPRU 3.2.25 R (1)(d) (Condition relating to establishment in the *UK*) and that *exposure* would be exempt under (a) if that member was a *BIPRU firm*.

(2) The notification obligation in ■ BIPRU 3.2.35 R applies.

#### Special rules for the consolidated market risk requirement

8.7.24

FCA PRA

R

For the purposes of calculating the *consolidated market risk requirement* of a *UK consolidation group* or *non-EEA sub-group*, a *firm* must apply ■ BIPRU 1.2.3 R (Definition of the trading book) and ■ BIPRU 1.2.17 R (Size thresholds for the purposes of the definition of the trading book) to the whole *UK consolidation group* or *non-EEA sub-group* as if the group were a single *undertaking*.

8.7.25

FCA PRA

R

A *firm* may not apply the second method in ■ BIPRU 8.7.13 R (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 8.7.13 R (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 8.7.13 R (2) (method one) or ■ BIPRU 8.7.13 R (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.

#### Special rules for the consolidated operational risk requirement

8.7.26

FCA PRA

R

For the purposes of calculating the *consolidated operational risk requirement*, a *firm* must apply ■ BIPRU 6.2.9 R to ■ BIPRU 6.2.12 R (Combination of different methodologies) to the whole *UK consolidation group* or *non-EEA sub-group* as if the group were a single *undertaking*.

8.7.27

FCA PRA

R

- (1) This *rule* sets out how ■ BIPRU 6.3.2 R (3) (Negative figure arising in calculation of the relevant indicator under the *basic indicator approach*) applies on a consolidated basis.
- (2) If the calculation for any individual *undertaking* under method one in ■ BIPRU 8.7.13 R (2) (application of aggregation approach to the whole group) or method three as described in ■ BIPRU 8.7.13 R (4)(c) (mixture of aggregation and accounting consolidation) or for any sub-group created under method three as described in ■ BIPRU 8.7.13 R (4)(a) results in a figure of zero or a negative figure, that figure must be excluded.
- (3) If a *firm* is using method two in ■ BIPRU 8.7.13 R (accounting consolidation approach for the whole group), ■ BIPRU 6.3.2 R (3)

applies to the *UK consolidation group* or *non-EEA sub-group* as if it were a single *undertaking*.

- (4) (3) also applies to a sub-group created under method 3 as described in ■ BIPRU 8.7.13 R (4)(a).

### Special rules for calculating specific consolidated requirement components

8.7.28

FCA PRA

G

■ BIPRU 8.7.21 R to ■ BIPRU 8.7.26 R are generally examples of the application of the general principles in ■ BIPRU 8.2.1 R (Main consolidation rule for UK consolidation groups) and ■ BIPRU 8.3.1 R (Main consolidation rule for non-EEA sub-groups). ■ BIPRU 8.7.20 R and ■ BIPRU 8.7.25 R are exceptions to those principles.

### Elimination of intra-group transactions

8.7.29

FCA PRA

R

In accordance with ■ BIPRU 8.2.1 R and ■ BIPRU 8.3.1 R (The basic consolidation rules for a *UK consolidation group* or *non-EEA sub-group*), a *firm* may exclude that part of the *risk capital requirement* that arises as a result of:

- (1) (in respect of the *consolidated credit risk requirement*) intra-group balances; or
- (2) (in respect of the *consolidated operational risk requirement* and *consolidated fixed overheads requirement*) intra-group transactions;

with other *undertakings* in the *UK consolidation group* or *non-EEA sub-group*.

### Other provisions about calculating risk capital requirements

8.7.30

FCA PRA

R

- (1) This rule applies when the rules applicable under ■ BIPRU 8.7.12 R apply differently for different types of *firms*.
- (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*.
- (3) Where a *firm's UK consolidation group* or *non-EEA sub-group* is a group identified at Stage 2 in ■ BIPRU 8 Annex 5 R, the rules that apply are those that apply to a *full scope BIPRU investment firm*.
- (4) Where a *firm's UK consolidation group* or *non-EEA sub-group* is a group identified at Stage 3 in ■ BIPRU 8 Annex 5 R, the rules that apply are those that apply to a *BIPRU limited activity firm*.

- (5) Where a *firm's UK consolidation group* or *non-EEA sub-group* is a group identified at Stage 4 in ■ BIPRU 8 Annex 5 R, the rules that apply are those that apply to a *BIPRU limited licence firm*.

8.7.31

FCA PRA

G

If a *firm* is calculating a *risk capital requirement* for an *undertaking* that is not a *BIPRU firm* it should calculate it as if the *undertaking* were a *BIPRU firm*.

8.7.32

FCA PRA

G

Similarly ■ BIPRU 8.7.30 R 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*.

8.7.33

FCA PRA

G

A *firm* should not use an *advanced prudential calculation approach* for calculating a *risk capital requirement* unless this is permitted as explained in ■ BIPRU 8.8 (Advanced prudential calculation approaches).

#### Use of the solo requirements of another EEA competent authority

8.7.34

FCA PRA

R

A *firm* may calculate the *risk capital requirement* for an *institution* in the *firm's UK consolidation group* or *non-EEA sub-group* that is an *EEA firm* in accordance with the *CRD implementation measures* in the *EEA firm's EEA State* that correspond to the *appropriate regulator's rules* that would otherwise apply under this section if the *institution* is subject to those *CRD implementation measures*.

8.7.35

R

(1) [deleted]

(2) [deleted]

8.7.36

G

[deleted]

#### Use of the consolidated requirements of another EEA competent authority

8.7.37

FCA PRA

R

(1) This *rule* applies if:

- (a) a *firm* is applying an accounting consolidation approach to part of its *UK consolidation group* or *non-EEA sub-group* under method three as described in ■ BIPRU 8.7.13 R (4)(a); and
- (b) the part of the group in (a) constitutes the whole of a group subject to the consolidated capital requirements of a *competent authority* under the *CRD implementation measures* relating to consolidation under the *Banking Consolidation Directive* or the *Capital Adequacy Directive*.

(2) If the conditions in this *rule* are satisfied, a *firm* may apply the consolidated capital requirement in (1)(b) as the *risk capital requirement* for the group identified in (1)(a) so far as that

consolidated capital requirement corresponds to the *appropriate regulator's rules* that would otherwise apply under this section.

8.7.38 **R** [deleted]

**Prohibition on using the standardised rules of a regulator outside the EEA**

8.7.38A

**R**

**FCA PRA**

(1) This *rule* applies to a *firm* if:

- (a) an *institution* in its *UK consolidation group* or *non-EEA sub-group* is subject to any of the rules or requirements of, or administered by, a *third-country competent authority* applicable to its *financial sector* that correspond to the *sectoral rules* applicable to that *financial sector* ("corresponding sectoral rules"); or
- (b) a part of its *UK consolidation group* or *non-EEA sub-group* constitutes the whole of a group subject to the consolidated capital requirements of a *third-country competent authority* under the corresponding sectoral rules applicable to the *banking sector* or the *investment services sector* for a state or territory outside the *EEA*.

(2) A *firm* may not use the requirements under any of the corresponding sectoral rules of a state or territory outside the *EEA* in order to calculate the *consolidated capital resources requirement* of its *UK consolidation group* or *non-EEA sub-group* for the purpose of this chapter.

**Use of an advanced prudential calculation approach under the rules of an overseas regulator**

8.7.39

**G**

**FCA PRA**

A *firm* should not use the requirements of an overseas regulator if that would involve the use of an *advanced prudential calculation approach* unless this is permitted under

■ BIPRU 8.8 (Advanced prudential calculation approaches).

## 8.8 Advanced prudential calculation approaches

### General

8.8.1

FCA PRA

R

A *firm* must not apply any *advanced prudential calculation approach* for the purposes of this chapter unless it has an *advanced prudential calculation approach permission* and that *advanced prudential calculation approach permission* requires the *firm* to use that *advanced prudential calculation approach* for those purposes.

8.8.2

FCA PRA

G

■ BIPRU 1.3 (Applications for advanced approaches) deals with how to apply for an *advanced prudential calculation approach permission*.

### Prohibition on using the rules of an overseas regulator

8.8.3

FCA PRA

R

Even if a *firm* has an *advanced prudential calculation approach permission* that allows it to use an *advanced prudential calculation approach* for the purposes of this chapter, the *firm* may not use the requirements of another state or territory to the extent they provide for that *advanced prudential calculation approach*. Therefore a *firm* may not use ■ BIPRU 8.7.34 R and ■ BIPRU 8.7.37 R (Use of the capital requirements of another EEA competent authority) if that would involve using an *advanced prudential calculation approach*.

### Special provisions relating to the internal ratings based approach

8.8.4

FCA PRA

R

The conditions in ■ BIPRU 4.2.26 R (Combined use of methodologies under the IRB approach) apply to a *firm's UK consolidation group* or *non-EEA sub-group* as if that group were a single *undertaking*.

### Special provisions relating to the advanced measurement approach

8.8.5

FCA PRA

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.

8.8.6

FCA PRA

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.

8.8.7

FCA PRA

G

■ BIPRU 8.7.26 R deals with the combination of the *advanced measurement approach* with other approaches to *operational risk* on a group level.

#### Special provisions relating to the CCR internal model method

8.8.8

FCA PRA

G

■ BIPRU 8.7.17 R deals with the combination of the *CCR internal model method* with other approaches to calculating exposure values on a group level.

#### Corporate governance arrangement for the IRB approach and the AMA

8.8.9

FCA PRA

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 4.3.12 G (Approval and reporting arrangements for the *IRB approach* where rating systems are used on a unified group basis) and ■ BIPRU 6.5.32 G (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.



**8.9** [deleted]

- 8.9.1 [Deleted]
- 8.9.2 [Deleted]
- 8.9.3 [Deleted]
- 8.9.4 [Deleted]
- 8.9.5 [Deleted]
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- 8.9.22 [Deleted]
- 8.9.23 [Deleted]
- 8.9.24 [Deleted]
- 8.9.25 [Deleted]
- 8.9.26 [Deleted]
- 8.9.27 [Deleted]

## 8.9A Consolidated large exposure requirements

### Integrated groups: core UK group and non-core large exposures group

8.9A.1

R

FCA PRA

- (1) ■ BIPRU 10 (Large exposures) applies to a *firm's UK consolidation group* or (subject to (2)) *non-EEA sub-group* as if it were a single *undertaking*.
- (2) A *firm* may exempt the *exposures* of its *non-EEA sub-group* to its *core concentration risk group counterparty* or *non-core concentration risk group counterparty* from the limits in ■ BIPRU 10.5 (Limits on exposures) that apply to the *non-EEA sub-group* on a sub-consolidated basis.

8.9A.2

G

FCA PRA

The effect of ■ BIPRU 8.9A.1R (2) is that there is no limit on a sub-consolidated basis for *exposures* of a *firm's non-EEA sub-group* to its *core concentration risk group counterparty* or *non-core concentration risk group counterparty*. This is because those *exposures* are included in the *large exposure* limits that apply to the *firm's UK consolidation group*.

8.9A.3

R

FCA PRA

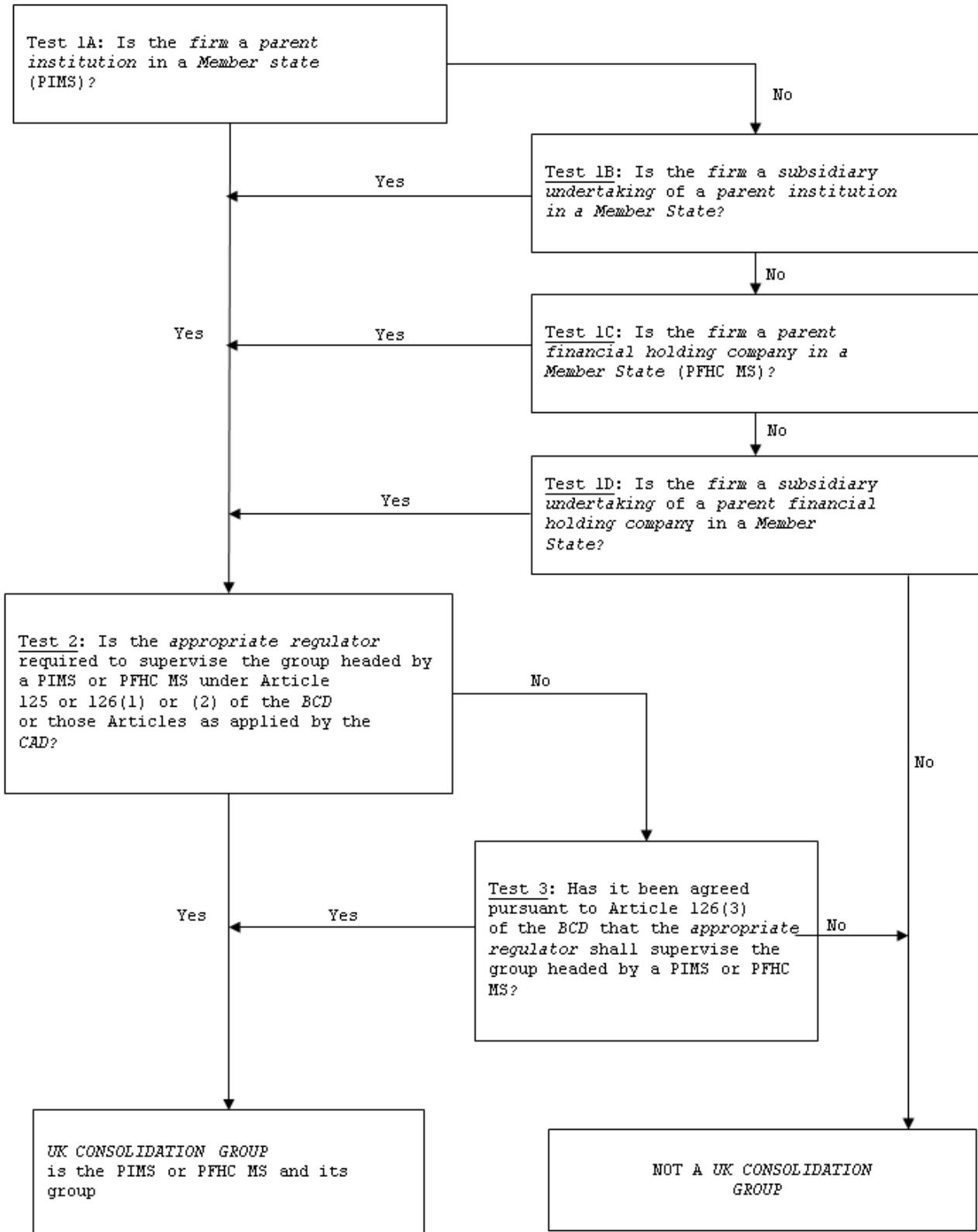
In relation to a *firm*, *intra-group exposures* that are exempt under a *non-core large exposures group waiver* may be excluded when calculating the limits in ■ BIPRU 10.5 (Limits on exposures) that apply to the *UK consolidation group* or *non-EEA sub-group*, provided that the total amount of such *exposures* and the other *exposures* which are exempt under a *non-core large exposures group waiver* do not exceed the limit in ■ BIPRU 10.9A.7 R (Non-trading book backstop large exposure limit for non-core large exposures group).



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**Decision tree identifying a UK consolidation group**

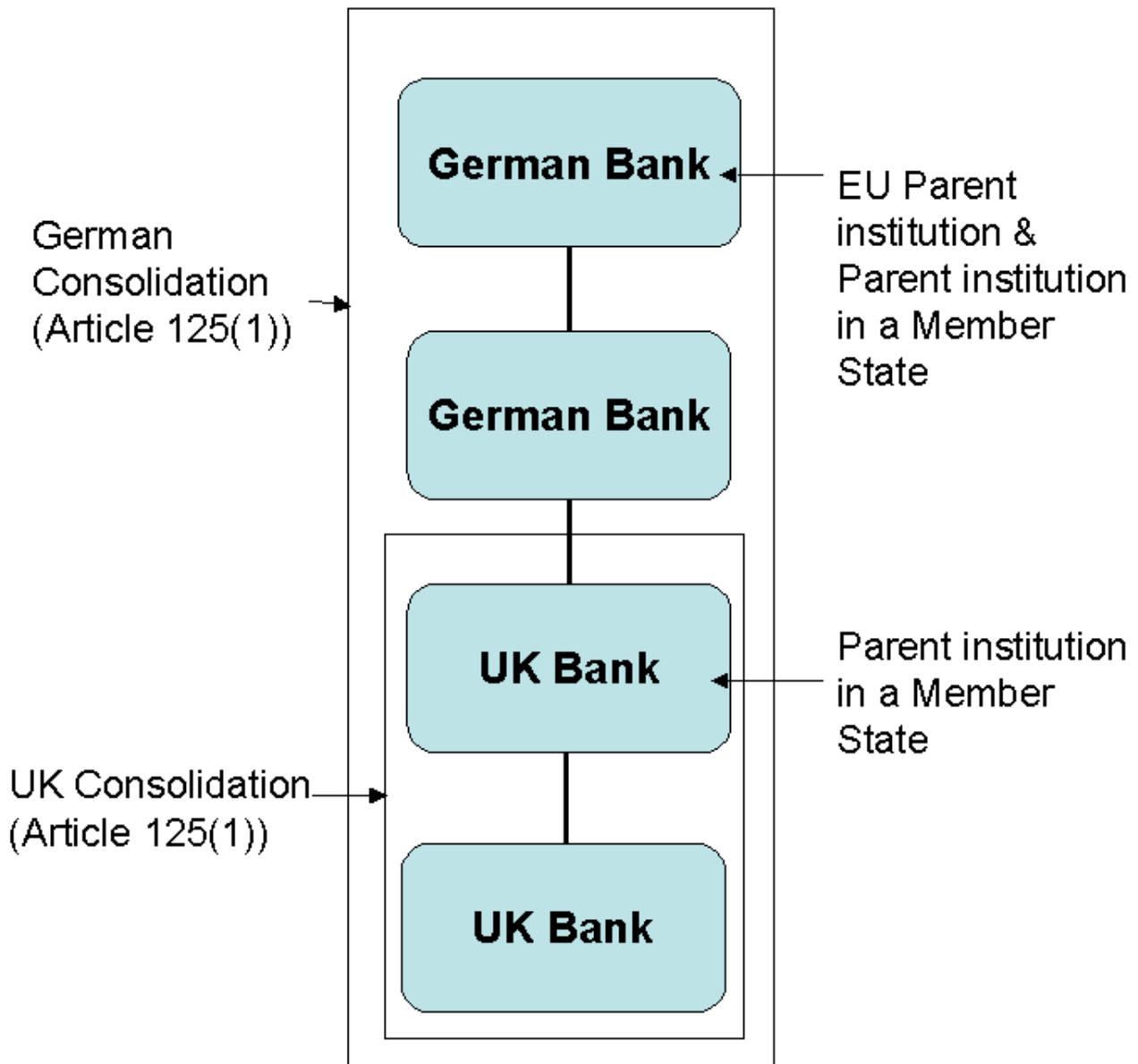
FCA PRA



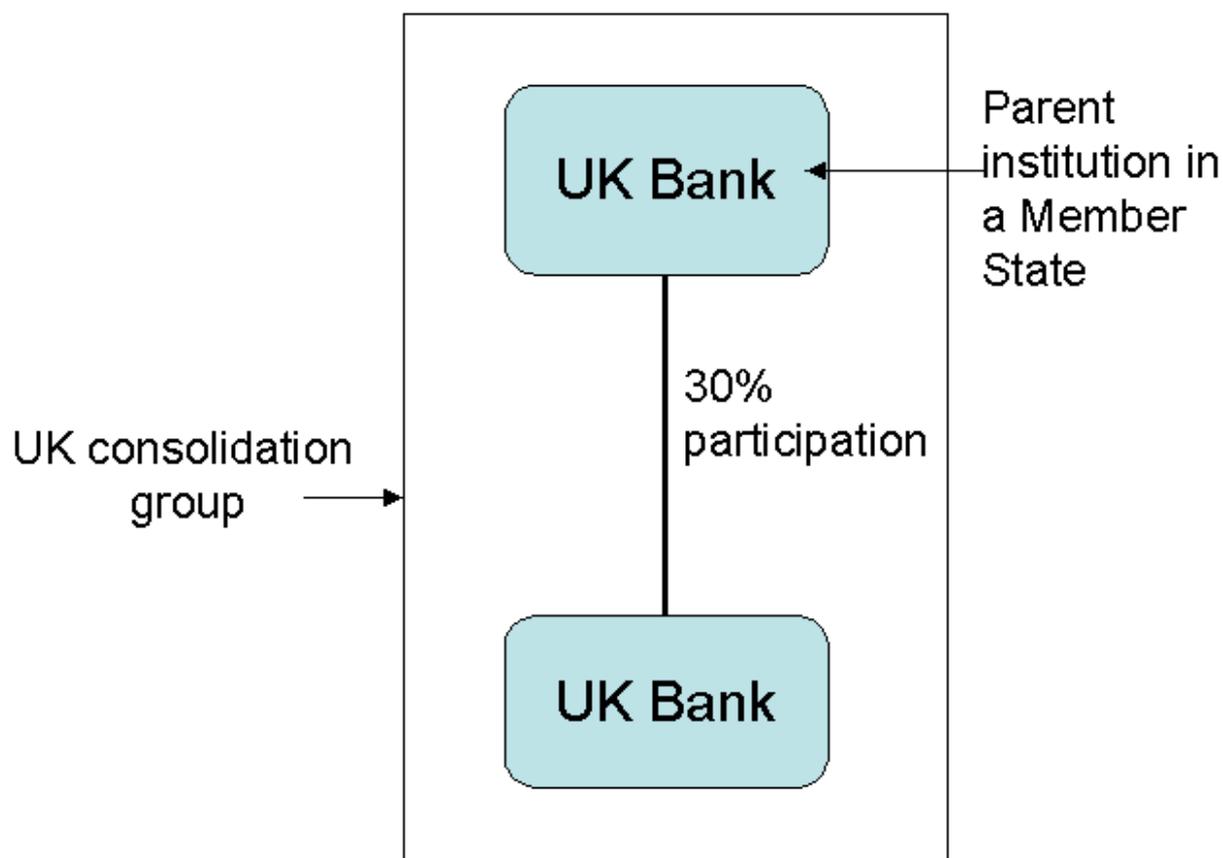
Examples of how to identify a UK consolidation group

**FCA** **PRA**

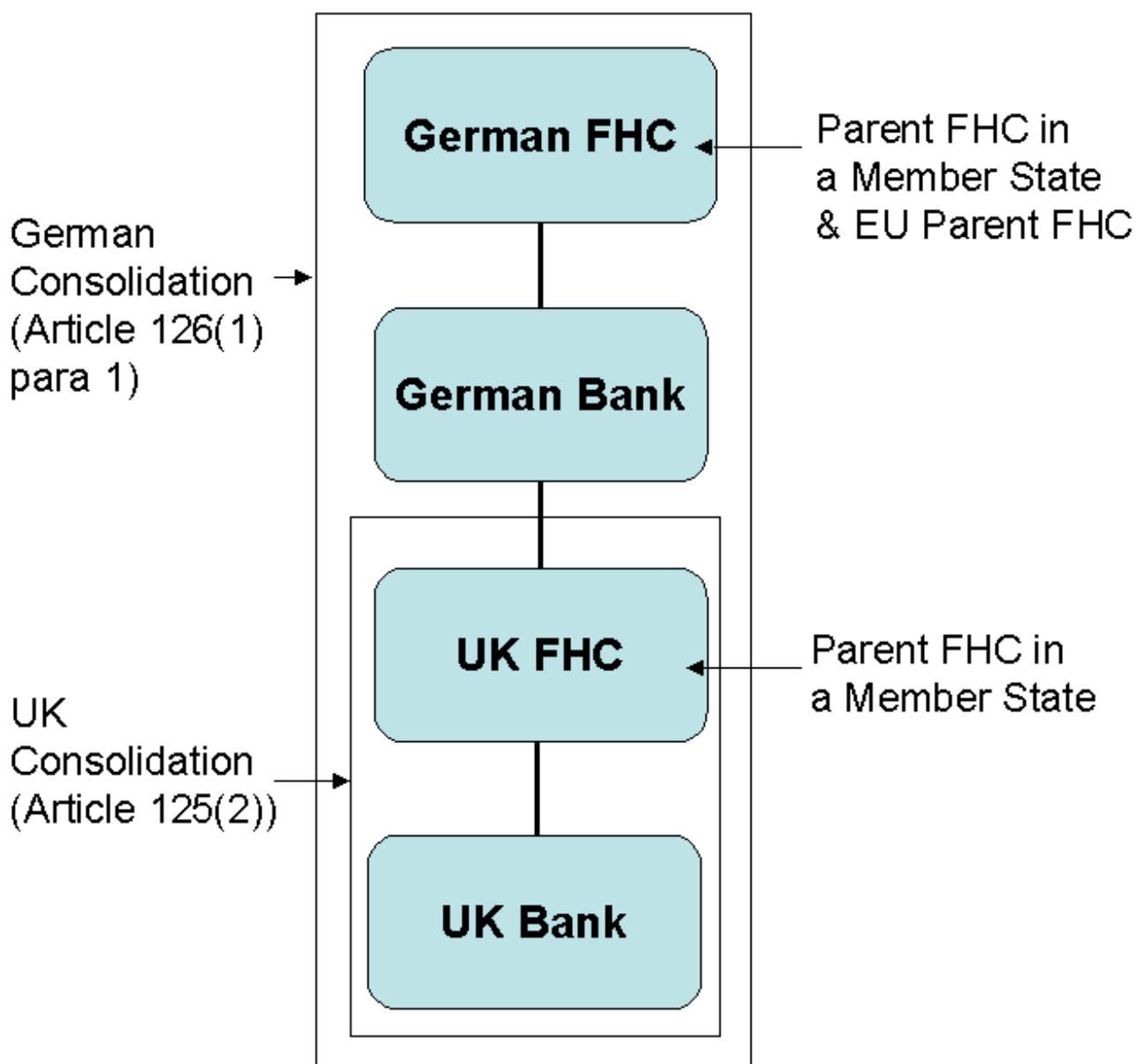
**Example 1**  
**(example of Article 125 (1))**



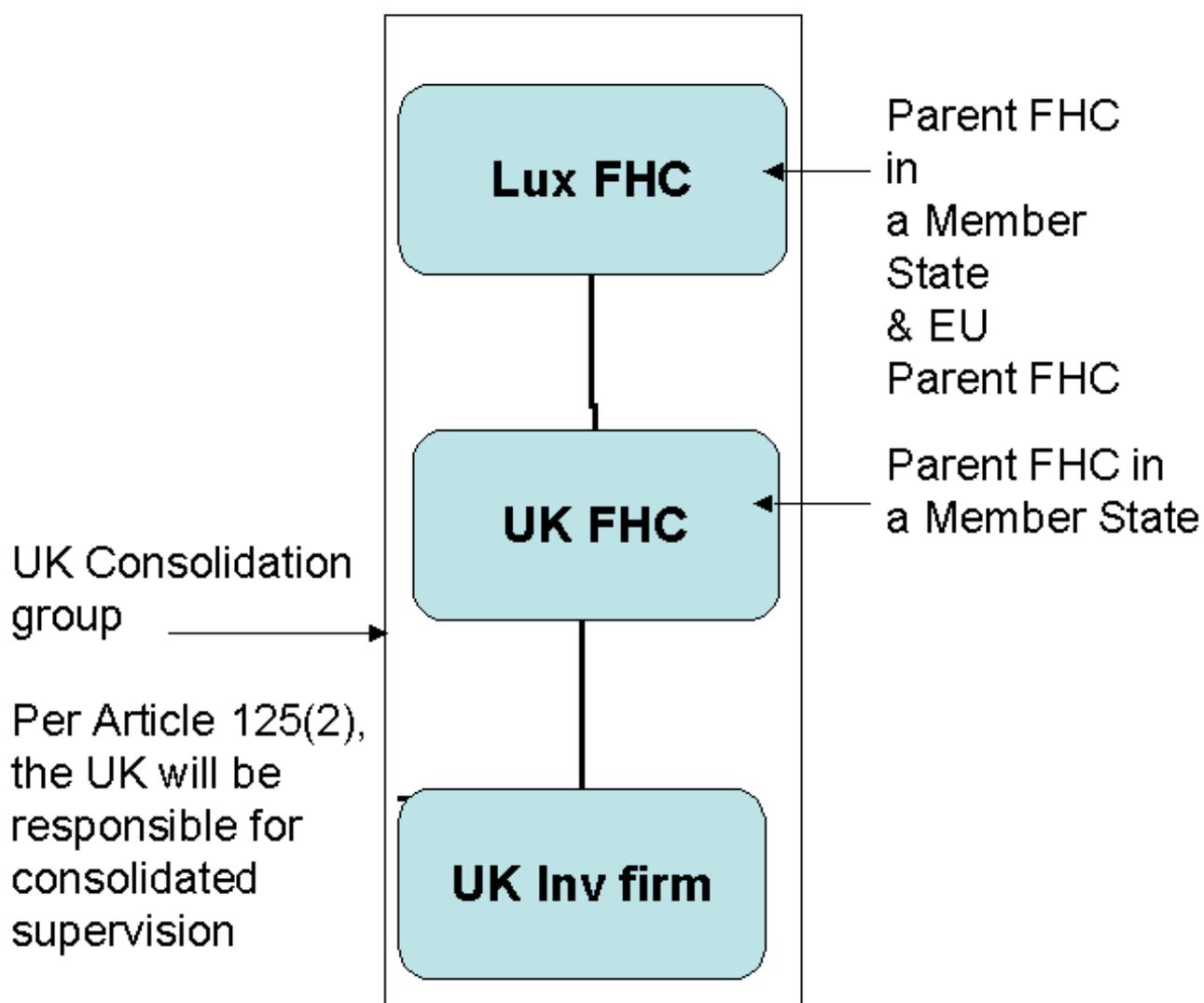
## Example 2 (example of Article 125 (1))



### Example 3 (example of Article 125 (2))

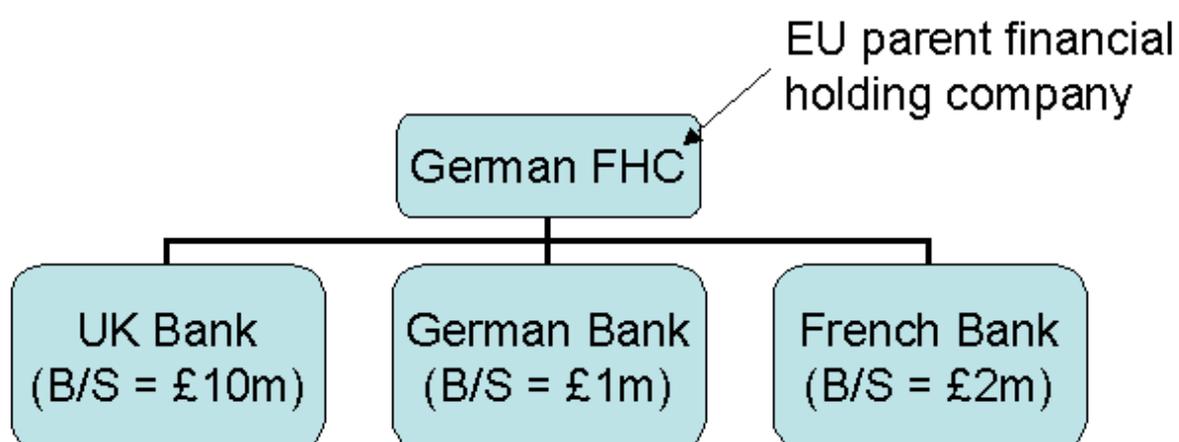


## Example 4 (example of Article 125 (2))



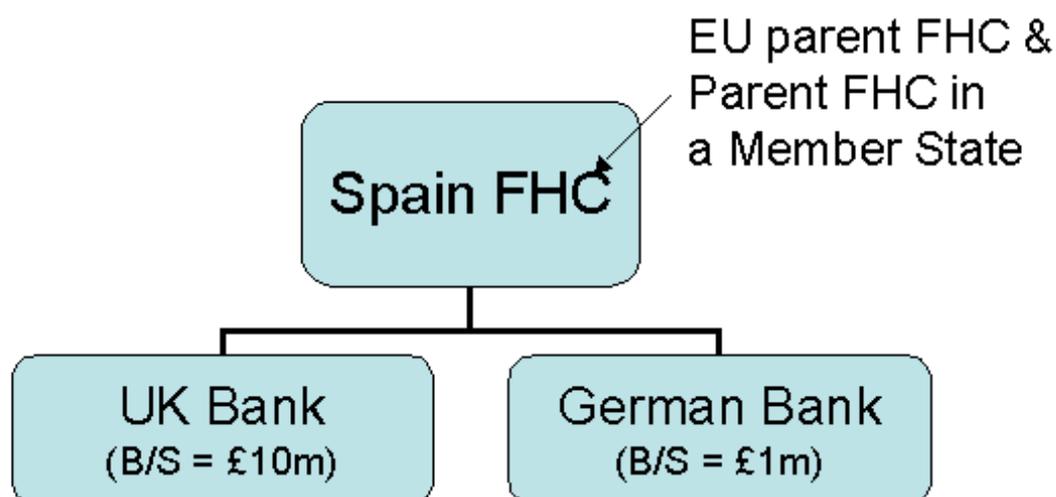
## Example 5 (example of Article 126 (1) para 1)

Germany will be responsible for consolidated supervision

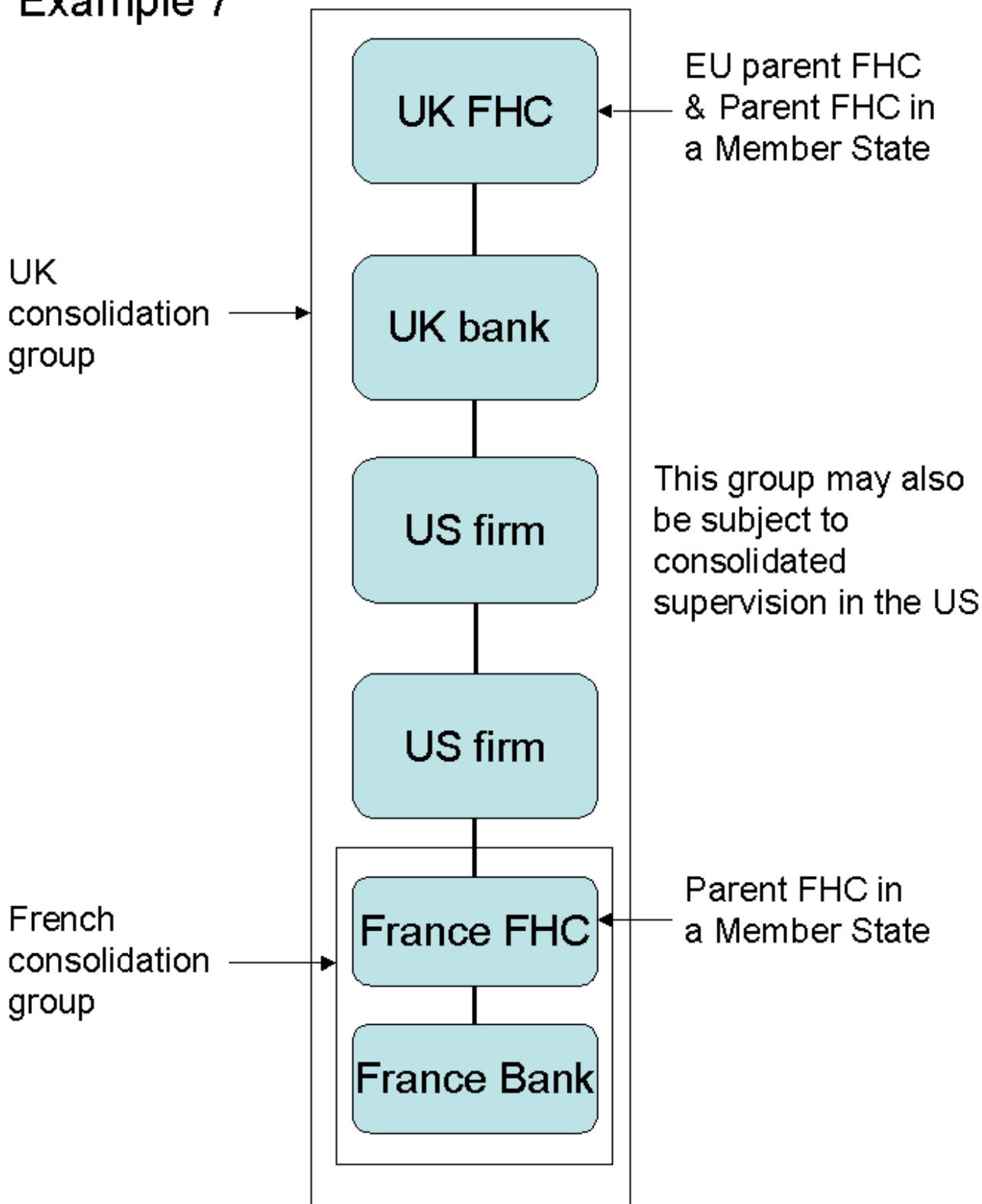


## Example 6 (example of Article 126 (2))

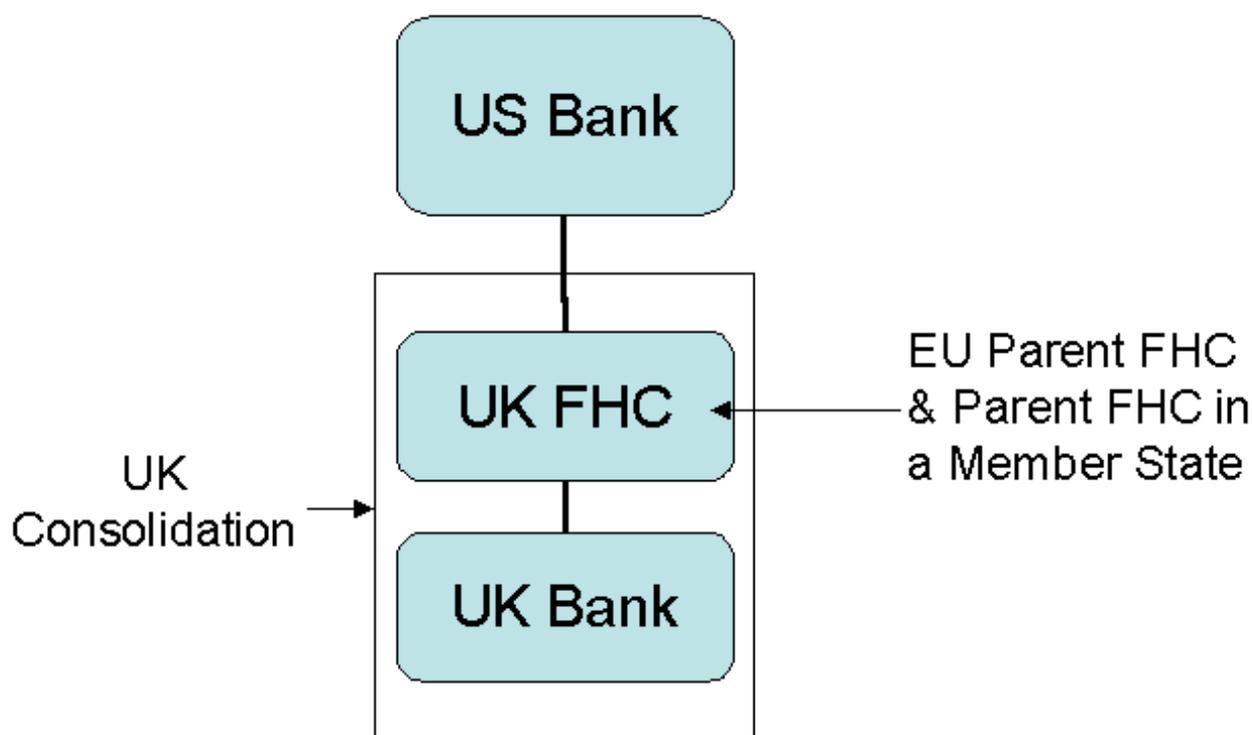
UK will be responsible for consolidated supervision



### Example 7



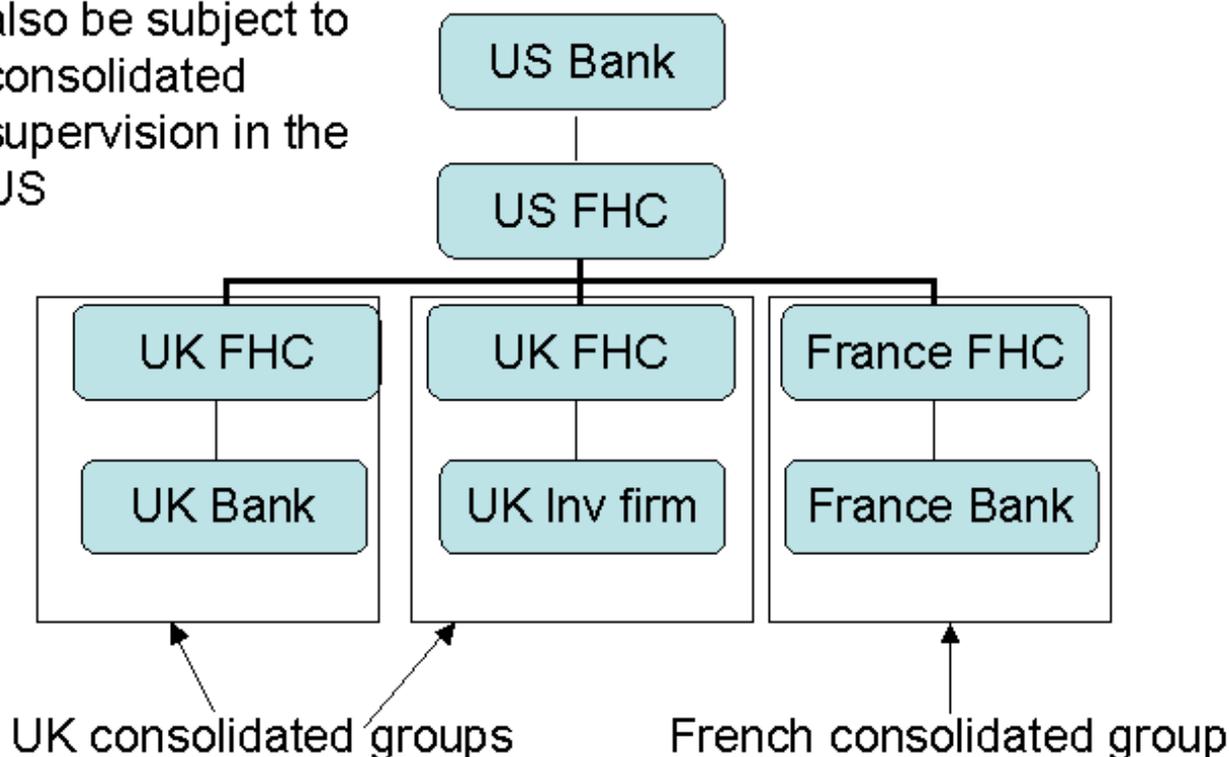
## Example 8 (example of a group headed up by a non-EEA parent)



The UK firms, as well as being members of a UK consolidation group and subject to BIPRU 8, are members of a third country group and subject to GENPRU 3.2.

## Example 9 (example of a group headed up by a non-EEA parent)

This group may  
also be subject to  
consolidated  
supervision in the  
US



The UK firms, as well as being members of a UK consolidation group and subject to BIPRU 8, are members of a third country group and subject to GENPRU 3.2.

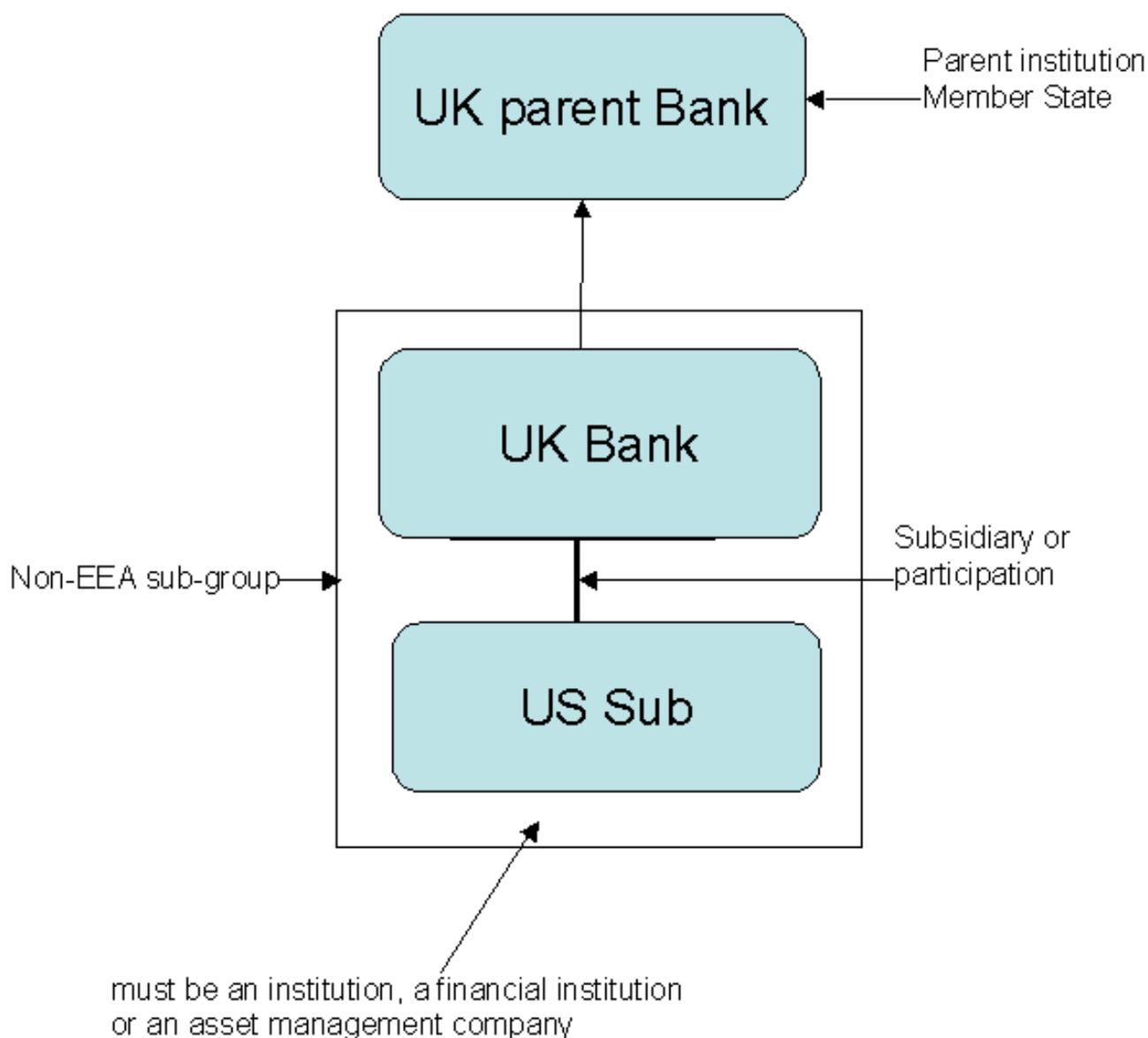


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**Examples of how to identify a non-EEA sub-group**

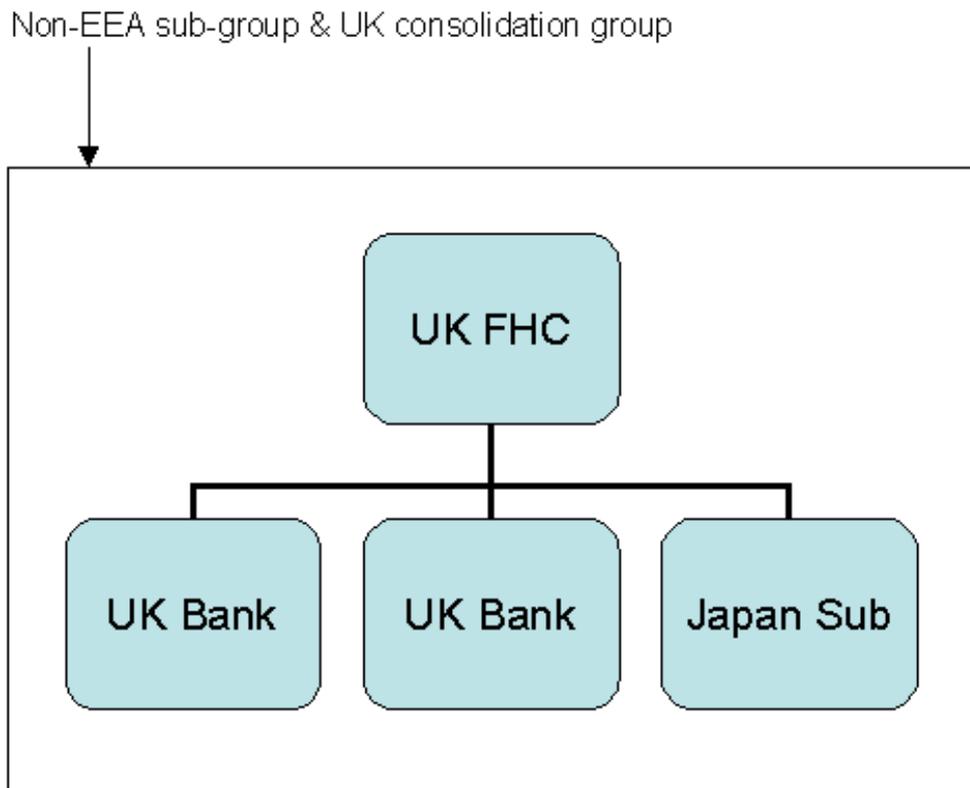
FCA PRA

**Example 1**  
(example refers to BIPRU 8.3.11)



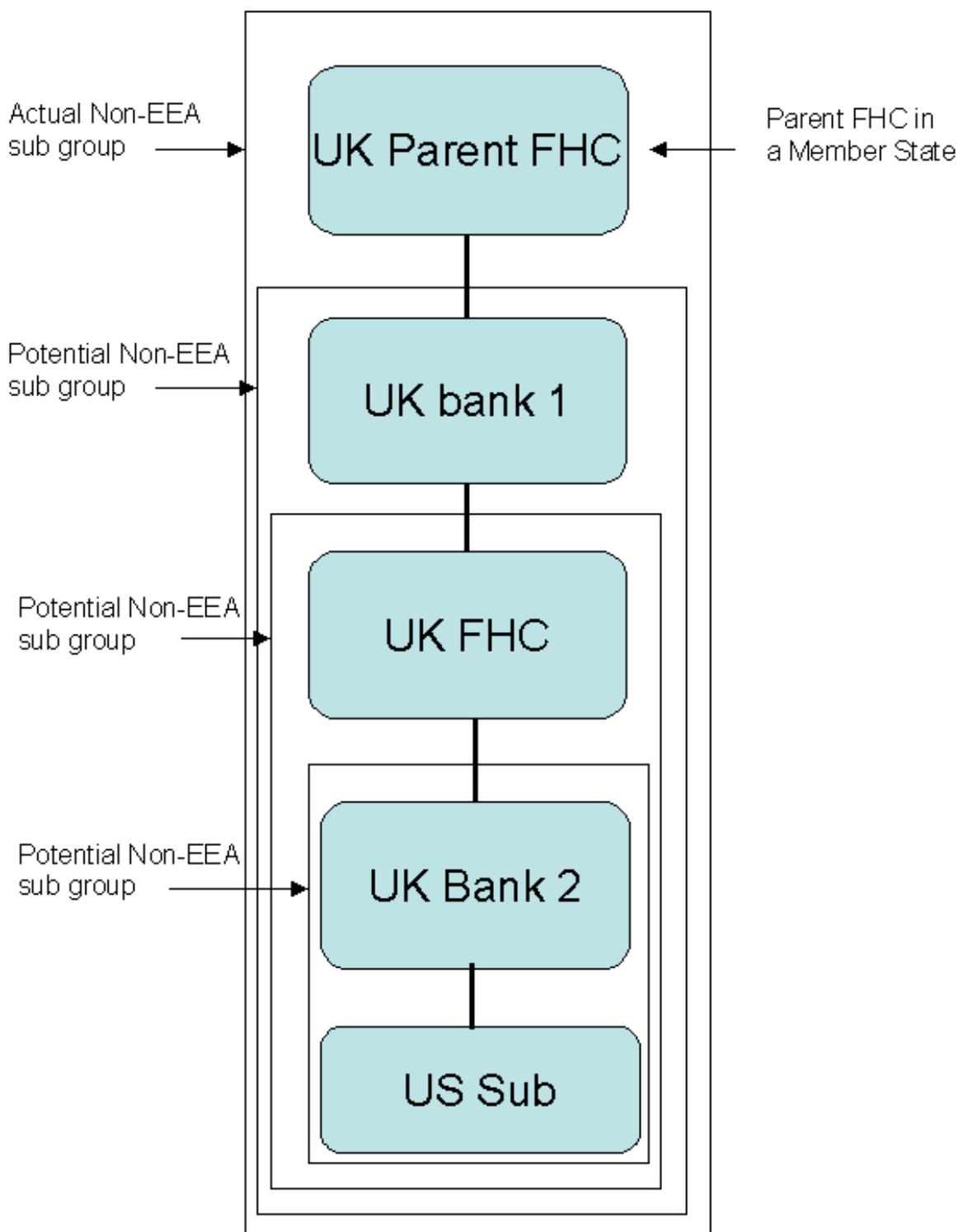
### Example 2

(example refers to BIPRU 8.3.14)



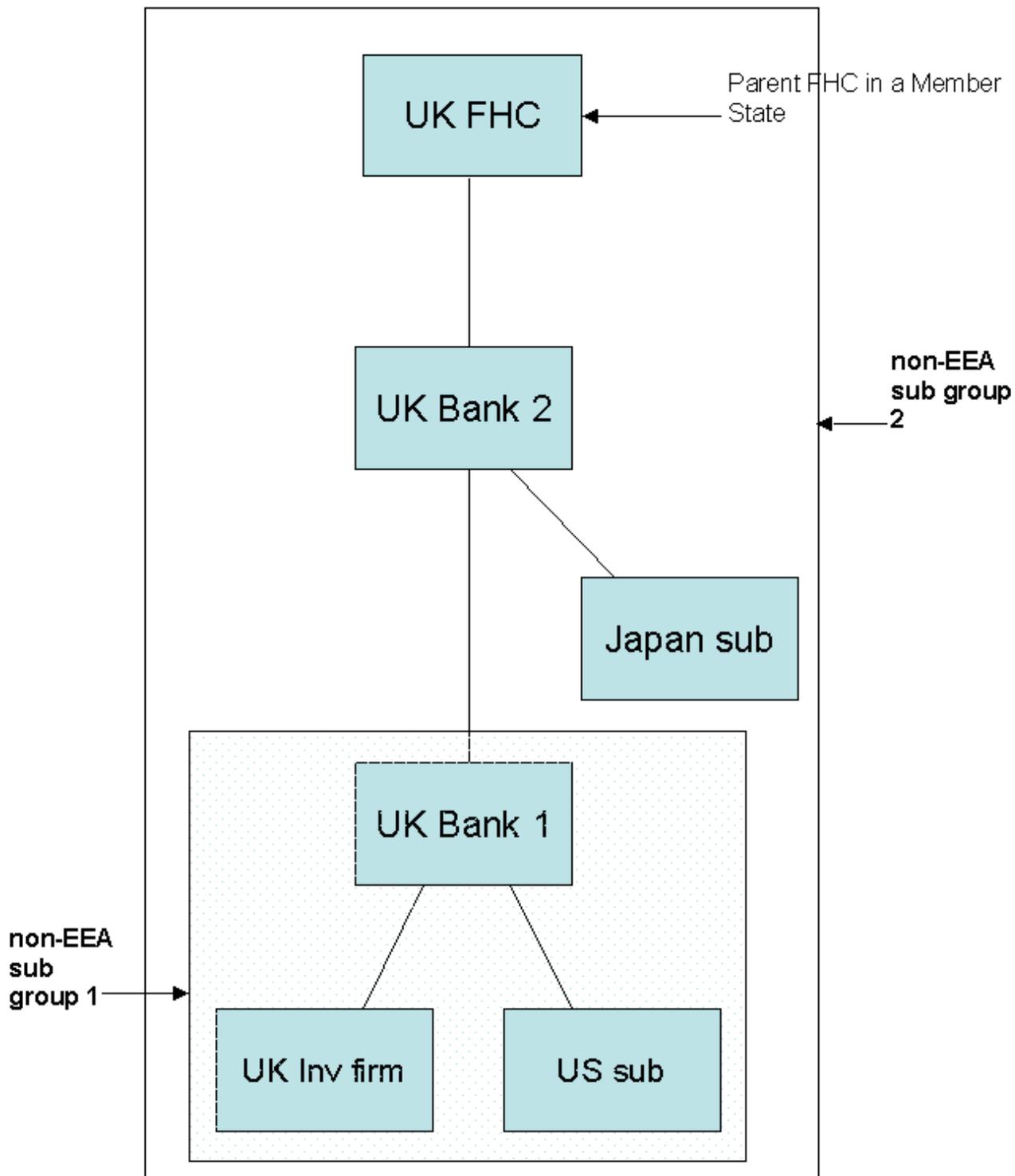
### Example 3

(example refers to BIPRU 8.3.9, 8.3.19 & 8.3.22)

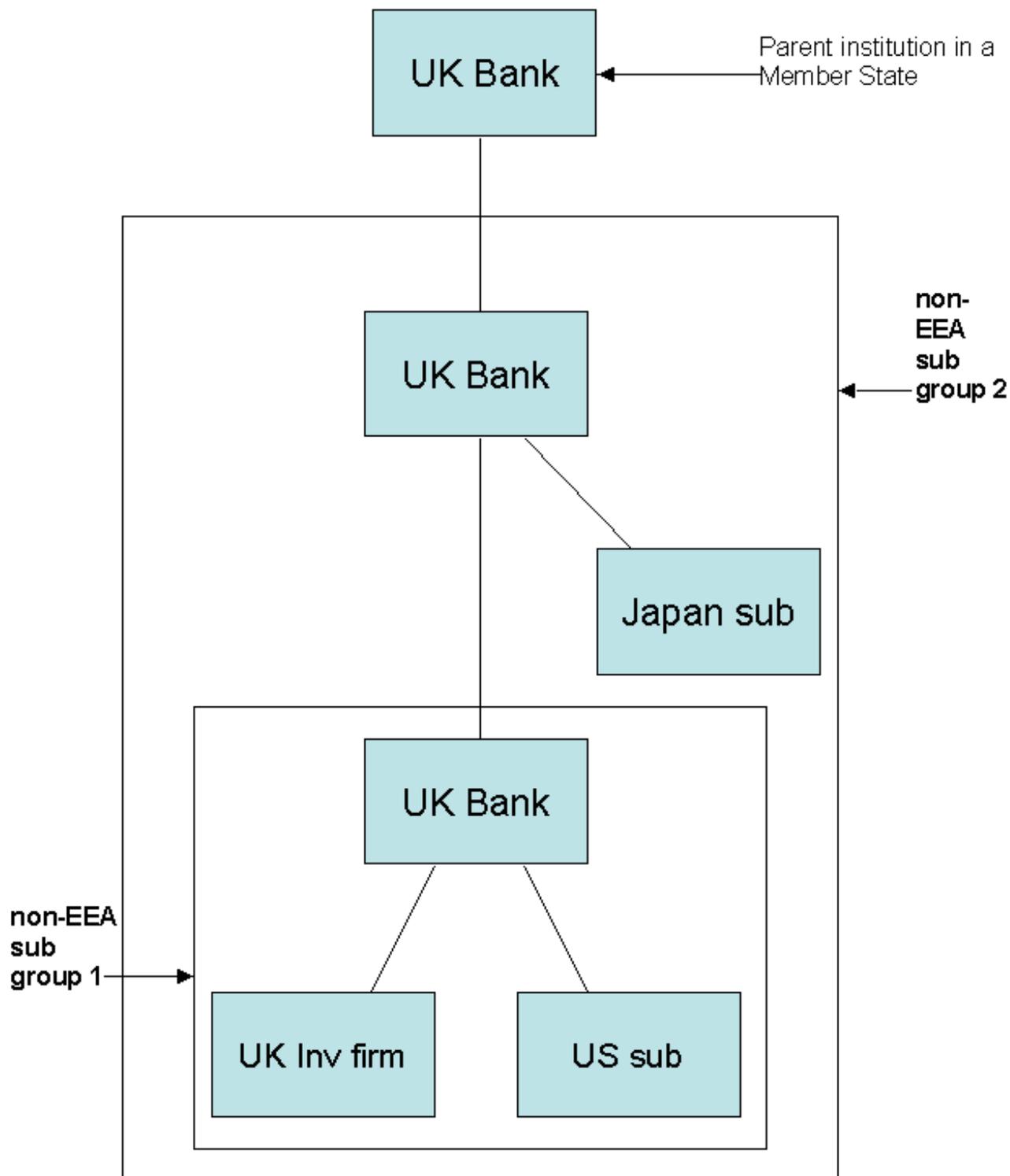


### Example 4

(example refers to BIPRU 8.3.21)

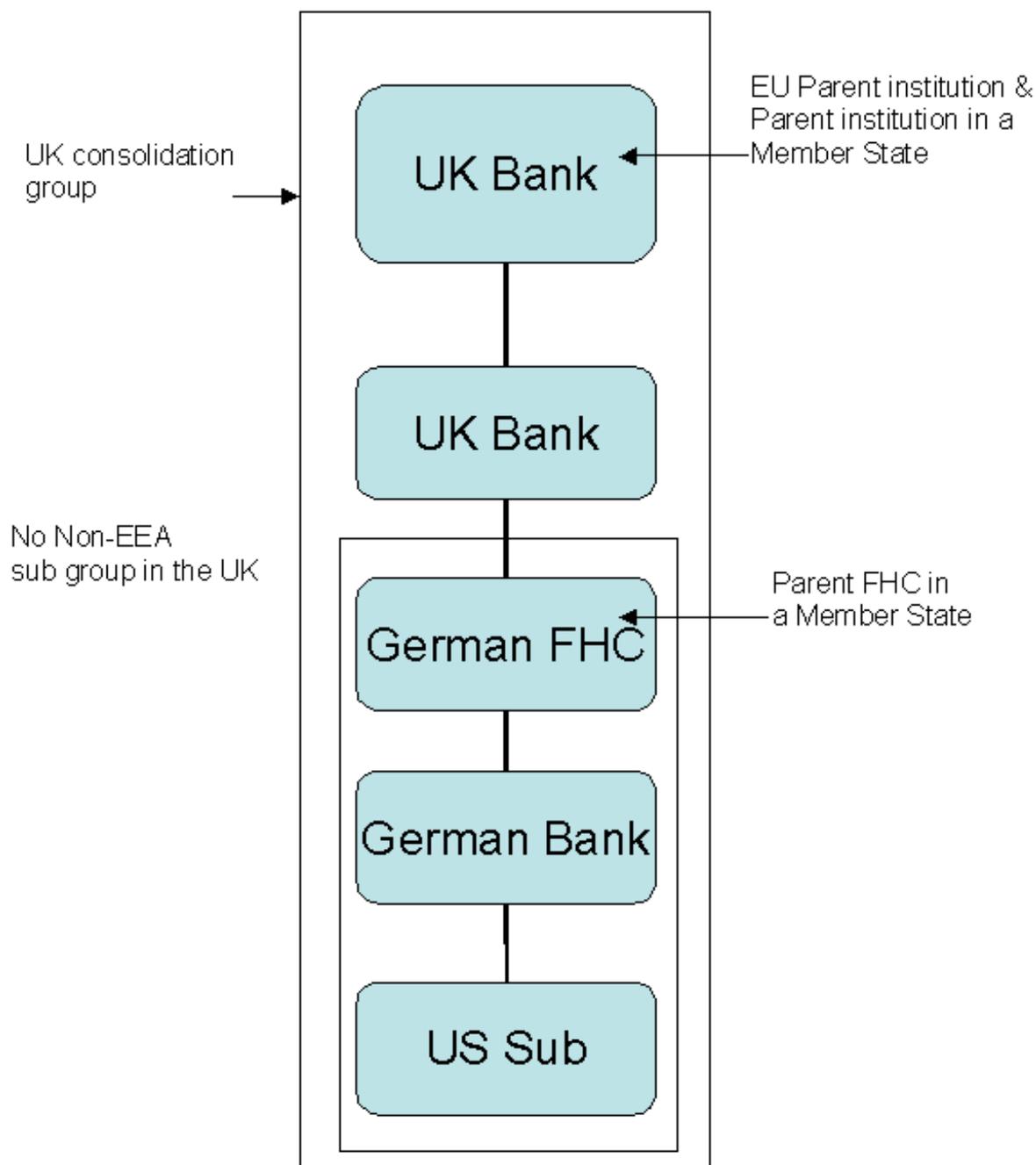


### Example 5 (example refers to BIPRU 8.3.21)



### Example 6

(example refers to BIPRU 8.3.24)





## Text of Articles 125 and 126 of the Banking Consolidation Directive

**FCA** **PRA**

## Article 125

1. Where a parent undertaking is a parent credit institution in a Member State or an EU parent credit institution, supervision on a consolidated basis shall be exercised by the competent authorities that authorised it under Article 6.
2. Where the parent of a credit institution is a parent financial holding company in a Member State or an EU parent financial holding company, supervision on a consolidated basis shall be exercised by the competent authorities that authorised that credit institution under Article 6.

## Article 126

1. Where credit institutions authorised in two or more Member States have as their parent the same parent financial holding company in a Member State or the same EU parent financial holding company, supervision on a consolidated basis shall be exercised by the competent authorities of the credit institution authorised in the Member State in which the financial holding company was set up.  
  
Where the parents of credit institutions authorised in two or more Member States comprise more than one financial holding company with head offices in different Member States and there is a credit institution in each of these States, supervision on a consolidated basis shall be exercised by the competent authority of the credit institution with the largest balance sheet total.
2. Where more than one credit institution authorised in the Community has as its parent the same financial holding company and none of these credit institutions has been authorised in the Member State in which the financial holding company was set up, supervision on a consolidated basis shall be exercised by the competent authority that authorised the credit institution with the largest balance sheet total, which shall be considered, for the purposes of this Directive, as the credit institution controlled by an EU parent financial holding company.
3. In particular cases, the competent authorities may by common agreement waive the criteria referred to in paragraphs 1 and 2 if their application would be inappropriate, taking into account the credit institutions and the relative importance of their activities in different countries, and appoint a different competent authority to exercise supervision on a consolidated basis. In these cases, before taking their decision, the competent authorities shall give the EU parent credit institution, or EU parent financial holding company, or credit institution with the largest balance sheet total, as appropriate, an opportunity to state its opinion on that decision.
4. [Omitted]

Note

The *Capital Adequacy Directive* says that generally references in Articles 125 and 126 of the *Banking Consolidation Directive* to *credit institution* should be read as including ones to *CAD investment firms*. Also, the *Banking Consolidation Directive* and the *Capital Adequacy Directive* apply to the *EEA*. Therefore for the purposes of BIPRU 8 Articles 125 and 126 of the *Banking Consolidation Directive* should be read with the following adjustments:

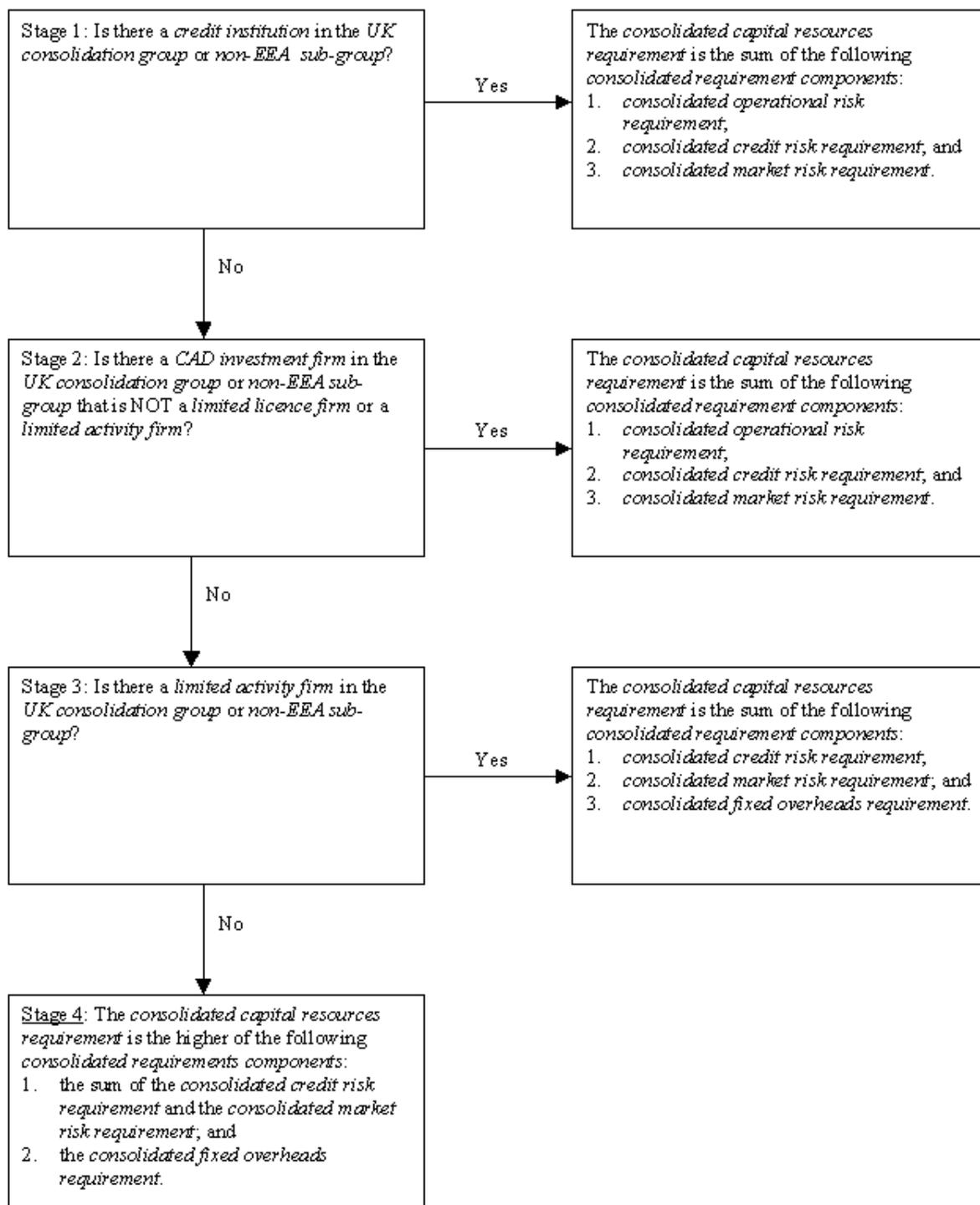
- (1) a reference to a credit institution should be read as being one to a *credit institution* or *CAD investment firm*;
- (2) a reference to a parent credit institution in a Member State should be read as being one to a *parent institution in a Member State*;
- (3) a reference to a EU parent credit institution should be read as being one to an *EEA parent institution*;
- (4) a reference to a EU parent financial holding company should be read as being one to an *EEA parent financial holding company*;
- (5) a reference to a Member State should be read as being one to an *EEA State*;
- (6) a reference to a credit institution authorised in the Community should be read as being one to a *credit institution* or *CAD investment firm* authorised in an *EEA State*.

Parent financial holding company in a Member State and financial holding company have the same meaning as they do in the *Glossary*.

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**Decision tree for identifying the consolidated capital resources requirement of a UK consolidation group or a non-EEA sub-group.**

**FCA** **PRA**



## Non-EEA regulators' requirements deemed CRD-equivalent for individual risks

**FCA** **PRA****Part 1 (Non-EEA banking regulators' requirements deemed CRD-equivalent for individual risks)**

Regime regulators	Market risk	Credit risk	Operational Risk
<b>USA</b>	✓	<b>X*</b>	<b>X</b>
<b>Office of the Comptroller of the Currency</b>	✓	<b>X*</b>	<b>X</b>
<b>Board of Governors of the Federal Reserve System</b>			
* a US banking subsidiary will be deemed equivalent for credit risk if:			
• it is categorised as well capitalised: and			
• it scales up its US Basel 1 credit risk requirement by 25%			
<b>Australia</b>	✓	✓	<b>X</b>
<b>Australian Prudential Regulation Authority [APRA]</b>			
<b>Canada</b>	✓	✓	✓
<b>Office of the Superintendent of Financial Institutions [OSFI]</b>			
<b>Switzerland</b>	✓	✓ See note 2	✓
<b>Swiss Federal Banking Commission [EBK]</b>			

Regime regulators	Market risk	Credit risk	Operational Risk
<b>Japan</b>	√	<b>X</b>	<b>X</b>
<b>Financial Services Agency, Japan [JFSA]</b>			
<b>South Africa</b>	√	√	√
<b>South African Reserve Bank [SARB]</b>			
<b>Hong Kong</b>	√	√	√
<b>Hong Kong Monetary Authority [HKMA]</b>			
<b>Singapore</b>	√	√	√
<b>Monetary Authority of Singapore [MAS]</b>			
<b>India</b>	√	√	√
<b>Reserve Bank of India [RBI]</b>			
<b>Korea</b>	√	<b>X</b>	<b>X</b>
<b>Financial Supervisory Service [FSS]</b>			
<b>Jersey</b>	√	√	√
<b>Guernsey</b>	<b>X</b>	√	√
<b>Isle of Man</b>	<b>X</b>	√	√

**Note 1:** A √ denotes that the requirements have been assessed as equivalent to *EEA* standards.

A **X** denotes that the requirements have been assessed as not being equivalent to *EEA* standards.

**Note 2:** √ International standardised approach only. The treatment of the Lombard loans is not equivalent and they must be treated under the *appropriate regulator's rules*.

**Part 2 (Non-EEA investment firm regulators' requirements deemed CRD-equivalent for individual risks)**

Regime regulators	Market risk	Credit risk	Operational Risk
<b>Australia</b>	✓	<b>X</b>	<b>X</b>
<b>Sydney Futures Exchange</b>	✓	<b>X</b>	<b>X</b>
<b>Australian Stock Exchange</b>			
<b>Canada</b>	✓	<b>X</b>	<b>X</b>
<b>Ontario Securities Commission</b>	✓	<b>X</b>	<b>X</b>
<b>Quebec Securities Commission</b>	✓	<b>X</b>	<b>X</b>
<b>British Columbia Securities Commission</b>	✓	<b>X</b>	<b>X</b>
<b>Alberta Securities Commission</b>			
<b>Investment dealers Association of Canada</b>			
<b>Hong Kong</b>	✓	<b>X</b>	<b>X</b>
<b>Hong Kong Monetary Authority [HKMA]</b>	✓	<b>X</b>	<b>X</b>
<b>Hong Kong Securities and Futures Commission</b>			
<b>Japan</b>	✓	<b>X</b>	<b>X</b>
<b>Financial Services Agency, Japan [JFSA]</b>			
<b>Singapore</b>	✓	<b>X</b>	<b>X</b>
<b>Monetary Authority of Singapore [MAS]</b>	✓	<b>X</b>	<b>X</b>
<b>Stock Exchange of Singapore</b>			

Regime regulators	Market risk	Credit risk	Operational Risk
<b>South Africa</b>	√	X	X
<b>South African Futures Exchange</b>	√	X	X
<b>Johannesburg Stock Exchange</b>	√	X	X
<b>Bond Exchange of South Africa</b>			
<b>Switzerland</b>	√	√ Note 2	√
<b>Swiss Federal Banking Commission [EBK]</b>			
<b>USA</b>	√ Note 3	√	X
<b>Securities &amp; Exchange Commission (SEC): Net Capital rule only</b>	√	X	X
<b>Commodities and Futures Trading Commission</b>			

**Note 1:** A √ denotes that the requirements have been assessed as equivalent to *EEA* standards.

**A X** denotes that the requirements have been assessed as not being equivalent to *EEA* standards.

**Note 2:** √ International standardised approach only. The treatment of Lombard loans is not equivalent and they must be treated under the *appropriate regulator's rules*.

**Note 3:** √ Where entities are subject to a local regulatory capital requirement.

## Chapter 9

# Securitisation

## 9.1 Application and purpose

### Application

9.1.1

FCA PRA

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

FCA PRA

G

The purpose of ■ BIPRU 9 is to implement:

- (1) Articles 94 to 96, paragraphs (1) and (5) of Article 97 , Article 99, Article 100(1) and Article 101;
- (2) Points 8 and 9 of Annex V; and
- (3) Parts 2, 3 (in part) and 4 of Annex IX;

of the *Banking Consolidation Directive*.

### General obligations: Risk-weighted exposures

9.1.3

FCA PRA

R

A *firm* must calculate the *risk weighted exposure amount* for *securitisation positions* in accordance with ■ BIPRU 9.

9.1.4

FCA PRA

G

A *firm* should apply the *securitisation* framework set out in this chapter for determining regulatory capital requirements on *exposures* arising from *traditional securitisations* and from *synthetic securitisations* and from structures that contain features of both.

9.1.5

FCA PRA

G

Since transactions may be structured in many different ways, the capital treatment of a position should be determined on the basis of its economic substance rather than merely its legal form. A *firm* should look to the economic substance of a transaction to determine whether the *securitisation* framework is applicable for purposes of determining regulatory capital. A *firm* should consult the *appropriate regulator* when there is uncertainty about whether a given transaction should be considered a *securitisation*.

**General obligations: Systems**

9.1.6

FCA PRA

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: BCD Annex V point 8]

9.1.7

FCA PRA

G

A *firm* that is a party to a *securitisation* should fully understand the risks it has assumed or retained. In particular it should do so in order that it can correctly determine in accordance with ■ BIPRU 9 the capital effects of the *securitisation*.

9.1.8

FCA PRA

G

The *appropriate regulator* expects an *originator* to continue to monitor any risks that it may be subject to when it has excluded the *securitised exposures* from its calculation of *risk weighted exposure amounts*. The *originator* should consider capital planning implications where risks may return and the impact that *securitisation* has on the quality of the remaining *exposures* held by the *originator*.

9.1.8A

FCA PRA

G

- (1) The *appropriate regulator* expects *firms* to conduct regular stress testing in relation to their *securitisation* activities and off-balance sheet *exposures*. The stress tests should consider the *firm-wide* impact of those activities and *exposures* in stressed market conditions 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.
- (2) The frequency and extent of the stress testing should be determined by the materiality of the *firm's* *securitisation* activities and off-balance sheet *exposures*.
- (3) 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*.

**Trading book and non-trading book**

9.1.9

FCA PRA

G

■ BIPRU 9 deals with:

- (1) requirements for investors, *originators* and *sponsors* of *securitisations* of *non-trading book exposures*;
- (2) the calculation of *risk weighted exposure amount* for *securitisation* positions for the purposes of calculating either the *credit risk capital component* or the *counterparty risk capital component*; and
- (3) the requirements that investors, *originators* and *sponsors* of *securitisations* in the *trading book* will have to meet (■ BIPRU 9.3.1AR, ■ BIPRU 9.3.15R to ■ BIPRU 9.3.20R, ■ BIPRU 9.6.1A R and ■ BIPRU 9.15R).

9.1.10

FCA PRA

G

■ BIPRU 7 sets out the calculation of the *market risk capital requirement* for *securitisation* positions held in the *trading book*.

## 9.2 Approach to be used

### 9.2.1

FCA PRA

R

- (1) Where a *firm* uses the *standardised approach* set out in ■ BIPRU 3 (Standardised approach to credit risk) for the calculation of *risk weighted exposure amount* for the *standardised credit risk exposure class* to which the *securitised exposures* would otherwise be assigned under ■ BIPRU 3, then it must calculate the *risk weighted exposure amount* for a *securitisation position* in accordance with the *standardised approach to securitisations* set out in ■ BIPRU 9.9, ■ BIPRU 9.10, ■ BIPRU 9.11 and ■ BIPRU 9.13.
- (2) In all other cases it must calculate a *risk weighted exposure amount* in accordance with the *IRB approach to securitisations* set out in ■ BIPRU 9.9, ■ BIPRU 9.10, ■ BIPRU 9.12, ■ BIPRU 9.13 and ■ BIPRU 9.14.

[Note: *BCD Article 94*]

## 9.3 Requirements for originators and sponsors

### 9.3.1

FCA PRA

R

- (1) Where significant credit risk associated with *securitised exposures* has been transferred from the *originator* in accordance with the terms of ■ BIPRU 9.4 or ■ BIPRU 9.5, that *originator* may:
- (a) in the case of a *traditional securitisation*, exclude from its calculation of *risk weighted exposure amounts* and, as relevant, *expected loss* amounts, the *exposures* which it has *securitised*; and
  - (b) in the case of a *synthetic securitisation*, calculate *risk weighted exposure amounts* and, as relevant, *expected loss* amounts in respect of such *exposures*, in accordance with the provisions of ■ BIPRU 9.5.
- (2) Where (1) applies, the *originator* must calculate the *risk weighted exposure amounts* prescribed in this chapter for the positions it may hold in the *securitisation*.
- (3) Where the *originator* fails to transfer significant credit risk in accordance with (1), it need not calculate *risk weighted exposure amounts* for any positions it may hold in the *securitisation* in question.

[Note: BCD Article 95]

### 9.3.1A

FCA PRA

R

The provisions of ■ BIPRU 9.3.15R to ■ BIPRU 9.3.20R apply with respect to:

- (1) new *securitisations* issued on or after 1 January 2011; and
- (2) from 31 December 2014, to existing *securitisations* where new underlying exposures are added or substituted after that date.

[Note: BCD, Article 122a, paragraph 8]

### 9.3.2

PRA

G

A *credit institution* should have regard to the Committee of European Banking Supervisors Guidelines to Article 122a of the *Banking Consolidation Directive* when

considering its obligations under ■ BIPRU 9.3.15 R to ■ BIPRU 9.3.20 R and ■ BIPRU 9.15. The Guidelines can be found at <http://www.eba.europa.eu/Publications/Standards-Guidelines.aspx>.

9.3.3 **G** [deleted]

9.3.4 **G** [deleted]

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

(2) [deleted]

[deleted]

9.3.6 **G** An *originator* should not adjust its assessment of the transfer of risk in order to reflect uncertainties related to the effectiveness of a *securitisation* under ■ BIPRU 9.4 or ■ BIPRU 9.5. Instead the *originator* should treat the terms of ■ BIPRU 9.4 or ■ BIPRU 9.5 as not having been satisfied.

9.3.7 **R** Significant credit risk will be considered to have been transferred for *originators* in the following cases:

**FCA** **PRA**

- (1) the *risk weighted exposure amounts* of the *mezzanine securitisation positions* held by the *originator* in the *securitisation* do not exceed 50% of the *risk weighted exposure amounts* of all *mezzanine securitisation positions* existing in this *securitisation*;
- (2) where there are no *mezzanine securitisation positions* in a given *securitisation* and the *originator* can demonstrate that the exposure value of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% *risk weight* exceeds a reasoned estimate of the expected loss on the *securitised exposures* by a substantial margin, the *originator* does not hold more than 20% of the exposure values of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% *risk weight*.

[Note: BCD, Annex IX, Part 2, Point 1, paragraph 1a and Point 2 paragraph 2a]

9.3.8 **R** An *originator* must notify the *appropriate regulator* that it is relying on the deemed transfer of significant credit risk under ■ BIPRU 9.3.7R within a reasonable period before or after a relevant transfer, not being later than one month after the date of the transfer. The notification must include the following information:

**FCA** **PRA**

- (1) the *risk weighted exposure amount* of the *securitised exposures* and retained *securitisation positions*;

- (2) the *exposure* value of the *securitised exposures* and the retained *securitisation positions*;
- (3) details of the *securitisation positions*, including rating, *exposure* value broken down by *securitisation positions* sold and retained;
- (4) a statement that sets out why the *firm* is satisfied that the reduction in *risk weighted exposure amounts* is justified by a commensurate transfer of credit risk to third parties;
- (5) any relevant supporting documents, for example, a summary of the transaction.

## 9.3.9

FCA PRA

G

In the event that the *appropriate regulator* decides that the possible reduction in *risk weighted exposure amounts* which the *originator* would achieve by the *securitisation* referred to in ■ BIPRU 9.3.7R is not justified by a commensurate transfer of credit risk to third parties, it will use its powers under section 55J of the *Act* (Variation etc on the Authority's own initiative) to require the *firm* to increase its *risk weighted exposure amount* to an amount commensurate with the *appropriate regulator's* assessment of the transfer of credit risk to third parties.

## 9.3.10

FCA PRA

G

An *originator* may be granted a *waiver* of the requirements in ■ BIPRU 9.3.7R and ■ BIPRU 9.3.8R.

## 9.3.11

FCA PRA

D

An *originator's* application for a *waiver* of the requirements in ■ BIPRU 9.3.7R and ■ BIPRU 9.3.8R must demonstrate that the following conditions are satisfied:

- (1) it has policies and methodologies in place which ensure that the possible reduction of capital requirements which the *originator* achieves by the *securitisation* is justified by a commensurate transfer of credit risk to third parties; and
- (2) that such transfer of credit risk to third parties is also recognised for the purposes of the *originator's* internal risk management and its internal capital allocation.

[Note: BCD, Annex IX, Part 2, Point 1, paragraph 1c and Point 2 paragraph 2c]

## 9.3.12

FCA PRA

G

■ BIPRU 1.3.10 G sets out the *appropriate regulator's* approach to the granting of *waivers*. The conditions in ■ BIPRU 9.3.11D are minimum requirements. Satisfaction of those does not automatically mean the *appropriate regulator* will grant the relevant *waiver*. The *appropriate regulator* will in addition also apply the tests in section 138A (Modification or waiver of rules) of the *Act*.

## 9.3.13

FCA PRA

G

When considering an application for a *waiver* of the requirements in ■ BIPRU 9.3.7R and ■ BIPRU 9.3.8R, the *appropriate regulator* may undertake a visit to the *firm* in order to examine the *firm's* risk management and governance arrangements. Before such a visit, the *appropriate regulator* may request information from the *firm* additional or supplementary to that provided in the *waiver* application.

9.3.14

FCA PRA

G

An *originator* should clearly state the scope of the *waiver* of the requirements in ■ BIPRU 9.3.7R and ■ BIPRU 9.3.8R it is seeking in its application. For example, residential mortgage backed securities may be subdivided into prime and sub-prime with only one sub-category within the scope of the *waiver*. Relevant asset classes may therefore be defined according to a *firm's* internal usage of terms.

#### Origination criteria

9.3.15

PRA

R

A *credit institution*, whether acting as *sponsor* or *originator*, must apply the same sound and well-defined criteria used for credit-granting in respect of exposures held on their *trading* and *non-trading book* under ■ SYSC 7.1.9 R to exposures to be securitised. The criteria applied must include the processes for approving and, where relevant, amending, renewing and re-financing credits.

[Note: BCD, Article 122a, paragraph 6]

9.3.16

PRA

R

A *credit institution*, whether acting as *sponsor* or *originator*, must apply the same standards of analysis as are applied under ■ BIPRU 9.3.15R to participations or underwritings in *securitisation* issues purchased from third parties regardless of whether those participations or underwritings are to be held on their *trading* or *non-trading book*.

[Note: BCD, Article 122a, paragraph 6]

9.3.17

PRA

R

Where a *credit institution* as *originator* fails to meet the requirements under ■ BIPRU 9.3.15R to ■ BIPRU 9.3.16R, it may not rely on and apply ■ BIPRU 9.3.1R (1) to reduce its *risk weighted exposure amounts* or exclude the relevant securitised exposures from the calculation of its *risk weighted exposure amounts*, and, as relevant, *expected loss* amounts of those *exposures*.

[Note: BCD, Article 122a, paragraph 6]

#### Disclosure requirements

9.3.18

PRA

R

The *sponsor* or *originator credit institution* of a *securitisation* must disclose to investors the level of its commitment to maintain a net economic interest in the *securitisation* under ■ BIPRU 9.15.3R.

[Note: BCD, Article 122a, paragraph 7]

9.3.19

PRA

R

The *sponsor* or *originator credit institutions* of a *securitisation* must ensure that prospective investors have readily available access to all materially relevant data concerning it, including:

- (1) on the credit quality and performance of the individual underlying *exposures*;
- (2) cash flows and collateral supporting the *securitisation exposure*; and

- (3) such information as is necessary to conduct comprehensive and well-informed stress-tests on the cash flows and collateral values supporting the underlying *exposures*.

[Note: *BCD*, Article 122a, paragraph 7]

9.3.20

PRA

R

Under ■ BIPRU 9.3.19R, materially relevant data is determined as at the date of the *securitisation* and where appropriate due to the nature of the *securitisation* thereafter.

[Note: *BCD*, Article 122a, paragraph 7]

9.3.21

FCA PRA

G

Subject to ■ BIPRU 9.3.22G, ■ BIPRU 9.15.9R and ■ BIPRU 9.15.10R, where the *originator* or *sponsor* of a *securitisation* fails to meet any of the requirements in ■ BIPRU 9.3.18R to ■ BIPRU 9.3.20R (disclosure requirements) in any material respect by reason of its negligence or omission, the *appropriate regulator* will use its powers under section 55J (Variation etc on the Authority's own initiative) of the *Act* to impose an additional *risk weight* of no less than 250% (capped at 1250%) of the *risk weight* that would otherwise apply to the relevant *securitisation positions* under the *rules* in ■ BIPRU 9.11 to ■ BIPRU 9.14. The additional *risk weight* imposed will be progressively increased with each relevant, subsequent infringement of the requirements in ■ BIPRU 9.3.18R to ■ BIPRU 9.3.20R.

[Note: *BCD*, Article 122a, paragraph 5]

9.3.22

FCA PRA

G

When calculating the additional *risk weight* it will impose, the *appropriate regulator* will take into account the exemption of certain *securitisations* from the scope of ■ BIPRU 9.15.3R under ■ BIPRU 9.15.9R and ■ BIPRU 9.15.10R and, if those exemptions are relevant, reduce the *risk weight* it would otherwise impose.

[Note: *BCD*, Article 122a, paragraph 5]

## 9.4 Traditional securitisation

### Minimum requirements for recognition of significant credit risk transfer

9.4.1

FCA PRA

R

The *originator* of a *traditional securitisation* may exclude *securitised exposures* from the calculation of *risk weighted exposure amounts* and *expected loss* amounts if either of the following conditions is fulfilled:

- (1) significant credit risk associated with the *securitised exposures* is considered to have been transferred to third parties; or
- (2) the *originator* applies a 1250% *risk weight* to all *securitisation positions* it holds in the *securitisation* or deducts these *securitisation positions* from *capital resources* according to
  - GENPRU 2.2.237 R;

and the transfer complies with the conditions in ■ BIPRU 9.4.2R  
 ■ BIPRU 9.4.14R.

[Note: BCD Annex IX Part 2 point 1, paragraph 1]

9.4.2

FCA PRA

R

The *securitisation* documentation must reflect the economic substance of the transaction.

[Note: BCD Annex IX Part 2 point 1 (part)]

9.4.3

FCA PRA

R

The *securitised exposures* must be put beyond the reach of the *originator* and its creditors, including in bankruptcy and receivership. This must be supported by the opinion of qualified legal counsel.

[Note: BCD Annex IX Part 2 point 1 (part)]

9.4.4

FCA PRA

G

Legal counsel's opinions should be reviewed as necessary. For example, an opinion should be reviewed if a relevant statutory provision is amended or where a new decision or judgment of a court might have a bearing on the conclusions reached.

9.4.5

FCA PRA

R

The securities issued must not represent payment obligations of the *originator*.

[Note: BCD Annex IX Part 2 point 1 (part)]

9.4.6

FCA PRA

R

The transferee must be a *securitisation special purpose entity*.

[Note: BCD Annex IX Part 2 point 1 (part)]

9.4.7

FCA PRA

R

The *originator* must not maintain effective or indirect control over the transferred *exposures*.

[Note: BCD Annex IX Part 2 point 1 (part)]

9.4.8

FCA PRA

R

Where there is a *clean-up call option*, the following conditions must be satisfied:

- (1) the *clean-up call option* is exercisable at the discretion of the *originator*;
- (2) the *clean-up call option* may only be exercised when 10% or less of the original value of the *exposures securitised* remains unamortised; and
- (3) the *clean-up call option* is not structured to avoid allocating losses to *credit enhancement* positions or other positions held by investors and is not otherwise structured to provide *credit enhancement*.

[Note: BCD Annex IX Part 2 point 1 (part)]

9.4.9

FCA PRA

R

The *securitisation* documentation must not contain clauses that:

- (1) other than in the case of *early amortisation provisions*, require positions in the *securitisation* to be improved by the *originator* including but not limited to altering the underlying credit exposures or increasing the yield payable to investors in response to a deterioration in the credit quality of the *securitised exposures*; or
- (2) increase the yield payable to holders of positions in the *securitisation* in response to a deterioration in the credit quality of the underlying pool.

[Note: BCD Annex IX Part 2 point 1 (part)]

9.4.10

FCA PRA

R

For the purposes of ■ BIPRU 9.4.7 R, an *originator* will be considered to have maintained effective control over the transferred *exposures* if it has the right to repurchase from the transferee the previously transferred *exposures* in order to realise their benefits or if it is obligated to re-assume transferred risk. The *originator's* retention of servicing rights or obligations in respect of the *exposures* does not of itself constitute indirect control of the *exposures*.

[Note: BCD Annex IX Part 2 point 1 (part)]

9.4.11

FCA PRA

R

Significant credit risk will be considered to be transferred for an *originator* in the following cases:

- (1) the *risk weighted exposure amounts* of the *mezzanine securitisation positions* held by the *originator* in the *securitisation* do not exceed 50% of the *risk weighted exposure amounts* of all *mezzanine securitisation positions* existing in this *securitisation*;
- (2) where there are no *mezzanine securitisation positions* in a given *securitisation* and the *originator* can demonstrate that the exposure value of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% *risk weight* exceeds a reasoned estimate of the expected loss on the *securitised exposures* by a substantial margin, the *originator* does not hold more than 20% of the exposure values of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% *risk weight*.

[Note: BCD, Annex IX, Part 2, Point 1, paragraph 1a]

9.4.12

FCA PRA

R

An *originator* must notify the *appropriate regulator* that it is relying on the deemed transfer of significant credit risk under ■ BIPRU 9.4.11R within a reasonable period before or after a relevant transfer, not being later than one month after the date of the transfer. The notification must include the following information:

- (1) the *risk weighted exposure amount* of the *securitised exposures* and retained *securitisation positions*;
- (2) the *exposure* value of the *securitised exposures* and the retained *securitisation positions*;
- (3) details of the *securitisation positions*, including rating, *exposure* value broken down by *securitisation positions* sold and retained;
- (4) a statement that sets out why the *firm* is satisfied that the reduction in *risk weighted exposure amounts* is justified by a commensurate transfer of credit risk to third parties;
- (5) any relevant supporting documents, for example, a summary of the transaction.

PAGE  
13

9.4.13

FCA PRA

G

In the event that the *appropriate regulator* decides that the possible reduction in *risk weighted exposure amounts* which the *originator* would achieve by the *securitisation* referred to in ■ BIPRU 9.4.11R is not justified by a commensurate transfer of credit risk to third parties, it will use its powers under section 55J (Variation etc on the Authority's own initiative) of the *Act* to require the *firm* to increase its *risk weight exposure amount* to an amount commensurate with the *appropriate regulator's* assessment of the transfer of credit risk to third parties.

- 9.4.14** FCA PRA G An *originator* may be granted a *waiver* of the requirements in ■ BIPRU 9.4.11R and ■ BIPRU 9.4.12R.
- 9.4.15** FCA PRA D An *originator's* application for a *waiver* of the requirements in ■ BIPRU 9.4.11R and ■ BIPRU 9.4.12R must demonstrate that the following conditions are satisfied.
- (1) it has policies and methodologies in place which ensure that the possible reduction of capital requirements which the *originator* achieves by the *securitisation* is justified by a commensurate transfer of credit risk to third parties; and
  - (2) that such a transfer of credit risk to third parties is also recognised for the purposes of all the *firm's* internal risk management and internal capital allocation.
- [Note: BCD, Annex IX, Part 2, Point 1, paragraph 1c]**
- 9.4.16** FCA PRA G ■ BIPRU 1.3.10 G sets out the *appropriate regulator's* approach to the granting of *waivers*. The conditions in ■ BIPRU 9.4.15D are minimum requirements. Satisfaction of those does not automatically mean the *appropriate regulator* will grant the relevant *waiver*. The *appropriate regulator* will in addition also apply the tests in section 138A (Modification or waiver of rules) of the *Act*.
- 9.4.17** FCA PRA G When considering an application for a *waiver* of the requirements in ■ BIPRU 9.4.11R and ■ BIPRU 9.4.12R, the *appropriate regulator* may undertake a visit to the *firm* in order to examine the *firm's* risk management and governance arrangements. Before such a visit, the *appropriate regulator* may request information from the *firm* additional or supplementary to that provided in the *waiver* application.
- 9.4.18** FCA PRA G An *originator* should clearly state the scope of the *waiver* of the requirements in ■ BIPRU 9.4.11R and ■ BIPRU 9.4.12R it is seeking in its application. For example, residential mortgage backed securities may be subdivided into prime and sub-prime with only one sub-category within the scope of the *waiver*. Relevant asset classes may therefore be defined according to a *firm's* internal usage of terms.

## 9.5 Synthetic securitisation

### Minimum requirements for recognition of significant credit risk transfer

9.5.1

R

FCA PRA

- (1) An *originator* of a *synthetic securitisation* may calculate *risk weighted exposure amounts*, and, as relevant, *expected loss amounts*, for the *securitised exposures* in accordance with ■ BIPRU 9.5.3 R and ■ BIPRU 9.5.4 R, if either of the following conditions is fulfilled:
- (a) significant credit risk is considered to have been transferred to third parties, either through funded or unfunded credit protection; or
  - (b) the *originator* applies a 1250% *risk weight* to all *securitisation positions* he holds in this *securitisation* or deducts these *securitisation positions* from *capital resources* according to ■ GENPRU 2.2.237 R;

and the transfer complies with the conditions in (2)-(8).

[Note: BCD, Annex IX, Part 2, Point 2, paragraph 2]

- (2) The *securitisation* documentation must reflect the economic substance of the transaction.
- (3) The credit protection by which the credit risk is transferred must comply with the eligibility and other requirements under ■ BIPRU 5 (Credit risk mitigation) and, so far as applicable, ■ BIPRU 4.10 (Credit risk mitigation under the IRB approach) for the recognition of such credit protection. For the purposes of this *rule*, *securitisation special purpose entities* must not be recognised as eligible unfunded protection providers.
- (4) The instruments used to transfer credit risk must not contain terms or conditions that:
  - (a) impose significant materiality thresholds below which credit protection is deemed not to be triggered if a credit event occurs;
  - (b) allow for the termination of the protection due to deterioration of the credit quality of the underlying *exposures*;

- (c) other than in the case of *early amortisation provisions*, require positions in the *securitisation* to be improved by the *originator*; or
  - (d) increase the *originator's* cost of credit protection or the yield payable to holders of positions in the *securitisation* in response to a deterioration in the credit quality of the underlying pool.
- (5) An opinion must be obtained from qualified legal counsel confirming the enforceability of the credit protection in all relevant jurisdictions.

[Note: BCD Annex IX Part 2 point 2]

- (6) Significant credit risk will be considered to have been transferred if either of the following conditions is met:
- (a) the *risk weighted exposure amounts* of the *mezzanine securitisation positions* which are held by the *originator* in this *securitisation* do not exceed 50% of the *risk weighted exposure amounts* of all *mezzanine securitisation positions* existing in this *securitisation*;
  - (b) where there are no *mezzanine securitisation positions* in a given *securitisation* and the *originator* can demonstrate that the *exposure* value of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% *risk weight* exceeds a reasoned estimate of the expected loss on the securitised exposures by a substantial margin, the *originator* does not hold more than 20% of the exposure values of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% risk weight.

[Note: BCD, Annex IX, Part 2, Point 2, paragraph 2a]

- (7) An *originator* must notify the *appropriate regulator* that it is relying on the deemed transfer of significant credit risk under ■ BIPRU 9.5.1R (6) within a reasonable period before or after a relevant transfer, not being later than one month after the date of the transfer. The notification must include the following information:
- (a) the *risk weighted exposure amount* of the *securitised exposures* and retained *securitisation positions*;
  - (b) the *exposure* value of the *securitised exposures* and the retained *securitisation positions*;
  - (c) details of the *securitisation positions*, including rating, *exposure* value broken down by *securitisation positions* sold and retained;

- (d) a statement that sets out why the *firm* is satisfied that the reduction in *risk weighted exposure amounts* is justified by a commensurate transfer of credit risk to third parties;
- (e) any relevant supporting documents, for example, a summary of the transaction.

## 9.5.1A

FCA PRA

G

An *originator* may be granted a *waiver* of the requirements in ■ BIPRU 9.5.1R (6) and ■ (7).

## 9.5.1B

FCA PRA

D

An *originator's* application for a *waiver* of the requirements in ■ BIPRU 9.5.1R (6) and ■ (7) must demonstrate that the following conditions are satisfied:

- (1) it has policies and methodologies in place which ensure that the possible reduction of capital requirements which the *originator* achieves by the *securitisation* is justified by a commensurate transfer of credit risk to third parties; and
- (2) that such transfer of credit risk to third parties is also recognised for the purposes of all the *originator's* internal risk management and its internal capital allocation.

[Note: BCD, Annex IX, Part 2, Point 2, paragraph 2c]

## 9.5.1C

FCA PRA

G

■ BIPRU 1.3.10 G sets out the *appropriate regulator* approach to the granting of *waivers*. The conditions in ■ BIPRU 9.5.1BD are minimum requirements. Satisfaction of those does not automatically mean the *appropriate regulator* will grant the relevant *waiver*. The *appropriate regulator* will in addition also apply the tests in section 138A (Modification or waiver of rules) of the *Act*.

## 9.5.1D

FCA PRA

G

When considering an application for a *waiver* of the requirements in ■ BIPRU 9.5.1R (6) and ■ (7), the *appropriate regulator* may undertake a visit to the *firm* in order to examine the *firm's* risk management and governance arrangements. Before such a visit, the *appropriate regulator* may request information from the *firm* additional or supplementary to that provided in the *waiver* application.

## 9.5.1E

FCA PRA

G

An *originator* should clearly state the scope of the *waiver* of the requirements in ■ BIPRU 9.5.1R (6) and ■ (7) it is seeking in its application. For example, residential mortgage backed securities may be subdivided into prime and sub-prime with only one sub-category within the scope of the *waiver*. Relevant asset classes may therefore be defined according to a *firm's* internal usage of terms.

## 9.5.1F

FCA PRA

G

In the event that the *appropriate regulator* decides that the possible reduction in *risk weighted exposure amounts* which the *originator credit institution* would achieve by the *securitisation* referred to in ■ BIPRU 9.5.1R (6) is not justified by a commensurate transfer of credit risk to third parties, it will use its powers under section 55J (Variation etc on the Authority's own initiative) of the *Act* to require the *firm* to increase its *risk weight exposure amount* to an amount commensurate with the *appropriate regulator's* assessment of the transfer of credit risk to third parties.

### Originators' calculation of risk-weighted exposure amounts for exposures securitised in a synthetic securitisation

9.5.2

FCA PRA

R

■ BIPRU 9.5.3 R-■ BIPRU 9.5.8 R apply to the calculation by an *originator* of *risk weighted exposure amounts* for *exposures securitised in a synthetic securitisation*.

9.5.3

FCA PRA

R

- (1) In calculating *risk weighted exposure amounts* for the *securitised exposures*, where the conditions in ■ BIPRU 9.5.1 R are met, the *originator* of a *synthetic securitisation* must, subject to the treatment of maturity mismatches set out in ■ BIPRU 9.5.6 R-■ BIPRU 9.5.8 R, use the relevant calculation methodologies set out in ■ BIPRU 9.9-■ BIPRU 9.14 and not those set out in ■ BIPRU 3 (Standardised credit risk) or ■ BIPRU 4 (IRB approach).
- (2) For *firms* calculating *risk weighted exposure amounts* and *expected loss* amounts under the *IRB approach*, the *expected loss* amount in respect of such *exposures* must be zero.
- (3) For clarity, this paragraph refers to the entire pool of *exposures* included in the *securitisation*.

[Note: BCD Annex IX Part 2 point 3 and point 4 (part)]

9.5.4

FCA PRA

R

Subject to the treatment of maturity mismatches set out in ■ BIPRU 9.5.6 R-■ BIPRU 9.5.8 R, the *originator* must calculate *risk weighted exposure amounts* in respect of all *tranches* in the *securitisation* in accordance with the provisions of ■ BIPRU 9.9-■ BIPRU 9.14. For example, where a *tranche* is transferred by means of unfunded credit protection to a third party, the *risk weight* of that third party must be applied to the *tranche* in the calculation of the *originators risk weighted exposure amount*.

[Note: BCD Annex IX Part 2 point 4 (part)]

### Treatment of maturity mismatches in synthetic securitisations

9.5.5

FCA PRA

R

■ BIPRU 9.5.6 R-■ BIPRU 9.5.8 R apply to the treatment of maturity mismatches in a *synthetic securitisation*.

9.5.6

FCA PRA

R

For the purposes of calculating *risk weighted exposure amounts* in accordance with ■ BIPRU 9.5.3 R, any maturity mismatch between the credit protection by which the *tranching* is achieved and the *securitised exposures* must be taken into consideration in accordance with ■ BIPRU 9.5.7 R-■ BIPRU 9.5.8 R.

[Note: BCD Annex IX Part 2 point 5]

9.5.7

FCA PRA

R

The maturity of the *securitised exposures* must be taken to be the longest maturity of any of those *exposures* subject to a maximum of five years. The maturity of the credit protection must be determined in accordance with ■ BIPRU 5 (Credit risk mitigation) and, so far as relevant, ■ BIPRU 4.10 (Credit risk mitigation under the IRB approach).

[Note: BCD Annex IX Part 2 point 6]

9.5.8

FCA PRA

R

- (1) An *originator* must ignore any maturity mismatch in calculating *risk weighted exposure amounts* for *tranches* appearing pursuant to ■ BIPRU 9.9-■ BIPRU 9.14 with a *risk weight* of 1250%. For all other *tranches* the maturity mismatch treatment prescribed in ■ BIPRU 5.8 (Maturity mismatches) must be applied in accordance with the following formula:

$$RW^* \text{ is } [RW(SP) \times (t-t^*)/(T-t^*)] + [RW(Ass) \times (T-t)/(T-t^*)]$$

- (2) The following apply for the purposes of the formula in (1):
- (a)  $RW^*$  is *risk weighted exposure amounts*;
  - (b)  $RW(Ass)$  is *risk weighted exposure amounts* for *exposures* if they had not been *securitised* calculated on a pro-rata basis;
  - (c)  $RW(SP)$  is *risk weighted exposure amounts* calculated under ■ BIPRU 9.6.3 G as if there was no maturity mismatch;
  - (d)  $T$  is maturity of the underlying *exposures* expressed in years;
  - (e)  $t$  is maturity of credit protection expressed in years; and
  - (f)  $t^*$  is 0.25.

[Note: BCD Annex IX Part 2 point 7]

## 9.6 Implicit support

### 9.6.1

FCA PRA

R

An *originator* which, in respect of a securitisation in the *non-trading book*, has made use of ■ BIPRU 9.3.1 R in the calculation of *risk weighted exposure amounts*, or a *sponsor*, must not, with a view to reducing potential or actual losses to investors, provide support to the *securitisation* beyond its contractual obligations.

[Note: BCD Article 101(1)]

### 9.6.1A

FCA PRA

R

An *originator* which has sold instruments in its *trading book* to an *SSPE* and no longer holds *market risk capital requirements* for these instruments, or a *sponsor*, must not, with a view to reducing potential or actual losses to investors, provide support to the *securitisation* beyond its contractual obligations.

[Note: BCD Article 101(1)]

### 9.6.2

FCA PRA

R

If an *originator* or *sponsor* fails to comply with ■ BIPRU 9.6.1 R or ■ BIPRU 9.6.1A R in respect of a *securitisation*, it must:

- (1) hold capital against all of the *securitised exposures* associated with the *securitisation* transaction as if they had not been *securitised*; and
- (2) disclose publicly:
  - (a) that it has provided non-contractual support; and
  - (b) the regulatory capital impact of doing so.

[Note: BCD Article 101(2)]

### 9.6.3

FCA PRA

G

- (1) *Securitisation* documentation should make clear, where applicable, that any repurchase of *securitised exposures* or *securitisation positions* by the *originator* or *sponsor* beyond its contractual obligations is not mandatory and may only be made at fair market value. In general, any such repurchase should be subject to a *firm's* credit review and approval process, which should be adequate to ensure that the repurchase complies with ■ BIPRU 9.6.1 R.

- (2) If an *originator* or *sponsor* repurchases *securitised exposures* or *securitisation positions*, it should be able to satisfy the *appropriate regulator* that it has adequately considered the following:
  - (a) the price of the repurchase;
  - (b) the *firm's* capital and liquidity position before and after repurchase;
  - (c) the performance of the *securitised exposures*; and
  - (d) the performance of the issued securities;

and has concluded that, taking into account those factors and any other relevant factors, the repurchase is not structured to provide support.
- (3) A *firm* should keep adequate records of the matters in (1) and (2).

## 9.6.4

FCA PRA

G

If a *firm* is found to have provided implicit support to a *securitisation*, that fact increases the expectation that the *firm* will provide future support to its *securitisations* thus failing to achieve a significant transfer of risk. The *appropriate regulator* will consider taking appropriate measures to reflect this increased expectation after an instance of implicit support is found.

## 9.6.5

FCA PRA

G

A *firm* may need to consider three main situations to determine whether there is a breach of the prohibition against implicit support in ■ BIPRU 9.6.1 R:

- (1) support given under a contractual obligation;
- (2) support given under the contractual documentation for the *securitisation* which the *firm* is entitled, but not obliged, to give; and
- (3) support which is not provided for under the contractual documentation for the *securitisation*.

## 9.6.6

FCA PRA

G

- (1) The support described in ■ BIPRU 9.6.5 G (1) is permitted by ■ BIPRU 9.6.1 R.
- (2) The support described in ■ BIPRU 9.6.5 G (3) is not permitted by ■ BIPRU 9.6.1 R.
- (3) The support described in ■ BIPRU 9.6.5 G (2) may be permitted by ■ BIPRU 9.6.1 R under the following conditions:
  - (a) the fact that the *firm* may give it is expressly set out in the contractual and marketing documents for the *securitisation*;
  - (b) the nature of the support that the *firm* may give is precisely described in the documentation;
  - (c) the maximum degree of support that can be given can be ascertained at the time of the *securitisation* both by the *firm* and by a *person* whose only information comes from the marketing documents for the *securitisation*;
  - (d) the assessment of whether there has been significant risk transfer and the amount of that transfer is made on the basis that the *firm* will provide support to the maximum degree possible; and
  - (e) the *firm's* capital resources and capital resources requirement are adjusted at the time of the *securitisation* on the basis that the *firm* has provided

support to the maximum degree possible, whether by an immediate deduction from capital or appropriate *risk weighting*.

**9.6.7****FCA** **PRA****G**

A waiver of the right to future margin income may not breach the prohibition against implicit support:

- (1) the degree of support that can be given can be defined precisely by reference to the *securitisation* contractual documentation, albeit the amount of support may not be ascertainable in absolute monetary terms; and
- (2) no adjustment to the *firm's capital resources* or *capital resources requirement* is required, as a *firm* should not in any case reflect future margin income in its income or *capital resources*.

**9.6.8****FCA** **PRA****G**

For the purposes of ■ BIPRU 9.6.2 R (2), *firms* will be expected to include disclosure of implicit support in accordance with the general and technical requirements on public disclosure, as outlined in ■ BIPRU 11 (Disclosure).

## 9.7 Recognition of credit assessments of ECAIs

### 9.7.1

FCA PRA

R

An ECAI's credit assessment may be used to determine the *risk weight* of a *securitisation position* in accordance with ■ BIPRU 9.9 only if the ECAI is an *eligible ECAI*.

[Note: BCD Article 97(1)]

### 9.7.2

FCA PRA

R

- (1) A *firm* must not use a credit assessment of an *eligible ECAI* to determine the *risk weight* of a *securitisation position* in accordance with ■ BIPRU 9.9 unless it complies with the principles of credibility and transparency as elaborated in (2) to (6).
- (2) There must be no mismatch between the types of payments reflected in the credit assessment and the types of payment to which the *firm* is entitled under the contract giving rise to the *securitisation position* in question.
- (3) The credit assessment must be available publicly to the market. Credit assessments may only be treated as publicly available if:
  - (a) they have been published in a publicly accessible forum, and
  - (b) they are included in the ECAI's transition matrix.
- (4) Credit assessments that are made available only to a limited number of entities may not be treated as publicly available.
- (5) The credit assessment must not be based, or partly based, on unfunded support provided by the *firm* itself.
- (6) In the case of a credit assessment referred to in (5), the *firm* must consider the relevant position as if it were not rated and must apply the relevant treatment of unrated positions as set out in ■ BIPRU 9.11 and ■ BIPRU 9.12.

[Note: BCD Article 97(5) and Annex IX Part 3 point 1]

### 9.7.2A

FCA PRA

G

The requirements in ■ BIPRU 9.7.2R (5) and ■ (6) apply to situations where a *firm* holds *securitisation positions* which receive a lower *risk weight* by virtue of unfunded credit

protection provided by the *firm* itself acting in a different capacity in the *securitisation* transaction. The assessment of whether a *firm* is providing unfunded support to its *securitisation positions* should take into account the economic substance of that support in the context of the overall transaction and any circumstances in which the *firm* could become exposed to a higher credit risk in the absence of that support.

## 9.7.3

FCA PRA

G

The *guidance* in ■ BIPRU 3.3 (Recognition of ratings agencies) applies for the purposes of ■ BIPRU 9 as it does to *exposure risk weighting* in ■ BIPRU 3, save that the reference in ■ BIPRU 3.3 to the regulation 22 of the *Capital Requirements Regulations 2006* should be read as a reference to regulation 23 of the *Capital Requirements Regulations 2006* for the purposes of ■ BIPRU 9.

## 9.7.4

FCA PRA

G

Where ■ BIPRU 9.7.2R (5) applies to *securitisation positions* in an *ABCP programme*, the *firm* may be granted a *waiver* which allows it to use the *risk weight* assigned to a *liquidity facility* in order to calculate the *risk weighted exposure amount* for the positions in the *ABCP programme*, provided that the *liquidity facility* ranks *pari passu* with the positions in the *ABCP programme* so that they form overlapping positions and 100% of the commercial paper issued by the *ABCP programme* is covered by *liquidity facilities*. For the purposes of this provision, overlapping positions means that the positions represent, wholly or partially, an *exposure* to the same risk such that, to the extent of the overlap, there is a single *exposure*.

[Note: BCD, Annex IX, Part 4, Point 5]

## 9.8 Use of ECAI credit assessments for the determination of applicable risk weights

**9.8.1** **R** The use of *ECAIs'* credit assessments for the calculation of a *firm's risk weighted exposure amounts* under ■ BIPRU 9 must be consistent and in accordance with ■ BIPRU 9.8.2 R ■ BIPRU 9.8.7 R. Credit assessments must not be used selectively.

FCA PRA

[Note: BCD Article 99]

**9.8.2** **R** A *firm* may nominate one or more *eligible ECAIs* the credit assessments of which must be used in the calculation of its *risk weighted exposure amounts* under ■ BIPRU 9 (a *nominated ECAI*).

FCA PRA

[Note: BCD Annex IX Part 3 point 2]

**9.8.3** **R** Subject to ■ BIPRU 9.8.5 R ■ BIPRU 9.8.7 R, a *firm* must use credit assessments from *nominated ECAIs* consistently in respect of its *securitisation positions*.

FCA PRA

[Note: BCD Annex IX Part 3 point 3]

**9.8.4** **R** Subject to ■ BIPRU 9.8.5 R and ■ BIPRU 9.8.6 R, a *firm* must not use an *ECAI's* credit assessments for its positions in some *tranches* and another *ECAI's* credit assessments for its positions in other *tranches* within the same structure that may or may not be *rated* by the first *ECAI*.

FCA PRA

[Note: BCD Annex IX Part 3 point 4]

**9.8.5** **R** Where a position has two credit assessments by *nominated ECAIs*, the *firm* must use the less favourable credit assessment.

FCA PRA

[Note: BCD Annex IX Part 3 point 5]

**9.8.6** **R** Where a position has more than two credit assessments by *nominated ECAIs*, the two most favourable credit assessments must be used. If the two most favourable assessments are different, the least favourable of the two must be used.

FCA PRA

[Note: BCD Annex IX Part 3 point 6]

9.8.7

FCA PRA

R

- (1) Where credit protection eligible under ■ BIPRU 5 (Credit risk mitigation) and, if applicable, ■ BIPRU 4.10 (Credit risk mitigation under the IRB approach) is provided directly to the *SSPE*, and that protection is reflected in the credit assessment of a position by a *nominated ECAI*, the *risk weight* associated with that credit assessment may be used.
- (2) If the protection is not eligible under ■ BIPRU 5 (Credit risk mitigation) and, if applicable, ■ BIPRU 4.10 (Credit risk mitigation under the IRB approach), the credit assessment must not be recognised.
- (3) In the situation where the credit protection is not provided to the *SSPE* but rather is provided directly to a *securitisation position*, the credit assessment must not be recognised.

[Note: *BCD* Annex IX Part 3 point 7]



## 9.9 Calculation of risk-weighted exposure amounts for securitisation positions

9.9.1

FCA PRA

R

To calculate the *risk weighted exposure amount* of a *securitisation position*, the relevant *risk weight* must be assigned to the *exposure* value of the position in accordance with ■ BIPRU 9.9 - ■ BIPRU 9.14 based on the credit quality of the position.

[Note: BCD Article 96(1) (part) and Annex IX, Part 4 point 1]

9.9.2

FCA PRA

R

For the purpose of ■ BIPRU 9.9.1 R, the credit quality of a position may be determined by reference to an *ECAI* credit assessment or otherwise, as set out in ■ BIPRU 9.9 ■ BIPRU 9.14.

[Note: BCD Article 96(1) (part)]

9.9.3

FCA PRA

R

- (1) Where there is an *exposure* to different *tranches* in a *securitisation*, the *exposure* to each *tranche* must be considered a separate *securitisation position*.
- (2) The providers of credit protection to *securitisation positions* must be treated as holding positions in the *securitisation*.
- (3) *securitisation positions* include *exposures* to a *securitisation* arising from interest rate or currency derivative contracts.

[Note: BCD Article 96(2)]

9.9.4

FCA PRA

R

Subject to ■ BIPRU 9.9.5 R,

- (1) where a *firm* calculates *risk weighted exposure amounts* under the *standardised approach* to *securitisations* outlined in ■ BIPRU 9.11, the *exposure* value of an on-balance sheet *securitisation position* must be its balance sheet value;
- (2) where a *firm* calculates *risk weighted exposure amounts* under the *IRB approach* to *securitisations* outlined in ■ BIPRU 9.12, the *exposure* value of an on-balance sheet *securitisation position* must be measured gross of value adjustments;

- (3) the *exposure* value of an off-balance sheet *securitisation position* must be its nominal value multiplied by a conversion figure as prescribed in this chapter; and
- (4) the conversion figure referred to in (3) must be 100% unless otherwise specified.

[Note: BCD Annex IX Part 4 point 2]

9.9.5

FCA PRA

R

The *exposure* value of a *securitisation position* arising from a *financial derivative instrument* must be determined in accordance with ■ BIPRU 13 (Treatment of derivative instruments).

[Note: BCD Annex IX Part 4 point 3]

9.9.6

FCA PRA

R

Where a *securitisation position* is subject to funded credit protection, the *exposure* value of that position may be modified in accordance with and subject to the requirements of ■ BIPRU 5 (Credit risk mitigation) as further specified in ■ BIPRU 9.11.13 R and ■ BIPRU 9.14.

[Note: BCD Annex IX Part 4 point 4]

9.9.7

FCA PRA

R

Where a *securitisation position* is subject to funded or unfunded credit protection the *risk weight* to be applied to that position may be modified in accordance with ■ BIPRU 5 (Credit risk mitigation) and, if applicable, ■ BIPRU 4.10 (Credit risk mitigation under the IRB approach) read in conjunction with ■ BIPRU 9.14.

[Note: BCD Article 96(3)]

9.9.8

FCA PRA

R

- (1) Where a *firm* has two or more overlapping positions in a *securitisation* the *firm* must, to the extent that the positions overlap, include in its calculation of *risk weighted exposure amounts* only the position, or portion of a position, producing the higher *risk weighted exposure amounts*. The *firm* may also recognise such an overlap between capital charges for *specific risk* in relation to *positions* in the *trading book* and capital charges for positions in the *non-trading book*, provided that the *firm* is able to calculate and compare the capital charges for the relevant positions.
- (2) For the purposes of (1), overlapping means that the positions, wholly or partially, represent an *exposure* to the same risk such that to the extent of the overlap there is a single *exposure*.

[Note: BCD Annex IX Part 4 point 5]

9.9.9

FCA PRA

R

Subject to the provisions of GENPRU that deal with the deduction of *securitisation positions* at stage M in the relevant *capital resources*

*table, the risk weighted exposure amount must be included in the firm's total of risk weighted exposure amounts for the purposes of the calculation of its credit risk capital requirement.*

[Note: BCD Article 96(4)]

**9.9.10****FCA** **PRA****G**

Where ■ BIPRU 9.7.2R (5) applies to *securitisation positions* in an ABCP programme, the firm may be granted a *waiver* in the terms described in ■ BIPRU 9.7.4 G.

[Note: BCD, Annex IX, Part 4, Point 5]



## 9.10 Reduction in risk-weighted exposure amounts

9.10.1

FCA PRA

R

■ BIPRU 9.10 applies as follows:

- (1) ■ BIPRU 9.10.2 R and ■ BIPRU 9.10.3 R apply to both the *standardised approach* and the *IRB approach*; and
- (2) ■ BIPRU 9.10.4 R ■ BIPRU 9.10.7 R apply to the *IRB approach*.

9.10.2

FCA PRA

R

In respect of a *securitisation position* in respect of which a 1250% *risk weight* is assigned, a *firm* may, as an alternative to including the position in its calculation of *risk weighted exposure amounts*, deduct from its *capital resources* the *exposure* value of the position. For these purposes, the calculation of the *exposure* value may reflect eligible funded protection in a manner consistent with ■ BIPRU 9.14.

[Note: BCD Annex IX Part 4 points 35, 74 and 75(b)]

9.10.3

FCA PRA

R

Where a *firm* applies ■ BIPRU 9.10.2 R, 12.5 times the amount deducted in accordance with that paragraph must, for the purposes of ■ BIPRU 9.11.5 R and ■ BIPRU 9.12.8 R, be subtracted from the amount specified in whichever of those *rules* applies as the maximum *risk weighted exposure amount* to be calculated by a *firm* to which one of those *rules* applies.

[Note: BCD Annex IX Part 4 point 36 and point 76]

9.10.4

FCA PRA

R

The *risk weighted exposure amount* of a *securitisation position* to which a 1250% *risk weight* is assigned may be reduced by 12.5 times the amount of any value adjustments made by the *firm* in respect of the *securitised exposures*.

[Note: BCD Annex IX Part 4 point 72 (part)]

9.10.5

FCA PRA

R

To the extent that value adjustments are taken account of for the purposes of ■ BIPRU 9.10.4 R they must not be taken account of for the purposes of the calculation indicated in ■ BIPRU 4.3.8 R (Treatment of expected loss amounts).

[Note: BCD Annex IX Part 4 point 72 (part)]

9.10.6

FCA PRA

R

The *risk weighted exposure amount* of a *securitisation position* may be reduced by 12.5 times the amount of any value adjustments made by the *firm* in respect of the position.

[Note: BCD Annex IX Part 4 point 73]

9.10.7

FCA PRA

R

For the purposes of ■ BIPRU 9.10.2 R (as it applies to the *IRB approach*):

- (1) the *exposure* value of the position may be derived from the *risk weighted exposure amounts* taking into account any reductions made in accordance with ■ BIPRU 9.10.4 R ■ BIPRU 9.10.6 R;
- (2) where the *supervisory formula method* is used to calculate *risk weighted exposure amounts* and  $L < K_{IRBR}$  and  $[L+T] > K_{IRBR}$  the position may be treated as two positions with L equal to  $K_{IRBR}$  for the more senior of the positions.

[Note: BCD Annex IX Part 4 point 75(a) and (c)]



## 9.11 Calculation of risk weighted exposure amounts under the standardised approach to securitisations

9.11.1

FCA PRA

R

Subject to ■ BIPRU 9.11.5 R, the *risk weighted exposure amount* of a rated *securitisation position* or *resecuritisation position* must be calculated by applying to the *exposure* value the *risk weight* associated with the *credit quality step* with which the credit assessment has been determined to be associated, as prescribed in ■ BIPRU 9.11.2 R .

[Note: BCD Annex IX Part 4 point 6]

9.11.2

FCA PRA

R

Table:

This table belongs to ■ BIPRU 9.11.1 R

<i>Credit Quality step</i>	1	2	3	4 (only for credit assessments other than short-term credit assessments)	All other credit quality steps
<i>Securitisation positions</i>	20%	50%	100%	350%	1250%
<i>Resecuritisation positions</i>	40%	100%	225%	650%	1250%

[Note: For mapping of the *credit quality step* to the credit assessments of *eligible ECAs*, refer to: <http://www.fca.org.uk/your-fca/documents/fsa-ecais-standardised-for-the-FCA> and <http://www.bankofengland.co.uk/publications/Documents/prabankingpolicy/2013/ecaissecuritisation.pdf> for the PRA]

[Note: BCD, Annex IX, Part 4, point 6, Table 1]

9.11.3

R

[deleted]

9.11.4

FCA PRA

R

Subject to ■ BIPRU 9.11.6 R ■ BIPRU 9.11.12 R, the *risk weighted exposure amount* of an *unrated securitisation position* must be calculated by applying a *risk weight* of 1250%.

[Note: BCD Annex IX Part 4 point 7]

#### Originator and sponsor firms

9.11.5

FCA PRA

R

For an *originator* or *sponsor*, the *risk weighted exposure amounts* calculated in respect of its positions in a *securitisation* may be limited to the *risk weighted exposure amounts* which would be calculated for the *securitised exposures* had they not been *securitised* subject to the presumed application of a 150% *risk weight* to all past due items and items belonging to regulatory high risk categories (see ■ BIPRU 3.4.104 R and ■ BIPRU 3 Annex 3 R) amongst the *securitised exposures*.

[Note: BCD Annex IX Part 4 point 8]

#### Treatment of unrated securitisation positions

9.11.6

FCA PRA

R

- (1) A *firm* having an *unrated securitisation position* may apply the treatment set out in this paragraph for calculating the *risk weighted exposure amount* for that position provided the composition of the pool of *exposures securitised* is known at all times.
- (2) A *firm* may apply the weighted-average *risk weight* that would be applied to the *securitised exposures* referred to in (1) under the *standardised approach* by a *firm* holding the *exposures* multiplied by a concentration ratio.
- (3) This concentration ratio is equal to the sum of the nominal amounts of all the *tranches* divided by the sum of the nominal amounts of the *tranches* junior to, or *pari passu* with, the *tranche* in which the position is held including that *tranche* itself.
- (4) The resulting *risk weight* must not be higher than 1250% or lower than any *risk weight* applicable to a *rated* more senior *tranche*.
- (5) Where the *firm* is unable to determine the *risk weights* that would be applied to the *securitised exposures* under the *standardised approach*, it must apply a *risk weight* of 1250% to the position.

[Note: BCD Annex IX Part 4 points 9 and 10]

9.11.7

FCA PRA

G

- (1) This provision contains *guidance* on the requirement in ■ BIPRU 9.11.6 R (1) that the composition of the pool of *exposures securitised* must be known at all times.
- (2) The composition should be known sufficiently at the time of purchase for the *firm* to be able accurately to calculate the *risk weighted exposure amounts* of the pool under the *standardised approach*.

- (3) Thereafter, any change to the composition of the pool during the life of the transaction that would lead to an increase in the *risk weighted exposure amount* of the pool of *exposures* under the *standardised approach* should be either:
  - (a) prohibited by the documentation; or
  - (b) included in the *firm's* capital calculations.
- (4) It would be sufficient for the purposes of (2) for the composition of the pool to be reported to the *firm* at least daily, via information service providers, secure web-sites or other appropriate sources.

#### Treatment of securitisation positions in a second loss tranche or better in an ABCP programme

9.11.8

FCA PRA

R

Subject to the availability of a more favourable treatment by virtue of the provisions concerning *liquidity facilities* in ■ BIPRU 9.11.10 R ■ BIPRU 9.11.12 R, a *firm* may apply to *securitisation positions* meeting the conditions set out in ■ BIPRU 9.11.9 R a *risk weight* that is the greater of:

- (1) 100%, or
- (2) the highest of the risk weights that would be applied to any of the *securitised exposures* under the *standardised approach* by a *firm* holding the *exposures*.

[Note: BCD Annex IX Part 4 point 11]

9.11.9

FCA PRA

R

For the treatment in ■ BIPRU 9.11.8 R to be available,:

- (1) the *securitisation position* must be in an *ABCP programme*;
- (2) the *securitisation position* must be in a *tranche* which is economically in a second loss position or better in the *securitisation* and the first loss *tranche* must provide meaningful *credit enhancement* to the second loss *tranche*;
- (3) the *securitisation position* must be of a quality the equivalent of investment grade or better; and
- (4) the *firm* in question must not hold a position in the first loss *tranche*.

[Note: BCD Annex IX Part 4 point 12]

#### Treatment of unrated liquidity facilities

9.11.10

FCA PRA

R

When the conditions in this paragraph have been met, and in order to determine its *exposure* value, a conversion figure of 50% may be applied to the nominal amount of a *liquidity facility*. The *risk weight* to be

applied is the highest *risk weight* that would be applied to any of the *securitised exposures* under the *standardised approach* by a *firm* holding the *exposures*. Those conditions are as follows:

- (1) the *liquidity facility* documentation must clearly identify and limit the circumstances under which the facility may be drawn;
- (2) it must not be possible for the facility to be drawn so as to provide credit support by covering losses already incurred at the time of draw for example, by providing liquidity in respect of *exposures* in default at the time of draw or by acquiring assets at more than fair value;
- (3) the facility must not be used to provide permanent or regular funding for the *securitisation*;
- (4) repayment of draws on the facility must not be subordinated to the claims of investors other than to claims arising in respect of interest rate or currency derivative contracts, fees or other such payments, nor be subject to waiver or deferral;
- (5) it must not be possible for the facility to be drawn after all applicable *credit enhancements* from which the *liquidity facility* would benefit are exhausted; and
- (6) the facility must include a provision that results in an automatic reduction in the amount that can be drawn by the amount of *exposures* that are in *default*, where *default* has the meaning given to it for the purposes of the *IRB approach*, or where the pool of *securitised exposures* consists of *rated* instruments, that terminates the facility if the average quality of the pool falls below investment grade.

[Note: BCD Annex IX Part 4 point 13]

#### Liquidity facilities that may be drawn only in the event of a general market disruption

9.11.11

R

[deleted]

#### Cash advance facilities

9.11.12

R

FCA PRA

To determine its *exposure* value, a conversion figure of 0% may be applied to the nominal amount of a *liquidity facility* that is unconditionally cancellable provided that the conditions set out at ■ BIPRU 9.11.10 R are satisfied and that repayment of draws on the facility are senior to any other claims on the cash flows arising from the *securitised exposures*.

[Note: BCD Annex IX Part 4 point 15]

**Standardised approach: recognition of credit risk mitigation on  
securitisation positions**  
.....

9.11.13

FCA PRA

R

Where a *firm* calculates the *risk weighted exposure amount* of a *securitisation position* under the *standardised approach*, where credit protection is obtained on a *securitisation position*, the calculation of *risk weighted exposure amounts* may be modified in accordance with ■ BIPRU 5 (Credit risk mitigation).

[Note: BCD Annex IX Part 4 point 34]

## 9.12 Calculation of risk-weighted exposure amounts under the IRB approach

**9.12.1** **R** ■ BIPRU 9.12 applies to the calculation of *risk weighted exposure amounts of securitisation positions* under the *IRB approach*.  
FCA PRA

[Note: BCD Annex IX Part 4 point 37 (part)]

### Hierarchy of methods

**9.12.2** **R** For a *rated position* or a position in respect of which an inferred *rating* may be used, the *ratings based method* must be used to calculate the *risk weighted exposure amount*.  
FCA PRA

[Note: BCD Annex IX Part 4 point 38]

**9.12.3** **R** For an *unrated position* the *supervisory formula method* must be used except where a *firm* uses the *ABCP internal assessment approach*.  
FCA PRA

[Note: BCD Annex IX Part 4 point 39]

**9.12.4** **G** In cases where both the *ABCP internal assessment approach* and the *supervisory formula method* are available, a firm should determine the most appropriate approach and apply that approach consistently.  
FCA PRA

**9.12.5** **R** A *firm* other than an *originator* or a *sponsor* may not use the *supervisory formula method* unless its *IRB permission* expressly permits it to do so.  
FCA PRA

[Note: BCD Annex IX Part 4 point 40]

**9.12.6** **R** Subject to any *IRB permission* of the type described in ■ BIPRU 9.12.28 G, in the case of an *originator* or *sponsor* unable to calculate  $K_{IRB}$  and which has not obtained approval to use the *ABCP internal assessment approach*, and in the case of other *firms* where they have not obtained approval to use the *supervisory formula method* or, for positions in *ABCP programmes*, the *ABCP internal assessment approach*, a *risk weight* of 1250% must be assigned to *securitisation positions* which are *unrated* and in respect of which an inferred *rating* may not be used.  
FCA PRA

[Note: BCD Annex IX Part 4 point 41]

9.12.7

FCA PRA

R

**Use of inferred ratings**

When the following minimum operational requirements are satisfied a *firm* must attribute to an *unrated position* an inferred credit assessment equivalent to the credit assessment of those *rated positions* (the reference positions) which are the most senior positions which are in all respects subordinate to the *unrated securitisation position* in question:

- (1) the reference positions must be subordinate in all respects to the *unrated securitisation position*;
- (2) the maturity of the reference positions must be equal to or longer than that of the *unrated position* in question; and
- (3) on an ongoing basis, any inferred *rating* must be updated to reflect any changes in the credit assessment of the reference positions.

[Note: BCD Annex IX Part 4 point 42]

9.12.8

FCA PRA

R

**Maximum risk-weighted exposure amounts**

For an *originator*, a *sponsor*, or for other *firms* which can calculate  $K_{IRB}$ , the *risk weighted exposure amounts* calculated in respect of its positions in a *securitisation* may be limited to that which would produce an amount in respect of its *credit risk capital requirement* equal to the sum of 8% of the *risk weighted exposure amount* which would be produced if the *securitised* assets had not been *securitised* and were on the balance sheet of the *firm* plus the *expected loss* amounts of those *exposures*.

[Note: BCD Annex IX Part 4 point 45]

9.12.9

FCA PRA

R

**Ratings based method**

■ BIPRU 9.12.10 R to ■ BIPRU 9.12.19 R apply to the calculation of *risk weighted exposure amount* of *securitisation positions* under the *ratings based method*.

9.12.10

FCA PRA

R

Under the *ratings based method*, the *risk weighted exposure amount* of a *rated securitisation position* or *resecuritisation position* must be calculated by applying to the *exposure* value the *risk weight* associated with the *credit quality step* with which the credit assessment is associated as prescribed in ■ BIPRU 9.12.11 R multiplied by 1.06.

[Note: BCD Annex IX Part 4 point 46]

9.12.11

FCA PRA

R

Table:

This table belongs to ■ BIPRU 9.12.10 R

Credit Quality Step		Securitisation positions			Resecuritisation positions	
Credit assessments other than short term	Short-term credit assessments	A	B	C	D	E
1	1	7%	12%	20%	20%	30%
2		8%	15%	25%	25%	40%
3		10%	18%	35%	35%	50%
4	2	12%	20%		40%	65%
5		20%	35%		60%	100%
6		35%	50%		100%	150%
7	3	60%	75%		150%	225%
8		100%			200%	350%
9		250%			300%	500%
10		425%			500%	650%
11		650%			750%	850%
all other, unrated		1250%				

[Note: For mapping of the *credit quality step* to the credit assessments of eligible *ECAIs*, refer to: <http://www.fca.org.uk/your-fca/documents/fsa-ecais-standardised> for the *FCA* and <http://www.bankofengland.co.uk/publications/Documents/prabankingpolicy/2013/ecaissecuritisation.pdf> for the *PRA*.]

[Note: *BCD*, Annex IX, Part 4, point 46]

9.12.12

R

[deleted]

9.12.13

FCA PRA

R

For the purposes of ■ BIPRU 9.12.10 R:

- (1) the weightings in column C of ■ BIPRU 9.12.11 R must be applied where the *securitisation position* is not a *resecuritisation position* and where the effective number of *exposures* securitised is less than six;
- (2) for the remainder of the *securitisation positions* that are not *resecuritisation positions*, the weightings in column B must be

applied unless the position is in the most senior *tranche* of a *securitisation*, in which case the weightings in column A must be applied; and

- (3) for *resecuritisation positions*, the weightings in column E must be applied unless the *resecuritisation position* is in the most senior *tranche* of the *resecuritisation* and none of the underlying *exposures* were themselves *resecuritisation exposures*, in which case column D must be applied.

[Note: BCD Annex IX Part 4 point 47(part)]

9.12.14

FCA PRA

R

When determining under ■ BIPRU 9.12.13 R whether a *tranche* is the most senior for these purposes, a *firm* need not take into consideration amounts due under interest rate or currency derivative contracts, fees due, or other similar payments.

[Note: BCD Annex IX Part 4 point 47 (part)]

9.12.15

FCA PRA

G

A senior *liquidity facility* need not be taken into account for the purposes of determining the most senior *tranche* under ■ BIPRU 9.12.13 R.

9.12.16

R

[deleted]

9.12.17

FCA PRA

R

In calculating the effective number of *exposures securitised*, multiple *exposures* to one obligor must be treated as one *exposure*. The effective number of *exposures* is calculated as:

$$N = \frac{((\sum_i) (EAD_i))^2}{(\sum_i) (EAD_i^2)}$$

where  $EAD_i$  represents the sum of the *exposure* values of all *exposures* to the  $i^{\text{th}}$  obligor. If the portfolio share associated with the largest *exposure*, C1, is available, the *firm* may compute N as  $1/C1$ .

[Note: BCD Annex IX Part 4 point 49]

9.12.18

R

[deleted]

9.12.19

R

[deleted]

#### The ABCP internal assessment approach

9.12.20

FCA PRA

R

(1) If:

- (a) a *firm's IRB permission* allows it to use this treatment; and
- (b) the conditions in (2)(16) are satisfied,

a *firm* may attribute to an *unrated position* in an *asset backed commercial paper programme* a *derived rating* as laid down in (3).

- (2) Positions in the commercial paper issued from the programme must be *rated positions*.
- (3) Under the *ABCP internal assessment approach*, the *unrated position* must be assigned by the *firm* to one of the rating grades described in (5). The position must be attributed a *derived rating* that is the same as the credit assessments corresponding to that *rating grade* as laid down in (5). Where this *derived rating* is, at the inception of the *securitisation*, at the level of investment grade or better, it must be treated in the same way as an eligible credit assessment by an *eligible ECAI* for the purposes of calculating *risk weighted exposure amounts*.
- (4) The internal assessment methodology must be used in the *firms* internal risk management processes, including its decision making, management information and capital allocation processes.
- (5) The *firms* internal assessment methodology must include rating grades. There must be a correspondence between such rating grades and the credit assessments of *eligible ECAIs*. This correspondence must be explicitly documented.
- (6) The *firm* must be able to satisfy the *appropriate regulator* that its internal assessment of the credit quality of the position reflects the publicly available assessment methodology of one or more *eligible ECAIs*, for the *rating* of securities backed by the *exposures* of the type *securitised*.
- (7) If a *firm's IRB permission* permits this, a *firm* need not comply with the requirement for the assessment methodology of the *ECAI* to be publicly available where it can demonstrate that due to the specific features of the *securitisation* for example its unique structure - there is as yet no publicly available *ECAI* assessment methodology.
- (8) The *ECAIs*, the methodology of which must be reflected as required by (6), must include those *ECAIs* which have provided an external rating for the commercial paper issued from the programme. Quantitative elements such as stress factors used in assessing the position to a particular credit quality must be at least as conservative as those used in the relevant assessment methodology of the *ECAIs* in question.
- (9) In developing its internal assessment methodology the *firm* must take into consideration relevant published ratings methodologies

of the *eligible ECAIs* that rate the commercial paper of the *ABCP programme*. This consideration must be documented by the *firm* and updated regularly, as outlined in (15).

- (10) The *ABCP programme* must have collections policies and processes that take into account the operational capability and credit quality of the servicer. The programme must mitigate seller/servicer risk through various methods, such as triggers based on current credit quality that would preclude commingling of funds.
- (11) The *ABCP programme* must incorporate structural features for example wind down triggers - into the purchase of *exposures* in order to mitigate potential credit deterioration of the underlying portfolio.
- (12) The *ABCP programme* must incorporate underwriting standards in the form of credit and investment guidelines. In deciding on an asset purchase, the programme administrator must consider the type of asset being purchased, the type and monetary value of the *exposures* arising from the provision of liquidity facilities and *credit enhancements*, the loss distribution, and the legal and economic isolation of the transferred assets from the entity selling the assets. A credit analysis of the asset sellers risk profile must be performed and must include analysis of past and expected future financial performance, current market position, expected future competitiveness, leverage, cash flow, and interest coverage, and debt rating. In addition, a review of the sellers underwriting standards, servicing capabilities, and collection processes must be performed.
- (13) The *ABCP programme's* underwriting standards must establish minimum asset eligibility criteria that, in particular,
  - (a) exclude the purchase of assets that are significantly past due or defaulted;
  - (b) limit excess concentration to individual obligor or geographic area; and
  - (c) limit the tenor of the assets to be purchased.
- (14) The aggregated estimate of loss on an asset pool that the *ABCP programme* is considering purchasing must take into account all sources of potential risk, such as credit risk and *dilution risk*. If the seller-provided *credit enhancement* is sized based on only credit-related losses, then a separate reserve must be established for *dilution risk*, if *dilution risk* is material for the particular *exposure* pool. In addition, in sizing the required enhancement level, the programme must review several years of historical

information, including losses, delinquencies, dilutions, and the turnover rate of the receivables.

- (15) Internal or external auditors, an ECAI, or the firm's internal credit review or risk management function must perform regular reviews of the internal assessment process and the quality of the internal assessments of the credit quality of the firms exposures to an ABCP programme. If the firms internal audit, credit review, or risk management functions perform the review, then these functions must be independent of the ABCP programme business line, as well as the customer relationship.
- (16) The firm must track the performance of its internal ratings over time to evaluate the performance of its internal assessment methodology and must make adjustments, as necessary, to that methodology when the performance of the exposures routinely diverges from that indicated by the internal ratings.

[Note: BCD Annex IX Part 4 points 43 and 44]

**Supervisory formula method**

9.12.21

FCA PRA

R

Subject to any permission of the type described in ■ BIPRU 9.12.28 G, under the supervisory formula method, the risk weight for a securitisation position must be the risk weight to be applied in accordance with ■ BIPRU 9.12.22 R. However, the risk weight must be no less than 20% for resecuritisation positions and no less than 7% for all other securitisation positions.

[Note: BCD Annex IX Part 4 point 52]

9.12.22

FCA PRA

R

- (1) Subject to any permission of the type described in ■ BIPRU 9.12.28 G, the risk weight to be applied to the exposure amount must be:

$$12.5 (S[L+T] - S[L]) / T$$

- (2) The remaining provisions of this paragraph define the terms used in the formulae in (1) and (3).

$$(3) \quad S[x] = \begin{cases} x & \text{when } x \leq K_{IRBR} \\ K_{IRBR} + K[x] - K[K_{IRBR}] + (d \cdot K_{IRBR} t^w) (1 - e^{-(K_{max} x / K_{min})}) & \text{when } K_{IRBR} < x \end{cases}$$

$$(4) \quad h = (1 - K_{IRBR} / ELGD)^N$$

$$(5) \quad c = K_{IRBR} / (1 - h)$$

$$(6) \quad v = \frac{(ELGD - K_{IRBR})K_{IRBR} + 0.25(1 - ELGD)K_{IRBR}}{N}$$

$$(7) \quad f = \left( \frac{v + \frac{K_{IRBR}^2}{1-h} - c^2}{1-h} \right) + \frac{(1 - K_{IRBR})K_{IRBR} - v}{(1-h)\tau}$$

$$(8) \quad g = \frac{(1-c)c}{f} - 1$$

$$(9) \quad a = g \cdot c$$

$$(10) \quad b = g \cdot (1-c)$$

$$(11) \quad d = 1 - (1-h) \cdot (1 - \text{Beta}[K_{IRBR}; a, b])$$

$$(12) \quad K[x] = (1-h) \cdot ((1 - \text{Beta}[x; a, b])x + \text{Beta}[x; a+1, b]c)$$

$$(13) \quad \tau = 1000,$$

$$(14) \quad \omega = 20.$$

(15) In these expressions, *Beta* [*x*; *a*, *b*] refers to the cumulative beta distribution with parameters *a* and *b* evaluated at *x*.

(16) *T* (the thickness of the *tranche* in which the position is held) is measured as the ratio of (a) the nominal amount of the *tranche* to (b) the sum of the *exposure* values of the *exposures* that have been *securitised*. For these purposes the *exposure* value of a *financial derivative instrument* must, where the current replacement cost is not a positive value, be the potential future credit exposure calculated in accordance with ■ BIPRU 13 (Treatment of derivative instruments).

(17)  $K_{IRBR}$  is the ratio of (a)  $K_{IRB}$  to (b) the sum of the *exposure* values of the *exposures* that have been *securitised*.  $K_{IRBR}$  is expressed in decimal form (for example,  $K_{IRB}$  equal to 15% of the pool would be expressed as  $K_{IRBR}$  of 0.15).

(18) *L* (the *credit enhancement* level) is measured as the ratio of the nominal amount of all *tranches* subordinate to the *tranche* in which the position is held to the sum of the *exposure* values of the *exposures* that have been *securitised*. Capitalised future income must not be included in the measured *L*. Amounts due

by counterparties to *financial derivative instruments* that represent *tranches* more junior than the *tranche* in question may be measured at their current replacement cost (without the potential future credit exposures) in calculating the enhancement level.

(19) N is the effective number of exposures calculated in accordance with ■ BIPRU 9.12.17 R - ■ BIPRU 9.12.18 R. In the case of *resecuritisations*, the *firm* must look at the number of *securitisation exposures* in the pool and not the number of underlying *exposures* in original pools from which the underlying *securitisation exposures* stem.

(20) ELGD, the *exposure-weighted average loss-given-default*, is calculated as follows:

$$ELGD = \frac{\sum_i LGD_i \cdot EAD_i}{\sum_i EAD_i}$$

(21) In (20)  $LGD_i$  represents the average *LGD* associated with all *exposures* to the  $i^{th}$  obligor, where *LGD* is determined in accordance with ■ BIPRU 4. In the case of *resecuritisation*, an *LGD* of 100% must be applied to the *securitised* positions. When default risk and *dilution risk* for purchased receivables are treated in an aggregate manner within a *securitisation* (e.g. a single reserve or over-collateralisation is available to cover losses from either source), the *LGD* input must be constructed as a weighted average of the *LGD* for credit risk and the 75% *LGD* for *dilution risk*. The weights are the stand-alone capital charges for credit risk and *dilution risk* respectively.

[Note: BCD Annex IX Part 4 point 53 (part)]

**Simplified inputs**

9.12.23

R

FCA PRA

(1) Under the *supervisory formula method*, if the *exposure* value of the largest *securitised exposure*,  $C_1$ , is no more than 3% of the sum of the *exposure* values of the *securitised exposures*, then for the purposes of the *supervisory formula method* the *firm* may set *LGD* equal 50% and N equal to either:

(a) 
$$N = \left( C_1 C_m + \left( \frac{C_m - C_1}{m - 1} \right) \max\{1 - m C_1, 0\} \right)^{-1}$$

;or

(b)  $N = 1 / C_1$ .

(2)  $C_m$  is the ratio of the sum of the *exposure* values of the largest 'm' *exposures* to the sum of the *exposure* values of the *exposures securitised*. The level of m may be set by the *firm*.

- (3) For *securitisations* involving *retail exposures*, the *supervisory formula method* may be implemented using the simplifications:  $h = 0$  and  $v = 0$ .

[Note: BCD Annex IX Part 4 point 53 (part)]

9.12.24

FCA PRA

G

Where a *securitisation of retail exposures* has a sufficiently low value of  $N$  for the simplification in ■ BIPRU 9.12.23 R (3) to result in a material change in the capital charge as compared to the position if the approach in ■ BIPRU 9.12.23 R were not taken, a *firm* should discuss with the *appropriate regulator* the suitability of its use.

### Liquidity Facilities

9.12.25

FCA PRA

R

The provisions in ■ BIPRU 9.12.26 R to ■ BIPRU 9.12.28 G apply for the purposes of determining the *exposure* value of an *unrated securitisation position* in the form of certain types of *liquidity facility*.

[Note: BCD Annex IX Part 4 point 55]

### Liquidity facilities only available in the event of general market disruption

9.12.26

R

[deleted]

### Cash advance facilities

9.12.27

FCA PRA

R

A conversion figure of 0% may be applied to the nominal amount of a *liquidity facility* that meets the conditions set out in ■ BIPRU 9.11.12 R.

[Note: BCD Annex IX Part 4 point 57]

### Exceptional treatment for liquidity facilities where $K_{IRB}$ cannot be calculated

9.12.28

FCA PRA

G

- (1) When it is not practical for the *firm* to calculate the *risk weighted exposure amounts* for the *securitised exposures* as if they had not been *securitised* and the position does not qualify for the *ABCP internal assessment approach*, a *firm* may apply to the *appropriate regulator* for a variation of its *IRB permission* under which, on an exceptional basis, it may temporarily apply the method in (2) for the calculation of *risk weighted exposure amounts* for an *unrated securitisation position* in the form of a *liquidity facility* that meets the conditions to be a *liquidity facility* set out in ■ BIPRU 9.11.10 R.
- (2) Under the method in this paragraph, the highest *risk weight* that would be applied under the *standardised approach* to any of the *securitised exposures* had they not been *securitised* may be applied to the *securitisation position* represented by the *liquidity facility*. To determine the *exposure* value of the position a conversion figure of 50% may be applied to the nominal amount of the *liquidity facility* if the facility has an original maturity of one year or less. In other cases a conversion factor of 100% must be applied.

[Note: BCD Annex IX Part 4 points 58 and 59]

## 9.13 Securitisations of revolving exposures with early amortisation provisions

### 9.13.1

FCA PRA

R

Where there is a *securitisation of revolving exposures* subject to an *early amortisation provision*, the *originator* must calculate an additional *risk weighted exposure amount* in accordance with this section in respect of the risk that the levels of credit risk to which it is exposed may increase following the operation of the *early amortisation provision*. Accordingly this section sets out how an *originator* must calculate a *risk weighted exposure amount* when it sells *revolving exposures* into a *securitisation* that contains an *early amortisation provision*.

[Note: BCD Article 100(1), Annex IX Part 4 points 16 and 68]

### Additional capital requirements for securitisations of revolving exposures with early amortisation provisions

### 9.13.2

FCA PRA

R

A *firm* must calculate a *risk weighted exposure amount* in respect of the sum of the *originators* interest and the investors interest.

[Note: BCD Annex IX Part 4 point 17]

### 9.13.3

FCA PRA

R

For *securitisation* structures where the *securitised exposures* comprise *revolving exposures* and non-revolving *exposures*, an *originator* must apply the treatment set out in this section to that portion of the underlying pool containing *revolving exposures*.

[Note: BCD Annex IX Part 4 point 18]

### 9.13.4

FCA PRA

R

For the purposes of this section, subject to ■ BIPRU 9.13.6 R:

- (1) *originators* interest means the exposure value of that notional part of a pool of drawn amounts sold into a *securitisation*, the proportion of which in relation to the amount of the total pool sold into the structure determines the proportion of the cash-flows generated by principal and interest collections and other associated amounts which are not available to make payments to those having *securitisation positions* in the *securitisation*;
- (2) to qualify as such the *originators* interest may not be subordinate to the investors interest; and

- (3) investors interest means the exposure value of the remaining notional part of the pool of drawn amounts.

[Note: BCD Annex IX Part 4 point 19]

9.13.5

FCA PRA

R

Subject to ■ BIPRU 9.13.7 R, the *exposure* of the *originator* associated with its rights in respect of the *originators* interest must not be treated as a *securitisation position* but as a *pro rata exposure* to the *securitised exposures* as if they had not been *securitised*.

[Note: BCD Annex IX Part 4 point 20]

9.13.6

FCA PRA

R

- (1) For *firms* using the *IRB approach* set out in ■ BIPRU 4, this paragraph applies in place of ■ BIPRU 9.13.4 R.
- (2) For the purposes of this section, *originators* interest means the sum of:
- (a) the exposure value of that notional part of a pool of drawn amounts sold into a *securitisation*, the proportion of which in relation to the amount of the total pool sold into the structure determines the proportion of the cash-flows generated by principal and interest collections and other associated amounts which are not available to make payments to those having *securitisation positions* in the *securitisation*; and
  - (b) the exposure value of that part of the pool of undrawn amounts of the credit lines, the drawn amounts of which have been sold into the *securitisation*, the proportion of which to the total amount of such undrawn amounts is the same as the proportion of the exposure value described in (a) to the exposure value of the pool of drawn amounts sold into the *securitisation*.
- (3) To qualify as such the *originators* interest may not be subordinate to the investors interest.
- (4) Investors interest means the exposure value of the notional part of the pool of drawn amounts not falling within (2)(a) plus the exposure value of that part of the pool of undrawn amounts of credit lines, the drawn amounts of which have been sold into the *securitisation*, not falling within (2)(b).

[Note: BCD Annex IX Part 4 points 69 and 70]

9.13.7

FCA PRA

R

For *firms* using the *IRB approach* set out in ■ BIPRU 4, this paragraph applies in place of ■ BIPRU 9.13.5 R. The *exposure* of the *originator* associated with its rights in respect of that part of the *originators* interest described in ■ BIPRU 9.13.6 R (2)(a) must not be treated as a *securitisation*

*position* but as a pro rata *exposure* to the *securitised* drawn amounts as if they had not been *securitised* in an amount equal to that described in ■ BIPRU 9.13.6 R (2)(a). The *originator* must also be considered to have a pro rata exposure to the undrawn amounts of the credit lines, the drawn amounts of which have been sold into the *securitisation*, in an amount equal to that described in ■ BIPRU 9.13.6 R (2)(b).

[Note: BCD Annex IX Part 4 point 71]

#### Exemptions from early amortisation treatment

9.13.8

FCA PRA

R

*Originators* of the following types of *securitisation* are exempt from the capital requirement in ■ BIPRU 9.13.1 R:

- (1) *securitisations* of *revolving exposures* whereby investors remain fully exposed to all future draws by borrowers so that the risk on the underlying facilities does not return to the *originator* even after an early amortisation event has occurred; and
- (2) *securitisations* where any *early amortisation provision* is solely triggered by events not related to the performance of the *securitised* assets or the *originator*, such as material changes in tax laws or regulations.

[Note: BCD Annex IX Part 4 point 21]

#### Maximum capital requirement

9.13.9

FCA PRA

R

For an *originator* subject to the capital requirement in ■ BIPRU 9.13.1 R the total of the *risk weighted exposure amounts* in respect of its positions in the investors interest (as defined in ■ BIPRU 9.13.4 R or ■ BIPRU 9.13.6 R) and the *risk weighted exposure amounts* calculated under ■ BIPRU 9.13.1 R must be no greater than the greater of:

- (1) the *risk weighted exposure amounts* calculated in respect of its positions in the investors interest (as so defined); and
- (2) the *risk weighted exposure amounts* that would be calculated in respect of the *securitised exposures* by a *firm* holding the *exposures* as if they had not been *securitised* in an amount equal to the investors interest (as so defined).

[Note: BCD Annex IX Part 4 point 22]

9.13.10

FCA PRA

R

Deduction of net gains, if any, arising from the capitalisation of future income required under ■ GENPRU 2.2.90 R (Core tier one capital: profit and loss account and other reserves: Securitisation) must be treated outside the maximum amount indicated in ■ BIPRU 9.13.9 R.

[Note: BCD Annex IX Part 4 point 23]

9.13.11

FCA PRA

R

**Calculation of risk-weighted exposure amounts**

The *risk weighted exposure amount* to be calculated in accordance with ■ BIPRU 9.13.1 R must be determined by multiplying the amount of the investors interest (as defined in ■ BIPRU 9.13.4 R or ■ BIPRU 9.13.6 R) by the product of:

- (1) the appropriate conversion figure as indicated in ■ BIPRU 9.13.16 R, ■ BIPRU 9.13.19 R or ■ BIPRU 9.13.20 R; and
- (2) the weighted average *risk weight* that would apply to the *securitised exposures* if the *exposures* had not been *securitised*.

[Note: BCD Annex IX Part 4 point 24]

9.13.12

FCA PRA

R

An *early amortisation provision* must be treated as controlled for the purposes of this section where the following conditions are met:

- (1) the *originator* has an appropriate capital/liquidity plan in place to ensure that it has sufficient capital and liquidity available in the event of an early amortisation;
- (2) throughout the duration of the transaction there is a pro rata sharing between the *originators* interest and the investors interest (as defined in ■ BIPRU 9.13.4 R or ■ BIPRU 9.13.6 R) of payments of interest and principal, expenses, losses and recoveries based on the balance of receivables outstanding at one or more reference points during each month;
- (3) the amortisation period is considered sufficient for 90% of the total debt (*originators* and investors interest (as defined in ■ BIPRU 9.13.4 R or ■ BIPRU 9.13.6 R)) outstanding at the beginning of the early amortisation period to have been repaid or recognised as in default; and
- (4) the speed of repayment is no more rapid than would be achieved by straight-line amortisation over the period set out in (3).

[Note: BCD Annex IX Part 4 point 25]

9.13.13

FCA PRA

R

In the case of a *securitisation* meeting the following conditions:

- (1) it is subject to an *early amortisation provision*;
- (2) the *securitisation* is of *retail exposures* which are uncommitted and unconditionally cancellable without prior notice; and
- (3) the early amortisation is triggered by the *excess spread* level falling to a specified level

a *firm* must, to calculate the appropriate conversion figure referred to in ■ BIPRU 9.13.11 R, compare the three-month average *excess spread* level with the *excess spread* levels at which *excess spread* is required to be trapped.

[Note: BCD Annex IX Part 4 point 26]

9.13.14

FCA PRA

R

Where the *securitisation* does not require *excess spread* to be trapped, the trapping point is deemed to be 4.5 percentage points greater than the *excess spread* level at which an early amortisation is triggered.

[Note: BCD Annex IX Part 4 point 27]

9.13.15

FCA PRA

R

The conversion figure to be applied must be determined by the level of the actual three month average *excess spread* in accordance with ■ BIPRU 9.13.16 R.

[Note: BCD Annex IX Part 4 point 28]

9.13.16

FCA PRA

R

Table: Conversion figures

This table belongs to ■ BIPRU 9.13.15 R

	Securitisations subject to a controlled early amortisation provision	Securitisation subject to a non-controlled early amortisation provision
3 months average <i>excess spread</i>	Conversion figure	Conversion figure
Above level A	0%	0%
Level A	1%	5%
Level B	2%	15%
Level C	10%	50%
Level D	20%	100%
Level E	40%	100%

9.13.17

FCA PRA

R

In ■ BIPRU 9.13.16 R:

- (1) Level A means levels of *excess spread* less than 133.33% of the trapping level of *excess spread* but not less than 100% of that trapping level;
- (2) Level B means levels of *excess spread* less than 100% of the trapping level of *excess spread* but not less than 75% of that trapping level;

- (3) Level C means levels of *excess spread* less than 75% of the trapping level of *excess spread* but not less than 50% of that trapping level;
- (4) Level D means levels of *excess spread* less than 50% of the trapping level of *excess spread* but not less than 25% of that trapping level; and
- (5) Level E means levels of *excess spread* less than 25% of the trapping level of *excess spread*.

[Note: BCD Annex IX Part 4 point 29]

9.13.18

FCA PRA

G

In the case of a *securitisation* meeting the conditions in this paragraph, a *firm* may apply to the *appropriate regulator* for a *waiver* that would allow a treatment which approximates closely to that prescribed in ■ BIPRU 9.13.13 R to ■ BIPRU 9.13.17 R for determining the conversion figure indicated. If a *firm* wants such a *waiver*, it should satisfy the *appropriate regulator* that:

- (1) the *securitisation* is subject to an *early amortisation provision* of retail *exposures*;
- (2) those retail *exposures* are uncommitted and unconditionally cancellable without prior notice;
- (3) the *early amortisation* is triggered by a quantitative value in respect of something other than the three month average *excess spread*;
- (4) the *firm* can establish a quantitative measure equivalent, in relation to the value in (3), to the trapping level of *excess spread*; and
- (5) that treatment is a prudent measure of the risk that the levels of credit risk to which it is exposed may increase following the operation of the *early amortisation provision* (referred to in BIPRU 9.13.1R).

[Note: BCD Annex IX Part 4 point 30]

9.13.19

FCA PRA

R

All other *securitisations* subject to a controlled *early amortisation provision of revolving exposures* are subject to a credit conversion figure of 90%.

[Note: BCD Annex IX Part 4 point 32]

9.13.20

FCA PRA

R

All other *securitisations* subject to a non-controlled *early amortisation provision of revolving exposures* are subject to a credit conversion figure of 100%.

[Note: BCD Annex IX Part 4 point 33]

9.13.21

FCA PRA

R

**Liquidity plans**

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: BCD Annex V point 9]

9



## 9.14 Recognition of credit risk mitigation on securitisation positions under the IRB approach

9.14.1

FCA PRA

R

This section applies to *credit risk mitigation* in relation to a *securitisation position* for a *firm* calculating *risk weighted exposure amounts* using the *IRB approach*.

[Note: BCD Annex IX Part 4 point 37 (part)]

9.14.2

FCA PRA

R

Where a *firm* uses the *ratings based method* to calculate the *risk weighted exposure amounts* of *securitisation positions*, the *firm* may recognise *credit risk mitigation* in accordance with ■ BIPRU 9.14.4 R to ■ BIPRU 9.14.6 R.

[Note: BCD Annex IX Part 4 point 51]

9.14.3

FCA PRA

R

Where a *firm* uses the *supervisory formula method* to calculate the *risk weighted exposure amounts* of *securitisation positions*, the *firm* may recognise *credit risk mitigation* in accordance with ■ BIPRU 9.14.4 R to ■ BIPRU 9.14.5 R and ■ BIPRU 9.14.7 R to ■ BIPRU 9.14.13 R.

[Note: BCD Annex IX Part 4 point 54]

### Funded protection

9.14.4

FCA PRA

R

Eligible funded protection is limited to that which is eligible for the calculation of *risk weighted exposure amounts* under the *standardised approach* as laid down under ■ BIPRU 5 and recognition is subject to compliance with the relevant minimum requirements as laid down under ■ BIPRU 5.

[Note: BCD Annex IX Part 4 point 60]

### Unfunded credit protection

9.14.5

FCA PRA

R

Eligible unfunded credit protection and unfunded protection providers are limited to those which are eligible under ■ BIPRU 5 (Credit risk mitigation) and ■ BIPRU 4.10 (Credit risk mitigation under the IRB approach) and recognition is subject to compliance with the relevant minimum requirements laid down under those provisions.

[Note: BCD Annex IX Part 4 point 61]

#### Credit risk mitigation under the ratings based method

9.14.6

FCA PRA

R

Where *risk weighted exposure amounts* are calculated using the *ratings based method*, the *exposure* value and/or the *risk weighted exposure amount* for a *securitisation position* in respect of which credit protection has been obtained may be modified in accordance with the provisions of ■ BIPRU 5 (Credit risk mitigation) as they apply for the calculation of *risk weighted exposure amounts* under the *standardised approach* set out in ■ BIPRU 3.

[Note: BCD Annex IX Part 4 point 62]

#### Credit risk mitigation under the supervisory formula method full credit protection

9.14.7

FCA PRA

R

■ BIPRU 9.14.8 R ■ BIPRU 9.14.10 R apply where *risk weighted exposure amounts* are calculated using the *supervisory formula method* where there is full credit protection.

[Note: BCD Annex IX Part 4 point 63 (part)]

9.14.8

FCA PRA

R

A *firm* must determine the effective *risk weight* of the position. It must do this by dividing the *risk weighted exposure amount* of the position by the *exposure* value of the position and multiplying the result by 100.

[Note: BCD Annex IX Part 4 point 63 (part)]

9.14.9

FCA PRA

R

In the case of funded credit protection, the *risk weighted exposure amount* of the *securitisation position* must be calculated by multiplying the funded protection-adjusted *exposure* amount of the position ( $E^*$ , as calculated under ■ BIPRU 5.4.28 R (3), taking the amount of the *securitisation position* to be  $E$ ) by the effective *risk weight*.

[Note: BCD Annex IX Part 4 point 64]

9.14.10

FCA PRA

R

In the case of unfunded credit protection, the *risk weighted exposure amount* of the *securitisation position* must be calculated by multiplying  $G_A$  (the amount of the protection adjusted for any currency mismatch and maturity mismatch in accordance ■ BIPRU 5.7.23 R (2)) by the *risk weight* of the protection provider; and adding this to the amount arrived at by multiplying the amount of the *securitisation position* minus  $G_A$  by the effective *risk weight*.

[Note: BCD Annex IX Part 4 point 65]

**Credit risk mitigation under the supervisory formula method partial protection**

9.14.11

FCA PRA

R

■ BIPRU 9.14.12 R ■ BIPRU 9.14.13 R apply where *risk weighted exposure amounts* are calculated using the *supervisory formula method* where there is partial protection.

9.14.12

FCA PRA

R

If the *credit risk mitigation* covers the first loss or losses on a proportional basis on the *securitisation position*, a *firm* may apply ■ BIPRU 9.14.7 R to ■ BIPRU 9.14.10 R.

[Note: BCD Annex IX Part 4 point 66]

9.14.13

FCA PRA

R

In other cases the *firm* must treat the *securitisation position* as two or more positions with the uncovered portion being the position with the lower credit quality. For the purposes of calculating the *risk weighted exposure amount* for this position, the provisions in ■ BIPRU 9.12.22 R to ■ BIPRU 9.12.24 G apply subject to the modifications that T is adjusted to  $e^*$  in the case of funded credit protection; and to  $T-g$  in the case of unfunded credit protection, where  $e^*$  denotes the ratio of  $E^*$  to the total notional amount of the underlying pool, where  $E^*$  is the adjusted *exposure amount* of the *securitisation position* calculated in accordance with ■ BIPRU 5.4.28 R (3) taking the amount of the *securitisation position* to be E; and g is the ratio of the nominal amount of credit protection (adjusted for any currency or maturity mismatch in accordance with the provisions of ■ BIPRU 5 (Credit risk mitigation)) to the sum of the *exposure amounts* of the *securitised exposures*. In the case of unfunded credit protection the *risk weight* of the protection provider must be applied to that portion of the position not falling within the adjusted value of T.

[Note: BCD Annex IX Part 4 point 67]

## 9.15 Requirements for investors

### Application

9.15.1

PRA

R

Subject to ■ BIPRU 9.15.1A R, ■ BIPRU 9.15 applies to:

- (1) new *securitisations* issued on or after 1 January 2011; and
- (2) from 31 December 2014, to existing *securitisations* where new underlying *exposures* are added or substituted after that date.

[Note: BCD, Article 122a, paragraph 8]

9.15.1A

PRA

R

■ BIPRU 9.15.16A R and ■ BIPRU 9.15.16B R only apply to:

- (1) new *securitisations* issued on or after 31 December 2011; and
- (2) from 31 December 2014, to existing *securitisations* where new underlying *exposures* are added or substituted after that date.

9.15.1B

PRA

G

A *credit institution* should have regard to the Committee of European Banking Supervisors Guidelines to Article 122a of the *Banking Consolidation Directive* when considering its obligations under ■ BIPRU 9.3.15 R to ■ BIPRU 9.3.20 R and ■ BIPRU 9.15. The Guidelines can be found at <http://www.eba.europa.eu/Publications/Standards-Guidelines.aspx>.

### Purpose

9.15.2

PRA

G

The purpose of ■ BIPRU 9.15 is to implement Article 122a of the *Banking Consolidation Directive*, with the exception of those parts of Article 122a that are implemented through the *rules* in ■ BIPRU 9.3.

### Exposures to transferred credit risk

9.15.3

PRA

R

Subject to ■ BIPRU 9.15.9 R and ■ BIPRU 9.15.10R, a *credit institution*, other than when acting as an *originator*, a *sponsor* or original lender, will be exposed to the credit risk of a *securitisation position* in its *trading book* or *non-trading book* only if the *originator*, *sponsor* or original lender has explicitly disclosed to the *credit institution* that it will retain, on an *ongoing basis*, a material net economic interest which, in any event, must not be less than 5%.

[Note: *BCD*, Article 122a, paragraphs 1 and 3]

### Retention of net economic interest

9.15.4

PRA

R

Retention of net economic interest means any of the following:

- (1) retention of no less than 5% of the nominal value of each of the *tranches* sold or transferred to the investors;
- (2) in the case of *securitisations of revolving exposures*, retention of the *originator's* interest of no less than 5% of the nominal value of the *securitised exposures*;
- (3) retention of randomly selected *exposures*, equivalent to no less than 5% of the nominal amount of the *securitised exposures*, where those *exposures* would otherwise have been *securitised* in the *securitisation* provided that the number of potentially *securitised exposures* is no less than 100 at origination;
- (4) retention of the first loss *tranche* and, if necessary, other *tranches* having the same or a more severe risk profile than those transferred or sold to investors and not maturing any earlier than those transferred or sold to investors, so that the retention equals in total no less than 5% of the nominal value of the *securitised exposures*.

[Note: *BCD*, Article 122a, paragraph 1]

9.15.5

PRA

R

Net economic interest is measured at the origination and must be maintained on an *ongoing basis*. It must not be subject to any *credit risk mitigation* or any short positions or any hedge. The net economic interest must be determined by the notional value for off-balance sheet items.

[Note: *BCD*, Article 122a, paragraph 1]

9.15.6

PRA

R

Multiple applications of the retention of net economic interest requirements for any given *securitisation* are not required.

[Note: *BCD*, Article 122a, paragraph 1]

9.15.7

PRA

R

Subject to ■ BIPRU 9.15.8R, where an *EEA* parent credit institution or an *EEA* financial holding company, or one of its *subsidiaries*, as an *originator* or a *sponsor*, *securitises exposures* from several *credit institutions, investment firms* or other *institutions* which are included within the scope of supervision on a consolidated basis, the requirement to retain a net economic interest referred to in ■ BIPRU 9.15.3R may be satisfied on the basis of the consolidated situation of the related *EEA* parent credit institution or *EEA* financial holding company.

[Note: *BCD*, Article 122a, paragraph 2]

9.15.8

PRA

R

■ BIPRU 9.15.7R only applies where the *credit institutions, investment firms* or *institutions* which created the *securitised exposures* have committed themselves to adhere to the requirements in ■ BIPRU 9.3.15R to ■ BIPRU 9.3.17R and deliver, in a timely manner, to the *originator* or *sponsor* and to the *EEA* parent credit institution or an *EEA* financial holding company the information needed to satisfy ■ BIPRU 9.3.18R to ■ BIPRU 9.3.20R.

[Note: *BCD*, Article 122a, paragraph 2]

9.15.9

PRA

R

■ BIPRU 9.15.3R does not apply where the *securitised exposures* are claims or contingent claims on, or fully, unconditionally and irrevocably guaranteed by:

- (1) central governments or *central banks*;
- (2) regional governments, local authorities and public sector entities of *EEA States*;
- (3) *institutions* to which a 50% *risk weight* or less is assigned under ■ BIPRU 3.4.31 R to ■ BIPRU 3.4.46 R; or
- (4) *multilateral development banks*.

[Note: *BCD*, Article 122a, paragraph 3]

9.15.10

PRA

R

The requirements in ■ BIPRU 9.15.3R do not apply with respect to the following:

- (1) transactions based on a clear, transparent and accessible index, where the underlying reference entities are identical to those that make up an index of entities that is widely traded, or are other tradable securities other than *securitisation positions*; or
- (2) syndicated loans, purchased receivables or credit default swaps where these instruments are not used to package and/or hedge a *securitisation* that is within the scope of ■ BIPRU 9.15.3 R.

[Note: *BCD*, Article 122a, paragraph 3]

#### Investor due diligence

9.15.11

PRA

R

Before investing, and as appropriate thereafter, a *credit institution* must be able to demonstrate to the *PRA* for each of its individual *securitisation positions*, that it has a comprehensive and thorough understanding of, and has implemented, formal policies and procedures appropriate to its *trading* and *non-trading book* and commensurate with the risk profile of its investments in *securitised positions* for analysing and recording:

- (1) information disclosed under ■ BIPRU 9.15.3R, by *originators* or *sponsors* to specify the net economic interest that they maintain, on an *ongoing basis*, in the *securitisation*;
- (2) the risk characteristics of the individual *securitisation position*;
- (3) the risk characteristics of the *exposures* underlying the *securitisation position*;
- (4) the reputation and loss experience in earlier *securitisations* of the *originators* or *sponsors* in the relevant *exposure* classes underlying the *securitisation position*;
- (5) the statements and disclosures made by the *originators* or *sponsors*, or their agents or advisors, about their due diligence on the *securitised exposures* and, where applicable, on the quality of the collateral supporting the *securitised exposures*;
- (6) where applicable, the methodologies and concepts on which the valuation of collateral supporting the *securitised exposures* is based and the policies adopted by the *originator* or *sponsor* to ensure the independence of the valuer; and
- (7) all the structural features of the *securitisation* that can materially impact the performance of the *credit institution's securitisation position*.

[Note: BCD, Article 122a, paragraph 4]

9.15.12

PRA

R

A *credit institution* must regularly perform its own stress tests appropriate to its *securitisation positions*.

[Note: BCD, Article 122a, paragraph 4]

9.15.13

PRA

R

For the purposes of ■ BIPRU 9.15.12R, a *credit institution* may rely on financial models developed by an *ECAI* provided that the *credit institution* can demonstrate, when requested by the *PRA*, that they took due care prior to investing to validate the relevant assumptions in and structuring of the models and to understand methodology, assumptions and results.

[Note: BCD, Article 122a, paragraph 4]

9.15.14

PRA

R

#### Monitoring requirements

A *credit institution*, other than when acting as *originator* or *sponsor* or original lender, must establish formal procedures appropriate to its *trading* and *non-trading book*, and commensurate with the risk profile of its investments in *securitised positions*, to monitor, on an *ongoing basis* and in a timely manner, performance information on the *exposures* underlying its *securitisation positions*.

[Note: BCD, Article 122a, paragraph 5]

9.15.15

PRA

R

- (1) Where relevant, the information required to be monitored under ■ BIPRU 9.15.14R must include:
- (a) the *exposure* type;
  - (b) the percentage of loans more than 30, 60 and 90 days past due, default rates, prepayment rates, loans in foreclosure;
  - (c) collateral type and occupancy;
  - (d) frequency distribution of credit scores or other measures of credit worthiness across underlying exposures;
  - (e) industry and geographical diversification; and
  - (f) frequency distribution of loan to value ratios with band widths that facilitate adequate sensitivity analysis.
- (2) Where underlying exposures are themselves *securitisation positions*, a *credit institution* must have the information set out in paragraph (1) not only on the underlying *securitisation tranches*, such as the issuer name and credit quality, but also on the characteristics and performance of the pools underlying those *securitisation tranches*.

[Note: BCD, Article 122a, paragraph 5]

9.15.16

PRA

R

A *credit institution* must have a thorough understanding of all structural features of a *securitisation transaction* that would materially impact the performance of its *exposures* to the *transaction*, such as the contractual waterfall and waterfall related triggers, credit enhancements, *liquidity* enhancements, market value triggers and deal-specific definition of default.

[Note: BCD, Article 122a, paragraph 5]

#### Group level requirements

9.15.16A

PRA

R

Subject to ■ BIPRU 9.15.16B R, a *credit institution* must ensure that any *undertaking* in relation to which the *credit institution* is a *parent undertaking*:

- (1) becomes exposed to the credit risk of a *securitisation* only where the *originator*, *sponsor* or original lender in the *securitisation* has explicitly disclosed to the *undertaking* that it will retain, on an *ongoing basis*, a material net economic interest which, in any event, must not be less than 5%, as set out in ■ BIPRU 9.15.3 R to ■ BIPRU 9.15.10 R;
- (2) complies before investing in a *securitisation*, and continues to comply thereafter, with the investor due diligence requirements set out in ■ BIPRU 9.15.11 R to ■ BIPRU 9.15.13 R; and

- (3) complies in relation to its investments in *securitisations* with the monitoring requirements set out in ■ BIPRU 9.15.14 R to ■ BIPRU 9.15.16 R.

9.15.16B **R** The requirements in ■ BIPRU 9.15.16A R do not apply in respect of subsidiaries of a *credit institution* which are *insurance undertakings*, *reinsurance undertakings* or *UCITS management companies*.  
PRA

9.15.16C **G** The purpose of ■ BIPRU 9.15.16A R is to ensure that a *credit institution* meets the requirements in ■ BIPRU 9.15 at *group* level in relation to its *subsidiary undertakings*. In order to comply with this *rule*, a *credit institution* should be able to demonstrate to the PRA that it has put in place adequate *group* policies and procedures which its *subsidiary undertakings* must follow in order to materially meet the requirements for investors set out in ■ BIPRU 9.15, and that it regularly monitors compliance with those policies.  
PRA

9.15.16D **G** Where a *credit institution* applies to the PRA for a *waiver* of ■ BIPRU 9.15.16A R in relation to its non-EEA *subsidiary undertakings*, the PRA may have regard in its assessment of the waiver tests under section 138A of the *Act* as to whether those *undertakings* are themselves subject to requirements in their jurisdiction similar to those set out in ■ BIPRU 9.15 and the extent to which complying with such requirements and ■ BIPRU 9.15.16A R would be unduly burdensome, including circumstances where it could create a substantial conflict for the *credit institution*.  
PRA

9.15.16E **G** Without prejudice to ■ BIPRU 9.15.16A R, when assessing group risk in accordance with ■ GENPRU 1.2.30 R a *credit institution* should have regard to the potential risks arising from *securitisation* investment activities carried out by other *undertakings* within its *group*, such as *affiliated companies* and *undertakings* in which the *credit institution* has a participating interest. Where these *undertakings* are not subject to similar requirements as those set out in ■ BIPRU 9.15, the PRA may seek to address the potential risks arising from this situation for example by imposing a specific capital add-on in the *credit institution's* ICG.  
PRA

### Consequences of failure to meet requirements

9.15.17 **G** (1) Subject to ■ BIPRU 9.3.22 G, ■ BIPRU 9.15.9 R to ■ BIPRU 9.15.10 R and ■ BIPRU 9.15.18 G, where a *credit institution* fails to meet any of the requirements in ■ BIPRU 9.3.18 R to ■ BIPRU 9.3.20 R (disclosure requirements), and ■ BIPRU 9.15.11 R to ■ BIPRU 9.15.16 R (investor due diligence requirements) in any material respect by reason of its negligence or omission, the PRA will use its powers under section 55J (Variation etc on the Authority's own initiative) of the *Act* to impose an additional *risk weight* of no less than 250% (capped at 1250%) of the risk weight that would otherwise apply to the relevant *securitisation positions* under ■ BIPRU 9.11 to ■ BIPRU 9.14. The additional *risk weight* imposed will be progressively increased with each relevant, subsequent infringement of the requirements in ■ BIPRU 9.3.18 R to ■ BIPRU 9.3.20 R and ■ BIPRU 9.15.11 R to ■ BIPRU 9.15.16 R.  
PRA

[Note: BCD, Article 122a, paragraph 5]

- (2) Subject to ■ BIPRU 9.3.22 G, ■ BIPRU 9.15.9 R to ■ BIPRU 9.15.10 R and ■ BIPRU 9.15.18 G, where a *credit institution* fails to meet in any material respect the requirements in ■ BIPRU 9.15.16A R (Group level requirements), the *PRA* may consider using its powers under section 55J (Variation etc on the Authority's own initiative) of the *Act* in the manner described in (1). In order to calculate the *risk weights* that would apply to the *credit institution*, the *PRA* may treat the *securitisation* investments of the *subsidiary undertaking* as if they were *securitisation positions* held directly by the *credit institution*.

9.15.18

PRA

G

When calculating the additional *risk weight* it will impose, the *PRA* will take into account the exemption of certain *securitisations* from the scope of ■ BIPRU 9.15.3R under ■ BIPRU 9.15.9R and ■ BIPRU 9.15.10R and, if those exemptions are relevant, reduce the *risk weight* it would otherwise impose.

[Note: *BCD*, Article 122a, paragraph 5]



# Chapter 10

## Large exposures requirements



## 10.1 Application and Purpose

### Application

10.1.1

**R**

**FCA PRA**

(1) This chapter applies to a *BIPRU firm* unless it is:

- (a) a *BIPRU limited licence firm*; or
- (b) a *BIPRU limited activity firm*

(2) It applies irrespective of whether the *firm* adopts the *standardised approach* or the *IRB approach*. If it adopts the *IRB approach*, it applies irrespective of whether the *firm* adopts the *foundation IRB approach* or the *advanced IRB approach*.

[Note: *BCD Article 111(1) (part)* and *CAD Article 28(1)*]

### Purpose

10.1.2

**G**

**FCA PRA**

This chapter sets out *rules and guidance* for *large exposures* and the *concentration risk capital component* (the *CNCOM*), implementing the *large exposures* requirements of articles 66(3) (in part) and 106 to 117 and paragraph 7 of Annex V of the *Banking Consolidation Directive* and articles 28 to 32 and Annex VI of the *Capital Adequacy Directive*.

10.1.3

**G**

**FCA PRA**

A *large exposure* may be in the form of a loan to a single borrower, or it may arise across many transactions involving different types of financial instruments with several *counterparties* within the same group of companies. Where a *firm's exposure* to its *counterparty* is large, it risks a large loss should the *counterparty* default. Such a loss may be sufficient on its own to threaten the solvency of the *firm*.

10.1.4

**G**

**FCA PRA**

The purpose of this chapter is to ensure that a *firm* manages its *exposure* to *counterparties* within appropriate limits set in relation to its *capital resources*.

10.1.5

**R**

[deleted]



## 10.2 Identification of exposures and recognition of credit risk mitigation

### 10.2.1

FCA PRA

**R**

Unless ■ BIPRU 10.2.2 R applies, an exposure is:

- (1) any of the items included in ■ BIPRU 3.2.9 R (Exposure classes for the purposes of the *standardised approach*) or the table in ■ BIPRU 3.7.2 R (Classification of off-balance-sheet items for the purposes of the *standardised approach*), whether held in the *trading book* or the *non-trading book*, without application of the *risk weight* or degrees of risk there provided for;

[Note: BCD Article 106(1) first paragraph]

- (2) any *exposure* arising from *financial derivative instruments*;

[Note: BCD Article 106(1) second paragraph (part)]

- (3) any *exposure* to an individual *counterparty* that arises in the *trading book* calculated by summing the following items:
  - (a) the excess - where positive - of the *firm's* long *positions* over its short *positions* in all the *CRD financial instruments* issued by the *counterparty* in question, the net position of each of the different *CRD financial instruments* being calculated in accordance with the relevant method in ■ BIPRU 7;
  - (b) the *firm's* net *underwriting exposure* to that *counterparty*; and
  - (c) any *exposure* due to the transactions, agreements and contracts referred to in ■ BIPRU 14.2.2 R (List of *trading book exposures* that give rise to a *counterparty credit risk* charge).

[Note: CAD Article 29(1) first paragraph]

### 10.2.2

FCA PRA

**R**

An *exposure* does not include:

- (1) an *exposure* which is entirely deducted from a *firm's* *capital resources*; or

- (2) in the case of *foreign currency* transactions, *exposures* incurred in the ordinary course of settlement during the two *business days* following payment; or
- (3) in the case of transactions for the purchase or sale of *securities*, *exposures* incurred in the ordinary course of settlement during the five *business days* following payment or delivery of the *securities*, whichever is earlier ; or
- (4) in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking or financial instruments clearing, settlement and custody services to clients, delayed receipts in funding and other *exposures* arising from client activity which do not last longer than the following *business day*; or
- (5) in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking, *intra-day exposures* to *institutions* providing those services.

[Note: BCD Articles 106(1) third paragraph and 106(2)]

**10.2.2A** G  
FCA PRA

The Committee of European Banking Supervisors (CEBS) has issued guidelines on the conditions applicable to the short-term *exposures* referred to in ■ BIPRU 10.2.2 R (4) and ■ (5) in order to be exempted from the *large exposures* limits in ■ BIPRU 10.5 (Limits on exposures). These guidelines can be found at: [http://www.c-eps.org/Publications/Standards-Guidelines/CEBS-Guidelines-on-Article-106\(2\)-\(c\)-and-\(d\)-of-D.aspx](http://www.c-eps.org/Publications/Standards-Guidelines/CEBS-Guidelines-on-Article-106(2)-(c)-and-(d)-of-D.aspx).

**10.2.3** G

[deleted]

**10.2.3A** G  
FCA PRA

- (1) An *exposure* does not include *exposures* outstanding with a *central counterparty* to which a *firm* has attributed an *exposure* value of zero for CCR in accordance with ■ BIPRU 13.3.13 R (Exposures to a central counterparty).
- (2) ■ BIPRU 13.3.13 R applies to derivative contracts and *long settlement transactions*, or to other *exposures* arising in respect of those contracts or transactions (but excluding an *exposure* arising from collateral held to mitigate losses in the event of default of other participants in the *central counterparty's* arrangements).

**10.2.4** G

[deleted]

**Calculation of exposures**

**10.2.5** FCA PRA R Subject to ■ BIPRU 10.2.6 R and ■ BIPRU 10.2.7 R, the value of a *firm's exposures*, whether in its *non-trading book* or its *trading book*, is the amount at risk calculated in line with ■ GENPRU 1.3 (Valuation).

**10.2.6** FCA PRA R A *firm* must calculate the value of its *exposures* in its *trading book* in the manner laid down in ■ BIPRU 14 (Capital requirements for settlement and counterparty risk) for the calculation of *exposure* values. For these purposes the reference in ■ BIPRU 14.2.11 R (How to calculate exposure values and risk weighted exposure amounts for the purpose of calculating the counterparty risk capital component) to the provisions of the *IRB approach* does not apply.

[Note: CAD Article 29(1)(c) (part) and fourth paragraph]

**10.2.7** FCA PRA R *Exposures* arising from *financial derivative instruments* must be calculated in accordance with one of the methods set out in ■ BIPRU 13 (Financial derivatives, SFTs and long settlement transactions). For the purposes of this chapter, ■ BIPRU 13.6.6 R (Scope of CCR internal model method) also applies.

[Note: BCD Article 106(1) second paragraph]

**10.2.8** FCA PRA R A *firm* must not offset *exposures* in the *non-trading book* and *trading book* for the purpose of calculating *exposures* except to the extent permitted under the *standardised approach* or, if applicable, the *IRB approach*.

**Recognition of credit risk mitigation**

**10.2.9** FCA PRA R Subject to this section, *funded credit protection* or *unfunded credit protection* that complies with the eligibility requirements and other minimum requirements set out in ■ BIPRU 5 (Credit risk mitigation) and, if relevant, ■ BIPRU 4.10 (The IRB approach: Credit risk mitigation) is permitted to be recognised for the purposes of calculating a *firm's exposure*. A *firm* utilising the methods below must still report to the *appropriate regulator* the gross value of its *exposures*.

[Note: BCD Articles 111(1) first paragraph (part) and 112(2)]

**10.2.10** FCA PRA R For the purposes of this section, the use of own estimates for *LGDs* and *conversion factors* under the *IRB approach* for an *IRB exposure class* is referred to as the full IRB approach.

**The financial collateral simple method under the standardised approach**

**10.2.11** FCA PRA G As indicated in ■ BIPRU 5.4.15 R (The financial collateral simple method), the *financial collateral simple method* is available only to *firms* using the *standardised approach* and only in relation to *exposures* for which they adopt the *standardised approach*.

10.2.12  
FCA PRA

**R**

A *firm* may only recognise collateral for the purpose of ■ BIPRU 10.2.9R (Recognition of credit risk mitigation) if the collateral complies with the eligibility requirements and other minimum requirements set out in ■ BIPRU 5 (Credit risk mitigation) for the purposes of calculating the *risk weighted exposure amounts* under the *standardised approach* using the *financial collateral simple method* or, if applicable, the method in ■ BIPRU 5.5 (Other funded credit risk mitigation). In particular a *firm* may not recognise collateral for that purpose if it is not eligible under the *financial collateral simple method* or other applicable method.

[Note: BCD Article 112(2) (part)]

10.2.13  
FCA PRA

**G**

For the purpose of ■ BIPRU 10.2.9R (Recognition of credit risk mitigation):

- (1) the requirements set out in ■ BIPRU 5 (Credit risk mitigation) include:
  - (a) the *securities* used as collateral should be valued at market price and should be either traded or effectively negotiable and regularly quoted on a *recognised investment exchange* or a *designated investment exchange*; and
  - (b) where there is a mismatch between the maturity of the *exposure* and the maturity of the credit protection, the collateral must not be recognised; and
- (2) where the issuer of *securities* used as collateral is an *institution*, that collateral may not constitute the *institution's capital resources*.

**The financial collateral comprehensive method**

10.2.14  
FCA PRA

**R**

A *firm* which uses the *financial collateral comprehensive method* (but not under the full IRB approach (see ■ BIPRU 10.2.10R)) may calculate the value of its *exposures* to a *counterparty* or to a *group of connected clients* as being the fully adjusted value of the *exposures* to the *counterparty* or *group of connected clients* calculated in accordance with the *financial collateral comprehensive method* under ■ BIPRU 5 (Credit risk mitigation) and, if relevant, ■ BIPRU 4.10 (The IRB approach: Credit risk mitigation) taking into account the *credit risk mitigation*, volatility adjustments and any maturity mismatch (E\*) in accordance with those *rules*.

[Note: BCD Article 114(1) first paragraph]

10.2.15  
FCA PRA

**G**

The *rules* setting out the calculation of the effects of *credit risk mitigation* under the *financial collateral comprehensive method* are set out in ■ BIPRU 5.4.24 R to ■ BIPRU 5.4.66 R.

10.2.16  
FCA PRA

**R**

For the purposes of ■ BIPRU 10.2.9R (Recognition of credit risk mitigation), a *firm* may use both the *financial collateral comprehensive*

*method* and the *financial collateral simple method* where it is permitted to use both those methods under ■ BIPRU 5.4.16 R.

[Note: BCD Article 117(1) last paragraph]

**10.2.17**  
FCA PRA

G

As indicated in ■ BIPRU 5.4.16 R, a *firm* may be permitted to use both the *financial collateral comprehensive method* and the *financial collateral simple method* when such use is for the purposes of carrying out the sequential implementation of its *IRB approach* in accordance with ■ BIPRU 4.2.17 R to ■ BIPRU 4.2.19 R (Implementation of the internal ratings based approach) and in relation to an *IRB exposure class* or *exposures* which is exempt from the *IRB approach* in accordance with ■ BIPRU 4.2.26 R (Combined use of methodologies), and such use is expressly permitted by the *firm's IRB permission*.

**10.2.18**  
FCA PRA

R

A *firm* may only recognise collateral for the purpose of ■ BIPRU 10.2.14R (Financial collateral comprehensive method) if the collateral complies with the eligibility requirements and other minimum requirements set out in ■ BIPRU 5 (Credit risk mitigation) and, if relevant, ■ BIPRU 4.10 (The IRB approach: Credit risk mitigation) for the purposes of calculating *risk weighted exposure amounts* under the *standardised approach* or, if applicable, the *IRB approach* using the *financial collateral comprehensive method*. In particular a *firm* may not recognise collateral for that purpose if it is not eligible under the *financial collateral comprehensive method*.

**Firms using full IRB approach**

**10.2.19**  
FCA PRA

R

A *firm* that uses the full IRB approach (see ■ BIPRU 10.2.10R) may recognise the effects described in (1) in calculating the value of its *exposures* to a *counterparty* or to a *group of connected clients* for the purposes of ■ BIPRU 10.5 (Limits on exposures) if:

- (1) the *firm* is able to satisfy the *appropriate regulator* that it can estimate the effects of financial collateral on its *exposures* separately from other *LGD*-relevant aspects;
- (2) the *firm* is able to demonstrate the suitability of the estimates produced; and
- (3) the *firm's IRB permission* specifically allows it (also see ■ BIPRU 4.1.23 R (4)).

[Note: BCD Article 114(2) first and second paragraphs]

**10.2.20**  
FCA PRA

R

If a *firm* that uses the full IRB approach (see ■ BIPRU 10.2.10R) uses its own estimates of the effects of financial collateral on its *exposures* for *large exposures* purposes, it must do so on a consistent basis and on a basis consistent with the approach adopted in the calculation of capital requirements. A *firm* may only use one of ■ BIPRU 10.2.14R (Financial collateral comprehensive method under standardised approach and IRB approach) and ■ BIPRU 10.2.19R (Own estimates of effects of financial collateral).

10.2.21  
FCA PRA

**R**

[Note: *BCD* Article 114(2) third and fourth paragraphs]

If a *firm* relies on ■ BIPRU 10.2.19R (Own estimates of effects of financial collateral) the recognition of credit protection is subject to the relevant requirements of the *IRB approach*.

[Note: *BCD* Article 112(3)]

**Stress testing of credit risk concentrations**.....

10.2.22  
FCA PRA

**R**

- (1) A *firm* which:
  - (a) uses the *financial collateral comprehensive method*; or
  - (b) calculates the value of its *exposures* in accordance with ■ BIPRU 10.2.19R (Own estimates of effects of financial collateral);

must conduct periodic stress tests of its credit risk concentrations including in relation to the realisable value of any collateral taken.
- (2) The stress tests required by this *rule* must address:
  - (a) risks arising from potential changes in market conditions that could adversely impact the *firm's* adequacy of *capital resources*; and
  - (b) risks arising from the realisation of collateral in stressed situations.
- (3) A *firm* must be able to satisfy the *appropriate regulator* that the stress tests it carries out under this *rule* are adequate and appropriate for the assessment of such risks.
- (4) In the event that a stress test carried out in accordance with this *rule* indicates a lower realisable value of collateral taken than would be permitted to be taken into account under ■ BIPRU 10.2.14R (Financial collateral comprehensive method) or ■ BIPRU 10.2.19R (Own estimates of effect of financial collateral) as appropriate, the value of collateral permitted to be recognised in calculating the value of *exposures* for the purposes of ■ BIPRU 10.5 (Limits on exposures) is the lower value.
- (5) A *firm* to which this *rule* applies must include in its strategy to address concentration risk:
  - (a) policies and procedures to address risks arising from maturity mismatches between *exposures* and any credit protection on those *exposures*;

- (b) policies and procedures in the event that a stress test indicates a lower realisable value of collateral than taken into account under ■ BIPRU 10.2.14R (Financial collateral comprehensive method) or ■ BIPRU 10.2.19R (Own estimates of effects of financial collateral); and
- (c) policies and procedures relating to concentration risk arising from the application of *credit risk mitigation* techniques, and in particular large indirect credit *exposures* (for example to a single issuer of *securities* taken as collateral).

[Note: BCD Article 114(3)]

10.2.23

FCA PRA

R

Unless, and to the extent, permitted under ■ BIPRU 10.6.3R (11) (Residential mortgages and leasing transactions) or ■ BIPRU 10.6.3R (12) (Commercial mortgages and leasing transactions), a *firm* must not take into account the following collateral for the purposes of this section:

- (1) amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year;
- (2) a physical item of a type other than those types indicated in ■ BIPRU 4.10.6 R to ■ BIPRU 4.10.12 R (Eligibility of real estate collateral); and
- (3) property leased under a leasing transaction.

[Note: BCD Article 112(4)]

10.2.24

FCA PRA

G

A *firm* should determine the frequency needed for the stress testing of its credit risk concentrations with emphasis on having sufficient frequency to maintain the currency of its capital calculations. In any case such testing should be carried out at least once a year.

10



## 10.3 Identification of counterparties

### 10.3.1

FCA PRA

R

An individual *counterparty* may be a natural or legal *person*.

### 10.3.2

FCA PRA

G

Examples of a *counterparty* include:

- (1) the *customer* or borrower; this includes governments, local authorities, public sector entities, individual trusts, corporations, unincorporated businesses (whether as *sole traders* or *partnerships*) and non-profit making bodies;
- (2) where the *firm* is providing a guarantee, the *person* guaranteed;
- (3) for a *derivatives* contract, the *person* with whom the contract was made;
- (4) for exchange traded contracts novated through a central clearing mechanism, that central clearing mechanism;
- (5) where a bill held by a *firm* has been accepted by a *credit institution*, the acceptor; and
- (6) where a *firm* is funding the activities of a *company* that trades on an exchange (whether as principal or on behalf of clients), that *company*.

### Identification of counterparties for guaranteed and collateralised exposures

### 10.3.3

FCA PRA

R

(1) Where an exposure to a *counterparty* is:

- (a) guaranteed by a third party, a *firm* may treat the portion of the *exposure* which is guaranteed as having been incurred to the guarantor rather than to the *counterparty*, provided that the unsecured *exposure* to the guarantor would be assigned an equal or lower *risk weight* than a *risk weight* of the unsecured *exposure* to the *counterparty* under the *standardised approach*; or
- (b) secured by collateral issued by a third party, a *firm* may treat the portion of the *exposure* collateralised by the market value of recognised collateral as having been incurred to the third party rather than to the *counterparty*, provided that the collateralised portion of the *exposure* would be assigned an equal or lower *risk weight* than a *risk weight* of the

unsecured *exposure* to the *counterparty* under the *standardised approach*.

[Note: *BCD* Article 117(1)(a) and (b)]

- (2) In deciding whether or not to treat the *exposure* as an *exposure* to the third party a *firm* must ensure that the identification of *counterparties* for concentration risk purposes is applied in a consistent manner.
- (3) [deleted]
- (4) [deleted]
- (5) [deleted]
- (6) A guarantee or collateral may only be treated in accordance with (1) if the *firm* complies with the eligibility requirements and other minimum requirements set out in ■ BIPRU 5 (Credit risk mitigation) and, if applicable, ■ BIPRU 4.10 (The IRB approach: Credit risk mitigation) for the purposes of calculating *risk weighted exposure amounts*.
- (7) For the purpose of this *rule*, guarantee includes a credit derivative recognised under ■ BIPRU 5 and, if applicable, ■ BIPRU 4.10, other than a credit linked note.

[Note: *BCD* Article 112(1)]

- (1) If a *firm* treats an *exposure* to a *counterparty* as guaranteed, or secured by collateral issued, by a third party for the purposes of ■ BIPRU 5 (Credit risk mitigation), it should apply the same approach on a consistent basis when identifying a *counterparty* for the purposes of this chapter.
- (2) An example of the eligibility requirements and other minimum requirements set out in ■ BIPRU 5 as referred to in ■ BIPRU 10.3.3 R (6) is the requirement for a legal review in ■ BIPRU 5.2.3 R.
- (3) Where the guarantee is denominated in a currency different from that in which the *exposure* is denominated, the provisions on the treatment of currency mismatch for *unfunded credit protection* in ■ BIPRU 5.7 (Unfunded credit protection) and, if applicable, ■ BIPRU 4.10 (The IRB approach: Credit risk mitigation) are applicable for the calculation of the amount of the *exposure* deemed to be covered.

[Note: *BCD* Article 117(2)(a)]

- (4) Where there is a mismatch between the maturity of the *exposure* and the maturity of the protection provided by guarantee, ■ BIPRU 5.8 (Maturity mismatches) and, if applicable, ■ BIPRU 4.10 (The IRB approach: Credit risk mitigation) are applicable for the treatment for mismatch.

10.3.4

FCA PRA

G

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[Note: BCD Article 117(2)(b)]

- (5) For the purpose of ■ BIPRU 10.3.3R (1), where there is a mismatch between the maturity of the *exposure* and the maturity of the protection provided by collateral, ■ BIPRU 5.8.7 R (Valuation of protection: Transactions subject to funded credit protection - financial collateral simple method) requires that the collateral must not be recognised.

[Note: BCD Article 117(1) second paragraph]

- (6) In relation to a guarantee, ■ BIPRU 5.7 (Unfunded credit protection) and, if applicable, ■ BIPRU 4.10 (The IRB approach: Credit risk mitigation) are applicable for the treatment of partial coverage.

[Note: BCD Article 117(2)(c)]

**Groups of connected clients**

10.3.5  
FCA PRA

**R** A *group of connected clients* means one of the following:

- (1) two or more *persons* who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others; or
- (2) two or more *persons* between whom there is no relationship of control as set out in (1) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would be likely to encounter funding or repayment difficulties.

[Note: Article 4(45) of the *Banking Consolidation Directive*]

10.3.5A  
FCA PRA

**R** Control in this context means control as defined in Article 1 of the Seventh Council Directive 83/349/EEC (the *Seventh Company Law Directive*) or a similar relationship between any *person* and an *undertaking*.

10.3.5B  
FCA PRA

**G** Where there is a relationship of control, there is a presumption of single risk unless shown otherwise.

10.3.6  
FCA PRA

- (1) In identifying a *group of connected clients*, a *firm* should consider both third party *clients* and *counterparties* that are, or may be, connected to the *firm* itself.
- (2) Relationships between individual *counterparties* or between the *firm* and a *counterparty* which might be considered to constitute a single risk for the purposes of the definition of *group of connected clients* include:
  - (a) *undertakings* in the same *group*;

- (b) *companies* whose ultimate owner (whether wholly or significantly) is the same individual or individuals, and which do not have a formal group structure;
- (c) *companies* having common directors or management;
- (d) where the same *persons* significantly influence the *governing body* of each of the *undertakings*;
- (e) where the *firm* has an *exposure* to an *undertaking* that was not incurred for the clear commercial advantage of the *firm* or the *firm's group* and which is not on an arm's length basis;
- (f) *counterparties* linked by cross guarantees;
- (g) where it is likely that the financial problems of one *counterparty* would cause difficulties for the other *counterparty* or *counterparties* in terms of full and timely repayment of liabilities;
- (h) where the funding problems of one *counterparty* are likely to spread to another due to a one-way or two-way dependence on the same main funding source, which may be the *firm* itself;
- (i) where counterparties rely on the *firm* for their main funding source, for example through explicit or implicit liquidity support or credit support; and
- (j) where the insolvency or default of one of them is likely to be associated with the insolvency or default of the other(s).

**10.3.7**

**FCA PRA**

**G**

The *appropriate regulator* would not regard the normal business relationships between *companies* which are competitors, and to which none of the relationships listed in ■ BIPRU 10.3.6 G apply, as falling within the definition of *group of connected clients*.

**10.3.8**

**R**

[deleted]

**10.3.8A**

**FCA PRA**

**G**

- (1) The Committee of European Banking Supervisors (CEBS) has issued guidelines in relation to the definition of a *group of connected clients*, in particular with reference to the concepts of control and economic interconnection. These guidelines can be found at: <http://www.c-ebs.org/Publications/Standards-Guidelines/CEBS-Guidelines-on-the-revised-large-exposures-reg.aspx> - Part I .
- (2) In applying the CEBS guidelines in relation to *counterparties* that are connected to the *firm* itself, the *PRA* has issued guidance in respect of structured finance vehicles. This guidance can be found at <http://www.fsa.gov.uk/library/policy/policy/2012/12-21.shtml>.

**Exposures to counterparties and groups of connected clients**

**10.3.9**

**FCA PRA**

**R**

*A firm's total exposure to a counterparty must be calculated by summing its exposures to that counterparty, including both trading book exposures and non-trading book exposures.*

**10.3.10**

**FCA PRA**

**R**

*A firm's total exposure to a group of connected clients must be calculated by summing its exposures to the individual persons within that group of*

*connected clients, including both trading book exposures and non-trading book exposures.*

10.3.11 **R** [deleted]

**Exposures to trustees**

10.3.12 **G**  
**FCA PRA**

If a *firm* has an *exposure* to a *person* ('A') when A is acting on his own behalf, and also an *exposure* to A when A acts in his capacity as trustee, custodian or general partner of an investment trust, unit trust, venture capital or other investment fund, pension fund or a similar fund (a "fund"), the *firm* may treat the latter *exposure* as if it was to the fund, unless such a treatment would be misleading.

10.3.13 **G**  
**FCA PRA**

When considering whether the treatment described in **■ BIPRU 10.3.12 G** 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.

10.3.14 **G**  
**FCA PRA**

In deciding whether a transaction is at arm's length for the purposes of **■ BIPRU 10.3.6G (2)(f)**, **■ BIPRU 10.3.13 G (4)** and **■ BIPRU 10.10A.1R (1)(d)**, 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 e.g. 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.

**Exposures to underlying assets**

10.3.15 **R**  
**FCA PRA**

Where under a transaction or scheme (for example, *securitisation positions* or claims in the form of *CIUs*) there is an *exposure* to underlying assets, a *firm* must assess the *exposure* to the transaction or scheme, or its underlying *exposures*, or both, in order to determine the existence of a *group of connected clients*. For the purpose of this *rule*, a *firm* must evaluate the economic substance and the risks inherent in the structure of the transaction.

[Note: *BCD* Article 106(3)]

10

PAGE 14

10.3.16

G

FCA PRA

The Committee of European Banking Supervisors (CEBS) has issued guidelines in relation to the treatment for *large exposures* purposes of schemes with *exposures* to underlying assets. These guidelines can be found at: <http://www.c-eps.org/Publications/Standards-Guidelines/CEBS-Guidelines-on-the-revised-large-exposures-reg.aspx> - Part II.



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## 10.5 Limits on exposures

### Definition of large exposure

10.5.1

FCA PRA

R

A *large exposure* of a *firm* means its *total exposure* to a *counterparty* or a *group of connected clients*, whether in the *firm's non-trading book* or *trading book* or both, which in aggregate equals or exceeds 10% of the *firm's capital resources*.

[Note: BCD Article 108]

### Definition of capital resources

10.5.2

FCA PRA

R

A *firm* must calculate its *capital resources* for the purposes of this chapter in accordance with ■ GENPRU 2.2 (Capital resources) and ■ BIPRU 10.5.3 R to ■ BIPRU 10.5.5 R.

10.5.3

FCA PRA

R

Subject to ■ BIPRU 10.5.4 R, for the purposes of this chapter, a *firm's capital resources* mean *capital resources* calculated at stage (N) of the calculation in the *capital resources table* (Total tier one capital plus tier two capital after deductions).

10.5.4

FCA PRA

R

For the purposes of monitoring against the *trading book* limits and charge regime, as set out in ■ BIPRU 10.10A.2 R to ■ BIPRU 10.10A.11R (Intra-group exposures: Trading book limits) , and calculating a *firm's CNCOM*, a *firm's capital resources* may include *tier three capital resources*, in which case a *firm's capital resources* mean *capital resources* calculated at stage (T) of the *capital resources table* (Total capital after deductions).

10.5.5

FCA PRA

R

A *firm* must not take into account the following items:

- (1) surplus provisions (see ■ GENPRU 2.2.190 R to ■ GENPRU 2.2.193 R); or
- (2) *expected loss* amounts and other negative amounts (see ■ GENPRU 2.2.236 R); or
- (3) *securitisation positions* (see ■ GENPRU 2.2.237 R).

[Note: *BCD* Article 66(3)]

**Large exposure limits**

10.5.6

**R**

**FCA PRA**

A *firm* must ensure that the total amount of its *exposures* to the following does not exceed 25% of its *capital resources* (as determined under ■ BIPRU 10.5.2 R, ■ BIPRU 10.5.3 R and ■ BIPRU 10.5.5 R):

- (1) a *counterparty*; or
- (2) a *group of connected clients*

[Note: *BCD* Article 111(1) first paragraph]

10.5.7

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## 10.6 Exemptions

### General exemptions

10.6.1

G

FCA PRA

This section applies to *exposures* in the *trading book* and the *non-trading book*.

10.6.2

R

FCA PRA

- (1) In ■ BIPRU 10.6.3 R and ■ BIPRU 10.6.4 R, references to guarantees include credit derivatives recognised under ■ BIPRU 5 (Credit risk mitigation) and, if applicable, ■ BIPRU 4.10 (The IRB approach: Credit risk mitigation), other than credit linked notes.

[Note: *BCD* Article 112(1)]

- (2) ■ BIPRU 10.3.3 R (6) (Compliance with minimum *credit risk mitigation* requirements) applies for the purpose of ■ BIPRU 10.6.3 R and ■ BIPRU 10.6.4 R.

10.6.3

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FCA PRA

The following *exposures* are exempt from the limits described in ■ BIPRU 10.5 (Limits on exposures):

- (1) asset items constituting claims on central governments or *central banks* which claims would unsecured receive a 0% *risk weight* under the *standardised approach*;
- (2) asset items constituting claims on *international organisations* or *multilateral development banks* which claims would unsecured receive a 0% *risk weight* under the *standardised approach*;
- (3) asset items constituting claims carrying the explicit guarantees of central governments, *central banks*, *international organisations* or *multilateral development banks*, where unsecured claims on the entity providing the guarantee would receive a 0% *risk weight* under the *standardised approach*;
- (4) other *exposures* attributable to, or guaranteed by, central governments, *central banks*, *international organisations*, *multilateral development banks* or *public sector entities* where unsecured claims on the entity to which the *exposure* is attributable

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or by which it is guaranteed would receive a 0% *risk weight* under the *standardised approach*;

- (5) [deleted]
- (6) [deleted]
- (7) asset items constituting claims on *EEA States'* regional governments or local authorities which claims would receive a 0% *risk weight* under the *standardised approach*;
- (8) other *exposures* to or guaranteed by *EEA States'* regional governments or local authorities claims on which would receive a 0% *risk weight* under the *standardised approach*;
- (9) [deleted]
- (10) [deleted]
- (11) loans secured by mortgages on residential property and leasing transactions under which the lessor retains full ownership of the residential property leased for as long as the lessee has not exercised his option to purchase, in all cases up to 50% of the value of the residential property concerned;
- (12) the following, where they would receive a 50% *risk weight* under the *standardised approach*, and only up to 50% of the value of the commercial property concerned:
  - (a) *exposures* secured by mortgages on offices or other commercial premises; and
  - (b) *exposures* related to property leasing transactions concerning offices or other commercial premises;
- (13) [deleted]
- (14) asset items and other *exposures* secured by collateral in the form of cash deposits placed with the *lending firm* or with a *credit institution* which is the *parent undertaking* or a *subsidiary undertaking* of the *lending firm*;
- (15) asset items and other *exposures* secured by collateral in the form of certificates of deposit issued by the *lending firm* or by a *credit institution* which is the *parent undertaking* or a *subsidiary undertaking* of the *lending firm* and lodged with either of them; and
- (16) *exposures* arising from undrawn credit facilities that are classified as low risk off-balance sheet items in ■ BIPRU 3.7.2 R

and provided that an agreement has been concluded with the *counterparty* or *group of connected clients* under which the facility may be drawn only if it has been ascertained that it will not cause the limit in ■ BIPRU 10.5.6 R (Limits on exposures) to be exceeded.

[Note: *BCD* Articles 113(3), 115(1) sub-paragraphs (a) and (b) and 115(2) sub-paragraphs (a) and (b)]

10.6.4

FCA PRA

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For the purposes of ■ BIPRU 10.6.3R (11) (Loan secured by residential mortgages and leasing transactions):

- (1) the requirements set out in ■ BIPRU 3.4.64 R to ■ BIPRU 3.4.73 R (Requirements for recognition of real estate collateral) apply;
- (2) the value of the property must be calculated on the basis of prudent valuation standards laid down by law, regulation or administrative provisions;
- (3) valuation must be carried out at least once every three years;
- (4) the valuation *rules* set out in ■ BIPRU 3.4.77 R to ■ BIPRU 3.4.80 R apply; and
- (5) residential property means a residence to be occupied or let by the borrower.

[Note: *BCD* Article 115(1) second to fourth paragraphs]

10.6.5

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10.6.6

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10.6.13

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10.6.14

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10.6.15	<b>R</b>	[deleted]
10.6.16	<b>R</b>	[deleted]
10.6.17	<b>R</b>	[deleted]
10.6.18	<b>G</b>	[deleted]
10.6.19	<b>R</b>	[deleted]
10.6.20	<b>R</b>	[deleted]
10.6.21	<b>R</b>	[deleted]
10.6.22	<b>R</b>	[deleted]
10.6.23	<b>R</b>	[deleted]
10.6.24	<b>R</b>	[deleted]
10.6.25	<b>R</b>	[deleted]
10.6.26	<b>R</b>	[deleted]
10.6.27	<b>G</b>	[deleted]
10.6.28	<b>R</b>	<p>For the purposes of <b>■ BIPRU 10.6.3R (12)</b> (Loans secured by commercial mortgages and leasing transactions):</p> <ol style="list-style-type: none"> <li>(1) the value of the property must be calculated on the basis of prudent valuation standards laid down by law, regulation or administrative provisions; and</li> <li>(2) the commercial property concerned must be fully constructed, leased and produce appropriate rental income.</li> </ol> <p>[Note: <i>BCD</i> Article 115(2) second and third paragraphs]</p>
10.6.29	<b>G</b>	<p>For the purposes of <b>■ BIPRU 10.6.3R (12)</b>, a 50% <i>risk weight</i> is not allowed under the <i>standardised approach</i> for commercial property based in the UK.</p>
10.6.30	<b>R</b>	<p>For the purposes of <b>■ BIPRU 10.6.3R (14)</b> (Cash deposits) and <b>■ BIPRU 10.6.3R (15)</b> (Certificates of deposit), a <i>firm</i> may only treat the asset items or other <i>exposures</i> as secured if the collateral complies with the eligibility requirements and other minimum requirements set out in <b>■ BIPRU 5</b> (Credit risk mitigation) and, if relevant, <b>■ BIPRU 4.10</b> (The IRB approach: Credit risk mitigation) for the purposes calculating a <i>firm's exposure</i>.</p>

10.6.31

FCA PRA

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In relation to ■ BIPRU 10.6.3R (14) (Cash deposits) and ■ BIPRU 10.6.3R (15) (Certificates of deposit), the collateral may in some cases give rise to an *exposure* between the *lending firm* and the *credit institution*. Where this is the case, the *exposure* is considered to be an intra-group *exposure*. A *firm* may apply ■ BIPRU 10.8A (Intra-group exposures: core UK group) or ■ BIPRU 10.9A (Intra-group exposures: non-core large exposures group), as appropriate.

### Institutional exemption

10.6.32

FCA PRA

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Where a *counterparty* is an *institution* or where a *group of connected clients* includes one or more *institutions*:

- (1) the total amount of a *firm's exposures* to the same *counterparty* or *group of connected clients* may exceed 25% of the *firm's capital resources* so long as the total amount of such *exposures* does not exceed 150 million;
- (2) the *firm* must ensure that the total amount of its *exposures*, after taking into account the effect of *credit risk mitigation*, to other *persons* in that *group of connected clients* which are not *institutions* does not exceed 25% of the *firm's capital resources*;
- (3) where the amount of 150 million in (1) is higher than an amount equivalent to 25% of the *firm's capital resources*, the *firm* must ensure the following:
  - (a) the total amount of those *exposures* in (1) in relation to the same *counterparty* or *group of connected clients* does not exceed a reasonable limit in terms of the *firm's capital resources*; and
  - (b) in any case, the limit in this *rule* must not exceed 100% of the *firm's capital resources*; and

*capital resources* are as determined under ■ BIPRU 10.5.2 R, ■ BIPRU 10.5.3 R and ■ BIPRU 10.5.5 R (Stage (N) of the calculation in the *capital resources table* (Total tier one capital plus tier two capital after deductions)); and

- (4) for the purpose of (3), the *firm* must determine the limit consistently with the policies and procedures required under ■ BIPRU 10.12.3 R (Concentration risk policies).

[Note: BCD Article 111(1) second to fourth paragraphs]

10.6.33

FCA PRA

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Article 111(4) of the *Banking Consolidation Directive* allows the *appropriate regulator* to waive the 100% limit on a case-by-case basis. 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).

**Sovereign large exposure waiver**

10.6.34  
FCA PRA

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■ BIPRU 10.6.35R to ■ BIPRU 10.6.37G apply to a *BIPRU firm* if it has a *sovereign large exposure waiver*.

10.6.35  
FCA PRA

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A *firm* that has a *sovereign large exposure waiver* must exempt from the limits described in ■ BIPRU 10.5 (Limits on exposures) the *exposures* as specified in the *sovereign large exposure waiver*. It must do so to the extent specified in that waiver.

10.6.36  
FCA PRA

R

For the purpose of the *sovereign large exposure waiver*, and in relation to a *firm*, the *exposures* referred to in ■ BIPRU 10.6.35R are limited to the following:

- (1) asset items constituting claims on *central banks* not within ■ BIPRU 10.6.3R (1), which are in the form of required minimum reserves held at those *central banks* which are denominated and funded in their national currencies; and
- (2) asset items constituting claims on central governments not within ■ BIPRU 10.6.3R (1), which are in the form of statutory liquidity requirements held in government securities denominated and funded in their national currencies.

[Note: BCD Article 113(4)(g) and (h)]

10.6.37  
FCA PRA

G

As part of the process of applying for a *sovereign large exposure waiver*, a *firm* should agree with the *appropriate regulator* the amount of the *exposures* that may be exempted. In general, the *appropriate regulator* will expect the likelihood of the *firm's* liabilities (that fund the particular exempt *exposure*) falling alongside a fall in that *exposure* in an event of default to form one of the key considerations in discussions with the *firm* regarding the total amount of such exempt *exposures*. For this purpose, the *appropriate regulator* will expect the *firm* to demonstrate that, taking into account the aggregate of all *exposures* exempted under other *sovereign large exposure waivers* granted to the *firm*, the criteria in section 138A of the *Act* (Modification or waiver of rules) are satisfied in relation to the *sovereign large exposure waiver* under consideration.



**10.7 [deleted]**

- 10.7.1**
- 10.7.2**
- 10.7.3**
- 10.7.4**
- 10.7.5**
- 10.7.6**



**10.8 [deleted]**

- 10.8.1
- 10.8.2
- 10.8.3
- 10.8.4
- 10.8.5
- 10.8.5A
- 10.8.6
- 10.8.7
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- 10.8.14
- 10.8.15
- 10.8.16

**10.8A Intra-group exposures: core UK group**

**Application**

10.8A.1

**R**

FCA PRA

This section applies to a *firm* if:

- (1) it is a member of a *core UK group* (under ■ BIPRU 3.2.25 R and this section); and
- (2) it has a *core UK group waiver*.

**Definition of core UK group**

10.8A.2

**R**

FCA PRA

An *undertaking* is a member of a *firm's core UK group* if, in relation to the *firm*, that *undertaking* satisfies the following conditions:

- (1) it is a *core concentration risk group counterparty*;
- (2) it is an *institution, financial holding company, financial institution, asset management company or ancillary services undertaking*;
- (3) (in relation to a *subsidiary undertaking*) 100% of the voting rights attaching to the *shares* in its capital is held by the *firm* or a *financial holding company* (or a *subsidiary undertaking* of the *financial holding company*), whether individually or jointly, and that *firm* or *financial holding company* (or its *subsidiary undertaking*) must have the right to appoint or remove a majority of the members of the board of *directors*, committee of management or other governing body of the *undertaking*;
- (4) it is subject to the same risk evaluation, measurement and control procedures as the *firm*;
- (5) it is incorporated in the *United Kingdom*; and
- (6) there is no current or foreseen material practical or legal impediment to the prompt transfer of *capital resources* or repayment of liabilities from the *counterparty* to the *firm*.

**10.8A.3**  
FCA PRA

G

In relation to ■ BIPRU 10.8A.2R (3), a *subsidiary undertaking* should generally be 100% owned and controlled by a single shareholder. However, if a *subsidiary undertaking* has more than one shareholder, that *undertaking* may be a member of the *core UK group* if all its shareholders are also members of that same *core UK group*.

**10.8A.4**  
FCA PRA

G

If a *core concentration risk group counterparty* is of a type that falls within the scope of the Council Regulation of 29 May 2000 on insolvency proceedings (Regulation 1346/2000/EC) and it is established in the *United Kingdom* other than by incorporation, a *firm* wishing to include that *counterparty* in its *core UK group* may apply to the *appropriate regulator* for a *waiver* of ■ BIPRU 10.8A.2R (5) if it can demonstrate fully to the *appropriate regulator* that the *counterparty's* centre of main interests is situated in the *United Kingdom* within the meaning of that Regulation.

### Minimum standards

**10.8A.5**  
FCA PRA

R

- (1) For the purpose of ■ BIPRU 10.8A.2R (6), a *firm* must be able to demonstrate fully to the *appropriate regulator* the circumstances and arrangements, including legal arrangements, by virtue of which there are no material practical or legal impediments, and none are foreseen, to the prompt transfer of *capital resources* or repayment of liabilities from the *counterparty* to the *firm*.
- (2) In relation to a *counterparty* that is not a *firm*, the arrangements referred to in (1) must include a legally binding agreement with each *firm* that is a member of the *core UK group* that it will promptly on demand by the *firm* increase that *firm's capital resources* by an amount required to ensure that the *firm* complies with ■ GENPRU 2.1 (Calculation of capital resources requirements), ■ BIPRU 10 (Large exposures requirements) and any other requirements relating to *capital resources* or concentration risk imposed on a *firm* by or under the *regulatory system*.

**10.8A.6**  
FCA PRA

G

The *appropriate regulator* will consider the following criteria when assessing whether the condition in ■ BIPRU 10.8A.2R (6) is going to be met:

- (1) the speed with which funds can be transferred or liabilities repaid to the *firm* and the simplicity of the method for the transfer or repayment;
- (2) whether there are any interests other than those of the *firm* in the *core concentration risk group counterparty* and what impact those other interests may have on the *firm's* control over the *core group concentration risk group counterparty* and the ability of the *firm* to require a transfer of funds or repayment of liabilities;
- (3) whether there are any tax disadvantages for the *firm* or the *core concentration risk group counterparty* as a result of the transfer of funds or repayment of liabilities;
- (4) whether the purpose of the *core concentration risk group counterparty* prejudices the prompt transfer of funds or repayment of liabilities;

- (5) whether the legal structure of the *core concentration risk group counterparty* prejudices the prompt transfer of funds or repayment of liabilities;
- (6) whether the contractual relationships of the *core concentration risk group counterparty* with the *firm* and other third parties prejudices the prompt transfer of funds or repayment of liabilities; and
- (7) whether past and proposed flows of funds between the *core concentration risk group counterparty* and the *firm* demonstrate the ability to make prompt transfer of funds or repayment of liabilities.

**10.8A.7**

**FCA PRA**

**G**

- (1) *Firms* are referred to the guidance relating to 0% *risk weights* for *exposures* within a *core UK group* under the *standardised approach* as follows:
  - (a) ■ BIPRU 3.2.28 G in respect of ■ BIPRU 10.8A.2R (3) on same risk evaluation, measurement and control procedures; and
  - (b) ■ BIPRU 3.2.30 G and ■ BIPRU 3.2.31 G in respect of ■ BIPRU 10.8A.2R (6) on prompt transfer of *capital resources* and repayment of liabilities.
- (2) For the purpose of ■ BIPRU 10.8A.5R (2), the obligation to increase the *firm's capital resources* may be limited to capital resources available to the *counterparty* and may reasonably exclude such amount of capital resources that, if transferred to the *firm*, would cause the *counterparty* to become balance sheet insolvent in the manner contemplated in section 123(2) of the Insolvency Act 1986.

**Exemption for a core UK group**

**10.8A.8**

**FCA PRA**

**R**

If this section applies, *exposures* between members of the *core UK group* are exempt from the limits described in ■ BIPRU 10.5 (Limits on exposures).

**10.8A.9**

**FCA PRA**

**G**

The *appropriate regulator* will expect a *firm* to which this section applies not to use any member of its *core UK group* which is not a *firm* to route lending or to have *exposures* to any third party in excess of the limits in ■ BIPRU 10.5 (Limits on exposures).

**Calculation of capital resources for a core UK group**

**10.8A.10**

**FCA PRA**

**R**

For the purposes of this section, a *firm* must calculate the capital resources of the *core UK group* in accordance with ■ GENPRU 3 Annex 1 R Part 2 (Method 2 of Annex 1 of the Financial Groups Directive (Deduction and aggregation Method)) and apply the limits set out in this section to those capital resources rather than the *capital resources* of the *firm*. For these purposes the definition of *solo capital resources* is adjusted so that the *rules* on which the calculation for each member of the *core UK group* is based are the ones that would apply under the procedure in ■ BIPRU 8.6.6 R to ■ BIPRU 8.6.9 R (Consolidated capital resources).

**10.8A.11**

**FCA PRA**

**G**

The calculation of capital resources under ■ GENPRU 3 Annex 1 R Part 2 (Method 2 of Annex 1 of the Financial Groups Directive (Deduction and aggregation Method)) is based on the *solo capital resources* of members of a *financial conglomerate*. The definition of *solo capital resources* depends on what type of *undertakings* the *financial conglomerate* contains. For example, if a *financial conglomerate* contains a bank the *solo capital resources*

calculation for every group member in the *banking sector* and the *investment services sector* is based on the *capital resources* calculation for *banks*. The purpose of ■ BIPRU 10.8A.10R is to apply the corresponding procedure that applies under ■ BIPRU 8.6 (Calculation of capital resources on a consolidated basis for BIPRU firms).

10.8A.12  
FCA PRA

**R**

**Notification**

A *firm* must immediately notify the *appropriate regulator* in writing if it becomes aware that any *exposure* that it has treated as exempt under this section or any *counterparty* that it has been treating as a member of its *core UK group* has ceased to meet the conditions for application of the treatment in this section.



**10.9 [deleted]**

- 10.9.1
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- 10.9.5
- 10.9.6
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- 10.9.10
- 10.9.11
- 10.9.12
- 10.9.13
- 10.9.14
- 10.9.15
- 10.9.16

**10.9A Intra-group exposures: non-core large exposures group**

**Application**

10.9A.1  
FCA PRA

**R**

This section applies to a *firm* if it has:

- (1) a *non-core large exposures group*; and
- (2) a *non-core large exposures group waiver*.

10.9A.2

**G**

[deleted]

**Definition of non-core large exposures group**

10.9A.3  
FCA PRA

**R**

The *non-core large exposures group* of a *firm* consists of each *non-core concentration risk group counterparty* of the *firm* that is not a member of its *core UK group* but satisfies all other conditions for membership of the *firm's core UK group* except for the following:

- (1) ■ BIPRU 10.8A.2R (1) (Core concentration risk group counterparty);
- (2) ■ BIPRU 10.8A.2R (5) (Establishment in the United Kingdom); and
- (3) ■ BIPRU 10.8A.5R (2) (Capital maintenance arrangements).

**Definition of non-core concentration risk group counterparty**

10.9A.4  
FCA PRA

**R**

A *non-core concentration risk group counterparty* (in relation to a *firm*) is a counterparty which is its *parent undertaking*, its *subsidiary undertaking* or a *subsidiary undertaking* of its *parent undertaking*, provided that (in each case) both the counterparty and the *firm* satisfy one of the following conditions:

- (1) they are included within the scope of consolidation on a full basis with respect to the same *UK consolidation group* and ■ BIPRU 8.3.1 R applies to the *firm* with respect to that *UK consolidation group*; or

- (2) they are included within the scope of consolidation on a full basis with respect to the same *group* by a *competent authority* of an *EEA State* other than the *United Kingdom* under the *CRD implementation measures* about consolidated supervision for that *EEA State*; or
- (3) they are included within the scope of consolidation on a full basis with respect to the same *group* by a *third country competent authority* under prudential rules for the *banking sector* or *investment services sector* of or administered by that *third country competent authority* and the *firm* or another *EEA firm* in that *group* has been notified in writing by the *appropriate regulator* or a *competent authority* of another *EEA State* pursuant to Article 143 of the *Banking Consolidation Directive* that that *group* is subject to equivalent supervision.

**Revised large exposure limits for a non-core large exposures group**

10.9A.5  
FCA PRA

**R**

A *firm* to which this section applies must ensure that the *rules* listed in ■ BIPRU 10.9A.6R are complied with on a consolidated basis subject to the following modifications:

- (1) (if the *firm* is not a member of a *core UK group*) the *rules* apply in relation to *exposures* of the *firm* to its *non-core large exposures group* as if it is a single undertaking;
- (2) if the *firm* is a member of a *core UK group*:
  - (a) the *rules* apply in relation to its *core UK group* rather than in relation to the *firm*; and
  - (b) the *core UK group* and the *non-core large exposures group* must each be treated as a single undertaking.

10.9A.6  
FCA PRA

**R**

The *rules* referred to in ■ BIPRU 10.9A.5R are:

- (1) ■ BIPRU 10.5.6 R (25% *large exposures* limit);
- (2) ■ BIPRU 10.10A.2 R (Trading book limits) other than ■ BIPRU 10.10A.2R (2) (CNCOM); and
- (3) ■ BIPRU 10.10A.3 R (500% limit for *trading book excess exposures*).

**Non-trading book backstop limit for a non-core large exposures group**

PAGE 35  
10.9A.7  
FCA PRA

**R**

A *firm* must ensure that the total amount of *non-trading book exposures* between:

- (1) itself and members of its *non-core large exposures group* does not exceed 100% of the *firm's capital resources*; or

- (2) if it is a member of a *core UK group*, the members of its *core UK group* and members of its *non-core large exposures group* does not exceed 100% of the capital resources of the *firm's core UK group*.

**Concentrated exposures in a non-core large exposures group**.....

10.9A.8

FCA PRA

R

- (1) Subject to the limit in ■ BIPRU 10.9A.7R (Back-stop large exposures limit), a *firm* may concentrate its intra-group *exposure* to a particular member of its *non-core large exposures group* in excess of 25% of the capital resources of the *firm's core UK group*.
- (2) A *firm* may not apply (1) unless it has given prior written notice to the *appropriate regulator* that it intends to do so.
- (3) The written notice referred to in (2) must contain the following:
  - (a) an explanation on how the *firm* will ensure that it will still meet the requirement in ■ BIPRU 10.9A.7R (Backstop large exposures limit) on a continuing basis when applying (1);
  - (b) details of the *counterparty*, the size of the *exposure* and the expected duration of the *exposure*; and
  - (c) an explanation of the reason for the *exposure*.
- (4) If a *firm* stops applying (1) it may start to apply it again if it notifies the *appropriate regulator* under (2) that it intends to do so.

**Calculation of capital resources for a core UK group**.....

10.9A.9

FCA PRA

R

■ BIPRU 10.8A.10R (Calculation of capital resources for a core UK group) applies for the purposes of this section in the same way that it applies for the purposes of ■ BIPRU 10.8A (Intra-group exposures: core UK group).

**Exemption for intra-group exposures on a solo basis**.....

10.9A.10

FCA PRA

R

If this section applies to a *firm*, then subject to ■ BIPRU 10.10A.12 (Core UK group and non-core large exposures group: treatment of the trading book concentration risk excess), it may, on a solo basis, treat an *exposure* to a member of its *non-core large exposures group* as exempt from the limits in ■ BIPRU 10.5 (Limits on exposures).

10.9A.11

FCA PRA

G

The purpose of ■ BIPRU 10.9A.10R is to reflect the fact that the limits in ■ BIPRU 10.5 (Limits on exposures), so far as they apply to a member of a *firm's non-core large exposures group*, are calculated on a consolidated basis with respect to a *firm's core UK group*. It is therefore necessary to switch them off on a purely solo basis.

10.9A.12

FCA PRA

**R**

**Notification**

A *firm* must immediately notify the *appropriate regulator* in writing if it becomes aware that any *exposure* that it has treated as exempt under this section or any *counterparty* that it has been treating as a member of its *non-core large exposures group* has ceased to meet the conditions for application of the treatment in this section.



**10.10 [deleted]**

- 10.10.1**
- 10.10.2**
- 10.10.3**
- 10.10.4**

## 10.10A Trading book limits

### Application

10.10A.1

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FCA PRA

This section only applies to *exposures* in a *firm's trading book* to *counterparties* which fulfil the following conditions:

- (1) subject to (2), and in relation to a *firm*, a counterparty ('P') to whom the *firm* has an *exposure* and who fulfils at least one of the following conditions:
  - (a) P is *closely related* to the *firm*; or
  - (b) P is an *associate* of the *firm*; or
  - (c) the same *persons* significantly influence the *governing body* of P and of the *firm*; or
  - (d) the *firm* has an *exposure* to P that was not incurred for the clear commercial advantage of the *firm* or the *firm's group* and which is not on an arm's length basis;
  
- (2) where P is Business Growth Fund plc or another *financial institution* which makes *venture capital investments* and the *firm* is entitled to ignore that *financial institution* in accordance with ■ GENPRU 2.2.209 R (2) for the purposes of determining whether there is a *material holding*, (1) applies with the following modifications to the definition of *associate*:
  - (a) paragraph (3)(c) (community of interest) of that definition does not apply; and
  - (b) in applying paragraph (3)(a) (affiliated company) of that definition, paragraph (1)(e) (participating interests) of the definition of *group* does not apply.

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10.10A.1A

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FCA PRA

In deciding whether a transaction is at arm's length for the purposes of

■ BIPRU 10.10A.1R (1)(d), the factors set out in ■ BIPRU 10.3.14 G should be taken into account.

10

**Trading book limits**

**10.10A.2**  
**FCA PRA**

**R**

*Exposures in a firm's trading book to counterparties falling within ■ BIPRU 10.10A.1 R are exempt from the 25% limit in ■ BIPRU 10.5.6 R (large exposures limit) if:*

- (1) the total amount of the *exposures* on the *firm's non-trading book to counterparties* falling within ■ BIPRU 10.10A.1 R does not exceed the limit laid down in that *rule*, calculated with reference to the definition of *capital resources* calculated at stage (N) of the calculation in the *capital resources table* (Total tier one capital plus tier two capital after deductions) as set out in ■ BIPRU 10.5.2 R, ■ BIPRU 10.5.3 R and ■ BIPRU 10.5.5 R, so that the excess arises entirely on the *trading book*; and
- (2) the *firm* meets the additional capital requirements relating to the *concentration risk capital component (CNCOM)* in relation to the relevant *trading book exposures*.

**10.10A.2A**  
**FCA PRA**

**G**

The applicable limit for the purposes of ■ BIPRU 10.10A.2R (1) is the total amount of the *exposures* on the *firm's non-trading book to counterparties* falling within ■ BIPRU 10.10A.1 R, even though there is no explicit limit to such *counterparties* in ■ BIPRU 10.5.6 R (large exposures limit).

**10.10A.3**  
**FCA PRA**

**R**

*A firm must ensure that the total amount of its trading book exposures to its counterparties falling within ■ BIPRU 10.10A.1 R does not exceed 500% of the firm's capital resources calculated at stage (T) of the capital resources table (Total capital after deductions).*

**How to calculate the concentration risk capital component**

**10.10A.4**  
**FCA PRA**

**G**

*A firm's CNCOM should be calculated as part of its credit risk capital requirement (CRCR) in accordance with ■ GENPRU 2.1 (Calculation of capital resources requirements).*

**10.10A.5**  
**FCA PRA**

**R**

*A firm's CNCOM is the sum of its individual counterparty CNCOMS.*

**10.10A.6**  
**FCA PRA**

**R**

*An individual counterparty CNCOM is the amount a firm must calculate in accordance with ■ BIPRU 10.10A.8R with respect to its exposures to its counterparties falling within ■ BIPRU 10.10A.1 R .*

**10.10A.7**  
**FCA PRA**

**G**

*A CNCOM calculation on a trading book exposure is in addition to, and not instead of, any capital requirement arising under the market risk capital requirement or counterparty risk capital component.*

10

10.10A.8

R

FCA PRA

A firm must calculate its *individual counterparty CNCOM* for its *exposures* to its *counterparties* falling within ■ BIPRU 10.10A.1 R as follows:

- (1) break down its *total exposure* into its *trading book* and *non-trading book* components;
- (2) calculate 25% of the *firm's capital resources* calculated at stage (N) of the calculation in the *capital resources table* (Total tier one capital plus tier two capital after deductions) to determine the total amount of the *exposures* in the *firm's non-trading book* does not exceed this limit in accordance with ■ BIPRU 10.10A.2R (1);
- (3) calculate 25% of the *firm's capital resources* calculated at stage (T) of the *capital resources table* (Total capital after deductions) and deduct those parts of the *total exposure* which are in the *non-trading book* falling within the limit in (2);
- (4) a firm must allocate (in the order set out in (6)) *trading book exposures* to its *counterparties* falling within ■ BIPRU 10.10A.1 R to the unutilised portion of the 25% limit of the *firm's capital resources* calculated at stage (T) of the *capital resources table* (Total capital after deductions) remaining after deducting the *non-trading book exposures* in accordance with (3);
- (5) no further *trading book exposures* can be allocated once the 25% limit in (4) has been reached; the remaining *trading book exposures* constitute the *trading book concentration risk excess* with respect to its *counterparties* falling within ■ BIPRU 10.10A.1 R ;
- (6) for the purposes of (4), a firm must allocate the *trading book exposures* in the order of the level of capital requirements, starting with the lowest capital requirements for *specific risk* under the *market risk capital requirement* and/or the lowest capital requirements under the *counterparty risk capital component* and moving towards those *trading book exposures* with the highest capital requirements last;
- (7) the *individual counterparty CNCOM* is the sum of the capital requirements for each individual *exposure* included in the *trading book concentration risk excess* in accordance with (8) and (9) (each such capital requirement being an *individual CNCOM*);
- (8) if the *trading book concentration risk excess* has persisted for 10 *business days* or less (irrespective of the age of each component part), the *individual CNCOMs* must be calculated in accordance with this formula:

each *individual CNCOM* = capital requirement referred to in (6) 200%;

- (9) if the *trading book concentration risk excess* has persisted for more than 10 *business days* (irrespective of the age of each component part), the *individual CNCOMs* must be calculated in accordance with this formula:

each *individual CNCOM* = capital requirement referred to in (6) appropriate percentage in ■ BIPRU 10.10A.9R.

10.10A.9  
FCA PRA

R

The appropriate percentage referred to in ■ BIPRU 10.10A.8R (9) must be established in accordance with the following:

- (1) the individual exposures included in the *trading book concentration risk excess* must be assigned to the bands in the first column of the table in ■ BIPRU 10.10A.10R;
- (2) the maximum amount that may be put in any band other than the last equals the percentage of the *firm's capital resources* in column 1 of that table;
- (3) no amount may be allocated to the second or any later band unless the one before has been filled;
- (4) *exposures* must be assigned to the bands in the order established by ■ BIPRU 10.10A.8R (6); and
- (5) for the purposes of (4), those *exposures* with the lowest capital requirements (as referred to in ■ BIPRU 10.10A.8R (6)) must be assigned first and those with the highest last.

**Percentages applicable under BIPRU 10.10A.9R**

10.10A.10  
FCA PRA

R

This table belongs to ■ BIPRU 10.10A.9 R

<i>Trading book concentration risk excess</i> (as a percentage of the <i>firm's capital resources</i> calculated at stage (T) of the <i>capital resources table</i> (Total capital after deductions))	Percentage
Up to 40%	200%
Portion from 40% - 60%	300%
Portion from 60% - 80%	400%
Portion from 80% - 100%	500%
Portion from 100% - 250%	600%
Portion over 250%	900%

**How CNCOM applies to the non-core large exposures group**

10.10A.11  
FCA PRA

**R**

A firm that has a *non-core large exposures group waiver* must meet the CNCOM in relation to *exposures* to members of its *non-core large exposures group* in accordance with this section, subject to the following:

- (1) in ■ BIPRU 10.10A.8 R, 25% is substituted with 100%; and
- (2) the excess *exposures* for the purpose of ■ BIPRU 10.10A.8R (9) must be assigned to the bands in the first column of the table in ■ BIPRU 10.10A.10 R beginning with the portion from 100% - 250%.

**Core UK group and non-core large exposures group: treatment of the trading book concentration risk excess**

10.10A.12  
FCA PRA

**R**

- (1) This rule applies to a firm that has a *core UK group waiver* or a *non-core large exposures group waiver*.
- (2) A firm must calculate the CNCOM in relation to the *core UK group* in question in accordance with ■ BIPRU 10.10A.2 R (Trading book limits).
- (3) A firm must then calculate the percentage of the amount calculated under (2) which is attributable to *exposures* of the firm.
- (4) A firm must add the result of the calculation in (3) to the CNCOM applied to the firm on a solo basis in accordance with ■ BIPRU 10.10A.5R to ■ BIPRU 10.10A.11R (How to calculate the concentration risk capital component).

**Examples**

10.10A.13  
FCA PRA

**G**

- (1) The table in ■ BIPRU 10.10A.14G sets out an example of a CNCOM calculation under ■ BIPRU 10.10A.8R.
- (2) ■ BIPRU 10 Annex 2 G (Examples of treatment of exposures under BIPRU 10) sets out examples of how the *large exposures* limits apply, particularly in relation to a *core UK group* and *non-core large exposures group*, taking into account various examples of firm's *exposure* profiles.

**Example of a CNCOM calculation (all numbers 000s)**

10.10A.14  
FCA PRA

**G**

This table belongs to ■ BIPRU 10.10A.13G (1)

Capital resources position	
(1)	An firm's capital resources comprises:
	Tier one and tier two capital resources 1000
	Eligible tier three capital resources 100
	Amended capital resources 1100
(2)	The components of the large exposure comprise:

10

Capital resources position	
(a) <i>Non-trading book exposure</i>	200
(b) Mark to market value of <i>trading book</i> securities:	
% <i>specific risk weight</i>	
Short: qualifying bond 1.00	(20)
Long: qualifying commercial paper 0.25	100
Long: equity 4.00	150
Long: qualifying convertible 1.60	30
Total net long securities position:	260
Total net large exposures position [(a) + (b)]	460
Calculating the exposure for which incremental capital is needed	
(3) The short position in the qualifying bond is offset against the highest specific risk weight items - in this case equities:	
Net long equity position (150- 20)	130
(4) The remaining items are ranked according to specific risk weight.	
% <i>specific risk weight</i>	Security
0.25	Qualifying commercial paper 100
1.60	Qualifying convertible 30
4.00	Equity (net) 130
(5) The 'headroom' between the <i>non-trading book</i> exposure and 25% of the amended <i>capital resources</i> is calculated.	
25% of amended capital base (1100)	275
<i>Non-trading book exposure</i>	200
Headroom	75
(6) Applying the securities positions in ascending order of specific <i>risk weight</i> , 75 of the 100 qualifying commercial paper may be counted before 25% of the amended capital base is reached.	
The remaining 25 of qualifying commercial paper, along with 30 qualifying convertible and 130 equity (net) are traded securities <i>exposures</i> in excess of the limit and should therefore be covered by incremental capital. The amount of incremental capital should be included in the calculation for determining how much <i>trading book</i> capital a <i>firm</i> should have.	
(7) If the excess <i>exposure</i> has been outstanding for 10 days or less, the specific <i>risk weights</i> for the elements over 25% of amended <i>capital resources</i> should be doubled.	
The 25% limit (275) is taken up by 200 <i>non-trading book exposure</i> and 75 <i>trading book exposure</i> within the limit. These two items, when added to the items in bold below, total 460. 460 is the total net <i>large exposures</i> position as set out in (2) above.	
Qualifying commercial paper <b>25</b> x 0.25% x 200% =	0.125

Capital resources position		
Qualifying convertible	<b>30</b> x 1.60% x 200% =	0.960
Equity	<b>130</b> x 4% x 200% =	10.400
Additional capital requirement		11.485
(8)	If the excess <i>exposure</i> has been outstanding for more than 10 days, the 25% limit (275) is taken up by 200 <i>non-trading book exposure</i> and 75 <i>trading book exposure</i> within the limit. These two items, when added to the items in bold below, total 460. 460 is the total net <i>large exposures</i> position as set out in (2) above.	
(a)	Over 25% and up to 40% of amended capital base at 200% (40% of 1100 = 440)	
	Amount of <i>trading book concentration risk excess</i> = 185	
	Appropriate % Multiplier Band = 200%	
	<b>25</b> x 0.25% x 200% =	0.125
	<b>30</b> x 1.60% x 200% =	0.960
	<b>110</b> x 4.00% x 200% =	8.800
(b)	Excess exposure 40% - 60% of amended capital base at 300%	
	<b>20</b> x 4.00% x 300% =	2.400
	Additional capital requirement [(a)+(b)]	12.285



**10.11 [deleted]**

**10.11.1**  
**10.11.2**



## 10.12 Systems and controls and general

### Systems and controls

10.12.1  
FCA PRA

R

A *firm* must have sound administrative and accounting procedures and adequate internal control mechanisms for the purposes of identifying and recording all *large exposures* and subsequent changes to them, and for that of monitoring those *large exposures* in the light of the *firm's* own *exposure* policies.

10.12.2  
FCA PRA

R

A *firm* must take reasonable care to establish and maintain adequate systems and controls to identify, monitor, and control *exposures* to a *parent undertaking* of the *firm*, a *subsidiary undertaking* of the *firm*, or a *subsidiary undertaking* of the *firm's* *parent undertaking*.

### Concentration risk policies

10.12.3  
FCA PRA

R

A *firm* must be able to demonstrate to the *appropriate regulator* that:

- (1) it has written policies and procedures to address and control the concentration risk arising from:
  - (a) *exposures* to *counterparties* and *groups of connected clients*;
  - (b) *counterparties* in the same economic sector or geographic region;
  - (c) the same activity or *commodity*; and
  - (d) the application of *credit risk mitigation* techniques, including in particular risks associated with large indirect credit exposures (for example to a single collateral issuer); and
- (2) those policies and procedures are implemented.

### Reporting

PAGE 47  
10.12.4  
FCA PRA

R

Other than in relation to *repurchase transactions* or *securities or commodities lending or borrowing transactions*, *exposures* must be reported on a gross basis, not including the recognition of *credit risk mitigation*.

**Artificial transactions**

10.12.5

**FCA PRA**

**R**

In line with the general principle in ■ GENPRU 2.2.1 R (Purposive interpretation) a *firm* must not, with a view to avoiding the additional capital requirements that it would otherwise incur on *exposures* exceeding the limits laid down in ■ BIPRU 10.5 (Limits on exposures and large exposures) once those *exposures* have been maintained for more than ten *business days*:

- (1) temporarily transfer the *exposures* in question to another *person* (whether in the same *group* or not); or
- (2) undertake artificial transactions to close out the *exposure* during the ten *business day* period and create a new *exposure*.

10.12.6

**FCA PRA**

**R**

A *firm* must notify the *appropriate regulator* if it enters into a transfer, transaction or arrangement of the type mentioned in ■ BIPRU 10.12.5 R.

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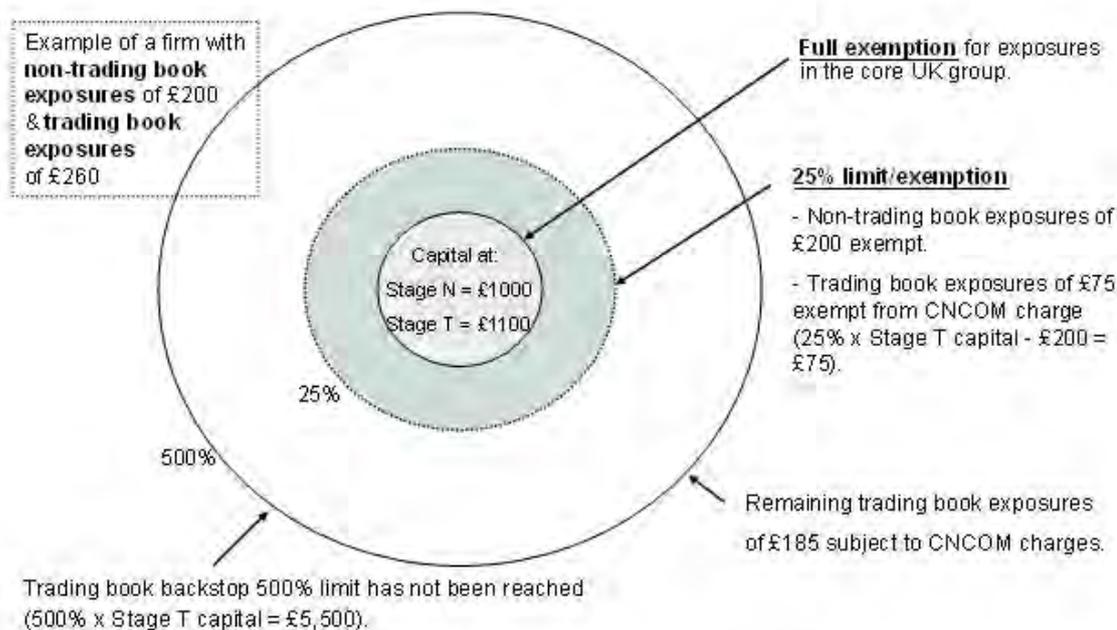


**Examples of treatment of intra-group exposures under BIPRU 10**

**FCA PRA**

Example 1

Intra group large exposures: CNCOM calculation  
(example of BIPRU 10.10A.14 G)



CNCOM charges as follows:

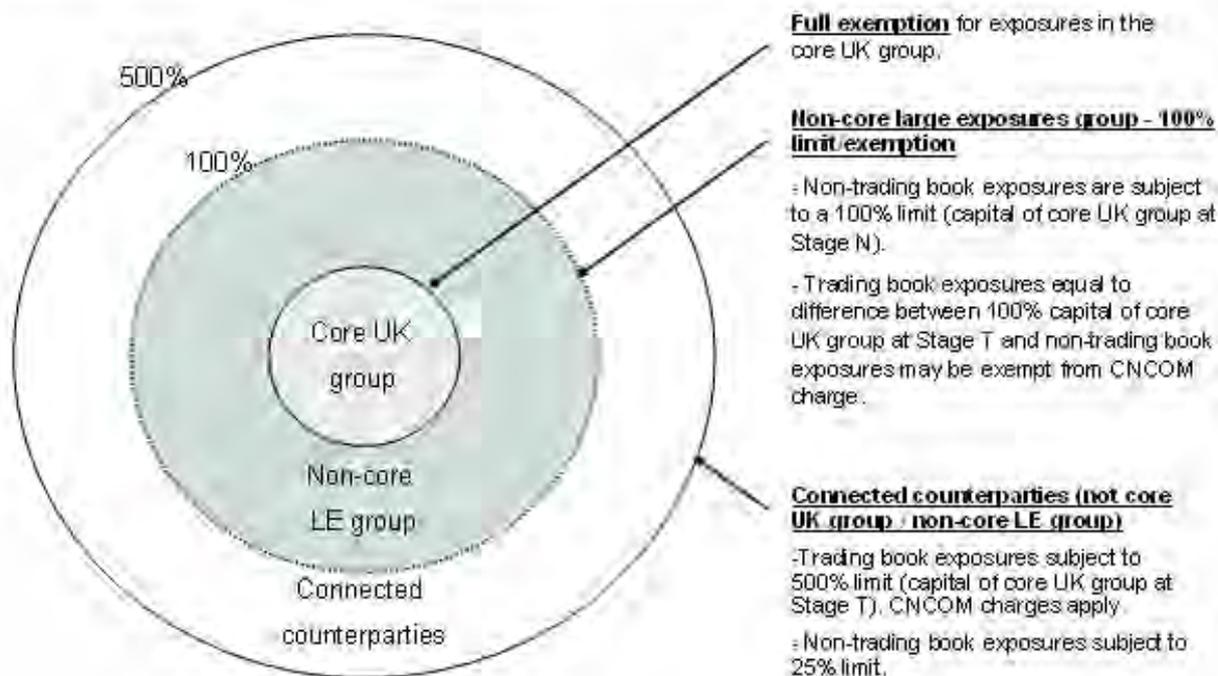
Trading book exposures of £75 exempt from CNCOM, CNCOM band charges start at 25%.

If excess exposures are >10 days, CNCOM bands calculated as:

25% - 40%	(£275 - £440)	=	£165	@	200%
40% - 60%	(£ remainder)	=	£20	@	300%
			£185		

Example 2

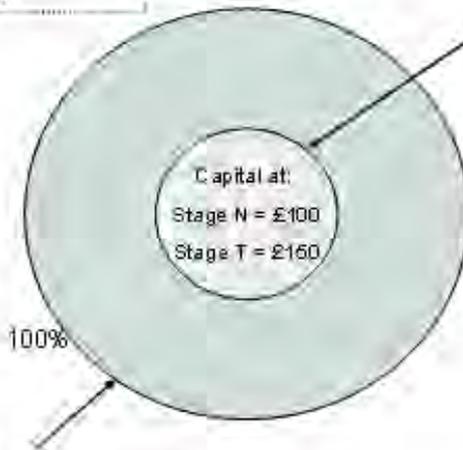
Intra group large exposures: Overview of interaction between BIPRU 10.8A (Core UK group), BIPRU 10.9A (Non-core LE group) & BIPRU 10.10A (Trading book limits)



Example 3

Intra group large exposures: example of non-trading book exposures

Example of a firm with intra group **non-trading book exposures** of £100



**Full exemption** for exposures in the core UK group.

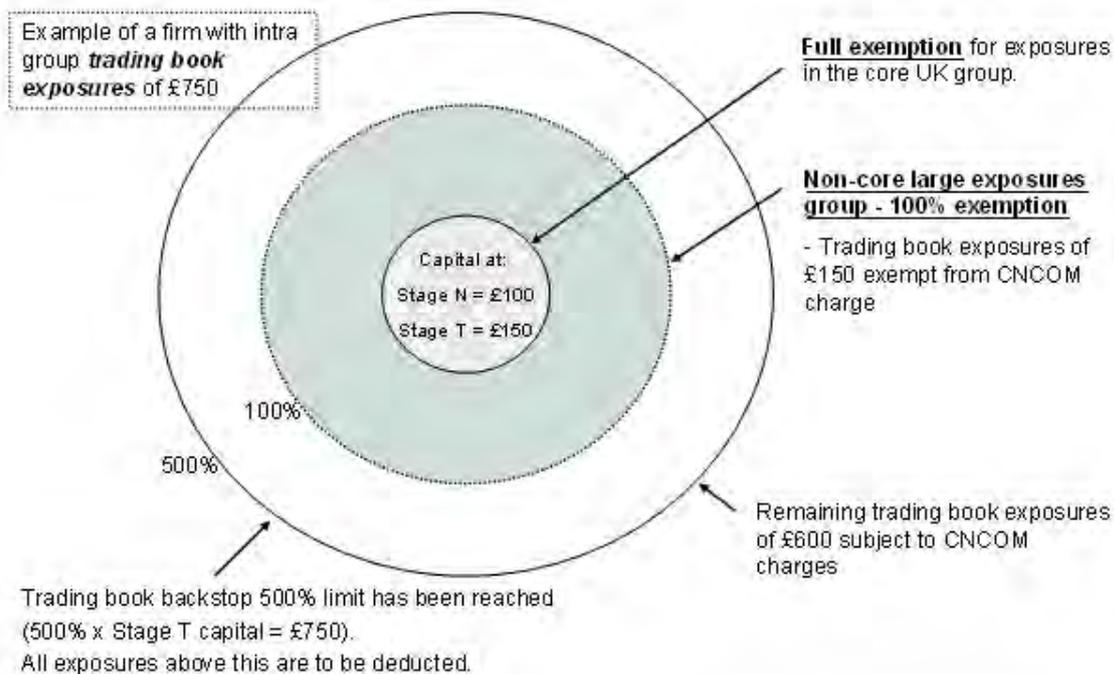
**Non-core large exposures group - 100% limit**

- Non-trading book exposures of £100

Non-trading book backstop of 100% limit has been reached (100% x Stage N capital = £100). All exposures above this are to be deducted.

Example 4

Intra group large exposures: example of trading book exposures



CNCOM charges as follows:

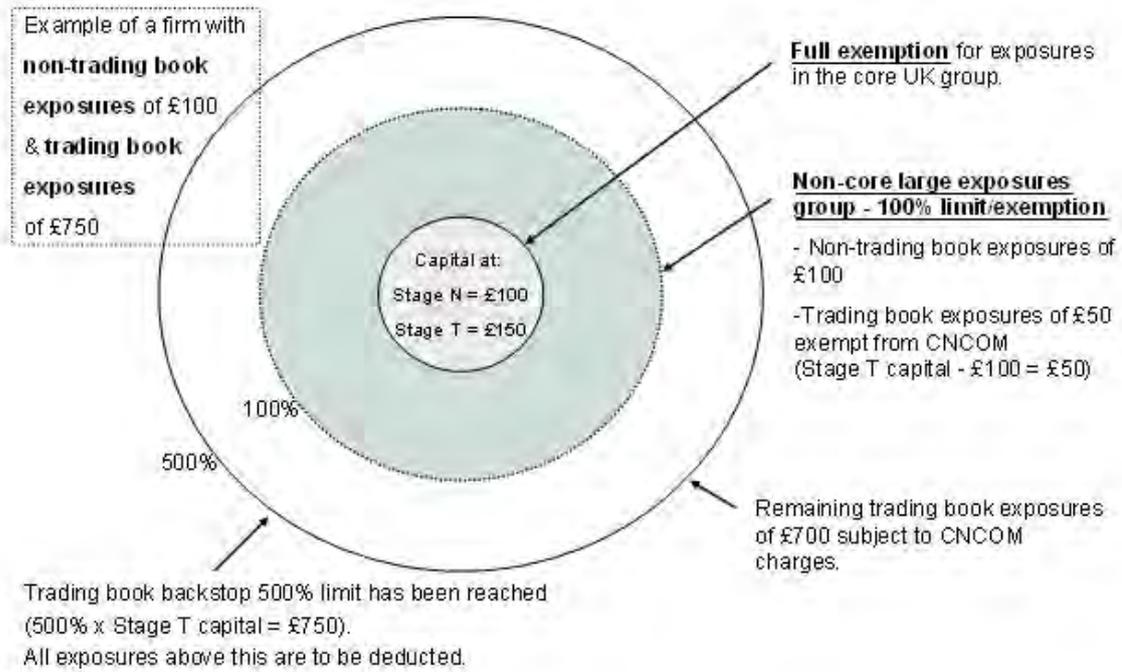
Trading book exposures of £150 exempt from CNCOM, CNCOM band charges start at 100%.

If excess exposures are >10 days, CNCOM bands calculated as:

100% - 250%	(£150 - £375)	=	£225	@	600%
>250%	(£ remainder)	=	£375	@	900%
			£600		

Example 5

Intra group large exposures: example of non-trading book & trading book exposures



CNCOM charges as follows:

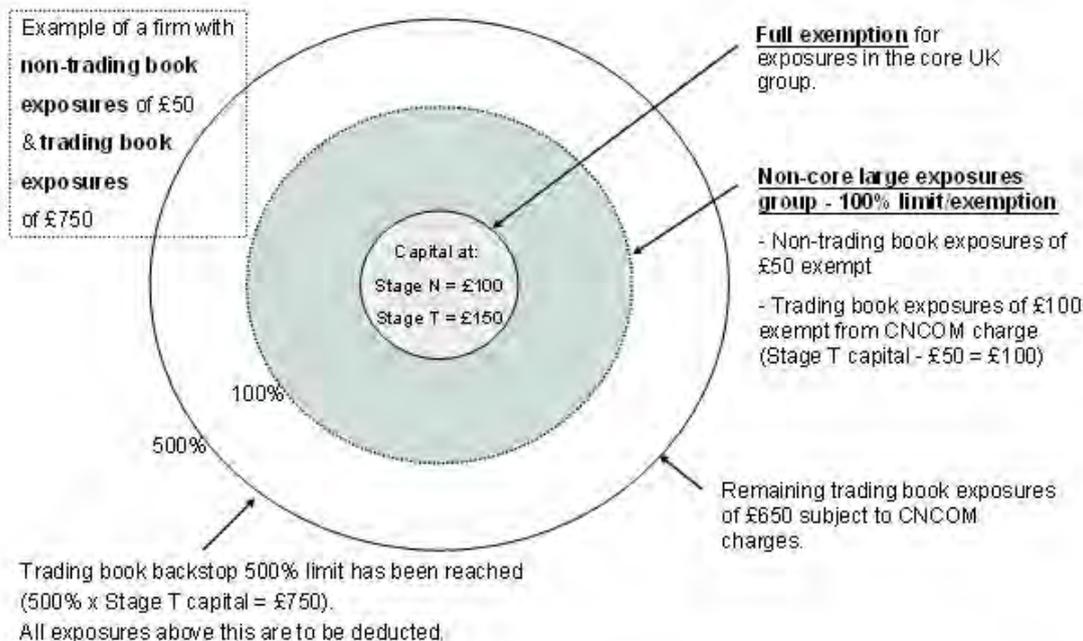
Trading book exposures of £50 exempt from CNCOM, CNCOM band charges start at 100%.

If excess exposures are >10 days, CNCOM bands calculated as:

100% - 250%	(£150 - £375)	=	£225	@ 600%
>250%	(£ remainder)	=	£475	@ 900%
			£700	

Example 6

Intra group large exposures: example of non-trading book & trading book exposures



CNCOM charges as follows:

Trading book exposures of £100 exempt from CNCOM, CNCOM band charges start at 100%,

If excess exposures are >10 days, CNCOM bands calculated as:

100% - 250%	(£150 - £375)	=	£225	@	600%
>250%	(£ remainder)	=	£425	@	900%
			£650		

# Chapter 11

## Disclosure (Pillar 3)



## 11.1 Application and purpose

### Application

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11.1.1

FCA PRA

R

■ BIPRU 11 applies to a *BIPRU firm*.

### Purpose

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11.1.2

FCA PRA

G

The purpose of BIPRU 11 is to implement:

- (1) (a) Article 68(3);  
(b) Article 72;  
(c) Articles 145 to 149; and  
(d) Annex XII;  
of the *Banking Consolidation Directive*; and
- (2) (a) Article 2, in part;  
(b) Point 3 of Article 23, in part; and  
(c) Article 39;  
of the *Capital Adequacy Directive*.

## 11.2 Basis of disclosures

### Disclosure on an individual basis

11.2.1

R

FCA PRA

The following must comply with the obligations laid down in ■ BIPRU 11.3 on an individual basis:

- (1) a *firm* which is neither a *parent undertaking* nor a *subsidiary undertaking*;
- (2) a *firm* which is excluded from a *UK consolidation group* or *non-EEA sub-group* pursuant to ■ BIPRU 8.5; and

[Note: BCD Article 68(3)]

- (3) a *firm* which is part of a *group* which has been granted an *investment firm consolidation waiver* under ■ BIPRU 8.4;

[Note: CAD.Article 23]

### EEA parent institutions

11.2.2

R

FCA PRA

A *firm* which is an *EEA parent institution* must comply with the obligations laid down in ■ BIPRU 11.3 on the basis of its consolidated financial situation.

[Note: BCD Article 72(1)]

11.2.3

R

FCA PRA

A *firm* which is a significant subsidiary of an *EEA parent institution* must disclose the information specified in ■ BIPRU 11.4.5 R on an individual or sub-consolidated basis.

### Firms controlled by an EEA parent financial holding company

11.2.4

R

FCA PRA

A *firm controlled by an EEA parent financial holding company* must comply with the obligations laid down in ■ BIPRU 11.3 on the basis of the consolidated financial situation of that *EEA parent financial holding company*.

[Note: BCD Article 72(2)]

11.2.5

FCA PRA

R

A *firm* which is a significant subsidiary of an *EEA parent financial holding company* must disclose the information specified in ■ BIPRU 11.4.5 R on an individual or sub-consolidated basis.

**Waiver: Comparable disclosures provided on a consolidated basis by a parent undertaking established in a third country**

11.2.6

FCA PRA

G

A *firm* which is included within comparable disclosures provided on a consolidated basis by a *parent undertaking* whose head office is not in an *EEA State* may apply for a *waiver* from the relevant disclosure requirements in ■ BIPRU 11.2.2 R - ■ BIPRU 11.2.5 R. The *appropriate regulator's* approach to granting *waivers* is set out in the Supervision manual (see ■ SUP 8).

[Note: BCD Article 72(3)]

11.2.7

FCA PRA

G

A *firm* applying for a *waiver* from one or more of the disclosure requirements in ■ BIPRU 11.2.2 R - ■ BIPRU 11.2.5 R will need to:

- (1) satisfy the *appropriate regulator* that it is included within comparable disclosures provided on a consolidated basis by a *parent undertaking* whose head office is not in an *EEA State*; and
- (2) notify the *appropriate regulator* of the location where the comparable disclosures are provided.

## 11.3 Disclosures: Information to be disclosed; Frequency, media and location of disclosures; Verification

### Information to be disclosed

11.3.1

FCA PRA

R

A *firm* must publicly disclose the information laid down in ■ BIPRU 11.5 subject to the provisions laid down in ■ BIPRU 11.3.5 R to ■ BIPRU 11.3.7 R.

[Note: BCD Article 145(1), CAD Article 39]

11.3.2

FCA PRA

R

- (1) A *firm* which has an *IRB permission* must publicly disclose the information laid down in ■ BIPRU 11.6.1 R to ■ BIPRU 11.6.4 R.
- (2) A *firm* which recognises *credit risk mitigation* in accordance with ■ BIPRU 5 must publicly disclose the information laid down in ■ BIPRU 11.6.5 R.
- (3) A *firm* using the *advanced measurement approach* for the calculation of its *operational risk capital requirement* must publicly disclose the information laid down in ■ BIPRU 11.6.6 R.

[Note: BCD Article 145(2), CAD Article 39]

### Disclosure policy

11.3.3

FCA PRA

R

- (1) A *firm* must adopt a formal policy to comply with the disclosure requirements laid down in ■ BIPRU 11.3.1 R and ■ BIPRU 11.3.2 R and have policies for assessing the appropriateness of its disclosures, including their verification and frequency.
- (2) A *firm* must also have policies for assessing whether its disclosures convey its risk profile comprehensively to market participants. Where those disclosures do not convey its risk profile comprehensively to market participants, a *firm* must publicly disclose the information necessary in addition to that required according to ■ BIPRU 11.3.3R (1). However, a *firm* may omit one or more items of information if those items are not, in the light of the criterion specified in ■ BIPRU 11.4.1 R, regarded as material, or if those items are, in the light of the criteria specified in ■ BIPRU 11.4.2 R and ■ BIPRU 11.4.3 R, regarded as proprietary or confidential.

[Note: BCD Article 145(3)]

#### Rating decisions

11.3.4

FCA PRA

R

A *firm* must, if requested, explain its rating decisions to SMEs and other corporate applicants for loans, providing an explanation in writing when asked. The administrative costs of the explanation have to be at an appropriate rate to the size of the loan.

[Note: BCD Article 145(4)]

#### Exemption from disclosure: Materiality

11.3.5

FCA PRA

R

A *firm* may omit one or more of the disclosures listed in ■ BIPRU 11.5 if the information provided by such disclosures is not, in the light of the criterion specified in ■ BIPRU 11.4.1 R, regarded as material.

[Note: BCD Article 146(1)]

#### Exemption from disclosure: Proprietary or confidential information

11.3.6

FCA PRA

R

A *firm* may omit one or more items of information included in the disclosures listed in ■ BIPRU 11.5 and ■ BIPRU 11.6 if those items include information which, in the light of the criteria specified in ■ BIPRU 11.4.2 R and ■ BIPRU 11.4.3 R, is regarded as proprietary or confidential.

[Note: BCD Article 146(2)]

11.3.7

FCA PRA

R

In the exceptional cases referred to in ■ BIPRU 11.3.6 R, a *firm* must:

- (1) state in its disclosures:
  - (a) the fact that the specific items of information are not disclosed; and
  - (b) the reason for non-disclosure; and
- (2) publish more general information about the subject matter of the disclosure requirement, except where these are to be classified as secret or confidential under the criteria set out in ■ BIPRU 11.4.2 R and ■ BIPRU 11.4.3 R.

[Note: BCD Article 146(3)]

#### Frequency of publication

11.3.8

FCA PRA

R

A *firm* must:

- (1) publish the disclosures required under ■ BIPRU 11.3.1 R to ■ BIPRU 11.3.5 R on an annual basis at a minimum;
- (2) publish disclosures as soon as practicable.

[Note: BCD Article 147(1)]

11.3.9

FCA PRA

R

A *firm* must also determine whether more frequent publication than is provided for in ■ BIPRU 11.3.8 R is necessary in the light of the criteria set out in ■ BIPRU 11.4.4 R.

[Note: BCD Article 147(2)]

#### Media and location of publication

11.3.10

FCA PRA

R

- (1) A *firm* may determine the appropriate medium, location and means of verification to comply effectively with the disclosure requirements laid down in ■ BIPRU 11.3.1 R to ■ BIPRU 11.3.4 R.
- (2) To the degree feasible, a *firm* must provide all disclosures in one medium or location.
- (3) Equivalent disclosures made by a *firm* under accounting, *listing* or other requirements may be deemed to constitute compliance with ■ BIPRU 11.3.1 R to ■ BIPRU 11.3.4 R.
- (4) If disclosures are not included in the financial statements, a *firm* must indicate where they can be found.

[Note: BCD Article 148]

## 11.4 Technical criteria on disclosure: General criteria

### Criterion for materiality

11.4.1

FCA PRA

R

A *firm* must regard information as material in disclosures if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.

[Note: BCD Annex XII Part 1 point 1]

### Criteria: Proprietary or confidential information

11.4.2

FCA PRA

R

- (1) A *firm* must regard information as proprietary information if sharing that information with the public would undermine its competitive position.
- (2) Proprietary information may include information on products or systems which, if shared with competitors, would render a *firm's* investments therein less valuable.

[Note: BCD Annex XII Part 1 point 2]

11.4.3

FCA PRA

R

A *firm* must regard information as confidential if there are obligations to customers or other counterparty relationships binding the *firm* to confidentiality.

[Note: BCD Annex XII Part 1 point 3]

### Criteria: Frequency of publication

11.4.4

FCA PRA

R

- (1) A *firm* must assess the need to publish some or all disclosures more frequently than annually in the light of the relevant characteristics of its business such as:
  - (a) scale of operations;
  - (b) range of activities;
  - (c) presence in different countries;
  - (d) involvement in different financial sectors;
  - (e) participation in international financial markets; and

(f) participation in payment, settlement and clearing systems.

(2) In making its assessment under (1) a *firm* must pay particular attention to the possible need for more frequent disclosure of:

- (a) items of information laid down in ■ BIPRU 11.5.3 R (2) and ■ BIPRU 11.5.3 R (5), and ■ BIPRU 11.5.4 R (2) - ■ BIPRU 11.5.4 R (5);
- (b) information on risk exposure and other items prone to rapid change.

[Note: BCD Annex XII Part 1 point 4]

#### Disclosures: Significant subsidiaries

11.4.5

FCA PRA

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A *firm* which is a significant subsidiary of:

- (1) an *EEA parent institution*; or
- (2) an *EEA parent financial holding company*;

must disclose the information specified in ■ BIPRU 11.5.3 R to ■ BIPRU 11.5.4 R on an individual or sub-consolidated basis.

[Note: BCD Annex XII Part 1 point 5]

## 11.5 Technical criteria on disclosure: General requirements

### Disclosure: Risk management objectives and policies

11.5.1

FCA PRA

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A *firm* must disclose its risk management objectives and policies for each separate category of risk, including the risks referred to under ■ BIPRU 11.5.1 R to ■ BIPRU 11.5.17 R. These disclosures must include:

- (1) the strategies and processes to manage those risks;
- (2) the structure and organisation of the relevant risk management function or other appropriate arrangements;
- (3) the scope and nature of risk reporting and measurement systems; and
- (4) the policies for hedging and mitigating risk, and the strategies and processes for monitoring the continuing effectiveness of hedges and mitigants.

[Note: BCD Annex XII Part 2 point 1]

### Disclosure: Scope of application of directive requirements

11.5.2

FCA PRA

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A *firm* must disclose the following information regarding the scope of application of the requirements of the *Banking Consolidation Directive*:

- (1) the name of the *firm* which is the subject of the disclosures;
- (2) an outline of the differences in the basis of consolidation for accounting and prudential purposes, with a brief description of the entities that are:
  - (a) fully consolidated;
  - (b) proportionally consolidated;
  - (c) deducted from *capital resources*;
  - (d) neither consolidated nor deducted;

- (3) any current or foreseen material practical or legal impediment to the prompt transfer of *capital resources* or repayment of liabilities among the *parent undertaking* and its *subsidiary undertakings*;
- (4) the aggregate amount by which the actual *capital resources* are less than the required minimum in all *subsidiary undertakings* not included in the consolidation, and the name or names of such *subsidiary undertakings*; and
- (5) if applicable, the circumstance of making use of the provisions laid down in ■ BIPRU 2.1 (Solo consolidation waiver).

[Note: BCD Annex XII Part 2 point 2]

#### Disclosure: Capital resources

11.5.3

FCA PRA

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A firm must disclose the following information regarding its *capital resources*:

- (1) summary information on the terms and conditions of the main features of all *capital resources* items and components thereof, including:
  - (a) *hybrid capital*;
  - (b) *capital instruments* which provide an incentive for the firm to redeem them; and
  - (c) *capital instruments* which the firm treats as *tier one capital* under ■ GENPRU TP8A;
- (2) *tier one capital resources*, with separate disclosure of:
  - (a) all positive items and deductions;
  - (b) the overall amount of *hybrid capital*, with specification of those instruments treated as *tier one capital* under ■ GENPRU TP 8A.1; and
  - (c) the overall amount of *capital instruments* that provide for an incentive to redeem them, with specification of those instruments treated as *tier one capital* under ■ GENPRU TP 8A.1;
- (3) the total amount (for the purposes of (3), the total amount must be stated gross of deductions) of:
  - (a) *tier two capital resources* plus any *innovative tier one capital resources*; and
  - (b) *tier three capital resources*;

- (4) deductions from *tier one capital resources* and *tier two capital resources*, with separate disclosure of items referred to in ■ GENPRU 2.2.236 R; and
- (5) total *capital resources*, net of deductions in ■ GENPRU 2.2 and limits laid down in ■ GENPRU 2.2.25 R to ■ GENPRU 2.2.30 R and ■ GENPRU 2.2.42 R to ■ GENPRU 2.2.50 R.

[Note: BCD Annex XII Part 2 point 3]

**Disclosure: Compliance with BIPRU 3, BIPRU 4, BIPRU 6, BIPRU 7, BIPRU 10 and the overall Pillar 2 rule**

11.5.4

FCA PRA

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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*:

- (1) a summary of the *firm's* approach to assessing the adequacy of its internal capital to support current and future activities;
- (2) for a *firm* calculating *risk weighted exposure amounts* in accordance with the *standardised approach* to credit risk, 8% of the *risk weighted exposure amounts* for each of the *standardised credit risk exposure classes*;
- (3) for a *firm* calculating *risk weighted exposure amounts* in accordance with the *IRB approach*, 8% of the *risk weighted exposure amounts* for each of the *IRB exposure classes*;

[Note: BCD Annex XII Part 2 point 4 (part)]

- (4) the *firm's* minimum capital requirements for the following:
  - (a) in respect of its *trading-book* business, its:
    - (i) *interest rate PRR*;
    - (ii) *equity PRR*;
    - (iii) *option PRR*;
    - (iv) *collective investment schemes PRR*;
    - (v) *counterparty risk capital component*;
    - (vi) *concentration risk capital component*; and
  - (b) in respect of all of its business activities, its:
    - (i) *commodity PRR*; and
    - (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)]

## 11.5.5

FCA PRA

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For *retail exposures*, the requirement under ■ BIPRU 11.5.4 R (3) applies to each of the following categories:

- (1) *exposures to retail SMEs*;
- (2) *retail exposures* secured by real estate collateral;
- (3) *qualifying revolving retail exposures*; and
- (4) other *retail exposures*.

[Note: BCD Annex XII Part 2 point 4(part)]

## 11.5.6

FCA PRA

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For *equity exposures*, the requirement under ■ BIPRU 11.5.4 R (3) applies to:

- (1) each of the approaches ( the simple risk weight approach, the PD/LGD approach and the internal models approach) provided for in ■ BIPRU 4.7.5 R to ■ BIPRU 4.7.6 R, ■ BIPRU 4.7.9 R to ■ BIPRU 4.7.11 R, ■ BIPRU 4.7.14 R to ■ BIPRU 4.7.16 R, ■ BIPRU 4.7.24 R to ■ BIPRU 4.7.25 R;
- (2) exchange traded *exposures*, private *equity exposures* in sufficiently diversified portfolios, and other *exposures*;
- (3) *exposures* subject to supervisory transition regarding capital requirements; and
- (4) *exposures* subject to grandfathering provisions regarding capital requirements.

[Note: BCD Annex XII Part 2 point 4(part)]

## 11.5.7

FCA PRA

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A *firm* must disclose the following information regarding its *exposure to counterparty credit risk*:

- (1) a discussion of the methodology used to assign internal capital and credit limits for counterparty credit *exposures*;
- (2) a discussion of policies for securing collateral and establishing credit reserves;
- (3) a discussion of policies with respect to *wrong-way risk exposures*;

- (4) a discussion of the impact of the amount of collateral the *firm* would have to provide given a downgrade in its credit rating;
- (5) gross positive fair value of contracts, netting benefits, netted current credit *exposure*, collateral held and 'net derivatives credit *exposure*', where 'net derivatives credit *exposure*' is the credit *exposure* on derivatives transactions after considering both the benefits from legally enforceable netting agreements and collateral arrangements;
- (6) measures for exposure value under the *CCR mark to market method*, the *CCR standardised method* or the *CCR internal model method*, whichever is applicable;
- (7) the notional value of credit derivative hedges, and the distribution of current credit *exposure* by types of credit *exposure*;
- (8) credit derivative transactions (notional), segregated between use for the *firm's* own credit portfolio, as well as in its intermediation activities, including the distribution of the credit derivatives products used, broken down further by protection bought and sold within each product group; and
- (9) the estimate of alpha ( $\alpha$ ) if the *firm's CCR internal model method permission* permits it to estimate  $\alpha$ .

[Note: *BCD Annex XII Part 2 point 5*]

#### Disclosure: Credit risk and dilution risk

A *firm* must disclose the following information regarding its *exposure* to credit risk and *dilution risk*:

- (1) the definitions for accounting purposes of past due and impaired;
- (2) a description of the approaches and methods adopted for determining value adjustments and provisions;
- (3) the total amount of *exposures* after accounting offsets and without taking into account the effects of *credit risk mitigation*, and the average amount of the *exposures* over the period broken down by different types of *exposure* classes;
- (4) the geographic distribution of the *exposures*, broken down in significant areas by material *exposure* classes, and further detailed if appropriate;

11.5.8

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- (5) the distribution of the *exposures* by industry or counterparty type, broken down by *exposure* classes, and further detailed if appropriate;
- (6) the residual maturity breakdown of all the *exposures*, broken down by *exposure* classes, and further detailed if appropriate;
- (7) by significant industry or counterparty type, the amount of:
  - (a) impaired *exposures* and past due *exposures*, provided separately;
  - (b) value adjustments and provisions; and
  - (c) charges for value adjustments during the period;
- (8) the amount of the impaired *exposures* and past due *exposures*, provided separately, broken down by the significant geographical areas including, if practical, the amounts of value adjustments and provisions related to each geographical area;
- (9) the reconciliation of changes in the value adjustments and provisions for impaired *exposures*, shown separately; and
- (10) value adjustments and recoveries recorded directly to the income statement must be disclosed separately.

[Note: BCD Annex XII Part 2 point 6 (part)]

## 11.5.9

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The information to be disclosed under ■ BIPRU 11.5.8 R (9) must comprise:

FCA PRA

- (1) a description of the type of value adjustments and provisions;
- (2) the opening balances;
- (3) the amounts taken against the provisions during the period;
- (4) the amounts set aside or reversed for estimated probable losses on *exposures* during the period, any other adjustments including those determined by exchange rate differences, business combinations, acquisitions and disposals of *subsidiary undertakings*, and transfers between provisions; and
- (5) the closing balances.

[Note: BCD Annex XII Part 2 point 6 (part)]

11.5.10

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**Disclosure: Firms calculating risk weighted exposure amounts in accordance with the standardised approach**

For a *firm* calculating *risk weighted exposure amounts* in accordance with the *standardised approach* to credit risk, the following information must be disclosed for each of the *standardised credit risk exposure classes*;

- (1) the names of the *nominated ECAIs* and export credit agencies and the reasons for any changes;
- (2) the *standardised credit risk exposure classes* for which each *ECAI* or export credit agency is used;
- (3) a description of the process used to transfer the issuer and issue credit assessments onto items not included in the *trading book*;
- (4) the association of the external rating of each *nominated ECAI* or export credit agency with the *credit quality steps* prescribed in ■ BIPRU 3, taking into account that this information need not be disclosed if the *firm* complies with the *credit quality assessment scale*; and
- (5) the *exposure* values and the *exposure* values after *credit risk mitigation* associated with each *credit quality step* prescribed in ■ BIPRU 3, as well as those deducted from *capital resources*.

[Note: BCD Annex XII Part 2 point 7]

**Disclosure: Firms calculating risk weighted exposure amounts using the IRB approach**

11.5.11

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A *firm* calculating *risk weighted exposure amounts* for *specialised lending exposures* in accordance with ■ BIPRU 4.5.8 R to ■ BIPRU 4.5.10 R or *equity exposures* in accordance with ■ BIPRU 4.7.9 R to ■ BIPRU 4.7.10 R (the simple risk weight approach) must disclose the *exposures* assigned:

- (1) to each category of the table in ■ BIPRU 4.5.9 R; or
- (2) to each *risk weight* mentioned in ■ BIPRU 4.7.9 R to ■ BIPRU 4.7.10 R.

[Note: BCD Annex XII Part 2 point 8]

**Disclosure: Market risk**

11.5.12

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A *firm* must disclose its *capital resources requirements* separately for each risk referred to in (1), (2) and (3):

- (1) in respect of its *trading-book* business, its:
  - (a) *interest rate PRR*;

- (b) *equity PRR*;
  - (c) *option PRR*;
  - (d) *collective investment schemes PRR*;
  - (e) *counterparty risk capital component*; and
  - (f) *concentration risk capital component*; and
- (2) in respect of all of its business activities, its:
- (a) *commodity PRR*; and
  - (b) *foreign currency PRR*; and
- (3) its specific interest-rate risk of *securitisation positions*.

[Note: BCD Annex XII Part 2 point 9]

#### Disclosure: Use of VaR model for calculation of market risk capital requirement

11.5.13

FCA PRA

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The following information must be disclosed by a *firm* which calculates its *market risk capital requirement* using a *VaR model*:

- (1) for each sub-portfolio covered:
  - (a) the characteristics of the models used;
  - (b) a description of stress testing applied to the sub-portfolio;
  - (c) a description of the approaches used for back-testing and validating the accuracy and consistency of the internal models and modelling processes;
  - (d) for the capital charges calculated according to the *incremental risk charge* and the *all price risk measure* separately, the methodologies used and the risks measured through the use of an internal model, including a description of the approach used by the *firm* to determine liquidity horizons, the methodologies used to achieve a capital assessment that is consistent with the required soundness standard and the approaches used in the validation of the model;
- (2) the scope of the *firm's VaR model permission*;
- (3) a description of the extent and methodologies for compliance with the requirements set out in ■ GENPRU 1.3.13 R (2) and ■ GENPRU 1.3.13 R (3) and ■ GENPRU 1.3.14 R to ■ GENPRU 1.3.34 R;
- (4) the highest, the lowest and the mean of the following:
  - (a) the daily *VaR measures* over the reporting period and the *VaR measure* as per the period end;

- (b) the *stressed VaR* measures over the reporting period and the *stressed VaR* measure as per the period end;
  - (c) the capital charge according to the *incremental risk charge* over the reporting period and as per the period end;
  - (d) the capital charge according to the *all price risk measure* over the reporting period and as per the period end;
- (5) the amount of capital according to the *incremental risk charge* and the amount of capital according to the *all price risk measure* shown separately, together with the weighted average liquidity horizon for each sub-portfolio covered; and
- (6) a comparison of the daily end-of-day *VaR measures* to the one-day changes of the portfolio's value by the end of the subsequent *business day* together with an analysis of any important overshooting during the reporting period.

[Note: *BCD* Annex XII Part 2 point 10]

#### Disclosure: Operational risk

11.5.14

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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]

#### Disclosure: Non-trading book exposures in equities

11.5.15

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A *firm* must disclose the following information regarding the *exposures* in *equities* not included in the *trading book*:

- (1) the differentiation between *exposures* based on their objectives, including for capital gains relationship and strategic reasons, and an overview of the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation and any significant changes in these practices;

- (2) the balance sheet value, the fair value and, for those exchange-traded, a comparison to the market price where it is materially different from the fair value;
- (3) the types, nature and amounts of exchange-traded *exposures*, private *equity exposures* in sufficiently diversified portfolios, and other *exposures*;
- (4) the cumulative realised gains or losses arising from sales and liquidations in the period; and
- (5) the total unrealised gains or losses, the total latent revaluation gains or losses, and any of these amounts included in *tier one*, *tier two* or *tier three capital resources*.

[Note: BCD Annex XII Part 2 point 12]

#### Disclosures: Exposures to interest rate risk in the non-trading book

11.5.16

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A *firm* must disclose the following information on its *exposure* to interest rate risk on positions not included in the *trading book*:

- (1) the nature of the interest rate risk and the key assumptions (including assumptions regarding loan prepayments and behaviour of non-maturity deposits), and frequency of measurement of the interest rate risk; and
- (2) the variation in earnings, economic value or other relevant measure used by the management for upward and downward rate shocks according to management's method for measuring the interest rate risk, broken down by currency.

[Note: BCD Annex XII Part 2 point 13]

#### Disclosures: Securitisation

11.5.17

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A *firm* calculating *risk weighted exposure amounts* in accordance with ■ BIPRU 9 or *capital resource requirements* according to ■ BIPRU 7.2.48A R to ■ BIPRU 7.2.48K R must disclose the following information, where relevant separately for its *trading book* and *non-trading book*:

- (1) a description of the *firm's* objectives in relation to *securitisation* activity;
- (1A) the nature of other risks, including *liquidity risk* inherent in securitised assets;
- (1B) the type of risks in terms of seniority of underlying *securitisation positions* and in terms of assets underlying these latter *securitisation positions* assumed and retained with *resecuritisation* activity;

- (2) the different roles played by the *firm* in the *securitisation* process;
- (3) an indication of the extent of the *firm's* involvement in each of them;
- (3A) a description of the processes in place to monitor changes in the credit and market risk of *securitisation exposures*, including how the behaviour of the underlying assets impacts *securitisation positions* and a description of how those processes differ for *resecuritisation positions*;
- (3B) a description of the *firm's* policy governing the use of hedging and unfunded protection to mitigate the risks of retained *securitisation* and *resecuritisation positions*, including identification of material hedge counterparties by relevant type of risk exposure;
- (4) the approaches to calculating *risk weighted exposure amounts* that the *firm* follows for its *securitisation* activities, including the types of *securitisation exposures* to which each approach applies;
- (4A) the types of *SSPEs* that the *firm*, as *sponsor*, uses to securitise third-party *exposures*, including whether, and in what form, and to what extent, the *firm* has *exposures* to these *SSPEs*, separately for on and off-balance sheet *exposures*, as well as a list of the entities that the *firm* manages, or advises, and that invest in either the *securitisation positions* that the *firm* has securitised or in *SSPEs* that the *firm* sponsors;
- (5) a summary of the *firm's* accounting policies for *securitisation* activities, including:
  - (a) whether the transactions are treated as sales or financings;
  - (b) the recognition of gains on sales;
  - (c) the methods, key assumptions, inputs and the changes from the previous period for valuing *securitisation positions*;
  - (d) the treatment of *synthetic securitisations* if this is not covered by other accounting policies;
  - (e) how assets awaiting *securitisation* are valued and whether they are recorded in the *firm's non-trading book* or *trading book*; and
  - (f) policies for recognising liabilities on the balance sheet for arrangements that could require the *firm* to provide financial support for securitised assets;

- (6) the names of the *ECAIs* used for *securitisations* and the types of *exposure* for which each agency is used;
- (6A) where applicable, a description of the *ABCP internal assessment approach* as set out in ■ BIPRU 9.12.20 R including the structure of the internal assessment process and relation between internal assessment and external ratings, the use of internal assessment other than for *ABCP internal assessment approach* capital purposes, the control mechanisms for the internal assessment process (including discussion of independence, accountability, and internal assessment process review), the *exposure* types to which the internal assessment process is applied and the stress factors used for determining *credit enhancement* levels, by *exposure* type;
- (6B) an explanation of significant changes to any of the quantitative disclosures in (8) and (13) to (15) since the last reporting period;
- (7) [deleted]
- (8) for the *non-trading book* and for *exposures securitised* by the *firm*, the amount of impaired and past due *exposures securitised*, and the losses recognised by the *firm* during the current period, broken down by *exposure* type;
- (9) [deleted]
- (10) [deleted]
- (11) [deleted]
- (12) [deleted]
- (13) separately for the *trading book* and the *non-trading book*, the following information broken down by *exposure* type:
  - (a) the total outstanding amount of *exposures securitised* by the *firm*, separately for *traditional securitisations* and *synthetic securitisations*, and *securitisations* for which the *firm* acts only as *sponsor*;
  - (b) the aggregate amount of on-balance sheet *securitisation positions* retained or purchased, and off-balance sheet *securitisation exposures*;
  - (c) the aggregate amount of assets awaiting *securitisation*;
  - (d) for securitised facilities subject to an *early amortisation provision*, the aggregate drawn-down *exposures* attributed to the *originator's* and investors' interests respectively, the aggregate *capital resources requirement* incurred by the *firm* against the *originator's* interest and the aggregate *capital*

*resources requirement* incurred by the *firm* against the investors' shares of drawn balances and undrawn lines;

- (e) the amount of *securitisation positions* that have been *risk weighted* at 1250% or deducted; and
  - (f) a summary of the *securitisation* activity of the current period, including the amount of *exposures securitised* and recognised gain or loss on sale;
- (14) separately for the *trading book* and the *non-trading book*, the following information:
- (a) the aggregate amount of *securitisation positions* retained or purchased and the associated *capital resources requirements*, broken down by *securitisation* and *resecuritisation exposures*, and further broken down into a meaningful number of *risk weight* or *capital resources requirement* bands, for each *capital resources requirement* approach used; and
  - (b) the aggregate amount of *resecuritisation exposures* retained or purchased, broken down according to the *exposure* before and after hedging or insurance, and the *exposure* to financial guarantors, broken down according to guarantor credit worthiness categories or guarantor name; and
- (15) for the *trading book*, the total outstanding *exposures securitised* by the *firm* and subject to a *market risk capital requirement*, broken down into *traditional* and *synthetic*, and by *exposure* type.

[Note: *BCD* Annex XII Part 2 point 14]

#### Disclosures: remuneration

A *firm* must disclose the following information, including regular, at least annual, updates, regarding its remuneration policy and practices for those categories of staff whose professional activities have a material impact on its risk profile:

- (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;
- (2) information on the link between pay and performance;
- (3) the most important design characteristics of the remuneration system, including information on the criteria used for

11.5.18

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performance measurement and risk adjustment, deferral policy and vesting criteria;

- (4) information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based;
- (5) the main parameters and rationale for any variable component scheme and any other non-cash benefits;
- (6) aggregate quantitative information on remuneration, broken down by business area;
- (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:
  - (a) the amounts of remuneration for the financial year, split into fixed and variable remuneration, and the number of beneficiaries;
  - (b) the amounts and forms of variable remuneration, split into cash, shares, share-linked instruments and other types;
  - (c) the amounts of outstanding deferred remuneration, split into vested and unvested portions;
  - (d) the amounts of deferred remuneration awarded during the financial year, paid out and reduced through performance adjustments;
  - (e) new sign-on and severance payments made during the financial year, and the number of beneficiaries of those payments;
  - (f) the amounts of severance payments awarded during the financial year, number of beneficiaries and highest such award to a single person.

[Note: Paragraph 15 of Annex XII to the *Banking Consolidation Directive*.]

11.5.19

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The *appropriate regulator* would normally consider the requirements to publish disclosures in accordance with ■ BIPRU 11.3.8 R and ■ 11.3.9 R in respect of ■ BIPRU 11.5 as a whole to meet the requirement in paragraph 15 of Annex XII to the *Banking Consolidation Directive* to publish "regular, at least annual, updates" (as implemented in ■ BIPRU 11.5.18 R).

11.5.20

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- (1) A *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 11.5.18 R at the level of *senior personnel*.
- (2) *Firms* must comply with the requirements set out in ■ BIPRU 11.5.18 R in a manner that is appropriate to their size,

internal organisation and the nature, scope and complexity of their activities and without prejudice to the *UK* or other national transposition of Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data.

[Note: Paragraph 15 of Annex XII to the *Banking Consolidation Directive*.]

[Note: The *appropriate regulator* has given *guidance* for the purpose of providing a framework for complying with the disclosure requirements of ■ BIPRU 11.5.18 R in accordance with the proportionality test set out in ■ BIPRU 11.5.20 R (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' 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>]

11.5.21

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In the *appropriate regulator's* view, the exemptions from disclosure provided for in ■ BIPRU 11.3.5 R (materiality) and ■ BIPRU 11.3.6 R (proprietary or confidential information) are unlikely to apply to the disclosure required by ■ BIPRU 11.5.18 R (having regard, amongst other things, to the fact that the requirements set out in ■ BIPRU 11.5.18 R are to be complied with in the manner described in ■ BIPRU 11.5.20 R (2)).

## 11.6 Qualifying requirements for the use of particular instruments or methodologies

### Disclosures: Firms using the IRB approach

11.6.1

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A firm calculating *risk weighted exposure amounts* in accordance with the *IRB approach* must disclose the following information:

- (1) the scope of the *firm's IRB permission*;
- (2) an explanation and review of:
  - (a) the structure of internal *rating systems* and relation between internal and external ratings;
  - (b) the use of internal estimates other than for calculating *risk weighted exposure amounts* in accordance with the *IRB approach*;
  - (c) the process for managing and recognising *credit risk mitigation*; and
  - (d) the control mechanisms for *rating systems* including a description of independence, accountability, and *rating systems* review;
- (3) a description of the internal ratings process, provided separately for the following *IRB exposure classes*:
  - (a) central governments and *central banks*;
  - (b) *institutions*;
  - (c) corporate, including SMEs, *specialised lending* and purchased corporate receivables;
  - (d) retail, for *exposures to retail SMEs exposures, retail exposures secured by real estate collateral, qualifying revolving retail exposures, and other retail exposures*; and
  - (e) *equities*;
- (4) the *exposure* values for each of the *IRB exposure classes*;

- (5) for each of the *IRB exposure classes* central governments and *central banks, institutions, corporate and equity*, and across a sufficient number of *obligor grades* (including *default*) to allow for a meaningful differentiation of credit risk, a *firm* must disclose:
- (a) the total *exposures* (for the *IRB exposure classes* central governments and *central banks, institutions and corporate exposures*, the sum of outstanding loans and *exposure* values for undrawn commitments; for *equity exposures*, the outstanding amount);
  - (b) for a *firm* using own *LGD* estimates for the calculation of *risk weighted exposure amounts*, the *exposure-weighted* average *LGD* in percentage;
  - (c) the *exposure-weighted* average *risk weight*; and
  - (d) for a *firm* using own estimates of *conversion factors* for the calculation of *risk weighted exposure amounts*, the amount of undrawn commitments and *exposure-weighted* average *exposure* values for each *IRB exposure class*;
- (6) for the *retail exposure* class and for each of the categories of:
- (a) *exposures* to *retail SMEs*;
  - (b) *retail exposures* secured by real estate collateral;
  - (c) *qualifying revolving retail exposures*; and
  - (d) other *retail exposures*;
- either the disclosures outlined under (5) (if applicable, on a pooled basis), or an analysis of *exposures* (outstanding loans and *exposure* values for undrawn commitments) against a sufficient number of *EL* grades to allow for a meaningful differentiation of credit risk (if applicable, on a pooled basis);
- (7) the actual value adjustments in the preceding period for each *IRB exposure class* (for *retail exposures*, for each of the categories in (6)(a) to (d)) and how they differ from past experience;
  - (8) a description of the factors that impacted on the loss experience in the preceding period (for example, whether the *firm* experienced higher than average *default* rates, or higher than average *LGDs* and *conversion factors*); and
  - (9) the *firm's* estimates against actual outcomes over a longer period including, at a minimum, information on estimates of losses against actual losses in each *IRB exposure class* (for *retail exposures*, for each of the categories in (6)(a) to (d)) over a

period sufficient to allow for a meaningful assessment of the performance of the internal rating processes for each *IRB exposure class* (for *retail exposures*, for each of the categories in (6)(a) to (d)).

[Note: BCD Annex XII Part 3 point 1 (part)]

11.6.2

FCA PRA

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For the purposes of ■ BIPRU 11.6.1 R (3), the description must include the types of *exposure* included in the *IRB exposure class*, the definitions, methods and data for estimation and validation of *PD* and, if applicable, *LGD* and *conversion factors*, including assumptions employed in the derivation of these variables, and the descriptions of material deviations from the definition of *default*, including the broad segments affected by such deviations.

[Note: BCD Annex XII Part 3 point 1 (part)]

11.6.3

FCA PRA

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For the purposes of ■ BIPRU 11.6.1 R (4), where a *firm* uses its own estimates of *LGDs* or *conversion factors* for the calculation of *risk weighted exposure amounts* for *exposures* falling into the *sovereign, institution and corporate IRB exposure class*, the *firm* must disclose those *exposures* separately from *exposures* for which it does not use such estimates.

[Note: BCD Annex XII Part 3 point 1 (part)]

11.6.4

FCA PRA

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For the purposes of ■ BIPRU 11.6.1 R (9), where appropriate, a *firm* must further decompose the information to provide analysis of *PD* and, for a *firm* using own estimates of *LGDs* and/or *conversion factors*, *LGD* and *conversion factor* outcomes against estimates provided in the quantitative risk assessment disclosures under ■ BIPRU 11.6.1 R to ■ BIPRU 11.6.4 R.

[Note: BCD Annex XII Part 3 point 1 (part)]

#### Disclosures: Credit risk mitigation

11.6.5

FCA PRA

R

A *firm* applying *credit risk mitigation* techniques must disclose the following information:

- (1) the policies and processes for, and an indication of the extent to which the *firm* makes use of, on- and off-balance sheet netting;
- (2) the policies and processes for collateral valuation and management;
- (3) a description of the main types of collateral taken by the *firm*;
- (4) the main types of guarantor and credit derivative counterparty and their creditworthiness;
- (5) information about *market risk* or credit risk concentrations within the credit mitigation taken;

- (6) for *firms* calculating *risk weighted exposure amounts* using the *standardised approach* to credit risk or the *IRB approach*, but not providing own estimates of *LGDs* or *conversion factors* in respect of the *exposure* class, separately for each *exposure* class, the total *exposure* value (after, where applicable, on- or off-balance sheet netting) that is covered - after the application of volatility adjustments - by eligible financial collateral, and other eligible *collateral*; and
- (7) for *firms* calculating *risk weighted exposure amounts* using the *standardised approach* or the *IRB approach*, separately for each *exposure* class, the total *exposure* (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees or credit derivatives; for *equity exposures*, this requirement applies to each of the approaches ( the simple risk weight approach, the PD/LGD approach and the internal models approach) provided for in ■ BIPRU 4.7.5 R to ■ BIPRU 4.7.6 R, ■ BIPRU 4.7.9 R to ■ BIPRU 4.7.11 R, ■ BIPRU 4.7.14 R to ■ BIPRU 4.7.16 R, ■ BIPRU 4.7.24 R to ■ BIPRU 4.7.25 R.

[Note: BCD Annex XII Part 3 point 2]

**Disclosure: Insurance for the purpose of mitigating operational risk**.....

11.6.6

FCA PRA

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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]

## Chapter 12

# Liquidity standards

## 12.1 Application

12.1.1

FCA PRA

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Subject to ■ BIPRU 12.1.2R, ■ BIPRU 12 applies 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*.

12.1.2

FCA PRA

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■ BIPRU 12.5 (Individual Liquidity Adequacy Standards), ■ BIPRU 12.6 (Simplified ILAS), ■ BIPRU 12.7 (Liquid assets buffer) and ■ BIPRU 12.9 (Individual liquidity guidance and regulatory intervention points) apply only to an *ILAS BIPRU firm*.

12.1.3

FCA PRA

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A *firm* that is an *exempt full scope BIPRU investment firm* is not an *ILAS BIPRU firm*.

12.1.4

FCA PRA

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- (1) An *exempt full scope BIPRU investment firm* is a *full scope BIPRU investment firm* that at all times has total net assets which are less than or equal to 50 million.
- (2) In this *rule*, total net assets are the sum of a *firm's* total *trading book* assets and its total *non-trading book* assets, less the sum of its called up share capital, reserves and minority interests.
- (3) For the purpose of (2), the value attributed to each of the specified balance sheet items must be that which is reported to the *FCA* in the *firm's* most recent *FCA001 data item*.

- 12.1.5** FCA PRA G The effect of ■ BIPRU 12.1.4R is therefore to require the *firm* to sum the values of cell entries 20A and 20B in *data item* FSA001 and deduct from that total the sum of the values of cell entries 42, 43 and 44 in the same *data item*.
- 12.1.6** FCA PRA G There are some provisions in other sections of ■ BIPRU 12 which apply only to an *ILAS BIPRU firm*. Where this is the case, the provision in question says so.
- 12.1.7** FCA PRA R In relation to an *incoming EEA firm* or a *third country BIPRU firm*, this chapter applies only with respect to the activities of the *firm's UK branch*.

## 12.2 Adequacy of liquidity resources

### The overall liquidity adequacy rule

12.2.1

FCA PRA

R

- (1) A *firm* must at all times maintain liquidity resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.
- (2) For the purpose of (1):
  - (a) a *firm* may not include liquidity resources that can be made available by other members of its *group*;
  - (b) an *incoming EEA firm* or a *third country BIPRU firm* may not, in relation to its *UK branch*, include liquidity resources other than those which satisfy the conditions in
    - BIPRU 12.2.3R;
  - (c) a *firm* may not include liquidity resources that may be made available through emergency liquidity assistance from a central bank (including the European Central Bank).

12.2.2

FCA PRA

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■ BIPRU 12.2.1R is the *overall liquidity adequacy rule*.

### Branch liquidity resources

12.2.3

FCA PRA

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The conditions to which ■ BIPRU 12.2.1R (2)(b) refers are that the *firm's* liquidity resources are:

- (1) under the day-to-day control of the *UK branch's* senior management;
- (2) held in an account with one or more *custodians* in the sole name of the *UK branch*;
- (3) unencumbered; and
- (4) for the purpose of the *overall liquidity adequacy rule* only, attributed to the balance sheet of the *UK branch*.

## 12.2.4

FCA PRA

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The effect of ■ BIPRU 12.2.1R (2)(b) and ■ BIPRU 12.2.3 R is to require an *incoming EEA firm* or a *third country BIPRU firm* to maintain a local operational liquidity reserve in relation to the activities of its *UK branch*. ■ BIPRU 12.9 contains further *guidance* on this point.

### Liquidity resources: general

## 12.2.5

FCA PRA

G

For the purposes of the *overall liquidity adequacy rule*, liquidity resources are not confined to the amount or value of a *firm's* marketable, or otherwise realisable, assets. Rather, in assessing the adequacy of those resources, a *firm* should have regard to the overall character of the resources available to it which enable it to meet its liabilities as they fall due. Therefore, for the purposes of that *rule*, a *firm* should ensure that:

- (1) it holds sufficient assets which are marketable, or otherwise realisable;
- (2) it is able to generate funds from those assets in a timely manner;
- (3) it maintains a prudent funding profile in which its assets are of appropriate maturities, taking account of the expected timing of that *firm's* liabilities; and
- (4) it is able to generate unsecured funding of appropriate tenor in a timely manner.

## 12.2.6

FCA PRA

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The *overall liquidity adequacy rule* is expressed to apply to each *firm* on a solo basis. Each *firm* must be able to satisfy that *rule* relying solely on its own liquidity resources. Where the *firm* is an *incoming EEA firm* or a *third country BIPRU firm*, compliance with the *overall liquidity adequacy rule* with respect to the *UK branch* must be achieved relying solely on liquidity resources that satisfy the conditions in ■ BIPRU 12.2.3R.

## 12.2.7

FCA PRA

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The starting point, therefore, is that each *firm*, or where relevant its *UK branch*, must be self-sufficient in terms of its own liquidity adequacy. The *appropriate regulator* does, however, recognise that there are circumstances in which it may be appropriate for a *firm* or *branch* to rely on liquidity support provided by other entities in its *group* or from elsewhere within the *firm*. A *firm* wishing to rely on support of this kind, whether for itself or for its *UK branch*, may only do so with the consent of the *appropriate regulator*, given by way of a *waiver* under section 138A (Modification or waiver of rules) of the *Act* to the *overall liquidity adequacy rule*.

### Liquid assets buffer and funding profile

## 12.2.8

FCA PRA

R

For the purposes of the *overall liquidity adequacy rule*, an *ILAS BIPRU firm* must also ensure that:

- (1) its liquidity resources contain an adequate buffer of high quality, unencumbered assets; and
- (2) it maintains a prudent funding profile.

## 12.2.9

FCA PRA

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The purpose of ■ BIPRU 12.2.8R is to ensure that an *ILAS BIPRU firm* has a buffer of liquid assets which are available to meet those liabilities which fall due in periods of stress experienced by that *firm*. Those periods of stress may be both market-wide and idiosyncratic in nature. The *appropriate regulator* acknowledges that in periods of stress a *firm's* liquid assets buffer may be eroded.

**12.2.10** FCA PRA G The *appropriate regulator* recognises, however, that it may take time for a *firm* to build a buffer which is of a sufficient size and quality to help reduce the effect of periods of stress on the *firm*. In particular, the *appropriate regulator* recognises that the transition from the *appropriate regulator's* liquidity regime in force immediately prior to the ■ BIPRU 12 regime is likely to be a gradual one for many *firms*. The *appropriate regulator* will seek to agree with a *firm* an appropriate period of time over which its liquid assets buffer ought to be built. The *appropriate regulator* will, in any event, incorporate into the *individual liquidity guidance* which it gives to the *firm* details of the steps that it expects the *firm* to take so that it may establish an appropriately robust liquid assets buffer.

**12.2.11** FCA PRA R In complying with ■ BIPRU 12.2.8R, a *simplified ILAS BIPRU firm* must ensure that its liquid assets buffer is at least equal to the amount of liquidity resources required by the *simplified buffer requirement*.

**12.2.12** FCA PRA G The *appropriate regulator* is likely to regard a *simplified ILAS BIPRU firm* whose liquid assets buffer accords with the *simplified buffer requirement* as having an adequate buffer of assets and a prudent funding profile for the purpose of ■ BIPRU 12.2.8R. Further *guidance* on this matter is provided in ■ BIPRU 12.6.5G.

**12.2.13** FCA PRA G ■ BIPRU 12.7 contains more detailed *rules* and *guidance* about the type of assets that an *ILAS BIPRU firm* is permitted to hold in order to satisfy ■ BIPRU 12.2.8R.

### Individual assessments of liquidity adequacy

**12.2.14** FCA PRA G The adequacy of an *ILAS BIPRU firm's* liquidity resources needs to be assessed both by that *firm* and by the *appropriate regulator* . This process involves:

- (1) in the case of a *standard ILAS BIPRU firm*, an *Individual Liquidity Adequacy Assessment (ILAA)* which such a *firm* is obliged to carry out in accordance with ■ BIPRU 12.5;
- (2) in the case of a *simplified ILAS BIPRU firm*, an *Individual Liquidity Systems Assessment (ILSA)* which such a *firm* is obliged to carry out in accordance with ■ BIPRU 12.6; and
- (3) a *Supervisory Liquidity Review Process (SLRP)*, which is conducted by the *appropriate regulator*.

**12.2.15** FCA PRA G ■ BIPRU 12.5 sets out the *ILAS* framework. That section describes some of the stress tests that a *standard ILAS BIPRU firm* must carry out in conducting its *ILAA* and identifies a number of sources of *liquidity risk* in relation to which a *firm* is required to assess the impact of those stresses. For a *standard ILAS BIPRU firm*, the requirements in ■ BIPRU 12.5 are in addition to the stress testing requirements in ■ BIPRU 12.4. The *rules* in ■ BIPRU 12.5 require a *standard ILAS BIPRU firm* to report the results of both sets of stress tests in its *ILAA*, while the *rules* in ■ BIPRU 12.6 require a *simplified ILAS BIPRU firm* to report those results in its *ILSA*.

## 12.2.16

FCA PRA

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As part of its *SLRP*, the *appropriate regulator* will, having regard to the *liquidity risk* profile of the *firm*, consider:

- (1) the adequacy, both as to amount and quality, of the liquidity resources (including the liquid assets buffer) held by the *firm*; and
- (2) the degree of prudence reflected in the *firm's* funding profile.

## 12.2.17

FCA PRA

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In assessing the adequacy of those resources, the *appropriate regulator* will consider a *firm's* overall ability to generate funding in a way that ensures that it can meet its liabilities as they fall due both in stressed and in ordinary business conditions.

## 12.2.18

FCA PRA

G

After completing a review of the *ILAA* as part of the *SLRP*, the *appropriate regulator* will give a *standard ILAS BIPRU firm individual liquidity guidance*, advising it of the amount and quality of liquidity resources which the *appropriate regulator* considers are appropriate having regard to the *liquidity risk* profile of the *firm*. In giving *individual liquidity guidance*, the *appropriate regulator* will also advise the *firm* of what it considers to be a prudent funding profile for the *firm*. In giving the *firm individual liquidity guidance* as to its funding profile, the *appropriate regulator* will consider the extent to which the *firm's* liabilities are adequately matched by assets of appropriate maturities. Although the *appropriate regulator* may have given a *firm individual liquidity guidance*, this does not remove the need for the *firm* to monitor its *liquidity risk* profile on an ongoing basis and to consider whether it should be holding liquidity resources that are greater in amount or higher in quality, or maintaining a more prudent funding profile, than those advised in its *individual liquidity guidance*.

## 12.2.19

FCA PRA

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■ BIPRU 12.5 sets out in greater detail the *appropriate regulator's ILAS* regime. ■ BIPRU 12.9 sets out in greater detail the *appropriate regulator's* process for issuing an *ILAS BIPRU firm* with *individual liquidity guidance* and its approach to monitoring a *firm's* adherence to that *guidance* or, as the case may be, to the *simplified buffer requirement*.

## 12.3 Liquidity risk management

### 12.3.1

FCA PRA

G

The approach taken in ■ BIPRU 12.3 is to set out:

- (1) overarching systems and controls provisions in relation to a *firm's* management of its *liquidity risk*;
- (2) provisions outlining the responsibilities of that *firm's governing body* and *senior managers* for the oversight of *liquidity risk*;
- (3) more detailed provisions covering a number of specific areas, including:
  - (a) pricing *liquidity risk*;
  - (b) intra-day management of liquidity;
  - (c) management of collateral;
  - (d) management of liquidity across legal entities, business lines and currencies; and
  - (e) funding diversification and market access.

### 12.3.2

FCA PRA

G

■ BIPRU 12.4 contains further *rules* and *guidance* on stress testing and *contingency funding plans*. These are both extensions of the overarching systems and controls provisions in ■ BIPRU 12.3. In formulating the *rules* and *guidance* in these two sections, the *appropriate regulator* has taken account of the Principles for Sound Liquidity Management and Supervision dated September 2008 issued by the Basel Committee on Banking Supervision. It is intended that the content of ■ BIPRU 12.3 and ■ BIPRU 12.4 be consistent with those Principles.

### 12.3.3

FCA PRA

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■ BIPRU 12.5.4R provides that, in relation to a *standard ILAS BIPRU firm*, it must include in its *ILAA* an assessment of its compliance with the standards set out in ■ BIPRU 12.3 and ■ BIPRU 12.4, including the results of the stress tests required by the *rules* in ■ BIPRU 12.4. A *simplified ILAS BIPRU firm* is not subject to ■ BIPRU 12.5 and consequently it is not required to prepare an *ILAA*. Instead, the *rules* in ■ BIPRU 12.6 provide that such a *firm* is to carry out an *ILSA*, being alone an assessment of that *firm's* compliance with the standards set out in ■ BIPRU 12.3 and ■ BIPRU 12.4.

**Overarching liquidity systems and controls requirements**

12.3.4

FCA PRA

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 and entities and must include adequate allocation mechanisms of liquidity costs, benefits and risks.

[Note: annex V paragraph 14 of the *Banking Consolidation Directive*]

12.3.4A

FCA PRA

G

The strategies, policies, processes and systems referred to in ■ BIPRU 12.3.4 R should include those which enable it to assess and maintain on an ongoing basis the amounts, types and distribution of liquidity resources that it considers adequate to cover:

- (1) the nature and level of the *liquidity risk* to which it is or might be exposed;
- (2) the risk that the *firm* cannot meet its liabilities as they fall due; and
- (3) in the case of an *ILAS BIPRU firm*, the risk that its liquidity resources might in the future fall below the level, or differ from the quality and funding profile, of those resources advised as appropriate by the *appropriate regulator* in that *firm's individual liquidity guidance* or, as the case may, its *simplified buffer requirement*.

12.3.5

FCA PRA

R

The strategies, policies, processes and systems referred to in ■ BIPRU 12.3.4 R must be proportionate to the complexity, risk profile and scope of operation of the *firm*, and the liquidity risk tolerance set by the *firm's governing body* in accordance with ■ BIPRU 12.3.8 R, and must reflect the *firm's* importance in each *EEA State*, in which it carries on business .

[Note: annex V paragraph 14a of the *Banking Consolidation Directive*]

12.3.6

FCA PRA

A

- (1) [deleted]
- (2) [deleted]
- (3) A *firm* should ensure that its strategies, policies, processes and systems in relation to *liquidity risk* enable it to identify, measure, manage and monitor its *liquidity risk* positions for:
  - (a) all sources of contingent liquidity demand (including those arising from off-balance sheet activities);
  - (b) all currencies in which that *firm* is active; and
  - (c) correspondent, custody and settlement activities.
- (4) [deleted]
- (5) A *firm* should ensure that it has in place early warning indicators to identify immediately the emergence of increased *liquidity risk*

or vulnerabilities, including indicators that signal whether embedded triggers in funding or security arrangements such as warranties, covenants, events of default, conditions precedent or terms having similar effect are likely to, or will, be breached, occur or fail to be satisfied, or contingent risks will or are likely to crystallise, in either case with the result that access to liquidity resources may be impaired.

- (6) A *firm* should ensure that it has in place reliable management information systems to provide its *governing body*, *senior managers* and other appropriate personnel with timely and forward-looking information on the liquidity position of the *firm*.
- (7) Contravention of any of (3), (5) and (6) may be relied upon as tending to establish contravention of ■ BIPRU 12.3.4R.

## 12.3.7

FCA PRA

G

As well as the *rules* in ■ BIPRU 12.3 requiring a *firm* to have robust systems to enable it to identify, measure, manage and monitor *liquidity risk*, an ILAS BIPRU *firm* is also subject to obligations in ■ SUP 16 (Reporting requirements) requiring it to report quantitative data about its liquidity position to the *appropriate regulator*. That chapter of SUP sets out the applicable *data items* and the *rules* governing the frequency of their submission to the *appropriate regulator*. Absent a *firm-specific liquidity stress* or a *market liquidity stress*, the *rules* in ■ SUP 16 do not require daily (weekly for a *low frequency liquidity reporting firm* and a *simplified ILAS BIPRU firm*) reporting of *data items*. An ILAS BIPRU *firm* should, however, note that those *rules* do require that it has systems in place to ensure that it is able at all times to meet the requirements for daily (or weekly as applicable) reporting of applicable *data items* even if there is no *firm-specific liquidity stress* or *market liquidity stress* and none is expected.

### Governing body and senior management oversight: liquidity risk tolerance

## 12.3.8

FCA PRA

R

A *firm* must ensure that:

- (1) its *governing body* establishes that *firm's liquidity risk* tolerance and that this is appropriately documented;
- (2) its *liquidity risk* tolerance is appropriate for its business strategy and reflects its financial condition and funding capacity; and
- (3) its *liquidity risk* tolerance is communicated to all relevant business lines.

[Note: annex V paragraph 14a of the *Banking Consolidation Directive*]

## 12.3.9

FCA PRA

G

As part of the SLRP, the *appropriate regulator* will assess the appropriateness of the *liquidity risk* tolerance adopted by an ILAS BIPRU *firm* to ensure that this risk tolerance is consistent with maintenance by the *firm* of adequate liquidity resources for the purpose of the *overall liquidity adequacy rule*. The *appropriate regulator* will expect a *firm* to provide it with an adequately reasoned explanation for the level of *liquidity risk* which that *firm's governing body* has decided it should assume. In assessing the appropriateness of the *liquidity risk* tolerance adopted by a *firm*, the

*appropriate regulator* will consider whether the tolerance adopted is consistent with the *firm's* satisfaction of threshold condition 2E, 3D, 4E or 5E as applicable . Consistent with the *appropriate regulator's* statutory objectives under the *Act*, in assessing the appropriateness of a *firm's* adopted *liquidity risk* tolerance the *appropriate regulator* will also have regard to the role and importance of a *firm* in the *UK financial system*.

### Governing body and senior management oversight: approval and review of arrangements

**12.3.10** **R** A *firm* must ensure that its *governing body* approves the *firm's* strategies, policies, processes and systems relating to the management of *liquidity risk*, including those described in ■ BIPRU 12.3.4R.  
**FCA** **PRA**

**12.3.11** **R** A *firm* must ensure that its *governing body* reviews regularly (and not less frequently than annually):

- (1) the continued adequacy of any strategies, policies, processes and systems approved in accordance with ■ BIPRU 12.3.10R; and
- (2) the *firm's liquidity risk* tolerance.

**12.3.12** **R** A *firm* must ensure that its *senior managers*:

- (1) continuously review that *firm's* liquidity position, including its compliance with the *overall liquidity adequacy rule*; and
- (2) report to its *governing body* on a regular basis adequate information as to that *firm's* liquidity position and its compliance with the *overall liquidity adequacy rule* and with ■ BIPRU 12.3.4R.

**12.3.13** **G** Although a *firm's senior managers* are likely to develop strategies, policies and practices for the management of that *firm's liquidity risk*, it is the responsibility of a *firm's governing body* to approve those strategies, policies and practices as adequate. In determining the adequacy of those strategies, policies and practices, a *firm's governing body* should have regard to that *firm's liquidity risk* tolerance established in accordance with ■ BIPRU 12.3.8R.  
**FCA** **PRA**

**12.3.14** **G** The *appropriate regulator* will assess the adequacy of an *ILAS BIPRU firm's* *liquidity risk* management framework as part of the *SLRP*.  
**FCA** **PRA**

### Pricing liquidity risk

**12.3.15** **A** (1) In relation to all significant business activities, a *firm* should ensure that it accurately quantifies liquidity costs, benefits and risks and fully incorporates them into:

- (a) product pricing;
- (b) performance measurement and incentives; and
- (c) the approval process for new products.

**FCA** **PRA**

- (2) For the purposes of (1), a *firm* should ensure that it:
  - (a) includes significant business activities whether or not they are accounted for on-balance sheet; and
  - (b) carries out the exercise of quantification and incorporation both in normal financial conditions and under the stresses required by ■ BIPRU 12.4.1R.
- (3) A *firm* should ensure that the liquidity costs, benefits and risks are clearly and transparently attributed to business lines and are understood by business line management.
- (4) Contravention of any of (1), (2) or (3) may be relied upon as tending to establish contravention of ■ BIPRU 12.3.4R.

## 12.3.16

FCA PRA

G

The incorporation of liquidity pricing into a *firm's* processes assists in aligning the risk-taking incentives of individual business lines within that *firm* with the *liquidity risk* to which the *firm* as a whole is exposed as a result of their activities. It is important that all significant business activities are addressed, including activities which involve the creation of contingent exposures which may not have an immediate balance sheet impact.

**Intra-day management of liquidity**

## 12.3.17

FCA PRA

R

**A *firm* must actively manage its intra-day liquidity positions and any related risks so that it is able to meet its payment and settlement obligations on a timely basis.**

## 12.3.18

FCA PRA

G

In complying with ■ BIPRU 12.3.17R, a *firm* should take into account all obligations arising from its acting as a custodian, a correspondent bank or a settlement agent.

## 12.3.19

FCA PRA

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For the purposes of ■ BIPRU 12.3.17R, a *firm* must ensure that:

- (1) **it is able to meet its payment and settlement obligations on a timely basis under both normal financial conditions and under the stresses required by ■ BIPRU 12.4.1R; and**
- (2) **its arrangements for the management of intra-day liquidity enable it to identify and prioritise the most time-critical payment and settlement obligations.**

## 12.3.20

FCA PRA

G

The *appropriate regulator* considers that a *firm's* ability to meet its payment and settlement obligations on an intra-day basis is important not just for that *firm*, but also for the liquidity position of that *firm's* counterparties and for the smooth functioning of payment and settlement systems as a whole.

## 12.3.21

FCA PRA

A

- (1) A *firm* should ensure that its intra-day liquidity management arrangements enable it, in relation to the markets in which it is

active and the currencies in which it has significant positions, to:

- (a) measure expected daily gross liquidity inflows and outflows, anticipate the intra-day timing of these flows where possible, and forecast the range of potential net funding shortfalls that might arise at different points during the day;
- (b) monitor its intra-day liquidity positions against expected activities and available resources;
- (c) identify gross liquidity inflows and outflows attributable to any correspondent, custodian or settlement agency services provided by that *firm*;
- (d) manage the timing of its liquidity outflows such that priority is given to that *firm*'s most time-critical obligations;
- (e) deal with unexpected disruptions to its intra-day liquidity flows;
- (f) acquire sufficient intra-day funding such that it is able to meet its most time-critical obligations when expected and other less time-critical obligations as soon as possible thereafter; and
- (g) manage and mobilise collateral as necessary for the purposes of achieving the aim in (f).

- (2) Contravention of any of (1)(a) to (g) may be relied upon as tending to establish contravention of ■ BIPRU 12.3.4R.

#### Management of collateral

12.3.22

FCA PRA

R

A *firm* must actively manage its collateral positions.

12.3.22A

FCA PRA

R

A *firm* must distinguish between pledged and unencumbered assets that are available at all times, in particular during emergency situations. A *firm* must also take into account the legal entity in which assets reside, the country where assets are legally recorded either in a register or in an account as well as their eligibility and must monitor how assets can be mobilised in a timely manner.

[Note: annex V paragraph 16 of the *Banking Consolidation Directive*]

12.3.22B

FCA PRA

R

A *firm* must also have regard to existing legal, regulatory and operational limitations to potential transfers of liquidity and unencumbered assets amongst entities, both within and outside the *EEA*.

[Note: annex V paragraph 17 of the *Banking Consolidation Directive*]

12.3.23

FCA PRA

R

For the purposes of ■ BIPRU 12.3.22R, a *firm* must, in relation to all currencies in which it has significant positions and all jurisdictions in which it carries on significant business activities, ensure that it:

- (1) can calculate all of its collateral positions, including assets currently provided as collateral, relative to the total amount of security required;
- (2) can calculate the amount of unencumbered assets available to it to be provided as collateral;
- (3) can mobilise collateral in a timely manner;
- (4) monitors the location of available collateral;
- (5) takes into account the extent to which counterparties with which it has deposited collateral may have re-hypothecated that collateral;
- (6) has access to adequately diversified sources of collateral;
- (7) assesses the eligibility of each major asset class that it holds for use as collateral with central banks;
- (8) assesses on an ongoing basis the acceptability of its assets to major counterparties and providers of funds in secured funding markets; and
- (9) monitors and manages the impact that the terms of existing funding or security arrangements, such as warranties, covenants, events of default, negative pledges and cross default clauses could have on its ability to mobilise collateral including for use in borrowing under any central bank facility (in particular, emergency liquidity assistance on a secured basis).

12.3.24

FCA PRA

G

For the purposes of ■ BIPRU 12.3.23R (8) and ■ (9), a *firm* should take into account the impact of the stresses that it conducts under ■ BIPRU 12.4.1R on the requirements which may be imposed on the provision of its assets as collateral (for example, haircuts) and also the availability of funds from private counterparties during such periods of stress.

12.3.25

FCA PRA

A

- (1) A *firm* should ensure that its arrangements for the management of *liquidity risk*:
  - (a) enable it to monitor shifts between intra-day and overnight or term collateral usage;
  - (b) enable it to appropriately adjust its calculation of available collateral to account for assets that are part of a tied hedge;

- (c) include adequate consideration of the potential for uncertainty around, or disruption to, intra-day asset flows; and
- (d) take into account the potential for additional collateral requirements under the terms of contracts governing existing collateral positions (for example, as a result of a deterioration in its own credit rating).

(2) Contravention of any of (1)(a) to (d) may be relied upon as tending to establish contravention of ■ BIPRU 12.3.4 R.

#### **Managing liquidity across legal entities, business lines and currencies** .....

12.3.26

FCA PRA

R

In complying with ■ BIPRU 12.3.4 R, a *firm* must ensure that:

- (1) it actively manages its *liquidity risk* exposures and related funding needs; and
- (2) it takes into account:
  - (a) the impact on its own liquidity position of its forming part of a *group*;
  - (b) the need to manage the liquidity position of individual business lines in addition to that of the *firm* as a whole; and
  - (c) the *liquidity risk* arising from its taking positions in foreign currencies; and
- (3) where it forms part of a *group*, it understands and has regard to any legal, regulatory, operational or other constraints on the transferability to it of funds and collateral by other entities in that *group*.

12.3.27

FCA PRA

R

A *firm* must develop methodologies for the identification, measurement, management and monitoring of funding positions. Those methodologies must include the current and projected material cash-flows in and arising from assets, liabilities, off-balance-sheet items, including contingent liabilities and the possible impact of reputational risk.

[Note: annex V paragraph 15 of the *Banking Consolidation Directive*]

12.3.28

FCA PRA

G

In its *liquidity risk* management plans, a *firm* should identify clearly its assumptions regarding the transferability of funds and collateral. A *firm* should expect that the *appropriate regulator* will scrutinise those assumptions.

#### **Funding diversification and market access** .....

12.3.29

FCA PRA

R

In complying with ■ BIPRU 12.3.4 R, a *firm* must ensure that it has access to funding which is adequately diversified, both as to source and tenor.

12.3.30

FCA PRA

R

A *firm* must ensure that its *governing body*:

- (1) is aware of the composition, characteristics and degree of diversification of its assets and funding sources; and
- (2) regularly reviews its funding strategy in the light of any changes in the environment in which it operates.

12.3.31

FCA PRA

G

Funding diversification should not be considered an end in its own right. Rather, the purpose of diversification is to ensure that a *firm* has in place alternative sources of funding that strengthen its capacity to withstand a variety of severe yet plausible institution-specific and market-wide liquidity shocks.

12.3.32

FCA PRA

A

- (1) A *firm* should ensure that funding diversification is taken into account in that *firm's* business planning process.
- (2) A *firm* should ensure that its funding arrangements take into account correlations between market conditions and the ability to access funds from different sources.
- (3) A *firm* should ensure that in establishing adequate diversification it sets limits on its funding according to the following variables:
  - (a) maturity;
  - (b) nature of depositor or counterparty;
  - (c) levels of secured and unsecured funding;
  - (d) instrument type;
  - (e) securitisation vehicle;
  - (f) currency; and
  - (g) geographic market.
- (4) A *firm* should ensure that it maintains an ongoing presence in its chosen funding markets and strong relationships with its chosen providers of funds.
- (5) A *firm* should regularly test its capacity to raise funds quickly from its chosen funding sources to provide short, medium and long-term liquidity.
- (6) A *firm* should ensure that its *senior managers* identify the main factors that affect its ability to raise funds and should monitor those factors closely to ensure that their estimates of fund raising capacity remain valid.
- (7) Contravention of any of (1) to (6) may be relied upon as tending to establish contravention of ■ BIPRU 12.3.4 R.

## 12.4 Stress testing and contingency funding

12.4.-2  
FCA PRA

R

A *firm* must consider different liquidity risk mitigation tools, including a system of limits and liquidity buffers in order to be able to withstand a range of different stress events and an adequately diversified funding structure and access to funding sources. Those arrangements must be reviewed regularly.

[Note: annex V paragraph 18 of the *Banking Consolidation Directive*]

### Stress testing

12.4.-1  
FCA PRA

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. 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, in relation to which the *firm* acts as *sponsor* or provides material liquidity support.

[Note: annex V paragraph 19 of the *Banking Consolidation Directive*]

12.4.1  
FCA PRA

R

In order to ensure compliance with the *overall liquidity adequacy rule* and with ■ BIPRU 12.3.4R and ■ BIPRU 12.4.-1 R , a *firm* must:

- (1) conduct on a regular basis appropriate stress tests so as to:
  - (a) identify sources of potential liquidity strain;
  - (b) ensure that current liquidity exposures continue to conform to the *liquidity risk* tolerance established by that *firm's governing body*; and
  - (c) identify the effects on that *firm's* assumptions about pricing; and
- (2) analyse the separate and combined impact of possible future liquidity stresses on its:
  - (a) cash flows;
  - (b) liquidity position;

(c) profitability; and

(d) solvency.

12.4.2

FCA PRA

R

In accordance with ■ BIPRU 12.3.11R, ■ BIPRU 12.4.-2 R and ■ BIPRU 12.4.-1 R, a *firm* must ensure that its *governing body* reviews regularly the stresses and scenarios tested to ensure that their nature and severity remain appropriate and relevant to that *firm*.

12.4.3

FCA PRA

G

Consistent with ■ BIPRU 12.3.5R, the *appropriate regulator* expects that the extent and frequency of such testing, as well as the degree of regularity of *governing body* review under ■ BIPRU 12.4.2R, should be proportionate to the nature scale and complexity of a *firm's* activities, as well as to the size of its liquidity risk exposures. Consistent with the *appropriate regulator's* statutory objectives under the *Act*, in assessing the adequacy of a *firm's* stress testing arrangements (including their frequency and the regularity of *governing body* review) the *appropriate regulator* will also have regard to the role and importance of that *firm* in the *UK financial system*. The *appropriate regulator* will, however, expect stress testing and *governing body* review to be carried out no less frequently than annually. The *appropriate regulator* expects that a *firm* will build into its stress testing arrangements the capability to increase the frequency of those tests in special circumstances, such as in volatile market conditions or where requested by the *appropriate regulator*.

12.4.4

FCA PRA

G

For the purposes of ■ BIPRU 12.4.2R, a review should take into account:

- (1) changes in market conditions;
- (2) changes in the nature, scale or complexity of the *firm's* business model and activities; and
- (3) the *firm's* practical experience in periods of stress.

12.4.5

A

(1) [deleted]

(2) [deleted]

12.4.5A

FCA PRA

R

A *firm* must consider the potential impact of institution-specific, market-wide and combined alternative scenarios. Different time horizons and varying degrees of stressed conditions must be considered.

[Note: annex V paragraph 20 of the *Banking Consolidation Directive*]

12.4.6

FCA PRA

G

The *appropriate regulator* expects every *firm*, including a *firm* with an apparently strong liquidity profile, to consider the potential impact of severe stress scenarios.

12.4.7

FCA PRA

G

In conducting its stress testing, a *firm* should also, where relevant, consider the impact of its chosen stresses on the appropriateness of its assumptions relating to:

- (1) correlations between funding markets;
- (2) the effectiveness of diversification across its chosen sources of funding;

- (3) additional margin calls and collateral requirements;
- (4) contingent claims, including potential draws on committed lines extended to third parties or to other entities in that *firm's group*;
- (5) liquidity absorbed by off-balance sheet vehicles and activities (including conduit financing);
- (6) the transferability of liquidity resources;
- (7) access to central bank market operations and liquidity facilities;
- (8) estimates of future balance sheet growth;
- (9) the continued availability of market liquidity in a number of currently highly liquid markets;
- (10) ability to access secured and unsecured funding (including retail *deposits*);
- (11) currency convertibility; and
- (12) access to payment or settlement systems on which the *firm* relies.

## 12.4.8



FCA	PRA
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- (1) A *firm* should ensure that the results of its stress tests are:
  - (a) reviewed by its *senior managers*;
  - (b) reported to that *firm's governing body*, specifically highlighting any vulnerabilities identified and proposing appropriate remedial action;
  - (c) reflected in the processes, strategies and systems established in accordance with ■ BIPRU 12.3.4R;
  - (d) used to develop effective *contingency funding plans*;
  - (e) integrated into that *firm's* business planning process and day-to-day risk management; and
  - (f) taken into account when setting internal limits for the management of that *firm's liquidity risk* exposure.
- (2) Contravention of any of (1)(a) to (f) may be relied upon as tending to establish contravention of ■ BIPRU 12.3.4 R.

## 12.4.9



FCA	PRA
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A *firm* must ensure that the results of its stress tests are reported to the *appropriate regulator* in a timely manner.

#### Contingency funding plans

## 12.4.10



FCA	PRA
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A *firm* must adjust its strategies, internal policies and limits on *liquidity risk* and develop an effective *contingency funding plan*, taking into account the outcome of the alternative scenarios referred to in ■ BIPRU 12.4.-1 R.

12.4.11

FCA PRA

R

[Note: annex V paragraph 21 of the *Banking Consolidation Directive*]

In order to deal with liquidity crises, a *firm* must have in place contingency plans setting out adequate strategies and proper implementation measures in order to address possible liquidity shortfalls. Those plans must be regularly tested, updated on the basis of the outcome of the alternative scenarios set out in ■ BIPRU 12.4.-1 R, and be reported to and approved by the *firm's governing body*, so that internal policies and processes can be adjusted accordingly.

12.4.12

FCA PRA

G

[Note: annex V paragraph 22 of the *Banking Consolidation Directive*]

A *contingency funding plan* sets out a *firm's* strategies for addressing liquidity shortfalls in emergency situations. Its aim should be to ensure that, in each of the stresses required by ■ BIPRU 12.4.1R, it would still have sufficient liquidity resources to ensure that it can meet its liabilities as they fall due.

12.4.13

FCA PRA

R

A *firm* must ensure that its *contingency funding plan*:

- (1) outlines strategies, policies and plans to manage a range of stresses;
- (2) establishes a clear allocation of roles and clear lines of management responsibility;
- (3) is formally documented;
- (4) includes clear invocation and escalation procedures;
- (5) is regularly tested and updated to ensure that it remains operationally robust;
- (6) outlines how that *firm* will meet time-critical payments on an intra-day basis in circumstances where intra-day liquidity resources become scarce;
- (7) outlines that *firm's* operational arrangements for managing a retail funding run;
- (8) in relation to each of the sources of funding identified for use in emergency situations, is based on a sufficiently accurate assessment of:
  - (a) the amount of funding that can be raised from that source; and
  - (b) the time needed to raise funding from that source;
- (9) is sufficiently robust to withstand simultaneous disruptions in a range of payment and settlement systems;

## 12.4.14

FCA PRA



- (10) outlines how that *firm* will manage both internal communications and those with its external stakeholders; and
  - (11) establishes mechanisms to ensure that the *firm's governing body* and *senior managers* receive management information that is both relevant and timely.
- (1) In designing a *contingency funding plan* a *firm* should ensure that it takes into account:
- (a) the impact of stressed market conditions on its ability to sell or securitise assets;
  - (b) the impact of extensive or complete loss of typically available market funding options;
  - (c) the financial, reputational and any other additional consequences for that *firm* arising from the execution of the *contingency funding plan* itself;
  - (d) its ability to transfer liquid assets having regard to any legal, regulatory or operational constraints; and
  - (e) its ability to raise additional funding from central bank market operations and liquidity facilities.
- (2) Contravention of any of (1)(a) to (e) may be relied upon as tending to establish contravention of ■ BIPRU 12.3.4R.

## 12.4.15

FCA PRA



A *firm* should ensure that its *contingency funding plan* takes into account the terms and conditions of any central bank liquidity facilities to which it has access, including both facilities that form part of normal liquidity management operations and emergency liquidity assistance on a secured basis. Where a *firm* includes in its *contingency funding plan* the use of central bank liquidity facilities it should consider the nature of those facilities, collateral eligibility, haircuts to which its collateral might be subject, terms in its existing or available funding arrangements which might impact its ability to access central bank facilities, operational arrangements for accessing those facilities and the potential reputational consequences for that *firm* in accessing them. In formulating its *contingency funding plan*, a *firm* should not rely on expectations it may have about future changes to central bank facilities, either in relation to their normal liquidity management operations or in relation to the availability of specific liquidity facilities in exceptional circumstances.

## 12.4.16

FCA PRA



The *appropriate regulator* expects that a *firm's contingency funding plan* will encompass a range of actions that the *firm* might take in anticipation of or in response to changes in its funding position. These changes could result from either *firm*-specific or general developments. The *appropriate regulator* anticipates that different actions in a *contingency funding plan* would be taken at different stages of a developing situation.

## 12.5 Individual Liquidity Adequacy Standards

### Individual Liquidity Adequacy Assessment

12.5.1

FCA PRA

R

This section applies to a *standard ILAS BIPRU firm*.

12.5.2

FCA PRA

R

A *firm* must carry out an individual liquidity adequacy assessment (*ILAA*) in accordance with this section.

12.5.3

FCA PRA

G

In conducting its *ILAA*, a *firm* is obliged to comply with the stress testing and related requirements which appear in this section. The *rules* in this section also provide that in its *ILAA* a *firm* must include an assessment of the *firm's* compliance with the standards set out in ■ BIPRU 12.3 and ■ BIPRU 12.4.

12.5.4

FCA PRA

R

A *firm* must ensure that:

- (1) it regularly carries out an *ILAA*;
- (2) it makes a written record of its *ILAA*;
- (3) its *ILAA* is proportionate to the nature, scale and complexity of its activities;
- (4) its *ILAA* takes into account whole-*firm* and group-wide liquidity resources only to the extent that reliance on these is permitted by the *appropriate regulator*;
- (5) its *ILAA* includes an assessment of the results of the stress tests required by ■ BIPRU 12.5.6 R; and
- (6) its *ILAA* includes an assessment of the *firm's* compliance with ■ BIPRU 12.3 and ■ BIPRU 12.4, including the results of the stress tests required by the rules in ■ BIPRU 12.4.

12.5.5

FCA PRA

G

A *firm* should carry out an *ILAA* at least annually, or more frequently if changes in its business or strategy or the nature, scale or complexity of its activities or the operational environment suggest that the current level of liquidity resources is no longer adequate. A *firm* should expect that its usual supervisory contact at the *appropriate regulator* will ask for the *ILAA* to be submitted as part of the ongoing supervisory process.

12.5.6

FCA PRA

R

A *firm* must ensure that in carrying out its *ILAA* it considers how that *firm's* liquidity resources change as a result of:

- (1) the stress in ■ BIPRU 12.5.8 R (the first liquidity stress);
- (2) the stress in ■ BIPRU 12.5.11 R (the second liquidity stress); and
- (3) the first and second liquidity stresses occurring simultaneously.

#### ILAA stresses

12.5.7

FCA PRA

G

The *appropriate regulator* will review the results of a *firm's* *ILAA*, including the results of the stress tests required by ■ BIPRU 12.5.6R, as part of its *Supervisory Liquidity Review Process (SLRP)*. The *appropriate regulator's* review of the stress test results will assist it assessing the adequacy of a *firm's* liquidity resources relative to other *ILAS BIPRU firms* and, consequently, in calibrating the *individual liquidity guidance* that it gives to that *firm*. ■ BIPRU 12.9.2G sets out the *appropriate regulator's* approach to assessing the adequacy of a *firm's* liquidity resources and indicates that, among other factors, it will have regard to the *firm's* *ILAA*. It is not, therefore, the case that the amount of liquidity resources advised to the *firm* as being adequate in its *individual liquidity guidance* will necessarily equate to the amount needed to meet its liabilities as they fall due in the stresses required by ■ BIPRU 12.5.6R. The *appropriate regulator* will assess the adequacy of a *firm's* liquidity resources on a case-by-case basis and, accordingly, the amount of liquidity resources judged as adequate in the *firm's* *individual liquidity guidance* might be either above or below the amount needed to survive the stresses required by ■ BIPRU 12.5.6R.

#### First liquidity stress

12.5.8

FCA PRA

R

The first liquidity stress to which ■ BIPRU 12.5.6R refers is an unforeseen, name-specific, liquidity stress in which:

- (1) financial market participants and retail depositors consider that in the short-term the *firm* will be or is likely to be unable to meet its liabilities as they fall due;
- (2) the *firm's* counterparties reduce the amount of intra-day credit which they are willing to extend to it;
- (3) the *firm* ceases to have access to foreign currency spot and *swap* markets; and
- (4) over the longer-term the *firm's* obligations linked to its credit rating crystallise as a result of a reduction in that credit rating.

12.5.9

FCA PRA

R

For the purpose of ■ BIPRU 12.5.8R (1) to ■ (3), a *firm* must assume that the initial, short-term, period of stress lasts for at least two weeks.

12.5.10

FCA PRA

G

For the purpose of ■ BIPRU 12.5.8R (4), a *firm* should consider the effect of credit rating downgrades of varying degrees of severity. In doing so, it should also consider the cumulative effect of successive credit rating downgrades to its long-term credit rating.

12.5.11

FCA PRA

R

The second liquidity stress to which ■ BIPRU 12.5.6R refers is an unforeseen, market-wide liquidity stress of three *months* duration.

12.5.12

FCA PRA

R

For the purpose of ■ BIPRU 12.5.11R, a *firm* must assume that the second liquidity stress is characterised by:

- (1) uncertainty as to the accuracy of the valuation attributed to that *firm's* assets and those of its counterparties;
- (2) inability to realise, or ability to realise only at excessive cost, particular classes of assets, including those which represent claims on other participants in the financial markets or which were originated by them;
- (3) uncertainty as to the ability of a significant number of *firms* to ensure that they can meet their liabilities as they fall due; and
- (4) risk aversion among participants in the markets on which the *firm* relies for funding.

#### ILAA methodology

12.5.13

FCA PRA

R

In carrying out the liquidity stresses required by ■ BIPRU 12.5.6R, a *firm* must:

- (1) analyse each of the sources of risk identified in ■ BIPRU 12.5.14R;
- (2) record the evidence which supports any behavioural assumptions that it makes in carrying out those stress tests;
- (3) record the evidence which supports its assessment of the adequacy of its liquid assets buffer; and
- (4) identify those of the measures set out in its *contingency funding plan* that it would implement.

12.5.14

FCA PRA

R

The sources of risk referred to in ■ BIPRU 12.5.13R are:

- (1) wholesale secured and unsecured funding risk;
- (2) retail funding risk;
- (3) intra-day *liquidity risk*;
- (4) intra-group *liquidity risk*;
- (5) cross-currency *liquidity risk*;

- (6) off-balance sheet *liquidity risk*;
- (7) franchise-viability risk;
- (8) marketable assets risk;
- (9) non-marketable assets risk; and
- (10) funding concentration risk.

#### Wholesale secured and unsecured funding risk

12.5.15

FCA PRA

R

For the purpose of assessing its wholesale funding risk, a *firm* must estimate the gross wholesale outflows that could occur under the liquidity stresses required by ■ BIPRU 12.5.6R.

12.5.16

FCA PRA

R

In assessing its wholesale funding risk, a *firm* must:

- (1) identify its wholesale liabilities;
- (2) determine how those liabilities behave under normal financial conditions;
- (3) assess how they will behave under the stresses required by ■ BIPRU 12.5.6R; and
- (4) divide its wholesale liabilities into funding which the *firm* assesses as having a higher than average likelihood of withdrawal in response to actual or perceived changes in the *firm's* credit-worthiness (Type A wholesale funding) and other funding (Type B wholesale funding).

12.5.17

FCA PRA

G

In assessing how its liabilities behave under stress, the *firm* should categorise its liabilities according to value, maturity and estimated speed of outflow. The *firm* should bear in mind that wholesale funding risk may crystallise as an acute loss of funds in the short term, or as a longer-term gradual leakage of funds, or as both.

12.5.18

FCA PRA

G

In the *appropriate regulator's* view, Type A wholesale funding is likely to include at least funding which:

- (1) is accepted from a *credit institution*, local authority, *insurance undertaking*, pension fund, money market fund, asset manager (including a hedge fund manager), government-sponsored agency, sovereign government, or sophisticated non-financial corporation; or
- (2) is accepted through the treasury function of a sophisticated non-financial corporation which may be assumed to respond swiftly to negative news about a *firm's* credit-worthiness; or
- (3) is accepted on wholesale market terms as a part of a *firm's* money market operations; or

- (4) is accepted from a depositor with whom a *firm* does not have a long-established relationship or to whom a *firm* does not supply a range of services; or
- (5) is accepted from overseas counterparties (other than those in the country or territory of incorporation of a *firm's parent undertaking* or, in the case of a *UK branch*, of the *firm* of which it forms part); or
- (6) is obtained through unsecured debt instruments (such as certificates of deposit, medium-term notes and commercial paper); or
- (7) is not obtained through *repo* against assets of the type described in ■ BIPRU 12.7.2R (1) or ■ BIPRU 12.7.2R (2); or
- (8) is obtained from counterparties with a relatively low creditor seniority on the liquidation of the *firm*.

12.5.19

FCA PRA

R

For the purpose of ■ BIPRU 12.5.15R, a *firm* must assume that it is unable to roll any of its Type A wholesale funding in the first two weeks of the stresses.

#### Retail funding risk

12.5.20

FCA PRA

R

In this part of ■ BIPRU 12.5, retail funding is funding that is accepted from a *consumer*.

12.5.21

FCA PRA

R

For the purpose of assessing its retail funding risk, a *firm* must:

- (1) estimate the gross retail outflows that could occur under the liquidity stresses required by ■ BIPRU 12.5.6R;
- (2) identify the stress, or combination of stresses, to which it considers its retail funding to be most vulnerable and estimate the gross retail outflows that could occur under that stress or combination of stresses; and
- (3) divide its retail funding into funding which the *firm* assesses as having a higher than average likelihood of withdrawal in response to actual or perceived changes in the *firm's* credit-worthiness (Type A retail funding) and other funding (Type B retail funding).

12.5.22

FCA PRA

G

In general, the *appropriate regulator* expects a *firm's* retail funding to be less responsive than its wholesale funding to actual or perceived changes in the *firm's* credit-worthiness. However, a *firm* should nevertheless make its own assessment of the relative responsiveness of its wholesale and retail funding.

12.5.23

FCA PRA

G

For the purposes of assessing behaviour under stress, a *firm* should categorise its retail liabilities according to: value, maturity, estimated speed of outflow, product type, interest rate applied and any other factor that it considers relevant to its retail *deposit* structure.

## 12.5.24

FCA PRA

G

A *firm* should also be mindful that its retail funding profile is unlikely to be constant. In carrying out its *ILAA*, a *firm* should have regard to any changes to its retail funding profile since the previous *ILAA* and also to the possible impact of any future changes on its ability to maintain retail funding during periods of stress. In its *ILAA* submission to the *appropriate regulator*, a *firm* should include an analysis of:

- (1) its retail funding profile as at the date of its *ILAA*;
- (2) its retail funding profile over the twelve *months* preceding its *ILAA*;
- (3) its projected retail funding profile over the twelve *months* following the date of its *ILAA*; and
- (4) its approach to assessing which of its retail funding it has classed as Type A retail funding and which as Type B retail funding.

## 12.5.25

FCA PRA

G

In the *appropriate regulator's* view Type A retail funding is likely to include at least funding which:

- (1) has been accepted through the internet; or
- (2) is considered to have a more than average sensitivity to interest rate changes (such as a *deposit* whose acceptance can reasonably be attributed to the use of price-focused advertising by the *firm* accepting the *deposit*); or
- (3) in relation to any individual depositor exceeds to a significant extent the amount of that individual's *deposits* with the accepting *firm* that are covered by a national deposit guarantee scheme; or
- (4) is not accepted from a depositor with whom the *firm* has had a long relationship; or
- (5) is accepted from retail depositors who can access their *deposits* before their residual contractual maturity subject to a loss of interest or payment of another form of early access charge (as a general proposition, the behaviour of liabilities to retail depositors is likely to depend in part on the contractual terms and conditions which give rise to those liabilities); or
- (6) is not held in an account which is maintained for transactional purposes.

### Intra-day liquidity risk

## 12.5.26

FCA PRA

R

For the purpose of assessing its intra-day *liquidity risk* arising from its direct participation in a payment or settlement system, a *firm* must in relation to each such system in which it participates:

- (1) calculate on an intra-day basis the net amounts of collateral and cash required by that *firm* to fund participation in that system; and
- (2) estimate how the amounts in (1) could change under the liquidity stresses required by ■ BIPRU 12.5.6 R.

- 12.5.27** FCA PRA G For the purpose of calculating the net amounts of collateral and cash under ■ BIPRU 12.5.26R, a *firm* should separately analyse:
- (1) the amounts of collateral and cash needed in relation to both its own payments and those of its customers; and
  - (2) the intra-day timing of the payment of cash and the posting of the collateral, including the time at which the demand for its collateral and cash is greatest.
- 12.5.28** FCA PRA G For the purpose of ■ BIPRU 12.5.26R, a *firm* should ensure that it takes into account, in both normal financial conditions and in periods of stress, the effect of:
- (1) other participants in a payment system withholding some or all of the payments expected from them; and
  - (2) its customers increasing either or both the volume and value of their payments.
- 12.5.29** FCA PRA R At the same time as it carries out the calculation and estimation in ■ BIPRU 12.5.26 R, a *firm* which participates directly in one or more payment or settlement systems must also estimate the impact on its liquidity position of the customer to which it has the largest intra-day credit exposure defaulting on its payment obligations to the *firm*:
- (1) under normal financial conditions; and
  - (2) under the stresses required by ■ BIPRU 12.5.6 R.
- 12.5.30** FCA PRA G For the purpose of ■ BIPRU 12.5.29R, a *firm* should assume that the effect of that default is that the exposure is rolled overnight.
- 12.5.31** FCA PRA R A *firm* must, as part of its *ILAA* submission to the *appropriate regulator* :
- (1) identify those payment and settlement systems in which it is a direct participant; and
  - (2) provide details of the intra-day credit policies that it applies, including the criteria against which it sets credit limits, when extending credit to a customer which is not a direct participant in the payment or settlement system in question.
- 12.5.32** FCA PRA G For the purpose of ■ BIPRU 12.5.31R, the *appropriate regulator* would expect a *firm*, in relation to each payment or settlement system in which it participates directly, to provide details of:
- (1) that *firm's* charges for providing intra-day credit;
  - (2) any collateral requirements which it applies to its customers;

- (3) the credit limits that it imposes (and the circumstances, if any, in which credit may be provided notwithstanding a limit breach);
- (4) the extent to which the customers of that *firm* make use of the credit extended to them; and
- (5) where relevant, the points during the day at which a customer is required to settle, or provide assets as collateral to cover, that *firm*'s credit exposure to it.

## 12.5.33

FCA PRA

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■ BIPRU 12.5.34R applies to a *firm* which:

- (1) is not a direct participant in a given payment or settlement system;
- (2) is a customer of a *firm* that is a direct participant in such a system for the purposes of gaining access to that system; and
- (3) receives intra-day credit from that participant *firm* or prefunds its account with such a *firm*.

## 12.5.34

FCA PRA

R

For the purpose of assessing its intra-day *liquidity risk* a *firm* to which ■ BIPRU 12.5.33R applies must assess the effect on its own position of a participant *firm* from which it receives intra-day credit or with which it has a prefunded account being unable to perform its obligations to that *firm*:

- (1) under normal financial conditions; and
- (2) under the stresses required by ■ BIPRU 12.5.6 R.

## 12.5.35

FCA PRA

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As part of its *ILAA* submission to the *appropriate regulator*, a *firm* to which ■ BIPRU 12.5.33R applies should include:

- (1) details of any alternative arrangements that it has in place to ensure that it continues to be able to meet its liabilities as they fall due in the circumstances set out in ■ BIPRU 12.5.34R; and
- (2) details of the policies governing the use of intra-day credit provided to it by a *firm* which is a direct participant in a given payment or settlement system, including details of the criteria against which that participant will decide whether to reduce or cease the provision of intra-day credit.

### Intra-group liquidity risk

## 12.5.36

FCA PRA

R

Where a *firm* has an *intra-group liquidity modification* permitting it to rely on liquidity from other members of its *group* in order to satisfy the *overall liquidity adequacy rule*, or may be exposed to calls on its own liquidity resources from others in its *group*, then in assessing its *intra-group liquidity risk* it must:

- (1) take into account:

- (a) the extent to which it and other entities in its *group* have access to central bank funding;
  - (b) in relation to any *group* entity on which a *firm* relies for liquidity support, the legal and regulatory regime to which that entity is subject, in particular that covering liquidity regulation; and
  - (c) the contractual arrangements governing any agreed forms of intra-*group* liquidity support (including committed funding lines); and
- (2) assume that in periods of stress, *group* entities will not repay loans or *deposits* made by the *firm* to them, but that the *firm* will meet its liabilities that fall due to other *group* entities during the period of the relevant stress.

12.5.37

FCA PRA

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For the purpose of ■ BIPRU 12.5.36R, a *firm* should consider the full range of legal and regulatory restrictions on the availability to it of liquidity support from other members of its *group*. A *firm* should ensure that it understands restrictions in force in other jurisdictions, as well as the potential for such restrictions to be imposed in the future, as to the allowable size of intra-*group* exposures. A *firm* should also consider the circumstances in which it may find itself obliged to transfer liquidity resources to other entities in its *group*.

12.5.38

FCA PRA

R

In relation to an *incoming EEA firm* or *third country BIPRU firm* which does not have a *whole-firm liquidity modification*, that *firm* must assess the risk that its *UK branch* may be exposed to calls on liquidity under its control from its head office:

- (1) in normal financial conditions; and
- (2) under the liquidity stresses required by ■ BIPRU 12.5.6 R.

12.5.39

FCA PRA

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In complying with ■ BIPRU 12.5.38R a *firm* is therefore assessing its exposure to inter-office *liquidity risk*, rather than intra-*group liquidity risk*. It is the *appropriate regulator's* assessment of the *firm's* inter-office *liquidity risk* that is one of the factors that will inform the *appropriate regulator's* decision as to the appropriate size for the *firm's* local operational liquidity reserve (as described in ■ BIPRU 12.2).

### Cross-currency liquidity risk

12.5.40

FCA PRA

R

For the purpose of assessing its cross-currency *liquidity risk*, a *firm* must:

- (1) in relation to each currency in which it has significant positions, calculate its gross outflows and gross inflows having regard to their respective maturities;

- (2) where it identifies a net outflow in (1), assess how it will fund that outflow; and
- (3) estimate how the amounts in (1) and the assessment in (2) could change under the liquidity stresses required by ■ BIPRU 12.5.6R.

12.5.41

FCA PRA

R

A *firm* must, as part of its *ILAA* submission to the *appropriate regulator*, in relation to each currency in which it has significant positions:

- (1) identify the type of financial instruments which that firm uses to raise funding in that currency;
- (2) identify the main counterparties which provide funding to that *firm* in that currency; and
- (3) describe the arrangements that it has in place to fund net outflows in that currency on a timely basis.

#### Off-balance sheet liquidity risk

12.5.42

FCA PRA

R

For the purpose of assessing its off-balance sheet *liquidity risk*, a *firm* must:

- (1) identify all off-balance sheet activities that might affect its cash flows;
- (2) calculate the effect on its cash flows of those activities in normal financial conditions; and
- (3) estimate the effect on its cash flows of those activities under the liquidity stresses required by ■ BIPRU 12.5.6R.

12.5.43

FCA PRA

R

For the purpose of ■ BIPRU 12.5.42R, a *firm* must take into account the circumstances in which it may choose to provide liquidity support in respect of its off-balance sheet activities beyond its contractual obligations (if any) to do so.

12.5.44

FCA PRA

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For the purpose of ■ BIPRU 12.5.42R, a *firm* must in particular consider the impact on its cash flows of:

- (1) *derivatives* positions;
- (2) contingent liabilities;
- (3) commitments given; and
- (4) liquidity facilities to support securitisation programmes.

12.5.45

FCA PRA

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In relation to *derivatives* positions, a *firm* should:

- (1) assess the effect on its cash flows arising from the maturity, exercise and repricing of *derivatives* in which it holds a position, including the impact of counterparties:
  - (a) who may require the posting of additional margin or collateral in the event of a decline in that *firm's* credit rating;
  - (b) who may require the posting of additional margin or collateral (or the return to them of margin or collateral) in the event of a change in the value of a *derivative* or of the posted collateral;
  - (c) who (in the case of those that are any of a *recognised investment exchange*, a *designated investment exchange* or a *recognised clearing house*) may require the posting of additional margin in volatile market conditions;
  - (d) who may choose to terminate an *OTC derivative* which they have entered into with the *firm* rather than post additional margin or collateral;
  - (e) who, in periods of name-specific liquidity stress experienced by the *firm*, may choose to terminate out of the money *derivatives* which they have entered into with that *firm*; and
  - (f) who, in periods of stress, may choose to post less liquid collateral than would likely be the case in normal financial conditions; and
- (2) assume that under the stresses required by ■ BIPRU 12.5.6 R there may be uncertainty as to the accuracy of the valuation attributed to a *derivative* contract.

12.5.46

FCA PRA

G

In relation to its contingent liabilities, a *firm* should:

- (1) calculate the impact on its cash flows of those of its contingent obligations that will be triggered in normal financial conditions; and
- (2) estimate the impact on its cash flows of those of its contingent obligations that may be triggered under the liquidity stresses required by ■ BIPRU 12.5.6 R.

12.5.47

FCA PRA

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For the purpose of ■ BIPRU 12.5.46G, a *firm* should therefore assess the impact on its cash flows of the triggering of contingent obligations contained in all contractual documentation to which it is party, including: acceptances, endorsements, guarantees, underwriting agreements, standby letters of credit, documentary credits, warrants, indemnities, undrawn note issuance facilities and other revolving credit facilities. A *firm* should also assess the degree of concentration in its total contingent liabilities as respects obligations arising from particular types of contract, counterparty and market sector.

12.5.48

FCA PRA

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In relation to its commitments (other than liquidity facilities to support securitisation programmes)), a *firm* should:

- (1) calculate its maximum contractual exposure arising from those commitments;

- (2) calculate the effect on its cash flows of the drawing of those commitments in normal financial conditions; and
- (3) estimate the effect on its cash flows of the drawing of those commitments under the liquidity stresses required by ■ BIPRU 12.5.6 R.

## 12.5.49

FCA PRA

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For the purpose of ■ BIPRU 12.5.48G, a firm should:

- (1) consider its contractual exposure to the following types of commitment: committed funding facilities, undrawn loans and advances to wholesale counterparties, mortgages that have been agreed but not yet been drawn down, credit cards, overdrafts (and other retail lending facilities);
- (2) ensure that its analysis of each type of commitment is sufficiently granular to enable that *firm* to:
  - (a) assess the circumstances in which counterparties will draw down;
  - (b) identify the extent of any correlations as between counterparties in deciding whether or not to draw down;
  - (c) identify the extent to which decisions by the *firm's* counterparties to draw down may be correlated to a decline in the *firm's* own liquidity resources; and
  - (d) assess the proportion of its total commitments attributable to particular counterparties; and
- (3) assess the extent to which draw down requires the counterparty in question to deliver to the *firm* collateral in the form of marketable assets, while also assessing the anticipated effect of such a requirement on:
  - (a) the likelihood that the counterparty in question will draw down; and
  - (b) the *firm's* liquidity position if the counterparty in question delivers collateral on draw down; and
- (4) assess the impact on its cash flows of its commitment counterparties experiencing liquidity stress at the same time as that *firm* is subject to the stresses required by ■ BIPRU 12.5.6 R.

## 12.5.50

FCA PRA

G

In relation to liquidity facilities to support securitisation programmes, a *firm* should:

- (1) assess the extent of its contractual obligations to provide liquidity support to sponsored and third-party structured vehicles;
- (2) identify the circumstances in which support will, or is likely to, be called; and
- (3) assess the impact on that *firm's* cash flows of such support being called:
  - (a) in normal financial conditions; and
  - (b) under the liquidity stresses required by ■ BIPRU 12.5.6R.

**12.5.51** FCA PRA G For the purpose of ■ BIPRU 12.5.50G (2), a *firm* should consider the impact of the following events on the likelihood of a call for liquidity support: inability of a vehicle to roll over commercial paper (due either to disruption in the CP market or to concern as to the quality of the assets securitised) and, in relation to sponsored vehicles, concern as to the solvency of that *firm* as sponsor and, separately, the possibility of draw down of undrawn commitments entered into by the sponsored vehicle in its own right.

#### Franchise-viability risk

**12.5.52** FCA PRA R For the purposes of assessing its franchise-viability risk, a *firm* must assess, under the liquidity stresses required by ■ BIPRU 12.5.6 R, the liquidity resources required to maintain its core business franchise and reputation.

**12.5.53** FCA PRA G Franchise-viability risk is the risk that in the stresses required by ■ BIPRU 12.5.6R a *firm* may not have sufficient liquidity resources to maintain its core business franchise and reputation.

**12.5.54** FCA PRA G In complying with ■ BIPRU 12.5.52R, a *firm* should assess the extent to which it can and realistically will:

- (1) restrict new retail lines without significantly damaging customer relationships;
- (2) restrict new wholesale lending without significantly damaging its ability to resume such lending following the period of stress in question;
- (3) cease to provide liquidity support to its sponsored vehicles;
- (4) decline to exercise call *options* whose effect if not exercised might be to cause market participants to question the *firm's* ability to continue to meet its liabilities as they fall due; and
- (5) continue any regular programme of buying back its issued debt.

**12.5.55** FCA PRA G For the purpose of ■ BIPRU 12.5.54G (5), a *firm* may wish to continue repurchasing its debt to help demonstrate that a two-way market continues to be made in its paper and, more generally, in order to maintain the long-term viability of its debt issuance programme. Equally, a *firm* may wish to continue repaying retail depositors before the contractual maturity of those *deposits* in order to maintain confidence in its ability to continue to meet its liabilities as they fall due.

#### Marketable assets risk

**12.5.56** FCA PRA R For the purpose of assessing its exposure to marketable assets risk, a *firm* must assess how the marketable assets comprised in its liquidity resources will behave:

- (1) under normal financial conditions; and
- (2) under the liquidity stresses identified in ■ BIPRU 12.5.6R, including an assessment of the effect of these stresses on:

- (a) its ability to derive funding from its marketable assets in a timely fashion;
- (b) the potential for using those assets as collateral to raise secured funding and the size of the haircut likely to be required by a counterparty;
- (c) the likelihood and extent of forced-sale loss; and
- (d) the effect on its business activities of any changes in (a) to (c) identified as likely to result from those liquidity stresses.

12.5.57

FCA PRA

G

In complying with ■ BIPRU 12.5.56R, a *firm* should consider all marketable assets which count towards its liquidity resources for the purposes of meeting the *overall liquidity adequacy rule*. A firm should therefore include in this assessment any assets that it holds in its liquid assets buffer.

12.5.58

FCA PRA

G

The *appropriate regulator* regards as marketable those of a *firm's* assets that it is able to sell outright or *repo*. For liquidity management purposes, a *firm* would ordinarily expect to hold a stock of assets of this kind in order to reduce the likelihood that it may need to borrow unsecured at short notice. To the extent that these assets may behave differently under stress conditions than under normal financial conditions, a *firm* is subject to marketable assets risk.

12.5.59

FCA PRA

G

As a general proposition, the speed with which a *firm* may be able to realise a marketable asset, and the price impact of doing so, will depend to a significant extent on the volume of those assets which that *firm* wishes to realise and the market conditions prevailing at the time.

12.5.60

FCA PRA

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The behaviour of a *firm's* marketable assets under conditions of stress is likely to depend on a number of different factors, including:

- (1) the depth and competitiveness of the market for the marketable asset in question, the size of the bid-offer spread, the presence of committed market-makers, the nature of the information available to potential counterparties, the degree of structural complexity of the assets in question and the assets eligibility in central bank market operations and liquidity facilities; and
- (2) that *firm's* operational capability to generate funding from those assets in a timely manner.

12.5.61

FCA PRA

G

In considering its operational capability to generate funding from assets, a *firm* should be aware that its capability in this regard is likely to depend on:

- (1) whether it has in place arrangements for *repo*;
- (2) the extent to which that *firm* already holds a significant proportion of the market for the marketable asset in question;
- (3) the extent to which that *firm* periodically realises some or all of its holdings of that asset; and

- (4) that *firm's* accounting treatment and valuation of that asset.

12.5.62

FCA PRA

R

For the purpose of its *ILAA* submission to the *appropriate regulator*, a *firm* must provide the *appropriate regulator* with an analysis of the profile of its marketable assets as at the date of submission in a way that:

- (1) separately identifies its marketable assets according to asset class, maturity, currency, their eligibility for use in central bank monetary operations and liquidity facilities and any other characteristic that it uses in its liquidity management; and
- (2) assesses the degree of diversification achieved across its marketable assets.

#### Non-marketable assets risk

12.5.63

FCA PRA

R

For the purpose of assessing its exposure to non-marketable assets risk, a *firm* must assess how the non-marketable assets in its liquidity resources will behave:

- (1) under normal financial conditions; and
- (2) under the liquidity stresses required by ■ BIPRU 12.5.6 R, including an assessment of the effect of these stresses on:
  - (a) the *firm's* ability to derive funding from its non-marketable assets; and
  - (b) the impact on the *firm's* liquidity position of any consequences for its funding ability identified in (a).

12.5.64

FCA PRA

G

In complying with ■ BIPRU 12.5.63R, a *firm* should consider all non-marketable assets which count towards its liquidity resources for the purposes of meeting the *overall liquidity adequacy rule*.

12.5.65

FCA PRA

G

■ BIPRU 12.2.5 G notes that a *firm* should include in its liquidity resources sufficient assets which are marketable or otherwise realisable. The *appropriate regulator* considers those assets which are capable of realisation, but other than through *repo* or outright sale, as non-marketable assets. To the extent that these assets may behave differently under stress conditions than under normal financial conditions, a *firm* is subject to non-marketable assets risk. Different forms of non-marketable assets risk arise, particularly in relation to:

- (1) retail loans; and
- (2) unsecured wholesale assets.

12.5.66

FCA PRA

G

In addition to realising a *firm's* marketable assets, a *firm* can meet its outflows in part by expected inflows from maturing non-marketable assets such as retail loans. Inflows

from these assets (principal and interest) may in stressed conditions be affected by counterparty behaviour, exposing that *firm* to non-marketable assets risk.

12.5.67

FCA PRA

R

For the purpose of assessing its exposure to non-marketable assets risk a *firm* must assess the extent to which the behaviour of inflows from retail loans under the liquidity stresses required by ■ BIPRU 12.5.6R may differ from that suggested by their contractual terms.

12.5.68

FCA PRA

G

For the purpose of the assessment in ■ BIPRU 12.5.67R, a *firm* should ensure that it assesses repayment behaviour at a level of granularity sufficient to enable it to draw informed conclusions about its liquidity exposure. The *appropriate regulator* would expect a *firm's* assessment to analyse separately the non-marketable assets risk associated with each of its relevant products and with each type of counterparty from whom it is expecting repayments.

12.5.69

FCA PRA

G

For the purpose of the assessment in ■ BIPRU 12.5.67R, a *firm* should in particular have regard to the risk associated with:

- (1) repayment defaults; and
- (2) exercise by its counterparties of contractual rights to repay before the expected maturity date or to delay repayment beyond that date.

12.5.70

FCA PRA

G

A *firm* may also use its unsecured wholesale assets to generate liquidity, otherwise than by outright sale or *repo*. A *firm* may, for example, choose to generate funding from some of the assets included in its liquidity resources by using them in securitisation or covered bond programmes. Assets that are typically used to raise liquidity in this manner include residential mortgage loans; commercial mortgage and other loans; credit card and automobile receivables, which have been packaged for the wholesale markets. To the extent that the ability to fund from these non-marketable assets may be limited under stressed conditions, a *firm* may be exposed to non-marketable assets risk.

12.5.71

FCA PRA

G

The assessment required by ■ BIPRU 12.5.63R is particularly important for a *firm* which:

- (1) ordinarily does not raise funding from its non-marketable assets in this way; or
- (2) places proportionately greater reliance on securitisation programmes as compared to other funding strategies to generate liquidity.

12.5.72

FCA PRA

R

In complying with ■ BIPRU 12.5.63R, a *firm* must in particular assess the non-marketable assets risk associated with asset securitisations, having regard to:

- (1) the existence of early amortisation triggers and the consequences of their operation; and
- (2) its financing of assets which are warehoused prior to their securitisation.

12.5.73

FCA PRA

G

A *firm* which chooses to warehouse assets in the way described in ■ BIPRU 12.5.72R should consider the particular risks that arise from the method of financing that it uses to pre-fund those assets. For example, financing of warehoused assets by means of short-term (rather than long-term) funding is more likely to put that *firm* under liquidity pressure in the event that its proposed securitisation is not completed (either at all, or at the expected date).

### Funding concentration risk

12.5.74

FCA PRA

G

A *firm* with a sufficiently flexible funding strategy should be able to reduce its *liquidity risk* by diversifying its liquidity resources.

12.5.75

FCA PRA

R

**As part of its ILAA, a *firm* must assess the impact on the degree of diversification in its liquidity resources of the stresses required by ■ BIPRU 12.5.6R.**

12.5.76

FCA PRA

G

For the purpose of ■ BIPRU 12.5.75R, a *firm* should take into account the extent to which its liquidity resources are diversified according to:

- (1) type of instrument and product;
- (2) currency;
- (3) counterparty;
- (4) liability term structure; and
- (5) market for their realisation (provided that such market is open to the *firm* as counterparty).

12.5.77

FCA PRA

G

A *firm* should be aware that the degree of diversification in its liquidity resources can be compromised, particularly in periods of stress, by a number of factors, including:

- (1) reduced or terminated funding provision from some counterparties as a result of that *firm's* credit-rating being downgraded or its financial condition deteriorating;
- (2) disputes over the terms of legally binding commitments to lend which delay the provision of funding;
- (3) markets previously used by the *firm* for raising funding ceasing to be open or operating but at reduced capacity;
- (4) reliance on a small number of brokers to access funding sources; and
- (5) positive correlations in the behaviour of different instruments and products.

## 12.6 Simplified ILAS

### 12.6.1

FCA PRA

G

The *appropriate regulator* recognises that it may not always be appropriate to apply ■ BIPRU 12.5 (Individual Liquidity Adequacy Standards) to every *ILAS BIPRU firm*. For a *firm* which operates a relatively simple business model, it may instead be appropriate to allow the *firm* to calculate the size and content of its liquid assets buffer according to a simplified approach prescribed in the *Handbook* in advance of any review of that *firm's liquidity risk* conducted by the *appropriate regulator*. This section sets out the *simplified ILAS* approach to maintaining a liquid assets buffer and a *firm* that operates that approach is a *simplified ILAS BIPRU firm*.

### 12.6.2

FCA PRA

R

**An *ILAS BIPRU firm* that wishes to operate the *simplified ILAS* approach must:**

- (1) satisfy the conditions in ■ BIPRU 12.6.6R to ■ BIPRU 12.6.8R; and
- (2) obtain a *simplified ILAS waiver* from the *appropriate regulator*.

### 12.6.3

FCA PRA

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A *firm* will therefore lose the benefit of its *simplified ILAS waiver* if it ceases to satisfy the conditions in ■ BIPRU 12.6.6R to ■ BIPRU 12.6.8R. Consistent with *Principle 11* (Relations with regulators), if a *firm* anticipates that it may breach those conditions, it should notify the *appropriate regulator* promptly.

### 12.6.4

FCA PRA

R

**A *simplified ILAS BIPRU firm* must calculate the size of its *simplified buffer requirement* in accordance with ■ BIPRU 12.6.9R to ■ BIPRU 12.6.18R.**

### 12.6.5

FCA PRA

G

The *appropriate regulator* is likely to regard a *simplified ILAS BIPRU firm* whose liquid assets buffer accords with the *simplified buffer requirement* as having an adequate buffer of assets and a prudent funding profile for the purpose of ■ BIPRU 12.2.8R. However, the *simplified ILAS* approach does not relieve a *simplified ILAS BIPRU firm* from the obligation to hold liquidity resources which are adequate for the purpose of meeting the *overall liquidity adequacy rule* or from the obligation in ■ BIPRU 12.3.4R to assess and maintain on an ongoing basis the adequacy of its liquidity resources. Consequently, where a *firm's* own assessment of the adequacy of its liquidity resources indicates that its liquid assets buffer should be larger in size than that produced by the application of the *simplified buffer requirement*, the *appropriate regulator* will expect that *firm* to maintain a liquid assets buffer which is consistent with the results of its own assessment. Equally, following any review by the *appropriate regulator* of the *liquidity risk* to which a *simplified ILAS BIPRU firm* is exposed, the *appropriate regulator* may give that *firm individual liquidity guidance* advising it that its liquid assets buffer should be bigger than that which is produced by the application of the *simplified buffer requirement*.

12.6.6

FCA PRA

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**Simplified ILAS conditions**

The first condition is that:

- (1) no less than 75% of the *firm's* total liabilities are accounted for by retail *deposits* and :
  - (a) the *firm's* total assets do not exceed 250 million; or
  - (b) the *firm's* total assets do not exceed 1 billion and no less than 70% of those assets are accounted for by:
    - (i) assets of the kind that fall into ■ BIPRU 12.7.2 R and which the *firm* counts towards its *simplified buffer requirement*; and
    - (ii) retail loans; or
  - (c) no less than 70% of the *firm's* total assets are accounted for by retail loans; or
  - (d) no less than 70% of the *firm's* total assets are accounted for by:
    - (i) *money-market instruments* with a residual contractual maturity of three *months* or less; or
    - (ii) sight *deposits* held with a *credit institution*; or
    - (iii) term *deposits* with a residual contractual maturity of three *months* or less held with a *credit institution*; or
- (2) no less than 80% of the *firm's* total liabilities are accounted for by liabilities owed to its *parent undertaking* and the amount of the *firm's* total assets does not exceed 1 billion.
  - (a) [deleted]
  - (b) [deleted]
  - (c) [deleted]
- (3) [deleted]

12.6.6A

FCA PRA

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For the purpose of ■ BIPRU 12.6.6 R, a *firm* must calculate:

- (1) its total assets by reference to its most recent 001 *data item*; and
- (2) its retail loans as the total of its lending to the retail sector recorded in cell 11A in its most recent 015 *data item*.

12.6.7

FCA PRA

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In this section :

- (1) a retail *deposit* is a *deposit* accepted from a *consumer*; and
- (2) SME *deposits* are *deposits* accepted from, and account balances where the account holders are, *small and medium-sized enterprises* (or *partnerships* or *sole traders* or *charities* which would be *small and medium-sized enterprises* if they were companies).

12.6.8

FCA PRA

R

The second condition is that no less than 99.5% of the *firm's* total assets and no less than 99.5% of its total liabilities are denominated in sterling, euros or United States dollars.

#### Size of the simplified buffer requirement

12.6.9

FCA PRA

R

- (1) A *simplified ILAS BIPRU firm* must ensure that the size of its liquid assets buffer is at all times greater than or equal to 50% of the amount produced by adding:
  - (a) the wholesale net cash outflow component;
  - (b) the retail and SME *deposit* component; and
  - (c) the credit pipeline component.
- (2) This is the *simplified buffer requirement*.

#### The wholesale net cash outflow component

12.6.10

FCA PRA

R

- (1) The wholesale net cash outflow component is a *firm's* peak cumulative wholesale net cash outflow over the next three *months* where the peak is established by:
  - (a) calculating the daily wholesale net cash flow by reference to a *firm's* wholesale assets maturing that day and its wholesale liabilities falling due on that day;
  - (b) for each of the *business days* in the next three *months*, calculating the cumulative total of such daily net cash flows as at the *business day* in question; and
  - (c) identifying the minimum cumulative total figure out of all of the cumulative total figures calculated in accordance with (b).
- (2) The figure identified in (1)(c) is the peak cumulative wholesale net cash outflow.
- (3) For the purpose of calculating the peak cumulative wholesale net cash outflow, a *firm* must:
  - (a) exclude from the calculation in (1)(a) cash flows attributable to *repo* and reverse *repo*, forward sales, forward purchases, redemptions and any other transactions entered into by the

*firm* where the security leg of the transaction in question is in respect of securities of the type described in

■ BIPRU 12.7.2R (1) and ■ (2);

- (b) include wholesale cash outflows in that calculation according to their earliest contractual maturity;
- (c) exclude wholesale cash flows attributable to reserves in the form of sight deposits with a central bank and *designated money market funds* that it includes in its liquid assets buffer in accordance with the *rules* on asset eligibility in ■ BIPRU 12.7; and
- (d) exclude any retail *deposits* or SME *deposits*.

#### The retail and SME deposit component

12.6.11

FCA PRA

R

- (1) The retail and SME *deposit* component is the sum represented by:
  - (a) 20% of a *firm's* Type A retail *deposits*;
  - (b) 10% of a *firm's* Type B retail *deposits* ; and
  - (c) 20% of a *firm's* SME *deposits*.
- (2) A *firm* must:
  - (a) assess the likelihood that retail *deposits* that it holds will be withdrawn in response to actual or perceived changes in the *firm's* credit-worthiness;
  - (b) calculate the amount of retail *deposits* that it assesses as having a higher than average likelihood of withdrawal in the circumstances described in (a) (Type A retail *deposits*); and
  - (c) class all other of its retail *deposits* as Type B retail *deposits*.

12.6.12

FCA PRA

G

In the *appropriate regulator's* view, a Type A retail *deposit* is likely to include one which:

- (1) has been accepted through the internet; or
- (2) is considered to have a more than average sensitivity to interest rate changes (such as a deposit whose acceptance can reasonably be attributed to the use of price-focused advertising by the *firm* accepting the *deposit*); or
- (3) in relation to any individual depositor exceeds to a significant extent the amount of that individuals *deposits* with the accepting *firm* that are covered by a national deposit guarantee scheme; or
- (4) is not accepted from a depositor with whom the *firm* has had a long relationship; or

- (5) is accepted from retail depositors who can access their *deposits* before their residual contractual maturity subject to a loss of interest or payment of another form of early access charge (as a general proposition, the behaviour of liabilities to retail depositors is likely to depend in part on the contractual terms and conditions which give rise to those liabilities); or
- (6) is not held in an account which is maintained for transactional purposes.

## 12.6.13

FCA PRA

R

Before applying for a *simplified ILAS waiver*, a *firm* must prepare a written policy statement recording its approach to assessing the likelihood of withdrawal of its retail *deposits* in the circumstances described in ■ BIPRU 12.6.11R (2)(a) and ensure that:

- (1) the *firm's governing body* approves and conducts appropriate reviews of the policy statement; and
- (2) the *firm* submits a copy of the policy statement to its usual supervisory contact at the *appropriate regulator*.

## 12.6.14

FCA PRA

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In considering a *firm's* application for a *simplified ILAS waiver*, the *appropriate regulator* will take into account the *firm's* policy statement submitted to it under ■ BIPRU 12.6.13R and form a view about the appropriateness of the assumptions on which the policy statement is based. Where a policy statement submitted after the grant of a *simplified ILAS waiver* reflects a materially different assessment to that set out in the policy statement considered as part of a *firm's* *waiver* application, a *firm* should expect that the *appropriate regulator* will wish to review the continued appropriateness of the *firm's* *simplified ILAS waiver* and in so doing will re-examine afresh all matters to which it had regard when the *waiver* in question was granted. The *appropriate regulator* expects a *firm* to review the appropriateness of its policy statement as often as is necessary and in any event no less frequently than annually. A *firm* should always review the continued appropriateness of its policy statement following a material change to the nature of the *firm's* business. Where a *firm* updates or otherwise changes its policy statement it should submit promptly to the *appropriate regulator* the new document.

### The credit pipeline component

## 12.6.15

FCA PRA

R

The credit pipeline component is the sum represented by 25% of a *firm's* credit facilities offered to its *customers* but which are yet to be drawn down, including:

- (1) offers to make loans secured on residential property;
- (2) overdraft facilities; and
- (3) credit card facilities.

### Buffer securities restriction

## 12.6.16

FCA PRA

R

- (1) A *simplified ILAS BIPRU firm* may only include in its liquid assets buffer eligible government and *designated multilateral development bank* debt securities up to the value of the *buffer securities restriction*.

- (2) For the purpose of calculating the *buffer securities restriction*, a *firm* must:
  - (a) calculate its daily net flow in government and *designated multilateral development bank* debt securities eligible as classes of assets for inclusion in the *firm's* liquid assets buffer;
  - (b) for each of the *business days* in the next three *months* calculate the cumulative total of such daily securities flows, including the opening balance, as at the *business day* in question; and
  - (c) identify the minimum cumulative total figure out of all of the cumulative total figures calculated in accordance with (b).
  
- (3) For the purpose of (2)(a), a *firm* must include :
  - (a) all contractual inflows and outflows of eligible debt securities arising from *repo*, reverse *repo*, forward sales, forward purchases, redemptions and any other transactions involving those securities; and
  - (b) those cash flows excluded under ■ BIPRU 12.6.10 R (3)(a).

12.6.17

FCA PRA

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In mathematical terms the calculation in ■ BIPRU 12.6.9R and ■ BIPRU 12.6.16R may be represented as follows:

Liquidity Buffer  $\geq$  (Wholesale net cash outflow component + Retail and SME deposit component + Credit pipeline component)  $\times 0.5$

Liquidity buffer	$FSA048_{18,1} + FSA048_{19,1} + FSA048_{6,1} + FSA048_{6,2} + FSA048_{25,2} + FSA048_{34,2}$ $+ \inf \{f(x) : x = 1,2,3..y\}$ <p>where :</p> $f(x) = \sum_{m=1}^x FSA047_{6,m} + \sum_{m=1}^x FSA047_{25,m} + \sum_{m=1}^x FSA047_{34,m}$
Retail and SME deposit component	$\left( 0.2 \times \sum_{n=33}^{54} \sum_{m=1}^{10} FSA048_{n,m} \right) + \left( 0.1 \times \sum_{m=1}^{10} FSA048_{55,m} \right)$
Credit pipeline component	$0.25 \times \left( \sum_{n=39}^{69} FSA048_{n,1} \right)$
Wholesale net cash outflow component	$\min \left( 0, \left( \sum_{n=20}^{22} FSA048_{n,1} \right) + \left( \sum_{n=26}^{30} FSA048_{n,2} \right) + \left( \sum_{n=35}^{39} FSA048_{n,2} \right) + \left( \sum_{n=44}^{51} FSA048_{n,1} \right) + \left( \sum_{m=1}^5 FSA048_{52,m} \right) + FSA048_{36,1} + \inf \{g(x) : x = 1,2,3..y\} \right)$ <p>where :</p> $g(x) = \sum_{m=1}^y \left[ \left( \sum_{n=20}^{23} FSA047_{n,m} \right) + \left( \sum_{n=26}^{30} FSA047_{n,m} \right) + \left( \sum_{n=35}^{51} FSA047_{n,m} \right) + FSA047_{57,m} \right]$

Where :

y = number of business days in three months

FSAxxx<sub>m,n</sub> = The entry in FSAxxx row m column n

inf {f(x) : x = 1,2,3} represents the greatest lower bound of the function f(x) over the range x = 1,2,3

**Foreign currency positions**

12.6.18

FCA PRA

R

- (1) Subject to (3), a *simplified ILAS BIPRU firm* that has assets or liabilities denominated in either or both euros and United States dollars must carry out separate calculations under ■ BIPRU 12.6.9R in relation to its positions in each of those currencies, in addition to that which it carries out in relation to its sterling positions (if any).
- (2) A *firm* to which (1) applies must ensure that, for the purpose of meeting the *simplified buffer requirement*, it holds in its liquid assets buffer assets denominated in either or both euros and United States dollars (as relevant) greater than or equal to the amount produced by the calculation in the corresponding currency required under (1), in addition to any sterling liquid assets that it is required to hold in its buffer in respect of its sterling positions.
- (3) Paragraph (1) does not apply to a *simplified ILAS BIPRU firm* that hedges fully its positions in either or both euros and United States dollars such that the *firm* is not exposed to any cross-currency *liquidity risk* in respect of those positions.

### Content of the simplified ILAS liquid assets buffer

12.6.19

FCA PRA

G

The *rules* in ■ BIPRU 12.7 set out the sorts of assets that are eligible for the liquid assets buffer of an *ILAS BIPRU firm*. Every *ILAS BIPRU firm* may include in its buffer reserves in the form of sight deposits at a central bank and high quality debt securities issued by governments and *designated multilateral development banks* subject to the eligibility rules in ■ BIPRU 12.7. ■ BIPRU 12.7 provides that a *simplified ILAS BIPRU firm* may also include in its buffer investments in a *designated money market fund*.

12.6.20

FCA PRA

G

A *simplified ILAS BIPRU firm* may include in the liquid assets buffer any combination of the eligible assets permitted by the *rules* in ■ BIPRU 12.7.

### ILSA

12.6.21

FCA PRA

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- (1) A *simplified ILAS BIPRU firm* must regularly carry out an *ILSA* which contains an assessment of the *firm's* compliance with the standards set out in ■ BIPRU 12.3 and ■ BIPRU 12.4, including the results of the stress tests required by the rules in ■ BIPRU 12.4.
- (2) The *firm* must make a written record of its *ILSA*.
- (3) The *ILSA* must be proportionate to the nature, scale and complexity of that *firm's* activities.
- (4) The *ILSA* must take into account *group-wide* liquidity resources only to the extent that reliance on these is permitted by the *appropriate regulator*.

12.6.22

FCA PRA

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For the purpose of ■ BIPRU 12.6.21R, a *firm* should carry out an *ILSA* at least annually, or more frequently if changes in its business or strategy or the nature, scale or complexity of its activities or the operational environment suggest that the current level of liquidity resources is no longer adequate. A *firm* should expect that the *firm's* usual supervisory contact at the *appropriate regulator* will ask for the *ILSA* to be submitted as part of the ongoing supervisory process.

## 12.7 Liquid assets buffer

### 12.7.1

FCA PRA

G

■ BIPRU 12.2 provides that an *ILAS BIPRU firm* must ensure that its liquidity resources contain an adequate buffer of high quality, unencumbered assets. ■ BIPRU 12.7 describes in more detail the nature of the assets that are eligible for inclusion in that buffer. The *rules* in this section provide that some types of assets are eligible for use only by a *simplified ILAS BIPRU firm*.

### 12.7.2

FCA PRA

R

For the purpose of satisfying ■ BIPRU 12.2.8R, a *firm* to which this section applies may include in its liquid assets buffer only:

- (1) high quality debt securities issued by a government or central bank;
- (2) securities issued by a *designated multilateral development bank*;
- (3) reserves in the form of sight deposits with a central bank of the kind specified in ■ BIPRU 12.7.5R and ■ BIPRU 12.7.6R; and
- (4) in the case of a *simplified ILAS BIPRU firm* only, investments in a *designated money market fund*.

### 12.7.3

FCA PRA

R

Subject to ■ BIPRU 12.7.4R, for the purpose of ■ BIPRU 12.7.2R (1), a *firm* may include only a debt security which is:

- (1) issued by the central government or central bank of an *EEA State*;  
or
- (2) issued by the central government or central bank of Canada, the Commonwealth of Australia, Japan, Switzerland or the United States of America.

### 12.7.4

FCA PRA

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 1* 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)); and

- (2) that debt security is either:
  - (a) denominated in the domestic currency of the country in question; or
  - (b) denominated in a currency other than the domestic currency, provided it is denominated in any of Canadian dollars, euros, Japanese yen, sterling, Swiss francs or United States dollars.

## 12.7.5

FCA PRA

R

Subject to ■ BIPRU 12.7.6R, for the purpose of ■ BIPRU 12.7.2R (3) a *firm* may include only reserves in the form of sight deposits held by the *firm* with the central bank of:

- (1) an *EEA State*; or
- (2) Canada, the Commonwealth of Australia, Japan, Switzerland or the United States of America.

## 12.7.6

FCA PRA

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 ECAs* as having a credit rating associated with *credit quality step 1* in the *credit quality assessment scale* published by the *appropriate regulator* for the purpose of ■ BIPRU 3 (The Standardised Approach: mapping of the ECAs credit assessments to credit quality steps (Long term mapping)); and
- (2) those reserves are denominated in the domestic currency of the central bank in question.

## 12.7.6A

FCA PRA

R

For the purpose of ■ BIPRU 12.7.2R (2), a *firm* may not include securities issued by a *designated multilateral development bank* unless:

- (1) the *designated multilateral development bank* in question has been assessed by at least two *eligible ECAs* as having a credit rating associated with *credit quality step 1* in the *credit quality assessment scale* published by the *appropriate regulator* for the purpose of ■ BIPRU 3 (The Standardised Approach: mapping of the ECAs' credit assessments to credit quality steps (Long term mapping)); and
- (2) those securities are denominated in any of Canadian dollars, euros, Japanese yen, sterling, Swiss francs or United States dollars.

- 12.7.7** FCA PRA G It is important that a *firm* identifies and understands the range of central bank facilities in which it is eligible to participate. A *firm* may be eligible to participate in some facilities of this kind by virtue of its having a *branch* in a particular country. In addition to identifying the central bank facilities to which it has access, a *firm* should ensure that it has in place appropriate legal and administrative arrangements to enable it to draw on those facilities in a timely manner.
- 12.7.8** FCA PRA G In deciding on the precise composition of its liquid assets buffer, a *firm* should ensure that it tailors the contents of the buffer to the needs of its business and the *liquidity risk* that it faces. In particular, a *firm* should ensure that it holds assets in its buffer which can be realised with the speed necessary to meet its liabilities as they fall due. In doing so, a *firm* should have regard to the currencies in which its liabilities are denominated and should take into account the potential effect of stressed conditions on its ability to access spot and *swap* foreign exchange markets in a manner consistent with the settlement cycles of foreign exchange settlement systems. A *firm* should have regard to the results of its *ILAA* or, as the case may be, its *ILSA*, in assessing the speed with which its liabilities fall due in stressed and non-stressed conditions.
- 12.7.9** FCA PRA R For the purposes of ■ BIPRU 12.7.2R (1) and ■ (2), a *firm* must only count securities:
- (1) which are unencumbered;
  - (2) (a) to which it has legal title; or
    - (b) to which a *central bank* has legal title but which meet the requirements of ■ BIPRU 12.7.9AR (1), subject to ■ BIPRU 12.7.9AR (2); and
  - (3) which that *firm* realises on a regular basis.
- 12.7.9A** FCA PRA R
- (1) For the purposes of ■ BIPRU 12.7.9R (2)(b) the requirements are that:
    - (a) the securities are in excess of the amount of collateral required to be held by that *central bank*; and
    - (b) the *firm* is entitled to regain legal title to such securities without any encumbrance.
  - (2) The *firm* may only count securities that meet the requirements of ■ BIPRU 12.7.9 R and ■ BIPRU 12.7.9AR (1) from the point in time when the *firm* would regain legal title to the securities from the *central bank*, subsequent to any required notice period.
  - (3) For the purposes of ■ BIPRU 12.7.9AR (2) any required notice period is deemed to commence on the first *business day* that the *central bank* could receive notice from the *firm*.
- 12.7.10** FCA PRA G The *appropriate regulator* regards as encumbered any asset which the *firm* in question has provided as collateral. Therefore, where assets have been used as collateral in this way (for example, in a *repo*), they should not be included in the *firms* liquid assets buffer.

However, any assets provided by the *firm* to a *central bank* as collateral which meet the requirements in ■ BIPRU 12.7.9A R will be recognised as unencumbered by the for the purposes of ■ BIPRU 12.7.9R (1). For the avoidance of doubt, there is no need for notice to have actually been served to meet the requirements in ■ BIPRU 12.7.9AR (2).

## 12.7.11

FCA PRA

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- (1) For the purpose of ■ BIPRU 12.7.9R (3), a *firm* must periodically realise a proportion of the assets in its liquid assets buffer through *repo* or outright sale to the market.
- (2) [deleted]
- (3) A *firm* must ensure that in carrying out such periodic realisation:
  - (a) it does so without reference to the *firm's* day-to-day liquidity needs;
  - (b) it realises in varying amounts the assets in its liquid assets buffer;
  - (c) the cumulative effect of its periodic realisation over any twelve *month* period is that a significant proportion of the assets in its liquid assets buffer is realised; and
  - (d) in *repo* to the market it enters into transactions of varying durations.
- (4) A *firm* must establish and maintain a written policy setting out its approach to periodic realisation of its assets.
- (5) A *firm* must also ensure that it periodically tests its operational ability to raise funds, through the use of central bank liquidity facilities to which it has access, using a proportion of those of its assets not in its liquid assets buffer.

## 12.7.12

FCA PRA

G

The *appropriate regulator* will, as part of its review of a *firm's* ILAA or, as the case may be, its ILSA, assess the adequacy of a *firm's* periodic realisation policy and its implementation in practice.

## 12.8 Cross-border and intra-group management of liquidity

### 12.8.1

FCA PRA

G

Every *firm* subject to ■ BIPRU 12 is subject to the *overall liquidity adequacy rule*. The effect of that rule is that every *firm* is required to be self-sufficient in terms of liquidity adequacy and to be able to satisfy that rule relying on its own liquidity resources. Where the *firm* is an *incoming EEA firm* or *third country BIPRU firm* compliance with the *overall liquidity adequacy rule* with respect to the *UK branch* must be achieved relying solely on liquidity resources that satisfy the conditions in ■ BIPRU 12.2.3 R.

### 12.8.2

FCA PRA

G

However, the *appropriate regulator* recognises that there may be circumstances in which it would be appropriate for a *firm* to rely on liquidity resources which can be made available to it by other members of its *group*, or for a *firm* to rely on liquidity resources elsewhere in the *firm* for the purposes of ensuring that its *UK branch* has adequate liquidity resources in respect of the activities carried on from the *branch*. Where the *appropriate regulator* is satisfied that the statutory tests in section 138A (Modification or waiver of rules) of the *Act* are met, the *appropriate regulator* will consider modifying the *overall liquidity adequacy rule* to permit reliance on liquidity support of this kind.

### 12.8.3

FCA PRA

G

■ BIPRU 12.8 provides *guidance* on two types of modification to the *overall liquidity adequacy rule* and to other *rules* in ■ BIPRU 12 for which the *appropriate regulator* considers a *firm* may wish to apply, namely:

- (1) an *intra-group liquidity modification*; and
- (2) a *whole-firm liquidity modification*.

### 12.8.4

FCA PRA

G

In considering whether the statutory tests in section 138A of the *Act* have been met, the *appropriate regulator* will, amongst others, have regard to the factors detailed below in relation to an *intra-group liquidity modification* (of the kind permitting the inclusion in a *firm's* liquidity resources of *parent undertaking* liquidity support) and a *whole-firm liquidity modification*. In practice it is likely that the *appropriate regulator* will view these as preconditions to the grant of an *intra-group liquidity modification* of that type or a *whole-firm liquidity modification* and will therefore ordinarily need to be satisfied fully that each has been adequately addressed. They include matters on which the *appropriate regulator* will need to reach agreement with the *Home State regulator*, *third country competent authority*, or other relevant supervisor, and also matters which it will need to agree directly with a *firm* or the *parent undertaking* of a *firm*. It is likely that a number of these matters will be reflected as requirements or conditions in the modification.

12.8.5

FCA PRA

G

This section represents merely an indication of the matters to which the *appropriate regulator* will have regard in considering an application for a *whole-firm liquidity modification* or an *intra-group liquidity modification*. In considering such an application, the will always take into account anything that it reasonably considers to be relevant for the purposes of assessing whether the statutory tests in section 138A of the *Act* are met. In doing so, it will have regard to the role and importance of a *firm* or *UK branch* in the *UK financial system*.

12.8.6

FCA PRA

G

The *appropriate regulator* anticipates that an application to modify the *overall liquidity adequacy rule* may be accompanied by an application to waive or modify other rules in ■ BIPRU 12 (for example, the stress testing and *contingency funding plan rules* in ■ BIPRU 12.4). The *appropriate regulator* offers some *guidance* in this section on applications of this type.

### Intra-group liquidity modification: general

12.8.7

FCA PRA

G

The *appropriate regulator* recognises that a *firm* may be part of a wider *group* which manages its liquidity on a *group-wide* basis. A *firm* which considers that the statutory tests in section 138A of the *Act* are met may apply for an *intra-group liquidity modification* permitting it to rely on liquidity support from elsewhere in its *group*. Until a *firm* has such a modification it will need to meet the *overall liquidity adequacy rule* from its own liquidity resources. The effect of an *intra-group liquidity modification* is to modify the *overall liquidity adequacy rule* to recognise the extent to which the *appropriate regulator* is prepared to accept liquidity resources from other entities in a *firm's* group for the purposes of the *firm's* own compliance with the *overall liquidity adequacy rule*. ■ BIPRU 12.8.11G offers additional *guidance* on the likely extent of this recognition.

12.8.8

FCA PRA

G

■ BIPRU 12.8.14 G to ■ BIPRU 12.8.20 G set out the *appropriate regulator's* likely approach in considering an application for an *intra-group liquidity modification* in which a *firm* seeks to rely on support from a *parent undertaking* which is constituted under the law of a country or territory outside the *United Kingdom*.

12.8.9

FCA PRA

G

The *appropriate regulator* may also consider an application for an *intra-group liquidity modification* where a *firm* wishes to rely on liquidity resources from an entity in its *group* other than an *overseas parent undertaking*. The *appropriate regulator* recognises that a *firm* incorporated in the *United Kingdom* and to which ■ BIPRU 12 applies may wish to rely on liquidity support from another such *firm*. In practice, the *appropriate regulator* anticipates that a *firm* applying for an *intra-group liquidity modification* in these circumstances will be asking for permission to rely on support from its *parent undertaking* in the *United Kingdom*. In any event, the *appropriate regulator* will consider such applications on a case-by-case basis and will apply the approach outlined in ■ BIPRU 12.8.14 G to ■ BIPRU 12.8.20 G where relevant and by analogy.

12.8.10

FCA PRA

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The also recognises that a *firm* incorporated in the *United Kingdom* and to which ■ BIPRU 12 applies may wish to rely on liquidity support from a *subsidiary undertaking* of that *firm* which is incorporated in a country or territory outside the *United Kingdom*. The *appropriate regulator* is, however, likely to consider that an application for an *intra-group liquidity modification* that contemplates reliance for liquidity support on only, or mostly, an applicant *firm's* overseas *subsidiary undertakings* is unlikely to satisfy the tests in section 138A of the *Act*. As a general principle, and unless persuaded otherwise by an applicant *firm's* arguments in support of its application for an

*intra-group liquidity modification*, the *appropriate regulator* is likely to take the view that a *firm's* overseas *subsidiary undertakings* are likely to be constrained in their ability to provide meaningful levels of liquidity support to their *parent undertaking*.

## 12.8.11

FCA PRA

G

In each application for an *intra-group liquidity modification*, the *appropriate regulator* will consider the extent to which it is appropriate to modify the *overall liquidity adequacy rule* to allow reliance by an applicant *firm* on liquidity resources elsewhere in a *firm's* *group*. However, it is unlikely that the *appropriate regulator* would consider the conditions in section 138A of the *Act* to be met in circumstances in which the *overall liquidity adequacy rule* was modified to allow unlimited reliance on liquidity resources that are not the applicant *firm's* own. As a general principle, the *appropriate regulator* is likely to wish to ensure that, having regard to the results of an applicant *firm's* ILAA:

- (1) once modified, the *overall liquidity adequacy rule* still requires the *firm* to have adequate liquidity resources to enable it to wind down its business in an orderly and controlled manner in circumstances in which its business ceases to be viable; and
- (2) the amount of liquidity support permitted in the modification is a reasonable one having regard to the total liquidity resources of the *group* entity on which it is proposed that reliance should be placed.

## 12.8.12

FCA PRA

G

In determining the appropriate duration of an *intra-group liquidity modification*, the *appropriate regulator* will have regard to the role and importance of the *firm* in question in the *UK financial system*. In some cases, the *appropriate regulator* may take the view that an *intra-group liquidity modification* covering a *firm* whose role and importance in the *UK financial system* are significant ought to be reviewed more regularly than one granted in respect of a less systemically significant *firm*. The *appropriate regulator* will consider this issue in determining the appropriate duration of such a modification.

## 12.8.13

FCA PRA

G

In modifying the *overall liquidity adequacy rule* by means of an *intra-group liquidity modification*, the *appropriate regulator* may also modify the stress testing and *contingency funding plan rules* in ■ BIPRU 12.4 such that an applicant *firm* may achieve compliance with those *rules* by its *parent undertaking* conducting *group-wide* stress testing and preparing a *group-wide contingency funding plan* which gives adequate recognition to the position of the applicant *firm*.

### Consideration of an application for an intra-group liquidity modification

## 12.8.14

FCA PRA

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■ BIPRU 12.8.15 G to ■ BIPRU 12.8.20 G set out some of the matters on which the *appropriate regulator* will expect to be satisfied before granting an *intra-group liquidity modification* where permission is sought to rely on support from an *overseas parent undertaking* which is itself subject to a regime of liquidity regulation.

## 12.8.15

FCA PRA

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In relation to the regime of liquidity regulation imposed by the authority that regulates for liquidity purposes an applicant *firm's* *parent undertaking* which is constituted under the law of a country or territory outside the *United Kingdom*, the *appropriate regulator* will ordinarily expect to be satisfied that:

- (1) the regime of liquidity regulation to which that *undertaking* is subject delivers outcomes as regards the regulation of that *undertaking's* *liquidity risk* that are broadly equivalent to those intended by ■ BIPRU 12; and

- (2) there is clarity as to any legal constraints imposed by the authority which regulates that *undertaking* for liquidity purposes on the provision of liquidity from that *undertaking* to the applicant *firm*.

## 12.8.16

FCA PRA

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It will not always be the case that an applicant *firm* wishes to rely on a *parent undertaking*, or other *group* entity, that is itself subject to a regime of liquidity regulation, whether or not equivalent to the *appropriate regulator's*. In assessing a *firm's* application for an *intra-group liquidity modification*, the *appropriate regulator* will always have regard to the regulatory framework to which the entity on which it is proposed to rely for liquidity support is subject. Other things being equal, however, the *appropriate regulator* is more likely to be persuaded that the tests in section 138A of the *Act* are met in circumstances in which the entity on which it is proposed to rely for liquidity support is itself subject to an appropriate degree of regulation. Even where the *parent undertaking*, or other *group* entity, in question is subject to a regime of liquidity regulation, the *appropriate regulator* will in principle be more likely to grant an *intra-group liquidity modification* in circumstances in which the applicant *firm* does not accept a significant amount of retail *deposits*.

## 12.8.17

FCA PRA

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In relation to an applicant *firm* wishing to rely on liquidity support from a *parent undertaking* constituted under the law of a country or territory outside the *United Kingdom*, the *appropriate regulator* will ordinarily expect to reach agreement with the authority that regulates that *undertaking* for liquidity purposes in a number of areas, including agreement that:

- (1) it will notify the *appropriate regulator* of any material or persistent breaches by that *undertaking* of that authority's liquidity rules, or of risks that such breaches are imminent;
- (2) it is satisfied with the adequacy of the *parent undertaking's* arrangements for *liquidity risk* management;
- (3) it is satisfied as to the adequacy of the *parent undertaking's* liquidity resources including:
  - (a) the size and quality of its liquid assets buffer; and
  - (b) the size and quality of any liquidity resources that are held in the *United Kingdom* for the purpose of meeting the liabilities of an applicant *firm* as they fall due;
- (4) it does not object to any undertakings given by that *parent undertaking* in respect of an applicant *firm* to ensure that the *firm* has adequate liquidity resources; and
- (5) it will have due regard to the views of the *appropriate regulator* in its supervision of the liquidity position of that *parent undertaking*.

## 12.8.18

FCA PRA

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In relation to an applicant *firm* wishing to rely on liquidity support from a *parent undertaking* constituted under the law of a country or territory outside the *United Kingdom*, the *appropriate regulator* will, before granting an *intra-group liquidity modification*, ordinarily expect to have reached agreement with that *parent undertaking* that:

- (1) it will make available liquidity resources at all times to that applicant *firm* if needed;
- (2) it will enter into an undertaking in a suitable form with an applicant *firm* committing it to provide liquidity support to that *firm* on the occurrence of certain defined events;
- (3) it will ensure that the applicant *firm* maintains liquidity resources of appropriate size and quality in the *United Kingdom* for the purposes of meeting the liquidity needs of that *firm*;
- (4) it will maintain arrangements, including having adequate liquidity resources, to ensure that it, the applicant *firm* and any other entities in its *group* to which it provides liquidity support are able to wind down their businesses in an orderly and controlled manner in circumstances where its, or their, businesses cease to be viable;
- (5) it will make available to the *appropriate regulator* information in an appropriate format on *group* liquidity; and
- (6) it will participate in the *appropriate regulator's* thematic supervisory work in relation to liquidity when requested to do so by the *appropriate regulator*.

## 12.8.19

FCA PRA

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The *appropriate regulator* will wish to ensure that it has adequate data at the time of consideration of the *intra-group liquidity modification* application and, if the application is granted, on a continuing basis thereafter, about the liquidity position of any *group* entity on which the applicant *firm* proposes to rely for liquidity purposes. It is therefore likely that an applicant *firm* will be asked to provide as part of its application relevant liquidity *data items* populated by the entities on which the applicant *firm* proposes to rely. It is also likely that an applicant *firm* will be asked to ensure as a condition of the modification, if granted, that the entities on which it is given permission to rely for the purpose of meeting the *overall liquidity adequacy rule* provide completed relevant *data items* to the *appropriate regulator* on a continuing basis. The frequency of *data item* submission will be determined as part of the *appropriate regulator's* consideration of the applicant *firm's* case but is in any event likely to be reflective of the *appropriate regulator's* assessment of the *liquidity risk* profile of the entities on which liquidity support is permitted.

## 12.8.20

FCA PRA

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In addition, the *appropriate regulator* will also wish to understand in relation to any *group* entity on which an applicant *firm* proposes to rely for liquidity support the legal structure of the *group* and the extent to which that structure, or any relevant legal principles, may restrict the provision of timely liquidity support in appropriate amounts to the applicant *firm* when required.

### Ongoing requirements

## 12.8.21

FCA PRA

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The *appropriate regulator* also anticipates that an *intra-group liquidity modification* would be made subject to a number of ongoing conditions and requirements. These are likely to include:

- (1) the *appropriate regulator* receiving annual confirmation from the authority that regulates an applicant *firm's parent undertaking* for liquidity purposes that it remains satisfied with the arrangements in respect of that *undertaking* for liquidity supervision and their operation; and

- (2) an annual meeting with the same authority to discuss liquidity supervision of that *undertaking*.

### Whole-firm liquidity modification: general

12.8.22

FCA PRA

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In relation to an *incoming EEA firm* or *third country BIPRU firm*, the *overall liquidity adequacy rule* provides that, for the purpose of complying with that *rule*, a *firm* may not, in relation to its *UK branch*, include liquidity resources other than those which satisfy the conditions in ■ BIPRU 12.2.3 R. Those conditions seek to ensure that a *firm* of this kind has a reserve of liquidity for operational purposes that is under the control of, and available for use by, that *firm's UK branch*. Further *guidance* is given in ■ BIPRU 12.5.39 G in relation to the local operational liquidity reserve. In addition, ■ BIPRU 12.9.10 G explains how the *appropriate regulator* will approach the giving of *individual liquidity guidance* to an *incoming EEA firm* or *third country BIPRU firm*. The *appropriate regulator* does, however, recognise that there are circumstances in which it may be appropriate for a *UK branch* to rely on the availability of liquidity resources from elsewhere within the *firm*. A *firm* wishing to rely on support of this kind for its *UK branch* may apply for a modification to the *overall liquidity adequacy rule* where it considers that the statutory tests in section 138A of the *Act* are met.

12.8.23

FCA PRA

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Although an *incoming EEA firm* or *third country BIPRU firm* may apply to modify the *overall liquidity adequacy rule* and other *rules* in ■ BIPRU 12, in relation to its *UK branch*, the *appropriate regulator* anticipates that many such *firms* will wish to apply for a modification in the form which the *appropriate regulator* defines as a *whole-firm liquidity modification*. In the *appropriate regulator's* view, a modification to the *overall liquidity adequacy rule* for a *firm* of this kind will tend to be appropriate where an applicant *firm* manages its liquidity on an integrated, *whole-firm* basis. Where that is the case, and having regard to the matters outlined in the *guidance* in this section, the *appropriate regulator* is likely to consider it more appropriate for the *UK branch* to be subject, in large part, to the same regulatory liquidity regime which applies to the rest of the *firm*. In granting a *whole-firm liquidity modification* the *appropriate regulator* therefore recognises that in certain circumstances a *UK branch* can have adequate liquidity resources in circumstances where the liquidity resources upon which the *firm* seeks to rely do not meet the criteria set out in ■ BIPRU 12.2.3 R.

12.8.24

FCA PRA

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Accordingly, a *whole-firm liquidity modification* envisages:

- (1) a modification to the *overall liquidity adequacy rule* so as to permit reliance by the *firm*, in relation to its *UK branch*, on liquidity resources wherever held in the *firm* for the purposes of meeting that *rule*; and
- (2) a *waiver* of the remainder of the substantive *rules* in ■ BIPRU 12, with the effect that the *UK branch* of the applicant *firm* becomes subject for the purpose of day-to-day liquidity supervision to the liquidity regime of the *Home State regulator* or *third country competent authority* in question.

12.8.25

FCA PRA

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The effect of a *whole-firm liquidity modification* is that the *appropriate regulator* will in its supervision of the liquidity of the *UK branch* place reliance on the liquidity regime of the *Home State regulator* or *third country competent authority* in question. The *appropriate regulator* will wish to ensure that it has adequate data at the time of consideration of the *whole-firm liquidity modification* application and, if the application is granted, on a continuing basis thereafter, about the liquidity position of the *firm* as a whole. It is therefore likely that an applicant *firm* will be asked to provide as part

of its application relevant liquidity *data items* covering the liquidity position of the *firm* as a whole. It is also likely that an applicant *firm* will be asked, as part of its application, to provide an appropriately detailed account as to the activities conducted by its *UK branch* as at the date of the application. In addition, the *appropriate regulator* anticipates that an applicant *firm* will be asked to ensure as a condition of the modification, if granted, that it provides relevant *data items*, covering the whole-*firm* liquidity position, to the *appropriate regulator* on a continuing basis at a frequency to be determined as part of the *appropriate regulator's* consideration of the applicant *firm's* case but in any event likely to be reflective of the *appropriate regulator's* assessment of the *liquidity risk* profile of the *firm*.

### Consideration of an application for a whole-firm liquidity modification

12.8.26

FCA PRA

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In relation to the *Home State regulator's* or *third country competent authority's* regime of liquidity regulation, the *appropriate regulator* will, before granting a *whole-firm liquidity modification*, ordinarily expect to be satisfied that:

- (1) the regime in question delivers outcomes as regards the regulation of the applicant *firm's liquidity risk* that are broadly equivalent to those intended by this chapter; and
- (2) there is clarity as to any legal constraints imposed by the *Home State regulator* or *third country competent authority* on the provision of liquidity by a *firm* to its *UK branch*, as well as the potential for such restrictions to be imposed in the future.

12.8.27

FCA PRA

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In relation to the applicant *firm* in question, the *appropriate regulator* will, before granting a *whole-firm liquidity modification*, ordinarily expect to have reached agreement with the *Home State regulator* or *third country competent authority* in a number of areas, including agreement that:

- (1) it will notify the *appropriate regulator* promptly of any material or persistent breaches by that *firm* of its liquidity rules, or of risks that such breaches are imminent;
- (2) it is satisfied with the adequacy of the arrangements in place for *firm-wide liquidity risk* management;
- (3) it is satisfied as to the adequacy of that *firm's* liquidity resources including the size and quality of its liquid assets buffer;
- (4) it does not object to any undertakings given by that *firm* in respect of its *UK branch* to ensure that the *branch* has adequate liquidity resources; and
- (5) it will have due regard to the views of the *appropriate regulator* in its supervision of that *firm's* liquidity position.

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12.8.28

FCA PRA

G

In relation to the applicant *firm* in question, the *appropriate regulator* will, before granting a *whole-firm liquidity modification*, ordinarily expect to have reached agreement with that *firm* in a number of areas, including agreement that:

- (1) it will make available liquidity resources at all times to its *UK branch* if needed;

- (2) it will make available to the *appropriate regulator* information in an appropriate format on *firm-wide* liquidity;
- (3) it will notify the *appropriate regulator* at the same time as it notifies the *Home State regulator* or *third country competent authority* of any issues relevant to the liquidity position of its *UK branch* or compliance with the rules to which it is subject in respect of its liquidity (including with the terms of its *whole-firm liquidity modification*);
- (4) its *UK branch* will continue to be fully integrated with the rest of the *firm* for *liquidity risk* management purposes; and
- (5) it will participate in the *appropriate regulator's* thematic supervisory work in relation to liquidity when requested to do so by the *appropriate regulator*.

### Ongoing requirements

12.8.29

FCA PRA

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The *appropriate regulator* also anticipates that a *whole-firm liquidity modification* would be made subject to a number of ongoing conditions and requirements. These are likely to include:

- (1) the *appropriate regulator* receiving annual confirmation from the *Home State regulator* or *third country competent authority* that it remains satisfied with the arrangements in respect of that *firm* for liquidity supervision and their operation;
- (2) an annual meeting with the *Home State regulator* or *third country competent authority* to discuss liquidity supervision of that *firm*;
- (3) the *appropriate regulator* receiving annual confirmation from the *firm*, approved by its *governing body*, that it remains in full compliance with the terms of its *whole-firm liquidity modification*; and
- (4) as at the first anniversary of the grant of the *whole-firm liquidity modification* and on each anniversary thereafter, the *appropriate regulator* receiving from the *firm*:
  - (a) an appropriate account of the activities conducted by the *UK branch* over the previous year; and
  - (b) a copy of the *firm's* latest business plan where this differs from that previously sent to the *appropriate regulator* after grant of its *whole-firm liquidity modification*.

12.8.30

FCA PRA

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In determining the appropriate duration of a *whole-firm liquidity modification*, the *appropriate regulator* will have regard to the role and importance of the *UK branch* in question in the *UK financial system*. In some cases, the *appropriate regulator* may take the view that a *whole-firm liquidity modification*, covering a *UK branch* whose role and importance in the *UK financial system* are significant, ought to be reviewed more regularly than one granted in respect of a less systemically significant *branch*. The *appropriate regulator* will consider this issue in determining the appropriate duration of such a modification. The *appropriate regulator* is also likely to consider it appropriate in modifications other than those of short duration to reflect in the terms of the modification representations made either in an applicant *firm's* business plan or direct to the *appropriate regulator* as part of the application process, but in either

case as to the expected nature and size of the *UK branch's* activities over the course of the duration of the modification. Where requirements are included in a modification in relation to these matters, a *firm* that anticipates that it will breach those requirements will need to apply in advance of any such event for a variation to its then existing *whole-firm liquidity modification*. In considering an application to vary, the *appropriate regulator* will consider afresh whether the tests in section 138A of the *Act* continue to be met for the grant of a *whole-firm liquidity modification* to the *firm* in question.

## 12.9 Individual liquidity guidance and regulatory intervention points

### Appropriate regulator assessment process

12.9.1

FCA PRA

G

The *appropriate regulator* will give *individual liquidity guidance* to a *standard ILAS BIPRU firm*. Ordinarily, the *appropriate regulator* will give *individual liquidity guidance* after a review of a *standard ILAS BIPRU firm's ILAA*. The *appropriate regulator* will, however, issue *individual liquidity guidance* to such a *firm* whenever it is considered appropriate.

12.9.2

FCA PRA

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In assessing the adequacy of an *ILAS BIPRU firm's* liquidity resources, the *appropriate regulator* draws on more than just a review of the submitted *ILAA*, or in the case of a *simplified ILAS BIPRU firm*, the submitted *ILSA*. Use is made of wider supervisory knowledge of a *firm* and of wider market developments and practices. When forming a view of the *individual liquidity guidance* to be given to an *ILAS BIPRU firm*, the *appropriate regulator* will also consider the regulator's firm risk assessment and any other issues arising from day-to-day supervision.

12.9.3

FCA PRA

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The *appropriate regulator* will take a risk-based and proportionate approach to the review of a *firm's ILAA* or *ILSA*, focusing where appropriate on that *firm's* approach to dealing with the risks it faces.

12.9.4

FCA PRA

G

As part of the *SLRP*, the *appropriate regulator* will give a *standard ILAS BIPRU firm individual liquidity guidance* advising it of the amount and quality of liquidity resources which the *appropriate regulator* considers are appropriate, having regard to the *liquidity risk* profile of that *firm*. In giving *individual liquidity guidance*, the *appropriate regulator* will also advise the *firm* of what it considers to be a prudent funding profile for the *firm*. In giving the *firm individual liquidity guidance* as to its funding profile, the *appropriate regulator* will consider the extent to which the *firm's* liabilities are adequately matched by assets of appropriate maturities. In both cases, the *appropriate regulator* will have regard to the adequacy of a *firm's* systems and controls in relation to *liquidity risk* when judged against the standard described in the *rules and guidance* in ■ BIPRU 12.3 and ■ BIPRU 12.4. *Individual liquidity guidance* will therefore have two components:

- (1) *guidance* about the *firm's* liquid assets buffer; and
- (2) *guidance* about the *firm's* funding profile.

12.9.5

FCA PRA

G

The *appropriate regulator* will ordinarily not expect to give *individual liquidity guidance* to a *simplified ILAS BIPRU firm*. However, if after review of such a *firm's ILSA*, the

*appropriate regulator* is not satisfied that the *simplified buffer requirement* delivers an adequate amount and quality of liquidity resources for that *firm*, having regard to its *liquidity risk* profile, the *appropriate regulator* will issue the *firm* with *individual liquidity guidance* and may also consider revoking the *firm's simplified ILAS waiver*.

## 12.9.6

FCA PRA

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In giving *individual liquidity guidance*, the *appropriate regulator* seeks a balance between delivering consistent outcomes across the *individual liquidity guidance* that it gives to every *ILAS BIPRU firm* and recognising that such *guidance* should reflect the individual features of a *firm*. Comparison with the assumptions used by other *firms* will be used to trigger further enquiry.

## 12.9.7

FCA PRA

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Following an internal validation process, the *appropriate regulator* will write to the *standard ILAS BIPRU firm* whose *ILAA* it has reviewed, providing both quantitative and qualitative feedback on the results of the *appropriate regulator's* assessment. This letter will notify that *firm* of the *individual liquidity guidance* that the *appropriate regulator* considers appropriate together with its reasons for concluding that such *guidance* is appropriate. The *appropriate regulator* will adopt the same process where it chooses to give *individual liquidity guidance* to a *simplified ILAS BIPRU* following a review of that *firm's ILSA*.

## 12.9.8

FCA PRA

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Where the amount and quality of liquidity resources which the *appropriate regulator* considers a *firm* needs having regard to its *liquidity risk* profile are not the same as the *firm's* own assessment of those resources under its *ILAA*, the *appropriate regulator* expects to discuss any such difference with the *firm*.

## 12.9.9

FCA PRA

G

Consistent with *Principle 11* (Relations with regulators), the *appropriate regulator* will expect a *firm* to notify it if the *firm* does not propose to follow its *individual liquidity guidance*. The *appropriate regulator* will expect any such notification to be accompanied by a clear account of the *firm's* reasons for considering the *individual liquidity guidance* to be inappropriate. The *appropriate regulator* will expect to receive any such notification within one *month* from the date on which it gives *individual liquidity guidance* to the *firm*. If agreement through further analysis and discussion cannot be reached (including through use of the *appropriate regulator's* powers under section 166 (Reports by skilled persons) of the *Act*), then the *appropriate regulator* will consider using its powers under the *Act* (for example, its power under section 55J to vary, on its own initiative, a *firm's Part IV permission* or its *power of intervention* under section 196) so as to require a *firm* to hold such liquidity resources as the *appropriate regulator* considers are adequate having regard to the *liquidity risk* profile of the *firm*.

### Additional guidance for branches

## 12.9.10

FCA PRA

G

In relation to an *incoming EEA firm* or *third country BIPRU firm*, where the *appropriate regulator* gives that *firm individual liquidity guidance* in relation to its *UK branch*, it will have regard to the *liquidity risk* profile of the *branch*. In the absence of a *whole-firm liquidity modification*, the effect of ■ BIPRU 12.2.1R (2)(b) and ■ BIPRU 12.2.3 R is to require the *firm* to hold a liquid assets buffer of the amount identified as appropriate in its *individual liquidity guidance* (or in the case of a *simplified ILAS BIPRU firm*, the amount of its *simplified buffer requirement* unless this has been superseded by the *appropriate regulator* issuing *individual liquidity guidance* to the *firm* in question) in the form of a local operational liquidity reserve. Further *guidance* is given in ■ BIPRU 12.5.39 G in relation to the local operational liquidity reserve. In determining the appropriate size of such a *firm's* liquid assets buffer the *appropriate regulator* will have regard to all relevant factors,

including the extent to which the *appropriate regulator* has adequate data to enable it to assess accurately the *liquidity risk* elsewhere in the *firm* beyond its *UK branch*.

### Regulatory intervention points for ILAS BIPRU firms

12.9.11

FCA PRA

G

■ BIPRU 12.2.9 G records the *appropriate regulator's* recognition that in periods of stress a *firm's* liquid assets buffer may be eroded. It may also be the case that in such periods a *firm's* funding profile deteriorates such that it no longer conforms to the prudent liquidity profile described in the *individual liquidity guidance* given to the *firm*. Deviation by a *firm* from the terms of the *individual liquidity guidance* given to it by the *appropriate regulator* or, as the case may be, from the *simplified buffer requirement*, does not automatically mean that the *appropriate regulator* will consider that the *firm* is in breach of, or likely to breach, *threshold conditions*.

12.9.12

FCA PRA

G

The *appropriate regulator* will examine any deviation on its own facts and will always want to understand clearly the reasons for that deviation and the *firm's* plans for remedying it. Deviation is, however, likely to prompt a re-examination by the *appropriate regulator* of the *firm's* compliance, and likely future compliance, with *threshold conditions*. The *appropriate regulator* will have regard to the information provided by the *firm* and to any other relevant factors in assessing the *firm's* continuing ability to satisfy *threshold conditions*. ■ BIPRU 12.9.13 R to ■ BIPRU 12.9.18 R set out a number of requirements which apply to an *ILAS BIPRU firm* that deviates from its *individual liquidity guidance*, or as the case may be, from the *simplified buffer requirement*.

12.9.12A

FCA PRA

G

The *appropriate regulator* expects that a *firm* will respond dynamically to any deterioration in its liquidity position and will take contingent action as set out in its *contingency funding plan* well in advance of a potential event.

12.9.13

FCA PRA

R

As soon as a *firm* becomes aware of the occurrence or expected occurrence of the events identified in ■ BIPRU 12.9.14 R, it must immediately provide to the *appropriate regulator* :

- (1) notification in writing of the event;
- (2) an adequately reasoned explanation for the event; and
- (3) an indication of the management actions the *firm* has taken to date to address the event, including actions from its *contingency funding plan*.

12.9.14

FCA PRA

R

For the purpose of ■ BIPRU 12.9.13 R, the events in question are:

- (1) in the case of a *simplified ILAS BIPRU firm* only, breach of the *simplified buffer requirement* unless this has been superseded by *individual liquidity guidance* that it has accepted;
- (2) in the case of a *standard ILAS BIPRU firm* or a *simplified ILAS BIPRU firm*, being a *firm* which in either case has accepted

*individual liquidity guidance* given to it by the *appropriate regulator*:

- (a) its liquid assets buffer falling below the level advised in the *guidance*; or
- (b) its funding profile ceasing to conform to that advised in the *guidance*.

12.9.15

FCA PRA

G

As part of the *appropriate regulator's* enquiry into the reasons for a *firm's* deviation, or expected deviation, from its *individual liquidity guidance* or, as the case may be, its *simplified buffer requirement*, the *appropriate regulator* may ask for further assessments and analyses of a *firm's* liquidity resources and the risks faced by the *firm*. The *appropriate regulator* may consider the use of its powers under section 166 of the *Act* to assist in such circumstances.

12.9.16

FCA PRA

G

Consistent with *Principle 11* of the *appropriate regulator's Principles for Businesses* (Relations with regulators), if a *firm* has not accepted *individual liquidity guidance* given by the *appropriate regulator* it should, nevertheless, notify the *appropriate regulator* as soon as it becomes aware of either of the events identified in ■ BIPRU 12.9.14R (2)(a) or ■ (b).

12.9.17

FCA PRA

R

No later than two *days* after the *day* on which a *firm* notifies the *appropriate regulator* under ■ BIPRU 12.9.13R (1), the *firm* must submit a liquidity remediation plan to the *appropriate regulator*.

12.9.18

FCA PRA

R

For the purposes of ■ BIPRU 12.9.17 R, a *firm's* liquidity remediation plan must:

- (1) be communicated in writing;
- (2) detail the *firm's* forward estimates of the evolution of the size of the *firm's* liquid assets buffer and of its funding profile;
- (3) in relation to any of the events identified in ■ BIPRU 12.9.14 R that has occurred, or is expected to occur, detail the actions that the *firm* intends to take to remedy the event, or avoid the expected event, as the case may be, including information about:
  - (a) the amount of funding that it is intended to raise;
  - (b) the intended funding providers; and
  - (c) the maturity profile of the intended funding;
- (4) identify clear timescales for achieving each of the actions that it details in accordance with ■ BIPRU 12.9.18R (3); and
- (5) include an adequately reasoned assessment of the likelihood of the timely achievement of the actions that it details in accordance with ■ BIPRU 12.9.18R (3).

**12.9.19** FCA PRA G The *appropriate regulator* will assess the adequacy of the liquidity remediation plan submitted by a *firm*, including the likelihood of its success. A *firm* should expect that the *appropriate regulator* will want to discuss the terms of the liquidity remediation plan submitted to it under ■ BIPRU 12.9.18 R. In its re-examination of the *firm's* compliance, and likely future compliance, with *threshold conditions* taken as a whole, the *appropriate regulator* will have regard to the adequacy of the *firm's* liquidity remediation plan.

**12.9.20** FCA PRA G Other things being equal, the *appropriate regulator* will expect a *firm* which is not experiencing a period of stress to restore its liquidity resources more rapidly than one which is under stress at the time that it deviates from its *individual liquidity guidance* or, as the case may be, from its *simplified buffer requirement*.

**12.9.21** FCA PRA G If agreement through discussion with the *appropriate regulator* cannot be reached as to the necessary actions and timescales to remedy deviation from that *guidance*, the *appropriate regulator* will consider using its powers under the *Act* (for example, its power under section 55J to vary, on its own initiative, a *firm's Part 4A permission* or its *power of intervention* under section 196) so as to require the *firm* to take such actions as the *appropriate regulator* considers are necessary to return the *firm* to conformity with the terms of its *individual liquidity guidance* or, as the case may be, with its *simplified buffer requirement*.

**12.9.22** FCA PRA G Although ■ BIPRU 12.9.17 R to ■ BIPRU 12.9.21 G set out the *appropriate regulator's* likely approach, the *appropriate regulator* will take whatever action it considers appropriate in the particular circumstances of a given case.

**12.9.23** FCA PRA G A *firm* that deviates from current *individual liquidity guidance* that it has accepted or, as the case may be, from its *simplified buffer requirement*, will be experiencing a *firm-specific liquidity stress* for the purpose of the reporting rules in ■ SUP 16 (Reporting requirements). Those rules require the *firm* to report specified *data items* more frequently than would otherwise be the case. Additionally, a *firm* that is implementing a liquidity remediation plan should expect that the *appropriate regulator* will wish to monitor its implementation of that plan. The *firm's* progress in achieving the remedial actions identified in its plan is a matter to which the *appropriate regulator* will have regard in considering the *firm's* compliance, and likely future compliance, with *threshold conditions*.

#### Monitoring requirement

**12.9.24** FCA PRA R An *ILAS BIPRU firm* must monitor on each *business day* whether it is in conformity with *individual liquidity guidance* that it has accepted or, as the case may be, with the *simplified buffer requirement*.

#### Mode of notification

**12.9.25** FCA PRA R Notification to the *appropriate regulator* under ■ BIPRU 12.9.13R (1) and submission to the *appropriate regulator* under ■ BIPRU 12.9.17 R must be made to the following *appropriate regulator* email address: data\_collection@fca.org.uk.

**12.9.26**

**FCA PRA**

**G**

Although ■ BIPRU 12.9.25 R requires notification and submission in the way prescribed in that *rule*, the *appropriate regulator* expects that a *firm* would also bring to the attention of its usual supervisory contact at the *appropriate regulator* the fact that it had made such a notification or submission.

**12.9.27**

**FCA PRA**

**G**

For the purpose of the notification expected under ■ BIPRU 12.9.26 G, the *appropriate regulator* would expect any such notification to be made in the way envisaged in ■ BIPRU 12.9.25 R.



## Chapter 13

# The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions

## 13.1 Application and Purpose

### Application

13.1.1

FCA PRA

R

■ BIPRU 13 applies to a *BIPRU firm*.

13.1.2

FCA PRA

R

(1) ■ BIPRU 13 applies to items in the *non-trading book*.

(2) ■ BIPRU 13 applies to *trading book* items for the purposes of ■ BIPRU 14.

13.1.3

FCA PRA

G

The requirement to calculate the *counterparty credit risk* capital charge for *trading book* items is set out in ■ BIPRU 14.

### Purpose

13.1.4

FCA PRA

G

■ BIPRU 13 implements:

(1) Article 78(2) and (4);

(2) point 3 of Part 1, and Parts 2, 3, 5, 6 and 7 of Annex III; and

(3) Annex IV;

of the *Banking Consolidation Directive*.

13.1.5

FCA PRA

G

■ BIPRU 13.3 sets out the calculations of *exposure* values for *financial derivative instrument*, *long settlement transactions* and certain other transactions under the *standardised approach* and, subject to ■ BIPRU 4, under the *IRB approach*. ■ BIPRU 13.4, ■ 13.5 and ■ 13.6 set out the provisions relating to the *CCR mark to market method*, the *CCR standardised method* and the *CCR internal model method* in turn.

13.1.6

FCA PRA

G

■ BIPRU 13.8 sets out a summary of the treatment of *securities financing transactions*.

**13.2 Unusual Transactions**

13.2.1

FCA PRA

R

If the calculation of the amount of an *exposure* or of a combination of *exposures* under ■ BIPRU 13 would materially understate the amount of the *counterparty credit risk* the *firm* must increase the amount of the *credit risk capital requirement* by an amount sufficient to compensate for that understatement.

13.2.2

FCA PRA

R

If a *firm* in relation to an *exposure* covered by ■ BIPRU 13:

- (1) has an *exposure* of a non-standard type; or
- (2) an *exposure* that is part of a non-standard arrangement; or
- (3) has an *exposure* that, taken together with other *exposures* (whether or not they are subject to ■ BIPRU 13), gives rise to a non-standard *counterparty credit risk*; or
- (4) is subject to the *rule* in ■ BIPRU 13.2.1 R;

it must notify the *appropriate regulator* as soon as practicable of that fact, the counterparty involved, the nature of the *exposure* or arrangement and the treatment of those *exposures* it has adopted for the purpose of the calculation of the *credit risk capital requirement*.

13.2.3

FCA PRA

R

■ BIPRU 13.2.2 R does not apply to *exposures* which are within the scope of a *firm's CCR internal model method permission*.

13.2.4

FCA PRA

R

A *firm* must judge the question of what is non-standard for the purposes of ■ BIPRU 13.2.2 R by reference to the standards:

- (1) prevailing at the time the *rule* is being applied; and
- (2) of *firms* generally who carry on business which might give rise to *exposures* covered by ■ BIPRU 13 rather than merely by reference to the *firm's* own business.

13.2.5

FCA PRA

G

The methodologies which have been developed assume instruments with standard characteristics. There are many examples, however, of instruments which, although based

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...a standard contract, contain structural features which make the *rules*, as stated, inappropriate. In such circumstances a *firm* should consult the *appropriate regulator*



## 13.3 Calculation of exposure values for financial derivatives and long settlement transactions: General provisions

### Financial derivative instruments

13.3.1

FCA PRA

R

A *firm* must determine the *exposure* value of a *financial derivative instrument* in accordance with ■ BIPRU 13, with the effects of contracts of novation and other netting agreements taken into account for the purposes of those methods in accordance with ■ BIPRU 13.

[Note: BCD Article 78(2) first sentence]

13.3.2

FCA PRA

R

Subject to ■ BIPRU 13.3, a *firm* must determine the *exposure* value for *financial derivative instruments* with the *CCR mark to market method*, the *CCR standardised method* or the *CCR internal model method*.

[Note: BCD Annex III, Part 2 point 1]

### Definition of financial derivative instrument

13.3.3

FCA PRA

R

Each of the following is a *financial derivative instrument*:

- (1) an interest-rate contract, being:
  - (a) a single-currency interest rate swap;
  - (b) a basis-swap;
  - (c) a forward rate agreement;
  - (d) an interest-rate future;
  - (e) a purchased interest-rate *option*; and
  - (f) other contracts of similar nature.
  
- (2) a *foreign currency* contract or contract concerning gold, being:
  - (a) a cross-currency interest-rate swap;
  - (b) a forward *foreign currency* contract;
  - (c) a currency future;
  - (d) a currency *option* purchased;

- (e) other contracts of a similar nature; and
  - (f) a contract concerning gold of a nature similar to (2)(a) to (e).
- (3) a contract of a nature similar to those in 1(a) to (e) and 2(a) to (d) concerning other reference items or indices, including as a minimum all instruments specified in points 4 to 7, 9 and 10 of Section C of Annex I to the *MIFID* not otherwise included in (1) or (2).

[Note: *BCD* Annex IV]

#### Long settlement transactions

13.3.4

FCA PRA

R

*Long settlement transaction* means a transaction where a counterparty undertakes to deliver a *security*, a *commodity*, or a *foreign currency* amount against cash, other *financial instruments*, or *commodities*, or vice versa, at a settlement or delivery date that is contractually specified as more than the lower of the market standard for this particular transaction and five business days after the date on which the *firm* enters into the transaction.

[Note: *BCD* Annex III Part 1 point 3]

13.3.5

FCA PRA

R

A *firm* must calculate the *exposure* value of a *long settlement transaction* in accordance with either:

- (1) ■ BIPRU 13; or
- (2) the *master netting agreement internal models approach*, if it has a *master netting agreement internal models approach waiver* which permits it to apply that approach.

[Note: *BCD* Article 78(2) second sentence, in respect of *long settlement transaction*]

13.3.6

FCA PRA

R

A *firm* may determine *exposures* arising from *long settlement transactions* using any of the *CCR mark to market method*, the *CCR standardised method* and the *CCR internal model method*, regardless of the methods chosen for treating *financial derivatives instruments* and *repurchase transactions*, *securities or commodities lending or borrowing transactions*, and *margin lending transactions*. In calculating capital requirements for *long settlement transactions*, a *firm* that uses the *IRB approach* may apply the *risk weights* under the *standardised approach* on a permanent basis and irrespective of the materiality of such positions.

[Note: *BCD* Annex III Part 2 point 7]

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FCA PRA

required to calculate the *exposure* value of a transaction as a *long settlement transaction* for the purposes of BIPRU 13 if the transaction is a *financial derivative instrument* or a *securities financing transaction* and the *firm* chooses to calculate the capital requirement for the transaction according to the methods applicable to those *exposures*.

## General netting

13.3.8

FCA PRA

R

Under the *CCR mark to market method*, the *CCR standardised method* and the *CCR internal model method*, a *firm* must determine the *exposure* value for a given counterparty as equal to the sum of the *exposure* values calculated for each *netting set* with that counterparty.

[Note: BCD Annex III Part 2 point 5]

13.3.9

FCA PRA

R

A *firm* may only recognise netting for the purposes of ■ BIPRU 13.4, ■ BIPRU 13.5 and ■ BIPRU 13.6 if the requirements in ■ BIPRU 13.7 are met.

## Combined use

13.3.10

FCA PRA

R

The combined use of the *CCR mark to market method*, the *CCR standardised method* and the *CCR internal model method* is not permitted. The combined use of the *CCR mark to market method* and the *CCR standardised method* is permitted where one of the methods is used for the cases set out in ■ BIPRU 13.5.9 R to ■ BIPRU 13.5.10 R.

[Note: BCD Annex III Part 2 point 1(part)]

13.3.11

FCA PRA

G

The combined use of different approaches may be used across a group as described in ■ BIPRU 8.7.8 G and ■ BIPRU 8.7.9 G.

## Exposure to a central counterparty

13.3.12

FCA PRA

R

Notwithstanding ■ BIPRU 13.3.1 R and ■ BIPRU 13.3.5 R, a *firm* may determine the *exposure* value of a credit risk *exposure* outstanding with a *central counterparty* in accordance with ■ BIPRU 13.3.13 R, provided that the *central counterparty's counterparty credit risk exposure* with all participants in its arrangements are fully collateralised on a daily basis.

[Note: BCD Article 78(4) in respect of *financial derivatives* and *long settlement transactions*]

13.3.13

FCA PRA

R

A *firm* may attribute an *exposure* value of zero for CCR to derivative contracts and *long settlement transactions*, or to other *exposures* arising in respect of those contracts or transactions (but excluding an *exposure* arising from collateral held to mitigate losses in the event of the default of other participants in the *central counterparty's* arrangements) where they are outstanding with a *central counterparty* and have not been rejected by the *central counterparty*.

[Note: BCD Annex III Part 2 point 6 in respect of *financial derivatives and long settlement transactions*]

**Exceptions**

13.3.14

FCA PRA

**R**

When a *firm* purchases credit derivative protection against a *non-trading book*, *exposure* or against a *CCR exposure*, it must compute its capital requirement for the hedged asset in accordance with:

- (1) ■ BIPRU 5.7.16 R to ■ BIPRU 5.7.25 R and ■ BIPRU 4.10.49 R (4) to ■ (6) (Unfunded credit protection: Valuation and calculation of risk-weighted exposure amounts and expected loss amounts); or
- (2) where a *firm* calculates *risk weighted exposure amounts* in accordance with the *IRB approach*:
  - (a) ■ BIPRU 4.4.79 R (Double default); or
  - (b) ■ BIPRU 4.10.40 R to ■ BIPRU 4.10.48 R. (Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives).
- (3) [deleted]

[Note: BCD Annex III Part 2 point 3 (part)]

13.3.15

FCA PRA

**R**

- (1) In the cases in ■ BIPRU 13.3.14R, and where the option in the second sentence of ■ BIPRU 14.2.10 R is not applied, the *exposure* value for *CCR* for these *credit derivatives* is set to zero.
- (2) However, a *firm* may choose consistently to include for the purposes of calculating capital requirements for *counterparty credit risk* all credit derivatives not included in the *trading book* and purchased as protection against a *non-trading exposure* or against a *CCR exposure* where the credit protection is recognised under the *BCD*.

[Note: BCD Annex III Part 2 point 3 (part)]

13.3.16

FCA PRA

**R**

A *firm* must set the *exposure* value for *CCR* from sold credit default swaps in the *non-trading book*, where they are treated as credit protection provided by the *firm* and subject to a capital requirement for credit risk for the full notional amount, to zero.

[Note: BCD Annex III Part 2 point 4]



**13.4 CCR mark to market method**

**General**

13.4.1

**R**

The *rules* in ■ BIPRU 13.4 set out the *CCR mark to market method*.

FCA PRA

13.4.2

**R**

A *firm* must obtain the current replacement cost of all contracts with positive values by attaching current market values to contracts (marking to market).

FCA PRA

[Note: *BCD* Annex III Part 3, Step (a)]

13.4.3

**R**

A *firm* must obtain a figure for potential future credit *exposure* by multiplying the notional principal amounts or underlying values by the percentages in the table in ■ BIPRU 13.4.5 R.

FCA PRA

[Note: *BCD* Annex III Part 3, Step (b) (part)]

13.4.4

**R**

■ BIPRU 13.4.3 R does not apply in the case of single-currency "floating/floating" interest rate swaps.

FCA PRA

[Note: *BCD* Annex III Part 3, Step (b) (part)]

**Table: multiples to be applied to notional principal amounts or underlying values**

13.4.5

**R**

This table belongs to ■ BIPRU 13.4.5 R

FCA PRA

Residual maturity	Interest-rate contracts	Contracts concerning foreign currency rates and gold	Contracts concerning equities	Contracts concerning precious metals except gold	Contracts concerning commodities other than precious metals
One year or less	0%	1%	6%	7%	10%
Over one year, not	0,5%	5%	8%	7%	12%

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Residual maturity	Interest-rate contracts	Contracts concerning foreign currency rates and gold	Contracts concerning equities	Contracts concerning precious metals except gold	Contracts concerning commodities other than precious metals
exceeding five years					
Over five years	1.5%	7.5%	10%	8%	15%

[Note: BCD Annex III Part 3, Table 1]

13.4.6  
FCA PRA

**R** A *firm* must treat a contract which does not fall within one of the five categories indicated in the table in ■ BIPRU 13.4.5 R as a contract concerning *commodities* other than precious metals.

[Note: BCD Annex III Part 3, Table 1 footnote 25]

13.4.7  
FCA PRA

**R** For contracts with multiple exchanges of principal, a *firm* must multiply the percentages in the table in ■ BIPRU 13.4.5 R by the number of remaining payments still to be made according to the contract.

[Note: BCD Annex III Part 3, Table 1 footnote 26]

13.4.8  
FCA PRA

**R** For contracts that are structured to settle outstanding *exposure* following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, a *firm* must treat the residual maturity as equal to the time until the next reset date.

[Note: BCD Annex III Part 3, Table 1 footnote 27 (part)]

13.4.9  
FCA PRA

**R** In the case of interest-rate contracts that meet the criteria in ■ BIPRU 13.4.8 R and have a remaining maturity of over one year, a *firm* must apply a percentage no lower than 0.5%.

[Note: BCD Annex III Part 3, Table 1 footnote 27 (part)]

13.4.10  
FCA PRA

**R** For the purpose of calculating the potential future credit *exposure* in accordance with ■ BIPRU 13.4.3 R a *firm* may apply the percentages in the table in ■ BIPRU 13.4.11 R instead of those prescribed in the table in ■ BIPRU 13.4.5 R provided that it makes use of the *commodity extended maturity ladder approach* for contracts relating to commodities other than gold.

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Alternative multiples to be applied to notional principal amounts or underlying values

13.4.11

R

FCA PRA

This table belongs to ■ BIPRU 13.4.10 R

Residual maturity	Precious metals (except gold)	Base metals	Agricultural products (softs)	Other, including energy products
One year or less	2%	2,5%	3%	4%
Over one year, not exceeding five years	5%	4%	5%	6%
Over five years	7.5%	8%	9%	10%

[Note: BCD Annex III Part 3, Table 2]

13.4.12

R

FCA PRA

A *firm* must calculate the *exposure* value as the sum of:

- (1) the current replacement cost calculated under ■ BIPRU 13.4.2 R; and
- (2) the potential future credit *exposure* calculated under ■ BIPRU 13.4.3 R.

[Note: BCD Annex III Part 3, Step (c)]

13.4.13

G

FCA PRA

Contracts with a negative replacement cost should still be subject to an add-on if there is a possibility of the replacement costs becoming positive before maturity. Written options should therefore be exempt from add-ons.

13.4.14

G

FCA PRA

For the purposes of calculating the replacement cost, where an *exposure* relates to collateral posted to cover a negative mark to market position on a derivative contract, the negative mark to market *exposure* may be offset against the collateral *exposure* if the requirements in ■ BIPRU 5 are met.

### Alternative approach

13.4.15

R

FCA PRA

A *firm* must ensure that the notional amount to be taken into account is an appropriate yardstick for the risk inherent in the contract. Where, for instance, the contract provides for a multiplication of cash flows, a *firm* must adjust the notional amount in order to take into account the effects of the multiplication on the risk structure of that contract.

[Note: BCD Annex III Part 2 point 8]

**Netting: Contracts for novation**

13.4.16

FCA PRA

R

The single net amounts fixed by contracts for novation, rather than the gross amounts involved, may be weighted. For the purposes of the *CCR mark to market method*, a *firm* may obtain:

- (1) in ■ BIPRU 13.4.2 R, the current replacement cost; and
- (2) in ■ BIPRU 13.4.3 R, the notional principal amounts or underlying values;

by taking account of the contract for novation.

[Note: *BCD Annex III Part 7 point c(i)*]

**Netting: Other netting agreements**

13.4.17

FCA PRA

R

In application of the *CCR mark to market method*:

- (1) in ■ BIPRU 13.4.2 R a *firm* may obtain the current replacement cost for the contracts included in a netting agreement by taking account of the actual hypothetical net replacement cost which results from the agreement; in the case where netting leads to a net obligation for the *firm* calculating the net replacement cost, the current replacement cost is calculated as "0"; and
- (2) in ■ BIPRU 13.4.3 R a *firm* may reduce the figure for potential future credit *exposure* for all contracts included in a netting agreement according to the following formula:

$$PCE_{red} = 0.4 * PCE_{gross} + 0.6 * NGR * PCE_{gross}$$

where:

- (a)  $PCE_{red}$  = the reduced figure for potential future credit *exposure* for all contracts with a given counterparty included in a legally valid bilateral netting agreement;
- (b)  $PCE_{gross}$  = the sum of the figures for potential future credit *exposure* for all contracts with a given counterparty which are included in a legally valid bilateral netting agreement and are calculated by multiplying their notional principal amounts by the percentages set out in the table in ■ BIPRU 13.4.5 R; and
- (c) NGR = "net-to-gross ratio": the quotient of the net replacement cost for all contracts included in a legally valid bilateral netting agreement with a given counterparty (numerator) and the gross replacement cost for all contracts included in a legally valid bilateral netting agreement with that counterparty (denominator).

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13.4.18

**R**

**FCA** **PRA**

For the calculation of the potential future credit exposure according to the formula in **■ BIPRU 13.4.17 R** perfectly matching contracts included in the netting agreement may be taken into account as a single contract with a notional principal equivalent to the net receipts.

[Note: *BCD* Annex III Part 7 point c(ii) (part)]

13.4.19

**R**

**FCA** **PRA**

For the purposes of **■ BIPRU 13.4.18 R** a perfectly matching contract is a forward *foreign currency* contract or similar contract in which a notional principal is equivalent to cash flows if the cash flows fall due on the same value date and fully or partly in the same currency.

[Note: *BCD* Annex III Part 7 point c(ii) (part)]

## 13.5 CCR standardised method

### Scope

13.5.1

FCA PRA

R

A firm may use the *CCR standardised method* only for *financial derivative instruments* and *long settlement transactions*.

[Note: *BCD Annex III Part 5 point 1 (part)*]

### Derivation of risk position: payment legs

13.5.2

FCA PRA

R

- (1) When a *financial derivative instrument* transaction with a linear risk profile stipulates the exchange of a *financial instrument* for a payment, the payment Part is referred to as the *payment leg*.
- (2) Transactions that stipulate the exchange of payment against payment consist of two *payment legs*.
- (3) The *payment legs* consist of the contractually agreed gross payments, including the notional amount of the transaction.
- (4) A firm may disregard the *interest rate risk* from *payment legs* with a remaining maturity of less than one year for the purposes of the calculations in ■ BIPRU 13.5.
- (5) A firm may treat transactions that consist of two *payment legs* that are denominated in the same currency, such as interest rate swaps, as a single aggregate transaction. The treatment for *payment legs* applies to the aggregate transaction.

[Note: *BCD Annex III Part 5 point 2*]

### Derivation of risk position: mapping

13.5.3

FCA PRA

R

- (1) Transactions with a linear risk profile with equities (including equity indices), gold, other precious metals or other *commodities* as the underlying financial instruments must be mapped to a *risk position* in the respective equity (or equity index) or *commodity* (including gold and other precious metals) and an *interest rate risk position* for the *payment leg*.

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(1) If the *payment leg* is denominated in a *foreign currency*, it must be additionally mapped to a *risk position* in the respective currency.

[Note: BCD Annex III Part 5 point 3]

13.5.4

**R**

FCA PRA

- (1) Transactions with a linear risk profile with a debt instrument as the underlying instrument must be mapped to an interest rate *risk position* for the debt instrument and another interest rate *risk position* for the *payment leg*.
- (2) Transactions with a linear risk profile that stipulate the exchange of payment against payment, including *foreign exchange forwards*, must be mapped to an interest rate *risk position* for each of the *payment legs*.
- (3) If the underlying debt instrument is denominated in a *foreign currency*, the debt instrument must be mapped to a *risk position* in that *foreign currency*.
- (4) If a *payment leg* is denominated in *foreign currency*, the *payment leg* must be again mapped to a *risk position* in that *foreign currency*.
- (5) The *exposure* value to be assigned to a *foreign exchange* basis swap transaction is zero.

[Note: BCD Annex III Part 5 point 4]

## Derivation of risk position: calculating the size of the risk position

13.5.5

**R**

FCA PRA

A *firm* must calculate the *risk position* of the transaction or instrument in column 1 of the table in ■ BIPRU 13.5.6 R in accordance with column 2 of that table.

13.5.6

**R**

FCA PRA

This table belongs to ■ BIPRU 13.5.5 R.

Transaction or instrument	Calculation of size of <i>risk position</i>
Transaction with linear risk profile except for debt instruments.	The effective notional value (market price multiplied by quantity) of the underlying <i>financial instruments</i> (including <i>commodities</i> ) converted to the <i>firm's</i> domestic currency.
Debt instruments and <i>payment legs</i> .	The effective notional value of the outstanding gross payments (including the notional amount) converted to the <i>firm's base currency</i> , multiplied by the modified duration of the debt instrument, or <i>payment leg</i> , respectively.

Transaction or instrument	Calculation of size of <i>risk position</i>
Credit default swap	The notional value of the reference debt instrument multiplied by the remaining maturity of the credit default swap.
Nth to default credit default swap	The effective notional value of the reference debt instrument, multiplied by the modified duration of the nth to default derivative with respect to a change in the credit spread of the reference debt instrument.
Subject to BIPRU 13.5.9 R to BIPRU 13.5.10 R, <i>financial derivative instrument with a non-linear risk profile, including options and swaptions except in the case of an underlying debt instrument.</i>	Equal to the delta equivalent effective notional value of the <i>financial instrument</i> that underlies the transaction.
Subject to BIPRU 13.5.9 R to BIPRU 13.5.10 R, <i>financial derivative instrument with a non-linear risk profile, including options and swaptions, of which the underlying is a debt instrument or a payment leg.</i>	Equal to the delta equivalent effective notional value of the <i>financial instrument</i> or <i>payment leg</i> multiplied by the modified duration of the debt instrument, or <i>payment leg</i> , respectively.

[Note: BCD Annex III Part 5 points 5 to 9 and 15 (part) ]

**Derivation of risk position: effective notional value**

13.5.7

FCA PRA

**R**

A *firm* may use the following formulae to determine the size and sign of a *risk position*:

(1) for all instruments other than debt instruments:

effective notional value, or delta equivalent

$$\text{notional value} = p_{\text{ref}}((V)/(p))$$

where:

- (a)  $P_{\text{ref}}$  = price of the underlying instrument, expressed in the reference currency;
- (b)  $V$  = value of the financial instrument (in the case of an option this is the option price; in the case of a transaction with a linear risk profile this is the value of the underlying instrument itself);

$p$  = price of the underlying instrument, expressed in the same currency as  $V$ ;

(2) for debt instruments and the *payment legs* of all transactions:

effective notional value multiplied by the modified duration, or delta equivalent in notional value multiplied by the modified duration

$(V)/(r)$

where:

- (a)  $V$  = value of the financial instrument (in the case of an option this is the option price; in the case of a transaction with a linear risk profile this is the value of the underlying instrument itself or of the *payment leg*, respectively);
- (b)  $r$  = interest rate level.

(3) If  $V$  is denominated in a currency other than the reference currency, the derivative must be converted into the reference currency by multiplication with the relevant exchange rate.

[Note: *BCD Annex III Part 5 point 11*]

**Derivation of risk position: treatment of collateral**

13.5.8

FCA PRA

R

For the determination of *risk positions*, a *firm* must treat collateral received from a counterparty like a claim on the counterparty under a derivative contract (long position) that is due today, while collateral posted must be treated as an obligation to the counterparty (short position) that is due today.

[Note: *BCD Annex III Part 5 point 10*]

**Derivation of risk position: non-linear risks**

13.5.9

FCA PRA

R

A *firm* must apply the *CCR mark to market method* to transactions with a non-linear risk profile or for *payment legs* and transactions with debt instruments as underlying if:

- (1) the *firm* does not have a *CAD 1 model permission* or a *VaR model permission*; or
- (2) where the *firm* does have a *CAD 1 model permission* or a *VaR model permission* but cannot determine the delta or the modified duration, respectively, with its *CAD 1 model permission* or *VaR model permission*.

[Note: *BCD Annex III Part 5 point 19 (part)*]

FCA PRA

A firm must not recognise netting for the purpose of applying the CCR *mark to market method* to an *exposure* treated under ■ BIPRU 13.5.9 R (that is, the *exposure* value must be determined as if there were a *netting set* that comprises just the individual transaction).

[Note: BCD Annex III Part 5 point 19 (part)]

**Hedging sets: assignment**

13.5.11 FCA PRA

**R** A firm must group the *risk positions* into *hedging sets* and, for each *hedging set*, compute the absolute value amount of the sum of the resulting *risk positions*. This sum is termed the net *risk position* and is represented by:

$$((i)(RPT_{ij}) - (i)(RPC_{ij}))$$

in the formulae set out in ■ BIPRU 13.5.24 R.

[Note: BCD Annex III Part 5 point 12]

**Hedging sets: description**

13.5.12 FCA PRA

**R** For interest rate *risk positions* from money deposits received from the counterparty as collateral, from *payment leg* and from underlying debt instruments, to which according to the table in BIPRU 7.2.44R a capital charge of 1.60% or less applies, there are six *hedging sets* for each currency, as set out in the table in ■ BIPRU 13.5.13 R. *Hedging sets* are defined by a combination of the criteria maturity and referenced interest rates.

[Note: BCD Annex III Part 5 point 13]

**Table: Hedging sets**

13.5.13 FCA PRA

**R** This table belongs to ■ BIPRU 13.5.12 R:

	Government referenced interest rates	Non-government referenced interest rates
Maturity	<= 1 year	<= 1 year
Maturity	>1 <= 5 years	>1 <= 5 years
Maturity	> 5 years	> 5 years

[Note: BCD Annex III Part 5 Table 4]

13.5.14 FCA PRA

**R** For interest rate *risk positions* from underlying debt instruments or *payment legs* for which the interest rate is linked to a reference interest rate that represents a general market interest level, the remaining maturity is the length of the time interval up to the next re-adjustment of the interest rate. In all other cases, it is the remaining life of the underlying

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reference instrument, or in the case of a *payment leg* the remaining life of the transaction.

[Note: *BCD* Annex III Part 5 point 14]

13.5.15

FCA PRA

R

There is one *hedging set* for each issuer of a reference debt instrument that underlies a credit default swap. Nth to default basket credit default swaps must be treated as follows:

- (1) the size of a *risk position* in a reference debt instrument in a basket underlying an nth to default credit default swap is the effective notional value of the reference debt instrument, multiplied by the modified duration of the nth to default derivative, with respect to a change in the credit spread of the reference debt instrument;
- (2) there is one *hedging set* for each reference debt instrument in a basket underlying a given nth to default credit default swap; *risk positions* from different nth to default credit default swaps must not be included in the same *hedging set*; and
- (3) the CCR multiplier applicable to each *hedging set* created for one of the reference debt instruments of an nth to default derivative is 0.3% for reference debt instruments that have a credit assessment from a recognised *ECAI* equivalent to *credit quality step* 1 to 3, and 0.6% for other debt instruments.

[Note: *BCD* Annex III Part 5 point 15]

13.5.16

FCA PRA

R

Underlying financial instruments other than debt instruments must be assigned by a *firm* to the same respective *hedging sets* only if they are identical or similar instruments. In all other cases a *firm* must assign them to separate *hedging sets*.

[Note: *BCD* Annex III Part 5 point 17 (part)]

13.5.17

FCA PRA

R

- (1) The similarity of instruments for the purposes of ■ BIPRU 13.5.16 R is established in accordance with (2) to (5).
- (2) For equities, similar instruments are those of the same issuer. An equity index is treated as a separate issuer.
- (3) For precious metals, similar instruments are those of the same metal. A precious metal index is treated as a separate precious metal.
- (4) For electric power, similar instruments are those delivery rights and obligations that refer to the same peak or off-peak load time interval within any 24 hour interval.

(5) For *commodities*, similar instruments are those of the same *commodity*. A *commodity* index is treated as a separate *commodity*.

[Note: BCD Annex III Part 5 point 17 (part)]

**Hedging sets: collateral**

13.5.18

FCA PRA

R

- (1) For interest rate *risk positions* from money deposits that are posted with a counterparty as collateral when that counterparty does not have debt obligations of low *specific risk* outstanding and from underlying debt instruments, to which according to the table in ■ BIPRU 7.2.44 R a capital charge of more than 1.60% applies, there is one *hedging set* for each issuer.
- (2) When a *payment leg* emulates such a debt instrument, there is also one *hedging set* for each issuer of the reference debt instrument.
- (3) A *firm* may assign *risk positions* that arise from debt instruments of a certain issuer, or from reference debt instruments of the same issuer that are emulated by *payment legs*, or that underlie a credit default swap, to the same *hedging set*.

[Note: BCD Annex III Part 5 point 16]

13.5.19

FCA PRA

R

A *firm* that makes use of collateral to mitigate its CCR must have internal procedures to verify that, prior to recognising the effect of collateral in its calculations, the collateral meets the legal certainty standards set out in ■ BIPRU 5 modified, where relevant, by ■ BIPRU 4.10.

[Note: BCD Annex III Part 5 point 21]

**Hedging sets: netting**

13.5.20

FCA PRA

R

A *firm* must have internal procedures to verify that, prior to including a transaction in a *hedging set*, the transaction is covered by a legally enforceable netting contract that meets the requirements set out in ■ BIPRU 13.7.

[Note: BCD Annex III Part 5 point 20]

**Credit conversion factors : Table**

13.5.21

FCA PRA

R

A *firm* must apply the CCR multipliers for the different *hedging set* categories according to the Table in ■ BIPRU 13.5.22 R.

[Note: BCD Annex III Part 5 point 18]

**BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions**

FCA PRA

This table belongs to ■ BIPRU 13.5.21 R.

Hedging set categories	CCR Multiplier (CCRM)
(1) Interest Rates	0.2%
(2) Interest Rates for <i>risk positions</i> from a reference debt instrument that underlies a credit default swap and to which a capital charge of 1.60%, or less, applies under BIPRU 7.2.44 R.	0.3%
(3) Interest Rates for <i>risk positions</i> from a debt instrument or reference debt instrument to which a capital charge of more than 1.60% applies under BIPRU 7.2.44 R.	0.6%
(4) Exchange Rates	2.5%
(5) Electric power	4.0%
(6) Gold	5.0%
(7) Equity	7.0%
(8) Precious Metals (except gold)	8.5%
(9) Other <i>commodities</i> (excluding precious metals and electricity power)	10.0%
(10) Reference debt instruments of an nth to default derivative that have a credit assessment from a recognised <i>ECAI</i> equivalent to <i>credit quality step 1 to 3</i>	0.3%
(11) Reference debt instruments of an nth to default derivative that do not have a credit assessment from a recognised <i>ECAI</i> equivalent to <i>credit quality step 1 to 3</i>	0.6%

**BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions**

<i>Hedging set categories</i>	<i>CCR Multiplier (CCRM)</i>	
(12)	Underlying instruments of <i>financial derivative instrument</i> that are not in any of the above categories.	10.0%

[Note: BCD Annex III Part 5 Table 5 and Part 5 point 15 (c) ]

13.5.23

FCA PRA

R

A *firm* must assign underlying instruments of *financial derivatives instruments* (in line 10 of the Table in ■ BIPRU 13.5.22 R) to separate individual *hedging sets* for each category of underlying instrument.

**Exposure value**

13.5.24

FCA PRA

R

A *firm* must calculate the *exposure* value separately for each *netting set*.

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

**BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions**

FCA PRA

to determine the *exposure* value net of collateral, as follows:

$$exposure\ value = *max(CMV-CMC;_{(j)}((_{(i)}(RPT_{ij})-(_{(l)}(RPC_{lj}))*CCRM_j)$$

where:

CMV = *current market value* of the portfolio of transactions within the *netting set* with a counterparty gross of collateral.

That is, where:

$$CMV = (_{i})(CMV_i)$$

where:

CMV<sub>i</sub> = the *current market value* of transaction *i*;

CMC = the *current market value* of the collateral assigned to the *netting set*.

That is, where:  $CMC = (_{l})(CMC_l)$

where

CMC<sub>l</sub> = the *current market value* of collateral *l*;

*i* = index designating transaction;

*l* = index designating collateral;

*j* = index designating *hedging set* category. These *hedging sets* correspond to risk factors for which *risk positions* of opposite sign can be offset to yield a net *risk position* on which the *exposure* measure is then based;

RPT<sub>ij</sub> = *risk position* from transaction *i* with respect to *hedging set j*;

RPC<sub>lj</sub> = *risk position* from collateral *l* with respect to *hedging set j*;

CCRM<sub>j</sub> = CCR Multiplier set out in the Table in BIPRU 13.5.22R with respect to the *hedging set j*;

= 1.4.

[Note: BCD Annex III Part 5 point 1 (part)]

13.5.26

R

Collateral received from a counterparty has a positive sign; collateral posted to a counterparty has a negative sign.

FCA PRA

[Note: BCD Annex III Part 5 point 1 (part)]

**BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions**

FCA PRA

A *firm* may only recognise collateral for this method if it is collateral that is eligible under ■ BIPRU 5.4.8 R and ■ BIPRU 14.2.12 G to ■ BIPRU 14.2.13 R.

[Note: *BCD* Annex III Part 5 point 1 (part)]

13.5.28

G

FCA PRA

A worked example showing a US Dollar (USD)-based *firm*, single counterparty, single netting set, Risk-positions  $RP_{ij}$  by hedging sets  $j$  is set out in ■ BIPRU 13 Annex 1 G

**13.6 CCR internal model method**

**Introduction**

**13.6.1** **R** ■ BIPRU 13.6 sets out the *rules* relating to the *CCR internal model method*.

**FCA** **PRA**

**13.6.2** **R** A *firm* may only use the *CCR internal model method* if it has a *CCR internal model method permission*.

**FCA** **PRA**

**13.6.3** **G** ■ BIPRU 1.3 sets out the process for applying for a *CCR internal model method permission*.

**FCA** **PRA**

**13.6.4** **G** A *firm's CCR internal model method permission* will modify ■ BIPRU 13.6.2 R and will require the *firm* to use only the *CCR internal model method*, except to the extent that ■ BIPRU 13 permits the *firm* to combine the use of the *CCR internal model method* with one or more other methods.

**FCA** **PRA**

**13.6.5** **R** (1) A reference in the *Handbook* to a provision of the *CCR internal model method*, in relation to a *firm*:

**FCA** **PRA**

- (a) excludes any provision of the *CCR internal model method* set out in the *Handbook* which is not applied to that *firm* by its *CCR internal model method permission*;
- (b) includes any additional provision contained in the *CCR internal model method permission*; and
- (c) takes into account any other amendments made to the provisions in the *Handbook* relating to the *CCR internal model method* made by the *CCR internal model method permission*.

(2) To the extent that a *firm's CCR internal model method permission* does not allow it to use a particular approach in the *Handbook* relating to the *CCR internal model method*, the *Handbook* provision does not apply to the *firm*.

**Scope**

**13.6.6** **R** A *firm* may determine the *exposure* value for:

**FCA** **PRA**

- (1) *financial derivative instruments*;

- (2) *repurchase transactions;*
- (3) *securities or commodities lending or borrowing transactions;*
- (4) *margin lending transactions;* and
- (5) *long settlement transactions*

using the *CCR internal model method*.

[Note: BCD Annex III Part 2 point 2]

13.6.7

FCA PRA

R

A *firm* may use the *CCR internal model method* to calculate the *exposure value* for:

- (1) the transactions in ■ BIPRU 13.6.6 R (1); or
- (2) the transactions in ■ BIPRU 13.6.6 R (2), ■ (3) and ■ (4); or
- (3) the transactions in ■ BIPRU 13.6.6 R (1) to ■ (4).

[Note: BCD Annex III Part 6 point 1 (part)]

13.6.8

FCA PRA

R

In each of ■ BIPRU 13.6.7 R (1), ■ (2) and ■ (3), a *firm* may include *long settlement transactions* as well.

[Note: BCD Annex III Part 6 point 1 (part)]

#### Use of other models

13.6.9

FCA PRA

G

Point 2 of Part 6 of Annex III of the *Banking Consolidation Directive* provides that a *firm* using the *CCR internal model method* may use a type of model other than the type set out in ■ BIPRU 13.6. If the *appropriate regulator* agrees to this the details of the model and the necessary calculations will be set out in the *CCR internal model method permission*, which will modify ■ BIPRU 13.6 to the extent necessary. The *appropriate regulator* would not expect to agree to such a request unless the *firm* was able to satisfy the *appropriate regulator* that the method was at least as conservative as the method set out in BIPRU 13.6 and in particular that, for every *counterparty*, any method was more conservative than alpha multiplied by *effective EPE* calculated according to the equation in ■ BIPRU 13.6.27 R.

[Note: BCD Annex III Part 6 point 2 (second sentence) and point 11]

#### Partial use

13.6.10

FCA PRA

R

For all *financial derivative instruments* and for *long settlement transactions* which are outside the scope of a *firm's CCR internal model method permission*, a *firm* must use the *CCR mark to market method* or the *CCR standardised method*.

[Note: BCD Annex III Part 6 point 3 first sentence]

# BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions

FCA PRA

Under BIPRU 13.6.10 R, combined use of the *CCR mark to market method* and the *CCR standardised method* is only permitted where one of the methods is used for the cases set out in ■ BIPRU 13.5.9 R to ■ BIPRU 13.5.10 R.

[Note: BCD Annex III Part 6 point 3 second sentence]

13.6.12 FCA PRA

**R** Notwithstanding ■ BIPRU 13.3.10 R (Combined use), a *firm* may choose not to apply the *CCR internal model method* to *exposures* that are immaterial in size and risk.

[Note: BCD Annex III Part 6 point 1 third sentence]

13.6.13 FCA PRA

**R** If permitted by its *CCR internal model method permission*, and subject to its terms, a *firm* may carry out the implementation of the *CCR internal model method* sequentially across different transaction types; and during this period the *firm* may use the *CCR mark to market method* or the *CCR standardised method*.

[Note: BCD Annex III Part 6 point 2]

13.6.14 FCA PRA

**G** After the initial period following the granting of its *CCR internal model method permission*, as referred to in ■ BIPRU 13.6.13 R, a *firm* should extend the use of the *CCR internal model method* to cover any new business within a product category covered by its *CCR internal model method permission*. Subject to ■ BIPRU 13.6.10 R to ■ BIPRU 13.6.13 R, the *firm* should do so within a reasonable period of time. If the *firm* decides to exclude any business on, for example, the basis of materiality, it should document its reasons clearly.

13.6.15 FCA PRA

**G** In principle, the use of different measures of *exposure* within the *CCR internal model method* is possible within the same product category, including on a permanent basis. The *appropriate regulator* may allow a *firm*, through the *CCR internal model method permission*, to use a more conservative measure of *exposure* that is less risk sensitive (for instance a measure based on conservative haircuts) for certain parts of the business if justified on a cost-benefit basis. However, a *firm* would still need to meet the use test for these more conservative measures and would need to demonstrate that the aggregation of *CCR exposures* that come from different approaches and have different degrees of conservatism makes sense and is used for its *CCR* management purposes.

13.6.16 FCA PRA

**G** The *appropriate regulator* may, through the *CCR internal model method permission*, require a *firm* to apply a multiplier to the measures of *exposures* coming out of a less risk-sensitive approach to calculating *exposures* as referred to in ■ BIPRU 13.6.15 G where the *appropriate regulator* considers this to be appropriate due to the complexity of the business or the nature of the risks involved.

## Use of CCR internal model method

13.6.17 FCA PRA

**R** Subject to ■ BIPRU 13.6.10 R to ■ BIPRU 13.6.16 G, a *firm* that has a *CCR internal model method permission* must not use the *CCR mark to market method* or the *CCR standardised method* for transactions within the scope of the *firm's CCR internal model method permission*.

# BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions

[Note: BCD Annex III Part 6 point 4 (part)]

13.6.18  
FCA PRA

G

A *firm* which wishes to revert to the *CCR mark to market method* or the *CCR standardised method* will need to request the *appropriate regulator* to revoke or vary its *CCR internal model method permission*.

[Note: BCD Annex III Part 6 point 4 (part)]

13.6.19  
FCA PRA

G

The *appropriate regulator* will not agree to a *firm's* request to revoke or vary its *CCR internal model method permission* except for demonstrated good cause.

[Note: BCD Annex III Part 6 point 4 (part)]

13.6.20  
FCA PRA

R

If a *firm* ceases to comply with the requirements set out in ■ BIPRU 13.6, it must either present to the *appropriate regulator* a plan for a timely return to compliance or demonstrate that the effect of non-compliance is immaterial.

[Note: BCD Annex III Part 6 point 4 (part)]

13.6.21  
FCA PRA

G

If a *firm* ceases to comply with the requirements set out in ■ BIPRU 13.6, the *appropriate regulator* may revoke the *CCR internal model method permission* or take other appropriate supervisory action.

[Note: BCD Annex III Part 6 point 4 (part)]

## Exposure value

13.6.22  
FCA PRA

R

- (1) A *firm* must measure the *exposure value* at the level of the *netting set*.
- (2) The model must specify the forecasting distribution for changes in the market value of the *netting set* attributable to changes in market variables, such as interest rates, *foreign exchange rates*.
- (3) The model must then compute the *exposure value* for the *netting set* at each future date given the changes in the market variables.
- (4) For margined counterparties, the model may also capture future collateral movements.

[Note: BCD Annex III Part 6 point 5]

13.6.23  
FCA PRA

R

A *firm* may include eligible financial collateral as defined in ■ BIPRU 5.4.8 R (Eligible collateral under financial collateral comprehensive method) and ■ BIPRU 14.2.15 R to ■ BIPRU 14.2.17 R in its forecasting distributions for changes in the market value of the *netting set*, if the quantitative, qualitative and data requirements for the *CCR internal model method* are met for the collateral.

**BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions**

[Note: BCD Annex III Part 6 point 6]

13.6.24  
FCA PRA

**R** A firm must calculate the *exposure* value as the product of alpha ( $\alpha$ ), as set out in ■ BIPRU 13.6.31 R, times *effective EPE*:

$$\text{Exposure value} = \text{effective EPE}$$

[Note: BCD Annex III Part 6 point 7 first part]

**Effective EPE**

13.6.25  
FCA PRA

**R** A firm must compute *effective EPE* by estimating *expected exposure (EE<sub>t</sub>)* as the average *exposure* at future date  $t$ , where the average is taken across possible future values of relevant *market risk* factors. The model estimates *EE* at a series of future dates  $t_1, t_2, t_3$ , etc.

[Note: BCD Annex III Part 6 point 7 third part]

13.6.26  
FCA PRA

**R** A firm must compute *effective EE* recursively as:

$$\text{Effective EE}_{t_k} = \max(\text{effective EE}_{t_{k-1}}; \text{EE}_{t_k})$$

where:

the current date is denoted as  $t_0$  and *Effective EE<sub>t0</sub>* equals *current exposure*.

[Note: BCD Annex III Part 6 point 8]

13.6.27  
FCA PRA

**R** For the purposes of ■ BIPRU 13.6.25 R :

- (1) *effective EPE* is the average *effective EE* during the first year of future *exposure*;
- (2) if all contracts in the *netting set* mature within less than one year, *effective EPE* is the average of *effective EE* until all contracts in the *netting set* mature.

[Note: BCD Annex III Part 6 point 9, first part]

13.6.28  
FCA PRA

**R** A firm must compute *effective EPE* as a weighted average of *effective EE*:

$$\text{Effective EPE} = \sum_{k=1}^{\min(1 \text{ year}; \text{maturity})} ((\text{Effective EE}_{t_k}) * (t_k))$$

where:

the weights  $\lambda_{tk} = \frac{t_k - t_{k-1}}{t_k - t_{k-1}}$  allow for the case when future *exposure* is calculated at dates that are not equally spaced over time.

[Note: BCD Annex III Part 6 point 9, second part]

**BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions**

FCA PRA

A firm must calculate *EE* or *peak exposure* measures based on a *distribution of exposures* that accounts for the possible non-normality of the *distribution of exposures*.

[Note: BCD Annex III Part 6 point 10]

13.6.30

R

[deleted]

**Alpha**

13.6.31

R

FCA PRA

For the purposes of ■ BIPRU 13.6.24 R, alpha ( $\alpha$ ) is 1.4 or any higher amount specified in the *firm's CCR internal model method permission*.

[Note: BCD Annex III Part 6 point 7 second part]

13.6.32

G

FCA PRA

If the *appropriate regulator* does specify an alpha greater than 1.4, the reasons will be set out in the *firm's CCR internal model method permission*.

13.6.33

R

FCA PRA

If a *firm's CCR internal model method permission* permits it, the *firm* may use its own estimates of  $\alpha$ , subject to a floor of 1.2, where  $\alpha$  must equal the ratio of internal capital from a full simulation of *CCR exposure* across counterparties (numerator) and internal capital based on *EPE* (denominator).

[Note: BCD Annex III Part 6 point 12 (part)]

13.6.34

R

FCA PRA

For the purposes of ■ BIPRU 13.6.33 R:

- (1) in the denominator, *EPE* must be used as if it were a fixed outstanding amount;
- (2) a *firm* must be able to demonstrate that its internal estimates of capture in the numerator material sources of stochastic dependency of *distribution of market values* of transactions or of portfolios of transactions across counterparties;
- (3) internal estimates of  $\alpha$  must take account of the granularity of portfolios.

[Note: BCD Annex III Part 6 point 12 (part)]

13.6.35

R

FCA PRA

A *firm* must ensure that the numerator and denominator of  $\alpha$  are computed in a consistent fashion with respect to the modelling methodology, parameter specifications and portfolio composition. The approach used must be based on the *firm's* internal capital approach, be well-documented and be subject to independent validation. In addition, a *firm* must review their estimates on at least a quarterly basis, and more frequently when the composition of the portfolio varies over time. A *firm* must also assess the model risk.

# BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions [BCD Annex III Part 6 point 13]

13.6.35A  
FCA PRA

R

Where appropriate, volatilities and correlations of *market risk* factors used in the joint simulation of *market risk* and credit risk must be conditioned on the credit risk factor to reflect potential increases in volatility or correlation in an economic downturn.

[Note: BCD Annex III Part 6 point 14]

13.6.36  
FCA PRA

G

In reviewing its estimate of , a *firm* may not need to perform a full recalculation each quarter if it can demonstrate by other means that the estimate would not be materially different. A full recalculation should however be performed at least annually. If there is a structural change in the *firm's* portfolio that is likely to have the effect that the existing estimate of will be inappropriate, the *firm* should also recalculate it. A *firm* should have procedures in place to identify any such structural changes.

## Maturity adjustment

13.6.37  
FCA PRA

G

A *firm* using the *IRB approach* for risk weighting of exposures arising from a *CCR internal model method* should also apply a different maturity adjustment as set out in

■ BIPRU 4.4.67 R ■ BIPRU 4.4.70 R.

## Margin agreement

13.6.38  
FCA PRA

R

If the *netting set* is subject to a *margin agreement*, a *firm* must use one of the following *EPE* measures:

- (1) *effective EPE* without taking into account the *margin agreement*;
- (2) the *margin threshold*, if positive, under the *margin agreement* plus an add-on that reflects the potential increase in *exposure* over the *margin period of risk*:
  - (a) the add-on is computed as the expected increase in the *netting set's exposure* beginning from a *current exposure* of zero over the *margin period of risk*;
  - (b) a floor of five business days for *netting sets* consisting only of repo-style transactions subject to daily remargining and daily mark-to-market, and ten business days for all other *netting sets* is imposed on the *margin period of risk* used for this purpose.
- (3) if the model captures the effects of margining when estimating *EE*, the model's *EE* measure may be used directly in the equation in ■ BIPRU 13.6.28 R (Computation of effective EE), unless the *firm's CCR internal model method permission* does not apply this provision or does not permit that use.

[Note: BCD Annex III Part 6 point 15]

# BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions

FCA PRA

where the effects of margining are captured by the model itself, the *appropriate regulator* does not prescribe any floors for the *margin period of risk* but will challenge a *firm* that looks to use periods shorter than 5 days for *repurchase agreements* or *reverse repurchase agreements* or 10 days for *financial derivative instruments*.

## Operational requirements: General

13.6.40

FCA PRA

R

A *firm's EPE* model must meet the operational requirements set out in

■ BIPRU 13.6.41 R to ■ BIPRU 13.6.66 R.

[Note: BCD Annex III Part 6 point 16]

## Operational requirements: CCR control

13.6.41

FCA PRA

R

- (1) The *firm* must have a control unit that is responsible for the design and implementation of its *CCR* management system, including the initial and on-going validation of the model.
- (2) This unit must control input data integrity and produce and analyse reports on the output of the *firm's* risk measurement model, including an evaluation of the relationship between measures of risk *exposure* and credit and trading limits.
- (3) This unit must be:
  - (a) independent from units responsible for originating, renewing or trading *exposures* and free from undue influence;
  - (b) it must be adequately staffed; and
  - (c) it must report directly to the senior management of the *firm*.
- (4) The work of this unit must be closely integrated into the day-to-day credit risk management process of the *firm*; its output must, accordingly, be an integral part of the process of planning, monitoring and controlling the *firm's* credit and overall risk profile.

[Note: BCD Annex III Part 6 point 17]

13.6.42

FCA PRA

R

- (1) A *firm* must have *CCR* management policies, processes and systems that are conceptually sound and implemented with integrity.
- (2) A sound *CCR* management framework must include the identification, measurement, management, approval and internal reporting of *CCR*.

[Note: BCD Annex III Part 6 point 18]

## BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions

FCA PRA

A *firm's* risk management policies must take account of *market risk*, *liquidity risk*, and legal and *operational risk* that can be associated with *CCR*.

- (2) The *firm* must not undertake business with a counterparty without assessing its creditworthiness and must take due account of settlement and pre-settlement credit risk.
- (3) These risks must be managed as comprehensively as practicable at the counterparty level (aggregating *CCR exposures* with other credit *exposures*) and at the *firm-wide* level.

[Note: *BCD Annex III Part 6 point 19*]

13.6.44

R

FCA PRA

A *firm's governing body* and senior management must be actively involved in the *CCR control process* and must regard this as an essential aspect of the business to which significant resources need to be devoted. Senior management must be aware of the limitations and assumptions of the model used and the impact these can have on the reliability of the output. Senior management must also consider the uncertainties of the market environment and operational issues and be aware of how these are reflected in the model.

[Note: *BCD Annex III Part 6 point 20*]

13.6.45

R

FCA PRA

A *firm* must ensure that the daily reports prepared on its *exposures to CCR* are reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual credit managers or traders and reductions in the *firm's overall CCR exposure*.

[Note: *BCD Annex III Part 6 point 21*]

13.6.46

R

FCA PRA

- (1) A *firm's CCR management system* must be used in conjunction with internal credit and trading limits.
- (2) A *firm* must ensure that its credit and trading limits are related to its risk measurement model in a manner that is:
  - (a) consistent over time; and
  - (b) well understood by credit managers, traders and senior management.

[Note: *BCD Annex III Part 6 point 22*]

PAGE  
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13.6.47

R

FCA PRA

- (1) A *firm's measurement of CCR* must include measuring daily and intra-day usage of credit lines.
- (2) The *firm* must measure *current exposure* gross and net of collateral.

13

## BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions

(3) At portfolio and counterparty level, the *firm* must calculate and monitor *peak exposure* or potential future *exposure* (PFE) at the confidence interval chosen by the *firm*.

(4) The *firm* must take account of large or concentrated positions, including by groups of related counterparties, by industry, by market, etc.

[Note: BCD Annex III Part 6 point 23]

13.6.48

FCA PRA

R

(1) A *firm* must have a routine and rigorous program of stress testing in place as a supplement to the CCR analysis based on the day-to-day output of the *firm's* risk measurement model.

(2) The results of this stress testing must be reviewed periodically by senior management and must be reflected in the CCR policies and limits set by management and the *governing body*.

(3) Where stress tests reveal particular vulnerability to a given set of circumstances, prompt steps must be taken to manage those risks appropriately.

[Note: BCD Annex III Part 6 point 24]

13.6.49

FCA PRA

R

(1) A *firm* must have a routine in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operation of the CCR management system.

(2) The *firm's* CCR management system must be well documented and must provide an explanation of the empirical techniques used to measure CCR.

[Note: BCD Annex III Part 6 point 25]

13.6.50

FCA PRA

R

A *firm* must conduct an independent review of the CCR management system regularly through its own internal auditing process. This review must include both the activities of the business units referred to in ■ BIPRU 13.6.41 R and of the independent CCR control unit. A review of the overall CCR management process must take place at regular intervals and must specifically address, at a minimum:

(1) the adequacy of the documentation of the CCR management system and process;

(2) the organisation of the CCR control unit;

(3) the integration of CCR measures into daily risk management;

## BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions

- (4) the approval process for risk pricing models and valuation systems used by front and back-office personnel;
- (5) the validation of any significant change in the CCR measurement process;
- (6) the scope of CCR captured by the risk measurement model;
- (7) the integrity of the management information system;
- (8) the accuracy and completeness of CCR data;
- (9) the verification of the consistency, timeliness and reliability of data sources used to run models, including the independence of such data sources;
- (10) the accuracy and appropriateness of volatility and correlation assumptions;
- (11) the accuracy of valuation and risk transformation calculations; and
- (12) the verification of the model's accuracy through frequent back-testing.

[Note: BCD Annex III Part 6 point 26]

### Operational requirements: Use test

13.6.51

FCA PRA

R

The *distribution of exposures* generated by the model used to calculate *effective EPE* must be closely integrated into the day-to-day CCR management process of the *firm*. The model's output must accordingly play an essential role in the credit approval, CCR management, internal capital allocation, and corporate governance of the *firm*.

[Note: BCD Annex III Part 6 point 27]

13.6.52

FCA PRA

R

A *firm* must have a track record in the use of models that generate a *distribution of exposures* to CCR. Thus, the *firm* must be able to demonstrate that it has been using a model to calculate the *distribution of exposures* upon which the *EPE* calculation is based that meets, broadly, the minimum requirements set out in ■ BIPRU 13.6 for at least one year prior to the date of its *CCR internal model method permission*.

[Note: BCD Annex III Part 6 point 28]

13.6.53

FCA PRA

R

- (1) A *firm* must ensure that the model used to generate a *distribution of exposures* to CCR is part of a CCR management framework that includes the identification, measurement, management, approval and internal reporting of CCR. This framework must

## BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions

include the measurement of usage of credit lines (aggregating *CCR exposures* with other credit *exposures*) and internal capital allocation.

- (2) In addition to *EPE*, a *firm* must measure and manage *current exposures*.
- (3) Where appropriate, the *firm* must measure *current exposure* gross and net of collateral.
- (4) The use test is satisfied if a *firm* uses other *CCR* measures, such as *peak exposure* or *PFE* (see ■ BIPRU 13.6.47 R), based on the *distribution of exposures* generated by the same model to compute *EPE*.

[Note: BCD Annex III Part 6 point 29]

13.6.54

FCA PRA

R

A *firm* must have the systems capability to estimate *EE* daily if necessary, unless it is able to demonstrate to the *appropriate regulator* that its *exposures* to *CCR* warrant less frequent calculation. The *firm* must compute *EE* along a time profile of forecasting horizons that adequately reflects the time structure of future cash flows and maturity of the contracts and in a manner that is consistent with the materiality and composition of the *exposures*.

[Note: BCD Annex III Part 6 point 30]

13.6.55

FCA PRA

R

- (1) *Exposure* must be measured, monitored and controlled over the life of all contracts in the *netting set* (not just to the one year horizon).
- (2) A *firm* must have procedures in place to identify and control the risks for counterparties where the *exposure* rises beyond the one-year horizon.
- (3) A *firm* must input the forecast increase in *exposure* into the *firm's* internal capital model.

[Note: BCD Annex III Part 6 point 31]

### Operational requirements: Stress testing

13.6.56

FCA PRA

R

- (1) A *firm* must have in place sound stress testing processes for use in the assessment of capital adequacy for *CCR*.
- (2) These stress measures must be compared with the measure of *EPE* and considered by the *firm* as part of the process set out in ■ GENPRU 1.2.42 R.

## BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions

(5) Stress testing must also involve identifying possible events or future changes in economic conditions that could have unfavourable effects on a *firm's* credit *exposures* and an assessment of the *firm's* ability to withstand such changes.

[Note: BCD Annex III Part 6 point 32]

13.6.57

R

FCA PRA

- (1) A *firm* must stress test its *CCR exposures*, including jointly stressing *market risk* and credit risk factors.
- (2) In its stress tests of *CCR*, a *firm* must consider concentration risk (to a single counterparty or groups of counterparties), correlation risk across *market risk* and credit risk, and the risk that liquidating the counterparty's positions could move the market.
- (3) In its stress tests a *firm* must also consider the impact on its own positions of such market moves and integrate that impact in its assessment of *CCR*.

[Note: BCD Annex III Part 6 point 33]

### Operational requirements: Wrong-way risk

13.6.58

R

FCA PRA

A *firm* must give due consideration to *exposures* that give rise to a significant degree of *general wrong-way risk*.

[Note: BCD Annex III Part 6 point 34]

13.6.59

R

FCA PRA

A *firm* must have procedures in place to identify, monitor and control cases of *specific wrong-way risk*, beginning at the inception of a transaction and continuing through the life of the transaction.

[Note: BCD Annex III Part 6 point 35]

### Operational requirements: Integrity of modelling process

13.6.60

R

FCA PRA

A *firm* must ensure that:

- (1) the model reflects transaction terms and specifications in a timely, complete, and conservative fashion;
- (2) such terms include at least:
  - (a) contract notional amounts;
  - (b) maturity;
  - (c) reference assets;
  - (d) margining arrangements; and
  - (e) netting arrangements;

## BIPRU 13 : The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions

- (3) the terms and specifications are maintained in a database that is subject to formal and periodic audit;
- (4) the process for recognising netting arrangements requires:
  - (a) signoff by legal staff to verify the legal enforceability of netting and
  - (b) input into the database by an independent unit;
- (5) the transmission of transaction terms and specifications data to the model is also subject to internal audit; and
- (6) formal reconciliation processes are in place between the model and source data systems to verify on an ongoing basis that transaction terms and specifications are being reflected in *EPE* correctly or at least conservatively.

[Note: *BCD* Annex III Part 6 point 36]

13.6.61

FCA PRA

R

A *firm* must ensure that:

- (1) the model employs current market data to compute *current exposures*;
- (2) when using historical data to estimate volatility and correlations, at least three years of historical data are used and updated quarterly or more frequently if market conditions warrant;
- (3) the data covers a full range of economic conditions, such as a full business cycle;
- (4) a unit independent from the business unit validates the price supplied by the business unit;
- (5) the data is acquired independently of the lines of business, fed into the model in a timely and complete fashion, and maintained in a database subject to formal and periodic audit;
- (6) it has a well-developed data integrity process to clean the data of erroneous and/or anomalous observations; and
- (7) to the extent that the model relies on proxy market data, including for new products where three years of historical data may not be available, internal policies identify suitable proxies and the *firm* demonstrates empirically that the proxy provides a conservative representation of the underlying risk under adverse market conditions.

[Note: *BCD* Annex III Part 6 point 37]

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FCA PRA

includes the effect of collateral on changes in the market value of the *netting set*, a *firm* must have adequate historical data to model the volatility of the collateral.

13.6.63

R

FCA PRA

A *firm* must ensure that the model is subject to a validation process which:

- (1) is clearly articulated in *firms'* policies and procedures;
- (2) specifies the kind of testing needed to ensure model integrity
- (3) identifies conditions under which assumptions are violated and may result in an understatement of *EPE*; and
- (4) includes a review of the comprehensiveness of the model.

[Note: BCD Annex III Part 6 point 38]

13.6.64

R

FCA PRA

A *firm* must monitor the appropriate risks and have processes in place to adjust its estimation of *EPE* when those risks become significant. This includes the following:

- (1) the *firm* must identify and manage its *exposures to specific wrong-way risk*;
- (2) for *exposures* with a rising risk profile after one year, the *firm* must compare on a regular basis the estimate of *EPE* over one year with *EPE* over the life of the *exposure*; and
- (3) for *exposures* with a residual maturity below one year, the *firm* must compare on a regular basis the replacement cost (*current exposure*) and the realised *exposure* profile, and/or store data that would allow such a comparison.

[Note: BCD Annex III Part 6 point 39]

13.6.65

R

FCA PRA

A *firm* must have internal procedures to verify that, prior to including a transaction in a *netting set*, the transaction is covered by a legally enforceable netting contract that meets the requirements set out in ■ BIPRU 13.7.

[Note: BCD Annex III Part 6 point 40]

13.6.66

R

FCA PRA

A *firm* that makes use of collateral to mitigate its CCR must have internal procedures to verify that, prior to recognising the effect of collateral in its calculations, the collateral meets the legal certainty standards set out in ■ BIPRU 5 as modified, where relevant, by ■ BIPRU 4.10.

[Note: BCD Annex III Part 6 point 41]

13.6.67

FCA PRA

R

**Validation requirements**

- (1) A *firm's CCR internal model method* model must meet the validation requirements in (2) to (8).
- (2) The qualitative validation requirements set out in ■ BIPRU 7.10 must be met.
- (3) Interest rates, *foreign currency* rates, equity prices, *commodities*, and other *market risk* factors must be forecast over long time horizons for measuring *CCR exposure*. The performance of the forecasting model for *market risk* factors must be validated over a long time horizon.
- (4) The pricing models used to calculate *CCR exposure* for a given scenario of future shocks to *market risk* factors must be tested as part of the *CCR internal model method* model validation process. Pricing models for *options* must account for the nonlinearity of option value with respect to *market risk* factors.
- (5) The *CCR internal model method* model must capture transaction-specific information in order to aggregate *exposures* at the level of the *netting set*. A *firm* must verify that transactions are assigned to the appropriate *netting set* within the model.
- (6) The *CCR internal model method* model must also include transaction-specific information to capture the effects of margining. It must take into account both the current amount of margin and margin that would be passed between counterparties in the future. Such a model must account for the nature of *margin agreements* (unilateral or bilateral), the frequency of margin calls, the *margin period of risk*, the minimum threshold of unmargined *exposure* the *firm* is willing to accept, and the minimum transfer amount. Such a model must either model the mark-to-market change in the value of collateral posted or apply the *rules* set out in ■ BIPRU 5 as modified, where relevant, by ■ BIPRU 4.10.
- (7) Static, historical backtesting on representative counterparty portfolios must be part of the *CCR internal model method* model validation process. At regular intervals, a *firm* must conduct such backtesting on a number of representative counterparty portfolios (actual or hypothetical). These representative portfolios must be chosen based on their sensitivity to the material risk factors and correlations to which the *firm* is exposed.
- (8) If backtesting indicates that the *CCR internal model method* model is not sufficiently accurate, a *firm* must increase the *credit*

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*risk capital component* and, where ■ BIPRU 13 is applied for the purposes of ■ BIPRU 14, the *counterparty risk capital component* by an amount which is conservatively estimated to compensate for the inaccuracy of the model.

[Note: BCD Annex III Part 6 point 42 (part)]

13.6.68

FCA PRA

G

If backtesting indicates that the *CCR internal model method* model is not sufficiently accurate, the *appropriate regulator* may revoke a *firm's CCR internal model method permission* or take appropriate measures to ensure that the model is improved promptly. Measures taken by the *appropriate regulator* may include the use of its *own-initiative power* to require the *firm* to hold more *capital resources*.

[Note: BCD Annex III Part 6 point 42 (part)]

**13.7 Contractual netting**

**Scope**

13.7.1

FCA PRA

**R**

■ BIPRU 13.7 applies for the purpose of:

- (1) the *CCR mark to market method*;
- (2) the *CCR standardised method*;
- (3) if the *firm* has a *CCR internal model method permission*, the *CCR internal model method*.

**Types of netting recognised**

13.7.2

FCA PRA

**R**

For the purpose of ■ BIPRU 13.7:

- (1) counterparty means any entity (including natural *persons*) that has the power to conclude a contractual netting agreement; and
- (2) *contractual cross product netting agreement* means a written bilateral agreement between a *firm* and a counterparty which creates a single legal obligation covering all included bilateral master agreements and transactions belonging to different product categories.

[Note: *BCD Annex III Part 7 point (a) (part)*]

13.7.3

FCA PRA

**R**

*Contractual cross product netting agreements* do not cover netting other than on a bilateral basis.

[Note: *BCD Annex III Part 7 point (a) (part)*]

13.7.4

FCA PRA

**R**

For the purposes of *cross product netting*, the following are considered different product categories:

- (1) *repurchase transactions, reverse repurchase transactions, securities or commodities lending or borrowing transactions*;
- (2) *margin lending transactions*; and

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(5) *financial derivative instruments.*

[Note: BCD Annex III Part 7 point (a) (part)]

13.7.5

FCA PRA

R

A *firm* may recognise as risk-reducing the following types of contractual netting:

- (1) bilateral contracts for novation between a *firm* and its counterparty under which mutual claims and obligations are automatically amalgamated in such a way that this novation fixes one single net amount each time novation applies and thus creates a legally binding, single new contract extinguishing former contracts;
- (2) other bilateral agreements between a *firm* and its counterparty; and
- (3) a *firm* that has a *CCR internal model method permission* may recognise *Contractual cross product netting agreements* for transactions falling within the scope of its *CCR internal model method permission*; netting across transactions entered by members of a *group* is not recognised for the purposes of calculating capital requirements.

[Note: BCD Annex III Part 7 point (a) (part)]

**Conditions for recognition**

13.7.6

FCA PRA

R

A *firm* may treat contractual netting as risk-reducing only under the following conditions:

- (1) the *firm* must have a contractual netting agreement with its counterparty which creates a single legal obligation, covering all included transactions, such that, in the event of a counterparty's failure to perform owing to default, bankruptcy, liquidation or any other similar circumstance, the *firm* would have a claim to receive or an obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions;
- (2) the *firm* must be in a position to provide to the *appropriate regulator*, if requested, written and reasoned legal opinions to the effect that, in the event of a legal challenge, the relevant courts and administrative authorities would, in the cases described under (1), find that the *firm's* claims and obligations would be limited to the net sum, as described in (1), under:
  - (a) the law of the jurisdiction in which the counterparty is incorporated and, if a foreign *branch* of an *undertaking* is involved, also under the law of the jurisdiction in which the *branch* is located;
  - (b) the law that governs the individual transactions included; and

(c) the law that governs any contract or agreement necessary to effect the contractual netting;

- (3) the *firm* must have procedures in place to ensure that the legal validity of its contractual netting is kept under review in the light of possible changes in the relevant laws;
- (4) the *firm* must maintain all required documentation in its files;
- (5) the effects of netting must be factored into the *firm's* measurement of each counterparty's aggregate credit risk *exposure* and the *firm* must manage its *CCR* on such a basis; and
- (6) the *firm* must aggregate credit risk to each counterparty to arrive at a single legal *exposure* across transactions; this aggregation must be factored into credit limit purposes and internal capital purposes.

[Note: *BCD* Annex III Part 7 point (b) (part)]

13.7.7

FCA PRA

R

If any of the *competent authorities* concerned is not satisfied that the contractual netting is legally valid under the law of each of the relevant jurisdictions, the *firm* must not treat the contractual netting agreement as risk-reducing.

[Note: *BCD* Annex III Part 7 point (b) (part)]

13.7.8

FCA PRA

R

A legal opinion required under ■ BIPRU 13.7.6 R (2) may be in the form of a reasoned legal opinion drawn up by type of contractual netting.

[Note: *BCD* Annex III Part 7 point (b) (part)]

13.7.9

FCA PRA

R

A *firm* must not recognise as risk-reducing any contract containing a provision which permits a non-defaulting counterparty to make limited payments only, or no payments at all, to the estate of the defaulter, even if the defaulter is a net creditor (a "walkaway" clause).

[Note: *BCD* Annex III Part 7 point (b) (part)]

13.7.10

FCA PRA

R

In addition to the requirements in ■ BIPRU 13.7.2 R to ■ BIPRU 13.7.9 R, for *contractual cross product netting agreements* the following criteria must be met:

- (1) the net sum referred to in ■ BIPRU 13.7.6 R (1) must be the net sum of the positive and negative close out values of any included individual bilateral master agreement and of the positive and negative mark-to-market value of the individual transactions (the Cross-Product Net Amount);

- the written and reasoned legal opinions referred to in
- BIPRU 13.7.6 R (2) must address the validity and enforceability of the entire *contractual cross product netting agreement* under its terms and the impact of the netting arrangement on the material provisions of any included individual bilateral master agreement; a legal opinion must be generally recognised as such by the legal community in the *United Kingdom* or a memorandum of law that addresses all relevant issues in a reasoned manner;
- (3) the *firm* must have procedures in place under ■ BIPRU 13.7.6 R (3) to verify that any transaction which is to be included in a *netting set* is covered by a legal opinion; and
- (4) taking into account the *contractual cross product netting agreement*, the *firm* must continue to comply with the requirements for the recognition of bilateral netting and the requirements of ■ BIPRU 4.10 and ■ BIPRU 5 for the recognition of *credit risk mitigation*, as applicable, with respect to each included individual bilateral master agreement and transaction.

[Note: BCD Annex III Part 7 point (b) (part)]

#### Effects of recognition

13.7.11

FCA PRA

R

For the purposes of the *CCR mark to market method*, the *CCR standardised method* and the *CCR internal model method* a *firm* must recognise netting as set out in ■ BIPRU 13.3 and ■ BIPRU 13.6.

[Note: BCD Annex III Part 7 point (b) (part)]

## 13.8 Securities financing transactions

### Purpose

13.8.1

G

■ BIPRU 13.8 summarises the treatment for *securities financing transactions*.

FCA PRA

### Calculation of exposure value for SFTs

13.8.2

R

Subject to ■ BIPRU 13.8.3 R, in respect of a *securities financing transaction*, if a *firm*:

FCA PRA

- (1) has a *CCR internal model method permission* which covers the transaction; or
- (2) has a *master netting agreement internal models approach permission* which covers the transaction;

then the *firm* must use the *CCR internal model method approach* or the *master netting agreement internal models approach*, as applicable, to calculate the *exposure* value for that transaction unless an exception in ■ BIPRU 13 or ■ BIPRU 5 allows the *firm* to use another method.

[Note: BCD Article 78(2), second sentence, in respect of SFTs]

13.8.3

R

If a *firm* has a *CCR internal model method permission* and a *master netting agreement internal models approach permission*, and both cover a *securities financing transaction*, then the *firm* may choose which of those approaches it wishes to use to calculate the *exposure* value for that transaction.

FCA PRA

13.8.4

R

Where ■ BIPRU 13.8.2 R does not apply, a *firm* must use one of the following approaches to determine the *exposure* value of a *securities financing transaction*, as appropriate:

FCA PRA

- (1) if the transaction is covered by a master netting agreement which satisfies the requirements for recognition set out in ■ BIPRU 5.6.1 R to ■ BIPRU 5.6.3 R, a *firm* may calculate the *exposure* value under the master netting agreement method set out in ■ BIPRU 5.6.5 R to ■ BIPRU 5.6.11 R (Calculation of the fully adjusted exposure value: the supervisory volatility

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adjustments approach and the own estimates of volatility adjustments approach);

- (2) otherwise, a *firm* must calculate the *exposure* value of the transaction as its on-balance sheet value.

13.8.5

FCA PRA

G

A *firm* calculating *risk weighted exposure amounts* under the *standardised approach* to credit risk will not be eligible to use the approach in ■ BIPRU 13.8.4 R (1) if it is using the *financial collateral simple method* to determine the effects of *credit risk mitigation*, as set out in ■ BIPRU 5.4.16 R.

13.8.6

FCA PRA

G

If a *firm* calculates the *exposure* value of a *securities financing transaction* as its on-balance sheet value, in accordance with ■ BIPRU 13.8.4 R (2), it may recognise the effects of financial collateral in the same way as for its other exposures, for example by using either the *financial collateral simple method* or the *financial collateral comprehensive method*. However *firms* should note that the *financial collateral simple method* is not available:

- (1) to a *firm* using the *IRB approach* (■ BIPRU 5.4.16 R); or
- (2) for *securities financing transactions* in the *trading book* (■ BIPRU 14.2.11 R).

## Exposure to a central counterparty

13.8.7

FCA PRA

R

Notwithstanding ■ BIPRU 13.8.2 R, a *firm* must determine the *exposure* value of a credit risk *exposure* outstanding with a *central counterparty* in accordance with ■ BIPRU 13.8.8 R, provided that the *central counterparty's counterparty credit risk exposures* with all participants in its arrangements are fully collateralised on a daily basis.

[Note: BCD Article 78(4) in respect of SFTs]

13.8.8

FCA PRA

R

A *firm* may attribute an *exposure* value of zero for CCR to a *securities financing transaction* or to any other *exposures* in respect of that transaction (but excluding an *exposure* arising from collateral held to mitigate losses in the event of the default of other participants in the *central counterparty's* arrangements) which is outstanding with a *central counterparty* and has not been rejected by the *central counterparty*.

[Note: BCD Annex III Part 2 point 6 in respect of SFTs]

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							Interest rate risk hedging sets					FX risk hedging sets		Equity risk
i	Transaction type			Effective notional	Modified duration	CMV	USD non-gov M<1	USD non-gov M>5	EUR non-gov M<1	EUR non-gov M>5	JPY non-gov M>5	EURUSD	JPYUSD	DAX
			\$ million	years	\$ million	effective notional x modified	effective notional x modified duration	effective notional (+ = long, - = short)	effective notional (+ = long, - = short)	effective notional (+ = long, - = short)				
1	USD	IR swap	receiver leg	80	8	-6		640						
1	USD	IR swap	payer leg	80	-0.25		-20							
2	USD	IR swap	receiver leg	300	0.125		37.5							
2	USD	IR swap	payer leg	300	-6	2	-1800							
3	EUR	FX swap	receiver leg	100	15	0			1500		100			
3	USD	FX swap	payer leg	100	-0.125		-12.5							
4	EUR	cross ccy swap	receiver leg	60	7	1			420		60			
4	JPY	cross ccy swap	payer leg	60	-7					-420		-60		
5	DAX	Total return swap in EUR	receiver leg	150	0.125	4			18.75		150			
5	DAX	Total return swap in EUR	payer leg	150	not applicable								-150	
Sum of risk positions RPTij by hedging setj							5	-1160	18.75	1920	-420	310	-60	-150
Absolute amount  sum of RPTij  of risk positions by hedging setj							5	1160	18.75	1920	420	310	60	150
Credit conversion factors CCFj by hedging setj							0.20%	0.20%	0.20%	0.20%	0.20%	2.50%	2.50%	7%

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	Interest rate risk hedging sets			FX risk hedging sets	Equity risk			
CCF <sub>j</sub> x  sum of RPT <sub>ij</sub>  : CCF-weighted absolute amounts of risk positions by hedging set	0.0100	2.3200	0.0375	3.8400	0.8400	7.7500	1.5000	105000
Sum of (CCF <sub>j</sub> x  sum of RPT <sub>ij</sub>  )								26.7975
CMV: sum of <i>current market values</i> CMV <sub>i</sub> of the transactions								1.000
Max(CMV, sum of (CCF <sub>j</sub> x  sum of RPT <sub>ij</sub>  ))								26.7975
Beta:								1.4000
EAD								37.5165

## Chapter 14

# Capital requirements for settlement and counterparty risk



## 14.1 Application and purpose

### Application

14.1.1

FCA PRA

R

■ BIPRU 14 applies to a *BIPRU firm*.

14.1.2

FCA PRA

G

- (1) ■ BIPRU 14.2 deals with the calculation of the capital requirement for *CCR* for *trading book* positions arising from *financial derivative instruments*, *securities financing transactions* and *long settlement transactions*. The approaches used to calculate *exposure* values and *risk weighted exposure amounts* for these positions are largely based on the approaches applicable to *non-trading book* positions ( ■ BIPRU 3, ■ BIPRU 4, ■ BIPRU 5 and ■ BIPRU 13). However, there are some treatments that are specific to the *trading book*. These are set out in ■ BIPRU 14.2.
- (2) The calculation of the capital requirement for *CCR* for *trading book* positions is the first element of the *counterparty risk capital component* in ■ BIPRU 14.2.1 R. The second element of the *counterparty risk capital component* is for unsettled transactions in both the *trading book* and the *non-trading book*. It is calculated under ■ BIPRU 14.3.
- (3) ■ BIPRU 14.4 sets out the treatment for *free deliveries*.

### Purpose

14.1.3

FCA PRA

G

■ BIPRU 14 implements:

- (1) Article 3(1)(h), Article 17(1), and Article 40; and
- (2) Annex II;

of the *Capital Adequacy Directive*.



## 14.2 Calculation of the capital requirement for CCR

### Calculation of the counterparty risk capital component

14.2.1

FCA PRA

R

A *firm* must calculate the *counterparty risk capital component* as the sum of:

- (1) the capital requirement calculated under ■ BIPRU 14.2.13 R; and
- (2) the amount calculated under ■ BIPRU 14.3.

14.2.2

FCA PRA

R

A *firm* must hold capital calculated in accordance with ■ BIPRU 14.2.13 R against the CCR arising from *exposures* arising in the *trading book* due to the following:

- (1) *free deliveries* (where ■ BIPRU 14.4 requires it to be treated as an *exposure*);
- (2) *financial derivative instruments* and credit derivatives;
- (3) *repurchase agreements, reverse repurchase agreements, securities or commodities lending or borrowing transaction* based on *securities or commodities* included in the *trading book*;
- (4) *margin lending transactions* based on *securities or commodities*; and
- (5) *long settlement transactions*.

[Note: CAD Annex II point 5]

### Credit derivatives

14.2.3

FCA PRA

R

For the purposes of the calculation of the *counterparty risk capital component*, a *financial derivative instrument* means:

- (1) an item falling within ■ BIPRU 13.3.3 R other than an item to which an *exposure* value of zero is attributed under ■ BIPRU 13.3.13 R or ■ BIPRU 13.8.8 R (Exposure to a central counterparty); and

(2) a credit derivative.

[Note: CAD Article 3(1)(h) and Annex II point 7 first sentence]

14.2.4  
FCA PRA

**R** ■ BIPRU 14.2.5 R to ■ BIPRU 14.2.8 R apply for the purposes of ■ BIPRU 13.4 (CCR mark to market method).

14.2.5  
FCA PRA

**R** In the case of total return swap credit derivatives and credit default swap credit derivatives, a *firm* must obtain a figure for potential future credit *exposure* by multiplying the nominal amount of the instrument by the following percentages:

- (1) 5% where the reference obligation is one that if it gave rise to a direct *exposure* of the *firm* would be a *qualifying debt security* for the purposes of ■ BIPRU 7.2;
- (2) 10 % where the reference obligation is one that if it gave rise to a direct *exposure* of the *firm* would not be a *qualifying debt security* for the purposes of ■ BIPRU 7.2.

[Note: CAD Annex II point 7 (part)]

14.2.6  
FCA PRA

**R** In the case of a credit default swap, a *firm* the *exposure* of which arising from the swap represents a long position in the underlying may use a figure of 0% for potential future credit *exposure*, unless the credit default swap is subject to closeout upon the insolvency of the entity the *exposure* of which arising from the swap represents a short position in the underlying, even though the underlying has not defaulted, in which case the potential for future credit *exposure* of the *firm* must be limited to the amount of premia which are not yet paid by the entity to the *firm*.

[Note: CAD Annex II point 7]

14.2.7  
FCA PRA

**G** ■ BIPRU 14.2.6 R permits the seller of credit protection to determine potential future credit *exposure* as 0%, unless the protection is subject to close-out on the insolvency of the buyer.

14.2.8  
FCA PRA

**R** Where the credit derivative provides protection in relation to 'nth to default' amongst a number of underlying obligations, a *firm* must apply the percentage figure in ■ BIPRU 14.2.5 R applicable to the obligation with the nth lowest credit quality determined by whether it is one that if incurred by the *firm* would be a *qualifying debt security* for the purposes of ■ BIPRU 7.2.

14.2.9  
FCA PRA

**G** The operation of ■ BIPRU 14.2.8 R can be illustrated by an example as follows: where the credit derivative is a first to default transaction, the appropriate percentage for the potential future credit *exposure* will be determined by the lowest credit quality of the underlying obligations in the basket. If there are non-qualifying items in the basket, the percentage applicable to the non-qualifying reference obligation should be used. For second and subsequent to default transactions, underlying assets should continue

to be allocated according to credit quality: i.e. for a second to default transaction, the applicable percentage figure is the percentage applicable to the second lowest credit quality.

14.2.10

FCA PRA

R

Where a credit derivative included in the *trading book* forms part of an internal hedge and the credit protection is recognised under the *BCD*, there is deemed to be no counterparty risk arising from the position in the credit derivative. Alternatively, a *firm* may consistently include for the purposes of calculating *capital requirements* for *counterparty credit risk* all credit derivatives included in the *trading book* forming part of internal hedges or purchased as protection against *CCR exposure* where the credit protection is recognised under the *BCD*.

[Note: CAD Annex II point 11]

### Calculation

14.2.11

FCA PRA

R

Subject to ■ BIPRU 14.2.3 R to ■ BIPRU 14.2.5 R and ■ BIPRU 14.2.14 R to ■ BIPRU 14.2.17 R, a *firm* must calculate *exposure* values and *risk weighted exposure amounts* for the *exposures* falling under ■ BIPRU 14.2.2 R (1) to ■ BIPRU 14.2.2R (5) in accordance with:

- (1) the *standardised approach* to credit risk; or
- (2) if the *firm* has an *IRB permission*, the *IRB approach* in accordance with the terms of the *firm's IRB permission*.

[Note: CAD Annex II point 6]

14.2.12

FCA PRA

G

For the purpose of calculating counterparty *exposure* values for *financial derivative instruments*, *securities financing transactions* and *long settlement transactions*, or for *credit risk mitigation*, the effect of ■ BIPRU 14.2.11 R is to direct a *firm* to ■ BIPRU 13 or ■ BIPRU 5 as appropriate.

14.2.13

FCA PRA

R

A *firm* must calculate the capital requirement for the purposes of ■ BIPRU 14.2.2 R as 8% of the total *risk weighted exposure amounts*.

[Note: CAD Annex II point 12]

### Collateral

14.2.14

FCA PRA

R

For the purposes of ■ BIPRU 14.2.11 R, in calculating *risk weighted exposure amounts* a *firm* must not use the *financial collateral simple method* for the recognition of the effects of financial collateral.

[Note: CAD Annex II point 8]

14.2.15

FCA PRA

R

For the purposes of ■ BIPRU 14.2.11 R:

- (1) in the case of *repurchase transactions* and *securities or commodities lending or borrowing transactions* booked in the

*trading book*, all *CRD financial instruments* and *commodities* that are eligible to be included in the *trading book* may be recognised as eligible collateral;

- (2) for *exposures* due to *financial derivative instruments* and *long settlement transactions* booked in the *trading book*, *commodities* that are eligible to be included in the *trading book* may also be recognised as eligible collateral;
- (3) for the purposes of calculating volatility adjustments where such *CAD financial instruments* or *commodities* which are not eligible under ■ BIPRU 5 and ■ BIPRU 4.10 are lent, sold or provided, or borrowed, purchased or received by way of collateral or otherwise under such a transaction, and the *firm* is using the *supervisory volatility adjustments approach*, such instruments and *commodities* must be treated in the same way as non-main index equities listed on a *recognised investment exchange* or a *designated investment exchange*.

[Note: CAD Annex II point 9 (part)]

14.2.16 FCA PRA R

- (1) Where a *firm* is using the *own estimates of volatility adjustments approach* in respect of *CAD financial instruments* or *commodities* which are not eligible under ■ BIPRU 5 and ■ BIPRU 4.10 it must calculate volatility adjustments for each individual item.
- (2) Where a *firm* is using the *master netting agreement internal models approach* set out in ■ BIPRU 5, it may also apply this approach in the *trading book*.

[Note: CAD Annex II point 9 (part) ]

14.2.17 FCA PRA R

For the purposes of ■ BIPRU 14.2.11 R, in relation to the recognition of master netting agreements covering *repurchase transactions* and/or *securities or commodities lending or borrowing transactions* and/or other *capital market-driven transactions* netting across positions in the *trading book* and the *non-trading book* may only be recognised when the netted transactions fulfil the following conditions:

- (1) all transactions are marked to market daily;
- (2) any items borrowed, purchased or received under the transactions may be recognised as eligible financial collateral under ■ BIPRU 5 and ■ BIPRU 4.10 without the application of ■ BIPRU 14.2.14 R to ■ BIPRU 14.2.15 R.

[Note: CAD Annex II point 9 (part)]

14.2.18

FCA PRA

**R**

**Treatment of expected loss amounts under the IRB approach**

Where a *firm* calculates *risk weighted exposure amounts* for the purposes of ■ BIPRU 14 in accordance with the *IRB approach*, then for the purposes of the calculation provided for in ■ BIPRU 4.3.8 R, the following will apply:

- (1) value adjustments made to take account of the credit quality of the counterparty may be included in the sum of value adjustments and provisions made for the *exposures* indicated in ■ BIPRU 14; and
- (2) unless the *firm's IRB permission* does not permit it, if the credit risk of the counterparty is adequately taken into account in the valuation of a position included in the *trading book* the *expected loss* amount for the counterparty risk *exposure* must be zero.

[Note: CAD Article 17(1)]

14.2.19

**R**

[deleted]

**Exposures to recognised third-country investment firms, recognised clearing houses and designated investment exchanges**

14.2.20

FCA PRA

**R**

For the purposes of the calculation of the *counterparty risk capital component*, without prejudice to ■ BIPRU 13.3.13 R and ■ BIPRU 13.8.8 R (Exposure to a central counterparty) *exposures to recognised third-country investment firms* and *exposures* incurred to *recognised clearing houses* and *designated investment exchanges* must be treated as exposures to *institutions*.

[Note: CAD Article 40]

**Netting of trading book exposures against non-trading book exposures**

14.2.21

FCA PRA

**R**

For the purposes of *counterparty credit risk*, a *firm* may net *exposures* arising from items in the *trading book* against *exposures* arising from items in the *non-trading book*.

14.2.22

FCA PRA

**R**

Where a *firm* carries out netting under ■ BIPRU 14.2.21 R, it must allocate the net *exposure* to:

- (1) the *trading book* for the purposes of the calculation under ■ BIPRU 14.2.11 R, if the gross *trading book exposures* exceed gross *non-trading book exposures*; and
- (2) the *non-trading book* for the purposes of ■ BIPRU 13, if the gross *non-trading book exposures* exceed gross *trading book exposures*.

14.2.23

FCA PRA

**R**

A *firm* may only net *exposures* under ■ BIPRU 14.2.21 R if it continues to meet other *GENPRU* and *BIPRU* requirements applicable to the *trading book* or *non-trading book* in respect of those *exposures*.

14.2.24

FCA PRA

G

For example, in relation to ■ BIPRU 14.2.23 R, collateral which is eligible only against *trading book exposures* will not be applicable against *non-trading book exposures*; and the large *exposures* limits on *non-trading book* positions will also remain applicable.



## 14.3 Unsettled transactions

### Scope

14.3.1

**R**

**FCA PRA**

■ BIPRU 14.3 applies in respect of items in the *trading book* and the *non-trading book*.

14.3.2

**G**

**FCA PRA**

The capital requirement for unsettled transactions is an element of the *counterparty risk capital component* set out in ■ BIPRU 14.2.1 R.

### Calculation

14.3.3

**R**

**FCA PRA**

In the case of transactions in which debt instruments, equities, *foreign currencies* and *commodities* (excluding *repurchase agreements* and *reverse repurchase agreements* and *securities or commodities lending* and *securities or commodities borrowing*) are unsettled after their due delivery dates, a *firm* must calculate the price difference to which it is exposed, being the difference between the agreed settlement price for the debt instrument, equity, *foreign currency* or *commodity* in question and its *current market value*, where the difference could involve a loss for the *firm*.

[Note: CAD Annex II point 1 (part)]

14.3.4

**R**

**FCA PRA**

A *firm* must multiply the price difference calculated under ■ BIPRU 14.3.3 R by the appropriate factor in column A of the Table in ■ BIPRU 14.3.4 R in order to calculate its capital requirement for the purposes of ■ BIPRU 14.3.

[Note: CAD Annex II point 1 (part)]

### Table: Factors for the multiplication of price differences

14.3.5

**R**

**FCA PRA**

This table belongs to ■ BIPRU 14.3.4 R

Number of working days after due settlement date	Column A (%)
5 - 15	8
16 - 30	50
31 - 45	75
46 or more	100

[Note: CAD Annex II Table 1]

14.3.5

FCA PRA

G

In cases of a system wide failure of a settlement or clearing system, a *firm* should refer to the emergency provisions in ■ GEN 1.3. Where the requirements of ■ GEN 1.3.2 R are met, until the situation is rectified failure of a counterparty to settle a trade will not be deemed a default for purposes of credit risk.

[Note: CAD Annex II point 4]



## 14.4 Free deliveries

### Scope

14.4.1

**R**

FCA PRA

■ BIPRU 14.4 applies in respect of items in the *trading book* and the *non-trading book*.

14.4.2

**R**

FCA PRA

A *firm* must hold *capital resources* with respect to a *free delivery*, as set out in the Table in ■ BIPRU 14.4.3 R, if:

- (1) it has paid for *securities, foreign currencies* or *commodities* before receiving them or it has delivered *securities foreign currencies* or *commodities* before receiving payment for them; and
- (2) in the case of cross-border transactions, one day or more has elapsed since it made that payment or delivery.

[Note: CAD Annex II point 2]

### Exposure

14.4.3

**R**

FCA PRA

Table: Capital treatment for free deliveries

This table belongs to ■ BIPRU 14.4.2 R.

Transaction Type	Up to first contractual <i>payment leg</i> or <i>delivery leg</i>	From first contractual <i>payment leg</i> or <i>delivery leg</i> up to four days after second contractual <i>payment leg</i> or <i>delivery leg</i>	From 5 business days post second contractual <i>payment leg</i> or <i>delivery leg</i> until extinction of the transaction
<i>Free delivery</i>	No capital charge in the <i>trading book</i>	Treat as an <i>exposure</i>	Deduct value transferred plus current positive <i>exposure</i> from <i>capital resources</i>

[Note: CAD Annex II Table 2]

14.4.4  
FCA PRA

**R**

- (1) In the case of the *non-trading book*, a *firm* must treat an *exposure* falling into columns 2 and 3 of the table in ■ BIPRU 14.4.3 R in accordance with the relevant provisions of the *standardised approach* to credit risk or the *IRB approach*, as the case may be.
- (2) In the case of the *trading book*, a *firm* must apply the treatment set out in ■ BIPRU 14.4.5 R.

[Note: CAD Annex II point 3 (part)]

14.4.5  
FCA PRA

**R**

- (1) In applying a *risk weight* to *free delivery exposures* treated according to column 3 of the table in ■ BIPRU 14.4.3 R, a *firm* using the *IRB approach* may assign *PD* to *counterparties*, for which they have no other *non-trading book exposure*, on the basis of the counterparty's external rating.
- (2) A *firm* using own estimates of *LGDs* may apply the *LGD* set out in ■ BIPRU 4.4.34 R to ■ BIPRU 4.4.35 R ■ BIPRU 4.4.35 R (IRB foundation approach: *LGDs*) to *free delivery exposures* treated according to column 3 of the table in ■ BIPRU 14.4.3 R, provided that it applies it to all such *exposures*.
- (3) Alternatively, a *firm* using the *IRB approach* may apply the *risk weights*, as set out in the *standardised approach* to credit risk provided that it applies them to all such *exposures* or may apply a 100% *risk weight* to all such *exposures*.

[Note: CAD Annex II point 3 (part)]

14.4.6  
FCA PRA

**R**

If the amount of positive *exposure* resulting from *free delivery* transactions is not material, a *firm* may apply a *risk weight* of 100% to these *exposures*.

14.4.7  
FCA PRA

**G**

In cases of a system wide failure of a settlement or clearing system, a *firm* should refer to the emergency provisions in ■ GEN 1.3. Where the requirements of ■ GEN 1.3.2 R are met, until the situation is rectified failure of a counterparty to settle a trade will not be deemed a default for purposes of credit risk.

[Note: CAD Annex II point 4]

# Prudential sourcebook for Banks, Building Societies and Investment Firms

## BIPRU TP 1 Applicable chapter of IPRU and other general provisions

FCA PRA

TP 1		Applicable chapter of IPRU and other general provisions
		Application
1.1	R	<p>BIPRU TP 1 applies to:</p> <ol style="list-style-type: none"> <li>(1) a <i>BIPRU firm</i>; and</li> <li>(2) any <i>firm</i> to which BIPRU 8 (Group risk - consolidation) applies.</li> </ol> <p>Version of IPRU to be used</p>
1.2	R	<p>Any reference in <i>BIPRU TP</i> to <i>IPRU</i> is to the version in force on 31 December 2006.</p> <p>Categorisation of BIPRU investment firms</p>
1.3	R	<p>For the purposes of <i>BIPRU TP</i> the definitions of <i>securities and futures firm</i>, <i>investment management firm</i> and <i>personal investment firm</i> are amended as follows:</p> <ol style="list-style-type: none"> <li>(1) if a <i>firm</i> fell into one of those categories on 31 December 2006 it remains in that category unless changed under (2);</li> <li>(2) if a <i>firm</i> has got a <i>permission</i> that includes a <i>requirement</i> that it comply with the provisions of <i>BIPRU TP</i> applicable to one of those categories, that <i>firm</i> falls into that category; and</li> <li>(3) a <i>BIPRU investment firm</i> that is not an <i>investment management firm</i>, <i>UCITS investment firm</i> or a <i>personal investment firm</i> is a <i>securities and futures firm</i>.</li> </ol> <p>Applicable part of IPRU on a solo basis</p>
1.4	R	<ol style="list-style-type: none"> <li>(1) This <i>rule</i> identifies which part of <i>IPRU</i> applies where <i>BIPRU TP</i> applies <i>IPRU</i> to a <i>firm</i> on a solo basis.</li> <li>(2) <i>IPRU(BANK)</i> applies to a <i>bank</i>.</li> </ol>

		(3)	<i>IPRU(BSOC)</i> applies to a <i>building society</i> .
		(4)	<i>IPRU(INV)</i> applies to a <i>BIPRU investment firm</i> as follows:
		(a)	Chapter 5 applies to an <i>investment management firm</i> ;
		(b)	Chapter 7 applies to a <i>UCITS investment firm</i> ;
		(c)	Chapter 10 applies to a <i>securities and futures firm</i> ; and
		(d)	Chapter 13 applies to a <i>personal investment firm</i> .
		General provisions about consolidation	
1.5	R	Each provision of <i>BIPRU TP</i> that applies on a solo basis also applies for the purposes of BIPRU 8 (Group risk - consolidation). This is subject to the provisions of <i>BIPRU TP</i> concerned.	
1.6	G	Many sections of <i>BIPRU TP</i> deal specifically with when and how they apply on a consolidated basis. However <i>BIPRU TP</i> will still apply for consolidation purposes even where this is not the case. <i>BIPRU TP</i> 1.5R does not apply to <i>BIPRU TP</i> 2.1 (Solo consolidation) as solo consolidation is a concept that only applies to solo requirements.	
		Classification of groups for certain consolidation rules	
1.7	R	(1)	This <i>rule</i> sets out how to classify a <i>UK consolidation group</i> or <i>non-EEA sub-group</i> ("group") to which consolidated requirements are applied under certain parts of <i>BIPRU TP</i> .
		(2)	If the answer to the question at stage 1 of 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) with respect to the group is Yes and there is a <i>building society</i> in the group, the group is referred to in <i>BIPRU TP</i> as a building society group.

- (3) If a *non-EEA sub-group* is part of a *UK consolidation group* that is a building society group then the *non-EEA sub-group* is also a building society group. However a *firm* may use (2) for the purposes of calculating the consolidated capital resources of the *non-EEA sub-group* where capital resources are calculated under *IPRU*.
- (4) If the answer to the question at stage 1 of the decision tree in BIPRU 8 Annex 2R with respect to the group is Yes and the group is not a building society group, the group is referred to in *BIPRU TP* as a banking group.
- (5) In any other case the group is referred to in *BIPRU TP* as an investment services group.



## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 2 Capital floors for a firm using the IRB or AMA approaches

FCA PRA

			<b>Application</b>
2.1	R		Subject to <i>BIPRU</i> TP 2.2R, this section applies to a <i>BIPRU</i> firm that applies the <i>IRB approach</i> or the <i>advanced measurement approach</i> .
2.2	R		<i>BIPRU</i> TP 2.30R to <i>BIPRU</i> TP 2.34G apply to any firm to which <i>BIPRU</i> 8 (Group risk - consolidation) applies and which applies the <i>IRB approach</i> or the <i>advanced measurement approach</i> on a consolidated basis.
			<b>Purpose</b>
2.3	G		This section in part implements Articles 152(1) - (7) of the <i>Banking Consolidation Directive</i> and Article 43 of the <i>Capital Adequacy Directive</i> .
2.4	G		The purpose of this section is to limit the amount of capital reduction arising from the implementation of the <i>Banking Consolidation Directive</i> and the <i>Capital Adequacy Directive</i> compared with the requirements arising from the previous versions of those Directives. As such it is effectively a comparison of the capital resource requirements arising from <i>BIPRU</i> with those arising from the appropriate <i>IPRU</i> sourcebook that would have applied as at 31 December 2006. However the effect of changes to the market risk requirements is removed by requiring <i>BIPRU</i> 7 (Market risk) to be used for both sides of the comparison.
			<b>How to apply the capital floors</b>
2.5	G		This section does not require a firm to continue to have capital resources equal to a fixed percentage of the capital requirement that applied to it as at 31 December 2006. Instead a firm should apply the requirements in this section to its business as it

2.6	G	<p>changes over time. So for example if a <i>firm</i> is calculating its capital requirements as at 31 December 2008 it will have two calculations. The first is carried out under <i>BIPRU</i> and <i>GENPRU</i>. The second is carried out under <i>IPRU</i> and this section. Both sets of requirements are applied to the <i>firm's</i> figures as at 31 December 2008.</p> <p>The Directive provisions on which this section is based are written as a floor on a <i>firm's</i> capital resources requirement. This section however is written as a second capital resources requirement that sits beside the general capital resources requirements of <i>BIPRU</i> and <i>GENPRU</i>. The reason for this is that a <i>firm</i> should meet the general capital resources requirements of <i>BIPRU</i> and <i>GENPRU</i> using <i>capital resources</i> calculated under <i>GENPRU</i> 2.2 (Capital resources). On the other hand a <i>firm</i> should meet the capital resources requirements of this section (which are based on <i>IPRU</i>) using the relevant <i>IPRU</i> definition. In practice the two sets of definitions of capital resources are similar apart from the provisions about <i>expected loss</i>. Therefore as shown by the example in <i>BIPRU</i> TP 2.12G and <i>BIPRU</i> TP 2.13G, in practice a <i>firm</i> is subject to a single capital resources requirement.</p>
2.7	G	<p><i>BIPRU</i> TP 9 explains how the general principle in this section is applied to a <i>personal investment firm</i>.</p>
2.8	R	<p><b>Capital floors: solo</b></p> <p>A <i>firm</i> calculating <i>risk weighted exposure amounts</i> in accordance with the <i>IRB approach</i> must during the following twelve-month periods after 31 December 2006 provide capital resources that equal or exceed the following amounts:</p> <ol style="list-style-type: none"> <li data-bbox="772 1653 1347 1720">(1) for the first twelve-month period, 95%;</li> <li data-bbox="772 1742 1378 1809">(2) for the second twelve-month period, 90%; and</li> <li data-bbox="772 1832 1362 1944">(3) for the third and each subsequent twelve-month period, 80%;</li> </ol> <p>of the solo capital resources requirement that applies to the <i>firm</i> under whichever part of <i>IPRU</i> applies under <i>BIPRU</i> TP 1.4R.</p>

2.9	R	<p>A <i>firm</i> using the <i>advanced measurement approach</i> 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 <i>BIPRU</i> TP 2.8R(2) and <i>BIPRU</i> TP 2.8R(3).</p> <p><b>Capital resources: solo</b></p>
2.10	R	<p>A <i>firm</i> must calculate its capital resources in accordance with whichever part of <i>IPRU</i> applies under <i>BIPRU</i> TP 1.4R.</p>
2.11	R	<p>Compliance with the requirements of this section must be on the basis of amounts of capital resources fully adjusted to reflect differences in the calculation of capital resources under <i>IPRU</i> and the calculation of <i>capital resources</i> under <i>GENPRU</i> and <i>BIPRU</i> deriving from the separate treatments of <i>expected loss</i> and <i>unexpected loss</i> under the <i>IRB approach</i>.</p> <p><b>Waiver from IPRU capital resources requirement</b></p>
2.11A	G	<p>Article 152(5d) and (5e) of the <i>Banking Consolidation Directive</i> allows the <i>appropriate regulator</i> to waive the capital floor calculation based on the <i>IPRU</i> capital resources requirement in <i>BIPRU</i> TP 2.8R(3), or <i>BIPRU</i> TP 2.8R(3) as applied in <i>BIPRU</i> TP 2.9R, on a case-by-case basis only if a <i>firm</i> started to use the <i>IRB approach</i> or the <i>advanced measurement approach</i> on or after 1 January 2010. The <i>appropriate regulator</i> will consider an application for such a <i>waiver</i> in the light of the criteria in section 138A of the <i>Act</i> (Modification or waiver of rules).</p>
2.11B	R	<p>If a <i>firm</i> has a <i>waiver</i> referred to in <i>BIPRU</i> TP 2.11AG, it must provide <i>capital resources</i> that equal or exceed 80% of the <i>capital resources requirement</i> that the <i>firm</i> would be required to provide under the relevant sections of <i>BIPRU</i> applicable to it immediately before it started to use the <i>IRB approach</i> or the <i>advanced measurement approach</i> as those sections were in force on 31 December 2010.</p> <p><b>Explanation of the calculation</b></p>
2.12	G	<p>The following provides an illustrative example of the application of this section to a <i>bank</i> in a period in which <i>BIPRU</i> TP 2.8R(1) applies (i.e. the 95% requirement). Say that under <i>IPRU</i>(<i>BANK</i>) the</p>

2.13	G	<p><i>firm's</i> 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.</p> <p>Say that in the absence of this section, the Pillar 1 capital resources requirement of the <i>firm</i> in BIPRU TP 2.12G would be £6.4m, and the sum of value adjustments and provisions are £0.25mn less than <i>expected losses</i>. For the purposes of the <i>expected loss</i> calculation, if the result is negative (i.e. value adjustments and provisions are less than <i>expected losses</i>) that amount is deducted from <i>capital resources</i> (which is equivalent to an increase in the <i>capital resources requirement</i>). If the result is positive it is added to <i>capital resources</i> (which is equivalent to a decrease in the <i>capital resources requirement</i>). 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 <i>firm</i> is subject to the (higher) IPRU requirement. If the sum of the BIPRU requirements had been greater than £7.125mn, then the <i>firm</i> would not have been subject to the capital resources requirement in this section.</p> <p><b>Adjustments to the calculation of capital resources</b></p>
2.14	R	<p>A <i>firm</i> may treat any <i>capital instrument</i> that complies with the requirements of GENPRU 2.2 (Capital resources) as complying with the corresponding requirements of IPRU.</p>
2.15	G	<p>An example of BIPRU TP 2.14R is that a <i>firm</i> may treat subordinated debt with a term of five years or over that qualifies as <i>lower tier two capital</i> for the purposes of GENPRU as complying with the corresponding provisions for five year subordinated debt under IPRU.</p> <p><b>Market risk</b></p>
2.16	R	<p>A <i>firm</i> must substitute the requirements in BIPRU for the calculation of the <i>market risk capital requirement</i> (excluding those provisions to the ex-</p>

2.17	G	<p>tent that they would involve using the <i>IRB approach</i>) for the corresponding provisions of <i>IPRU</i>.</p> <p>BIPRU TP 4 to BIPRU TP 9 (Pre CRD capital requirements applying on a solo basis during 2007) explain which parts of <i>IPRU</i> correspond to the <i>market risk capital requirement</i>.</p>
2.18	R	<p><b>CAD 1 model and VaR model</b></p> <p>If a <i>firm</i> has a <i>CAD 1 permission</i> or a <i>VaR model permission</i> it must also use it for the purposes of the capital floor calculations in this section.</p>
2.19	G	<p>In applying BIPRU TP 2.18R, a <i>firm</i> should not adjust the <i>CAD 1 permission approach</i> or <i>VaR model approach</i> (including the scope of the <i>CAD 1 permission</i> or <i>VaR model permission</i>) so that it is consistent with Directive 93/6 (the Capital Adequacy Directive) as it stood on 31 December 2006.</p>
2.20	R	<p><b>Individual capital guidance</b></p> <p>The <i>IPRU</i> capital resources requirement does not include any individual capital ratio notified to a <i>bank</i> under Chapter CO of <i>IPRU(BANK)</i> or any similar notification by the <i>appropriate regulator</i> to any other <i>firm</i>.</p>
2.21	G	<p>Any further capital resource requirements that a <i>firm</i> is required to meet under GENPRU 1.2 (Adequacy of financial resources) (i.e. Pillar 2) should not be taken into account.</p>
2.22	R	<p><b>How to apply IPRU</b></p> <p>If the part of <i>IPRU</i> that applies to a <i>firm</i> applies different calculations to different types of <i>firm</i> the <i>firm</i> 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).</p>
2.23	R	<p>If the part of <i>IPRU</i> that applies to a <i>firm</i> gives the <i>firm</i> a choice between methods of calculating capital resources or capital resources requirements it must exercise that choice consistently with the corresponding choices it makes in calculating <i>capital resources</i> or <i>capital resources requirement</i> under <i>GENPRU</i> and <i>BIPRU</i>.</p>
2.24	G	<p>BIPRU TP 4 to BIPRU TP 9 (Pre CRD capital requirements applying on a solo basis during 2007) explain how concepts in <i>IPRU</i> and <i>GENPRU</i> map onto the ones in <i>IPRU</i>. This will enable a <i>firm</i> to decide</p>

2.25	G	<p>which calculations it should use for the purposes of <i>BIPRU</i> TP 2.22R and <i>BIPRU</i> TP 2.23R.</p> <p>An example of the effect of <i>BIPRU</i> TP 2.22R and <i>BIPRU</i> TP 2.23R is that a <i>securities and futures firm</i> that calculates its <i>capital resources</i> under <i>GENPRU 2 Annex 4 R</i> (Capital resources table for a BIPRU investment firm deducting material holdings) should calculate its capital resources under <i>IPRU</i> using table 10-62(2)A of chapter 10 of <i>IPRU(INV)</i>.</p>
2.26	R	<p>For the purpose of calculating the part of the <i>IPRU</i> capital resources requirement that corresponds to the <i>concentration risk capital component</i> a <i>firm</i> may identify the <i>trading book exposures</i> on which that requirement is based using <i>BIPRU 10</i> (Large exposures requirements) except to the extent that <i>BIPRU 10</i> involves the <i>IRB approach</i>.</p>
2.27	G	<p>The <i>concentration risk capital component</i> is the capital requirement for a <i>firm</i> that chooses to have <i>trading book exposures</i> that exceed the <i>large exposure</i> limits for the <i>non-trading book</i>. In most cases <i>IPRU</i> has a similar capital requirement. The purpose of <i>BIPRU</i> TP 2.26R is to allow a <i>firm</i> to calculate the amount of the excess <i>trading book exposures</i> for which it calculates the additional capital charge using <i>BIPRU 10</i> (Large exposures requirements) in order to avoid having to apply the <i>IPRU</i> large exposure requirements for this purpose only.</p>
2.28	R	<p>The calculations under this section do not take into account the <i>base capital resources requirement</i> or the part of the <i>IPRU</i> solo capital resources requirement that corresponds to the <i>base capital resources requirement</i>.</p> <p><b>Solo consolidation</b></p>
2.29	R	<p>If a <i>firm</i> has a <i>solo consolidation waiver</i> it also applies for the purpose of this section in place of any corresponding provision of <i>IPRU</i>.</p> <p><b>Capital floors: consolidation</b></p>
2.30	R	<p>If a <i>firm</i> calculates <i>risk weighted exposure amounts</i> on a consolidated basis in accordance with the <i>IRB approach</i> or uses the <i>advanced measurement approach</i> on a consolidated basis, <i>BIPRU</i> TP 2.8R to <i>BIPRU</i> TP 2.27G apply on a</p>

2.31	R	consolidated basis in accordance with <i>BIPRU</i> TP 2.30R to <i>BIPRU</i> TP 2.31R.
		A <i>firm</i> must calculate the consolidation requirements under <i>BIPRU</i> TP 2.30R for the group in question (the group in question is specified in <i>BIPRU</i> TP 2.32R) in accordance with the following:
		(1) if the group is a banking group as defined in <i>BIPRU</i> TP 1.7R (Classification of groups for certain consolidation rules), the consolidation provisions of <i>IPRU(BANK)</i> apply;
		(2) if the group is a building society group as defined in <i>BIPRU</i> TP 1.7R, the consolidation provisions of <i>IPRU(BSOC)</i> apply; and
		(3) if the group is an investment firm group as defined in <i>BIPRU</i> TP 1.7R, chapter 14 of <i>IPRU(INV)</i> applies.
2.32	R	The scope of the consolidation under <i>BIPRU</i> TP 2.30R and any exemption from consolidation is determined in accordance with <i>BIPRU</i> 8 (Group risk - consolidation) rather than <i>IPRU</i> . In particular, the following adjustments apply:
		(1) if a <i>firm</i> is a member of a <i>UK consolidation group</i> and applies the <i>IRB approach</i> or the <i>AMA</i> with respect to that <i>UK consolidation group</i> , <i>BIPRU</i> TP 2.30R applies with respect to that <i>UK consolidation group</i> ; and
		(2) if a <i>firm</i> is a member of a <i>non-EEA sub-group</i> and applies the <i>IRB approach</i> or the <i>AMA</i> with respect to that <i>non-EEA</i>

2.33	G	<p>If for example the consolidation <i>rules</i> that apply for the purposes of this section are those in chapter 14 of <i>IPRU(INV)</i> (Consolidated supervision of <i>investment firms</i>) then <i>IPRU(INV)</i> 14.1 (Application) and 14.2 (Scope of consolidation) do not apply. BIPRU 8.2 (Scope and basic consolidation requirements for UK consolidation groups), BIPRU 8.3 (Scope and basic consolidation requirements for non-EEA sub-groups), BIPRU 8.4 (CAD Article 22 groups and investment firm consolidation waiver) and BIPRU 8.5 (Basis of consolidation) apply instead.</p>	<p><i>sub-group, BIPRU TP 2.30R applies with respect to that non-EEA sub-group.</i></p>
2.34	G	<p><b>Capital floors: waiver from consolidation</b></p> <p>If a <i>firm</i> has an <i>investment firm consolidation waiver</i> and it is applying the <i>IRB approach</i> or the <i>AMA</i>, the <i>waiver</i> will explain how the <i>investment firm consolidation waiver</i> applies for the purpose of this section.</p>	

## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 3 Pre CRD capital requirements applying on a solo basis during 2007

		<b>Application</b>
3.1	R	This section applies to a <i>BIPRU firm</i> .
		<b>Purpose</b>
3.2	G	This section (together with BIPRU TP 4 - BIPRU TP 10) implements Articles 152(8) - (14) of the <i>Banking Consolidation Directive</i> and Article 50(1) of the <i>Capital Adequacy Directive</i> .
		<b>Duration of transitional</b>
3.3	R	This section applies until 1 January 2008.
		<b>Continued use of IPRU</b>
3.4	R	Unless a <i>firm</i> notifies the <i>appropriate regulator</i> to the contrary, a <i>firm</i> must use on a solo basis the credit risk <i>rules</i> in whichever part of <i>IPRU</i> applies to it under BIPRU TP 1 rather than the ones in <i>BIPRU</i> .
3.5	R	BIPRU TP 3 sets out, for all types of <i>firm</i> , which parts of <i>GENPRU</i> and <i>BIPRU</i> do and do not apply when BIPRU TP 3 applies.
3.6	G	BIPRU TP 4 - BIPRU TP 9 set out, for each category of <i>BIPRU firm</i> , which sections of the part of <i>IPRU</i> that applies to it do and do not apply during 2007 as follows:
		(1) BIPRU TP 4 applies to a <i>bank</i> ;
		(2) BIPRU TP 5 applies to a <i>building society</i> ;
		(3) BIPRU TP 6 applies to an <i>investment management firm</i> ;

		(4)	BIPRU TP 7 applies to a <i>UCITS investment firm</i> ;
		(5)	BIPRU TP 8 applies to a <i>securities and futures firm</i> ; and
		(6)	BIPRU TP 9 applies to a <i>personal investment firm</i> .
3.7	G		BIPRU TP 10 explains how this section is applied on a consolidated basis.

			<b>Disapplication of GENPRU and BIPRU</b>
3.8	R		Table: Parts of GENPRU and BIPRU that apply in 2007
			This table belongs to <i>BIPRU TP 3.5R</i>

GENPRU and BIPRU provisions		A Y denotes that the provision does apply
		An N denotes that it does not apply

<i>GENPRU</i> TP (Transitional provisions)		Y
GENPRU 1.1 (Application and scope)		Y
GENPRU 1.2 (Adequacy of financial resources)	The <i>overall financial adequacy rule</i>	Y
	GENPRU 1.2 so far as it applies to liquidity risk	Y
	The rest of GENPRU 1.2 for purposes other than liquidity risk	N
GENPRU 1.3 (Valuation)		Y
GENPRU 1.4 (Actions for damages)		Y
GENPRU 1.5 (Application of GENPRU 1 to Lloyd's)		Not applicable as does not apply to <i>BIPRU firms</i>
GENPRU 2.1 (Calculation of capital resources requirements)		Y
GENPRU 2.2 (Capital resources)		Y
GENPRU 2.3 (Application of GENPRU 2 to Lloyd's)		Not applicable as does not apply to <i>BIPRU firms</i>
GENPRU 3.1 (Cross sector groups)		Y

GENPRU and BIPRU provisions		A Y denotes that the provision does apply
		An N denotes that it does not apply
GENPRU 3.2 (Third-country groups)		Y
BIPRU TP (Transitional provisions)		Y
BIPRU 1.1 (Application and scope)		Y
BIPRU 1.2 (Definition of the trading book)		Y
BIPRU 1.3 (Application for advanced approaches)		Y
BIPRU 1.4 (Actions for damages)		Y
BIPRU 2.1 (Solo consolidation)		Y
BIPRU 2.2 (Adequacy of financial resources)		N
BIPRU 2.3 (Interest rate risk in the non-trading book);		N
BIPRU 3 (Standardised approach to credit risk)		N
BIPRU 4 (The IRB approach)		N
BIPRU 5 (Credit risk mitigation)		N
BIPRU 6 (Operational risk)		N
BIPRU 7 (Market risk)	BIPRU 7.2.43 R to BIPRU 7.2.49 R (Interest rate specific risk calculation)	N ( BIPRU TP 4 - BIPRU TP 9 set out what applies in place of these <i>rules</i> )
	BIPRU 7.11.18 R to BIPRU 7.11.58 R (Special treatment of credit default swaps)	N
	Rest of BIPRU 7	Y
BIPRU 8 (Group risk - consolidation)		Y
BIPRU 9 (Securitisation)		N
BIPRU 10 (Concentration risk)	BIPRU 10.5.2 R to BIPRU 10.5.5 R (Capital resources)	Y
	BIPRU 10.5.14 R (Notification of trading book excesses)	Y Only applies if BIPRU TP 4 to BIPRU TP 10 allow excess <i>exposures</i> in the <i>trading book</i> .
	The rest of BIPRU 10	N
(Disclosure) BIPRU 11		N
BIPRU 12		Chapter does not yet exist
BIPRU 13 (Financial derivatives, SFTs and long settlement transactions)		N

## GENPRU and BIPRU provisions

A Y denotes that the provision does apply

An N denotes that it does not apply

BIPRU 14 (Capital requirements for settlement and counterparty risk) N

This table is subject to the adjustments set out in *BIPRU* TP 3.15R to *BIPRU* TP 3.21R when a *firm* also uses the *IRB approach*.

			<b>Application of BIPRU concentration risk rules for underwriting</b>
3.9	G		Even though BIPRU 10 (Concentration risk) does not apply, the provisions in BIPRU 7.8 (Securities underwriting) about the calculation of the <i>net underwriting exposures</i> still apply.
			<b>How to interpret cross-references</b>
3.10	R		If a provision in <i>BIPRU</i> or <i>GENPRU</i> that applies under this section refers to a provision of <i>BIPRU</i> or <i>GENPRU</i> that does not apply that reference must be read as referring to the <i>IPRU</i> provision that applies instead under this section (if any). If a provision in <i>IPRU</i> that applies under this section refers to a provision of <i>IPRU</i> that does not apply that reference must be read as referring to the corresponding provision in <i>BIPRU</i> or <i>GENPRU</i> that applies under this section.
3.11	G		<i>BIPRU</i> TP 4 - <i>BIPRU</i> TP 9 set out, for each category of <i>BIPRU firm</i> , some of the main examples of the sort of cross-references referred to in <i>BIPRU</i> TP 3.10R.
3.12	G		<i>GENPRU</i> 2.2.187 R and <i>GENPRU</i> 2.2.188 R (Upper tier two capital: General/collective provisions) still applies to a <i>firm</i> that uses <i>BIPRU</i> TP 3.4R. The reference to the sum of <i>risk weighted assets</i> under the <i>standardised approach</i> for credit risk should be read as being to the sum of risk-weighted assets under the provisions of <i>IPRU</i> that apply under this section.
			<b>Combination of IPRU with the standardised approach to credit risk</b>
3.13	R		A <i>firm</i> may not combine the <i>standardised approach</i> to credit risk with the use of <i>IPRU</i> under <i>BIPRU</i> TP 3.4R.

3.14	G	<p><b>Effect of switching off</b> GENPRU 1.2</p> <p>If GENPRU 1.2 (Adequacy of financial resources) does not apply to a <i>firm</i>, stress and scenario testing obligations in other parts of the <i>Handbook</i> still apply. In particular these include stress and scenario tests required under the <i>IRB approach</i> (see in particular BIPRU 4.3.39 R to BIPRU 4.3.42 G (Stress tests used in assessment of capital adequacy) and BIPRU 2.2.41 R to BIPRU 2.2.45 G), under the <i>VaR model approach</i> and under BIPRU 10.6.22 R to BIPRU 10.6.27 G (Stress testing of credit risk concentrations).</p> <p><b>Continued use of IPRU combined with the IRB approach</b></p>
3.15	R	<p>BIPRU TP 3.16R to BIPRU TP 3.21R only apply to a <i>firm</i> that is applying the <i>IRB approach</i> as well as using <i>IPRU</i>.</p>
3.16	R	<p>If a <i>firm's IRB permission</i> allows it to do this, a <i>firm</i> may combine the <i>IRB approach</i> with the use of <i>IPRU</i> under BIPRU TP 3.4R.</p>
3.17	G	<p>If an <i>exposure</i> comes within the scope of a <i>firm's IRB permission</i> the <i>firm</i> should use the <i>IRB approach</i> to calculate the <i>credit risk capital component</i> and the <i>counterparty risk capital component</i> with respect to that <i>exposure</i> in accordance with BIPRU rather than <i>IPRU</i>. In particular BIPRU 4 (The <i>IRB approach</i>), BIPRU 5 (Credit risk mitigation), BIPRU 9 (Securitisation), BIPRU 13 (Financial derivatives, SFTs and long settlement transactions) and BIPRU 14 (Capital requirements for settlement and counterparty risk) apply.</p>
3.18	R	<p>If a <i>firm</i> combines the <i>IRB approach</i> with the use of <i>IPRU</i> under BIPRU TP 3.14R, the disapplication of BIPRU 10 (Concentration risk) still applies. However in the case of <i>exposures</i> to which the <i>firm</i> applies the <i>IRB approach</i>:</p> <p>(1) BIPRU 10.6.14 R to BIPRU 10.6.26 R (Exemptions for firms using the financial collateral comprehensive method , Exemptions for firms using own estimates of LGDs and conversion factors under the <i>IRB approach</i></p>

			and Stress testing of credit risk concentrations) apply;
		(2)	a <i>firm</i> may not recognise <i>credit risk mitigation</i> if it does not comply with BIPRU 5 and BIPRU 4.10 (Credit risk mitigation) to the extent they apply to BIPRU 10; and
		(3)	BIPRU 5 and BIPRU 4.10 apply for the purpose of calculating the amount of <i>credit risk mitigation</i> to the extent that they apply to BIPRU 10.
3.19	R		BIPRU 11 (Disclosure) applies to <i>exposures</i> to which the <i>firm</i> applies the <i>IRB approach</i> . The rest of BIPRU 11 also applies except to the extent that it relates to parts of <i>BIPRU</i> and <i>GENPRU</i> that do not apply under this section.
3.20	R		BIPRU 7.11.18 R to BIPRU 7.11.58 R (Special treatment of credit default swaps) apply to <i>exposures</i> subject to the <i>IRB approach</i> .
3.21	R		<b>Reduced operational risk capital requirement</b> Where <i>BIPRU TP 3.4R</i> applies, the <i>operational risk capital requirement</i> is reduced by the percentage representing the ratio of the value of the <i>firm's exposures</i> for which capital requirements are calculated in accordance with <i>BIPRU TP 3.4R</i> to the total value of its <i>exposures</i> .

## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 4 Pre CRD capital requirements applying on a solo basis during 2007: Banks

4.1	R	<p><b>Application</b></p> <p>BIPRU TP 4 applies to a <i>BIPRU firm</i> that is:</p> <ol style="list-style-type: none"> <li>(1) a <i>bank</i>; and</li> <li>(2) applying <i>BIPRU TP 3.4R</i> (Pre CRD capital requirements applying on a solo basis during 2007).</li> </ol>
4.2	G	<p><b>Purpose of this section</b></p> <p>BIPRU TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) says that during 2007 a <i>firm</i> may apply the credit risk requirements of <i>IPRU</i> instead of the ones in <i>BIPRU</i>. For a <i>bank</i> this involves applying the credit risk requirements in <i>IPRU(BANK)</i>. This section explains how this is done. In particular BIPRU TP 4 explains:</p> <ol style="list-style-type: none"> <li>(1) which parts of <i>IPRU(BANK)</i> should be treated as credit risk requirements for this purpose;</li> <li>(2) what parts of <i>IPRU(BANK)</i> apply during 2007 and what changes are made to <i>IPRU(BANK)</i> for that purpose; and</li> <li>(3) what changes are made to <i>GENPRU</i> and <i>BIPRU</i> to reflect the fact that <i>IPRU(BANK)</i> applies in place of parts of <i>GENPRU</i> and <i>BIPRU</i>.</li> </ol>

			<b>Duration of transitional</b>
4.3	R		This section applies until 1 January 2008.
			<b>Drafting approach in this section</b>
4.4	G		The purpose of BIPRU TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) is that the basic provisions of BIPRU and GENPRU should be in force from 1 January 2007. However a <i>firm</i> should be able to calculate the capital requirements for credit risk under IPRU and use the large exposures requirements in IPRU. This means that a <i>bank</i> should slot the credit risk requirements of IPRU(BANK) into the general requirements of GENPRU and BIPRU.
4.5	G		The capital calculation for credit risk under BIPRU is made up of three elements, which are set out in GENPRU 2.1.51 R (Calculation of the credit risk capital requirement). These are the <i>credit risk capital component</i> , the <i>counterparty risk capital component</i> and the <i>concentration risk capital component</i> . So the approach in BIPRU TP 4.4G involves finding equivalents for these three elements in IPRU(BANK).
4.6	G		BIPRU TP 3.8R (Parts of GENPRU and BIPRU that apply in 2007) provides that GENPRU 2.2 (Capital resources) applies during 2007. So a <i>bank</i> using BIPRU TP 3.4R (Pre CRD capital requirements applying on a solo basis during 2007) should calculate its <i>capital resources</i> under GENPRU 2.2, instead of calculating its capital under IPRU(BANK).
			<b>Parts of IPRU(BANK) that apply in 2007: Chapter GN</b>
4.7	R		The parts of Chapter GN of IPRU(BANK) that do and do not apply during the period that BIPRU TP 3.4R applies are as set out in BIPRU TP 4.8R.
4.8	R		Table: Parts of Chapter GN of IPRU(BANK) that apply in 2007  This table belongs to BIPRU TP 4.7R

Provisions of Chapter GN of IPRU(BANK)	A Y denotes that the provision does apply	Remarks
	An N denotes that it does not apply	
GN 3.3.19R to GN 3.3.20G (requirement to have adequate systems and controls for monitoring, controlling and calculating LE)	Y	
GN 3.3.21R to GN 3.3.22G (requirement to notify FSA if breach or propose to breach the 25% limit)	Y	Solo consolidation is dealt with by BIPRU 2.1 (Solo consolidation)
GN 3.4.1R to GN 3.4.2G (requirement to have written policy statement for LE)	Y	
GN 3.4.5R to GN 3.4.6G (requirement to have written provisioning policy statement)	Y	The reference to <i>rule</i> 3.3.17 is replaced by a reference to the requirements in GENPRU 1.3.4 R (General requirements: Accounting principles to be applied)
GN 3.4.9E to GN 3.4.12R (Policy statement procedures)	Y	Applies in relation to large exposures and provisioning policy statements
GN 3.5.1R (Definitions)	Y	Applies for the purpose of the provisions that continue in force under this table
GN 3.6.1 R (Transitional rule for policy statements)	Y	Applies in relation to large exposures and provisioning policy statements
The parts of Chapter GN that remain in force even if the <i>bank</i> is not applying BIPRU TP 3.4R (Pre CRD capital requirements applying on a solo basis during 2007)	Y	See in particular <i>rules</i> 3.4.3 and 3.4.9 (Liquidity policy statement)
Rest of Chapter GN	N	
A <i>bank</i> must calculate its capital for the purposes of the <i>rules</i> in this table about large exposures in accordance with BIPRU 10.5.2 R to BIPRU 10.5.5 R (Capital resources for concentration risk purposes).		
<b>Parts of IPRU(BANK) that apply in 2007</b>		
4.9	G	The parts of IPRU(BANK) that do and do not apply during the peri-

4.10	G	<p>od that <i>BIPRU</i> TP 3.4R applies are as set out in <i>BIPRU</i> TP 4.11G. This section does not explain what parts of <i>IPRU(BANK)</i> do and do not apply to an overseas <i>bank</i> as this section only applies to a <i>bank</i> that is a <i>BIPRU firm</i>.</p> <p>The table in <i>BIPRU</i> TP 4.11G assumes that the <i>firm</i> is not applying the <i>IRB approach</i>. <i>BIPRU</i> TP 4.40G to <i>BIPRU</i> TP 4.43G deal with a <i>firm</i> that does apply the <i>IRB approach</i>.</p>
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4.11	G	<p>Table: Parts of <i>IPRU(BANK)</i> that apply in 2007</p> <p>This table belongs to <i>BIPRU</i> TP 4.9G</p>
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Provisions of <i>IPRU(BANK)</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
GN (General)		See the table in <i>BIPRU</i> TP 4.8R
CO (Capital Adequacy Overview)	Sections 1-3 Section 4	Y N
CB (Trading Book/Banking Book Division)	N	
CA (Definition of Capital)	N	
BC (Credit Risk in the Banking Book)	Y	
BO (Proxies for Market Risk in Banking Book)	Y	
FX (Foreign Exchange Risk)	N	
CM (Commodities Risk)	N	
DU (Common Treatments for Counterparty Risk)	Y	

Provisions of <i>IPRU(BANK)</i>	A Y denotes that the provision does apply  An N denotes that it does not apply	Remarks
TI (Interest Rate Position Risk)	N	
TE (Equity Position Risk)	N	
TC (Counterparty Risk in the Trading Book)	Y	
TL (Incremental Capital for Large Exposures)	Y	
TU (Underwriting in Capital Adequacy Framework)	N	
TS (CAD 1 Models)	N	
TV (The Use of Internal Models)	N	
LE (Large Exposures)	Y	
CD (Credit Derivatives)	Y	(1) Applies for the purpose of credit risk (the calculation of the <i>credit risk capital requirement</i> )
		(2) Applies for the purpose of large exposures to the extent set out in the chapter.
		(3) Does not apply for the purpose <i>position</i> risk (calculation of the <i>market risk capital requirement</i> ).
SE (Securitisation and Asset Transfers)	Y	See <i>BIPRU</i> TP 4.17G to <i>BIPRU</i> TP 4.19G
LM (Mismatch Liquidity)	Y	Subject to the other provisions of this section, applies in the same way as it does for a <i>bank</i> that does not use <i>BIPRU</i> TP 3.4R (Pre CRD capital requirements applying on

Provisions of IPRU(BANK)	A Y denotes that the provision does apply An N denotes that it does not apply		Remarks
LS (Sterling Stock Liquidity)	Y		<p>a solo basis during 2007).</p> <p>Subject to the other provisions of this section, applies in the same way as it does for a <i>bank</i> that does not use <i>BIPRU</i> TP 3.4R (Pre CRD capital requirements applying on a solo basis during 2007).</p>
AR (Accounting and Other Records and Internal Control Systems)	N		
ST (Foreign Exchange -Risk-Based Supervision)	N		
FR (Fraud)	N		
CL (Comfort letters)	N		
VA (Valuation)	Section 4	Y	<p>(1) Applies for the purpose of credit risk (the calculation of the <i>credit risk capital requirement</i>)</p> <p>(2) Applies for the purpose of large exposures to the extent set out in the chapter.</p>
	Rest	N	
NE (Collateral and Netting)	Y		<p>(1) Applies for the purpose of credit risk (the calculation of the <i>credit risk capital requirement</i>)</p> <p>(2) Applies for the purpose of large exposures to the extent set out in the chapter.</p>

Provisions of IPRU(BANK)	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
CS (Consolidated Supervision)	Paragraph 2b) of Section 3 Y	(1) Applies to the extent it provides for zero risk weighting for intra-group exposures on a solo basis.  (2) Applies for the purpose of the exemption for certain intra-group exposures for large exposure purposes on a solo basis (see paragraph 7 of section 9.2.2 of chapter LE of IPRU(BANK)).  (3) Otherwise does not apply.
	Appendices C and D (equivalent third country prudential regimes) Y	Only has effect to extent that these apply on a solo basis for the purposes of the parts of IPRU(BANK) that apply under this table. In particular applies for the purposes of IPRU(BANK) BC Section 3 paragraph 6 (f) a) regarding equivalent CAD regimes.
	Rest N	
OS (Outsourcing)	N	
PN (Provisioning Policy Statement)	Y	

**4.12** **G** **General material about the parts of IPRU(BANK) that apply in 2007**

Many of the chapters of IPRU(BANK) that apply under the table in BIPRU TP 4.11G (particularly the application sections) deal with the application of the material on a consolidated basis. However this does not apply for the purpose of this section as consolidation is dealt with under BIPRU TP 10 (Pre CRD capital requirements applying on a con-

		<p>solidated basis during 2007). Likewise those provisions also deal with solo consolidation but this material does not apply either as the provisions about solo consolidation in <i>IPRU(BANK)</i> do not apply for the purpose of this section. Nevertheless it is possible to combine the use of this section with solo consolidation under BIPRU 2.1 (Solo consolidation).</p>
4.13	G	<p><b>Status of material on credit risk charges</b></p> <p>The credit risk provisions of <i>IPRU(BANK)</i> are mostly <i>guidance</i> on rule 3.3.13 of Chapter GN of <i>IPRU(BANK)</i>. That <i>rule</i> does not apply in 2007. When the credit risk provisions of <i>IPRU(BANK)</i> are applied under this section they are <i>guidance</i> on the <i>overall financial adequacy rule</i>. In turn the <i>overall financial adequacy rule</i> is the <i>rule</i> on which the calculation of the capital requirements for credit risk under <i>GENPRU</i> and <i>BIPRU</i> is based for a <i>bank</i> under this section.</p>
4.14	G	<p><b>How to calculate credit risk charges</b></p> <p>A <i>bank</i> should calculate the <i>BIPRU</i> credit risk charge for <i>non-trading book</i> items, called the <i>credit risk capital component</i>, by adding together the following:</p> <ol style="list-style-type: none"> <li>(1) the capital charge calculated under Chapter BC (taking into account the revised risk weights in Chapter BO);</li> <li>(2) the capital charge for OTC derivatives in the banking book under section 3 of Chapter DU;</li> <li>(3) the capital charge for free deliveries for banking book items in section 4 of Chapter DU; and</li> </ol>
4.15	G	<p>A <i>bank</i> should calculate the <i>BIPRU</i> credit risk charge for <i>trading book</i> items, called the <i>counterparty risk capital component</i>, by adding together the following:</p>

			(1)	the capital charge calculated under Chapter TU;
			(2)	the capital charge for OTC derivatives in the trading book under section 3 of Chapter DU;
			(3)	the capital charge for unsettled transactions and free deliveries for trading book items in section 4 of Chapter DU; and
			(4)	the capital charge for unsettled transactions in the banking book calculated under Chapter TU (the calculation of the <i>counterparty risk capital component</i> includes a capital charge for unsettled transactions in the <i>non-trading book</i> as an exception to the principle that the <i>counterparty risk capital component</i> relates to the <i>trading book</i> ).
4.16	G			<i>BIPRU</i> TP 4.28G deals with how to calculate the <i>concentration risk capital component</i> .
4.17	G			<b>Adjustments to securitisation requirements</b> Under Chapter SE a <i>bank</i> should deduct certain credit enhancements from capital. A <i>bank</i> should deduct these credit enhancements at stage M of the calculation in the <i>capital resources table</i> (Deductions from the totals of tier one and two).
4.18	G			Paragraph 6 of section 10.4 of Chapter SE of <i>IPRU(BANK)</i> says that if a <i>bank</i> does not meet the policy on liquidity facilities provided by sponsors or repackagers it should fully consolidate the scheme. This does not apply under this section. Instead a <i>bank</i> should treat the scheme assets as being on its balance sheet.
4.19	G			The definition of investment grade for the purposes of Chapter SE (see in particular sections 3.2.2, 9.3 and 11.1) remains based on Chapter TI of <i>IPRU(BANK)</i> .

			<p><b>Adjustments to counterparty credit risk: General</b></p>
4.20	G		<p>Broadly speaking the Directive transitional provisions that allow pre-2007 credit risk rules to be used in 2007 cover all credit risk rules. However the transitional provisions for <i>trading book</i> credit risk (Annex II of the <i>Capital Adequacy Directive</i>, which is implemented in BIPRU 14 (Capital requirements for settlement and counterparty risk)) is not quite as straightforward as that. In some cases pre-2007 requirements can be used. In others they cannot. One of the purposes of BIPRU TP 4.21G to BIPRU TP 4.25G is to reflect those cases in which the Directive requires the new requirements to apply from 1 January 2007.</p> <p><b>Adjustments to counterparty credit risk: Free deliveries</b></p>
4.21	G		<p>A bank should include <i>foreign currency</i> and <i>commodity</i> transactions in the calculations under IPRU(BANK) Chapter DU section 4.2 (Free deliveries).</p>
4.22	G		<p>A bank should apply the capital treatment in the table in BIPRU 14.4.3 R and BIPRU 14.4.4 R (Capital treatment for free deliveries). But when the capital treatment in that table is that the <i>firm</i> must treat the transaction as an <i>exposure</i>, the bank should apply the treatment in IPRU(BANK) Chapter BC for <i>non-trading book exposures</i> or TC for <i>trading book exposures</i> rather than BIPRU 14 (Capital requirements for settlement and counterparty risk).</p> <p><b>Adjustments to counterparty credit risk: Derivative transactions</b></p>
4.23	G		<p>A bank should treat a credit derivative in the <i>trading book</i> as a derivative to which section 3 of IPRU(BANK) Chapter TC (OTC derivatives) applies. However the capital treatment for credit derivatives as set out in BIPRU 14.2.5 R - BIPRU 14.2.8 R (Capital treatment for credit derivatives) does not apply; a bank should continue to use the treatment in IPRU(BANK) as adjusted by this section.</p> <p><b>Adjustments to counterparty credit risk: Unsettled transactions</b></p>
4.24	G		<p>The alternative treatment set out in IPRU(BANK) DU 4.1.3 does not apply.</p>

4.25	G	<p>A bank should include <i>foreign exchange</i> and <i>commodity</i> transactions in the calculations under <i>IPRU(BANK)</i> Chapter DU section 4.1 (Unsettled transactions).</p> <p><b>OTC derivatives</b></p>
4.26	G	<p>The treatment in section 3 of Chapter DU applies to the derivatives mentioned there whether or not they are off-balance sheet.</p> <p><b>How to use the IPRU(BANK) large exposure rules</b></p>
4.27	G	<p><i>IPRU(BANK)</i> Chapter LE (Large exposures) applies in place of BIPRU 10 (Concentration risk).</p>
4.28	G	<p>A bank should calculate the <i>concentration risk capital component</i> as being equal to the capital charge under <i>IPRU(BANK)</i> Chapter TL.</p>
4.29	G	<p>BIPRU 10.5.2 R to BIPRU 10.5.5 R (Capital resources for concentration risk purposes) apply in place of the corresponding provisions of <i>IPRU(BANK)</i>. The provisions in <i>IPRU(BANK)</i> about the calculation of the large exposures capital base (LECB) do not apply.</p>
4.30	G	<p>Generally a bank should use the specific risk weights that apply under BIPRU 7 (Market risk) for the purposes of the incremental capital calculation under section 2.2 of Chapter TL and the net trading book position under paragraph 2(b) of section 7 of Chapter LE. However <i>BIPRU TP 4.33G</i> also applies for these purposes.</p>
4.31	G	<p>References in paragraph 4(d) of section 9.2.1 and paragraph 7 of section 9.2.2 of Chapter LE to the requirements in Chapter CS about zero-risk weighting intra-group exposures still apply.</p>
4.32	G	<p>When Chapter LE of <i>IPRU(BANK)</i> is applied under this section it is <i>guidance</i> on the <i>overall financial adequacy rule</i> as well as on the relevant provisions of Chapter GN of <i>IPRU(BANK)</i>.</p> <p><b>Interest rate PRR</b></p>
4.33	G	<p>A bank should use <i>IPRU(BANK)</i> as it applies under BIPRU TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) and BIPRU TP 4 to calculate the <i>specific risk</i> portion of the <i>interest rate PRR</i> under BIPRU 7.2 (Interest rate PRR) to the ex-</p>

4.34	G	<p>tent that the relevant <i>rules</i> in BIPRU 7.2 require the use of the <i>standardised approach</i> to credit risk.</p> <p>The reason for BIPRU TP 4.33G is that the calculation of the <i>specific risk</i> portion of the <i>interest rate PRR</i> under BIPRU 7 (Market risk) involves the use of the <i>standardised approach</i> to credit risk. The <i>specific risk rules</i> therefore need to be adjusted for a <i>firm</i> that is not using the <i>standardised approach</i> to credit risk in 2007 so as to apply the pre-2007 method of calculating <i>specific risk</i>.</p>
4.35	G	<p><b>Valuation</b></p> <p>BIPRU TP 3.8R (Parts of GENPRU and BIPRU that apply in 2007) says that GENPRU 1.3 (Valuation) applies during 2007, so the values of assets and off balance sheet items used in the calculation of credit risk charges should be in accordance with GENPRU 1.3.</p>
4.36	G	<p><b>Definitions</b></p> <p>Any reference to a <i>qualifying debt security</i> in a part of BIPRU that applies during 2007 should be interpreted in accordance with IPRU(BANK). However BIPRU 7.2.50 R (Must not apply <i>qualifying debt security</i> treatment to risky assets) also applies.</p>
4.37	G	<p>The reason for BIPRU TP 4.36G is that the BIPRU definitions rely in part on the <i>standardised approach</i> to credit risk. The definitions therefore need to be adjusted for a <i>bank</i> that is not using the <i>standardised approach</i> to credit risk in 2007.</p> <p><b>Mapping GENPRU and BIPRU concepts onto IPRU</b></p>
4.38	G	<p>Some of the parts of IPRU(BANK) that apply in 2007 refer to parts of IPRU that do not apply. BIPRU TP 3.10R explains that where this happens a <i>firm</i> should interpret that cross-reference in accordance with the provision in BIPRU or GENPRU that corresponds to the IPRU provision that does not apply in 2007. A <i>firm</i> should refer to IPRU in the case of cross-references in GENPRU and BIPRU to provisions in GENPRU and BIPRU that do not apply in 2007. BIPRU TP 4.39G sets out how certain concepts in IPRU(BANK) correspond to ones in GENPRU and BIPRU. The purpose of the table is to help <i>firms</i> to interpret such cross-references.</p>

4.39	G	Table: Mapping GENPRU and BIPRU concepts onto ones in <i>IPRU(BANK)</i>
		This table belongs to <i>BIPRU TP 4.38G</i>

<i>GENPRU and BIPRU</i>	<i>IPRU(BANK)</i>
BIPRU 1.2	Chapter CB
GENPRU 2.2	Chapter CA
BIPRU 7.2	Chapter TI
BIPRU 7.3	Chapter TE
BIPRU 7.8	Chapter TU
BIPRU 7.4	Chapter CM
BIPRU 7.5	Chapter FX
BIPRU 7.10	Chapter TV
BIPRU 8	Chapter CS
GENPRU 1.3	Chapter VA
<i>Market risk capital component (excluding charges arising from FX and commodity banking book business) and the counterparty risk capital component, excluding unsettled transactions arising from the banking book.</i>	Trading book capital requirements
<i>Non-trading book</i>	Banking book
<i>Trading book</i>	Trading book
<i>Capital resources</i> calculated under BIPRU 10.5.2 R to BIPRU 10.5.5 R	Large exposures capital base (LECB)
<i>Concentration risk capital component or the capital resources used to meet it</i>	Incremental capital under Chapter TL
<i>Financial derivative instruments and trading book credit derivatives</i>	OTC derivatives
<i>the overall financial adequacy rule</i>	Rule GN 3.3.13R (Adequate capital)
<i>individual capital guidance</i>	individual capital ratio
<i>Bank that calculates its capital requirements under BIPRU 1.2.17R (Firm with small trading book using non-trading book treatments for certain trading book items)</i>	<i>Bank to which the Capital Adequacy Directive does not apply</i>
<i>trading book concentration risk excess</i>	Exposures over the 25% in the trading book under Chapter TL

			<b>Firms using the IRB approach during 2007: General</b>
4.40	G		<i>BIPRU</i> TP 4.41G to <i>BIPRU</i> TP 4.43G only apply to a <i>firm</i> that is applying the <i>IRB approach</i> under <i>BIPRU</i> TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) as well as using <i>IPRU</i> .
4.41	G		The effect of <i>BIPRU</i> TP 3.17G (Pre CRD capital requirements applying on a solo basis during 2007 for <i>firms</i> also using the <i>IRB approach</i> ) is that neither credit risk or counterparty risk requirements of <i>IPRU</i> ( <i>BANK</i> ) apply to an <i>exposure</i> to which the <i>firm</i> applies the <i>IRB approach</i> . The <i>IRB approach</i> requirements in <i>BIPRU</i> apply instead. The main requirements are listed in <i>BIPRU</i> TP 3.17G.
4.42	G		A <i>firm</i> should apply <i>BIPRU</i> 7.2.45 R - <i>BIPRU</i> 7.2.47 R (Using internal ratings to calculate <i>specific risk</i> and treatment of <i>securitisations</i> ) to calculate the <i>specific risk</i> portion of the <i>interest rate PRR</i> to the extent that the obligor or <i>exposure</i> in question comes within the scope of its <i>IRB permission</i> .
4.43	G		The definition of <i>qualifying debt security</i> in the <i>Glossary</i> applies if the security or obligor in question comes within the scope of a <i>firm's IRB permission</i> .

## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 5 Pre CRD capital requirements applying on a solo basis during 2007: Building societies

5.1	R	<p><b>Application</b></p> <p>This section applies to a <i>building society</i> that is applying <i>BIPRU</i> TP 3.4R (Use of IPRU on a solo basis during 2007).</p>
5.2	G	<p><b>Purpose of this chapter</b></p> <p><i>BIPRU</i> TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) says that during 2007 a <i>firm</i> may apply the credit risk requirements of <i>IPRU</i> instead of the ones in <i>BIPRU</i>. For a <i>building society</i> this involves applying the credit risk requirements in <i>IPRU(BSOC)</i>. This section explains how this is done. In particular this section explains what parts of <i>IPRU(BSOC)</i> apply during 2007 and what changes are made to <i>IPRU(BSOC)</i> for that purpose.</p>
5.3	R	<p><b>Duration of transitional</b></p> <p>This section applies until 1 January 2008.</p>
5.4	G	<p><b>Drafting approach in this chapter</b></p> <p>The purpose of <i>BIPRU</i> TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) is that the basic provisions of <i>BIPRU</i> and <i>GENPRU</i> should be in force from 1 January 2007.</p>

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However a *firm* should be able to calculate the capital requirement for credit risk under *IPRU* and use the large exposures requirements in *IPRU*. This means that a *building society* should slot the credit risk requirements of *IPRU(BSOC)* into the general requirements of *GENPRU* and *BIPRU*.

The capital calculation for credit risk under *BIPRU* is made up of three elements, which are set out in *GENPRU* 2.1.51R (Calculation of the credit risk capital requirement). These are the *credit risk capital component*, the *counterparty risk capital component* and the *concentration risk capital component*. So the approach in *BIPRU* TP 5.4G involves determining which of these three elements apply, and then finding their equivalents (if any) in *IPRU(BSOC)*.

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The general approach to calculating the capital requirements for credit risk in *GENPRU* and *BIPRU* is to calculate the overall *credit risk capital requirement* (which is the sum of the three components listed in *BIPRU* TP 5.5G) - a monetary amount - and to compare it with *capital resources*, also a monetary amount.

5.7

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The general approach in *IPRU(BSOC)* is different. A *building society* calculates the total of its own funds (after making the relevant deductions) and the total of its risk weighted assets and off balance sheet items (in the latter case, after applying credit conversion factors). The own funds total is divided by the risk weighted assets total and the quotient expressed

5.8	G	<p>as a percentage: this is the pre-CRD solvency ratio.</p> <p>To enable a <i>building society</i> to use <i>BIPRU TP 3.4R</i> (Pre CRD capital requirements applying on a solo basis during 2007), the calculation method set out in <i>IPRU(BSOC)</i>, which is designed to produce the solvency ratio, needs adjustment so that it produces the <i>credit risk capital component</i> instead.</p>
5.9	G	<p><i>BIPRU TP 3.8R</i> (Parts of GENPRU and BIPRU that apply in 2007) provides that <i>GENPRU 2.2</i> (Capital resources) applies during 2007. So a <i>building society</i> using <i>BIPRU TP 3.4R</i> (Pre CRD capital requirements applying on a solo basis during 2007) will calculate its <i>capital resources</i> under <i>GENPRU 2.2</i>, instead of calculating its own funds under <i>IPRU(BSOC)</i>.</p> <p><b>Rules in IPRU(BSOC) that apply in 2007</b></p>
5.10	R	<p>The <i>rules</i> in Chapter 7 of Volume 1 of <i>IPRU(BSOC)</i> (Large Exposures) apply during the period that <i>BIPRU TP 3.4R</i> applies. None of the other <i>rules</i> in <i>IPRU(BSOC)</i> apply except the <i>rules</i> in chapters 4 and 5 which apply to <i>building societies</i> generally whether or not they apply the treatment in this section.</p> <p><b>Parts of Volume 1 of IPRU(BSOC) that apply in 2007</b></p>
5.11	G	<p>The parts of Volume 1 of <i>IPRU(BSOC)</i> that do and do not apply during the period that <i>BIPRU TP 3.4R</i> applies are set out in <i>BIPRU TP 5.13G</i>.</p>
5.12	G	<p>The table in <i>BIPRU TP 5.13G</i> assumes that the <i>firm</i> is not apply-</p>

ing the *IRB approach*. *BIPRU* TP 5.36R to *BIPRU* TP 5.38R deal with a *firm* that does apply the *IRB approach*.

5.13 G Table: Parts of Volume 1 of IPRU(BSOC) that apply in 2007  
  
This table belongs to *BIPRU* TP 5.11G

<i>IPRU(BSOC) rule</i>	A Y denotes that the provision does apply  An N denotes that it does not apply	Remarks
Chapter X (Introduction)	<i>Rule X.2.1 (Application)</i> N	<i>BIPRU</i> TP 5.1R applies in its place for the purposes of <i>BIPRU</i> TP 5. However see <i>BIPRU</i> TP 5.15G.
	Definition of the BCD in X.7.1G Y	
	Other definitions in X.7 Y	Apply to the extent used in the parts of <i>IPRU(BSOC)</i> that have effect under this section.
	The rest of chapter X Chapter 1 (Solvency) N	
Section 1.1 (Introduction)	N	
Section 1.2 (Solvency rules)	N	
Section 1.3 (Purpose of Capital)	N	
Section 1.4 (EU Directives)	N	
Section 1.5 (Threshold Ratios)	Y	See <i>BIPRU</i> TP 5.25G to <i>BIPRU</i> TP 5.26G
Section 1.6 (Own Funds)	N	
Section 1.7 (Minority Interests)	N	

<i>IPRU(BSOC) rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
Section 1.8 (Deductions)	N	
Section 1.9 (Limits on Tier 2 capital)	N	
Section 1.10 (Solvency Ratio)	Y	<p>(1) Applies on a solo basis except to the extent <a href="#">BIPRU 2.1</a> (Solo consolidation) applies.</p> <p>(2) Application on a consolidated basis is covered by <a href="#">BIPRU TP 10</a> (Pre CRD capital requirements applying on a consolidated basis during 2007).</p> <p>(3) Requirement that the solvency ratio should be calculated on a consolidated basis where a <i>building society</i> has <i>subsidiary undertakings</i> does not otherwise apply.</p> <p>(4) See <a href="#">BIPRU TP 5.20G</a> to <a href="#">BIPRU TP 5.24G</a>.</p>
Section 1.11 (Solo consolidation)	N	
Section 1.12 (Mortgage Subsidiaries)	N	
Section 1.13 (Exclusions from consolidation)	N	
Section 1.14 (Mortgage Indemnity Captives)	N	
Section 1.15 (Securitisation)	Y	See <a href="#">BIPRU TP 5.33G</a> to <a href="#">BIPRU TP 5.35G</a>
Section 1.16 (Deductions of holdings)	N	
Section 1.17 (capital cost and pricing)	N	

<i>IPRU(BSOC) rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
Section 1.18 (CAD)	Y	Only applies to the extent that the relevant provisions of <i>IPRU(BANK)</i> apply to a <i>building society</i> under BIPRU TP 3.  See <i>BIPRU</i> TP 5.16R to <i>BIPRU</i> TP 5.19G.
Section 1.19 (Credit derivatives)	Y	
Annex 1A (Calculation of Own Funds)	N	
Annex 1B (Risk Asset Weights)	Y	See <i>BIPRU</i> TP 5.32G
Annex 1C (Off Balance Sheet Items)	Y	The treatment of items under section 1C.5 (The treatment of off-balance sheet items using the "mark to market" approach) applies to the types of item listed in section 1C.7 whether they are on or off balance sheet.
Annex 1D (Deductions from own funds)	N	
Annex 1E (Verification of Interim Profits)	N	
Annex 1F (Definition of Relevant Authority)	N	
Annex 1G (Definition of Zones A and B)	Y	
Annex 1H - Society Only Definitions	Y	
Annex 1J - Threshold Appraisal Sheet	Y	
Other chapters		

<i>IPRU(BSOC) rule</i>	A Y denotes that the provision does apply		Remarks
	An N denotes that it does not apply		
Chapter 2 (Issued Capital)	N		
Chapter 3 (Boards and Management)	N		
Chapter 4 (Financial Risk Management)	Annex 4B (Credit derivatives)	Y	The provisions in <a href="#">BIPRU TP 4</a> (Pre CRD capital requirements applying on a solo basis during 2007: Banks) about Chapter CD of <i>IPRU(BANK)</i> (Credit derivatives) apply.
	The rest of Chapter 4	Y	Subject to the other provisions of this section, applies in the same way as it does for a <i>building society</i> that does not use <a href="#">BIPRU TP 3.4R</a> (Pre CRD capital requirements applying on a solo basis during 2007). See <a href="#">BIPRU TP 5.15G</a> .
Chapter 5 (Liquidity (including Annexes 5A to 5C )	Y		Subject to the other provisions of this section, applies in the same way as it does for a <i>building society</i> that does not use <a href="#">BIPRU TP 3.4R</a> (Pre CRD capital requirements applying on a solo basis during 2007). See <a href="#">BIPRU TP 5.15G</a>
Chapter 6 (Lending)	N		
Chapter 7 (Large Exposures)	Y		(1) Applies on a solo basis except to the extent <a href="#">BIPRU 2.1</a> (Solo consolidation) applies.  (2) Application on a consolidated basis is covered by <a href="#">BIPRU TP 10</a> (Pre CRD capital require-

<i>IPRU(BSOC) rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
		<p>ments applying on a consolidated basis during 2007).</p> <p>(3) Requirement that large exposures of a <i>building society</i> with <i>subsidiary undertakings</i> should, in general, be monitored on a fully consolidated basis does not otherwise apply.</p> <p>(4) IPRU(BSOC) 7.7 (Systems) applies.</p> <p>(5) See <i>BIPRU TP 5.27R</i> to <i>BIPRU TP 5.30G</i>.</p>
Chapter 8 (Mortgage Indemnity Insurance)	N	
Chapter 9 (Systems)	N	
Chapter 10 (Securitisation)	Y	<p>The provisions in <i>BIPRU TP 4</i> (Pre CRD capital requirements applying on a solo basis during 2007: Banks) about Chapter SE of <i>IPRU(BANK)</i> (Securitisation) apply.</p> <p>See <i>BIPRU TP 5.33G</i> to <i>BIPRU TP 5.35G</i></p>
Chapter 11 (Outsourcing)	N	
5.14	G	<p><b>Volume 2 of IPRU(BSOC)</b></p> <p>Volume 2 of <i>IPRU(BSOC)</i> does not apply to a <i>building society</i> that applies <i>BIPRU TP 3.4R</i> (Use of IPRU on a solo basis during 2007). It has been replaced by the Building Societies Regulatory</p>

5.15	G	<p>Guide, which applies to all <i>building societies</i>, not just ones that apply <i>BIPRU TP 3.4R</i>.</p> <p><b>Chapters 4 and 5 of Volume 1 of IPRU(BSOC)</b></p>
		<p>(1) Chapters 4 and 5 of Volume 1 of <i>IPRU(BSOC)</i> apply to all <i>building societies</i>, not just ones that apply <i>BIPRU TP 3.4R</i> (Use of IPRU on a solo basis during 2007). The version that applies to a <i>building society</i> that applies <i>BIPRU TP 3.4R</i> is the one in force at the relevant time, not the version in force on 31 December 2006. However there are some exceptions to this, as explained in (2) and (3).</p>
		<p>(2) As <i>BIPRU 2.3</i> (Interest rate risk in the non-trading book) does not apply to a <i>firm</i> applying <i>BIPRU TP 3.4R</i>, references in Chapter 4 to <i>BIPRU 2.3</i> should be disregarded (see in particular paragraphs 4.1.3G, 4.7.1G and 4.7.7G of chapter 4 of Volume 1 of <i>IPRU(BSOC)</i>).</p>
		<p>(3) As shown in the table in <i>BIPRU TP 5.12G</i>, Annex 4B (Credit derivatives) applies to a <i>building society</i> that applies <i>BIPRU TP 3.4R</i>.</p>
		<p>(4) <i>rule X.2.1</i> of Chapter X of Volume 1 of <i>IPRU(BSOC)</i> (Application) applies to all <i>building societies</i>, not just ones that apply <i>BIPRU TP 3.4R</i>. However <i>BIPRU TP 5.1R</i> is the</p>

relevant application *rule* for the purpose of BIPRU TP 5.

### The trading book

5.16	R	BIPRU TP 4 (Pre CRD capital requirements applying on a solo basis during 2007: Banks) applies for the purpose of calculating the <i>counterparty credit risk component</i> and the <i>market risk capital requirement</i> .
5.17	G	The reason for BIPRU TP 5.16R is explained in BIPRU TP 5.18G to BIPRU TP 5.19G.
5.18	G	<p>(1) Only exceptionally will a <i>building society</i> have a <i>trading book</i>. If a <i>building society</i> does not have a <i>trading book</i>, the calculations that a <i>building society</i> should carry out under BIPRU TP 3 (Use of IPRU on a solo basis during 2007) and this section are simplified as described in this paragraph.</p> <p>(2) A <i>building society</i> does not have to calculate a <i>counterparty risk capital component</i> (the capital charge for counterparty risk in the <i>trading book</i>) or a <i>concentration risk capital component</i> (the capital charge for exceeding concentration risk limits in the <i>trading book</i>).</p> <p>(3) BIPRU 7 (Market risk) does not apply for the most part. This is because most of it only applies to the <i>trading book</i>.</p> <p>(4) BIPRU 7.5 (Foreign currency PRR) will apply</p>

			if a <i>building society</i> has <i>foreign currency exposure</i> even if the <i>building society</i> does not have a <i>trading book</i> .
		(5)	BIPRU 7.6 (Option PRR) will apply if a <i>building society</i> has <i>foreign currency option positions</i> .
		(6)	BIPRU 7.4 (Commodity PRR) and BIPRU 7.6 (Option PRR) apply to a <i>firm's commodity positions</i> in its <i>non-trading book</i> as well as its <i>trading book</i> . However a <i>building society</i> will not generally have <i>commodity positions</i> .
5.19	G		Paragraph 1.18.1G of Volume 1 of <i>IPRU(BSOC)</i> (CAD) says that a <i>building society</i> on the "Trading" approach to financial risk management (described in chapter 4 of Volume 1 of <i>IPRU(BSOC)</i> (Financial Risk Management)), under which it can trade securities and maintain unhedged foreign exchange positions within defined limits, should calculate the capital requirements for its trading book and foreign exchange positions separately in accordance with <i>IPRU(BANK)</i> . Therefore if a <i>building society</i> does have a <i>trading book</i> and applies <i>BIPRU TP 3.4R</i> (Use of <i>IPRU</i> on a solo basis during 2007):
		(1)	it should calculate its credit risk charge for items in the <i>trading book</i> using <i>IPRU(BANK)</i> as adjusted under <i>BIPRU TP 4</i> (Pre CRD capital requirements applying on a solo basis during 2007: Banks);
		(2)	it should calculate its capital requirements for <i>foreign currency positions</i> under <i>BIPRU 7</i> (Market risk), particular-

			<p>ly BIPRU 7.5 (Foreign currency PRR) as adjusted under BIPRU TP 4;</p> <p>(3) it should calculate its capital requirements for other market risks under BIPRU 7 as adjusted under BIPRU TP 4; and</p> <p>(4) even if a <i>building society</i> does have a <i>trading book</i> it still does not have to calculate a <i>concentration risk capital component</i> as <i>IPRU(BSOC)</i> does not allow a <i>building society</i> to exceed the limits in Chapter 7 of <i>IPRU(BSOC)</i> (Large exposures).</p>
5.20	G		<p><b>How to calculate a credit risk capital component under IPRU</b></p> <p>A <i>building society</i> should calculate its <i>credit risk capital component</i> (under paragraph 1.10 of Volume 1 of chapter 1 of <i>IPRU(BSOC)</i> (Solvency)) by taking the total of its risk weighted assets and off balance sheet items (using the risk weights in Annex 1B and the credit conversion factors in Annex 1C) and multiplying this by 8%.</p>
5.21	G		<p><i>BIPRU</i> TP 5.18G to <i>BIPRU</i> TP 5.19G explain why the <i>counterparty risk capital component</i> and the <i>concentration risk capital component</i> (which together with the <i>credit risk capital component</i> make up the <i>credit risk capital requirement</i>) are unlikely to apply to a <i>building society</i>.</p>
5.22	G		<p><i>BIPRU</i> TP 3.8R (Parts of GENPRU and BIPRU that apply in 2007) says that GENPRU 1.3 (Valuation) applies during 2007, so the values of assets and off balance sheet items used in the calculation under <i>BIPRU</i> TP 5.20G should be in accordance with GENPRU 1.3.</p>
5.23	G		<p>In the light of <i>BIPRU</i> TP 5.9G, <i>BIPRU</i> TP 5.20G and <i>BIPRU</i> TP 5.22G, the first two sentences and the fourth sentence of paragraph 1.10 of Volume 1 of <i>IPRU(BSOC)</i> should be disregarded. The</p>

5.24	G	<p>remainder of paragraph 1.10 gives useful detail on the credit risk calculations.</p> <p>The solvency ratio provisions of <i>IPRU(BSOC)</i> are mostly <i>guidance</i> on <i>rules</i> 1.2.1 and 1.2.2 of Chapter 1 of Volume 1 of <i>IPRU(BSOC)</i>. These <i>rules</i> do not apply in 2007. When the solvency ratio provisions of Volume 1 of <i>IPRU(BSOC)</i> are applied under this section they are <i>guidance</i> on the <i>overall financial adequacy rule</i>. In turn the <i>overall financial adequacy rule</i> is the <i>rule</i> on which the calculation of the capital requirements for credit risk under <i>GENPRU</i> and <i>BIPRU</i> is based for a <i>building society</i> under this section.</p>
5.25	G	<p><b>How to maintain the threshold ratio</b></p> <p>A <i>building society</i> should maintain the amount of <i>capital resources</i> (calculated under <i>GENPRU</i> 2.2 (Capital resources)) that corresponds to the result of multiplying the total of its risk weighted assets and off balance sheet items (as calculated for the purposes of <i>BIPRU</i> TP 5.20G) by its threshold ratio. Further transitional provisions about the threshold ratio can be found in <i>GENPRU</i> TP 9 (Individual capital guidance for <i>BIPRU</i> firms).</p>
5.26	G	<p>Complying with <i>BIPRU</i> TP 5.25G is treated as satisfying the expectation set out in section 1.5 of chapter 1 of Volume 1 of <i>IPRU(BSOC)</i> (Solvency) that a <i>building society</i> will maintain the threshold ratio. Maintaining the threshold ratio is in turn treated as satisfying the <i>overall Pillar 2 rule</i> so far as that <i>rule</i> requires a <i>firm</i> to maintain adequate capital resources.</p> <p><b>Large exposures</b></p>
5.27	G	<p>Chapter 7 of Volume 1 of <i>IPRU(BSOC)</i> (Large exposures) applies in place of <i>BIPRU</i> 10 (Concentration risk).</p>
5.28	G	<p><i>BIPRU</i> 10.5.2 R to <i>BIPRU</i> 10.5.3 R and <i>BIPRU</i> 10.5.5 R (Capital resources for concentration risk) apply for the purpose in <i>BIPRU</i> TP 5.27R. Although the table in <i>BIPRU</i> TP 3.8R (Parts of <i>GENPRU</i> and <i>BIPRU</i> that apply in 2007) says that <i>BIPRU</i> 10.5.14 R (Notification of trading book excesses) also applies, this is irrelevant to a <i>building society</i> as it relates to the regime for excess <i>exposures</i> in the <i>trading book</i>, which does not apply to a <i>building society</i>.</p>

5.29	G	The effect of <i>BIPRU</i> TP 5.28R is that a <i>building society</i> should treat all references to own funds in chapter 7 of Volume 1 of <i>IPRU(BSOC)</i> (Large exposures) as references to <i>capital resources</i> under <i>BIPRU</i> 10.5.2 R to <i>BIPRU</i> 10.5.3 R and <i>BIPRU</i> 10.5.5 R (Capital resources for concentration risk). The last sentence of paragraph 7.3.1 of Volume 1 of <i>IPRU(BSOC)</i> should be disregarded.
5.30	G	Chapter 7 of <i>IPRU(BSOC)</i> is mostly <i>guidance</i> on rules 1.2.1 and 1.2.2 of Chapter 1 of Volume 1 of <i>IPRU(BSOC)</i> . These <i>rules</i> do not apply in 2007. When the large exposures provisions of Volume 1 of <i>IPRU(BSOC)</i> are applied under this section they are <i>guidance</i> on the <i>overall financial adequacy rule</i> .
5.31	G	<b>Operational risk</b> <i>BIPRU</i> TP 3.21R provides that the <i>operational risk capital requirement</i> is reduced where a <i>firm</i> uses <i>BIPRU</i> TP 3.4R (Capital floors for a firm using the IRB or AMA approaches). A <i>building society</i> (unless, exceptionally, it has a <i>trading book</i> ) will apply <i>BIPRU</i> 3.4 to all its <i>exposures</i> . So the effect of <i>BIPRU</i> TP 3.21R in those cases will be to reduce the <i>operational risk capital requirement</i> to zero while <i>BIPRU</i> TP 3.4 applies.
5.32	G	<b>Miscellaneous modifications of IPRU(BSOC)</b> When using Annex 1B of Chapter 1 of Volume 1 of <i>IPRU(BSOC)</i> (Risk Asset Weights) for the purposes of <i>BIPRU</i> TP 5.20G, the definition of "relevant authority" will be found in Annex 5A of Chapter 5 of Volume 1 of <i>IPRU(BSOC)</i> (Prudential Liquidity) instead.
5.33	G	<i>BIPRU</i> TP 5.12R says that chapter 10 of Volume 1 of <i>IPRU(BSOC)</i> (Securitisation) applies. Under that chapter a <i>firm</i> should deduct certain credit enhancements from capital. A <i>building society</i> should deduct these credit enhancements at stage M of the calculation in the <i>capital resources table</i> (Deductions from the totals of tier one and two).
5.34	G	Paragraph 6 of section 10.4 of Chapter SE of <i>IPRU(BANK)</i> , which is applied to a <i>building society</i> by chapter 10 of Volume 1 of <i>IPRU(BSOC)</i> (Securitisation), says that if a <i>firm</i> does not meet the policy on liquidity facilities provided by sponsors or repackers it should fully consolidate

			the scheme. This does not apply under this section. Instead a <i>building society</i> should treat the scheme assets as being on its balance sheet.
5.35	G		The definition of investment grade for the purposes of Chapter SE (see in particular sections 3.2.2, 9.3 and 11.1) remains based on Chapter TI of <i>IPRU(BANK)</i> .
			<b>Firms using the IRB approach during 2007: General</b>
5.36	R		<i>BIPRU TP 5.37G to BIPRU TP 5.38R</i> only apply to a <i>firm</i> that is applying the <i>IRB approach</i> under <i>BIPRU TP 3</i> (Pre CRD capital requirements applying on a solo basis during 2007) as well as using <i>IPRU</i> .
5.37	G		The effect of <i>BIPRU TP 3.17G</i> (Pre CRD capital requirements applying on a solo basis during 2007 for <i>firms</i> also using the <i>IRB approach</i> ) is that Section 1.10 of Volume 1 of <i>IPRU(BSOC)</i> (Solvency Ratio) does not apply to an <i>exposure</i> to which the <i>firm</i> applies the <i>IRB approach</i> . The <i>IRB approach</i> requirements in <i>BIPRU</i> apply instead. The main requirements are listed in <i>BIPRU TP 3.17G</i> .
5.38	R		A <i>building society</i> that has a <i>trading book</i> must apply the parts of <i>BIPRU TP 4</i> (Pre CRD capital requirements applying on a solo basis during 2007: Banks) that deal with capital charges for items in the <i>trading book</i> for a <i>bank</i> that applies the <i>IRB approach</i> under <i>BIPRU TP 3</i> (Pre CRD capital requirements applying on a solo basis during 2007) as well as using <i>IPRU</i> .



## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 6

### Pre CRD capital requirements applying on a solo basis during 2007: Investment management firms

6.1	R	<p><b>Application</b></p> <p>This section applies to a <i>BIPRU firm</i> that:</p> <ol style="list-style-type: none"> <li>(1) is an <i>investment management firm</i>; and</li> <li>(2) is applying <i>BIPRU TP 3.4R</i> (Use of <i>IPRU</i> on a solo basis during 2007).</li> </ol>
6.2	G	<p><b>Purpose of this section</b></p> <p><i>BIPRU TP 3</i> (Pre CRD capital requirements applying on a solo basis during 2007) says that during 2007 a <i>firm</i> may apply the credit risk requirements of <i>IPRU</i> instead of the ones in <i>BIPRU</i>. For an <i>investment management firm</i> this involves applying the credit risk requirements in chapter 5 of <i>IPRU(INV)</i>. This section explains how this is done. In particular this section explains:</p> <ol style="list-style-type: none"> <li>(1) which parts of chapter 5 should be treated as credit risk requirements for this purpose;</li> <li>(2) what parts of chapter 5 apply during 2007 and what changes are made to chapter 5 for that purpose; and</li> <li>(3) what changes are made to <i>GENPRU</i> and <i>BIPRU</i> to reflect the fact that chapter 5 applies in place of parts of <i>GENPRU</i> and <i>BIPRU</i>.</li> </ol> <p><b>Duration of transitional</b></p>

6.3	R	This section applies until 1 January 2008.
		<b>Drafting approach in this section</b>
6.4	G	The purpose of BIPRU TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) is that the basic provisions of <i>BIPRU</i> and <i>GENPRU</i> should be in force from 1 January 2007. However a <i>firm</i> should be able to calculate the capital requirements for credit risk under <i>IPRU</i> and use the large exposures requirements in <i>IPRU</i> . This means that an <i>investment management firm</i> should slot the credit risk requirements of chapter 5 of <i>IPRU(INV)</i> into the general requirements of <i>GENPRU</i> and <i>BIPRU</i> .
6.5	G	The capital calculation for credit risk under <i>BIPRU</i> is made up of three elements, which are set out in <i>GENPRU 2.1.51 R</i> (Calculation of the credit risk capital requirement). These are the <i>credit risk capital component</i> , the <i>counterparty risk capital component</i> and the <i>concentration risk capital component</i> . So the approach in <i>BIPRU TP 6.4G</i> involves finding equivalents for these three elements in chapter 5 where this is possible.
6.6	G	Under <i>GENPRU</i> and <i>BIPRU</i> a <i>firm</i> calculating its capital resources may usually choose between deducting <i>illiquid assets</i> and <i>material holdings</i> . Only if it has a <i>waiver</i> from consolidated supervision need it deduct both. However under chapter 5, both illiquid assets and material holdings in credit and financial institutions are deducted.
6.7	G	The chapter 5 <i>rules</i> can still be made to work if a <i>firm</i> is allowed to choose between deducting <i>illiquid assets</i> and <i>material holdings</i> as any <i>exposure</i> that is not deducted is covered by the chapter 5 other assets requirement.
6.8	G	(1) To make the <i>GENPRU</i> and <i>BIPRU</i> requirements compatible with chapter 5 for the purpose of BIPRU TP 3 (Pre CRD capital requirements applying on a solo basis during 2007), this section takes the approach in this paragraph.

		(2)	The <i>illiquid assets</i> and <i>material holdings</i> provisions of GENPRU 2.2 (Capital resources) apply.
		(3)	The chapter 5 counterparty risk requirement and the other assets requirement are used to calculate the <i>BIPRU</i> credit risk charge for <i>non-trading book</i> items (called the <i>credit risk capital component</i> ) and the <i>BIPRU</i> credit risk charge for <i>trading book</i> items (called the <i>counterparty risk capital component</i> ).
		(4)	BIPRU 10 (Concentration risk) allows a <i>firm</i> to exceed the large exposure limits in the <i>trading book</i> . A <i>firm</i> that takes up that option is subject to an additional capital requirement, called the <i>concentration risk capital component</i> . Chapter 5 does not give a <i>firm</i> that option. Therefore the <i>concentration risk capital component</i> does not apply to a <i>firm</i> under this section.
		<b>Parts of chapter 5 of IPRU(INV) that apply in 2007</b>	
6.9	R		The parts of chapter 5 of <i>IPRU(INV)</i> that do and do not apply during the period that <i>BIPRU</i> TP 3.4R applies are set out in <i>BIPRU</i> TP 6.11R.
6.10	G		The table in <i>BIPRU</i> TP 6.11R assumes that the <i>firm</i> is not applying the <i>IRB approach</i> . <i>BIPRU</i> TP 6.31R to <i>BIPRU</i> TP 6.34R deal with a <i>firm</i> that does apply the <i>IRB approach</i> .

6.11	R	Table: Parts of chapter 5 of IPRU(INV) that apply in 2007
This table belongs to <i>BIPRU</i> TP 6.9R		

Chapter 5 rule	A Y denotes that the provision does apply		Remarks
	An N denotes that it does not apply		
5.1.1(1)(a) and (b) (Application)	N		<i>BIPRU</i> TP 6.1R applies instead
Table 5.1.1(1)(a) (What parts of chapter 5 apply to what <i>firm</i> )	N		<i>BIPRU</i> TP 6.1R applies instead
5.1.1(1)(c) (Interpretation)	Y		See <i>BIPRU</i> TP 6.26R to <i>BIPRU</i> TP 6.28G
5.2.1 (General requirement)	N		
5.2.2 (Financial resources)	N		GENPRU 2.2 (Capital resources) applies instead
5.2.3(1) (Determination of requirement)	N		
5.2.3(2) (Exceptions from the liquid capital requirement)	N		
5.2.3(3) (Own funds requirement)	N		
5.2.3(4) (Liquid capital requirement)	N		
5.2.3(5) (Total capital requirement)		Expenditure based requirement	N
		Position risk requirement	N
		Counterparty risk requirement	Y
		Foreign exchange requirement	N
		Other assets requirement	Y
5.2.4 (Annual audited expenditure)	N		

Chapter 5 rule	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
5.2.5 (Qualifying subordinated loans)	N	
5.2.6 (Qualifying property and qualifying undertakings)	N	
5.2.7 (Large exposures)	Y	See <i>BIPRU</i> TP 6.21R to <i>BIPRU</i> TP 6.22R
Table 5.2.2(1) (Calculation of own funds and liquid capital)	N	
Table 5.2.3(3)(b) (Own funds requirement)	N	
Table 5.2.3(5)(a) (Expenditure based requirement)	N	
Table 5.2.3(5)(b) (Position risk requirement)	N	See <i>BIPRU</i> TP 6.254
Table 5.2.3(5)(c) (Counterparty risk requirement)	Y	See <i>BIPRU</i> TP 6.13R to <i>BIPRU</i> TP 6.19G
Table 5.2.3(5)(c)(i) (Counterparty risk factor - cash settlements)	Y	
Table 5.2.3(5)(c)(ii) (Counterparty risk requirement)	Y	
Table 5.2.3(5)(c)(iii) (OTC derivatives calculation of credit equivalent amount)	Y	See <i>BIPRU</i> TP 6.15G and <i>BIPRU</i> TP 6.18R to <i>BIPRU</i> TP 6.19G
Table 5.2.3(5)(d) (Foreign exchange requirement)	N	
Table 5.2.3(5)(e) (Other assets requirement)	Y	See <i>BIPRU</i> TP 6.20R
5.3.1 (Records)	N	Applied in part under <i>BIPRU</i> TP 23 (Record keeping transitionals)

Chapter 5 rule	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
5.5.1 (Financial notification)	N	
5.7 (Consolidated supervision)	N	
Glossary	Y	See <i>BIPRU</i> TP 6.26R to <i>BIPRU</i> TP 6.28G
<b>Categorisation</b>		
6.12	R	Each <i>firm</i> is an <i>ISD</i> firm for the purposes of chapter 5 of <i>IPRU(INV)</i> as applied by <i>BIPRU</i> TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) and this section.
<b>How to use the chapter 5 Counterparty Risk Requirement and the Other Assets Requirement</b>		
6.13	R	A <i>firm</i> must calculate the sum of the <i>credit risk capital component</i> and the <i>counterparty risk capital component</i> as being equal to the sum of the counterparty risk requirement under chapter 5 of <i>IPRU(INV)</i> and of the other assets requirement under chapter 5 of <i>IPRU(INV)</i> .
6.14	R	If it is necessary to distinguish between the <i>credit risk capital component</i> and the <i>counterparty risk capital component</i> a <i>firm</i> must allocate: <ul style="list-style-type: none"> <li>(1) any amount calculated for an <i>exposure</i> in the <i>non-trading book</i> to the <i>credit risk capital component</i>; and</li> <li>(2) any amount calculated for an <i>exposure</i> in the <i>trading book</i> to the <i>counterparty risk capital component</i>;</li> </ul>
6.15	G	A <i>firm</i> may still apply the netting provisions for OTC derivatives in chapter 5 even though the OTC derivative calculation is split between the <i>credit risk capital component</i> and the <i>counterparty risk capital component</i> under <i>BIPRU</i> TP 6.14R. The net amount should be allocated to the <i>credit</i>

6.16	G	<p><i>risk capital component</i> if the gross value of the <i>non-trading book</i> derivatives is bigger and to the <i>counterparty risk capital component</i> if the gross value of the <i>trading book</i> derivatives is bigger.</p> <p><b>Adjustments to the Counterparty Risk Requirement calculations: General</b></p> <p>Broadly speaking the Directive transitional provisions that allow pre-2007 credit risk rules to be used in 2007 cover all credit risk rules. However the transitional provisions for <i>trading book</i> credit risk (Annex II of the <i>Capital Adequacy Directive</i>, which is implemented in BIPRU 14 (Capital requirements for settlement and counterparty risk)) is not quite as straightforward as that. In some cases pre-2007 requirements can be used. In others they cannot. The purpose of BIPRU TP 6.17R to BIPRU TP 6.19G is to reflect those cases in which the Directive requires the new requirements to apply from 1 January 2007.</p>
6.17	R	<p><b>Adjustments to the Counterparty Risk Requirement calculations: Free deliveries</b></p> <p>(1) The calculation of the part of the counterparty risk requirement set out in section 3 of Table 5.2.3(5)(c) of chapter 5 of <i>IPRU(INV)</i> (Free deliveries) is amended in accordance with this <i>rule</i> for the purposes of <i>trading book</i> calculations.</p> <p>(2) A <i>firm</i> must include <i>foreign currency</i> and <i>commodity</i> transactions.</p> <p>(3) The capital treatment in the table in BIPRU 14.4.3 R (Capital treatment for free deliveries) applies. But when the capital treatment in that table is that the <i>firm</i> must treat the transaction as an <i>exposure</i>, the <i>firm</i> must apply the treatment in chapter 5 of <i>IPRU(INV)</i></p>

rather than BIPRU 14 (Capital requirements for settlement and counterparty risk).

**Adjustments to the Counterparty Risk Adjustments calculations: Credit derivative transactions**

6.18 R *A firm* must treat a credit derivative in the *trading book* as a derivative to which section 6 of Table 5.2.3(5)(c) of chapter 5 of *IPRU(INV)* (OTC derivatives) and table 5.2.3(5)(c)(iii) (OTC derivatives calculation of credit equivalent amount) apply.

6.19 G The capital treatment for credit derivatives set out in BIPRU 14.2.5 R - BIPRU 14.2.8 R (Capital treatment for credit derivatives) does not apply.

**Adjustments to the Other Assets Requirement calculations**

6.20 R *A firm* must include the items listed in section 4 of Chapter BC of *IPRU(BANK)* that are in the *firm's non-trading book* as off-balance sheet items in table 5.2.3(5)(e) (Other assets requirement) whether they are on or off balance sheet. *A firm* must include a credit derivative as a full risk item.

**How to use the chapter 5 large exposure rules**

6.21 R Section 5.2.7 of chapter 5 of *IPRU(INV)* (Large exposures) applies in place of BIPRU 10 (Concentration risk).

6.22 R BIPRU 10.5.2 R to BIPRU 10.5.5 R (Capital resources for concentration risk purposes) apply in place of the definition of own funds that applies under section 5.2.7 of chapter 5 of *IPRU(INV)*.

**Specific risk calculations**

6.23 R *A firm* must calculate the *specific risk* portion of the *interest rate PRR* in accordance with BIPRU TP 8.28R (Pre CRD interest rate *PRR* for *securities and futures firms*).

6.24 R Any reference to a *qualifying debt security* in a part of BIPRU that applies during 2007 must be interpreted in accordance with the meaning it has when used in section A of Table 5.2.3(5)(b) of chapter 5 of *IPRU(INV)* (Position risk requirement for qualifying debt securities). However

6.25	G	<p>BIPRU 7.2.50 R (Must not apply <i>qualifying debt security</i> treatment to risky assets) also applies.</p> <p>The reason for BIPRU TP 6.23R and BIPRU TP 6.24R is that the calculation of the <i>specific risk</i> portion of the <i>interest rate PRR</i> under BIPRU 7 (Market risk) involves the use of the <i>standardised approach</i> to credit risk. The <i>specific risk rules</i> therefore need to be adjusted for a <i>firm</i> that is not using the <i>standardised approach</i> to credit risk in 2007 so as to apply the pre-2007 method of calculating <i>specific risk</i>. However chapter 5 does not use the concept of <i>specific risk</i>. The nearest equivalent is in chapter 10 of IPRU(INV) (<i>Securities and futures firms</i>).</p>
6.26	R	<p><b>Definitions</b></p> <p>The definition of trading book is replaced with the definition in the <i>Glossary</i>.</p>
6.27	R	<p>A <i>firm</i> may treat a reference in the Glossary to Chapter 5 of IPRU(INV) to a financial supervision regime at least equivalent to the Second Consolidated Supervision Directive and the Capital Adequacy Directive (No. 93/6/EEC) as including one to a regime equivalent to the <i>Banking Consolidation Directive</i> and Directive 2006/49 (the new version of the Capital Adequacy Directive).</p>
6.28	G	<p>GENPRU 1.3 (Valuation) applies. The definition of exposure in the Glossary to chapter 5 should be read accordingly.</p>
6.29	G	<p><b>Mapping GENPRU and BIPRU concepts onto IPRU</b></p> <p>Some of the parts of chapter 5 of IPRU(INV) that apply in 2007 refer to parts of chapter 5 that do not apply. BIPRU TP 3.10R explains that where this happens a <i>firm</i> should interpret that cross-reference in accordance with the provision in BIPRU or GENPRU that corresponds to the chapter 5 provision that does not apply in 2007. A <i>firm</i> should refer to IPRU in the case of cross-references in GENPRU and BIPRU to provisions in GENPRU and BIPRU that do not apply in 2007. BIPRU TP 6.30G sets out how certain concepts in chapter 5 of IPRU(INV) correspond to ones in GENPRU and BIPRU. The purpose of the table is to help <i>firms</i> to interpret such cross-references.</p>

6.30	G	Table: Mapping GENPRU and BIPRU concepts onto ones in chapter 5 of IPRU(INV)
		This table belongs to <i>BIPRU</i> TP 6.29G

<i>GENPRU</i> and <i>BIPRU</i>	Chapter 5 of <i>IPRU(INV)</i>
<i>Illiquid asset</i>	Illiquid asset
<i>Material holding</i>	Material holdings in credit and financial institutions (item 8 in Table 5.2.2(1) (Calculation of own funds and liquid capital))
Unsettled transaction under <i>BIPRU</i> 14.3	Delivery of cash against documents and settlements outstanding for 30 days or more (part of counterparty risk requirement)
<i>Free deliveries</i> under <i>BIPRU</i> 14.4	Free deliveries (part of counterparty risk requirement)
See <i>BIPRU</i> TP 6.8G	Counterparty risk requirement
See <i>BIPRU</i> TP 6.8G	Other assets requirement
<i>Market risk capital requirement</i>	The position risk requirement and the foreign exchange requirement
<i>Trading book concentration risk excess</i>	This concept does not apply in Chapter 5
<i>Risk weight</i>	Risk weights in Table 5.2.3(5)(c)(ii) (Counterparty risk requirement). In general where Table 5.2.3(5)(e) (Other assets requirement) applies a risk factor of 8% that is equivalent to applying a <i>risk weight</i> of 100%. Applying the 1.6% adjustment under that table is equivalent to applying a 20% <i>risk weight</i> under <i>BIPRU</i> together with the standard 8% <i>BIPRU</i> credit risk charge. The "NIL" adjustment under that table is equivalent to applying a 0% <i>risk weight</i> .

6.31	R	<p><b>Firms using the IRB approach during 2007: General</b></p> <p><i>BIPRU</i> TP 6.31R to <i>BIPRU</i> TP 6.34R only apply to a <i>firm</i> that is applying the <i>IRB approach</i> under <i>BIPRU</i> TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) as well as using <i>IPRU</i>.</p>
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6.32	G	<p>The effect of <i>BIPRU</i> TP 3.17G (Pre CRD capital requirements applying on a solo basis during 2007 for <i>firms</i> also using the <i>IRB approach</i>) is that the counterparty risk requirement and the other assets requirement do not apply to an <i>exposure</i> to which the <i>firm</i> applies the <i>IRB approach</i>. The <i>IRB approach</i> requirements in <i>BIPRU</i> apply instead. The main requirements are listed in <i>BIPRU</i> TP 3.17G.</p>
6.33	R	<p>A <i>firm</i> must apply <i>BIPRU</i> 7.2.45R - <i>BIPRU</i> 7.2.47R (Using internal ratings to calculate <i>specific risk</i> and treatment of <i>securitisations</i>) to calculate the <i>specific risk</i> portion of the <i>interest rate PRR</i> to the extent that the obligor or <i>exposure</i> in question comes within the scope of its <i>IRB permission</i>.</p>
6.34	R	<p>The definition of <i>qualifying debt security</i> in the <i>Glossary</i> applies if the security or obligor in question comes within the scope of a <i>firm's IRB permission</i>.</p>



## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 7 Pre CRD capital requirements applying on a solo basis during 2007: UCITS investment firms

7.1	R	<p><b>Application</b></p>
		<p>This section applies to a <i>BIPRU firm</i> that:</p> <ol style="list-style-type: none"> <li>(1) is a <i>UCITS investment firm</i>; and</li> <li>(2) is applying BIPRU TP 3 (Use of IPRU on a solo basis during 2007).</li> </ol>
7.2	G	<p><b>Purpose of this section</b></p> <p>BIPRU TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) says that during 2007 a <i>firm</i> may apply the credit risk requirements of <i>IPRU</i> instead of the ones in <i>BIPRU</i>. For a <i>UCITS investment firm</i> this involves applying the credit risk requirements in chapter 7 of <i>IPRU(INV)</i>. This section explains how this is done.</p>
7.3	R	<p><b>Duration of transitional</b></p> <p>This section applies until 1 January 2008.</p>
7.4	G	<p><b>Drafting approach</b></p> <p>Chapter 7 of <i>IPRU(INV)</i> does not contain any credit risk <i>rules</i>. Instead it cross refers to the ones in chapter 5 (Interim prudential requirements for former IMRO firms). Therefore this section applies BIPRU TP 6 (Pre CRD capital requirements applying on a solo basis during 2007: Investment management firms).</p>
7.5	R	<p><b>Parts of chapter 7 of IPRU(INV) that apply in 2007</b></p> <p>The parts of chapter 7 of <i>IPRU(INV)</i> that do and do not apply during the period that <i>BIPRU TP 3.4R</i> applies are set out in <i>BIPRU TP 7.7R</i>.</p>

7.6	G	The table in <i>BIPRU</i> TP 7.7R assumes that the <i>firm</i> is not applying the <i>IRB approach</i> . <i>BIPRU</i> TP 6.31R to <i>BIPRU</i> TP 6.34R (which are applied to a <i>UCITS investment firm</i> by <i>BIPRU</i> TP 7.8R) deal with a <i>firm</i> that does apply the <i>IRB approach</i> .
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7.7	R	Table: Parts of chapter 7 of IPRU(INV) that apply in 2007  This table belongs to <i>BIPRU</i> TP 7.5R
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Chapter 7 rule	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
7.1.1 (Application)	N	<i>BIPRU</i> TP 7.1R applies instead
7.1.2 and 7.1.3 ( <i>Guidance on types of UCITS management companies etc</i> )	Y	
7.2.1 (General rule about financial resources and financial resources requirements)	N	
7.2.2 (Financial resources requirement)	N	
7.2.3 (Liquid capital resource requirement)	13/52 annual audited fixed expenditure requirement	N
	Provision of paragraph (2) that says that requirements apply in respect of <i>designated investment business</i> other than when undertaking <i>scheme management activity</i>	Y
	Position risk requirement	N
	Counterparty risk requirement	Y
	Foreign exchange requirement	N

Chapter 7 rule	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
	Other assets requirement Y	
7.2.4 to 7.2.5 (Calculation of annual expenditure)	N	
7.3 (Method of calculation of financial resources)	N	GENPRU 2.2 (Capital resources) applies instead
7.4.1 (Application of rules in chapter 5 of IPRU(INV) about qualifying subordinated loans etc)	N	The record keeping rules referred to in rule 7.4.1(1)(c) are applied under BIPRU TP 23 (Record keeping transitionals)
7.4.2 (Application of rules in chapter 5 of IPRU(INV) about large exposures)	Y	
7.5 (Financial notification)	N	
7.6 (Records)	N	Applied under BIPRU TP 23 (Record keeping transitionals)
7.8	R	<b>Application of BIPRU TP 6</b> BIPRU TP 6 (Pre CRD capital requirements applying on a solo basis during 2007: Investment management firms) applies for the purposes of this section.



## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 8

### Pre CRD capital requirements applying on a solo basis during 2007: Securities and futures firms

		<b>Application</b>
8.1	R	<p>This section applies to a <i>BIPRU firm</i> that is:</p> <ol style="list-style-type: none"> <li>(1) <i>a securities and futures firm; and</i></li> <li>(2) <i>is applying BIPRU TP 3.4R (Pre CRD capital requirements applying on a solo basis during 2007).</i></li> </ol>
		<p><b>Purpose of this section</b></p> <p><i>BIPRU TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) says that during 2007 a firm may apply the credit risk requirements of IPRU instead of the ones in BIPRU. For a securities and futures firm this involves applying the credit risk requirements in chapter 10 of IPRU(INV). BIPRU TP 8 explains how this is done. In particular this section explains:</i></p> <ol style="list-style-type: none"> <li>(1) <i>which parts of chapter 10 should be treated as credit risk requirements for this purpose;</i></li> <li>(2) <i>what parts of chapter 10 apply during 2007 and what changes are made to chapter 10 for that purpose; and</i></li> <li>(3) <i>what changes are made to GENPRU and BIPRU to reflect the fact that chapter 10 applies in</i></li> </ol>
8.2	G	

place of parts of *GENPRU* and *BIPRU*.

#### Duration of transitional

8.3 R BIPRU TP 8 applies until 1 January 2008.

#### Drafting approach in this section

8.4 G The purpose of BIPRU TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) is that the basic provisions of *BIPRU* and *GENPRU* should be in force from 1 January 2007. However a *firm* should be able to calculate the capital requirements for credit risk under *IPRU* and use the large exposures requirements in *IPRU*. This means that a *securities and futures firm* should slot the credit risk requirements of chapter 10 of *IPRU(INV)* into the general requirements of *GENPRU* and *BIPRU*. A *firm* that applies BIPRU TP 3.4R should not use chapter 3 as the source of its pre-2007 credit risk requirements even if it was subject to chapter 3 before becoming a *BIPRU investment firm*.

8.5 G The capital calculation for credit risk under *BIPRU* is made up of three elements, which are set out in GENPRU 2.1.51 R (Calculation of the credit risk capital requirement). These are the *credit risk capital component*, the *counterparty risk capital component* and the *concentration risk capital component*. So the approach in BIPRU TP 8.4G involves finding equivalents for these three elements in chapter 10 where possible.

8.6 G Under *GENPRU* and *BIPRU* a *firm* calculating its capital resources may usually choose between deducting *illiquid assets* and *material holdings*. Only if it has a *waiver* from consolidated supervision need it deduct both. This broadly corresponds to the approach in calculating financial resources under Tables 10-62(2)A to 10-62(2)C.

8.7 G The financial resources requirements calculations under chapter 10 depend in part on which of the financial resources calculations in Tables 10-62(2)A to 10-62(2)C a *firm* uses. Where this is the case the *firm* should use the requirements calculation associated with the version of the tables in 10-62(2) that corresponds to the *capital resources* calculation the *firm* uses under GENPRU 2.2 (Capital resources). BIPRU TP 8.33G

8.8	G	explains how the <i>capital resources</i> calculations in GENPRU 2.2 map onto Tables 10-62(2)A to 10-62(2)C.
		(1) To make the <i>GENPRU</i> and <i>BIPRU</i> requirements compatible with chapter 10 for the purpose of <i>BIPRU TP 3</i> (Pre CRD capital requirements applying on a solo basis during 2007), this section takes the approach in this paragraph.
		(2) The <i>illiquid assets</i> and <i>material holdings</i> provisions of <i>GENPRU 2.2</i> (Capital resources) apply.
		(3) The 8% illiquid asset adjustment under <i>IPRU(INV)</i> 10-65 applies to a <i>firm</i> calculating its financial resources under Table 10-62(2)A. It is equivalent to a capital charge for credit risk under <i>BIPRU</i> . Therefore a <i>firm</i> using the <i>capital resources</i> calculation in <i>GENPRU</i> that corresponds to Table 10-62(2)A ( <i>GENPRU 2 Annex 4 R</i> (Capital resources table for a <i>BIPRU investment firm</i> deducting <i>material holdings</i> )) should continue to apply that adjustment. It should be included as part of the <i>non-trading book</i> credit risk charge in <i>BIPRU</i> , which is called the <i>credit risk capital component</i> .
		(4) A 100% illiquid asset adjustment under

*IPRU(INV)* 10-65 is equivalent to a deduction of *illiquid assets* under *GENPRU 2.2* (Capital resources). Therefore a *firm* should not use this adjustment. This is because, as explained in (2), the *illiquid assets* provisions in *GENPRU 2.2* apply. Any item that would have been caught by *IPRU(INV)* 10-65 but is not caught by the *illiquid assets* deduction under *GENPRU 2.2* should be dealt with under *IPRU(INV)* 10-66.

(5)

The *IPRU(INV)* 10-66 liquidity adjustment covers any asset that has not been subject to a liquidity adjustment for illiquid assets under *IPRU(INV)* 10-65. Therefore (subject to (3)) a *firm* should calculate the *credit risk capital component* (the *non-trading book* credit charge in *BIPRU*) by applying *IPRU(INV)* 10-66 to any asset not deducted as an *illiquid assets* under *GENPRU 2.2* (Capital resources).

(6)

The chapter 10 counterparty risk requirement is used to calculate the *BIPRU* credit risk charge for *trading book* items, called the *counterparty risk capital component*.

(7)

The chapter 10 LER calculation is used to

			calculate the <i>concentration risk capital component</i> .
			<b>Parts of chapter 10 of IPRU(INV) that apply in 2007</b>
8.9	R		The parts of chapter 10 of <i>IPRU(INV)</i> that do and do not apply during the period that <i>BIPRU</i> TP 3.4R applies are as set out in <i>BIPRU</i> TP 8.11R.
8.10	G		The table in <i>BIPRU</i> TP 8.11R assumes that the <i>firm</i> is not applying the <i>IRB approach</i> . <i>BIPRU</i> TP 8.35R to <i>BIPRU</i> TP 8.38R deal with a <i>firm</i> that does apply the <i>IRB approach</i> .
8.11	R		Table: Parts of chapter 10 of IPRU(INV) that apply in 2007  This table belongs to <i>BIPRU</i> TP 8.9R

Chapter 10 rule	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
10-A (Application of Chapter 10 Glossary)	Y	See <i>BIPRU</i> TP 8.32R
10-B (Application)	N	<i>BIPRU</i> TP 8.1R applies instead
10.10 to 10.12 (Record keeping and Reconciliations)	N	Applied in part under <i>BIPRU</i> TP 23 (Record keeping transitionals)
10-32 (Defaulting repo counterparty and LE Notification Requirements)	N	
10-41 (Repo and Valuation)	N	
10-60 to 10-63 (Initial Capital and Financial Resources)	N	
10-64 to 10-68 (Liquidity Adjustments, Charged Assets and Contingent Liabilities)	10-64(2) (Intangible assets) N	<a href="#">GENPRU 2.2</a> (Capital resources) applies instead
	10-65(12) (Material holdings) N	<a href="#">GENPRU 2.2</a> applies instead

Chapter 10 rule	A Y denotes that the provision does apply An N denotes that it does not apply		Remarks
	The rest	Y	See <i>BIPRU</i> TP 8.13R to <i>BIPRU</i> TP 8.19G. The requirement in 10-64(1)(c) for an illiquid asset adjustment for commodities to be calculated under appendix 6 (the <i>PRR</i> charge for <i>commodities</i> ) does not apply
10-69 (Deficiencies in subsidiaries)	N		
10-70 (Calculation of financial resources requirement)	N		
10-71 (Primary requirement)	N		
10-72 (Base requirement)	N		
10-73 (Expenditure requirement)	N		
10-74 (Secondary requirement)	Y		<i>BIPRU</i> TP 3.10R and the table in <i>BIPRU</i> TP 8.34G explain how the terms used in <i>rule</i> 10-74 are to be interpreted
10-80 to 10-120 (PRR)	N		But see <i>BIPRU</i> TP 8.29R to <i>BIPRU</i> TP 8.31G
10-170 to 10-176 (CRR)	10-170(3) and (9) (Valuation) and 10-173(8) (Daily valuation)	N	
	The rest	Y	See <i>BIPRU</i> TP 8.20R to <i>BIPRU</i> TP 8.25R
10-190 to 10-196 (Large exposures)	10-190(1) (Application)	N	<i>BIPRU</i> TP 10 (Pre CRD capital requirements applying on a consolidated basis during 2007) deals with consolidation

Chapter 10 rule	A Y denotes that the provision does apply An N denotes that it does not apply		Remarks
	The rest	Y	See <i>BIPRU</i> TP 8.26R to <i>BIPRU</i> TP 8.28R
10-200 to 10-204 (Consolidated supervision)	N		
10-300 (ACMPs)	Y		Applies to the extent relevant to the parts of chapter 10 that apply under <i>BIPRU</i> TP 8
Appendix 1 (Glossary of Terms for <i>IPRU(INV)</i> 10)	Y		See <i>BIPRU</i> TP 8.32R
Appendices 4 to 11 (PRR)	Appendix 4 43R to 47R (Specific risk portion of the interest rate PRR)	Y	
	The rest of Appendices 4 to 11	N	
Appendix 20 (Guidance notes on reconciliation of firm's balances with a counterparty which is a member of an exchange (rule 10-11(4)))	N		
Appendix 21 (Note on the valuation of positions)	N		
Appendix 43 (Guidance note on the financial resources and accounting treatment of soft commission agreements (rule 10-73 and 10-175))	Y		Applies so far as relevant to CRR
Appendix 47 (Counterparty weights to be applied in calculating liquidity adjustment and CRR (rules 10-64 to 10-68, and 10-172 to 10-176))	Y		
Appendix 48 (Securities and Futures firms: Guid-	Y		

Chapter 10 <i>rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
ance notes on the secondary requirement)		
Appendix 55 (Guidance notes on the application of adequate collateral or acceptable collateral to reduce counterparty exposures)	Y	
Appendix 56 (Guide to Adequate Credit Management Policy (ACMP) (rules 10-172 to 10-175, 10-300 and "ACMP"))	Y	See remarks for 10-300
Appendix 57 (List of exchanges and clearing houses recognised for the purposes of IPRU(INV))	Y	
Appendix 58 (Verification of interim profits by external auditors)	N	
Appendix 59 (List of regulators for the purposes of the definition of recognised third country investment firms)	Y	
Appendix 62 (Netting)	Y	
Appendix 63 (Guidance on Credit derivatives)	Y	(1) Applies so far as relevant to CRR.  (2) Applies so far as relevant to liquidity adjustments.  (3) Does not apply so far as relevant to the PRR.  (4) If the <i>firm</i> is the protection seller in relation

Chapter 10 rule	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
		to a credit derivative in the <i>non-trading book</i> it must apply the treatment in <i>IPRU(BANK)</i> .
		<b>Categorisation</b>
8.12	R	Each <i>firm</i> is a Category A firm for the purposes of chapter 10 of <i>IPRU(INV)</i> as applied by <a href="#">BIPRU TP 3</a> (Pre CRD capital requirements applying on a solo basis during 2007) and this section.
		<b>How to use the chapter 10 liquidity adjustment rules</b>
8.13	R	A <i>firm</i> must calculate the <i>credit risk capital component</i> by adding together the deductions under the liquidity adjustment <i>rules</i> that apply under <i>BIPRU TP 8.11R</i> .
8.14	R	The 100% liquidity adjustment in <i>IPRU(INV)</i> 10-65 (Liquidity adjustment on illiquid assets) does not apply.
8.15	G	The reason for <i>BIPRU TP 8.14R</i> is explained in <i>BIPRU TP 8.8G</i> .
8.16	R	<i>IPRU(INV)</i> 10-65 (Illiquid assets) only applies to a <i>firm</i> calculating <i>capital resources</i> under <a href="#">GENPRU 2 Annex 4 R</a> (Capital resources table for a BIPRU investment firm deducting material holdings).
8.17	G	The reason for <i>BIPRU TP 8.16R</i> is explained in <i>BIPRU TP 8.8G</i> .
8.18	R	A <i>firm</i> must calculate the credit risk charge for <i>commodities</i> in the <i>non-trading book</i> as a liquidity adjustment under <i>IPRU(INV)</i> 10-64(1)(c) in accordance with the CRR <i>rules</i> in Chapter 10. A <i>firm</i> must include that amount in the calculation of the <i>credit risk capital component</i> .
8.19	G	A <i>firm</i> may still apply the CRR netting provisions for <i>commodities</i> in chapter 10 even though the calculation is split between the <i>credit risk capital component</i> and the <i>counterparty risk capital component</i> under <i>BIPRU TP 8.18R</i> and <i>BIPRU TP 8.20R</i> . The net amount should be allocated to the

			<p><i>credit risk capital component</i> if the gross value of the <i>non-trading book commodities</i> is bigger and to the <i>counterparty risk capital component</i> if the gross value of the <i>trading book commodities</i> is bigger.</p>
8.20	R		<p>Subject to <i>BIPRU</i> TP 8.18R, a <i>firm</i> must calculate the <i>counterparty risk capital component</i> as being equal to the capital charge under the <i>CRR rules</i> that apply under <i>BIPRU</i> TP 8.11R.</p> <p><b>Adjustments to the CRR calculations: General</b></p>
8.21	G		<p>Broadly speaking the Directive transitional provisions that allow pre-2007 credit risk rules to be used in 2007 cover all credit risk rules. However the transitional provisions for <i>trading book</i> credit risk (Annex II of the <i>Capital Adequacy Directive</i>, which is implemented in <i>BIPRU</i> 14 (Capital requirements for settlement and counterparty risk)) is not quite as straightforward as that. In some cases pre-2007 requirements can be used. In others they cannot. The purpose of <i>BIPRU</i> TP 8.22R to <i>BIPRU</i> TP 8.25R is to reflect those cases in which the Directive requires the new requirements to apply from 1 January 2007.</p> <p><b>Adjustments to the CRR calculations: Free deliveries</b></p>
8.22	R	(1)	<p>The calculations under rule 10-172 of <i>IPRU(INV)</i> (Free deliveries) are amended in accordance with this rule.</p>
		(2)	<p>A <i>firm</i> must include <i>foreign currency</i> transactions.</p>
		(3)	<p>The capital treatment in the table in <i>BIPRU</i> 14.4.3 R (Capital treatment for free deliveries) applies. But when the capital treatment in that table is that the <i>firm</i> must treat the transaction as an <i>exposure</i>, the <i>firm</i> must apply the</p>

treatment in *rule* 10-172 rather than BIPRU 14 (Capital requirements for settlement and counterparty risk).

**Adjustments to the CRR calculations: Derivative transactions**

8.23 R A *firm* must treat a credit derivative in the *trading book* as a derivative to which *rule* 10-174 of *IPRU(INV)* (Derivative transactions) applies.

8.24 G The capital treatment for credit derivatives set out in BIPRU 14.2.5 R - BIPRU 14.2.8 R (Capital treatment for credit derivatives) does not apply.

**Adjustments to the CRR calculations: Cash against documents**

8.25 R A *firm* must include *foreign currency* transactions in the calculations under 10-171 of chapter 10 of *IPRU(INV)* (Cash against documents transactions).

**How to use the chapter 10 large exposure rules**

8.26 R 10-190 to 10-196 of chapter 10 of *IPRU(INV)* (Large exposures requirement) apply in place of BIPRU 10 (Concentration risk).

8.27 R A *firm* must calculate the *concentration risk capital component* as being equal to the capital charge under the *LER rules* that apply under BIPRU TP 8.11R.

8.28 R BIPRU 10.5.2 R to BIPRU 10.5.5 R (Capital resources for concentration risk purposes) apply in place of the corresponding provisions of chapter 10.

**Specific risk calculations**

8.29 R A *firm* must use chapter 10 of *IPRU(INV)* as it applies under BIPRU TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) and this section to calculate the *specific risk* portion of the *interest rate PRR* under BIPRU 7.2 (Interest rate PRR) to the extent that the relevant *rules* in BIPRU 7.2 require the use of the *standardised approach* to credit risk.

8.30 R Any reference to a *qualifying debt security* in a part of BIPRU that applies during 2007 must be interpreted in accordance with the definition in the Glossary to chapter 10 of *IPRU(INV)*. However

8.31	G	<p>BIPRU 7.2.50 R (Must not apply <i>qualifying debt security</i> treatment to risky assets) also applies.</p> <p>The effect of BIPRU TP 8.29R and BIPRU TP 8.30R is that a <i>firm</i> should apply rules 43R to 47R of Appendix 4 of Chapter 10 of IPRU(INV) (Specific risk portion of interest rate PRR) instead of BIPRU 7.2.43 R to BIPRU 7.2.49 R (Specific risk portion of <i>interest rate PRR</i>). The reason for this is that the calculation of the <i>specific risk</i> portion of the <i>interest rate PRR</i> under BIPRU 7 (Market risk) involves the use of the <i>standardised approach</i> to credit risk. The <i>specific risk rules</i> therefore need to be adjusted for a <i>firm</i> that is not using the <i>standardised approach</i> to credit risk in 2007 so as to apply the pre-2007 method of calculating <i>specific risk</i>.</p>
8.32	R	<p><b>Definitions</b></p> <p>The definitions of trading book, non-trading book, commodity, financial institution, illiquid asset and material holding in the Glossary to chapter 10 of IPRU(INV) are replaced by the corresponding definitions in the <i>Glossary</i>.</p>
8.33	G	<p><b>Mapping GENPRU and BIPRU concepts onto IPRU</b></p> <p>Some of the parts of chapter 10 of IPRU(INV) that apply in 2007 refer to parts of IPRU that do not apply. BIPRU TP 3.10R explains that where this happens a <i>firm</i> should interpret that cross-reference in accordance with the provision in BIPRU or GENPRU that corresponds to the IPRU provision that does not apply in 2007. A <i>firm</i> should refer to IPRU in the case of cross-references in GENPRU and BIPRU to provisions in GENPRU and BIPRU that do not apply in 2007. BIPRU TP 8.34G sets out how certain concepts in chapter 10 of IPRU(INV) correspond to ones in GENPRU and BIPRU. The purpose of the table is to help <i>firms</i> to interpret such cross-references.</p>
8.34	G	<p>Table: Mapping GENPRU and BIPRU concepts onto ones in chapter 10 of IPRU(INV)</p> <p>This table belongs to BIPRU TP 8.33G</p>

<i>GENPRU and BIPRU</i>	Chapter 10 of <i>IPRU(INV)</i>
Calculations of <i>counterparty risk capital component</i> and calculations under BIPRU 14 (Capital requirements for settlement and counterparty risk)	Calculation of CRR
<i>Illiquid asset</i>	Illiquid asset
Deduction from <i>capital resources</i> as an <i>illiquid assets</i>	100% liquidity adjustment
Calculation of the <i>credit risk capital component</i>	8% liquidity adjustment
<i>Concentration risk capital component</i>	LER
Unsettled transaction under BIPRU 14.3	Cash against documents ( <i>IPRU(INV)</i> 10-171)
<i>Free deliveries</i> under BIPRU 14.4	Free deliveries ( <i>IPRU(INV)</i> 10-172)
Calculation of <i>PRR</i> or of the <i>market risk capital requirement</i>	Calculation of <i>PRR</i> and the foreign exchange requirement
<i>Capital resources</i> calculations under GENPRU 2 Annex 4 R	Financial resources calculation under table 10-62(2)A
<i>Capital resources</i> calculations under GENPRU 2 Annex 6 R	Financial resources calculation under table 10-62(2)B
<i>Capital resources</i> calculations under GENPRU 2 Annex 5 R respectively	Financial resources calculation under table 10-62(2)C
<i>Investment firm consolidation waiver</i>	Exemption from consolidated supervision
<i>Commodity extended maturity ladder approach</i>	Modified maturity ladder approach (relevant to the CRR calculation - see 10-174)
The table in BIPRU 7.8.28 R (Net underwriting position reduction factors)	Table 27R of Appendix 7 (Net underwriting position reduction factors)
Consolidated supervision in accordance with <i>rules</i> 10-200 to 10-203 (see for example the reference in <i>rule</i> 10-192(1)(g))	Consolidated supervision under BIPRU 8 (Group risk - consolidation)
<i>Initial capital</i>	Initial capital
<i>Tier one capital resources plus tier two capital resources</i> after deductions (stage N of the <i>capital resources table</i> )	Own funds
<i>Capital resources</i>	Financial resources (as referred to for example in <i>rule</i> 10-74)
Externally verified interim net profits and losses and partners' capital as referred to in GENPRU 2.2.102 R	Interim profit and loss account (as referred to in <i>rule</i> 10-74)
<i>Trading book concentration risk excess</i>	Excess D under <i>rule</i> 10-194(3)
<i>Risk weight</i>	Counterparty weight.

		<b>Firms using the IRB approach during 2007: General</b>
8.35	R	<i>BIPRU</i> TP 8.36G to <i>BIPRU</i> TP 8.38R only apply to a <i>firm</i> that is applying the <i>IRB approach</i> under <i>BIPRU</i> TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) as well as using <i>IPRU</i> .
8.36	G	The effect of <i>BIPRU</i> TP 3.17G (Pre CRD capital requirements applying on a solo basis during 2007 for <i>firms</i> also using the <i>IRB approach</i> ) is that neither the illiquid asset adjustment nor the CRR requirements of chapter 10 apply to an <i>exposure</i> to which the <i>firm</i> applies the <i>IRB approach</i> . The <i>IRB approach</i> requirements in <i>BIPRU</i> apply instead. The main requirements are listed in <i>BIPRU</i> TP 3.17G.
8.37	R	A <i>firm</i> must apply <i>BIPRU</i> 7.2.45 R - 7.2.47R (Using internal ratings to calculate <i>specific risk</i> and treatment of <i>securitisations</i> ) to calculate the <i>specific risk</i> portion of the <i>interest rate PRR</i> to the extent that the obligor or <i>exposure</i> in question comes within the scope of its <i>IRB permission</i> .
8.38	R	The definition of <i>qualifying debt security</i> in the <i>Glossary</i> applies if the security or obligor in question comes within the scope of a <i>firm's IRB permission</i> .

## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 9

### Pre CRD capital requirements applying on a solo basis during 2007 and capital floors: Personal investment firms

		<b>Application</b>
9.1	R	<p>This section (except <i>BIPRU</i> TP 9.45R) applies to a <i>BIPRU</i> firm that:</p> <ol style="list-style-type: none"> <li>(1) is a <i>personal investment firm</i>; and</li> <li>(2) is applying <i>BIPRU</i> TP 3.4R (Use of IPRU on a solo basis during 2007).</li> </ol>
9.2	G	<p><i>BIPRU</i> TP 9.45R applies to a <i>BIPRU</i> firm that:</p> <ol style="list-style-type: none"> <li>(1) is a <i>personal investment firm</i>; and</li> <li>(2) applies <i>BIPRU</i> TP 2 (Capital floors for a firm using the IRB or AMA approaches).</li> </ol>
9.3	G	<p><b>Purpose of this section</b></p> <p><i>BIPRU</i> TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) says that during 2007 a <i>firm</i> may apply the credit risk requirements of <i>IPRU</i> instead of the ones in <i>BIPRU</i>. For a <i>personal investment firm</i> this involves applying the credit risk requirements in chapter 13 of <i>IPRU(INV)</i>. This section explains how this is done. In particular this section explains:</p> <ol style="list-style-type: none"> <li>(1) which parts of chapter 13 should be treated as credit risk requirements for this purpose;</li> <li>(2) what parts of chapter 13 apply during 2007 and what changes are made</li> </ol>

			to chapter 13 for that purpose; and
		(3)	what changes are made to <i>GENPRU</i> and <i>BIPRU</i> to reflect the fact that chapter 13 applies in place of parts of <i>GENPRU</i> and <i>BIPRU</i> .
9.4	G		This section also explains how the obligation in <i>BIPRU TP 2</i> (Capital floors for a firm using the IRB or AMA approaches) is applied to a <i>personal investment firm</i> .
			<b>Duration of transitional</b>
9.5	R		This section applies until 1 January 2008.
			<b>Drafting approach in this section</b>
9.6	G		The purpose of <i>BIPRU TP 3</i> (Pre CRD capital requirements applying on a solo basis during 2007) is that the basic provisions of <i>BIPRU</i> and <i>GENPRU</i> should be in force from 1 January 2007. However a <i>firm</i> should be able to calculate the capital requirements for credit risk under <i>IPRU</i> and use the large exposures requirements in <i>IPRU</i> . This means that a <i>firm</i> should slot the credit risk requirements of chapter 13 of <i>IPRU(INV)</i> into the general requirements of <i>GENPRU</i> and <i>BIPRU</i> .
9.7	G		The capital calculation for credit risk under <i>BIPRU</i> is made up of three elements, which are set out in <i>GENPRU 2.1.51 R</i> (Calculation of the credit risk capital requirement). These are the <i>credit risk capital component</i> , the <i>counterparty risk capital component</i> and the <i>concentration risk capital component</i> . So the approach in <i>BIPRU TP 9.6G</i> involves finding equivalents for these three elements in chapter 13 where possible.
9.8	G		The general approach to calculating the capital requirements for credit risk in <i>GENPRU</i> and <i>BIPRU</i> is to calculate the overall <i>credit risk capital requirement</i> (which is the sum of the three components listed in <i>BIPRU TP 9.7G</i> ) - a monetary amount - and to compare it with <i>capital resources</i> , also a monetary amount. A <i>firm</i> calculating its <i>capital resources</i> may usually choose between deducting <i>illiquid assets</i> and <i>material holdings</i> . Only if it has a <i>waiver</i> from consolidated supervision need it deduct both.

9.9	G	The drafting approach of chapter 13 to calculating the capital requirement for credit risk is different from the one in <i>GENPRU</i> and <i>BIPRU</i> . A <i>firm</i> calculates financial resources by adjusting the assets in the balance sheet, taking into account liabilities. Financial resources are then used to test compliance with an own funds test, an expenditure based requirement test and a net asset test. The equivalent of a credit risk charge in Chapter 13 is the deduction of an asset as an Illiquid Adjustment or the deduction of a portion of an asset calculated using the Counterparty Risk Adjustment. Both illiquid assets and material holdings in <i>credit institutions</i> , <i>investment firms</i> and <i>insurers</i> are deducted under Chapter 13.
9.10	G	To make the <i>GENPRU</i> and <i>BIPRU</i> requirements compatible with chapter 13 for the purpose of <a href="#">BIPRU TP 3</a> (Pre CRD capital requirements applying on a solo basis during 2007), this section takes the approach in <i>BIPRU TP 9.11G</i> to <i>BIPRU TP 9.18G</i> .
9.11	G	The <i>illiquid assets</i> and <i>material holdings</i> provisions of <a href="#">GENPRU 2.2</a> (Capital resources) apply.
9.12	G	The chapter 13 Illiquid Adjustment and the chapter 13 Counterparty Risk Adjustment are used to calculate the <i>BIPRU</i> credit risk charge for <i>non-trading book</i> items (called the <i>credit risk capital component</i> ) and the <i>BIPRU</i> credit risk charge for <i>trading book</i> items (called the <i>counterparty risk capital component</i> ).
9.13	G	When this section requires a <i>firm</i> to apply an Illiquid Adjustment to an asset a <i>firm</i> should apply a credit risk charge to that asset equal to the amount of the Illiquid Adjustment under Chapter 13 and include that charge in the calculation of the total credit risk charge. The amount of that credit risk charge will generally be equal to the amount of that asset. This is equivalent to a deduction from capital. A <i>firm</i> should not apply an Illiquid Adjustment to the extent that the asset has already been included as an <i>illiquid asset</i> or <i>material holding</i> and deducted from <i>capital resources</i> under <a href="#">GENPRU 2.2</a> .
9.14	G	The Chapter 13 Position Risk Adjustment no longer applies. If a <i>firm</i> has a <i>trading book</i> , an item in the <i>trading book</i> that would have received a Position Risk Adjustment is subject to a capital charge under <a href="#">BIPRU 7</a> (Market risk). An item in a <i>firm's non-</i>

9.15	G	<p><i>trading book</i> that would have received a Position Risk Adjustment is subject under this section to an Illiquid Adjustment. A <i>firm</i> should approach its usual supervisory contact at the <i>appropriate regulator</i> if it believes that this treatment is disproportionate.</p>
9.15	G	<p>When this section requires a <i>firm</i> to apply a Counterparty Risk Adjustment to an asset a <i>firm</i> should apply a credit risk charge to that asset equal to the amount of the Counterparty Risk Adjustment under Chapter 13 and include that charge in the calculation of the total credit risk charge. The amount of that credit risk charge will generally be equal to the amount of that asset multiplied by the percentage in Table 13.5.4B or 13.5.4C. A <i>firm</i> should not apply a Counterparty Risk Adjustment to the extent that the asset has already been included as an <i>illiquid asset</i> or <i>material holding</i> and deducted from <i>capital resources</i> under GENPRU 2.2.</p>
9.16	G	<p>All <i>non-trading book</i> items are excluded under IPRU(INV) 13.8. This exclusion is incorporated in the calculations under this section as a credit risk charge of 100%. IPRU(INV) 13.8 does not apply if the <i>firm</i> does not have a <i>trading book</i>.</p>
9.17	G	<p>The calculation of the capital requirements for credit risk in GENPRU and BIPRU is based on applying a capital charge to the <i>firm's</i> assets. The credit risk charge in GENPRU and BIPRU in broad terms reflects the risk to a <i>firm</i> that it will suffer loss because its counterparties do not pay what they owe to the <i>firm</i>. Thus generally it is not necessary to continue the requirement in Table 13.5.4 to deduct liabilities. However it is still necessary to include other liabilities deducted as part of the calculation of financial resources under Chapter 13 if they are of the type listed in section 4 of Chapter BC of IPRU(BANK). This is because the Directive provisions that allow pre-2007 credit risk requirements to be used during 2007 require a capital charge for this type of item. In practice it is unlikely that these items will be relevant to a <i>personal investment firm</i> except for guarantees.</p>
9.18	G	<p>The chapter 13 Large exposure Adjustment is used to calculate the <i>concentration risk capital</i></p>

		<i>component</i> . This is only relevant to a <i>firm</i> with a <i>trading book</i> .
		<b>Parts of chapter 13 of IPRU(INV) that apply in 2007</b>
9.19	R	The parts of chapter 13 of <i>IPRU(INV)</i> that do and do not apply during the period that <i>BIPRU TP 3.4R</i> applies are set out in <i>BIPRU TP 9.21R</i> .
9.20	G	The table in <i>BIPRU TP 9.21R</i> assumes that the <i>firm</i> is not applying the <i>IRB approach</i> . <i>BIPRU TP 9.41R</i> to <i>BIPRU TP 9.44R</i> deal with a <i>firm</i> that does apply the <i>IRB approach</i> .

9.21	R	Table: Parts of chapter 13 of IPRU(INV) that apply in 2007
		This table belongs to <i>BIPRU TP 9.19R</i>

Chapter 13 rule	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
13.1 (Application)	N	<i>BIPRU TP 9.1R</i> and <i>BIPRU TP 9.2R</i> apply instead
13.1.2 (General requirements)	N	
13.1.3 to 13.1.6 (Professional Indemnity insurance)	N	
13.1.7 to 13.1.9 (Notification)	N	
13.1.10 to 13.1.17 (Record keeping)	N	Applied in part under <i>BIPRU TP 23</i> (Record keeping transitionals)
13.2 (Financial Resources Tests)	N	
13.3 (Financial Resources Test 1 - Own funds)	N	
13.4 (Financial resources Test 1A - Adjusted net current assets)	N	

Chapter 13 rule	A	Y denotes that the provision does apply	Remarks
		An N denotes that it does not apply	
13.5.1R to 13.5.3AG (Expenditure-based Requirement)	N		
13.5.4 (Calculation of financial resources to meet Tests 1, 1A or 2)	Y		Only applies for the purpose of deciding whether Table 13.5.4(1) or Table 13.5.4(2) applies
13.5.4A (Obligation to identify trading book items and special adjustments)	Y		Does not apply to special adjustments that do not apply under this section
Part I of Tables 13.5.4(1) and (2) (Net assets requirement for firms in Category A): (Assets calculation)	Illiquid Adjustment	Y	See <i>BIPRU</i> TP 9.23R to <i>BIPRU</i> TP 9.26G
	Counterparty Risk Adjustment	Y	See <i>BIPRU</i> TP 9.23R to <i>BIPRU</i> TP 9.31G
	Position Risk Adjustment	N	If an <i>exposure</i> in the <i>non-trading book</i> would have been subject to a Position Risk Adjustment a <i>firm</i> must apply an Illiquid Adjustment to it.
	Large exposure Adjustment	Y	See <i>BIPRU</i> TP 9.34R
Part II of Tables 13.5.4(1) and (2) (Net assets requirement for firms in Category A): (Liabilities calculation)	Counterparty Risk Adjustments	Y	See <i>BIPRU</i> TP 9.23R to <i>BIPRU</i> TP 9.31G
	Liabilities if they are listed in section 4 of Chapter BC of <i>IPRU(BANK)</i> and are in the <i>firm's non-trading book</i>	Y	(1) This applies whether they are on or off balance sheet.  (2) A <i>firm</i> must include liabilities under a credit derivative.  (3) See <i>BIPRU</i> TP 9.23R

Chapter 13 rule	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
	Position Risk Adjustment N	If an <i>exposure</i> in the <i>non-trading book</i> would have been subject to a Position Risk Adjustment a <i>firm</i> must apply an Illiquid Adjustment to it.
	The rest N	
Table 13.5.4A (Position risk)	N	
Table 13.5.4B (Unsettled securities transactions)	N	See <i>BIPRU</i> TP 9.28R
Table 13.5.4C (Counter-party risk)	Y	See <i>BIPRU</i> TP 9.23R to <i>BIPRU</i> TP 9.31G
Table 13.5.4D (Over the counter derivatives)	Y	See <i>BIPRU</i> TP 9.26G and <i>BIPRU</i> TP 9.30R to <i>BIPRU</i> TP 9.31G
Table 13.5.4E (Foreign exchange risk)	N	
13.5.5 to 13.5.5C (Subordinated debt)	N	
13.6 (Large exposures)	Y	See <i>BIPRU</i> TP 9.32R to <i>BIPRU</i> TP 9.34R
13.7 (Consolidated Supervision of Group Companies)	N	
13.8 (Trading book)	Table 13.8(1) (Definition of trading book) N The rest Y	See <i>BIPRU</i> TP 9.23R and <i>BIPRU</i> TP 9.38R
13.9 to 13.9.12 (Financial resources tests for Category B firms)	N	
Glossary for chapter 13	Y	See <i>BIPRU</i> TP 9.38R
<b>Categorisation</b>		
9.22	R	Each <i>firm</i> is a Category A firm for the purposes of chapter 13 of <i>IPRU(INV)</i> as applied by <i>BIPRU</i> TP 3

9.23

R

(Pre CRD capital requirements applying on a solo basis during 2007) and this section.

**How to use the chapter 13 Illiquid Adjustment and the Counterparty Risk Adjustment**

A firm must calculate the sum of the *credit risk capital component* and the *counterparty risk capital component* as being equal to the sum of the following:

- (1) the amount of the Illiquid Adjustments under chapter 13 of *IPRU(INV)* so far as they are in force under *BIPRU TP 9.21R*;
- (2) the amount of any *non-trading book* assets that would be excluded under *rule 13.8.2* of chapter 13 of *IPRU(INV)* (exclusion of *non-trading book* items from financial resources calculations);
- (3) the amount in relation to unsettled securities transactions (Cash against documents) specified in *BIPRU TP 9.28R*;
- (4) the amount in relation to unsettled securities transactions (Free deliveries) specified in *BIPRU TP 9.29R*;
- (5) the amount of the Counterparty Risk Adjustments under whichever is applicable of point 22 of Part II of Table 13.5.4(1) and point 22 of Part II of Table 13.5.4(2) of chapter 13 of *IPRU(INV)* (Liabilities adjustments relating to OTC derivatives for

			calculating financial resources);
		(6)	the amount of the other Counterparty Risk Adjustments under whichever is applicable of Part I of Table 13.5.4(1) and Part I of Table 13.5.4(2) of chapter 13 of <i>IPRU(INV)</i> (Assets adjustments for calculating financial resources); and
		(7)	the amount of any other liabilities under whichever is applicable of Part II of Table 13.5.4(1) and Part II of Table 13.5.4(2) of chapter 13 of <i>IPRU(INV)</i> but only to the extent provided by <i>BIPRU</i> TP 9.21R.
9.24	R		A <i>firm</i> must not apply a credit risk charge to an <i>exposure</i> under <i>BIPRU</i> TP 9.23R to the extent that it has already been deducted as an <i>illiquid asset</i> or a <i>material holding</i> under <i>GENPRU</i> 2.2 (Capital resources).
9.25	R		If it is necessary to distinguish between the <i>credit risk capital component</i> and the <i>counterparty risk capital component</i> a <i>firm</i> must allocate:
		(1)	any amount calculated for an <i>exposure</i> in the <i>non-trading book</i> to the <i>credit risk capital component</i> ; and
		(2)	any amount calculated for an <i>exposure</i> in the <i>trading book</i> to the <i>counterparty risk capital component</i> .
9.26	G		A <i>firm</i> may still apply the netting provisions for OTC derivatives in chapter 13 even though the OTC derivative calculation is split between the <i>credit risk capital component</i> and the <i>counterparty risk capital component</i> under <i>BIPRU</i> TP 9.25R.

		<p>The net amount should be allocated to the <i>credit risk capital component</i> if the gross value of the <i>non-trading book</i> derivatives is bigger and to the <i>counterparty risk capital component</i> if the gross value of the <i>trading book</i> derivatives is bigger.</p> <p><b>Adjustments to the Counterparty Risk Adjustments calculations: General</b></p>
9.27	G	<p>Broadly speaking the Directive transitional provisions that allow pre-2007 credit risk rules to be used in 2007 cover all credit risk rules. However the transitional provisions for <i>trading book</i> credit risk (Annex II of the <i>Capital Adequacy Directive</i>, which is implemented in BIPRU 14 (Capital requirements for settlement and counterparty risk)) is not quite as straightforward as that. In some cases pre-2007 requirements can be used. In others they cannot. The purpose of BIPRU TP 9.28R to BIPRU TP 9.31G is to reflect those cases in which the Directive requires the new requirements to apply from 1 January 2007.</p> <p><b>Adjustments to the Counterparty Risk Adjustments calculations: Unsettled Securities Transactions</b></p>
9.28	R	<p>(1) The calculation of the credit risk charge for unsettled securities transactions is based on the Counterparty Risk Adjustment for such transactions adjusted in accordance with this <i>rule</i>.</p> <p>(2) Subject to the rest of this <i>rule</i>, the amount of the credit risk charge is equal to the Counterparty Risk Adjustment under paragraphs (a) and (b) in the unsettled securities transactions sections of Table 13.5.4(1) or (2).</p> <p>(3) The credit risk charge applies where the <i>firm</i> is exposed to loss if the</p>

			(4)	<p>counterparty does not perform.</p> <p>A <i>firm</i> must calculate the Counterparty Risk Adjustment for an unsettled securities transaction in the <i>trading book</i> under BIPRU 14.3 (Unsettled transactions) rather than under chapter 13 of <i>IPRU(INV)</i>.</p>
			<b>Adjustments to the Counterparty Risk Adjustments calculations: Free deliveries</b>	
9.29	R	(1)		<p>The calculation of the credit risk charge for a free delivery is based on the Counterparty Risk Adjustment for such transactions adjusted in accordance with this <i>rule</i>.</p>
		(2)		<p>Subject to the rest of this <i>rule</i>, the amount of the credit risk charge is equal to the Counterparty Risk Adjustment under paragraphs (a) and (b) in the free delivery sections of Table 13.5.4(1) or (2).</p>
		(3)		<p>A <i>firm</i> must include <i>foreign currency</i> and <i>commodity</i> for the purpose of <i>trading book</i> calculations.</p>
		(4)		<p>The capital treatment in the table in BIPRU 14.4.3 R (Capital treatment for free deliveries) applies for the purpose of <i>trading book</i> calculations. But when the capital treatment in that table is that the <i>firm</i> must treat the transaction as an <i>exposure</i>, the <i>firm</i> must</p>

			calculate a credit risk charge equal to the amount in (2).
			<b>Adjustments to the Counterparty Risk Adjustments calculations: Derivative transactions</b>
9.30	R		A <i>firm</i> must treat a credit derivative in the <i>trading book</i> as a derivative to which paragraph 22 of Part II of Table 13.5.4(1), paragraph 22 of Part II of Table 13.5.4(2) and table 13.5.4D of chapter 13 of <i>IPRU(INV)</i> (Over the counter derivatives) apply.
9.31	G		The capital treatment for a credit derivative set out in BIPRU 14.2.5 R - BIPRU 14.2.8 R (Capital treatment for credit derivatives) does not apply.
			<b>How to use the chapter 13 large exposure rules</b>
9.32	R		Section 13.6 of chapter 13 of <i>IPRU(INV)</i> (Large exposures) applies in place of BIPRU 10 (Concentration risk).
9.33	R		The following adjustments are made to section 13.6 of chapter 13 of <i>IPRU(INV)</i> (Large exposures):
		(1)	BIPRU 10.5.2 R to BIPRU 10.5.5 R (Capital resources for concentration risk purposes) apply in place of the definition of own funds that applies under section 13.6 of chapter 13 of <i>IPRU(INV)</i> ;
		(2)	<i>rule</i> 13.6.2B (Excess over EBR should not be excluded) does not apply; and
		(3)	BIPRU 10.5.14 R (Notification) applies instead of the notification requirement in 13.6.
9.34	R		A <i>firm</i> must calculate its <i>concentration risk capital component</i> as being equal to the sum of the Large exposure Adjustments under whichever is applicable of Part I of Table 13.5.4(1) and Part I of Table 13.5.4(2) of chapter 13 of <i>IPRU(INV)</i>

			(Assets adjustments for calculating financial resources).
			<b>Specific risk calculations</b>
9.35	R		A <i>firm</i> must calculate the <i>specific risk</i> portion of the <i>interest rate PRR</i> in accordance with <i>BIPRU TP 8.29R</i> (Pre CRD <i>interest rate PRR</i> for <i>securities and futures firms</i> ).
9.36	R		Any reference to a <i>qualifying debt security</i> in a part of <i>BIPRU</i> that applies during 2007 must be interpreted in accordance with the definition in the Glossary to chapter 13 of <i>IPRU(INV)</i> . However <i>BIPRU 7.2.50 R</i> (Must not apply <i>qualifying debt security</i> treatment to risky assets) also applies.
9.37	R		The reason for <i>BIPRU TP 9.35R</i> and <i>BIPRU TP 9.36R</i> is that the calculation of the <i>specific risk</i> portion of the <i>interest rate PRR</i> under <i>BIPRU 7</i> (Market risk) involves the use of the <i>standardised approach</i> to credit risk. The <i>specific risk rules</i> therefore need to be adjusted for a <i>firm</i> that is not using the <i>standardised approach</i> to credit risk in 2007 so as to apply the pre-2007 method of calculating <i>specific risk</i> . However chapter 13 does not distinguish between <i>specific risk</i> and <i>general market risk</i> . The nearest equivalent is in chapter 10 of <i>IPRU(INV)</i> ( <i>Securities and futures firms</i> ).
			<b>Definitions</b>
9.38	R		The definition of trading book is replaced with the definition in the <i>Glossary</i> . Section 13.8 of chapter 13 of <i>IPRU(INV)</i> (Trading book) and the definition in the Glossary to chapter 13 are amended accordingly.
			<b>Mapping GENPRU and BIPRU concepts onto IPRU</b>
9.39	G		Some of the parts of chapter 13 of <i>IPRU(INV)</i> that apply in 2007 refer to parts of chapter 13 that do not apply. <i>BIPRU TP 3.10R</i> explains that where this happens a <i>firm</i> should interpret that cross-reference in accordance with the provision in <i>BIPRU</i> or <i>GENPRU</i> that corresponds to the chapter 13 provision that does not apply in 2007. A <i>firm</i> should refer to <i>IPRU</i> in the case of cross-references in <i>GENPRU</i> and <i>BIPRU</i> to provisions in <i>GENPRU</i> and <i>BIPRU</i> that do not apply in 2007. <i>BIPRU TP 9.40G</i> sets out how certain concepts in chapter 13 of <i>IPRU(INV)</i> correspond to ones in <i>GENPRU</i> and

*BIPRU*. The purpose of the table is to help *firms* to interpret such cross-references.

9.40	G	Table: Mapping GENPRU and BIPRU concepts onto ones in chapter 13 of IPRU(INV)
		This table belongs to <i>BIPRU</i> TP 9.39G

<i>GENPRU</i> and <i>BIPRU</i>	Chapter 13 of <i>IPRU(INV)</i>
See <i>BIPRU</i> TP 9.10G to <i>BIPRU</i> TP 9.17G	Illiquid Adjustment
See <i>BIPRU</i> TP 9.10G to <i>BIPRU</i> TP 9.17G	Counterparty Risk Adjustment
See <i>BIPRU</i> TP 9. 18G	Large exposure Adjustment
<i>Material holding</i>	The nearest equivalent is point 13 of Part I of Table 13.5.4(1) and (2) (All other assets)
Unsettled transaction under <i>BIPRU</i> 14.3	Cash against documents
<i>Free deliveries</i> under <i>BIPRU</i> 14.4	Free deliveries
<i>Market risk capital requirement</i>	The Position Risk Adjustment and the Foreign Exchange Risk Adjustment
<i>Trading book concentration risk excess</i>	Excess X in Table 13.6.2(2)
A <i>firm</i> should use the <i>specific risk</i> portion of the relevant <i>PRR charge</i> under <i>BIPRU</i> 7 (Market risk) (subject to the other provisions of this section about specific risk) where Chapter 13 as applied by this section requires the <i>firm</i> to apply position risk discounts.	Position risk discounts (particularly relevant for the purposes of Table 13.6.2(2))
<i>Risk weight</i>	Where Chapter 13 requires an asset to be deducted from capital that is equivalent to applying a <i>risk weight</i> of 1250%. Applying the 1.6% adjustment under Table 13.5.4C is equivalent to applying a 20% <i>risk weight</i> under <i>BIPRU</i> together with the standard 8% <i>BIPRU</i> credit risk charge. The "NIL" adjustment under that table is equivalent to applying a 0% <i>risk weight</i> .

9.41	R	<b>Firms using the IRB approach during 2007: General</b> <i>BIPRU</i> TP 9.42G to <i>BIPRU</i> TP 9.44R only apply to a <i>firm</i> that is applying the <i>IRB approach</i> under <i>BIPRU</i> TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) as well as using <i>IPRU</i> .
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9.42	G	<p>The effect of <i>BIPRU</i> TP 3.17G (Pre CRD capital requirements applying on a solo basis during 2007 for <i>firms</i> also using the <i>IRB approach</i>) is that the Counterparty Risk Adjustments do not apply to an <i>exposure</i> to which the <i>firm</i> applies the <i>IRB approach</i>. The <i>IRB approach</i> requirements in <i>BIPRU</i> apply instead. The main requirements are listed in <i>BIPRU</i> TP 3.17G. The same applies to the Illiquid Adjustments although <i>illiquid assets</i> or <i>material holdings</i> will still have to be deducted under <i>GENPRU</i> 2.2 (Capital resources).</p>
9.43	R	<p>A <i>firm</i> must apply <i>BIPRU</i> 7.2.45 R - <i>BIPRU</i> 7.2.47 R (Using internal ratings to calculate <i>specific risk</i> and treatment of <i>securitisations</i>) to calculate the <i>specific risk</i> portion of the <i>interest rate PRR</i> to the extent that the obligor or <i>exposure</i> in question comes within the scope of its <i>IRB permission</i>.</p>
9.44	R	<p>The definition of <i>qualifying debt security</i> in the <i>Glossary</i> applies if the security or obligor in question comes within the scope of a <i>firm's IRB permission</i>.</p>
9.45	R	<p><b>Calculation of capital floors under <i>BIPRU</i> TP 2</b></p> <p>(1) This paragraph sets out how the obligation in <i>BIPRU</i> TP 2 (Capital floors for a firm using the <i>IRB</i> or <i>AMA approaches</i>) is applied to a <i>personal investment firm</i>.</p> <p>(2) A <i>firm</i> must apply Financial Resources Test 2 (Expenditure-based Requirement) for the periods specified in <i>BIPRU</i> TP 2 by multiplying the Expenditure-based Requirement by the percentage figure in <i>BIPRU</i> TP 2.8R or <i>BIPRU</i> TP 2.9R.</p> <p>(3) <i>BIPRU</i> TP 2 does not apply to Financial Resources Test 1 (Own funds) or Financial Re-</p>

sources Test 1A (Adjusted net current assets).

## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 10 Pre CRD capital requirements applying on a consolidated basis during 2007

			<b>Application</b>
10.1	R		This section applies to a <i>firm</i> to which BIPRU 8 (Consolidation) applies.
			<b>Purpose</b>
10.2	G		This section sets out how BIPRU TP 3 - BIPRU TP 9 (Use of IPRU during 2007) are applied on a consolidated basis.
			<b>Duration of transitional</b>
10.3	R		BIPRU TP 10 applies until 1 January 2008.
			<b>Main rule</b>
10.4	R		A <i>firm</i> may apply BIPRU TP 3 to BIPRU TP 9 (Use of IPRU during 2007 on a solo basis) on a consolidated basis. Applying them on a consolidated basis means that BIPRU 8 (Group risk - Consolidation) is modified by applying the relevant parts of BIPRU TP 3 to BIPRU TP 9 (as defined in BIPRU TP 10.5R) in place of the corresponding BIPRU credit risk and other rules.
10.5	R	(1)	This rule sets out what the relevant parts of BIPRU TP 3 to BIPRU TP 9 (Use of IPRU during 2007 on a solo basis) are for the purposes of BIPRU TP 10.4R. The answer depends on the kind of UK consolidation group or non-EEA sub-group ("group") to which consolidated requirements are being applied.
		(2)	If the group is a building society group as defined in BIPRU TP 1.7R, the relevant parts of BIPRU TP 3 to BIPRU TP 9 are those applicable to a <i>building society</i> .
		(3)	If the group is a banking group as defined in BIPRU TP 1.7R, the relevant

			<p>parts of BIPRU TP 3 to BIPRU TP 9 are those applicable to a <i>bank</i>.</p> <p>(4) If the group is an investment services group as defined in BIPRU TP 1.7R, the relevant parts of BIPRU TP 3 to BIPRU TP 9 are those applicable to the main BIPRU investment firm in that group. For these purposes the main BIPRU investment firm is identified in the same way as the "main firm" is identified under rule 14.4.2R(1) of chapter 14 IPRU(INV).</p>
10.6	G		<p>The application of BIPRU TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) on a consolidated basis is not done by applying the relevant consolidation provisions in IPRU. BIPRU 8 (Group risk - Consolidation) still applies, as modified by this section. BIPRU TP 10.7G to BIPRU TP 10.12G summarise how BIPRU TP 3 works on a consolidated basis under this section assuming that the firm does not use the IRB approach.</p>
10.7	G		<p>The consolidated credit risk charge (called the <i>consolidated credit risk requirement</i>) is normally calculated under BIPRU 8 by applying the solo BIPRU credit risk charges on a consolidated basis. Under this section the IPRU credit risk charges are applied instead, as modified by BIPRU TP 3 to BIPRU TP 9 (Use of IPRU during 2007 on a solo basis).</p>
10.8	G		<p>Under this section the applicable IPRU large exposure requirements, as modified by BIPRU TP 3 to BIPRU TP 9, apply instead of the ones in BIPRU 10 (Concentration risk requirements). BIPRU TP 10.15R disapplies most of BIPRU 8.9 (Consolidated concentration risk requirements).</p>
10.9	G		<p>A firm should calculate the <i>consolidated credit risk requirement</i> so far as it relates to the <i>concentration risk capital component</i> using the relevant IPRU rules. In particular a firm should not use the capital requirements of a regulator other than the <i>appropriate regulator</i> for this purpose.</p>
10.10	G		<p>A firm should still base its capital resources calculation for consolidation purposes on BIPRU 8.6 (Consolidated capital resources) rather than using the IPRU capital resources calculations. In turn, BIPRU 8.6 is based on GENPRU 2.2 (Capital resources). This applies for consolidated concentration risk purposes as well.</p>
10.11	G		<p>BIPRU 8.4 (CAD Article 22 groups and investment firm consolidation waiver) still applies.</p>

10.12	G	<p>The calculation of consolidated capital requirements under BIPRU 8.7 (Consolidated capital resources requirements) depends in part on whether the group contains <i>banks</i>, <i>BIPRU limited activity firms</i> or <i>BIPRU limited licence firms</i>. This continues to apply for the purpose of this section in addition to <i>BIPRU TP 10.5R</i>. So for instance, if a group contains only <i>BIPRU limited licence firms</i> the consolidated capital requirements for the group are based on the capital requirements for <i>BIPRU limited licence firms</i>. However in addition if, for example, the main <i>firm</i> (as defined in <i>BIPRU TP 10.5R</i>) is a <i>personal investment firm</i> the requirements for <i>BIPRU limited licence firm</i> are modified in accordance with <i>BIPRU TP 9</i> (Pre CRD capital requirements applying on a solo basis during 2007 and capital floors: Personal investment firms). The calculation of notional capital resources requirements under <i>BIPRU 8.4.13 R</i> (Capital adequacy obligations relating to a CAD Article 22 group: Capital resources requirement) works in a similar way.</p> <p><b>Consolidated capital resources requirement: Use of home state requirements for EEA firms</b></p>
10.13	R	<p>A <i>firm</i> may, for the purposes of <i>BIPRU TP 10.4R</i>, use the solo financial resources requirement to which an <i>EEA firm</i> is subject in accordance with <i>BIPRU 8.7.34 R</i> (Use of the solo requirements of another EEA competent authority) or the consolidated financial resources requirements of an <i>EEA competent authority</i> under <i>BIPRU 8.7.37 R</i> (Use of the consolidated requirements of another EEA competent authority). However those requirements must be ones that apply under the <i>CRD implementation measures</i> for Articles 152(8) - (14) of the <i>Banking Consolidation Directive</i> and Article 50(1) of the <i>Capital Adequacy Directive</i> for the relevant <i>EEA State</i> (Pre CRD capital requirements applying during 2007).</p> <p><b>Consolidated capital resources requirement: Use of home state requirements for third country undertakings</b></p>
10.14	R	<p>(1) A <i>firm</i> may, for the purposes of <i>BIPRU TP 10.4R</i>, use the solo financial resources requirement of a <i>third country competent authority</i> in accordance with <i>BIPRU 8.7.35 R</i> (Use of the solo requirements of a regulator outside the EEA) or the consolidated financial resources requirements of a <i>third country competent authority</i> under <i>BIPRU 8.7.38 R</i> (Use of the consolidated requirements of a regulator outside the EEA) in accordance with the adjustments in this <i>rule</i>.</p>

- (2) The list in BIPRU 8 Annex 6 R (List of equivalent third country regulators) does not apply and instead:
- (a) if the *UK consolidation group* or *non-EEA subgroup* is a banking group or building society group as defined in BIPRU TP 1.7R (Classification of groups for certain consolidation rules), the lists in Appendices C and D of chapter CS of *IPRU(BANK)* apply; and
  - (b) if the *UK consolidation group* or *non-EEA subgroup* is an investment firm group as defined in BIPRU TP 1.7R, the list in Appendix 59 of chapter 10 of *IPRU(INV)* applies.
- (3) The *firm* must apply the version of those requirements in force on 31 December 2006 or any later version that remains consistent with *EEA prudential sectoral legislation* for the *banking sector* or *investment services sector* in the form it was in on 31 December 2006.
- (4) The requirement in BIPRU 8.7.35 R (2) and the last sentence of BIPRU 8.7.38 R (2) (Requirement for calculation not to produce a lower figure than the *appropriate regulator's rules*) still applies.

#### Consolidated large exposures

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10.15	R	<p>A <i>firm</i> must apply the concentration risk requirements under BIPRU TP 3 to BIPRU TP 9 (Use of IPRU during 2007 on a solo basis) applicable to its <i>UK consolidation group</i> or <i>non-EEA sub-group</i> under BIPRU TP 10.4R as if it were a single <i>undertaking</i>. BIPRU 8.9.2 R (Definition of consolidated capital resources for concentration risk purposes) applies for the purpose of this <i>rule</i>. BIPRU 8.9 (Consolidated concentration risk requirements) does not otherwise apply.</p>
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# Prudential sourcebook for Banks, Building Societies and Investment Firms

## BIPRU TP 11 IRB transitionals

FCA PRA

11.1	R	<p><b>Application</b></p> <p>BIPRU TP 11 applies to a <i>BIPRU firm</i> that uses the <i>IRB approach</i>.</p>
11.2	G	<p><b>Purpose</b></p> <p>BIPRU TP 11 implements Articles 154(2), (3) and (5) of the <i>Banking Consolidation Directive</i> and (in part) Article 17 of the <i>Capital Adequacy Directive</i>.</p>
11.3	R	<p><b>Use requirement</b></p> <p>In accordance with Article 154(2) of the <i>Banking Consolidation Directive</i>, for a <i>firm</i> applying for the use of the <i>IRB approach</i> before 2010, the three years' use requirement prescribed in BIPRU 4.2.11 R (Requirements concerning the experience requirement) is reduced to a period of one year until 31 December 2009.</p>
11.4	R	<p>In accordance with Article 154(3) of the <i>Banking Consolidation Directive</i>, for a <i>firm</i> applying for the use of own estimates of <i>LGDs</i> and/or <i>conversion factors</i>, the three year use requirement prescribed in BIPRU 4.2.13 R (Requirements concerning the experience requirement) is reduced to two years until 31 December 2008.</p>
11.5	G	<p>The transitional period in BIPRU TP 11.3R rather than that in</p>

11.6	R	<p>BIPRU TP 11.4R applies to <i>retail exposures</i>.</p> <p><b>Residential properties</b></p> <p>In accordance with Article 154(5) of the <i>Banking Consolidation Directive</i>, until 31 December 2012, the <i>exposure</i>-weighted average <i>LGD</i> for all <i>retail exposures</i> secured by residential properties and not benefiting from guarantees from central governments must not be lower than 10%.</p>
11.7	R	<p><b>Expected loss</b></p> <p>BIPRU TP 11.3R to BIPRU TP 11.6R also apply for the purpose of BIPRU 14.2.18 R and BIPRU 14.2.19 R (Treatment of expected loss amounts under the IRB approach) and GENPRU 2.2.193 R (Upper tier two capital: Surplus provisions).</p>

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### BIPRU TP 12 Operational risk transitionals: small trading book

		<b>Application</b>
12.1	R	<p>Subject to <i>BIPRU</i> TP 12.2R, <i>BIPRU</i> TP 12 applies to a <i>BIPRU investment firm</i> that satisfies the following conditions:</p> <ol style="list-style-type: none"> <li>(1) it is a <i>full scope BIPRU investment firm</i>;</li> <li>(2) it does not fall within the definition of <i>limited licence firm</i> or <i>limited activity firm</i> in <i>BIPRU</i> 1.1.11 R to <i>BIPRU</i> 1.1.12 R (Definitions of <i>limited licence firm</i> or <i>limited activity firm</i>);</li> <li>(3) its total <i>trading book positions</i> never exceed 50 million Euro;</li> <li>(4) the average number of its relevant employees during the financial year does not exceed 100; and</li> <li>(5) the <i>firm</i> has a <i>waiver</i> that modifies <i>BIPRU</i> 6 (Operational risk) so as to require the <i>firm</i> to calculate its <i>ORCR</i> in accordance with <i>BIPRU</i> TP 12.</li> </ol>
12.2	R	<p><i>BIPRU</i> TP 12.12R to <i>BIPRU</i> TP 12.14G apply to any <i>firm</i> to which <i>BIPRU</i> 8 (Group risk - consolidation) applies.</p> <p><b>Purpose</b></p>
12.3	G	<p><i>BIPRU</i> TP 12 implements Article 46 of the <i>Capital Adequacy Directive</i>.</p> <p><b>Duration of transitional</b></p>
12.4	R	<p><i>BIPRU</i> TP 12 applies until 31 December 2011.</p> <p><b>Calculation of number of employees</b></p>
12.5	R	<p>In calculating the average number of its relevant employees a <i>firm</i> must:</p> <ol style="list-style-type: none"> <li>(1) include all its <i>directors</i>, officers having executive responsibilities and <i>senior managers</i>;</li> </ol>

		(2)	include all staff whose responsibilities include front office responsibilities in relation to activities that give rise to <i>positions</i> in the <i>trading book</i> ;
		(3)	include all staff whose responsibilities include back office, compliance or risk management responsibilities in relation to activities that give rise to <i>positions</i> in the <i>trading book</i> ;
		(4)	include contractors of or <i>persons</i> seconded to the <i>firm</i> or carrying out functions for the <i>firm</i> who would be relevant employees if they were employed by the <i>firm</i> ; and
		(5)	take into account the methodology for calculating an average number of employees referred to in section 382(6) of the Companies Act 2006.
12.6	R		A <i>firm</i> must have a written policy for identifying <i>persons</i> who are relevant employees for the purpose of BIPRU TP 12.5R.
			<b>Purpose of BIPRU TP 12.1R(2)</b>
12.7	G		The purpose of BIPRU TP 12.1R(2) is to exclude a <i>firm</i> that falls into the definition of <i>full scope BIPRU investment firm</i> because it has obtained a <i>waiver</i> or has a <i>Part IV permission</i> that enables it to calculate an <i>ORCR</i> instead of the <i>fixed overheads requirement</i> (see BIPRU 6.1.2 G).
			<b>Reduction of the ORCR</b>
12.8	R		The <i>ORCR</i> of a <i>firm</i> to which this <i>rule</i> applies is the lower of:
		(1)	the <i>ORCR</i> that would have applied but for this <i>rule</i> ; and
		(2)	12/88 of the higher of the following:
		(a)	the sum of <i>credit risk capital requirement</i> and the <i>market risk capital requirement</i> ; and
		(b)	the <i>fixed overheads requirement</i> , notwithstanding that the <i>fixed over-</i>

			<i>heads requirement does not apply.</i>
12.9	R	The fraction 12/88 in <i>BIPRU</i> TP 12.8R(2) increases in accordance with the table in <i>BIPRU</i> TP 12.10R.	
12.10	R	Table: Increase in 12/88 fraction	
		This table belongs to <i>BIPRU</i> TP 12.9R	

Date on which increase takes effect	Fraction
1 January 2008	27/88
1 January 2009	42/88
1 January 2010	57/88
1 January 2011	72/88

		<b>Minimum capital requirement</b>	
12.11	R	(1)	A <i>firm</i> must have capital resources at least equal to the capital resources requirement that applies to it under whichever part of <i>IPRU</i> applies to the <i>firm</i> under <i>BIPRU</i> TP 1.4R.
		(2)	A <i>firm</i> must calculate its capital resources for the purposes of this <i>rule</i> in accordance with the same part of <i>IPRU</i> .
		(3)	The following provisions of <i>BIPRU</i> TP 2 (Capital floors for a firm using the IRB or AMA approaches) apply for the purposes of this <i>rule</i> :
		(a)	<i>BIPRU</i> TP 2.14R to <i>BIPRU</i> TP 2.15G (Adjustments to the calculation of capital resources);
		(b)	<i>BIPRU</i> TP 2.18R to <i>BIPRU</i> TP 2.19G (CAD 1 model and VaR model);
		(c)	<i>BIPRU</i> TP 2.20R to <i>BIPRU</i> TP 2.21G (Individual capital guidance);
		(d)	<i>BIPRU</i> TP 2.22R to <i>BIPRU</i> TP 2.27G

(How to apply *IPRU* for the purposes of the capital floor calculations); and

(e) *BIPRU* TP 2.29R (Solo consolidation and the capital floor calculations).

### Consolidation

12.12 R A *firm* may only calculate the *consolidated operational risk requirement* with respect to its *UK consolidation group* or *non-EEA sub-group* in accordance with *BIPRU* TP 122 if the group in question satisfies the following conditions:

- (1) there is no *credit institution* in the group;
- (2) the *consolidated capital resources requirement* of the group is calculated in accordance with stage 2 in *BIPRU* 8 Annex 5 R (Consolidation requirements for a group containing a *CAD full scope firm*);
- (3) the group meets the conditions in *BIPRU* TP 12.1R(3) and (4) applied on a consolidated basis; and
- (4) the *firm* has a *waiver* that modifies *BIPRU* 8 (Group risk - consolidation) so as to require the *firm* to calculate its *consolidated operational risk requirement* in accordance with *BIPRU* TP 12.

### Minimum consolidated capital requirement

12.13 R If a *firm* applies *BIPRU* TP 12.12R to its *UK consolidation group* or *non-EEA sub-group* it must apply *BIPRU* TP 12.11R to that group in accordance with *BIPRU* TP 2.31R to *BIPRU* TP 2.33G (Consolidated capital floors for a *firm* using the *IRB approach* or *AMA (advanced measurement approach)*).

### Changes in a firm's business

12.14 G The *Capital Adequacy Directive* says that a *competent authority* may agree to reduce the capital floor implemented by *BIPRU* TP 12.11R and *BIPRU* TP 12.13R if such a reduction is prudentially justified by a reduction in the size of the *firm's* business. Those *rules* implement that option

by requiring a *firm* to apply the *IPRU* requirements to its business as it changes over time.



# Prudential sourcebook for Banks, Building Societies and Investment Firms

## BIPRU TP 13 Other operational risk transitionals

FCA PRA

13.1	R	<p><b>Application</b></p> <p>BIPRU TP 13 applies to a <i>BIPRU firm</i>.</p>
13.2	G	<p><b>Purpose</b></p> <p>BIPRU TP 13 implements Articles 155 of the <i>Banking Consolidation Directive</i> and Article 44 of the <i>Capital Adequacy Directive</i>.</p>
13.3	R	<p><b>Relevant indicator</b></p> <p>Until 31 December 2012, a percentage of 15% applies to the business line "Trading and Sales" of a <i>firm</i> whose relevant indicator (as referred to in BIPRU 6.4.6 R) for the business line "Trading and Sales" represents at least 50% of the total of the relevant indicators for all of the <i>firm's</i> business lines in accordance with BIPRU 6.4.6 R to BIPRU 6.4.16 G (Calculating the <i>ORCR</i> under the <i>standardised approach to operational risk</i>).</p>
13.4	G	<p><b>Reduced operational risk charge in 2007</b></p> <p><i>BIPRU</i> TP 3.21R (Reduced <i>ORCR</i> for a <i>firm</i> applying pre-CRD capital requirements in 2007) also contains a transitional rule about <i>operational risk</i>.</p> <p><b>Systems and controls in 2007</b></p>

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13.5	R	<p>A reference in BIPRU 6 (Operational risk) to SYSC 4 to SYSC 10 (referred to in this <i>rule</i> as the "common platform requirements") or a part of those requirements must be read as being to the corresponding provisions of SYSC 3. This <i>rule</i> ceases to have effect on 1 November 2007 or on any earlier date on which the <i>firm</i> elects to comply with the common platform requirements in accordance with SYSC.</p>
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# Prudential sourcebook for Banks, Building Societies and Investment Firms

## BIPRU TP 14 Market risk: VaR models

		<b>Application</b>
14.1	R	<p>BIPRU TP 14 applies to a <i>BIPRU firm</i> that:</p> <ol style="list-style-type: none"> <li>(1) has had a <i>VaR model permission</i> since 1 January 2007; and</li> <li>(2) on 31 December 2006 calculated its capital requirements under <i>IPRU</i> using the <i>VaR model approach</i> (as then in force) under a <i>waiver</i> or (in the case of a <i>firm</i> to which <i>IPRU(BANK)</i> or <i>IPRU(BSOC)</i> applied) written <i>guidance</i> (a "written concession").</li> </ol>
14.2	G	<p><b>Purpose</b></p> <p>BIPRU TP 14 implements Article 47 of the <i>Capital Adequacy Directive</i>.</p>
14.3	R	<p><b>Duration of transitional</b></p> <p>BIPRU TP 14 applies until 31 December 2009 or any earlier date specified in the <i>firm's VaR model permission</i>.</p>
14.4	R	<p><b>Specific risk calculations for VaR models</b></p> <p>A <i>firm</i> may treat:</p> <ol style="list-style-type: none"> <li>(1) the <i>VaR specific risk minimum requirements</i> and the provisions about backtesting in relation to <i>specific risk</i> as being replaced by the provisions of the written concession</li> </ol>

(2)

referred to in BIPRU TP 14.1 relating to *specific risk*; and

the *incremental risk charge* as being replaced by the provisions of that written concession relating to the calculation of capital requirements for *specific risk*.

## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 15 Commodities firm transitionals: Exemption from capital requirements

FCA

		<b>Application</b>
15.1	R	<p>Subject to <i>BIPRU</i> TP 15.2R, <i>BIPRU</i> TP 15 applies to a <i>BIPRU</i> investment firm:</p> <p>(1) whose main business consists exclusively of the provision of investment services or investment activities in relation to the financial instruments set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to the <i>MI-FID</i>; and</p> <p>(2) to whom the <i>ISD</i> would not have applied if it had remained in force in the form it was in on 31 December 2006.</p>
15.2	R	<p><i>BIPRU</i> TP 15.13R to <i>BIPRU</i> TP 15.14G apply to any firm to which <i>BIPRU</i> 8 (Group risk - consolidation) applies.</p> <p><b>Purpose</b></p>
15.3	G	<p><i>BIPRU</i> TP 15 implements Article 48(1) of the <i>Capital Adequacy Directive</i>.</p> <p><b>Duration of exemption</b></p>
15.4	R	<p><i>BIPRU</i> TP 15 applies until 31 December 2014 .</p> <p>[<b>Note:</b> <i>CAD</i> Article 48(1)]</p>
15.5	G	<p>If there are any modifications pursuant to paragraphs 2 and 3 of Article 48 of the <i>Capital Adequacy Directive</i> (European Commission review of prudential regime for exempt commodity firms), the <i>appropriate regulator</i> will revoke <i>BIPRU</i> TP 15 if the date of coming into force of the implementing measures in relation to those changes is before the date in <i>BIPRU</i> TP 15.4R.</p> <p><b>Exemption</b></p>

15.6	R	The provisions of <i>GENPRU</i> and <i>BIPRU</i> on capital requirements and <i>GENPRU</i> 1.2 (Adequacy of financial resources) do not apply to a <i>firm</i> to which <i>BIPRU</i> TP 15 applies. However <i>BIPRU</i> 10 (Large exposures requirements) continues to apply, including the <i>CNCOM</i> .
15.7	G	If a <i>firm</i> meets the conditions in <i>BIPRU</i> TP 16 (Commodities firm transitionals: large exposures) it will be exempt from <i>BIPRU</i> 10 as well.
15.8	G	An <i>exempt BIPRU commodities firm</i> (which is the name in the <i>Glossary</i> given to a <i>firm</i> with the benefit of the exemption in <i>BIPRU</i> TP 15.6R) may be subject to the requirements of Chapter 3 of <i>IPRU(INV)</i> . Details of which <i>exempt BIPRU commodities firm</i> are subject to those requirements can be found in Chapter 3 of <i>IPRU(INV)</i> .
15.9	G	The table in <i>BIPRU</i> TP 15.10G provides an indication of which parts of <i>GENPRU</i> and <i>BIPRU</i> generally apply to an <i>exempt BIPRU commodities firm</i> and which parts in general do not apply. If a section is shown as not in general applying the table also identifies any significant aspects of that section that do apply.

**FCA**

15.10	G	Table: Parts of <i>GENPRU</i> and <i>BIPRU</i> that apply to exempt <i>BIPRU</i> commodities firms
This table belongs to <i>BIPRU</i> TP 15.9G		

<i>GENPRU</i> and <i>BIPRU</i> provisions		Remarks
	A Y denotes that the provision generally does apply	
	An N denotes that generally it does not apply	
<i>GENPRU</i> TP (Transitional provisions)	Y	
<i>GENPRU</i> 1.1 (Application and scope)	Y	
<i>GENPRU</i> 1.2 (Adequacy of financial resources)	N	
<i>GENPRU</i> 1.3 (Valuation)	Y	
<i>GENPRU</i> 1.4 (Actions for damages)	Y	
<i>GENPRU</i> 1.5 (Application of <i>GENPRU</i> 1 to Lloyd's)		Not applicable as does not apply to <i>BIPRU</i> firms

<i>GENPRU</i> and <i>BIPRU</i> provisions	A Y denotes that the provision generally does apply  An N denotes that generally it does not apply	Remarks
<i>GENPRU</i> 2.1 (Calculation of capital resources requirements)	N	
<i>GENPRU</i> 2.2 (Capital resources)	Y	This applies for the purposes of <i>BIPRU</i> 10. If <i>BIPRU</i> 10 does not apply this does not apply either.
<i>GENPRU</i> 2.3 (Application of <i>GENPRU</i> 2 to Lloyd's)	Not applicable as does not apply to <i>BIPRU</i> firms	
<i>GENPRU</i> 3.1 (Cross sector groups)	Y	Only applies if the <i>firm</i> is a member of a <i>financial conglomerate</i>
<i>GENPRU</i> 3.2 (Third-country groups)	Y	Provisions about <i>financial conglomerate</i> only apply if the <i>firm</i> is a member of a <i>financial conglomerate</i>  See remarks on <i>BIPRU</i> 8 for provisions about a <i>third-country banking and investment group</i>
<i>BIPRU</i> TP (Transitional provisions)	Y	
<i>BIPRU</i> 1.1 (Application and scope)	Y	
<i>BIPRU</i> 1.2 (Definition of the trading book)	Y	
<i>BIPRU</i> 1.3 (Application for advanced approaches)	N	Provisions about <i>BIPRU</i> 2.1 and <i>BIPRU</i> 8 apply to the extent those parts of <i>BIPRU</i> apply. Otherwise does not apply.
<i>BIPRU</i> 1.4 (Actions for damages)	Y	
<i>BIPRU</i> 2.1 (Solo consolidation)	Y	Applies for the purposes of <i>BIPRU</i> 10.
<i>BIPRU</i> 2.2 (Adequacy of financial resources)	N	
<i>BIPRU</i> 2.3 (Interest rate risk in the non-trading book)	N	
<i>BIPRU</i> 3 (Standardised approach to credit risk)	N	

<i>GENPRU</i> and <i>BIPRU</i> provisions	A Y denotes that the provision generally does apply  An N denotes that generally it does not apply	Remarks
BIPRU 4 (The IRB approach)	N	
BIPRU 5 (Credit risk mitigation)	N	
BIPRU 6 (Operational risk)	N	
BIPRU 7 (Market risk)	N	BIPRU 7.8.38 R and BIPRU 7.3.39 R (Risk management systems and controls) apply in theory although it is unlikely that a <i>firm</i> will be able to carry out these activities without losing the exemption in BIPRU TP 15 .
BIPRU 8 (Group risk - consolidation)	Y	See <i>BIPRU</i> TP 15.13R to <i>BIPRU</i> TP 15.14G
BIPRU 9 (Securitisation)	N	<i>BIPRU</i> 9.1.6R to <i>BIPRU</i> 9.1.8G (Risk systems) apply
BIPRU 10 (Large exposures)	Y	If <i>firm</i> also qualifies for exemption under BIPRU TP 16 (Commodities firm transitionals: large exposures) BIPRU 10 does not apply except as described in <i>BIPRU</i> TP 16.7G
BIPRU 11 (Disclosure)	Y	
BIPRU 12		Chapter does not yet exist
BIPRU 13 (Financial derivatives, SFTs and long settlement transactions)	N	
BIPRU 14 (Capital requirements for settlement and counterparty risk)	N	

**FCA**

15.11	G	<i>SYSC</i> applies to an <i>exempt BIPRU commodities firm</i> .
		<b>Definitions</b>
15.12	R	The terms financial instrument, investment services and investment activities have the same meaning as they do in the <i>MIFID</i> .
		<b>Consolidation</b>

15.13	R	<p>BIPRU TP 15 does not apply for the purposes of BIPRU 8 with respect to a <i>firm's UK consolidation group</i> or, as the case may be, <i>non-EEA sub-group</i> unless the following conditions are satisfied:</p> <ol style="list-style-type: none"><li>(1) there is no <i>credit institution</i> in that group;</li><li>(2) each <i>investment firm</i> in the group meets the conditions in BIPRU TP 15.1R(1);</li><li>(3) each <i>investment firm</i> whose head office is in an <i>EEA State</i> satisfies the conditions in BIPRU TP 15.1R(2); and</li><li>(4) any <i>investment firm</i> whose head office is outside the <i>EEA</i> would have fallen into BIPRU TP 15.1R(2) if:<ol style="list-style-type: none"><li>(a) its head office had been in an <i>EEA State</i>; and</li><li>(b) it had carried on all its business in the <i>EEA</i> and had obtained whatever authorisations for doing so were required under the <i>ISD</i> in the form that Directive was in on 31 December 2006.</li></ol></li></ol>
15.14	G	<p>If an <i>exempt BIPRU commodities firm</i> is a member of a group that meets the conditions in BIPRU TP 15.13R, BIPRU 8 will not apply to the group. Chapter 14 of IPRU(INV) (Consolidation) applies instead.</p>



## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 16 Commodities firm transitionals: large exposures

FCA

		<b>Application</b>
16.1	R	<p>Subject to <i>BIPRU</i> TP 16.2R, <i>BIPRU</i> TP 16 applies to a <i>BIPRU investment firm</i> that satisfies the following conditions:</p> <ol style="list-style-type: none"> <li data-bbox="798 896 1473 1232">(1) it satisfies the requirements in <i>BIPRU</i> TP 15.1R and it remains eligible to apply the treatment in <i>BIPRU</i> TP 15 (Commodities firm transitionals: Exemption from capital requirements);</li> <li data-bbox="798 1254 1473 1523">(2) the <i>firm</i> provides investment services or investment activities related to the financial instruments listed in points 5, 6, 7, 9 and 10 of Section C of Annex I of the <i>MIFID</i>;</li> <li data-bbox="798 1545 1473 1724">(3) the <i>firm</i> does not provide such investment services or undertake such investment activities for, or on behalf of, retail clients;</li> <li data-bbox="798 1747 1473 2058">(4) breaches of the limits referred to in <i>BIPRU</i> TP 16.6R arise in connection with <i>exposures</i> resulting from contracts that are financial instruments as listed in (2) and relate to commodities or underlying</li> </ol>

			ings within the meaning of point 10 of Section C of Annex I of the <i>MI-FID</i> and are calculated in accordance with BIPRU 13 (Financial derivatives, SFTs and long settlement transactions) or in connection with <i>exposures</i> resulting from contracts concerning the delivery of <i>commodities</i> or emission allowances; and
		(5)	it satisfies the requirements in <i>BIPRU TP 16.8R</i> .
16.2	R		<i>BIPRU TP 16.11R</i> applies to any <i>firm</i> to which <i>BIPRU 8</i> (Group risk - consolidation) applies.
			<b>Purpose</b>
16.3	G		<i>BIPRU TP 16</i> implements Article 45 of the <i>Capital Adequacy Directive</i> . The condition in <i>BIPRU TP 16.1R(1)</i> is in addition to the Directive conditions.
			<b>Duration of transitional</b>
16.4	R		The treatment in <i>BIPRU TP 16</i> is available until 31 December 2014.
			[ <b>Note:</b> <i>CAD</i> Article 45(1)]
16.5	G		If there are any modifications consequent on the treatment of <i>large exposures</i> , pursuant to Article 119 of the <i>Banking Consolidation Directive</i> , the <i>FCA</i> will revoke <i>BIPRU TP 16</i> if the date of coming into force of the implementing measures in relation to those changes is before the date in <i>BIPRU TP 16.4R</i> . If the <i>FCA</i> revokes <i>BIPRU TP 15</i> it will also revoke <i>BIPRU TP 16</i> at the same time.
			<b>Exemption</b>
16.6	R	(1)	A <i>firm</i> may exceed the limits concerning <i>large exposures</i> in <i>BIPRU 10.5.6 R</i> (25% limit).
		(2)	The <i>CNCOM</i> does not apply.

16.7	G	<p>Broadly speaking the effect of <i>BIPRU</i> TP 16.6R is that <i>BIPRU</i> 10 (Large exposures ) does not apply to a <i>firm</i> that meets the conditions in <i>BIPRU</i> TP 16.1R. However <i>BIPRU</i> 10.12 (Systems and controls and general) continues to apply.</p>
16.8	R	<p><b>Documented strategy</b></p> <p>A <i>firm</i> must have a documented strategy for managing and, in particular, for controlling and limiting risks arising from the concentration of <i>exposures</i>. The <i>firm</i> must notify the <i>FCA</i> of this strategy and all material changes to this strategy without delay. The <i>firm</i> must make appropriate arrangements to ensure a continuous monitoring of the creditworthiness of borrowers, according to their impact on concentration risk. These arrangements must enable the <i>firm</i> to react adequately and sufficiently promptly to any deterioration in that creditworthiness.</p>
16.9	R	<p>Where a <i>firm</i> exceeds the internal limits set according to the strategy referred to in <i>BIPRU</i> TP 16.8R, it must notify the <i>FCA</i> without delay of the size and nature of the excess and of the <i>counterparty</i>.</p>
16.10	R	<p><b>Definitions</b></p> <p>The terms financial instrument, investment services and investment activities have the same meaning as they do in the <i>MIFID</i>.</p>
16.11	R	<p><b>Consolidation</b></p> <p><i>BIPRU</i> TP 16 does not apply for the purposes of <i>BIPRU</i> 8 (Group risk - consolidation) with respect to a <i>firm's</i> <i>UK consolidation group</i> or, as the case may be, <i>non-EEA sub-group</i> unless the following conditions are satisfied:</p> <p>(1) the group satisfies the requirements in <i>BIPRU</i> TP 15.13 (Application of <i>BIPRU</i> TP 15 on a consolidated basis) and the <i>firm</i> remains eligible to apply the treatment in <i>BIPRU</i> TP 15.13 with respect to that <i>UK consolidation group</i> or, as the case may be, <i>non-EEA sub-group</i>;</p>

- 
- (2) there is no *credit institution* in that group;
  - (3) each *investment firm* in the group meets the conditions in *BIPRU* TP 16.1R(2) and (3); and
  - (4) the group meets the conditions in *BIPRU* TP 16.1R(4) to (5) applied on a consolidated basis.

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## BIPRU TP 17 [Deleted]



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## BIPRU TP 18 [Deleted]



# Prudential sourcebook for Banks, Building Societies and Investment Firms

## BIPRU TP 19 [Deleted]



# Prudential sourcebook for Banks, Building Societies and Investment Firms

## BIPRU TP 20 Standardised credit risk transitionals

FCA PRA

		<b>Application</b>
20.1	R	This section applies to a <i>BIPRU firm</i> .
		<b>Days past due</b>
20.2	R	(1) This <i>rule</i> applies to an <i>exposure</i> in another <i>EEA State</i> of a type to which a <i>CRD implementation measure</i> in that <i>EEA State</i> for the first paragraph of Article 154(1) of the <i>Banking Consolidation Directive</i> (Transitional rule for days past due for claims on <i>PSEs</i> and <i>corporates</i> and <i>retail exposures</i> ) applies.
		(2) If the number of days past due set under that <i>CRD implementation measure</i> is greater than the number in <a href="#">BIPRU 3.4.96 R</a> (Treatment of items past due for more than 90 days) that higher number applies.
20.3	R	<i>BIPRU TP 20.2R</i> applies until 31 December 2011 or any earlier date on which the relevant <i>CRD implementation measure</i> ceases to apply.
20.4	G	<i>BIPRU TP 20.2R</i> implements (in part) Article 154(1) of the <i>Banking Consolidation Directive</i> .
		<b>Central government exposures</b>
20.5	R	Until 31 December 2015, a 0% <i>risk weight</i> applies to <i>exposures</i> to the central government of the <i>United Kingdom</i> and of the Bank of England denominated and funded in the currency of another <i>EEA State</i> .
20.6	R	If the <i>CRD implementation measures</i> of another <i>EEA State</i> apply a 0% <i>risk weight</i> to <i>exposures</i> to its central government or <i>central bank</i> denominated and funded in the domestic currency of another <i>EEA State</i> a <i>firm</i> must <i>risk weight</i> such <i>exposures</i> in the same manner.
20.7	R	<i>BIPRU TP 20.6R</i> applies until 31 December 2015 or any earlier date on which the relevant <i>CRD implementation measure</i> ceases to apply.
20.8	G	<i>BIPRU TP 20.5R</i> to <i>BIPRU TP 20.7R</i> implements (in part) Article 153 of the <i>Banking Consolidation Directive</i> .



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## BIPRU TP 21 Close substitutes for commodities

FCA PRA

21.1	R	<p><b>Application</b></p> <p>This section applies to a <i>BIPRU firm</i> that on 31 December 2006 was applying the approach referred to in the first column of the table in <i>BIPRU TP 21.3R</i> with respect to particular grades or brands of the same <i>commodity</i>-class.</p>
21.2	R	<p><b>Commodities: close substitutes</b></p> <p>A notice given under the <i>IPRU</i> provision in the second column of the table in <i>BIPRU TP 21.3R</i> is treated as having been given under <i>BIPRU 7.4.23 R</i> (Notice to the <i>appropriate regulator</i> about treatment of different grades or brands of the same <i>commodity</i>) for the purposes of <i>BIPRU 7.4.22 R</i> (Treatment of different grades or brands of the same <i>commodity</i>) with respect to the <i>commodity</i> grades or brands referred to in <i>BIPRU TP 21.1R</i>.</p>
21.3	R	<p>Table: Commodity treatments under <i>IPRU</i></p> <p>This table belongs to <i>BIPRU TP 21.2R</i></p>

PAGE  
1

<i>IPRU</i> provisions setting out <i>commodity</i> approach	<i>IPRU</i> provisions under which notice given
Paragraph 22(2) of appendix 6 of chapter 10 of <i>IPRU(INV)</i>	Paragraph 23 of appendix 6 of chapter 10 of <i>IPRU(INV)</i>
Paragraph 22(2) of chapter CM of <i>IPRU(BANK)</i>	Paragraph 23 of chapter CM of <i>IPRU(BANK)</i>

21.3

G

**Explanation**

BIPRU 7.4.22 R (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 7.4.23 R says that a *firm* should notify the *appropriate regulator* 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 7.4.23 R.

# Prudential sourcebook for Banks, Building Societies and Investment Firms

## BIPRU TP 22 Solo consolidation

	<b>Application</b>	
22.1	R	<p>This section applies to a <i>BIPRU firm</i> that:</p> <ol style="list-style-type: none"> <li>(1) is a <i>bank</i> or <i>building society</i>; and</li> <li>(2) on 31 December 2006, was, in accordance with the provision of <i>IPRU</i> referred to in <i>BIPRU TP 22.2R</i> and in accordance with a concession (as defined in <i>BIPRU TP 22.8R</i>), solo-consolidating a <i>subsidiary undertaking</i>.</li> </ol>
22.2	R	<p>The provisions of <i>IPRU</i> referred to in <i>BIPRU TP 22.1R</i> are:</p> <ol style="list-style-type: none"> <li>(1) (in the case of a <i>bank</i>) section 9 of chapter CS of <i>IPRU(BANK)</i>; and</li> <li>(2) (in the case of a <i>building society</i>) section 1.11 of chapter 1 of volume 1 of <i>IPRU(BSOC)</i>.</li> </ol>
		<b>Deemed solo consolidation waiver</b>
22.3	R	<p>A concession referred to in <i>BIPRU TP 22.1R</i> is treated as a <i>solo consolidation waiver</i> with respect to the <i>subsidiary undertaking</i> to which it relates if the <i>firm</i> notifies the <i>appropriate regulator</i> that the <i>firm</i> wishes to apply the treatment in <i>BIPRU 2.1</i> (Solo consolidation) to that <i>subsidiary undertaking</i>.</p>
		<b>Notice to the appropriate regulator</b>

22.4	R	<p>The following requirements apply to a notice under <i>BIPRU</i> TP 22.3R:</p> <ol style="list-style-type: none"> <li data-bbox="772 327 1398 510">(1) the <i>firm</i> must give the <i>appropriate regulator</i> the notice on or after 1 June 2006 and on or before 29 December 2006;</li> <li data-bbox="772 533 1398 640">(2) the notice must contain details of the concession concerned;</li> <li data-bbox="772 663 1398 882">(3) the notice must give the name of the <i>subsidiary undertaking</i> concerned and say where it is incorporated and has its head office; and</li> <li data-bbox="772 904 1398 1131">(4) the notice must say whether that <i>subsidiary undertaking</i> is a <i>body corporate</i> and state the legal form of that <i>subsidiary undertaking</i>.</li> </ol>
<b>Limitations</b>		
22.5	R	<p>Any condition, limitation or requirement to which a concession referred to in <i>BIPRU</i> TP 22.1R is subject continues to apply to the extent that it is compatible with <i>BIPRU</i>. In particular, if the concession was only for the purpose of large exposures it only has effect for the purposes of <a href="#">BIPRU 10</a> (Concentration risk) and if it was only for the purposes of capital adequacy it only has effect for the purposes of <a href="#">GENPRU 2.1.13 R</a> (Obligation to hold capital resources equal to or greater than the capital resources requirement) or <a href="#">GENPRU 2.1.60 R</a> (Calculation of base capital resources requirement for banks authorised before 1993).</p>
<b>Obligation to meet other qualifying conditions</b>		
22.6	R	<p>A <i>firm</i> with a deemed <i>solo consolidation waiver</i> under <i>BIPRU</i> TP 22.3R may not apply the treatment in <a href="#">BIPRU 2.1</a> (Solo consolidation) to the <i>subsidiary undertaking</i> concerned unless the conditions in <a href="#">BIPRU 2.1.20 R</a> to <a href="#">BIPRU 2.1.24 R</a> (Solo consolidation - Minimum standards) are met with respect to that <i>subsidiary undertaking</i>.</p>

		<b>Notification of relevance etc of concession</b>	
22.7	R		A <i>firm</i> which has the benefit of a concession that has effect under <i>BIPRU</i> TP 22.3R must notify the <i>appropriate regulator</i> immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the concession.
		<b>Meaning of concession</b>	
22.8	R		A concession means for the purposes of <i>BIPRU</i> TP 22:
		(1)	a consent or approval by the <i>appropriate regulator</i> under the provisions of <i>IPRU(BANK)</i> or <i>IPRU(BSOC)</i> referred to in <i>BIPRU</i> TP 22.2R; and
		(2)	a concession also means for the purposes of <i>BIPRU</i> TP 22 a written concession as defined in <i>SUP</i> TP 1.4 (Grandfathering of concessions granted by the <i>appropriate regulator's</i> predecessor regulators: rules in the Handbook) or <i>SUP</i> TP 1.2.6A (Grandfathering of concessions granted by the <i>appropriate regulator</i> predecessor regulators: guidance in the Handbook) that had effect for the purposes of the provisions of <i>IPRU(BANK)</i> or <i>IPRU(BSOC)</i> referred to in <i>BIPRU</i> TP 22.2R.
22.9	G		<i>BIPRU</i> TP 22.8R(2) provides a mechanism for keeping in effect solo consolidation concessions granted by the Bank of England and the Building Societies Commission.



## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 23 Record keeping transitionals

23.1	R	<p><b>Application</b></p> <p>This section applies to a <i>BIPRU investment firm</i>.</p>
23.2	R	<p><b>Duration of transitional</b></p> <p>This section applies until 1 November 2007.</p> <p><b>Continuing record keeping requirements</b></p> <p>A <i>firm</i> in the first column of the table in <i>BIPRU TP 23.4R</i> must comply with the <i>rules</i> in <i>IPRU(INV)</i> specified in the second column adjusted in accordance with <i>BIPRU TP 23.5R</i>.</p>
23.3	R	
23.4	R	<p>Table: List of IPRU reporting rules</p> <p>This table belongs to <i>BIPRU TP 23.3R</i></p>

Type of <i>firm</i>	<i>IPRU(INV) rules</i>
<i>Investment management firm</i>	<i>Rule 5.3.1 of chapter 5</i>
<i>UCITS investment firm</i>	<i>Rules 7.4.1(c) and 7.6.2 of chapter 7</i>
<i>Securities and futures firm</i>	<i>Rules 10-10, 10-11 and 10-12 of chapter 10</i>
<i>Personal investment firm</i>	<i>Rules 13.1.10 to 13.1.17 of chapter 13</i>

23.5	R	<p><b>Adjustments</b></p> <p>The adjustments referred to in <i>BIPRU TP 23.3R</i> are as follows:</p>
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- (1) a reference to a *firm's* financial resources requirements must be read as a reference to its obligations under [GENPRU 2.1](#) (Calculation of capital resources requirement) and any capital resources requirement under *BIPRU TP*;
- (2) the terms *trading book* and *non-trading book* have the meanings in the *Glossary*; and
- (3) a reference to requirements in *IPRU(INV)* must be read as a reference to the requirements of *GENPRU* and *BIPRU* applicable to the *firm* concerned.

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## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 24 Mid market valuations

24.1	R	<b>Application</b> This section applies to a <i>BIPRU firm</i> .
24.2	R	<b>Duration of transitional</b> This section applies until 1 January 2008.
24.3	R	<b>Transitional rule</b> When marking to market (see GENPRU 1.3.14 R to GENPRU 1.3.16 R (General requirements: Marking to market)) for the purposes of valuing a <i>trading book</i> item for the purpose of BIPRU 14 (Capital requirements for settlement and counterparty risk), a <i>firm</i> may choose between using the mid market value and the more prudent side of bid/offer whether or not the <i>firm</i> is a significant market maker in the item concerned. A <i>firm</i> must be consistent in the basis it chooses.



# Prudential sourcebook for Banks, Building Societies and Investment Firms

## BIPRU TP 25 Exclusions from consolidation

FCA PRA

25.1	R	<p><b>Application</b></p> <p>This section applies to a <i>firm</i> to which BIPRU 8 (Group risk - consolidation) applies.</p>
25.2	R	<p><b>Duration of transitional</b></p> <p>This section applies until 1 January 2008. However BIPRU TP 25.8R continues in force until it is revoked.</p>
25.3	R	<p><b>Transitional rule</b></p> <p>A <i>firm</i> may exclude a member of its <i>UK consolidation group</i> or <i>non-EEA sub-group</i> that would otherwise have been included under BIPRU 8.5 (Basis of consolidation) if, as at 31 December 2006, that member was excluded from the <i>firm's UK consolidation group</i> in accordance with any of the following:</p> <ul style="list-style-type: none"> <li data-bbox="798 1366 1473 1792">(1) bullet points one or three of paragraph 6 of section 4 of Chapter CS of IPRU(BANK) (exclusion from consolidation where inclusion would be inappropriate or misleading or where there are legal impediments to the transfer of information); or</li> <li data-bbox="798 1792 1473 2047">(2) section 1.13 of Chapter 1 of Volume 1 of IPRU(BSOC) (exclusion of subsidiary undertakings where inclusion in the consolidation would</li> </ul>

			<p>be misleading or inappropriate); or</p> <p>(3) <i>IPRU(INV)</i> 14.2.5R(2) (exclusion from consolidation where inclusion would be inappropriate or misleading); or</p> <p>(4) any <i>waiver</i> from the consolidation provisions of Chapter 14 of <i>IPRU(INV)</i> or (in the case of <i>IPRU(BSOC)</i>) a written consent or approval by the <i>appropriate regulator</i> on the ground set out in indent one of Article 52(3) of the Directive 2000/12 (the previous version of the <i>Banking Consolidation Directive</i>) (exclusion from consolidation where there are legal impediments to the transfer of information).</p>
25.4	R	<p>A <i>firm</i> may only apply <i>BIPRU</i> TP 25.3R to a member of its <i>UK consolidation group</i> or <i>non-EEA sub-group</i> if the <i>firm</i> or another member of its <i>UK consolidation group</i> notifies the <i>appropriate regulator</i> in writing that it intends to apply that <i>rule</i> to that member and the notice complies with the following requirements:</p> <p>(1) the <i>appropriate regulator</i> was notified on or after 1 November 2006 and on or before 29 December 2006;</p> <p>(2) the notice must give the name of the member concerned and say where it is incorporated and has its head office; and</p> <p>(3) the notice must say whether that member is</p>	

a *body corporate* and state the legal form of that member.

### Limitations

25.5 R Any condition, limitation or requirement to which the treatment in *BIPRU* TP 25.3R is subject continues to apply to the extent that it is compatible with *BIPRU*.

### Obligation to meet other qualifying conditions

25.6 R A *firm* may only apply the treatment in *BIPRU* TP 25.3R if the conditions in whichever is applicable of Article 73(1)(a) (exclusion from consolidation where there are legal impediments to transfer of information) or Article 73(1)(c) (exclusion from consolidation where inclusion would be inappropriate or misleading) of the *Banking Consolidation Directive* continue to be satisfied.

### Notification of relevance etc of concession

25.7 R A *firm* must notify the *appropriate regulator* immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the continuance of the treatment in *BIPRU* TP 25.3R.

### Small balance sheet size exclusion

25.8 R If a *firm* excluded a member of its *UK consolidation group* or *non-EEA sub-group* from the *firm's UK consolidation group* in accordance with:

- (1) bullet point two of paragraph 6 of section 4 of Chapter CS of *IPRU(BANK)* (exclusion from consolidation where combined balance sheet is below certain thresholds);
- (2) *IPRU(INV)* 14.2.5R(1) (exclusion from consolidation where combined balance sheet is below certain thresholds); or
- (3) a written consent or approval by the *appropriate regulator* under *IPRU(BSOC)* on the

ground set out in indent two of Article 52(3) of the Directive 2000/12 (the previous version of the *Banking Consolidation Directive*) (exclusion from consolidation where combined balance sheet is below certain thresholds);

the *firm* need not notify the *appropriate regulator* under BIPRU 8.5.9 R (exclusion from consolidation where combined balance sheet is below certain thresholds) as long as it has notified the *appropriate regulator* of its intention to take advantage of this *rule* and that notice complies with BIPRU TP 25.4R.

## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 26

### Quantitative aspects of BIPRU 12: all firms to which BIPRU 12 applies

#### Application

26.1 R BIPRU TP 26 applies to a *firm* which as at 1 December 2009 falls into BIPRU 12.1.1 R.

#### Transitional provisions

26.2

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional Provision	Transitional provision: dates in force	Handbook provisions: coming into force
1	BIPRU 12.2 and BIPRU 12.5 to BIPRU 12.9	R	In relation to a <i>firm</i> which as at 30 November 2009 calculates its liquidity resources in accordance with Chapter LS of <i>IPRU(BANK)</i> , the sections listed in column (2) do not apply.	1 December 2009 until 31 May 2010	1 December 2009
2	BIPRU 12.2 and BIPRU 12.5 to BIPRU 12.9	R	Subject to (3), in relation to a <i>firm</i> which as at 30 November 2009 calculates its liquidity resources in accordance with <i>IPRU(BSOC)</i> , the sections listed in column (2) do not apply.	1 December 2009 until 31 May 2010	1 December 2009
3	BIPRU 12.2 and BIPRU 12.5 to BIPRU 12.9	R	In relation to a <i>firm</i> which as at 30 November 2009 calculates its liquidity resources in accordance with <i>IPRU(BSOC)</i> and which as at 1 June 2010 has a <i>simplified ILAS waiver</i> , the sections listed in column (2) do not apply.	1 December 2009 until 30 September 2010	1 December 2009

4	BIPRU 12.2 and BIPRU 12.5 to BIPRU 12.9	R	In relation to a <i>firm</i> which as at 30 November 2009 calculates its liquidity resources in accordance with Chapter LM of <i>IPRU(BANK)</i> and which is not an <i>incoming EEA firm</i> or a <i>third country BIPRU firm</i> , the sections listed in column (2) do not apply.	1 December 2009 until 30 September 2010	1 December 2009
5	BIPRU 12.2 and BIPRU 12.5 to BIPRU 12.9	R	In relation to a <i>firm</i> which as at 30 November 2009 calculates its liquidity resources in accordance with Chapter LM of <i>IPRU(BANK)</i> and which is an <i>incoming EEA firm</i> or a <i>third country BIPRU firm</i> , the sections listed in column (2) do not apply.	1 December 2009 until 31 October 2010	1 December 2009
6	BIPRU 12.2 and BIPRU 12.5 to BIPRU 12.9	R	In relation to an <i>incoming EEA firm</i> or a <i>third country BIPRU firm</i> which as at 30 November 2009 has a Global Liquidity Concession (as described in <i>IPRU(BANK)</i> Chapter LM 4(2)), the sections listed in column (2) do not apply.	1 December until 31 October 2010 or, if earlier, the date on which the <i>firm</i> ceases to have a Global Liquidity Concession	1 December 2009
7	BIPRU 12.2 and BIPRU 12.5 to BIPRU 12.9	R	In relation to a <i>firm</i> which as at 1 December 2009 is a <i>full scope BIPRU investment firm</i> and which is also an <i>ILAS BIPRU firm</i> , the sections listed in column (2) do not apply.	1 December 2009 until 31 October 2010	1 December 2009
8	BIPRU 12.2 and BIPRU 12.8	R	In relation to a <i>firm</i> which as at 1 December 2009 is a <i>non-ILAS BIPRU firm</i> , the sections listed in column (2) do not apply.	1 December 2009 until 31 October 2010	1 December 2009

Guidance for a firm which becomes an ILAS BIPRU firm or non-ILAS BIPRU firm after 1 December 2009

- 26.3 G BIPRU TP 26 applies to a *firm* which becomes either an *ILAS BIPRU firm* or a *non-ILAS BIPRU firm* (as the case may be) on 1 December 2009. A *firm* which becomes an *ILAS BIPRU firm* or *non-ILAS BIPRU firm* after that date and before the end of the transitional period which would otherwise have applied will not therefore have the benefit of those *rules* and will be expected to comply with the *rules* and *guidance* in BIPRU 12 from the date on which it becomes either an *ILAS BIPRU firm* or a *non-ILAS BIPRU firm* (as the case may be).

## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 27

### Application of GENPRU 1.2, BIPRU 12.3 and BIPRU 12.4: all firms to which BIPRU 12 applies

#### Application

27.1	R	BIPRU TP 27 applies to a <i>firm</i> which as at 1 December 2009 falls into BIPRU 12.1.1 R.		
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#### Transitional Provisions

27.2

(1)	(2)	(3)	(4)	(5)
	Material to which the transitional provision applies		Transitional Provision	Handbook provisions: coming into force
1	BIPRU 12.3 and BIPRU 12.4	R	References to the <i>overall liquidity adequacy rule</i> contained in the <i>rules</i> and <i>guidance</i> in the sections of the Handbook listed in column (2) are replaced by ones to the <i>overall financial adequacy rule</i> .	1 December 2009
2	GENPRU 1.2.26 R	R	For the purposes of complying with GENPRU 1.2.26 R as regards the adequacy of liquidity resources, a <i>firm</i> must apply the <i>rules</i> and <i>guidance</i> in BIPRU 12.3 and BIPRU 12.4 instead of applying the <i>ICAAP rules</i> .	1 December 2009

Duration and application of *BIPRU* TP 27.2

27.3	R	In relation to each <i>firm</i> falling into BIPRU 12.1.1 R, BIPRU TP 27.2 applies in the way described in BIPRU TP 27.4.	
27.4			
(1)	(2)	(3)	(4)
		Transitional provision: dates in force	Transitional provision: application
1	R	1 December 2009 until 31 May 2010	A <i>firm</i> which as at 30 November 2009 calcu- lates its liquidity re- sources in accordance with Chapter LS of <i>IPRU(BANK)</i> .
2	R	1 December 2009 until 31 May 2010	Subject to (3), a <i>firm</i> which as at 30 Novem- ber 2009 calculates its liquidity resources in accordance with <i>IPRU(BSOC)</i> .
3	R	1 December 2009 until 30 September 2010	A <i>firm</i> which as at 30 November 2009 calcu- lates its liquidity re- sources in accordance with <i>IPRU(BSOC)</i> and which as at 1 June 2010 has a <i>simplified ILAS</i> <i>waiver</i> .
4	R	1 December 2009 until 30 September 2010	A <i>firm</i> which as at 30 November 2009 calcu- lates its liquidity re- sources in accordance with Chapter LM of <i>IPRU(BANK)</i> and which is not an <i>incoming EEA</i> <i>firm</i> or a <i>third country</i> <i>BIPRU firm</i> .
5	R	1 December 2009 until 31 October 2010	A <i>firm</i> which as at 30 November 2009 calcu- lates its liquidity re- sources in accordance with Chapter LM of <i>IPRU(BANK)</i> and which is an <i>incoming EEA firm</i>

6	R	1 December 2009 until 31 October 2010	or a <i>third country BIPRU firm</i> . A <i>firm</i> which as at 1 December 2009 is a <i>full scope BIPRU investment firm</i> and which is also an <i>ILAS BIPRU firm</i> .
7	R	1 December 2009 until 31 October 2010	A <i>firm</i> which as at 1 December 2009 is a <i>non-ILAS BIPRU firm</i> .

#### Guidance for a firm which becomes an ILAS BIPRU firm or non-ILAS BIPRU firm on 1 December 2009

27.5	G		<i>BIPRU TP 27</i> applies to a <i>firm</i> which becomes either an <i>ILAS BIPRU firm</i> or a <i>non-ILAS BIPRU firm</i> (as the case may be) on 1 December 2009. A <i>firm</i> which becomes an <i>ILAS BIPRU firm</i> or <i>non-ILAS BIPRU firm</i> after that date and before the end of the transitional period which would otherwise have applied will not therefore have the benefit of those <i>rules</i> and will be expected to comply with the <i>rules</i> and <i>guidance</i> in <i>BIPRU 12</i> from the date on which it becomes either an <i>ILAS BIPRU firm</i> or a <i>non-ILAS BIPRU firm</i> (as the case may be).
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## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 28 BIPRU 12.3 and BIPRU 12.4: banks with a Global Liquidity Concession

#### Application

28.1	R	BIPRU TP 28 applies to an <i>incoming EEA firm</i> or <i>third country BIPRU firm</i> which as at 30 November 2009 has a Global Liquidity Concession (as described in <i>IPRU(BANK)</i> Chapter LM 4(2)).
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#### Duration of transitional provisions

28.2	R	BIPRU TP 28 applies until 31 October 2010 or, if earlier, the date on which the <i>firm's</i> Global Liquidity Concession expires.
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#### Transitional provisions

28.3

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional Provision	Transitional provision: dates in force	Handbook provisions: coming into force
1	BIPRU 12.3 and BIPRU 12.4	R	The <i>rules</i> and <i>guidance</i> in the sections listed in column (2) do not apply.	1 December 2009 until 31 October 2010	1 December 2009



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## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 29

### Liquid assets buffer scalar: simplified ILAS BIPRU firms

#### Application

29.1 R [deleted]

#### Duration of transitional provisions

29.2 R [deleted]

#### Transitional provisions

29.3 R [deleted]

29.4 G [deleted]

29.5 G [deleted]



## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 30 Liquidity floor for certain banks

PRA

#### Application

30.1 R BIPRU TP 30 applies to a *firm* which as at 1 December 2009 is a *standard ILAS BIPRU firm* and which as at 30 November 2009 calculated its liquidity resources in accordance with Chapter LM of *IPRU(BANK)*.

#### Duration of transitional provisions

30.2 R BIPRU TP 30 applies:

- (1) in the case of an *incoming EEA firm* or a *third country BIPRU firm*, from 1 November 2010 until the earlier of the date on which the *firm* receives *individual liquidity guidance* from the PRA and 31 December 2012; and
- (2) in the case of any other *firm*, from 1 October 2010 until the earlier of the date on which the *firm* receives *individual liquidity guidance* from the PRA and 31 December 2012.

#### Transitional provisions

30.3 R A *standard ILAS BIPRU firm* falling into BIPRU TP 30.1 must ensure that at all times between 1 October 2010 or 1 November 2010 (as relevant) and the expiry of BIPRU TP 30 it maintains liquidity resources which are no less in amount than the higher of:

- (1) the amount it assesses as adequate in its *ILAA*; and
- (2) the amount that it would have maintained during that period had it calculated its liquidity resources solely in accordance with Chapter LM of *IPRU(BANK)* in the form in which it appeared on 30 September 2010 or 31 October 2010 (as relevant).

30.4 R (1) For the purpose of BIPRU 12.9.14 R (Regulatory intervention points for ILAS BIPRU firms) and for the duration of BIPRU TP 30, there is added one further event which is to constitute a regulatory intervention point for a *standard ILAS BIPRU firm*.

- (2) The further event to which (1) refers is the amount of the *firm's* liquid assets falling below, or being expected to fall below, the level required in BIPRU TP 30.3.

30.5 G (1) BIPRU TP 30.3 R deals with the overall amount of liquidity resources a *firm* is required to hold. It does not specify the proportion of those liquidity

- resources that a *firm* must hold in a liquid assets buffer that meets the liquid asset buffer requirements ( BIPRU 12.2.8 R (1) and BIPRU 12.7).
- (2) The *PRA* recognises that it may take time for a *firm* to build a buffer which is of a sufficient size and quality and that the transition from the *PRA's* liquidity regime in force immediately prior to the BIPRU 12 regime is likely to be a gradual one (see BIPRU 12.2.10 G).
  - (3) In carrying out its *ILAA*, a *firm* must record the evidence which supports its assessment of the adequacy of its liquid assets buffer (see BIPRU 12.5.13 R (3)). While a *firm* is building up its liquid assets buffer, its assessment of the adequacy of that buffer should include an analysis of its ability to satisfy its liquidity needs with liquidity resources that are not eligible to be included in the liquid assets buffer.

## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 31 Consequential changes to the Handbook occasioned by BIPRU 12: all firms to which BIPRU 12 applies

Application	
31.1	R <i>BIPRU</i> TP 31 applies to a <i>firm</i> which as at 1 December 2009 falls into BIPRU 12.1.1 R.
31.2	G The Prudential Sourcebook for Banks, Building Societies and Investment Firms (Liquidity) (Consequential Amendments) Instrument 2009 (FSA 2009/68) comes into force on 1 December 2009 (with the exception of Annex F which comes into force on 1 June 2010). The effect of BIPRU TP 26 is that the quantitative aspects of BIPRU 12 are disapplied for a period following 1 December 2009, the exact period of disapplication varying according to the type of <i>firm</i> in question. As a result of the phased application of the quantitative aspects of BIPRU 12, the associated consequential <i>Handbook</i> changes are also phased. <i>BIPRU</i> TP 31 deals with the phasing of those consequential <i>Handbook</i> changes.

#### 31.3 Transitional Provisions

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional Provision	Transitional provision: dates in force	Handbook provisions: coming into force
1	The changes to <i>GENPRU</i> set out in Annex C (Part 2) to instrument <i>appropriate regulator</i> 2009/68.	R	In relation to a <i>firm</i> which as at 30 November 2009 calculates its liquidity resources in accordance with Chapter LS of <i>IPRU(BANK)</i> , the changes effected by the Annex listed in column (2) do not apply.	1 December 2009 until 31 May 2010	1 December 2009
2	The changes to <i>GENPRU</i> set out in Annex C (Part 2) to instrument	R	Subject to (3), in relation to a <i>firm</i> which as at 30 November 2009 calculates its	1 December 2009 until 31 May 2010	1 December 2009

## 31.3 Transitional Provisions

	<i>appropriate regulator</i> 2009/68.		liquidity resources in accordance with <i>IPRU(BSOC)</i> , the changes effected by the Annex listed in column (2) do not apply.		
3	The changes to <i>GENPRU</i> set out in Annex C (Part 2) to instrument <i>appropriate regulator</i> 2009/68.	R	In relation to a <i>firm</i> which as at 30 November 2009 calculates its liquidity resources in accordance with <i>IPRU(BSOC)</i> and which as at 1 June 2010 has a <i>simplified ILAS waiver</i> , the changes effected by the Annex listed in column (2) do not apply.	1 December 2009 until 30 September 2010	1 December 2009
4	The changes to <i>GENPRU</i> set out in Annex C (Part 2) to instrument <i>appropriate regulator</i> 2009/68.	R	In relation to a <i>firm</i> which as at 30 November 2009 calculates its liquidity resources in accordance with Chapter LM of <i>IPRU(BANK)</i> and which is not an <i>incoming EEA firm</i> or a third country <i>BIPRU firm</i> , the changes effected by the Annex listed in column (2) do not apply.	1 December 2009 until 30 September 2010	1 December 2009
5	The changes to <i>GENPRU</i> set out in Annex C (Part 2) to instrument <i>appropriate regulator</i> 2009/68.	R	In relation to a <i>firm</i> which as at 30 November 2009 calculates its liquidity resources in accordance with Chapter LM of <i>IPRU(BANK)</i> and which is an <i>incoming EEA firm</i> or	1 December 2009 until 31 October 2010	1 December 2009

## 31.3 Transitional Provisions

			a <i>third country BIPRU firm</i> , the changes effected by the Annex listed in column (2) do not apply.		
6	The changes to <i>GENPRU</i> set out in Annex C (Part 2) to instrument <i>appropriate regulator</i> 2009/68.	R	In relation to an <i>incoming EEA firm</i> or a <i>third country BIPRU firm</i> which as at 30 November 2009 has a Global Liquidity Concession, the changes effected by the Annex listed in column (2) do not apply.	1 December until 31 October 2010 or, if earlier, the date on which the <i>firm</i> ceases to have a Global Liquidity Concession	1 December 2009
7	The changes to <i>GENPRU</i> set out in Annex C (Part 2) to instrument <i>appropriate regulator</i> 2009/68.	R	In relation to a <i>firm</i> which as at 1 December 2009 is a <i>full scope BIPRU investment firm</i> and which is also an <i>ILAS BIPRU firm</i> , the changes effected by the Annex listed in column (2) do not apply.	1 December 2009 until 31 October 2010	1 December 2009
8	The changes to <i>GENPRU</i> set out in Annex C (Part 2) to instrument <i>appropriate regulator</i> 2009/68.	R	In relation to a <i>firm</i> which as at 1 December 2009 is a <i>non-ILAS BIPRU firm</i> , the changes effected by the Annex listed in column (2) do not apply.	1 December 2009 until 31 October 2010	1 December 2009



## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 32 Consequential changes to the Handbook occasioned by BIPRU 12: simplified ILAS building societies

#### 32.1 Application

R *BIPRU* TP 32 applies to a *firm* which:

- (1) as at 30 November 2009 calculates its liquidity resources in accordance with *IPRU(BSOC)*; and
- (2) as at 1 June 2010 has a *simplified ILAS waiver*.

#### 32.2 Transitional Provisions

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional Provision	Transitional provision: dates in force	Handbook provisions: coming into force
1	The changes to <i>IPRU(BSOC)</i> set out in Annex F to instrument FSA 2009/68.	R	The changes effected by the Annex listed in column (2) do not apply.	1 June 2010 until 30 September 2010	1 December 2009



## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 33

## Intra-group exposures: Transitional provisions for core UK group and large exposures

FCA PRA

#### Application

- 33.1 R (1) This section applies to a *BIPRU firm* that on 30 December 2010 was applying any of the exemptions under the following provisions in the version in force on that date:
- (a) BIPRU 3.2.25 R (Zero risk-weighting for intra-group exposures);
  - (b) BIPRU 10.6.5 R to BIPRU 10.6.7 R (Parental guarantees and capital maintenance arrangements);
  - (c) BIPRU 10.7 (Treasury concession and intra-group securities financing transactions);
  - (d) BIPRU 10.8 (UK integrated group); or
  - (e) BIPRU 10.9 (Wider integrated group), if it has a *wider integrated group waiver* that expires after 31 December 2010.
- (2) In order to continue applying any of the exemptions in (1), a *firm* must be able on an ongoing basis to demonstrate to the *appropriate regulator* that it continues to comply fully with the provisions applicable to that exemption.

#### Duration of transitional

33.2 R This section applies until 31 December 2012.

#### Zero risk-weighting for intra-group exposures

33.3 R A *firm* may assign a *risk weight* of 0% to *exposures* that are eligible for that treatment under the criteria in BIPRU 3.2.25 R in the version in force on 30 December 2010.

#### Exemptions from large exposures limits for intra-group exposures

33.4 R A *firm* may, to the extent permitted by this section, treat an *exposure* to a *concentration risk group counterparty* as exempt or partially exempt in accordance with BIPRU 10 (Concentration risk requirements) in the version in force on 30 December 2010.

33.5 G The term *concentration risk group counterparty* broadly covers group members if they and the *firm* are subject to consolidated supervision by the *appropriate regulator*, another *EEA competent authority* or certain non-*EEA* regulators. The full definition can be found in the *Glossary* in the version in force on 30 December 2010.

33.6 G If the context requires, BIPRU 8.9 (Consolidated concentration risk requirements) as it was in force on 30 December 2010 continues to apply to a *firm* that applies BIPRU TP 33.4 R.

#### Effect of this section on intra-group exemptions in BIPRU 10

33.7 R If a *firm* applies this section, BIPRU 10.8A (Intra-group exposures: core UK group) to BIPRU 10.9A (Intra-group exposures: exposures outside of the core UK group) do not apply.

33.8 G The effect of BIPRU TP 33.7 is that a *firm* should not apply BIPRU 10.8A (Intra-group exposures: core UK group) to BIPRU 10.9A (Intra-group exposures: exposures outside the core UK group) to some *exposures to core concentration risk group counterparties* or *non-core concentration risk group counterparties* and this section to others. The purpose of BIPRU TP 33.7 R is that a *firm* should choose between treating intra-group *exposures* under BIPRU 10.8A (Intra-group exposures: core UK group) to BIPRU 10.9A (Intra-group exposures: exposures outside the core UK group) and treating them under this section but that it should not mix the approaches.

#### Notice to the appropriate regulator

33.9 R A *firm* may only apply the treatment in BIPRU TP 33.3 R or BIPRU TP 33.4 R if the *firm* has notified the *appropriate regulator* in writing that it intends to apply the relevant *rule* to the particular counterparty or *concentration risk group counterparty* respectively.

33.10 R The notice in BIPRU TP 33.9 R must comply with the following requirements:

- (1) the *appropriate regulator* was notified on or before 31 December 2010;
- (2) the notice must give the following:
  - (a) in the case of the treatment in BIPRU TP 33.3 R:
    - (i) the name of the counterparty concerned; and
    - (ii) details of the *firm's* initial plans on how and when it will ensure that *exposures* that will not be within its *core UK group* are treated in accordance with the relevant *rules* in BIPRU 3;
  - (b) in the case of the treatment in BIPRU TP 33.4 R:
    - (i) the name of the *concentration risk group counterparty* concerned and the intra-group exemption or exemptions that apply to it; and
    - (ii) details of the *firm's* initial plans on how and when it intends to comply with the *large exposures* limits that apply to a *core UK group* or *non-core large exposures group*.

## Prudential sourcebook for Banks, Building Societies and Investment Firms

### BIPRU TP 34

#### Large exposures: General transitional provisions

##### Application

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

##### Purpose

34.2 G This section implements the intra-group exemption in Article 113(3)(f) and the national discretion for exemptions in Articles 113(4)(a) and (c) of the *Banking Consolidation Directive* and the national discretion for *trading book concentration risk excess* in Article 31 of the *Capital Adequacy Directive*.

##### Duration of transitional

34.3 R This section applies until 31 December 2010.

##### Version of BIPRU to be used

34.4 R Any reference in this section to *BIPRU* is to the version in force on 30 December 2010.

##### Rules in BIPRU that apply until 31 December 2010

34.5 R The following *rules* apply until 31 December 2010:

- (1) [BIPRU 10.6.3 R \(10\)](#) (Exemption for covered bonds from the large exposure limit);
- (2) [BIPRU 10.5](#) (Limits on exposures and large exposures);
- (3) [BIPRU TP 17](#) (Large exposures: Exemptions for intra-group exposures for banks and investment firms), if a *firm* has a *waiver* that expires on 31 December 2010 which has the effect of allowing it to apply the exemptions in [BIPRU TP 17](#); and
- (4) [BIPRU TP 19](#) (Large exposures: Exemptions for intra-group exposures on a consolidated basis), if a *firm* has a *waiver* that expires on 31 December 2010 which has the effect of allowing it to apply the exemptions in [BIPRU TP 17](#) on a consolidated basis.

34.6 G The Capital Requirements Directive (Large Exposures) Instrument 2010 (FSA 2010/41) comes into force on 31 December 2010. The effect of *BIPRU TP 34.5R* is that the *BIPRU* provisions contained in that instrument that amend, delete or replace, the *rules* set out in *BIPRU TP 34.5R* are disapplied until 1 January 2011.



# Prudential sourcebook for Banks, Building Societies and Investment Firms

## Schedule 1 Record keeping requirements

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FCA PRA

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
BIPRU 2.2.5 G	<i>Firm's ICAAP</i>	<p>(1) The results of the <i>ICAAP</i></p> <p>(2) An explanation of the processes used</p> <p>(3) How the process is used internally and for what purpose</p> <p>(4) Internal governance</p> <p>(5) The main sources of risk to which the <i>firm</i> is exposed</p> <p>(6) How the <i>firm</i> is managing each of those risks</p> <p>(7) Details of stress and scenario testing that has been conducted</p>	Annually	Not specified

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
BIPRU 5.2.3 R, BIPRU 5.4.11 R (2), BIPRU 9.5.1 R (5)	Legal opinions confirming enforceability	(8) The rationale behind the chosen scenarios  (9) The results of those scenario tests  A record of the legal review showing enforceability of credit protection arrangements in all relevant jurisdictions	Not specified, but before risk mitigant is recognised	Review conducted as necessary
BIPRU 5.2.9 R	Risk management processes	Documented risk management processes to control the risks that <i>firm</i> may be exposed to as a result of carrying out <i>credit risk mitigation</i>	Not specified, but before risk mitigant is recognised	Not specified
BIPRU 5.4.12 R	Collateral procedures	(1) A clear and robust procedure for the liquidation of collateral  (2) Documented policies covering the types and amounts of collateral accepted	Not specified, but before collateral is recognised	Not specified
BIPRU 5.4.59 R, BIPRU 5.4.60 R	Volatility adjustments for financial collateral	(1) Documentation of a system estimating volatility adjustments and the integration of the volatility adjustments in its risk management process  (2) Review of system estimating volatility adjustments	Not specified, but before <i>own estimates of volatility adjustments approach</i> is used for capital purposes	Not specified
BIPRU 5.7.8 R	System to manage concentration of risk arising from guarantees and credit derivatives	Documentation of a system to manage potential concentration risk arising from <i>unfunded credit protection</i> and how this interacts with its management of its overall risk profile	Not specified, but before <i>unfunded credit protection</i> is recognised	Not specified

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
BIPRU 7.10.53 R, BIPRU 7.10.54 G	Material risks not captured in the firm's <i>VaR model</i>	Documented risks not captured in the <i>VaR model</i> and creation of a prudent incremental <i>PRR</i> charge for the risk not captured	Not specified	Not specified
BIPRU 9.4.3 R	Legal opinions for <i>securitised exposures</i>	A record of the legal opinions confirming that the <i>securitised exposures</i> have been put beyond the reach of the <i>originator</i>	Not specified, but before <i>securitised exposures</i> are excluded from capital calculation	Review conducted as necessary
BIPRU 9.13.12 R (1)	Capital plan in case of early amortisation	For controlled amortisation, the capital/liquidity plan to ensure that sufficient capital and liquidity are available in the event of early amortisation	Not specified	Not specified
BIPRU 9.13.21 R	Capital plan in case of either scheduled or early amortisation	The capital plan to address the capital implications of both scheduled and early amortisation	Not specified	Not specified
BIPRU 12.3.8 R (1)	<i>A firm's liquidity risk tolerance</i>	An appropriately documented account of the <i>firm's liquidity risk tolerance</i>	Not specified	Not specified
BIPRU 12.4.13 R	<i>A firm's contingency funding plan</i>	Formal documentation of the <i>contingency funding plan</i>	Not specified	Not specified
BIPRU 12.5.4 R (2)	<i>An ILAS BIPRU firm's ILAA</i>	A written record of the <i>firm's ILAA</i>	Not specified	Not specified
BIPRU 12.5.13 R (2)	<i>ILAA methodology</i>	Evidence supporting the behavioural assumptions that an <i>ILAS BIPRU firm</i> makes in carrying out its BIPRU 12.5.6 R stress tests for the purpose of its <i>ILAA</i>	Not specified	Not specified
BIPRU 12.5.13 R (3)	<i>ILAA methodology</i>	Evidence supporting an <i>ILAS BIPRU firm's</i> assessment of the adequacy of its liquidity buffer for the purpose of its <i>ILAA</i>	Not specified	Not specified
BIPRU 12.6.13 R	The <i>simplified ILAS waiver application</i>	A written policy statement assessing	Not specified	Not specified

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
		the likelihood of withdrawal of retail <i>deposits</i> in the circumstances described in BIPRU 12.6.11 R (2)(a)		
BIPRU 12.6.21 R	<i>A simplified ILAS</i> BIPRU <i>firm's ILSA</i>	A written record of the <i>firm's ILSA</i>	Not specified	Not specified
BIPRU 12.7.11 R	Periodic realisation of assets	A written policy setting out the <i>firm's</i> approach to periodic realisation of its assets	Not specified	Not specified
BIPRU 13.6.48 R	Operation of <i>CCR</i> management system	Documented set of internal policies, controls and procedures concerning the operation of the <i>CCR</i> management system	Prior to application for <i>CCR internal model method permission</i>	Continuous
BIPRU 13.7.6 R (2)	Legal opinion regarding netting agreements	A record of legal opinions that, in the event of a legal challenge, relevant courts and administrative authorities would find that the <i>firm's</i> claims and obligations would be limited to the net sum in BIPRU 13.7.6 R (1)	On entering into a transaction and making use of netting agreements	While transaction held

# Prudential sourcebook for Banks, Building Societies and Investment Firms

## Schedule 2 Notification and reporting requirements

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FCA PRA

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
BIPRU 1.2.30 R	Adoption of or significant change to a <i>trading book policy statement</i>	Copy of the <i>trading book policy statement</i>	Adoption of or significant change to a <i>trading book policy statement</i>	Immediately
BIPRU 3.2.35 R (5)	Fact of <i>exposure</i> or <i>firm</i> ceasing to meet the conditions in BIPRU 3.2.25 R	(5): Fact of <i>exposure</i> or <i>firm</i> ceasing to meet the conditions in BIPRU 3.2.25 R	(5): Ceasing to meet conditions	(5): First report date after the obligation to notify becomes due
BIPRU 7.2.48B R	Total sum of a <i>firm's</i> weighted net long and net short <i>securitisation</i> and <i>resecuritisation positions</i> , broken down by types of underlying assets	Total sum of a <i>firm's</i> weighted net long and net short <i>securitisation</i> and <i>resecuritisation positions</i> , broken down by types of underlying assets	Periodically as set out in SUP 16.12	In accordance with SUP 16.12
BIPRU 7.4.23 R	Intention to rely on approach in BIPRU 7.4.22 R (1)(b)	Fact of intention and details on which <i>commodities</i> the <i>firm</i> intends to treat as same <i>commodity</i> -class and justification	Intention to rely	At least 20 <i>business days</i> prior to the date the <i>firm</i> starts relying on BIPRU 7.4.23 R
BIPRU 7.5.4 R	Intention to use an exclusion under BIPRU 7.5.4 R (1)	Fact of intention and the terms on which the relevant item will be excluded from the <i>firm's</i> <i>foreign currency</i> PRR calculation	Intention to use	Before use of the exclusion

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
BIPRU 7.10.55ZA R	Material shortfall in the amount of capital required under the <i>all price risk measure</i> identified as a result of performing the stress tests under BIPRU 7.10.55Z R	Information about the stress tests and the material shortfall in capital	Existence of a material shortfall in capital	No later than two <i>business days</i> after the <i>business day</i> on which the material shortfall occurred
BIPRU 7.10.104 R	Occurrence of <i>backtesting exception</i>	Fact of <i>backtesting exception</i>	<i>Backtesting exception</i>	Orally within 2 <i>business days</i> , and written account of all <i>backtesting exceptions</i> that <i>Month</i> , within 5 <i>business days</i> after the <i>Month</i>
BIPRU 7.10.129 R	Operation of the <i>VaR model</i> , systems and controls relating to it and changes to the <i>VaR model</i> and those systems and controls	Documentation specified in the <i>VaR model waiver/VaR model permission</i>	<i>appropriate regulator</i> specified requirements	No later than number of <i>business days</i> after the end of each quarter specified in the <i>VaR model permission</i>
BIPRU 7.10.130 R	Details of significant planned changes to the <i>VaR model</i>	Information about the nature of the change and an estimate of the impact on <i>VaR numbers</i> and the <i>incremental risk charge</i>	Intention to change	Prior to any changes being implemented
BIPRU 8.4.18 R(2)	Serious risk that could undermine the financial stability of the <i>CAD Article 22 group</i>	Fact of serious risk to group financial stability	Events/ activities leading to serious risk to group financial stability	As soon as the <i>firm</i> becomes aware of that risk
BIPRU 8.4.18 R (3)	<i>Consolidated capital resources</i> and <i>consolidated capital resources requirement</i> of the <i>CAD Article 22 group</i> as set out in the <i>investment firm consolidation waiver</i>	Amount of <i>CAD Article 22 group consolidated capital resources</i> and <i>consolidated capital resources requirement</i>	Periodically as set out in the <i>investment firm consolidation waiver</i>	Not specified
BIPRU 8.4.18 R (4)	Large exposures risks of the <i>CAD Article 22 group</i> including <i>undertakings</i> not located in a member State	Large exposures risks of the <i>CAD Article 22 group</i> including <i>undertakings</i> not located in a member State	Periodically as set out in the <i>investment firm consolidation waiver</i>	Not specified
BIPRU 8.5.9 R	Intention to exclude an <i>undertaking</i> from consolidation	Fact of intention and details of <i>undertaking</i> to be excluded	Intention to exclude	In accordance with SUP 15.7

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
BIPRU 8.6.1B R	Intention of a <i>group undertaking</i> to issue a <i>capital instrument</i> for inclusion in <i>capital resources</i> or <i>consolidated capital resources</i>	Fact of intention and details of intended amount, issue date, type of investor, stage of capital, features of instrument and confirmation of compliance with <i>rules</i>	Intention to issue	As soon as proposed issue becomes known to <i>firm</i>
BIPRU 8.6.1C R	Proposed changes to details of the issue of a <i>capital instrument</i> notified under BIPRU 8.6.1B R	Proposed change and all information required under BIPRU 8.6.1B R (1) to BIPRU 8.6.1B R (4)	Intention to change any details of the issue previously notified to the <i>appropriate regulator</i>	As soon as the changes are proposed
BIPRU 8.6.1D R	Proposed establishment of a debt securities program by a <i>group undertaking</i>	All information required under BIPRU 8.6.1B R (1) to BIPRU 8.6.1B R (4)	Intention to establish	As soon as proposed establishment becomes known to <i>firm</i>
BIPRU 8.6.1F R	Issue of <i>capital instruments</i> by a <i>group undertaking</i> under BIPRU 8.6.1E R	All information required under BIPRU 8.6.1B R (1) to BIPRU 8.6.1B R (3) and confirmation no changes have been made to the terms of the instrument from a previous similar issue	Intention to issue	No later than the date of issue
BIPRU 8.7.16 R	(1) The choice of consolidation technique in BIPRU 8.7.13 R it applies for which consolidated requirement component: and  (2) to which members of the relevant group it is applying the different methods in BIPRU 8.7.13 R	(1) The choice of consolidation technique in BIPRU 8.7.13 R to be applied for each consolidated requirement component  (2) the members of the relevant group to which it is applying the different methods in BIPRU 8.7.13 R	See SUP 16	See SUP 16
BIPRU 9.6.2 R	Provision of implicit support to a <i>securitisation</i>	(1) Provision of non-contractual support, and  (2) The regulatory capital impact of providing implicit support	Provision of implicit support	Not specified
BIPRU 10.8A.12 R	<i>Exposure</i> being treated as exempt under BIPRU 10.8A (Core UK group) ceases to meet the conditions for ap-	Fact or expectation of any <i>exposure</i> to which it has applied the treatment ceases to meet the conditions	Awareness of situation	Immediately

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
BIPRU 10.9A.8 R (2)	Intention to use BIPRU 10.9A.8 R (1) to concentrate an <i>exposure</i> to a particular member of the <i>non-core large exposures group</i> that exceeds 25% of the capital resources of the <i>firm's core UK group</i>	for application of the treatment Fact of intention and the information in BIPRU 10.9A.8 R (3)	Intention to use BIPRU 10.9A.8 R (1)	Not specified
BIPRU 10.9A.12 R	<i>Exposure</i> being treated as exempt under BIPRU 10.9A (Intra-group exposures: exposures outside the core UK group) ceases to meet the conditions for application of the treatment	Fact or expectation of any <i>exposure</i> to which it has applied the treatment ceases to meet the conditions for application of the treatment	Awareness of situation	Immediately
BIPRU 10.12.6 R	Artificial transfer, transaction or arrangement.	Fact of entry into a transfer, transaction or arrangement of the type mentioned in BIPRU 10.12.5 R	Entry into an artificial transfer, transaction or arrangement	Not specified
BIPRU 12.4.9 R	Results of the BIPRU 12.4 stress tests	The results referred to in column (2)	The carrying out of the BIPRU 12.4 stress tests	To be reported in a timely manner
BIPRU 12.6.13 R (2)	A <i>simplified ILAS BIPRU firm's</i> policy statement prepared in accordance with BIPRU 12.6.13 R	The policy statement referred to in column (2)	The <i>firm's</i> decision to apply for a <i>simplified ILAS waiver</i>	Prior to the <i>firm's</i> application for a <i>simplified ILAS waiver</i>
BIPRU 12.9.13 R	The occurrence of any of the events identified in BIPRU 12.9.14 R	Fact of occurrence and adequately reasoned explanation for the deviation	The occurrence of any of the events identified in BIPRU 12.9.14 R	As soon as the <i>firm</i> becomes aware of the event in question
BIPRU 12.9.18 R	A <i>firm's</i> liquidity remediation plan	The matters identified in BIPRU 12.9.18 R	The occurrence of any of the events identified in BIPRU 12.9.14 R	Within two days of the notification made under BIPRU 12.9.13 R
BIPRU 13.2.2 R	Counterparty risk <i>exposure</i> of non-standard type	Fact of <i>exposure</i> , <i>counterparty</i> involved, nature of the <i>exposure</i> and capital treatment adopted	Entry into non-standard <i>exposure</i>	Immediately
BIPRU 13.6.20 R	Cessation to comply with requirements set out in BIPRU 13.6 for	Plan for timely return to compliance or demonstration that	Ceasing to comply with requirements	Immediately

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Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
	<i>CCR internal model method permission</i>	the effect of non-compliance is immaterial		



# Prudential sourcebook for Banks, Building Societies and Investment Firms

## Schedule 3 Fees and other requirement payments

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FCA PRA

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



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# Prudential sourcebook for Banks, Building Societies and Investment Firms

## Schedule 4 Powers exercised

### 4.1 G

The following powers and related provisions in the *Act* have been exercised by the *FSA* to make the *rules* in *BIPRU*:

Section 138 (General rule-making power)

Section 148(3) (Modification or waiver of rules)

Section 149 (Evidential provisions)

Section 150(2) (Actions for damages) and

Section 156 (General supplementary powers)

### Sch 4.2 G

The following additional powers have been exercised by the *FSA* to make the *rules* in *BIPRU*:

Regulation 2(3) (application for permission) of the Capital Requirements Regulations 2006 (SI 2006/3221)

### Sch 4.3 G

The following power in the *Act* has been exercised by the *FSA* to give the *guidance* in *BIPRU*:

Section 157(1) (Guidance).



# Prudential sourcebook for Banks, Building Societies and Investment Firms

## Schedule 5 Rights of action for damages

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FCA

1. The table below sets out the rules in *BIPRU* 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 *appropriate regulator* has removed the right of action under section 138D(3) of the Act. If so, a reference to the rule in which it is removed is also given.
3. The column headed "For other person" indicates whether the rule may be actionable by a person other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of person by whom the rule may be actionable is given.

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



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# Prudential sourcebook for Banks, Building Societies and Investment Firms

## Schedule 6 Rules than can be waived

**G****FCA** **PRA**

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

# Prudential sourcebook for Insurers

## Prudential sourcebook for Insurers

<b>INSPRU 1</b>	<b>Capital resources requirements and technical provisions for insurance business</b>
1.1	Application
1.2	Mathematical reserves
1.3	With-profits insurance capital component
1.4	Equalisation provisions
1.5	Internal-contagion risk
1.6	Insurance Special Purpose Vehicles
1 Annex 1	INSPRU 1.2 (Mathematical reserves) and INSPRU 1.3 (With-profits insurance capital component)
<b>INSPRU 2</b>	<b>Credit risk in insurance</b>
2.1	Application
2.2	Asset-related Capital Requirement
<b>INSPRU 3</b>	<b>Market risk</b>
3.1	Market risk in insurance
3.2	Derivatives in insurance
<b>INSPRU 4</b>	<b>Liquidity risk management</b>
4.1	Application
<b>INSPRU 5</b>	<b>Operational Risk Management</b>
5.1	Application
<b>INSPRU 6</b>	<b>Group Risk: Insurance Groups</b>
6.1	Application
<b>INSPRU 7</b>	<b>Individual Capital Assessment</b>
7.1	Application

<b>INSPRU 8</b>	<b>General provisions applying INSPRU and GENPRU to Lloyd's</b>
8.1	Application
8.2	Special provisions for Lloyd's
8.3	The Central Fund
8.4	Capacity Transfer Market
8.5	Former underwriting members
8.6	Prudential risk management and associated systems and controls

<b>INSPRU 9</b>	<b>Actions for damages</b>
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9.1	Actions for damages
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### **Transitional Provisions and Schedules**

TP	Transitional provisions
Sch 1	Record keeping requirements
Sch 2	Notification and reporting requirements
Sch 3	Fees and other requirement payments
Sch 4	Powers exercised
Sch 5	Rights of action for damages
Sch 6	Rules that can be waived



# Chapter 1

## Capital resources requirements and technical provisions for insurance business

## 1.1 Application

### 1.1.1

FCA PRA

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■ INSPRU 1.1 applies to an *insurer* unless it is:

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*.

### 1.1.2

FCA PRA

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- (1) This section applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.
- (2) Where a *firm* carries on both *long-term insurance business* and *general insurance business*, this section applies separately to each type of business.

### 1.1.3

FCA PRA

R

For a *non-EEA insurer* with a *branch* in the *United Kingdom* whose *insurance business* in the *United Kingdom* is not restricted to *reinsurance* (other than an *EEA-deposit insurer*, a *Swiss general insurer* or a *UK-deposit insurer*):

- (1) the part of this section headed "Capital requirements for insurers" (■ INSPRU 1.1.43 G to ■ INSPRU 1.1.92B G) applies to its world-wide activities;
- (2) the parts of this section headed:
  - (a) "Establishing technical provisions" (■ INSPRU 1.1.12 R to ■ INSPRU 1.1.19 G);
  - (b) "Reinsurance and analogous non-reinsurance financing agreements: risk transfer principle" ( ■ INSPRU 1.1.19A R to ■ INSPRU 1.1.19F G);
  - (c) "Assets of a value sufficient to cover technical provisions and other liabilities" ( ■ INSPRU 1.1.20 R to ■ INSPRU 1.1.29 G);

(d) "Matching of assets and liabilities" (■ INSPRU 1.1.34 R to ■ INSPRU 1.1.40 G); and

(e) "Premiums for new business" (■ INSPRU 1.1.41 R to ■ INSPRU 1.1.42 G);

apply separately in respect of its world-wide activities and its activities carried on from a *branch* in the *United Kingdom*; and

(3) the part of this section headed "Localisation" (■ INSPRU 1.1.30 R to ■ INSPRU 1.1.33 R) does not apply (see ■ INSPRU 1.5 (Internal contagion risk)).

**1.1.4**

**FCA PRA**

**R**

For an *EEA-deposit insurer* or a *Swiss general insurer*:

(1) the parts of this section headed:

(a) "Establishing technical provisions" (■ INSPRU 1.1.12 R to ■ INSPRU 1.1.19 G);

(b) "Reinsurance and analogous non-reinsurance financing agreements: risk transfer principle" ( ■ INSPRU 1.1.19A R to ■ INSPRU 1.1.19F G);

(c) "Assets of a value sufficient to cover technical provisions and other liabilities" ( ■ INSPRU 1.1.20 R to ■ INSPRU 1.1.29 G);

(d) "Matching of assets and liabilities" (■ INSPRU 1.1.34 R to ■ INSPRU 1.1.40 G); and

(e) "Premiums for new business" (■ INSPRU 1.1.41 R to ■ INSPRU 1.1.42 G);

apply in respect of the activities of the *firm* carried on from a *branch* in the *United Kingdom*; and

(2) the parts of this section headed "Capital requirements for insurers" (■ INSPRU 1.1.43 G to ■ INSPRU 1.1.92B G) and "Localisation" (■ INSPRU 1.1.30 R to ■ INSPRU 1.1.33 R) do not apply.

**1.1.5**

**FCA PRA**

**R**

For a *UK-deposit insurer*:

(1) the part of this section headed "Capital requirements for insurers" (■ INSPRU 1.1.43 G to ■ INSPRU 1.1.92B G) applies to its world-wide activities;

(2) the parts of this section headed:

(a) "Establishing technical provisions" (■ INSPRU 1.1.12 R to ■ INSPRU 1.1.19 G);

- (b) "Reinsurance and analogous non-reinsurance financing agreements: risk transfer principle" ( ■ INSPRU 1.1.19A R to ■ INSPRU 1.1.19F G);
- (c) "Assets of a value sufficient to cover technical provisions and other liabilities" ( ■ INSPRU 1.1.20 R to ■ INSPRU 1.1.29 G);
- (d) "Matching of assets and liabilities" (■ INSPRU 1.1.34 R to ■ INSPRU 1.1.40 G); and
- (e) "Premiums for new business" (■ INSPRU 1.1.41 R to ■ INSPRU 1.1.42 G);

apply separately in respect of its world-wide activities and its activities carried on from *branches* in *EEA States*; and

- (3) the part of this section headed "Localisation" (■ INSPRU 1.1.30 R to ■ INSPRU 1.1.33 R) does not apply (see ■ INSPRU 1.5 (Internal contagion risk)).

1.1.6  
FCA PRA

**G** This section may apply in cases where a *firm* has its head office in another *EEA State* but is neither an *incoming EEA firm* nor an *incoming Treaty firm*; this could arise in the case of a *non-directive mutual*.

**Purpose**

1.1.7  
PRA

**G** ■ INSPRU 1.1 has the aim of reducing the risk that a *firm* may fail to meet its liabilities to its *policyholders* as a result of insurance risk, that is, the risk that arises from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities.

1.1.8  
PRA

**G** This section requires that the *technical provisions* that *firms* establish are adequate to meet their liabilities to *policyholders* under *contracts of insurance*. It also requires that *firms* hold assets of a value sufficient to cover their liabilities, including *technical provisions*, and that there is suitable matching of assets and liabilities. *Technical provisions* are the on-balance sheet provisions made by a *firm* in respect of liabilities arising under or in connection with *contracts of insurance*. There are different *rules* and *guidance* applicable to the calculation of *technical provisions* for *general insurance business* and for *long-term insurance business*.

1.1.9  
PRA

**G** This section implements requirements of the *Insurance Directives* for both *general insurance business* and *long-term insurance business* with regard to the *technical provisions*. The relevant articles of the Directives include:

- (1) article 15 of the *First Non-Life Directive*, as substituted by article 17 of the *Third Non-Life Directive*; and
- (2) article 20 of the *Consolidated Life Directive* (this Directive consolidates the provisions of the previous *First, Second* and *Third Life Directives*).

**1.1.10** **G** This section also sets out detailed *rules* and *guidance* on the calculation of the following elements of a *firm's capital resources requirement* (CRR) (see ■ GENPRU 2.1):

**PRA**

- (1) the *general insurance capital requirement*; and
- (2) the *long-term insurance capital requirement*.

**1.1.11** **G** These requirements are dealt with in the part of this section headed "Capital requirements for insurers" (see ■ INSPRU 1.1.43 G to ■ INSPRU 1.1.91 R). That part of this section also contains *rules* about the calculation of the *enhanced capital requirement* for *firms* carrying on *general insurance business*, including the calculation of the *insurance-related capital requirement*. The calculation of the *asset-related capital requirement*, which also forms part of the calculation of the *ECR* for *firms* carrying on *general insurance business* is set out in ■ INSPRU 2.2.

**PRA**

**Establishing technical provisions**

**1.1.12** **R** For *general insurance business*, a *firm* must establish adequate technical provisions:

**PRA**

- (1) in accordance with the *rules* in ■ INSPRU 1.4 for *equalisation provisions*; and
- (2) otherwise, in accordance with ■ GENPRU 1.3.4 R.

**1.1.13** **G** For *general insurance business*, the *technical provisions* include outstanding *claims* provisions, *unearned premiums* provisions, unexpired risk provisions and *equalisation provisions*. These provisions take into account the expected ultimate cost of *claims*, including those not yet incurred, related expenses and include an allowance for smoothing *claims* (the *equalisation provision*).

**PRA**

**1.1.14** **G** *Discounting* (that is discounting for the time value of money) *general insurance business technical provisions* may be carried out only in limited circumstances and on a prudent basis (see ■ GENPRU 2.2.107 R and paragraph 48 of the *insurance accounts rules*). The fact that the expected liabilities are generally not *discounted* helps to protect against risk from inherent uncertainty in the timing, but not necessarily the amount, of *claims*.

**PRA**

**1.1.15** **G** For some categories of *general insurance business*, *equalisation provisions* are required. These ensure that a *firm* retains additional assets to provide some extra protection against uncertainty as to the amount of *claims*. *Equalisation provisions* are particularly suitable for volatile business, where *claims* in any future year may be subject to significant adverse deviation from recent or average expected *claims* experience, or where trends in *claims* experience may be subject to change. Such volatile *claims* experience arises in a number of types of business, for example, property, marine and aviation, nuclear, certain *non-proportional reinsurance treaty* business, and credit insurance. The *equalisation provisions* help to equalise fluctuations in loss ratios in future years (see ■ INSPRU 1.4 (*Equalisation provisions*)).

**PRA**

1.1.16  
PRA

**R**

For *long-term insurance business*, a *firm* must establish adequate technical provisions in respect of its *long-term insurance contracts* as follows:

- (1) *mathematical reserves* in accordance with the *rules and guidance* in ■ INSPRU 1.2 relating to such reserves, and with due regard to generally accepted actuarial practice; and
- (2) for liabilities in respect of such contracts that have fallen due, in accordance with ■ GENPRU 1.3.4 R.

1.1.17  
PRA

**G**

*Rules and guidance* for calculating *mathematical reserves* are set out in ■ INSPRU 1.2. *Firms* are advised by the *actuarial function* (see ■ SUP 4) on the methods and assumptions to be used in calculating the *mathematical reserves*. The standards and guidance issued by the Board for Actuarial Standards to assist actuaries appointed to the *actuarial function* are important sources of evidence as to generally accepted actuarial practice, as referred to in ■ INSPRU 1.1.16 R (1).

1.1.18  
PRA

**G**

For *long-term insurance business*, the *technical provisions* include the *mathematical reserves*. These are actuarial estimates of a *firm's* liabilities in respect of future benefits due to *policyholders*, including bonuses already declared. The *mathematical reserves* may be reduced by the actuarial value of that component of future *premiums* attributable to meeting future liabilities (see ■ INSPRU 1.2 (*Mathematical reserves*)).

1.1.19  
PRA

**G**

For *long-term insurance business*, the *mathematical reserves* are typically valued on a discounted basis but include valuation margins intended to provide protection against adverse deviations in experience (see ■ INSPRU 1.2).

**Reinsurance and analogous non-reinsurance financing agreements: risk transfer principle**

1.1.19A  
PRA

**R**

- (1) A *firm* may only take credit for *reinsurance* if and to the extent that there has been an effective transfer of risk from the *firm* to a third party.
- (2) In ■ INSPRU 1.1.19A R to ■ INSPRU 1.1.19F G, references to *reinsurance* and contracts of *reinsurance* include:
  - (a) all contracts of *reinsurance* with an *ISPV*; and
  - (b) analogous non-*reinsurance* financing agreements.

1.1.19B  
PRA

**R**

For the purposes of ■ INSPRU 1.1.19A R (2)(b), analogous non-*reinsurance* financing agreements include contingent loans, securitisations and any other arrangements in respect of *contracts of insurance* that are analogous to contracts of *reinsurance* in terms of the risks transferred and the finance provided.

1.1.19C

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There are a number of ways in which a *firm* may be able to take credit for *reinsurance* under the *rules* in *GENPRU* and *INSPRU*. Examples include:

- (1) treating the *reinsurer's* share of *technical provisions* as an *admissible asset* in accordance with ■ GENPRU 2 Annex 7 R;
- (2) reducing its solvency requirements in accordance with the deduction for *reinsurance* allowed in the calculation of the *general insurance capital requirement* or the *long-term insurance capital requirement* under ■ INSPRU 1.1; and
- (3) bringing into account amounts receivable under the contract when valuing cash flows for the purpose of a prospective valuation of *mathematical reserves* under ■ INSPRU 1.2. In particular, a contingent loan or other analogous non-*reinsurance* financing agreement may then give rise to an addition to *capital resources* as a positive valuation difference in accordance with ■ GENPRU 2.2.105 R.

1.1.19D

PRA

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The amount of credit taken by a *firm* for a risk transferred should be measured by applying the standard methods for determining the regulatory balance sheet set out in *INSPRU*. For example, where credit is being taken so as to reduce *technical provisions*, the amount of that credit should reflect the difference in *technical provisions* that arises from changing the assumptions used to reflect the risk transferred.

1.1.19E

PRA

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For the purposes of ■ INSPRU 1.1.19A R (1), the transfer of risk from the *firm* to the third party should be effective in all circumstances in which the *firm* may wish to rely upon the transfer. Examples of factors which the *firm* should take into account in assessing whether the transaction effectively transfers risk and the extent of that transfer include:

- (1) whether the documentation associated with the *reinsurance* reflects the economic substance of the transaction;
- (2) whether the extent of the risk transfer is clearly defined and incontrovertible;
- (3) whether the transaction contains any terms or conditions the fulfilment of which is outside the direct control of the *firm*. Such terms or conditions may include those which:
  - (a) would allow the third party unilaterally to cancel the transaction, except for the non-payment of monies due from the *firm* to the third party under the contract; or
  - (b) would increase the effective cost of the transaction to the *firm* in response to an increased likelihood of the third party experiencing losses under the transaction; or
  - (c) would oblige the *firm* to alter the risk that had been transferred with the purpose of reducing the likelihood of the third party experiencing losses under the transaction; or
  - (d) would allow for the termination of the transaction due to an increased likelihood of the third party experiencing losses under the transaction; or
  - (e) could prevent the third party from being obliged to pay out in a timely manner any monies due under the transaction; or
  - (f) could allow the maturity of the transaction to be reduced;

- (4) whether the transaction is legally effective and enforceable in all relevant jurisdictions.

**1.1.19F**  
**PRA**

**G**

A *firm* should also take into account circumstances in which the benefit to the *firm* of the transfer of risk could be undermined. For instance, where the *firm*, with a view to reducing potential or actual losses to third parties, provides support to the transaction, including support beyond its contractual obligations (implicit support). Another example of a situation where the *firm* should consider whether it should take reduced credit for a transaction is where it has invested in the bonds issued by an *ISPV* with which it has reinsured risks.

**Assets of a value sufficient to cover technical provisions and other liabilities**

**1.1.20**  
**PRA**

**R**

A *firm* which is not a *composite firm* must hold *admissible assets* of a value at least equal to the amount of:

- (1) the *technical provisions* that it is required to establish under ■ [INSPRU 1.1.12 R](#) or ■ [INSPRU 1.1.16 R](#); and
- (2) its other *general insurance liabilities* or *long-term insurance liabilities*;

but excluding, where the *firm* is not a *pure reinsurer*, *property-linked liabilities* and *index-linked liabilities* and the assets held to cover them under ■ [INSPRU 3.1.57 R](#) and ■ [INSPRU 3.1.58 R](#).

**1.1.21**  
**PRA**

**R**

A *composite firm* must ensure that:

- (1) it holds *admissible assets* separately identified in accordance with ■ [INSPRU 1.5.18 R](#) of a value at least equal to the amount of:
  - (a) the *technical provisions* that it is required to establish under ■ [INSPRU 1.1.16 R](#); and
  - (b) its other *long-term insurance liabilities*;
 but excluding, where the *firm* is not a *pure reinsurer*, *property-linked liabilities* and *index-linked liabilities* and the assets held to cover them under ■ [INSPRU 3.1.57 R](#) and ■ [INSPRU 3.1.58 R](#); and
- (2) it holds other *admissible assets* (other than those excluded under (1)) of a value at least equal to the amount of:
  - (a) the *technical provisions* that it is required to establish under ■ [INSPRU 1.1.12 R](#); and
  - (b) its other *general insurance liabilities*.

- 1.1.22**  
**PRA** **G** ■ INSPRU 1.5 (Internal-contagion risk) sets out the *rules* and *guidance* on identifying and holding in a separate fund *long-term insurance assets*.
- 1.1.23**  
**PRA** **G** When valuing assets for the purposes of ■ INSPRU 1.1.20 R and ■ INSPRU 1.1.21 R, a *firm* should bear in mind:
- (1) that the *technical provisions* and other *long-term insurance liabilities* or *general insurance liabilities* should be covered by *admissible assets* (see ■ GENPRU 2 Annex 7 R); and
  - (2) the market and *counterparty* limits set out in ■ INSPRU 2.1 (Credit risk in insurance). ■ INSPRU 2.1 requires that a *firm* restrict to prudent levels its exposure to *reinsurer* and other *counterparties*, and, in particular, that for the purpose of its balance sheet, a *firm* must not take into account any exposure which exceeds the large exposure limits.
- 1.1.24**  
**PRA** **G** *Rules* and *guidance* on the valuation of assets are set out in ■ GENPRU 1.3 (Valuation), including the treatment of *shares* in, and debts due from, *related undertakings* in ■ GENPRU 1.3.43 R to ■ GENPRU 1.3.54 G. ■ INSPRU 3.1 (Market risk in insurance) addresses *market risk* and sets out the matching requirements for linked assets and liabilities. ■ INSPRU 3.1 also sets out *rules* and *guidance* on the matching by currency of assets and liabilities, to reduce a *firm's* exposure to currency *market risk*.
- 1.1.25**  
**PRA** **R** For the purpose of determining the value of assets available to meet *technical provisions* and other *long-term insurance liabilities* in accordance with ■ INSPRU 1.1.20 R, ■ INSPRU 1.1.21 R, ■ INSPRU 1.1.27 R and ■ INSPRU 1.1.28 R, no value is to be attributed to:
- (1) debts owed by *reinsurers*; or
  - (2) *claims*; or
  - (3) tax recoveries; or
  - (4) claims against *compensation funds*;
- to the extent already offset in the calculation of *technical provisions*.
- 1.1.26**  
**PRA** **G** Certain debts and claims are excluded from ■ INSPRU 1.1.20 R, ■ INSPRU 1.1.21 R, ■ INSPRU 1.1.27 R and ■ INSPRU 1.1.28 R to avoid double-counting. The *rules* and *guidance* in ■ INSPRU 1.2 (*Mathematical reserves*) set out how a *firm* may offset debts and *claims* against liabilities in calculating the *mathematical reserves* required for *long-term insurance business*.

1.1.27  
FCA PRA

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A firm carrying on long-term insurance business must ensure that it has *admissible assets* in each of its *with-profits funds* of a value sufficient to cover:

- (1) the *technical provisions* in respect of all the business written in that *with-profits fund*; and
- (2) its other *long-term insurance liabilities* in respect of that *with-profits fund*.

1.1.28  
FCA PRA

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In addition to complying with ■ INSPRU 1.1.27 R, a *realistic basis life firm* must also ensure that the *realistic value of assets* for each of its *with-profits funds* is at least equal to the *realistic value of liabilities* of that fund.

1.1.29  
FCA PRA

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■ INSPRU 1.1.27 R and ■ INSPRU 1.1.28 R support the funding of *policyholder* benefits by requiring *firms* to maintain *admissible assets* in *with-profits funds* to cover the *technical provisions* and other *long-term insurance liabilities* relating to all the business in that fund and, in the case of a *realistic basis life firm*, realistic assets to cover the realistic liabilities of the *with-profits insurance contracts* written in the fund.

#### Localisation (UK firms only)

1.1.30  
PRA

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- (1) Subject to (2), a *UK firm* must hold *admissible assets* held pursuant to ■ INSPRU 3.1.53 R:
  - (a) (where the *admissible assets* cover *technical provisions* in pounds sterling), in any *EEA State*; and
  - (b) (where the *admissible assets* cover *technical provisions* in any currency other than pounds sterling), in any *EEA State* or in the country of that currency.
- (2) In the case of a *community co-insurance operation* and a *relevant insurer*, the *admissible assets* covering *technical provisions* must be held in any *EEA State*.

1.1.31  
PRA

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■ INSPRU 1.5 (Internal contagion risk) sets out the *rules* and *guidance* on localisation for *firms* other than *UK firms*.

1.1.32  
PRA

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■ INSPRU 1.1.30 R does not apply to:

- (1) a *pure reinsurer*; or
- (2) debts owed by *reinsurers*; or
- (3) *insurance business* carried on by a *UK firm* outside the *EEA States*; or

1.1.33

PRA

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For the purposes of ■ INSPRU 1.1.30 R:

- (1) a tangible asset is to be treated as held in the country or territory where it is situated;
- (2) an *admissible asset* consisting of a claim against a debtor is to be treated as held in any country or territory where it can be enforced by legal action;
- (3) a *security* which is *listed* is to be treated as held in any country or territory where there is a *regulated market* on which the *security* is dealt; and
- (4) a *security* which is not *listed* is to be treated as held in the country or territory in which the *issuer* has its head office.

**Matching of assets and liabilities**

1.1.34

PRA

R

- (1) Subject to (4), the assets held by a *firm* to cover its *technical provisions* and other *long-term insurance liabilities* or *general insurance liabilities* (see ■ INSPRU 1.1.20 R and ■ INSPRU 1.1.21 R) must:
  - (a) have characteristics of safety, yield and marketability which are appropriate to the type of business carried on by the *firm*;
  - (b) be diversified and adequately spread; and
  - (c) comply with (2).
- (2) The assets referred to in (1) must, in addition to meeting the criteria set out in (1)(a) and (b), be of a sufficient amount, and of an appropriate currency and term, to ensure that the cash inflows from those assets will meet the expected cash outflows from the *firm's* insurance liabilities as they become due.
- (3) For the purpose of (2), a *firm* must take into consideration in determining expected cash outflows any options which exist in the *firm's contracts of insurance*.
- (4) (1) does not apply to:
  - (a) a *pure reinsurer*; or
  - (b) assets held to cover *index-linked liabilities* or *property-linked liabilities*, except that where the *linked long-term contract of insurance* in question includes a guarantee of investment performance or some other guaranteed benefit, (1) will

nevertheless apply to assets held to cover that guaranteed element.

<p><b>1.1.34A</b> <b>PRA</b></p>	<p><b>G</b></p>	<p>■ INSPRU 1.1.34 R is not applied to <i>pure reinsurers</i> because they are subject under ■ INSPRU 3.1.61A R to the "prudent person" investment principles from the <i>Reinsurance Directive</i>.</p>
<p><b>1.1.35</b> <b>PRA</b></p>	<p><b>G</b></p>	<p>A <i>firm</i> should take account of the amount, currency and timing of its expected cash outflows in determining whether the assets it holds to cover its <i>technical provisions</i> and other <i>long-term insurance liabilities</i> or <i>general insurance liabilities</i> meet the requirements of ■ INSPRU 1.1.34 R (2).</p>
<p><b>1.1.36</b> <b>PRA</b></p>	<p><b>G</b></p>	<p>For the purpose of ■ INSPRU 1.1.34 R (2), the relevant cash inflows are those which the <i>firm</i> reasonably expects to receive from the <i>admissible assets</i> which it holds to cover its <i>technical provisions</i> and other <i>long-term insurance liabilities</i> or <i>general insurance liabilities</i>. A <i>firm</i> may receive cash inflows as a result of:</p> <ol style="list-style-type: none"> <li>(1) selling assets or closing out transactions;</li> <li>(2) holding assets that generate dividends, interest or other income; and</li> <li>(3) receiving future <i>premiums</i> for existing business.</li> </ol>
<p><b>1.1.37</b> <b>PRA</b></p>	<p><b>G</b></p>	<p>Anticipated cash inflows from future new business should not be included, for example where the <i>customer</i> has not yet contracted to pay the <i>premium</i>, and where the associated liabilities and potential cash outflows should also not be included.</p>
<p><b>1.1.38</b> <b>PRA</b></p>	<p><b>G</b></p>	<p>A <i>firm</i> should compare cash inflows and outflows based on current expectations of amounts and timings. Current market expectations of future asset values, interest rates and currency exchange rates should be used. Where inflows are received in a currency different from that in which outflows are to be paid, account should be taken of the cost of converting the currency received.</p>
<p><b>1.1.39</b> <b>PRA</b></p>	<p><b>G</b></p>	<p>In considering the value and suitability of assets required to ensure that the <i>firm's</i> liabilities are met as they become due, a <i>firm</i> should take account of the risk of default on inflows from those assets, and other risks that may mean that future inflows are reduced relative to outflows.</p>
<p><b>1.1.40</b> <b>PRA</b></p>	<p><b>G</b></p>	<p>■ INSPRU 1.1.20 R lays down a general requirement for a <i>firm</i> that carries on <i>long-term insurance business</i> to hold <i>admissible assets</i> that are of a value sufficient to cover its <i>technical provisions</i> and other <i>long-term insurance liabilities</i>. The ■ INSPRU 1.1.34 R (2) requirement to match liabilities with assets that allow cash outflows to be met with suitable inflows as the outflows become due may mean that a <i>firm</i> has to hold assets of a value greater than would otherwise be required by the general <i>rule</i> in ■ INSPRU 1.1.20 R.</p>

**Premiums for new business**

1.1.41

PRA

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A *firm* must not enter into a *long-term insurance contract* unless it is satisfied on reasonable actuarial assumptions that:

- (1) the *premiums* receivable and the investment income expected to be earned from those *premiums*; and
- (2) the *reinsurance* arrangements made in respect of the risk or risks covered by that new contract are sufficient to enable it, when taken together with the *firm's* other resources, to:
  - (a) establish adequate *technical provisions* as required by ■ INSPRU 1.1.16 R;
  - (b) hold *admissible assets* of a value at least equal to the amount of the *technical provisions* and other *long-term insurance liabilities* as required by ■ INSPRU 1.1.20 R to ■ INSPRU 1.1.28 R; and
  - (c) maintain adequate overall financial resources as required by the *overall financial adequacy rule*.

1.1.42

PRA

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For the purposes of ■ INSPRU 1.1.41 R, the adequacy of *premiums* may be assessed in the context of a *firm's* total portfolio of business and its other resources. It thus does not prevent a *firm* writing loss leaders nor writing contracts which might incur large losses, but only if the *firm* can meet the losses that might reasonably arise, including those that would arise from an event specifically insured against.

**Capital requirements for insurers**

1.1.43

PRA

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- (1) ■ GENPRU 2.1.13 R requires a *firm* to maintain *capital resources* equal to or in excess of its *capital resources requirement (CRR)*. ■ GENPRU 2.1 sets out the overall framework of the *CRR*; in particular, ■ GENPRU 2.1.17 R requires that for a *firm* carrying on *general insurance business* the *CRR* is equal to the *minimum capital requirement (MCR)*. ■ GENPRU 2.1.18 R requires that for *realistic basis life firms* the *CRR* is the higher of the *MCR* and the *ECR*. ■ GENPRU 2.1.23 R requires that for *regulatory basis only life firms* the *CRR* is equal to the *MCR*.
- (2) For non-life *firms* the *MCR* represents the *minimum capital requirement* (or margin of solvency) prescribed by the *Insurance Directives*. ■ GENPRU 2.1.24 R provides that, for a *firm* carrying on *general insurance business*, the *MCR* in respect of that business is the higher of the *base capital resources requirement for general insurance business* applicable to that *firm* and the *general insurance capital requirement*. ■ GENPRU 2.1.24A R provides that, for a *firm* carrying on *long-term insurance business* which is a *realistic basis life firm*, the *MCR* in respect of that business is the higher of the *base capital resources requirement for long-term insurance business* applicable to that *firm* and the *long-term insurance capital requirement*. ■ GENPRU 2.1.25 R provides that, for a *firm* carrying on *long-term insurance business* which is a *regulatory basis only life firm*, the *MCR* in respect of that business is the higher of the *base capital resources requirement for long-term insurance business* applicable to that *firm* and the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*. As specified in ■ GENPRU 2.1.14 R, a *firm* carrying on both

*general insurance business* and *long-term insurance business* must apply ■ GENPRU 2.1.13 R (referred to in paragraph (1) above) separately to its *general insurance business* and its *long-term insurance business*.

- (3) The calculation of the *general insurance capital requirement* is set out in ■ INSPRU 1.1.44 G to ■ INSPRU 1.1.72 R below. ■ INSPRU 1.1.73 to ■ INSPRU 1.1.79 R set out the calculation of the *insurance-related capital requirement* for non-life firms. The calculation of the *long-term insurance capital requirement* is set out in ■ INSPRU 1.1.80 G to ■ INSPRU 1.1.91 R below.

### General insurance capital requirement

1.1.44  
PRA

G

In relation to the MCR (see ■ INSPRU 1.1.43 G), ■ GENPRU 2.1.34 R requires a firm to calculate its *general insurance capital requirement (GICR)* as the highest of the *premiums amount*, the *claims amount*, and the *brought forward amount*. The elements for this computation are set out in ■ INSPRU 1.1 as follows:

- (1) the *premiums amount* in ■ INSPRU 1.1.45 R;
- (2) the *claims amount* in ■ INSPRU 1.1.47 R; and
- (3) the *brought forward amount* in ■ INSPRU 1.1.51 R.

### The premiums amount

1.1.45  
PRA

R

The *premiums amount* is:

- (1) 18% of the *gross adjusted premiums amount*; less 2% of the amount, if any, by which the *gross adjusted premiums amount* exceeds €61.3 million; multiplied by
- (2) the reinsurance ratio set out in ■ INSPRU 1.1.54 R.

1.1.46  
PRA

G

Rules and guidance as to how the *gross adjusted premiums amount* is to be calculated are set out in ■ INSPRU 1.1.56 R to ■ INSPRU 1.1.59 G.

### The claims amount

1.1.47  
PRA

R

The *claims amount* is:

- (1) 26% of the *gross adjusted claims amount*; less 3% of the amount, if any, by which the *gross adjusted claims amount* exceeds €42.9 million; multiplied by
- (2) the reinsurance ratio set out in ■ INSPRU 1.1.54 R.

1.1.48  
PRA

G

Rules and guidance as to how the *gross adjusted claims amount* is to be calculated are set out in ■ INSPRU 1.1.60 R to ■ INSPRU 1.1.65 G.

1.1.49

PRA

G

- (1) Under the *Insurance Directives* the Euro amounts specified in ■ INSPRU 1.1.45 R (1) and ■ INSPRU 1.1.47 R (1) are subject to annual review. The relevant amounts will be increased by the percentage change in the European index of consumer prices (comprising all EU member states, as published by Eurostat) from 20 March 2002, to the relevant review date, rounded up to a multiple of 100,000, provided that where the percentage change since the last increase is less than 5%, no increase will take place.
- (2) No provision for the index-linking of these amounts is made by the *Reinsurance Directive*. However, to ensure consistency as between *pure reinsurers*, *mixed insurers* and other *insurers*, the PRA intends to amend the Euro amounts specified in ■ INSPRU 1.1.45 R (1) and ■ INSPRU 1.1.47 R (1) for all such *firms* when an index-linked increase is required by the *Insurance Directives*.

1.1.50

PRA

R

For the purposes of ■ INSPRU 1.1.45 R (1) and ■ INSPRU 1.1.47 R (1), the exchange rate from the Euro to the pound sterling for each year beginning on 31 December is the rate applicable on the last day of the preceding October for which the exchange rates for the currencies of all the European Union member states were published in the Official Journal of the European Union.

**The brought forward amount**

1.1.51

PRA

R

- (1) Subject to (2) and (3), the *brought forward amount* is the *general insurance capital requirement (GICR)* for the prior *financial year*, multiplied, if the ratio is less than one, by the ratio (expressed as a percentage) of:
  - (a) the (calculated net of ) for outstanding at the end of the prior , determined in accordance with ■ INSPRU 1.1.12 R; to
  - (b) the *technical provisions* (calculated net of *reinsurance*) for *claims* outstanding at the beginning of the prior *financial year*, determined in accordance with ■ INSPRU 1.1.12 R.
- (2) If the amount of the *technical provisions* (calculated net of *reinsurance*) in (1)(a) and (b) is in both cases zero, the *brought forward amount* is the *general insurance capital requirement (GICR)* for the prior *financial year*, multiplied, if the ratio is less than one, by the ratio (expressed as a percentage) of:
  - (a) the *technical provisions* (calculated gross of *reinsurance*) for *claims* outstanding at the end of the prior *financial year*, determined in accordance with ■ INSPRU 1.1.12 R; to
  - (b) the *technical provisions* (calculated gross of *reinsurance*) for *claims* outstanding at the beginning of the prior *financial year*, determined in accordance with ■ INSPRU 1.1.12 R.
- (3) If the amount of the *technical provisions* (calculated gross of *reinsurance*) in (2)(a) and (b) is in both cases zero, the *brought*

*forward amount* is the *general insurance capital requirement (GICR)* for the prior *financial year*.

1.1.52  
PRA

G

The *brought forward amount* is the same as the *GICR* for the prior *financial year*, except where *claims* outstanding have fallen during that *financial year*. If the *technical provisions* (calculated net of *reinsurance*) have fallen, the *brought forward amount* is itself reduced by the same percentage fall. If the *technical provisions* (calculated net of *reinsurance*) are zero at the beginning and end of that *financial year* and the *technical provisions* gross of *reinsurance* have fallen, the *brought forward amount* is reduced by the percentage fall in *technical provisions* gross of *reinsurance*.

1.1.53

G

[deleted]

**Reinsurance ratio used in calculating the premiums amount and the claims amount**

1.1.54  
PRA

R

The reinsurance ratio referred to in ■ INSPRU 1.1.45 R (2) and ■ INSPRU 1.1.47 R (2) is:

- (1) if the ratio lies between 50% and 100%, the ratio (expressed as a percentage) of:
  - (a) the *claims* incurred (net of *reinsurance*) in the *financial year in question* and the two previous *financial years*; to
  - (b) the gross *claims* incurred in that three-year period;
- (2) 50%, if the ratio calculated in (a) and (b) of (1) is 50% or less; and
- (3) 100%, if the ratio calculated in (a) and (b) of (1) is 100% or more.

1.1.54A  
PRA

G

For the treatment of amounts recoverable from *ISPVs* when calculating the reinsurance ratio, see ■ INSPRU 1.1.92A R and ■ INSPRU 1.1.92B G.

1.1.55  
PRA

G

*Rules* and *guidance* as to how the net and gross *claims* are to be calculated are set out in ■ INSPRU 1.1.66 R to ■ INSPRU 1.1.71 R.

**Gross adjusted premiums amount used in calculating the premiums amount**

1.1.56  
PRA

R

For the purpose of ■ INSPRU 1.1.45 R, the *gross adjusted premiums amount* is the higher of the *gross written premiums* and *gross earned premiums* (as adjusted in accordance with ■ INSPRU 1.1.66 R) for the *financial year in question*, adjusted by:

- (1) except for a *pure reinsurer* which became a *firm in run-off* before 31 December 2006 and whose *Part 4A permission* has not subsequently been varied to add back the *regulated activity*

of *effecting contracts of insurance*, increasing by 50% the amount included in respect of the *premiums* for *general insurance business classes* 11, 12 and 13;

- (2) deducting 66.7% of the *premiums* for *actuarial health insurance* that meets the conditions set out in ■ INSPRU 1.1.72 R; and
- (3) multiplying the resulting figure by 12 and dividing by the number of months in the *financial year*. For the purposes of this calculation, the number of months in the *financial year* is the number of complete calendar months in the *financial year* plus any fractions of a month at the beginning and the end of the *financial year*.

1.1.57  
PRA

G A firm may use statistical methods in order to allocate *premiums* in respect of the *classes* 11, 12 and 13 for the purposes of ■ INSPRU 1.1.56 R.

1.1.58  
PRA

G *General insurance business classes* 11, 12 and 13 are, respectively, the marine liability, aviation liability and general liability insurance classes.

1.1.59  
PRA

G Where the firm did not carry on *insurance business* in the *financial year in question*, the *gross adjusted premiums amount*, and therefore the *premiums amount*, is nil.

**Gross adjusted claims amount used in calculating the claims amount**

1.1.60  
PRA

R For the purpose of ■ INSPRU 1.1.47 R and subject to ■ INSPRU 1.1.62 R, the *gross adjusted claims amount* is the amount of gross *claims* incurred (as determined in accordance with ■ INSPRU 1.1.66 R) over the reference period (as specified in ■ INSPRU 1.1.63 R) and adjusted by:

- (1) except for a *pure reinsurer* which became a *firm in run-off* before 31 December 2006 and whose *Part 4A permission* has not subsequently been varied to add back the *regulated activity* of *effecting contracts of insurance*, increasing by 50% the amount included in respect of the *claims* incurred for 11, 12 and 13;
- (2) deducting 66.7% of the *claims* for *actuarial health insurance* that meets the conditions set out in ■ INSPRU 1.1.72 R; and
- (3) multiplying the resulting figure by 12 and dividing by the number of months in the reference period. For the purposes of this calculation, the number of months in the reference period is the number of complete calendar months in the reference period plus any fractions of a month at the beginning and the end of the reference period.

1.1.61  
PRA

G A firm may use statistical methods in order to allocate *claims* in respect of *classes* 11, 12 and 13 for the purposes of ■ INSPRU 1.1.60 R.

1.1.62  
PRA

R

For the purposes of ■ INSPRU 1.1.47 R, in relation to *general insurance business class 18*, the amount of *claims* incurred used to calculate the *gross adjusted claims amount* must be the amount of costs recorded in the *firm's* books in the reference period as borne by the *firm* (whether or not borne in the reference period) in respect of the assistance given.

1.1.63  
PRA

R

- (1) Except in those cases where paragraph (2) applies, the reference period to be used in ■ INSPRU 1.1.60 R and ■ INSPRU 1.1.62 R must be:
  - (a) the *financial year in question* and the two previous *financial years*; or
  - (b) the period the *firm* had been in existence at the end of the *financial year in question*, if shorter.
- (2) In the case of a *firm* which underwrites only one or more of the *general insurance business risks* of credit, storm, hail or frost (including other business written in connection with such risks), the reference period to be used must be:
  - (a) the *financial year in question* and the six previous *financial years*; or
  - (b) the period the *firm* had been in existence at the end of the *financial year in question*, if shorter.

1.1.64  
PRA

G

The classification of the risks referred to in ■ INSPRU 1.1.63 R (2) is as follows: credit - as included in *general insurance business class 14*; storm - as included in *general insurance business class 8*; hail - as included in *general insurance business class 9*; and frost - as included in *general insurance business class 9*.

1.1.65  
PRA

G

Where the *firm* did not carry on *insurance business* in the reference period, the *gross adjusted claims amount*, and therefore the *claims amount*, is nil.

#### Accounting for premiums and claims

1.1.66  
PRA

R

For the purposes of ■ INSPRU 1.1.54 R, ■ INSPRU 1.1.56 R, ■ INSPRU 1.1.60 R and ■ INSPRU 1.1.62 R, amounts of *premiums* and *claims* must be:

- (1) determined in accordance with the *insurance accounts rules* or the Friendly Societies (Accounts and Related Provisions) Regulations 1994, as appropriate; and
- (2) adjusted for transfers that were approved by the relevant authority (or became effective where approval by an authority was not required) before the end of the *financial year in question*:

- (a) to exclude any amount included in, or adjustment made to, *premiums* and *claims* to reflect the consideration for a transfer of *contracts of insurance* to or from the *firm*;
- (b) to exclude *premiums* and *claims* which arose from *contracts of insurance* that have been transferred by the *firm* to another body; and
- (c) to account for *premiums* and *claims* which arose from *contracts of insurance* that have been transferred to the *firm* from another body as if they were receivable by or payable by the *firm*.

1.1.67

PRA

G

To ensure that all rights and obligations under a *contract of insurance* are transferred, a number of alternative mechanisms could be used. These are: an *insurance business transfer* under Part VII of the *Act*; under earlier *United Kingdom* insurance legislation; under equivalent foreign legislation; or by novation of contracts. The term "relevant authority" in paragraph (2) of ■ **INSPRU 1.1.66 R** may refer to whatever body has responsibility in a country, whether within or outside the *EEA*, for the approval of transfers of portfolios of *contracts of insurance*; the body may be a supervisory authority for financial services as such or it may be a judicial authority which has the necessary responsibility.

1.1.68

PRA

G

■ **INSPRU 1.1.66 R (2)(b)** requires a *firm*, for the purpose of calculating its *GICR*, to account for *contracts of insurance* transferred by it to another body as if it had never written those contracts. All amounts of *premiums* and *claims* arising in respect of those contracts are excluded, including amounts that arose in the *financial year in question* or previous *financial years*.

1.1.69

PRA

G

Conversely, ■ **INSPRU 1.1.66 R (2)(c)** requires a *firm*, for the purpose of calculating its *GICR*, to account for *contracts of insurance* transferred to it by another body as if it had been responsible for those contracts from inception and not merely from the date of transfer. All amounts of *premiums* and *claims* that arose from those contracts are included even where they arose prior to the date of transfer and were, in fact, receivable by or payable by the other body.

1.1.70

PRA

G

For both transfers to and from the *firm*, the consideration receivable or payable in respect of the transfer is excluded from *premiums* and *claims* in order to avoid double counting.

1.1.71

PRA

R

Where there has been a significant change in the business portfolio of the *firm* since the end of the *financial year in question*, for example, a line of business has been transferred to another *firm*, or the *firm* no longer carries on a particular *class of insurance business*, the *gross adjusted premiums amount* and the *gross adjusted claims amount* must both be recalculated to take into account the impact of this change. The recalculation must take into account the requirements of the *insurance accounts rules* or the *Friendly Societies (Accounts and Related Provisions) Regulations 1994*, as appropriate.

**Actuarial health insurance**

1.1.72  
PRA

**R**

The conditions referred to in ■ INSPRU 1.1.56 R (2) and ■ INSPRU 1.1.60 R (2) are that:

- (1) the health insurance is underwritten on a similar technical basis to that of life insurance;
- (2) the *premiums* paid are calculated on the basis of sickness tables according to the mathematical method applied in insurance;
- (3) a provision is set up for increasing age;
- (4) an additional *premium* is collected in order to set up a safety margin of an appropriate amount;
- (5) it is not possible for the *firm* to cancel the contract after the end of the third year of insurance; and
- (6) the contract provides for the possibility of increasing *premiums* or reducing payments even for current contracts.

**Enhanced capital requirement for general insurance business**

1.1.72A  
PRA

**G**

This section sets out the requirement for *firms* carrying on *general insurance business*, other than *non-directive insurers*, to calculate their *ECR*. The *ECR* for *firms* carrying on *general insurance business* is an indicative measure of the *capital resources* that a *firm* may need to hold based on risk sensitive calculations applied to its business profile. For *firms* carrying on *general insurance business*, the *PRA* will use the *ECR* as a benchmark for its consideration of the appropriateness of the *firm's* own capital assessment. For *firms* where an *ECR* is not calculated, the *MCR* will provide a benchmark for the *firm's* own capital assessment.

1.1.72B  
PRA

**R**

A *firm* carrying on *general insurance business*, other than a *non-directive insurer*, must calculate the amount of its *ECR*.

1.1.72C  
PRA

**R**

A *firm* to which ■ INSPRU 1.1.72B R applies must calculate its *ECR* in respect of its *general insurance business* as the sum of:

- (1) the *asset-related capital requirement*; and
- (2) the *insurance-related capital requirement*; less
- (3) the *firm's equalisation provisions*.

1.1.72D  
PRA

**G**

Details of the calculation of the *asset-related capital requirement* are set out in ■ INSPRU 2.2.10 R to ■ INSPRU 2.2.16 R. Details of the calculation of the *insurance-related capital requirement* are set out in ■ INSPRU 1.1.76 R to ■ INSPRU 1.1.79 R.

**Insurance-related capital requirement**

1.1.73

[intentionally blank]

1.1.74

**G**

The *insurance-related capital requirement* is a measure of the capital that a *firm* should hold against the risk of:

- (1) an adverse movement in the value of a *firm's* liabilities, to recognise that there may be substantial volatility in *claims* and other *technical provisions* made by the *firm*. Such variations may be due to inflationary increases, interest rate changes, movements in the underlying provisions themselves, changes in expense costs, inadequate rate pricing or *premium* collections (or both) from intermediaries differing from projected assumptions; and
- (2) the *premiums* a *firm* charges in respect of particular business not being adequate to fund future liabilities arising from that business.

1.1.75

**G**

The *insurance-related capital requirement* is calculated by applying capital charge factors, expressed as a percentage, to the value of the *net written premiums* and the *technical provisions* in respect of different classes of business. *Firms* should refer to ■ GENPRU 1.3.4 R which sets out how a *firm* must recognise and value assets and liabilities.

**Calculation of the insurance-related capital requirement**

1.1.76

**R**

**PRA**

A *firm* must calculate its *insurance-related capital requirement* in accordance with ■ INSPRU 1.1.77 R.

1.1.77

**R**

**PRA**

- (1) The value of:
  - (a) the *net written premiums*; and
  - (b) the *technical provisions*;in respect of each class of business listed in the table in ■ INSPRU 1.1.79 R must be multiplied by the corresponding capital charge factor.
- (2) If any amount which is to be multiplied by a capital charge factor is a negative amount, that amount shall be treated as zero.
- (3) The amounts resulting from multiplying the *net written premiums* in respect of each such class of business by the corresponding capital charge factor must be aggregated.
- (4) The amounts resulting from multiplying the *technical provisions* in respect of each such class of business by the corresponding capital charge factor must be aggregated.
- (5) The *insurance-related capital requirement* is the sum of the amounts calculated in accordance with (3) and (4).

1.1.78

PRA

**R**

In ■ INSPRU 1.1.77 R references to *technical provisions* comprise:

- (1) outstanding *claims*;
- (2) provisions for incurred but not reported (*IBNR claims*);
- (3) provisions for incurred but not enough reported (*IBNER claims*);
- (4) *unearned premium* reserves less *deferred acquisition costs*; and
- (5) unexpired risk reserves;

in each case net of *reinsurance* receivables.

1.1.79

PRA

**R**

Table: Insurance-related Capital Charge Factors

Class of Business	Net Written Premium capital charge factor	Technical provision capital charge factor
<b>Reporting Group: Direct and facultative business</b>		
<b>Direct and facultative accident and health</b>	<b>5.0%</b>	<b>7.5%</b>
<b>Direct and facultative personal lines motor business</b>	<b>10.0%</b>	<b>9.0%</b>
<b>Direct and facultative household and domestic all risks</b>	<b>10.0%</b>	<b>10.0%</b>
<b>Direct and facultative personal lines financial loss</b>	<b>25.0%</b>	<b>14.0%</b>
<b>Direct and facultative commercial motor business</b>	<b>10.0%</b>	<b>9.0%</b>
<b>Direct and facultative commercial lines property</b>	<b>10.0%</b>	<b>10.0%</b>
<b>Direct and facultative commercial lines liability</b>	<b>14.0%</b>	<b>14.0%</b>
<b>Direct and facultative commercial lines financial loss</b>	<b>25.0%</b>	<b>14.0%</b>
<b>Direct and facultative aviation</b>	<b>32.0%</b>	<b>14.0%</b>
<b>Direct and facultative marine</b>	<b>22.0%</b>	<b>17.0%</b>

Class of Business	Net Written Premium capital charge factor	Technical provision capital charge factor
<b>Direct and facultative goods in transit</b>	<b>12.0%</b>	<b>14.0%</b>
<b>Direct and facultative miscellaneous</b>	<b>25.0%</b>	<b>14.0%</b>
<b>Reporting Group: Non-Proportional Treaty</b>		
<b>Non-proportional accident &amp; health</b>	<b>35.0%</b>	<b>16.0%</b>
<b>Non-proportional motor</b>	<b>10.0%</b>	<b>14.0%</b>
<b>Non-proportional transport</b>	<b>16.0%</b>	<b>15.0%</b>
<b>Non-proportional aviation</b>	<b>61.0%</b>	<b>16.0%</b>
<b>Non-proportional marine</b>	<b>38.0%</b>	<b>17.0%</b>
<b>Non-proportional property</b>	<b>53.0%</b>	<b>12.0%</b>
<b>Non-proportional liability (non-motor)</b>	<b>14.0%</b>	<b>14.0%</b>
<b>Non-proportional financial lines</b>	<b>39.0%</b>	<b>14.0%</b>
<b>Non-proportional aggregate cover</b>	<b>53.0%</b>	<b>12.0%</b>
<b>Reporting Group: Proportional Treaty</b>		
<b>Proportional accident &amp; health</b>	<b>12.0%</b>	<b>16.0%</b>
<b>Proportional motor</b>	<b>10.0%</b>	<b>12.0%</b>
<b>Proportional transport</b>	<b>12.0%</b>	<b>15.0%</b>
<b>Proportional aviation</b>	<b>33.0%</b>	<b>16.0%</b>
<b>Proportional marine</b>	<b>22.0%</b>	<b>17.0%</b>
<b>Proportional property</b>	<b>23.0%</b>	<b>12.0%</b>
<b>Proportional liability (non-motor)</b>	<b>14.0%</b>	<b>14.0%</b>
<b>Proportional financial lines</b>	<b>25.0%</b>	<b>14.0%</b>
<b>Proportional aggregate cover</b>	<b>23.0%</b>	<b>12.0%</b>
<b>Reporting Group: Miscellaneous Reinsurance</b>		

Class of Business	Net Written Premium capital charge factor	Technical provision capital charge factor
Miscellaneous reinsurance accepted business	39.0%	14.0%

**Long-term insurance capital requirement**

1.1.80  
PRA

G

■ GENPRU 2.1.13 R requires an *insurer* to maintain *capital resources* equal to or in excess of its *capital resources requirement*. ■ GENPRU 2.1.18 R defines the *capital resources requirement* for a *firm* to which that *rule* applies (a *realistic basis life firm*) as the higher of the MCR and the ECR. For other *firms* carrying on *long-term insurance business* (*regulatory basis only life firms*), the *capital resources requirement* is equal to the MCR. Except where the *base capital resources requirement* is the higher requirement, the MCR in respect of *long-term insurance business* is the sum of the *long-term insurance capital requirement* (LTICR) and the *resilience capital requirement* or, in the case of a *realistic basis life firm*, the LTICR (see ■ GENPRU 2.1.24A R, ■ GENPRU 2.1.25 R and ■ GENPRU 2.1.26 R). ■ GENPRU 2.1.36 R defines the LTICR as the sum of the *insurance death risk, health risk and life protection reinsurance, expense risk, and market risk capital components* (see ■ INSPRU 1.1.81 R to ■ INSPRU 1.1.91 R). *Rules and guidance* about the *resilience capital requirement* are set out in ■ INSPRU 3.1.9 G to ■ INSPRU 3.1.26 R.

**Insurance death risk capital component**

1.1.81  
PRA

R

The *insurance death risk capital component* is the aggregate of the amounts which represent the fractions specified by ■ INSPRU 1.1.82 R of the capital at risk, defined in ■ INSPRU 1.1.83 R, for each category of *contracts of insurance* (as specified in ■ INSPRU 1.1.81A R), in respect of those contracts where the capital at risk is not a negative figure, multiplied by the higher of:

- (1) 50%; and
- (2) the ratio as at the end of the *financial year in question* of:
  - (a) the aggregate capital at risk in respect of that category of contracts net of *reinsurance* cessions; to
  - (b) the aggregate capital at risk in respect of that category of contracts gross of *reinsurance* cessions.

1.1.81A  
PRA

R

For the purpose of ■ INSPRU 1.1.81 R, the categories of *contracts of insurance* are as follows:

- (1) contracts which fall in *long-term insurance business classes I, II or IX*; and
- (2) contracts which fall in *long-term insurance business classes III, VII or VIII*.

1.1.82

PRA

**R** For the purpose of ■ INSPRU 1.1.81 R, the fraction is:

- (1) for *long-term insurance business classes I, II and IX*, except for a *pure reinsurer*:
  - (a) 0.1% for temporary insurance on death where the original term of the contract is three years or less;
  - (b) 0.15% for temporary insurance on death where the original term of the contract is five years or less but more than three years; and
  - (c) 0.3% in any other case;
- (2) 0.3% for *long-term insurance business classes III, VII and VIII*, except for a *pure reinsurer*; and
- (3) 0.1% for a *pure reinsurer*.

1.1.83

PRA

**R** For the purpose of ■ INSPRU 1.1.81 R, the capital at risk is:

- (1) where the benefit under a *contract of insurance* payable as a result of death includes periodic or deferred payments, the present value of the benefits payable; and
- (2) in any other case, the amount payable as a result of death;

less, in either case, the *mathematical reserves* for the contract.

1.1.83A

PRA

**R** ■ INSPRU 1.1.81 R does not apply to:

- (1) a *pure reinsurer*; or
- (2) a *mixed insurer*;

in respect of *life protection reinsurance business*.

1.1.84

PRA

**G** The *insurance death risk capital component* only relates to the risk of death. There is a separate risk component for insured health risks (*class IV*) which also applies to the risk of death covered in the *life protection reinsurance business* of *pure reinsurers* and *mixed insurers*. *Tontines (class V)* and *capital redemption operations (class VI)* also have separate risk components. There is no specified risk margin for other insured risks.

1.1.84A

PRA

**G** For the treatment of amounts recoverable from *ISPVs* when calculating the *insurance death risk capital component* in accordance with ■ INSPRU 1.1.81 R, see ■ INSPRU 1.1.92A R and ■ INSPRU 1.1.92B G.

**Insurance health risk and life protection reinsurance capital component**

1.1.85  
PRA

R

The *insurance health risk and life protection reinsurance capital component* is the highest of:

- (1) the *premiums amount* (determined in accordance with ■ INSPRU 1.1.45 R);
- (2) the *claims amount* (determined in accordance with ■ INSPRU 1.1.47 R); and
- (3) the *brought forward amount* (determined in accordance with ■ INSPRU 1.1.51 R); in respect of:
  - (a) *contracts of insurance falling in long-term insurance business class IV* (see ■ INSPRU 1.1.86 R);
  - (b) risks falling in *general insurance business classes 1 or 2* that are written as part of a *long-term insurance contract*; and
  - (c) in the case of a *pure reinsurer* or a *mixed insurer, life protection reinsurance business*.

1.1.86  
PRA

R

For the purposes of ■ INSPRU 1.1.85 R, in the case of *contracts of insurance falling in long-term insurance business class IV*, condition (3) as set out in ■ INSPRU 1.1.72 R (*actuarial health insurance*) is modified to: "either the reserves include a provision for increasing age, or the business is conducted on a group basis."

1.1.87  
PRA

G

The *insurance health risk and life protection reinsurance capital component* only applies to *permanent health insurance (long-term insurance business class IV)*, *accident and sickness insurance (general insurance business classes 1 and 2)* and the *life protection reinsurance business of pure reinsurers and mixed insurers*.

**Insurance expense risk capital component**

1.1.88  
PRA

R

The *insurance expense risk capital component* is:

- (1) in respect of *long-term insurance business classes III, VII and VIII*, an amount equivalent to 25% of the net *administrative expenses* in the *financial year in question* relevant to the business of each of those *classes*, in so far as the *firm* bears no investment risk and the allocation to cover *management expenses* in the *contract of insurance* does not have a fixed upper limit which is effective as a limit for a period exceeding 5 years from the commencement of the contract;
- (2) in respect of any *tontine (long-term insurance business class V)*, 1% of the assets of the *tontine*;

1.1.88A

PRA

R

■ INSPRU 1.1.88 R does not apply to:

- (1) a *pure reinsurer*; or
- (2) a *mixed insurer*;

in respect of:

- (a) *life protection reinsurance business*; or
- (b) *permanent health reinsurance business*.

#### Insurance market risk capital component

1.1.89

PRA

R

The *insurance market risk capital component* is 3% of the "adjusted *mathematical reserves*" (as defined in ■ INSPRU 1.1.89A R) for all insurance liabilities except those of a kind which:

- (1) arise from *contracts of insurance* falling in *long-term insurance business classes III, VII or VIII* to the extent that the *firm* does not bear any investment risk; or
- (2) arise from *contracts of insurance* falling in *long-term insurance business class V*; or
- (3) for a *pure reinsurer* or a *mixed insurer*, arise from *contracts of insurance* falling within:
  - (a) its *life protection reinsurance business*; or
  - (b) its *permanent health reinsurance business*.

#### Adjusted mathematical reserves

1.1.89A

PRA

R

(1) For the purpose of ■ INSPRU 1.1.88 R and ■ INSPRU 1.1.89 R, the "adjusted *mathematical reserves*" is the aggregate of the amounts which result from the performance of the calculation in ■ INSPRU 1.1.90 R for each category of insurance liability specified in (2).

(2) The categories of insurance liability referred to in (1) are:

- (a) for the purpose of ■ INSPRU 1.1.88 R, those categories described in ■ INSPRU 1.1.91 R (1), ■ (2), ■ (3), ■ (4) and ■ (5); and
- (b) for the purpose of ■ INSPRU 1.1.89 R, those categories described in ■ INSPRU 1.1.91 R (1), ■ (2), ■ (4) and ■ (5).

1.1.90

PRA

R

The calculation referred to in ■ INSPRU 1.1.89A R (1) is the multiplication of the amount of the *mathematical reserves* (gross of *reinsurance* cessions) in respect of a category of insurance liability by the higher of:

- (1) 85% or, in the case of a *pure reinsurer*, 50%; and
- (2) the ratio as at the end of the *financial year in question* of:
  - (a) the *mathematical reserves* in respect of that category of insurance liability net of *reinsurance* cessions; to
  - (b) the *mathematical reserves* in respect of that category of insurance liability gross of *reinsurance* cessions.

1.1.91

PRA

R

For the purpose of ■ INSPRU 1.1.89A R and ■ INSPRU 1.1.90 R, the categories of insurance liability are as follows:

- (1) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business classes* I, II or IX;
- (2) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business classes* III, VII or VIII to the extent that the *firm* bears an investment risk;
- (3) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business classes* III, VII or VIII to the extent that the *firm* bears no investment risk and where the allocation to cover *management expenses* in the *contract of insurance* has a fixed upper limit which is effective as a limit for a period exceeding 5 years from the commencement of the contract;
- (4) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business class* IV; and
- (5) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business class* VI.

1.1.92

PRA

G

Where a *firm* has written a unit-linked contract, the *firm's* liability under the contract may consist of a unit liability, where the *firm* bears no investment risk, and other liabilities for which the *firm* bears an investment risk, and for which a separate reserve is held. ■ INSPRU 1.1.91 R (2) and ■ (3) require a *firm* to analyse its liabilities under unit-linked contracts between those for which it bears an investment risk and those for which it does not. ■ INSPRU 1.1.88 R and ■ INSPRU 1.1.89 R taken together result in a capital requirement for any liabilities for which the *firm* bears an investment risk of 4% of "adjusted *mathematical reserves*" (1% for expense risk and 3% for market risk).

**Insurance special purpose vehicles**

1.1.92A

PRA

R

A *firm* must not treat any amounts recoverable from an *ISPV* as *reinsurance* for the purposes of the calculation of:

- (1) the *reinsurance ratio* in accordance with ■ INSPRU 1.1.54 R; or
- (2) the *insurance death risk capital component* in accordance with ■ INSPRU 1.1.81 R; or
- (3) the "*adjusted mathematical reserves*" in accordance with ■ INSPRU 1.1.90 R.

1.1.92B

PRA

G

A *firm* may treat amounts recoverable from an *ISPV* as *reinsurance* for these purposes if it obtains a *waiver* of ■ INSPRU 1.1.92A R under sections 138A and 138B of the *Act*. The conditions that will need to be met, in addition to the statutory tests under section 138A(4) of the *Act*, before the *PRA* will consider granting such a *waiver* are set out in ■ INSPRU 1.6.13 G to ■ INSPRU 1.6.18 G

**Application of INSPRU 1.1 to Lloyd's**

1.1.93

PRA

R

■ INSPRU 1.1 applies to the *Society* in accordance with ■ INSPRU 8.1.2 R.

1.1.94

PRA

R

The following *rules* and *guidance* apply to *managing agents* in accordance with ■ INSPRU 8.1.4 R:

- (1) ■ INSPRU 1.1.12 R to ■ INSPRU 1.1.20 R (except ■ INSPRU 1.1.12R (1));
- (2) ■ INSPRU 1.1.42 G to ■ INSPRU 1.1.43 G; and
- (3) ■ INSPRU 1.1.74 G to ■ INSPRU 1.1.80 G.

1.1.95

PRA

R

The *Society* must calculate the *brought forward amount* for the *members* in aggregate in accordance with ■ INSPRU 1.1.51 R, using the result of ■ GENPRU 2.3.6 R for the prior *financial year* and the aggregate of all *members' technical provisions* for the relevant periods.

1.1.96

PRA

R

For the purposes of ■ INSPRU 1.1.66 R and further to that *rule*, in the case of Lloyd's *members*, amounts of *premiums* and *claims* must be adjusted for *approved reinsurance to close* to exclude any amount included in, or adjustment made to, *premiums* and *claims* to reflect the consideration for an *approved reinsurance to close*.

## 1.2 Mathematical reserves

### Application

1.2.1

FCA PRA

R

■ INSPRU 1.2 applies to a *long-term insurer* unless it is:

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*.

### Purpose

1.2.2

PRA

G

This section follows on from the overall requirement on *firms* to establish adequate *technical provisions* (see ■ INSPRU 1.1.16 R). The *mathematical reserves* form the main component of *technical provisions* for *long-term insurance business*. ■ INSPRU 1.2 sets out *rules* and *guidance* as to the methods and assumptions to be used in calculating the *mathematical reserves*. The *rules* and *guidance* set out the minimum basis for *mathematical reserves*. Methods and assumptions that produce reserves that are demonstrably equal to or greater than the minimum basis may also be used, though they must meet the basic requirements for methods and assumptions set out in ■ INSPRU 1.2.7 R to ■ INSPRU 1.2.27 G.

1.2.3

PRA

G

This section applies to all *firms* carrying on *long-term insurance business* and implements some of the requirements contained in article 20 of the *Consolidated Life Directive*. The implementation is designed to ensure that a *firm's mathematical reserves* in respect of *long-term insurance contracts* meet the minimum requirements set by the *Consolidated Life Directive*. A *firm* may use a prospective or a retrospective method to value its *mathematical reserves* (see ■ INSPRU 1.2.7 R).

1.2.4

PRA

G

The required procedures are summarised in the flowchart in ■ INSPRU 1 Annex 1 G.

1.2.5

PRA

G

*Firms* to which ■ GENPRU 2.1.18 R applies are required to calculate a *with-profits insurance capital component* (see ■ GENPRU 2.1.38 R). In order to calculate its *with-profits insurance capital component*, such a *firm* is required to carry out additional calculations of its liabilities on a realistic basis (see ■ INSPRU 1.3), which it is required to report to the PRA (see Forms 18,19). A *firm* that reports its liabilities on a realistic basis is referred to in GENPRU and INSPRU as a *realistic basis life firm*. Such *firms* are subject to different *rules* relating to the calculation of *mathematical reserves* (see

■ INSPRU 1.2.46 R and ■ INSPRU 1.2.76 R) compared with those that apply to *firms* that report on a regulatory basis only (*regulatory basis only life firms*).

1.2.6

FCA PRA

G

A number of the *rules* in this section require a *firm* to take into account its regulatory duty to treat *customers* fairly. In this section, references to such a duty are to the duty of a *firm* regulated by the *FCA* to pay due regard to the interests of its *customers* and to treat them fairly (see the *FCA's Principle 6* in *PRIN*). This duty is owed to both *policyholders* and potential *policyholders*.

1.2.6A

FCA PRA

G

A number of *rules* in this section are made by the *FCA* and the *PRA*. Some of the rules made by the *FCA* and *PRA* contain references to, or are reliant on, *rules* that are only made by the *PRA*. *Firms* should consider ■ GEN 2.2.13A R (cross-references in the *Handbook*) and ■ GEN 2.2.23 R to ■ GEN 2.2.25 G (cutover: application of provisions made by both the *FCA* and the *PRA*) when applying these *rules*. In the context of mathematical reserves, the *FCA rules* ensure a *firm* takes into account its regulatory duty to treat *customers* fairly. Where an *FCA rule* refers to a *PRA rule*, ■ GEN 2.2.13A R and ■ GEN 2.2.23 R will apply so that the *PRA rule* is also made by the *FCA* to the extent necessary to make the *FCA rule* function but only to the extent of the *FCA's* powers and regulatory responsibilities.

**Basic valuation method**

1.2.7

PRA

R

- (1) Subject to (2), a *firm* must establish its *mathematical reserves* using a prospective actuarial valuation on prudent assumptions of all future cash flows expected to arise under, or in respect of, each of its *long-term insurance contracts*.
- (2) But a *firm* may use a retrospective actuarial valuation where:
  - (a) a prospective method cannot be applied to a particular type of contract; or
  - (b) the *firm* can demonstrate that the resulting amount of the *mathematical reserves* would be no lower than would be required by a prudent prospective actuarial valuation.

1.2.8

PRA

G

A prospective valuation sets the *mathematical reserves* at the present value of future net cash flows. A retrospective method typically sets the *mathematical reserves* at the level of *premiums* received (and accumulated with investment return), less *claims* and expenses paid. A prospective valuation is preferred because it takes account of circumstances that might have arisen since the *premium* rate was set and of changes in the perception of future experience. Circumstances in which a retrospective valuation might be appropriate include:

- (1) where the assumptions initially made in determining the *premium* rate were sufficiently prudent at inception and have not been overtaken by subsequent events; and
- (2) where the liability depends on the emerging experience.

1.2.9

PRA

R

Except in ■ INSPRU 1.2.71 R (1), ■ INSPRU 1.2 does not apply to *final bonuses*. In addition, for *realistic basis life firms* only, ■ INSPRU 1.2 does not apply to other discretionary benefits, including future *annual bonuses*.

**Methods and assumptions**

1.2.10

FCA

PRA

R

In the actuarial valuation under ■ INSPRU 1.2.7 R, a *firm* must use methods and prudent assumptions which:

- (1) are appropriate to the business of the *firm*;
- (2) are consistent from year to year without arbitrary changes (see ■ INSPRU 1.2.11 G);
- (3) are consistent with the method of valuing assets (see ■ GENPRU 1.3);
- (4) include appropriate margins for adverse deviation of relevant factors (see ■ INSPRU 1.2.12 G);
- (5) recognise the distribution of profits (that is, emerging surplus) in an appropriate way over the duration of each *contract of insurance*;
- (6) take into account its regulatory duty to treat its *customers* fairly (see *FCA's Principle 6*); and
- (7) are in accordance with generally accepted actuarial practice.

1.2.11

FCA

PRA

G

■ INSPRU 1.2.10 R (2) prohibits only arbitrary changes in methods and assumptions, that is, changes made without adequate reasons. Any such changes would hinder comparisons over time as to the amount of the *mathematical reserves* and so obscure trends in solvency and the emergence of surplus.

1.2.12

PRA

G

The relevant factors referred to in ■ INSPRU 1.2.10 R (4) may include, but are not limited to, factors such as future investment returns, expenses, mortality, morbidity, options, persistency and *reinsurance* (see also ■ INSPRU 1.2.13 R to ■ INSPRU 1.2.19 G).

**Margins for adverse deviation**

1.2.13

PRA

R

The appropriate margins for adverse deviation required by ■ INSPRU 1.2.10 R (4) must be sufficiently prudent to ensure that there is no significant foreseeable risk that liabilities to *policyholders* in respect of *long-term insurance contracts* will not be met as they fall due.

1.2.14

PRA

G

The margins for adverse deviation are a prudential margin in respect of the risks that arise under a *long-term insurance contract*.

1.2.15

PRA

G

■ INSPRU 1.2.13 R sets the normal standard of prudence required for margins.  
■ INSPRU 1.2.16 G suggests benchmarks against which a *firm* should compare the margins it has set in accordance with ■ INSPRU 1.2.10 R (4) and ■ INSPRU 1.2.13 R. ■ INSPRU 1.2.17 G gives *guidance* where a market risk premium is not readily obtainable.

1.2.16

PRA

G

When setting the margins for adverse deviation required by ■ INSPRU 1.2.10 R (4) in relation to a particular contract, a *firm* should consider, where appropriate:

- (1) the margin for adverse deviation included in the *premium* for similar *long-term insurance contracts*, if any, newly issued by the *firm*; and
- (2) where a sufficiently developed and diversified market for transferring a risk exists, the risk premium that would be required by an unconnected party to assume the risk in respect of the contract.

The margin for adverse deviation of a risk should generally be greater than or equal to the relevant market price for that risk.

1.2.17

PRA

G

Where a risk premium is not readily available, or cannot be determined, an external proxy for the risk should be used, such as adjusted industry mortality tables. Where there is a considerable range of possible outcomes, the *PRA* expects *firms* to use stochastic techniques to evaluate these risks. In time, for example, longevity risk, where this constitutes a significant risk for the *firm*, may fall into this category.

1.2.18

PRA

G

The margins for adverse deviation should be recognised as profit only as the *firm* itself is released from risk over the duration of the contract.

1.2.19

PRA

G

Further detailed *rules* and *guidance* on margins for adverse deviation are included in ■ INSPRU 1.2.32 G to ■ INSPRU 1.2.89 G. In particular, the cross-references for the different assumptions used in calculating the *mathematical reserves* are as follows:

- (1) expenses ( ■ INSPRU 1.2.50 R to ■ INSPRU 1.2.58 G);
- (2) mortality and morbidity ( ■ INSPRU 1.2.59 R to ■ INSPRU 1.2.61 G);
- (3) options ( ■ INSPRU 1.2.62 R to ■ INSPRU 1.2.72 G);
- (4) persistency ( ■ INSPRU 1.2.76 R and ■ INSPRU 1.2.77 G); and
- (5) *reinsurance* ( ■ INSPRU 1.2.77A R to ■ INSPRU 1.2.89 G).

The *rules* and *guidance* on margins for adverse deviation in respect of future investment returns, which are also required in the calculation of *mathematical reserves*, are set out in ■ INSPRU 3.1.28 R to ■ INSPRU 3.1.48 G.

1.2.20

FCA PRA

R

**Record keeping**

A *firm* must make, and retain for an appropriate period, a record of:

- (1) the methods and assumptions used in establishing its *mathematical reserves*, including the margins for adverse deviation, and the reasons for their use; and
- (2) the nature of, reasons for, and effect of, any change in approach, including the amount by which the change in approach increases or decreases its *mathematical reserves*.

1.2.21

FCA PRA

G

■ SYSC 14.1.53 R requires *firms* to maintain accounting and other records for a minimum of three years, or longer as appropriate. For the purposes of ■ INSPRU 1.2.20 R, a period of longer than three years will be appropriate for a *firm's long-term insurance business*. In determining an appropriate period, a *firm* should have regard to:

- (1) the detailed *rules* and *guidance* on record keeping in ■ SYSC 14.1.51 G - ■ SYSC 14.1.64 G;
- (2) the nature and term of the *firm's* long-term insurance business; and
- (3) any additional provisions or statutory requirements applicable to the *firm* or its records.

**Valuation of individual contracts**

1.2.22

PRA

R

- (1) Subject to (2) and (3), a *firm* must determine the amount of the *mathematical reserves* separately for each *long-term insurance contract*.
- (2) Approximations or generalisations may be made:
  - (a) in the case of non-attributable expenses, in relation to a group of contracts with the same or similar expense risk characteristics, provided that the *mathematical reserves* in respect of such expenses established by the firm in relation to that group of contracts have a minimum value of at least zero; and
  - (b) in any other case, where they are likely to provide the same, or a higher, result than a determination made in accordance with (1).
- (3) A *firm* must set up additional *mathematical reserves* on an aggregated basis for general risks that are not specific to individual contracts.
- (4) For the purpose of (2), non-attributable expenses are expenses which are not directly attributable to a particular *long-term insurance contract*.

1.2.23

PRA

G

■ INSPRU 1.2.22 R to ■ INSPRU 1.2.89 G set out *rules* and *guidance* for the separate prospective valuation of each contract. These may be applied instead to groups of contracts where the conditions set out in ■ INSPRU 1.2.22 R (2)(a) or ■ (b) are satisfied. Guidance on non-attributable expenses and the application of ■ INSPRU 1.2.22 R (2)(a) is provided in ■ INSPRU 1.2.54A G.

**Negative mathematical reserves**

1.2.24

PRA

R

A *firm* may calculate a negative value for the *mathematical reserves* in respect of a *long-term insurance contract* provided that:

- (1) this is based on assumptions which meet the general requirements for prudent assumptions as set out in ■ INSPRU 1.2.10 R and ■ INSPRU 1.2.13 R;
- (2) the contract does not have a *surrender value* which at the *actuarial valuation date* is guaranteed; and
- (3) the total *mathematical reserves* established by the *firm* have a minimum value of at least:
  - (a) where the *firm's long-term insurance contracts* include *linked long-term contracts*, the sum of the *surrender values* of all its *linked long-term contracts* at the *actuarial valuation date*; and
  - (b) in any other case, zero.

1.2.25

PRA

G

- (1) A separate prospective valuation for each contract may identify contracts for which the value of future cash inflows under and in respect of the contract exceeds that of outflows. In these circumstances, the *firm* may calculate the *mathematical reserves* for that contract as having a negative value and treat that value as available to off-set *mathematical reserves* for other contracts which have a positive value when establishing the overall *mathematical reserves*.
- (2) In complying with ■ INSPRU 1.1.34 R or ■ INSPRU 3.1.61A R, as applicable, with respect to the matching of assets and liabilities, *insurers* should consider the suitability for offset of contracts whose *mathematical reserves* are negative against liabilities on other contracts and only offset them if it is prudent to do so. While ■ INSPRU 1.2.24 R applies at a *firm* level, it may be relevant when assessing the prudence of the offset of contracts whose *mathematical reserves* are negative to consider the fact that contracts with negative *mathematical reserves* written outside a *with-profits fund* are not, for the purpose of ■ INSPRU 1.1.27 R, permitted to be offset against contracts with positive *mathematical reserves* written within that *with-profits fund*.

1.2.25A

PRA

G

In addition, the *Consolidated Life Directive* requires that no contract should be valued at less than its guaranteed *surrender value* (see ■ INSPRU 1.2.62A G). As a result, no contract with a guaranteed *surrender value* to which the *Consolidated Life Directive* applies should be valued as if it were an asset. Although the *Reinsurance Directive* does not require this treatment of contracts with guaranteed *surrender values* to be applied to *pure reinsurers*, the *PRA's* policy is that there should be equal treatment in this respect. ■ INSPRU 1.2.62 R makes further provision relating to the *mathematical reserves* to be established in respect

of such contracts. When considering the impact that the amount payable on surrender may have on the valuation of a contract, a *firm* should have regard to ■ INSPRU 1.2.71 R.

**Avoidance of future valuation strain**

1.2.26  
PRA

R

- (1) A *firm* must establish *mathematical reserves* for a *contract of insurance* which are sufficient to ensure that, at any subsequent date, the *mathematical reserves* then required are covered solely by:
  - (a) the assets covering the current *mathematical reserves*; and
  - (b) the resources arising from those assets and from the contract itself.
- (2) For the purposes of (1), the *firm* must assume that:
  - (a) the assumptions adopted for the current valuation of liabilities remain unaltered and are met; and
  - (b) discretionary benefits and charges will be set so as to fulfil its regulatory duty to treat its *customers* fairly.
- (3) Subject to (4), (1) may be applied to a group of similar contracts instead of to the individual contracts within that group.
- (4) (1) must be applied to a group of contracts in relation to which *mathematical reserves* in respect of non-attributable expenses are established for that group of contracts in accordance with ■ INSPRU 1.2.22 R (2)(a), instead of to the individual contracts within that group.

1.2.27  
PRA

G

The valuation of each contract, or group of similar contracts, should allow for the possibility, where it exists, that contracts may be surrendered (wholly or in part), lapsed or made paid-up at any time. The valuation assumptions include margins for adverse deviation (see ■ INSPRU 1.2.13 R). ■ INSPRU 1.2.26 R requires *mathematical reserves* to be established such that, if future experience is in line with the valuation assumptions, there would be no future valuation strain.

**Cash flows to be valued**

1.2.28  
FCA PRA

R

In a prospective valuation, a *firm* must:

- (1) include in the cash flows to be valued the following:
  - (a) future *premiums* (see ■ INSPRU 1.2.35 G to ■ INSPRU 1.2.47 G);
  - (b) expenses, including *commissions* (see ■ INSPRU 1.2.50 R to ■ INSPRU 1.2.58 G);
  - (c) benefits payable (see ■ INSPRU 1.2.29 R); and

- (d) subject to (2), amounts to be received or paid in respect of the *long-term insurance contracts* under contracts of *reinsurance* or analogous *non-reinsurance* financing agreements (see ■ INSPRU 1.2.77A R to ■ INSPRU 1.2.89 G); but

(2) exclude from those cash flows amounts recoverable from an *ISPV*.

1.2.28A

FCA PRA

G

A *firm* may include amounts recoverable from an *ISPV* in the cash flows to be valued in a prospective valuation if it obtains a *waiver* of ■ INSPRU 1.2.28 R under sections 138A and 138B of the *Act*. The conditions that will need to be met, in addition to the statutory tests under section 138A(4) of the *Act*, before the *PRA* will consider granting such a *waiver* are set out in ■ INSPRU 1.6.13 G to ■ INSPRU 1.6.18 G.

1.2.29

FCA PRA

R

For the purpose of ■ INSPRU 1.2.28R (1)(c) , benefits payable include:

- (1) all guaranteed benefits including guaranteed *surrender values* and paid-up values;
- (2) vested, declared and allotted bonuses to which the *policyholder* is entitled;
- (3) all options available to the *policyholder* under the terms of the contract; and
- (4) discretionary benefits payable in accordance with the *firm's* regulatory duty to treat its *customers* fairly.

1.2.30

FCA PRA

G

All cash flows are to be valued using prudent assumptions in accordance with generally accepted actuarial practice. Cash flows may be omitted from the valuation calculations provided the reserves obtained as a result of leaving those cash flows out of the calculation are not less than would have resulted had all cash flows been included (see ■ INSPRU 1.2.22 R (2)(b)). Provision for future expenses in respect of *with-profits insurance contracts* (excluding *accumulating with-profits policies*) may be made implicitly, using the *net premium* method of valuation (see ■ INSPRU 1.2.43 R below). For the purposes of ■ INSPRU 1.2.28R (1)(b) , any charges included in expenses should be determined in accordance with the *firm's* regulatory duty to treat its *customers* fairly.

1.2.31

FCA PRA

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■ INSPRU 1.2.29 R (4) requires *regulatory basis only life firms* to make allowance for any future *annual bonus* that a *firm* would expect to grant, assuming future experience is in line with the assumptions used in the calculation of the *mathematical reserves*. *final bonuses* do not have to be taken into consideration in these calculations except in relation to *accumulating with-profits policies* (see ■ INSPRU 1.2.9 R). The calculations required for *accumulating with-profits policies* are set out in ■ INSPRU 1.2.71 R (1). For *realistic basis life firms*, except for *accumulating with-profits policies*, the *mathematical reserves* may be calculated without taking into account discretionary benefits, including both *annual bonuses* and *final bonuses*. For such *firms* full allowance for discretionary benefits is made in the calculation of the *realistic value of liabilities* (see ■ INSPRU 1.3.105 R (5)).

**Valuation assumptions: detailed rules and guidance**

**1.2.32** **G** More detailed *rules* and *guidance* about the valuation of cash flows are set out in **INSPRU 1.2.33 R** to **INSPRU 1.2.89 G**.  
**PRA**

**Valuation rates of interest**

**1.2.33** **R** In calculating the present value of future net cash flows, a *firm* must determine the rates of interest to be used in accordance with **INSPRU 3.1.28 R** to **INSPRU 3.1.47 R**.  
**PRA**

**1.2.34** **G** The *rules* in **INSPRU 3.1.28 R** to **INSPRU 3.1.47 R** set out the approach *firms* must take in setting margins for adverse deviation in the interest rates assumed in calculating the *mathematical reserves*. This includes a margin to allow for adverse deviation in *market risk* and, where relevant, credit risk. The requirements set out in **INSPRU 3.1.28 R** to **INSPRU 3.1.47 R** protect against the *market risk* that the return actually achieved on assets may fall below the market yields on assets at the *actuarial valuation date*.  
**PRA**

**Future premiums**

**1.2.35** **G** **INSPRU 1.2.46 R** and **INSPRU 1.2.47 G** apply to the valuation of *with-profits insurance liabilities* for a *realistic basis life firm*. **INSPRU 1.2.38 R** to **INSPRU 1.2.45 G** apply to a *regulatory basis only life firm*.  
**PRA**

**1.2.36** **G** For *non-profit insurance contracts* no specific method of valuation for future *premiums* is required by *INSPRU*. However, the method of valuation used should be sufficiently prudent taking into account, in particular, the risk of voluntary discontinuance by the *policyholder*.  
**PRA**

**Future premiums: firms reporting only on a regulatory basis**

**1.2.37** **R** **INSPRU 1.2.38 R** to **INSPRU 1.2.43 R** apply to a *regulatory basis only life firm*.  
**PRA**

- 1.2.38** **R**
- (1) This *rule* applies to with-profits insurance contracts except accumulating with-profits policies written on a recurring single premium basis.
  - (2) The value attributed to a *premium* due in any future *financial year* (a future *premium*) must not exceed the lower of the value of:
    - (a) the actual *premium* payable under the contract; and
    - (b) the *net premium*.
  - (3) The *net premium* may be increased for *deferred acquisition costs* in accordance with **INSPRU 1.2.43 R**.

**1.2.39** **G** The valuation method for future *premiums* in **INSPRU 1.2.38 R** retains the difference, if any, between the gross *premium* and the *net premium* as an implicit margin available  
**PRA**

to finance future bonuses, expenses and other costs. It thus helps to protect against the risk that adequate resources may not be available in the future to meet those costs. Where expenses are not directly attributable to a particular contract, a *firm* may establish *mathematical reserves* in respect of such expenses in relation to a group of contracts with the same or similar expense risk characteristics in accordance with ■ INSPRU 1.2.22 R (2)(a).

1.2.40  
PRA

**R** Where the terms of a *contract of insurance* have changed since it was first entered into, a *firm* must apply one of the methods in ■ INSPRU 1.2.41 R in determining the *net premium* for the purpose of ■ INSPRU 1.2.38 R (2)(b).

1.2.41  
PRA

**R** A *firm* must treat the change referred to in ■ INSPRU 1.2.40 R as if either:

- (1) it had been included in the original contract but came into effect from the time the change became effective; or
- (2) the original contract were cancelled and replaced by a new contract (with an initial *premium* paid on the new contract equal to the liability under the original contract immediately prior to the change); or
- (3) it gave rise to two separate contracts where:
  - (a) all *premiums* are payable under the first contract and that contract provides only for such benefits as those *premiums* could have purchased from the *firm* at the date the change became effective; and
  - (b) no *premiums* are payable under the second contract and that contract provides for all the other benefits.

1.2.42  
PRA

**G** ■ INSPRU 1.2.41 R permits three alternative methods. However, the third method is only possible where a meaningful comparison can be made between the terms of the contract (as changed) and the terms upon which the *firm* was *effecting* its new *contracts of insurance* at the time the contract was changed.

**Future net premiums: adjustment for deferred acquisition costs**.....

1.2.43  
PRA

- R**
- (1) The amount of any increase to the *net premium* for *deferred acquisition costs* must not exceed the equivalent of the recoverable acquisition expenses spread over the period of *premium* payments and calculated in accordance with the rates of interest, mortality and morbidity assumed in calculating the *mathematical reserves*.
  - (2) For the purpose of (1), recoverable acquisition expenses means the amount of expenses, after allowing for the effects of taxation, which it is reasonable to expect will be recovered from future *premiums* payable under the contract.
  - (3) The recoverable acquisition expenses in (1) must not exceed the lower of:

- (a) the value of the excess of actual *premiums* over *net premiums*; and
- (b) 3.5% of the *relevant capital sum*.

(4) Recoverable acquisition expenses may be calculated as the average for a group of similar contracts weighted by the *relevant capital sum* for each contract.

1.2.44  
PRA

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■ INSPRU 1.2.43 R allows a *firm* to spread acquisition costs over the lifetime of a *contract of insurance*, but only if it is reasonable to expect those costs to be recoverable from future *premium* income from that contract. Further prudence is provided by the limitation of recoverable acquisition expenses to 3.5% of the *relevant capital sum*. This adjustment for acquisition costs is sometimes termed a Zillmer adjustment.

1.2.45  
PRA

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In determining the extent, if any, to which it is reasonable to expect acquisition costs to be recoverable from future *premium* income, the *firm* should make prudent assumptions as to levels of voluntary discontinuance by *policyholders*.

**Future premiums: firms also reporting with-profits insurance liabilities on a realistic basis**

1.2.46  
PRA

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- (1) Subject to (2), for a *realistic basis life firm*, the future *premiums* to be valued in the calculation of the *mathematical reserves* for its *with-profits insurance contracts* must not be greater than the gross *premiums* payable by the *policyholder*.
- (2) This *rule* does not apply to *accumulating with-profits policies* written on a recurring single *premium* basis (see ■ INSPRU 1.2.48 R).

1.2.47  
PRA

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The gross *premium* is the full amount of *premium* payable by the *policyholder* to the *firm*. The gross *premium* method contrasts with the *net premium* method which is required from *regulatory basis only life firms* (see ■ INSPRU 1.2.37 R to ■ INSPRU 1.2.45 G).

**Future premiums: accumulating with-profits policies**

1.2.48  
PRA

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- (1) This *rule* applies to *accumulating with-profits policies* written on a recurring single *premium* basis.
- (2) A *firm* must not attribute any value to a future *premium* under the contract.
- (3) Any liability arising only upon the payment of that *premium* may be ignored except to the extent that the value of that liability upon payment would exceed the amount of that *premium*.

1.2.49  
PRA

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■ INSPRU 1.2.48 R prohibits a *firm* from taking credit for recurring single *premiums* under *accumulating with-profits policies*. As there is no contractual commitment to

pay any future *premiums* the amount and timing of which are uncertain, the recognition of any potential margins would not be prudent. Where the payment of a future *premium* would give rise to a liability in excess of the *premium* a provision should be established.

**Expenses**

1.2.50

PRA

R

(1) A *firm* must make provision for expenses, either implicitly or explicitly, in its *mathematical reserves* of an amount which is not less than the amount expected, on prudent assumptions, to be incurred in fulfilling its *long-term insurance contracts*.

(2) For the purpose of (1), expenses must be valued:

- (a) after taking account of the effect of taxation;
- (b) having regard to the *firm's* actual expenses in the last 12 months before the *actuarial valuation date* and any increases in expenses expected to occur in the future;
- (c) after making prudent assumptions as to the effects of inflation on future increases in prices and earnings; and
- (d) at no less than the level that would be incurred if the *firm* were to cease to transact new business 12 months after the *actuarial valuation date*.

(3) A *firm* must not rely upon an implicit provision arising from the method of valuing future *premiums* except to the extent that:

- (a) it is reasonable to assume that expenses will be recoverable from future *premiums*; and
- (b) the expenses would only arise if the future *premiums* were received.

1.2.51

PRA

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For *with-profits insurance contracts* where the *net premium* valuation method applies, an implicit provision arises because the future *premiums* valued are limited to the *net premium* adjusted as permitted by ■ INSPRU 1.2.43 R. This excludes the allowance within the gross *premium* for expenses (other than recoverable acquisition expenses). It also excludes other margins within the actual *premium* that are a prudential margin in respect of the risks that arise under the contract or that are needed to provide for future discretionary benefits. To the extent that these other margins are not needed for the purpose for which they were originally established, they may also constitute an implicit provision for expenses.

1.2.52

PRA

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An implicit provision may also arise for other types of *long-term insurance contract* where, for example, no value is attributed to future *premiums*, but the *firm* is entitled to make deductions from future regular *premiums* before allocating them to secure *policyholder* benefits.

1.2.53

PRA

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A *firm* should only reduce the provision for future expenses to take account of expected taxation recoveries related to those expenses where recovery is reasonably certain, and after taking into account the assumption that the *firm* ceases to transact new business 12

months after the *actuarial valuation date*. An appropriate adjustment for discounting should be made where receipt of the taxation recoveries is not expected until significantly after the expenses are incurred.

**1.2.54**

**PRA**

**G**

The *firm's* actual expenses in the 12 months prior to the *actuarial valuation date* may serve as a guide to the assumptions for future expenses, taking into consideration the mix of acquisition and renewal expenses. The expense assumptions should not be reduced to account for expected future improvements in efficiency until such efficiency improvements result in a reduced level of actual expenditure. However, the assumptions should take account of all factors which might increase costs including earnings and price inflation.

**1.2.54A**

**PRA**

**G**

- (1) A *firm* should attribute to an individual contract at least those expenses which are directly attributable to that contract including expenses which vary with the volume of business for that type of contract. Commission payments, charges to a fund on a 'per policy' basis and investment management fees are generally directly attributable. For expenses of the fund which are calculated directly based on actual expenses (and not calculated in accordance with a management services agreement), the attributable expenses will also include those costs which vary with the volume of business for that product, for example, salaries and accommodation costs of staff in a processing centre, printing and postage of communications to *policyholders* and associated computer services.
- (2) Non-attributable expenses may include overheads which are relatively insensitive to the volume of business for the type of contract in question and an apportionment of group overheads. Examples of expenses that *firms* may consider non-attributable include salaries of head office staff involved in monitoring products and drafting standard communications to *policyholders* and allocated overheads for centralised functions such as human resources, finance and IT. Where non-attributable expenses arise in relation to a homogeneous risk group of contracts sharing the same or similar expense risk characteristics, a *firm* may determine the reserve for those expenses at the level of that risk group, provided that the reserve so established has a minimum value of at least zero (see ■ INSPRU 1.2.22 R (2)(a)). In identifying its homogeneous risk groups, a *firm* should consider all risks that impact on the level of expenses borne by contracts including persistency risk and expense inflation risk. For example, business that is subject to bulk lapse risk, such as any large group contract that would give rise to a reduction in surplus on lapse, should be considered as forming a homogeneous risk group of its own. A *firm* must document and justify its approach to identifying homogeneous risk groups in accordance with the record-keeping requirements of ■ INSPRU 1.2.20 R. This approach to reserving for expenses ensures that prudent reserves are established in respect of both directly attributable and non-attributable expenses arising in relation to the *firm's long-term insurance business*.

**1.2.54B**

**PRA**

**G**

In valuing cash flows in respect of *commissions*, a *firm* may wish to take into account any contractual arrangements for the "clawback" or repayment of *commissions* already paid in the event of voluntary discontinuance of a *contract of insurance*. In deciding how to treat such arrangements in determining the *mathematical reserves* for a *contract of insurance*, the *firm* must use assumptions which meet the general requirements for prudent assumptions as set out in ■ INSPRU 1.2.10 R and ■ INSPRU 1.2.13 R. For example,

the *firm* should establish prudent margins for adverse deviation in respect of the credit risk of the intermediary by whom the *commission* would be repayable.

1.2.55

PRA

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The provisions for expenses (whether implicit or explicit) required by ■ INSPRU 1.2.50 R must be sufficient to cover all the expenses of running off the *firm's* existing *long-term insurance business* including:

- (1) all discontinuance costs (for example, redundancy costs and closure costs) that would arise if the *firm* were to cease transacting new business 12 months after the *actuarial valuation date* in circumstances where (and to the extent that) the discontinuance costs exceed the projected surplus available to meet such costs;
- (2) all costs of continuing to service the existing business taking into account the loss of economies of scale from, and any other likely consequences of, ceasing to transact new business at that time; and
- (3) the lower of:
  - (a) any projected valuation strain from writing new business for the 12 months following the *actuarial valuation date* to the extent the actual amount of that strain exceeds the projected surplus on prudent assumptions from existing business in the 12 months following the *actuarial valuation date*; and
  - (b) any projected new business expense overrun from writing new business for the 12 months following the *actuarial valuation date* to the extent the projected expenses exceed the expenses that the new business can support on a prudent basis.

1.2.56

PRA

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The provision for future expenses, whether implicit or explicit, should include a prudent margin for adverse deviation in the level and timing of expenses (see ■ INSPRU 1.2.13 R to ■ INSPRU 1.2.19 G). The margin should cover the risk of underestimating expenses whether due to, for example, initial under-calculation or subsequent increases in the amount of expenses. In setting the amount of the margin, the *firm* should take into account the extent to which:

- (1) an appropriately validated method based on reliable data is used to allocate expenses as between attributable and non-attributable expenses or between acquisition and non-acquisition expenses and by product type, by distribution channel or by homogeneous risk group, as appropriate;
- (2) the volume of existing and new business and its distribution by product type or distribution channel is stable or predictable;
- (3) costs vary in the short, medium or long term dependent upon the volume of existing or new business and its distribution by product type or distribution channel; and
- (4) cost control is well-managed.

1.2.57

PRA

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In setting the margin, the *firm* should also take into account:

- (1) the length of the period over which it is necessary to project costs;
- (2) the extent to which it is reasonable to expect inflation to be stable or predictable over that period; and
- (3) whether, if inflation is higher than expected, it is reasonable to expect that the excess would be offset by increases in investment returns.

1.2.58

PRA

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Where a *firm* has entered into an agreement with any other person for the sharing or reimbursement of costs, in setting the margin it should take into account the potential impact of that agreement and of its discontinuance.

### **Mortality and Morbidity**

1.2.59

FCA PRA

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**A *firm* must set the assumptions for mortality and morbidity using prudent rates of mortality and morbidity that are appropriate to the country or territory of residence of the person whose life or health is insured.**

1.2.60

FCA PRA

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The rates of mortality or morbidity should contain prudent margins for adverse deviation (see ■ INSPRU 1.2.13 R to ■ INSPRU 1.2.19 G). In setting those rates, a *firm* should take account of:

- (1) the systems and controls applied in underwriting *long-term insurance contracts* and whether they provide adequate protection against anti-selection (that is, selection against the *firm*) including:
  - (a) adequately defining and identifying non-standard risks; and
  - (b) where such risks are underwritten, allocating to them an appropriate weighting;
- (2) the nature of the contractual exposure to mortality or morbidity risk including:
  - (a) whether lower mortality increases or decreases the *firm's* liability;
  - (b) the period of cover and whether risk charges can be varied during that period and, if so, how quickly; and
  - (c) whether the options in the contract give rise to a significant risk of anti-selection (for example, opportunities for voluntary discontinuance, guaranteed renewal at the option of the *policyholder* and rights for conversion of benefits);
- (3) the credibility of the *firm's* actual experience as a basis for projecting future experience including:
  - (a) whether there is sufficient data (especially for medical or financial risks and for new types of benefit or new methods of distribution); and
  - (b) whether the data is reliable and has been appropriately validated;

- (4) the availability and reliability of:
  - (a) any published tables of mortality or morbidity for the country or territory of residence of the person whose life or health is insured; and
  - (b) any other information as to the industry-wide insurance experience for that country or territory;
  
- (5) anticipated or possible future trends in experience including, but only where they increase the liability:
  - (a) anticipated improvements in mortality;
  - (b) changes arising from improved detection of morbidity (including critical illnesses);
  - (c) diseases the impact of which may not yet be reflected fully in current experience; and
  - (d) changes in market segmentation (such as impaired life annuities) which, in the light of developing experience, may require different assumptions for different parts of the policy class.

1.2.61

**FCA PRA**

**G**

An additional provision for diseases covered by ■ INSPRU 1.2.60 G (5)(c) may be needed, in particular for unit-linked policies. In determining whether such a provision is needed a *firm* may take into consideration any ability to increase product charges commensurately (provided that such increase does not infringe on its regulatory duty to treat its *customers* fairly), but a provision would still be required for the period until such an increase could be brought into effect.

### Options

1.2.62

**FCA PRA**

**R**

When a *firm* establishes its *mathematical reserves* in respect of a *long-term insurance contract*, the *firm* must include an amount to cover any increase in liabilities which might be the direct result of its *policyholder* exercising an option under, or by virtue of, that *contract of insurance*. Where the *surrender value* of a contract is guaranteed, the amount of the *mathematical reserves* for that contract at any time must be at least as great as the value guaranteed at that time.

1.2.62A

**FCA PRA**

**G**

A contract has a guaranteed *surrender value* where the *policy* wording states that a *surrender value* is payable and either provides for a minimum amount payable on surrender or sets out a method for calculating such an amount. For example, where a unit-linked contract provides for a *surrender value* equal to the value of the units allocated to the contract, the *firm* must establish *mathematical reserves* for that contract greater than or equal to the value of the units allocated at the valuation date.

1.2.63

**FCA PRA**

**G**

An option exists where a *policyholder* is given a choice between alternative forms of benefit, for example, a choice between receiving a cash benefit upon maturity or an annuity at a guaranteed rate. In some cases, the contract may designate one or other of these alternatives as the principal benefit and any other as an option. This designation, in itself, is not one of substance in the context of reserving since it does not affect the *policyholder's* choices. Other forms of option include:

- (1) the right to convert to a different contract on guaranteed terms;

- (2) the right to increase cover on guaranteed terms;
- (3) the right to a specified amount on surrender; and
- (4) the right to a paid up value.

**1.2.64**

**FCA PRA**

**G**

The *firm* should provide for the benefit which the *firm* anticipates the *policyholder* is most likely to choose. Past experience may be used as a guide, but only if this is likely to give a reasonable estimate of future experience. For example, past experience of the take-up of a cash payment option instead of an annuity would not be a reliable guide, if, in the past, market rates exceeded those guaranteed in the annuity but no longer do so. Similarly, past experience on the take-up of options may not be relevant in the light of the assumptions made in respect of future interest rates and mortality rates in the valuation of the benefits.

**1.2.65**

**FCA PRA**

**G**

Many options are long-term and need careful consideration. Improving longevity, for example, can increase the value of guaranteed annuity options vesting further in the future. *firms* also need to have regard to the fact that *policyholder* behaviour can change in the future as *policyholders* become more aware of the value of their options. The impact on *policyholder* behaviour of possible changes in taxation should also be considered.

**1.2.66**

**FCA PRA**

**G**

In accordance with ■ INSPRU 1.2.7 R and ■ INSPRU 1.2.13 R, take-up rates for guaranteed annuity options should be assessed on a prudent basis with assumptions that include margins for adverse deviation (see ■ INSPRU 1.2.13 R to ■ INSPRU 1.2.19 G) that take account of current experience and the potential for future change. The *firm* should reserve for option take-up at least at a prudent margin over current experience for options shortly to vest. For longer term options where the option becomes increasingly valuable in the future due to projected mortality improvements, increased take-up rates should be assumed. In view of the growing uncertainty over take-up rates for projections further in the future, for guaranteed annuity option dates 20 years or more ahead at least a 95% take-up rate assumption should be made.

**1.2.67**

**FCA PRA**

**G**

Where there is considerable variation in the cost of the option depending on conditions at the time the option is exercised, and where that variation constitutes a material risk for the *firm*, it will generally be appropriate to use stochastic modelling. In this case prices from the asset model used in the stochastic approach should be benchmarked to relevant market asset prices before determining the value of the option. Where stochastic modelling is not undertaken, market option prices should be used to determine suitable assumptions for the valuation of the option. If no market exists for a particular option, a *firm* should take the value of the nearest equivalent benefit or right for which a market exists and document the way in which it has adjusted that valuation to reflect the original option.

**1.2.68**

**FCA PRA**

**G**

Where the option offers a choice between two non-discretionary financial benefits (such as between a guaranteed cash sum or a guaranteed annuity value, or between a unit value and a maturity guarantee) and where there is a wide range of possible outcomes, the *firm* should normally model such liabilities stochastically. In carrying out such modelling *firms* should take into account the likely choices to be made by *policyholders* in each scenario. *Firms* should make and retain a record of the development and application of the model.

1.2.69

FCA PRA

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The value of a contract with an option is greater than the value of a similar contract without the option, that is, the option has value whether it is expected to be exercised or not. Although in theory a *firm* can rebalance its investments to match the expected cost of the option to the *firm* (including the time value of the option), this takes time to achieve and the market may move more quickly than the *firm* is able to respond. Also, there are likely to be transaction costs. *Firms* should take these aspects into consideration in setting up *mathematical reserves*.

1.2.70

FCA PRA

R

- (1) Where a *policyholder* may opt to be paid a cash amount, or a series of cash payments, the *mathematical reserves* for the *contract of insurance* established under ■ **INSPRU 1.2.7 R** must be sufficient to ensure that the payment or payments could be made solely from:
  - (a) the assets covering those *mathematical reserves*; and
  - (b) the resources arising from those assets and from the contract itself.
- (2) In (1) references to a cash amount or a series of cash payments include the amount or amounts likely to be paid on a voluntary discontinuance.
- (3) For the purposes of (1), the *firm* must assume that:
  - (a) the assumptions adopted for the current valuation remain unaltered and are met; and
  - (b) discretionary benefits and charges will be set so as to fulfil the *firm's* regulatory duty to treat its *customers* fairly.
- (4) (1) may be applied to a group of similar contracts instead of to the individual contracts within that group except where the cash amount or series of cash payments is the amount or amounts likely to be paid on a voluntary discontinuance.

1.2.71

FCA PRA

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For the purposes of ■ **INSPRU 1.2.70 R**, a *firm* must assume that the amount of a cash payment secured by the exercise of an option is:

- (1) in the case of an *accumulating with-profits policy*, the lower of:
  - (a) the amount which the *policyholder* would reasonably expect to be paid if the option were exercised, having regard to the representations made by the *firm* and including any expectations of a *final bonus*; and
  - (b) that amount, disregarding all discretionary adjustments;
- (2) in the case of any other *policy*, the amount which the *policyholder* would reasonably expect to be paid if the option were exercised, having regard to the representations made by the *firm*, without taking into account any expectations regarding future distributions

of profits or the granting of discretionary additions in respect of an *established surplus*.

1.2.72

FCA PRA

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■ INSPRU 1.2.71 R (1) applies only to *accumulating with-profits policies*;  
 ■ INSPRU 1.2.71 R (2) applies to any other type of *policy*, including *non-profit insurance contracts*. In ■ INSPRU 1.2.71 R (1)(a) a *firm* must take into consideration, for example, a market value adjustment where such an adjustment has been described in representations made to *policyholders* by the *firm*. However, any discretionary adjustment, such as a market value adjustment, must not be included in the amount calculated in ■ INSPRU 1.2.71 R (1)(b).

**Persistency assumptions**

1.2.73

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1.2.74

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1.2.75

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1.2.76

PRA

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A *firm* may make assumptions about voluntary discontinuance rates in the calculation of the *mathematical reserves* provided that those assumptions meet the general requirements for prudent assumptions as set out in ■ INSPRU 1.2.10 R and ■ INSPRU 1.2.13 R.

1.2.77

PRA

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The prudential margin in respect of assumptions of voluntary discontinuance should be validated both in relation to recent experience and to variations in future experience that might arise as a result of reasonably foreseeable changes in conditions. In particular, where estimates of experience are being made well into the future, the assumptions should contain margins that take into account the increased risk of adverse experience arising from changed circumstances. *firms* should also consider the possibility of anti-selection by *policyholders* and of variations in persistency experience for different classes and cohorts of business.

**Reinsurance**

1.2.77A

PRA

R

In ■ INSPRU 1.2.78 G to ■ INSPRU 1.2.89 G references to:

- (1) *reinsurance* and contracts of *reinsurance* include analogous non-*reinsurance* financing agreements, including contingent loans, securitisations and any other arrangements in respect of *contracts of insurance* that are analogous to contracts of *reinsurance* in terms of the risks transferred and the finance provided;
- (2) reinsured risks, in relation to a contract of *reinsurance* entered into by a *firm*, means that part of:
  - (a) the risks insured by the *firm* under *long-term insurance contracts* entered into by it; and
  - (b) the other risks arising directly from the *firm's long-term insurance business*;

that have been transferred to the *reinsurer* under that contract of *reinsurance*; and

- (3) *reinsurance* cash outflows include any reduction in *policy* liabilities recognised as covered under a contract of *reinsurance* or any reduction of any debt to the *firm* under or in respect of a contract of *reinsurance*.

1.2.78

PRA

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The prospective valuation of future cash flows to determine the amount of the *mathematical reserves* includes amounts to be received or paid under contracts of *reinsurance* in respect of *long-term insurance business* (see ■ INSPRU 1.2.28R (1)(d) ). This applies even where those cash flows cannot be identified as related to particular *long-term insurance contracts* (see ■ INSPRU 1.2.22 R (3)).

1.2.79

PRA

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A *firm* must value *reinsurance* cash flows using methods and assumptions which are at least as prudent as the methods and assumptions used to value the underlying *contracts of insurance* which have been reinsured. In particular:

- (1) *reinsurance* recoveries must not be recognised unless the underlying liabilities to which they relate have also been recognised;
- (2) *reinsurance* cash outflows need not to be valued provided that:
  - (a) they are unambiguously linked to the emergence as surplus of margins included in the valuation of existing *contracts of insurance* or to the exercise by a *reinsurer* of its rights under a termination clause (see ■ INSPRU 1.2.85 R); and
  - (b) the conditions in ■ INSPRU 1.2.79A R are satisfied;
- (3) *reinsurance* cash inflows that are contingent on factors or conditions other than the reinsured risks must not be valued.

1.2.79A

PRA

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The conditions referred to in ■ INSPRU 1.2.79R (2)(b) are that:

- (1) the *reinsurance* is not connected with any other transaction, which, when taken together with the *reinsurance*, could result in the requirements set out in ■ INSPRU 1.2.79R (2) no longer being satisfied or in the risk transferred under the *reinsurance* being undermined; and
- (2) the present value of the future *reinsurance* cash outflows that may be disregarded under ■ INSPRU 1.2.79R (2) must not at any time exceed the value of the aggregate net cash inflows that have already been received by the *firm* under the contract of *reinsurance* accumulated at an assumed rate of LIBOR + 6% per annum.

1.2.79B

PRA

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Examples of connected transactions that could have the effect described in ■ INSPRU 1.2.79AR(1) might include a *deposit*, loan, *repo*, or *stock lending* transaction between the *firm* and the *reinsurer*, or between the *firm* and an undertaking that is closely related to the *reinsurer*. For these purposes, the expression closely related shall have the meaning set out in ■ INSPRU 2.1.40 R.

1.2.80

PRA

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In valuing *reinsurance* cash flows, a *firm* should establish prudent margins for adverse deviation (see ■ INSPRU 1.2.13 R to ■ INSPRU 1.2.19 G) including margins in respect of:

- (1) any uncertainty as to the amount or timing of amounts to be paid or received; and
- (2) the risk of credit default by the *reinsurer*.

1.2.81

PRA

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In assessing the risk of credit default, the *firm* should take into account the *rules* and *guidance* in ■ INSPRU 2.1 (Credit risk in insurance).

1.2.82

PRA

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It will not necessarily be appropriate to use the same assumptions in ■ INSPRU 1.2.79 R as for the underlying contracts. For example, if only a subgroup of the original contracts is reinsured, it may be appropriate to use different mortality rates.

1.2.83

PRA

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Only *reinsurance* cash inflows that are triggered unambiguously by the reinsured risks may be valued. *Reinsurance* cash inflows that depend on other contingencies where the outcome does not form part of the valuation basis should not be given credit.

1.2.84

PRA

G

*Firms* should assess the extent of margins in the valuation of the existing *contracts of insurance* where these provide implicit provision for the *reinsurance* cash outflows in ■ INSPRU 1.2.79 R. Where the *reinsurance* asset exceeds the estimated value of the future surplus under reinsured contracts *firms* should assess their credit risk exposure to the *reinsurer*.

1.2.85

PRA

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For the purposes of ■ INSPRU 1.2.79 R (2), the "link" must be such that a contingent liability to pay or repay the amount to the *reinsurer* could not arise except when, and to the extent that, the margins in the valuation of the existing *contracts of insurance* emerge as surplus, or the *reinsurer* exercises its rights under a termination clause in the contract of *reinsurance* as a result of:

- (1) fraudulent conduct by the *firm* under or in relation to the contract of *reinsurance*; or
- (2) a representation as to the existence, at or before the time the contract of *reinsurance* is entered into, of a state of affairs which is within the knowledge or control of the *firm* and which is material to the *reinsurer's* decision to enter into the contract being discovered to be false; or
- (3) the non-payment of *reinsurance premiums* by the *firm*; or

(4) a transfer by the *firm* of the whole or a specified part of its business without the agreement of the *reinsurer*, except where that agreement has been unreasonably withheld.

1.2.86

FCA PRA

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For the purposes of ■ INSPRU 1.2.79 R (2) and ■ INSPRU 1.2.85 R, future surplus may only be offset against future *reinsurance* cash outflow in respect of surplus on *non-profit insurance contracts* and the charges or shareholder transfers arising as surplus from *with-profits insurance contracts*. Such charges and transfers may only be allowed for to the extent consistent with the regulatory duty of the *firm* to treat its *customers* fairly.

1.2.87

PRA

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For the purposes of ■ INSPRU 1.2.85 R, a contingent liability means a liability that would only arise upon the happening of a particular contingency, even where that contingency is not expected to occur. For example, if the *firm* has a *reinsurance* arrangement in force that in the event the *firm* were wound up would give rise to repayments other than out of surplus emerging, the *reinsurance* cash outflows should be valued as a liability.

1.2.88

PRA

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■ INSPRU 1.2.85 R allows a *firm* not to value *reinsurance* cash outflows provided the contingencies in which the *reinsurance* would require repayment other than out of future surpluses are limited to termination clauses concerning fraud, material misrepresentation, non-payment of *reinsurance premiums* by the *firm* or a transfer of business by the *firm* without the agreement of the *reinsurer*, except if unreasonably withheld.

1.2.89

PRA

G

Where the *reinsurance* cash outflow is payable by a fund or sub-fund that generates such profits, charges or transfers, the *firm* need make no provision for such payments provided that repayment to the *reinsurer* is linked unambiguously (as defined in ■ INSPRU 1.2.85 R) to the emergence of future surplus. Where the profits, charges or transfers arising under a block of business are payable by a fund or sub-fund to another part of the *firm* then only where the *firm* has committed to remit such profits, charges or transfers directly to the *reinsurer* would it be acceptable for no provision for payments to the *reinsurer* to be made.

1.2.90

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1.2.91

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**Application of INSPRU 1.2 to Lloyd's**

1.2.92

FCA PRA

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■ INSPRU 1.2 applies to *managing agents* in accordance with ■ INSPRU 8.1.4 R.

**Approved reinsurance to close**

1.2.93

PRA

R

In respect of business that has been subject to an *approved reinsurance to close*, *managing agents* must calculate *mathematical reserves* (before and after deduction of reinsurance cessions) for the reinsuring and not for the reinsured *member*.



## 1.3 With-profits insurance capital component

### Application

**1.3.1** R ■ INSPRU 1.3 applies to a *realistic basis life firm*.

FCA PRA

**1.3.2** G A *realistic basis life firm* means a *firm* to which ■ GENPRU 2.1.18 R applies. The application of ■ GENPRU 2.1.18 R is set out in ■ GENPRU 2.1.19 R and ■ GENPRU 2.1.20 R. ■ GENPRU 2.1.13 R requires that a *firm* must maintain at all times *capital resources* equal to or in excess of its *capital resources requirement*. The *enhanced capital requirement* forms part of the *capital resources requirement* for a *realistic basis life firm*. The *with-profits insurance capital component* forms part of the *enhanced capital requirement* which a *realistic basis life firm* is required to calculate in accordance with ■ GENPRU 2.1.38 R.

FCA PRA

### Purpose

**1.3.3** G This section sets out *rules* and *guidance* as to the methods and assumptions to be used in calculating the *with-profits insurance capital component*.

PRA

**1.3.4** G The purpose of the *with-profits insurance capital component* is to supplement the *mathematical reserves* so as to ensure that a *firm* holds adequate financial resources for the conduct of its *with-profits insurance business*. In particular, capital in excess of the *mathematical reserves* may be needed to ensure that adequate *final bonuses* can be awarded to *policyholders*. That is, adequate in the sense that in setting bonuses payable to *policyholders* the *firm* pays due regard to the interests of its *policyholders* and treats them fairly. The *mathematical reserves* for a *realistic basis life firm* are not required to include provision for future *annual bonuses* or *final bonuses* (■ INSPRU 1.2.9 R).

PRA

**1.3.5** G The required procedures are summarised in the flowchart in ■ INSPRU 1 Annex 1 G.

PRA

### Main requirements

**1.3.6** R A *firm* must calculate the *with-profits insurance capital component* in accordance with ■ INSPRU 1.3.7 R.

PRA

**1.3.7** R (1) The *with-profits insurance capital component* for a *firm* is the aggregate of any amounts that:

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(a) result from the calculations specified in (2) and (3); and

- (b) are greater than zero.
- (2) Subject to (3), in relation to each *with-profits fund* within the *firm*, the *firm* must deduct B from A, where:
- (a) A is the amount of the *regulatory excess capital* for that fund (see ■ INSPRU 1.3.23 R); and
  - (b) B is the sum of:
    - (i) the *realistic excess capital* for that fund (see ■ INSPRU 1.3.32 R);
    - (ii) the value, in the most adverse scenario required by ■ INSPRU 1.3.43 R (3), of future internal transfers from the fund to shareholders or another of the *firm's* funds in respect of the future distribution of surplus between *policyholders* and shareholders; and
    - (iii) an amount not exceeding the value, in the most adverse scenario required by ■ INSPRU 1.3.43 R (3), of any other future internal transfers from the fund to a *non-profit fund* in respect of expense-related charges to the extent that the future receipt of the amount transferred is not already taken into account in the calculation of the *firm's capital resources* or in establishing its *technical provisions*.
- (3) Where a capital instrument that can be included in the *firm's capital resources* in accordance with ■ GENPRU 2.2 has been attributed wholly or partly to a *with-profits fund* and that instrument meets the requirements of ■ GENPRU 2.2.271 R, the *firm* must add to the amount calculated under (2) for that fund the result, subject to a minimum of zero, of deducting D from C where:
- (a) C is the outstanding face amount of the instrument to the extent attributed to the fund; and
  - (b) D is the realistic value of the instrument to the extent attributed to the fund in the single event that determines the *risk capital margin* under ■ INSPRU 1.3.43 R.

**1.3.7A**

**PRA**

**G**

Future internal transfers from a *with-profits fund* are included in the *realistic value of liabilities* (see ■ INSPRU 1.3.105 R, ■ INSPRU 1.3.119 R, ■ INSPRU 1.3.128 R and ■ INSPRU 1.3.165 R). ■ INSPRU 1.1.27 R ensures that sufficient assets are maintained in a *with-profits fund* to meet those future internal transfers. In calculating the WPICC, the economic value to the *firm* of those future transfers in the most adverse scenario required in calculating the *risk capital margin* (see ■ INSPRU 1.3.43 R) should be recognised. In the case of internal transfers to a *non-profit fund* in respect of expense-related charges, those transfers may only be recognised to the extent that those cash flows have not already been taken into account in calculating the *firm's capital resources* or *technical provisions*. In effect, the future asset of the shareholders or another of the *firm's* funds is available to offset the corresponding liability of the *with-profits fund* and should, therefore, subject

to the limitation in ■ INSPRU 1.3.7 R (2)(b)(iii), be treated as capital arising from that fund which is available to reduce the amount of the *WPICC*.

**1.3.8**  
**PRA**

**G**

Subordinated debt which is subordinated to *policyholder* interests (see ■ GENPRU 2.2.271 R) is an example of the sort of capital instrument that may give rise to a component of the *WPICC* under ■ INSPRU 1.3.7 R (3). Such instruments are treated as capital under ■ GENPRU 2.2, subject to the requirements of ■ GENPRU 2.2.271 R. Under realistic reserving the capital instrument is valued as a realistic liability (■ INSPRU 1.3.40 R) and in calculating the *risk capital margin* such an instrument would be valued at its realistic value in the single event outlined in ■ INSPRU 1.3.43 R (see also ■ INSPRU 1.3.162 R). Overall, the effect of ■ GENPRU 2.2, ■ INSPRU 1.3.7 R (3) and ■ INSPRU 1.3.43 R is to enable a *firm* that obtains subordinated debt to benefit from additional *capital resources* equal to the face amount of that debt.

**1.3.9**  
**FCA PRA**

**G**

■ SUP 4 (Actuaries) sets out the role and responsibilities of the *actuarial function* and of the *with-profits actuary*.

- (1) As part of his duties under ■ SUP 4.3.13 R, the *actuary* appointed by the *firm* to perform the *actuarial function* must calculate the *firm's mathematical reserves* and, in the context of the calculation of the *with-profits insurance capital component*, must also:
  - (a) advise the *firm's governing body* on the methods and assumptions to be used in the calculation of the *firm's with-profits insurance capital component*;
  - (b) perform that calculation in accordance with the methods and assumptions determined by the *firm's governing body*; and
  - (c) report to the *firm's governing body* on the results of that calculation.
- (2) As part of his duties under SUP 4.3.16G, the *with-profits actuary* must advise the *firm's governing body* on the discretion exercised by the *firm*. In the context of the calculation of the *with-profits insurance capital component*, the *with-profits actuary* must also advise the *firm's governing body* as to whether the methods and assumptions (including the allowance for management actions) used for that calculation are consistent with the *firm's Principles and Practices of Financial Management* (PPFM - see ■ COBS 20.3 ) and with its regulatory duty to treat its *customers* fairly.

**General**

**Definitions**

**1.3.10**  
**PRA**

**R**

In this section, real estate means an interest in land, buildings or other immovable property.

**1.3.11**  
**PRA**

**R**

In this section, the long-term gilt yield is the annualised equivalent of the yield on the 15-year index for United Kingdom Government fixed-interest securities jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries.

**1.3.12** **R** For the purposes of this section, a *firm* has an exposure to an asset or liability where the *firm's* valuation of its assets or liabilities changes when the value of the asset or liability changes.  
**PRA**

**1.3.13** **R** Unless the context otherwise requires, all references (however expressed) in this section to realistic liabilities, or to liabilities which are included in the calculation of realistic liabilities, include discretionary benefits payable by the *firm* in accordance with the *firm's* regulatory duty to treat its *customers* fairly.  
**FCA PRA**

**1.3.14** **G** In this section, any reference to a *firm's* regulatory duty to treat its *customers* fairly is a reference to the duty of a *firm* regulated by the FCA under FCA's *Principle 6* (Customers' interests). This states that a *firm* must pay due regard to the interests of its *customers* and treat them fairly.  
**FCA PRA**

**1.3.15** **G** In this section, any reference to the *Principles and Practices of Financial Management (PPFM)* is a reference to the requirements in the FCA's *rules* at **COBS 20.3** (Principles and Practices of Financial Management) for *firms* to establish, maintain and record the principles and practices of financial management according to which the business of its *with-profits funds* is conducted.  
**FCA PRA**

**1.3.16** **G** The extent to which a *firm* requires a separate PPFM for each of its *with-profits funds* will depend on the *firm's* circumstances and any relevant representations made by the *firm* to its with-profits *policyholders*. In this section, any reference to a *firm's* PPFM refers to the PPFM which relate to the *with-profits fund* or the *with-profits insurance contracts* in question.  
**FCA PRA**

**Record keeping**

**1.3.17** **R** A *firm* must make, and retain for an appropriate period of time, a record of:  
**FCA PRA**

- (1) the methods and assumptions used in making any calculation required for the purposes of this section (and any subsequent changes) and the reasons for their use; and
- (2) any change in practice and the nature of, reasons for, and effect of, any change in approach with respect to those methods and assumptions.

**1.3.18** **G** **SYSC 14.1.53 R** requires *firms* to maintain accounting and other records for a minimum of three years, or longer as appropriate. For the purposes of **INSPRU 1.3.17 R**, a period of longer than three years will be appropriate for a *firm's long-term insurance business*. In determining an appropriate time period, a *firm* should have regard to:

- (1) the detailed *guidance* on record keeping in **SYSC 14.1.51 G** to **SYSC 14.1.64 G**;
- (2) the nature and term of the *firm's long-term insurance contracts*; and
- (3) any additional provisions or statutory requirements applicable to the *firm* or its records.

1.3.19  
FCA PRA

**R**

A *firm* must also identify in the record required to be kept by ■ INSPRU 1.3.17 R changes in practice, in particular changes in those items which will or may be significant in relation to the eventual *claim* values.

1.3.20  
FCA

**G**

Some of the changes identified in accordance with ■ INSPRU 1.3.19 R may have to be notified to the *firm's policyholders* in accordance with the *firm's PPFM*.

**General principles for allocating aggregate amounts**

1.3.21  
PRA

**R**

Where any calculation is required under this section which:

- (1) is to be made in respect of any *with-profits fund* of a *firm*; and
- (2) covers an amount that is otherwise calculated in relation to the *firm* as a whole;

the *firm* must make an allocation of that amount as between all of its funds (including funds which are not *with-profits funds*).

1.3.22  
PRA

**R**

In any case where:

- (1) *non-profit insurance contracts* are written in any *with-profits fund* of a *firm*; and
- (2) any calculation is required under this section which:
  - (a) is to be made in respect of the *regulatory excess capital* or *realistic excess capital* for the fund; and
  - (b) covers an amount that is otherwise calculated or allocated in relation to the fund as a whole;

the *firm* must make an allocation of the amount in (2)(b) as between the *with-profits insurance contracts* and *non-profit insurance contracts* written in the fund.

**Calculation of regulatory excess capital**

1.3.23  
PRA

**R**

A *firm* must calculate the *regulatory excess capital* for each of its *with-profits funds* by deducting B from A, where:

- (1) A is the *regulatory value of assets* of the fund ( ■ INSPRU 1.3.24 R; and
- (2) B is the sum of:
  - (a) the *regulatory value of liabilities* of the fund ( ■ INSPRU 1.3.29 R); and
  - (b) the *long-term insurance capital requirement* in respect of the fund's *with-profits insurance contracts*.

Regulatory value of assets

1.3.24  
PRA

R

- (1) For the purposes of ■ INSPRU 1.3.23 R (1), the *regulatory value of assets* of a *with-profits fund* is equal to the sum of:
- (a) the amount of the fund's *long-term admissible assets*; and
  - (b) the amount of any *implicit items* allocated to that fund; less an amount, representing any *non-profit insurance contracts* written in that fund, determined in accordance with (2).
- (2) Where *non-profit insurance contracts* are written in a *with-profits fund*, the amount representing those contracts is the sum of:
- (a) the *mathematical reserves* in respect of the *non-profit insurance contracts* written in the fund; and
  - (b) an amount in respect of the *non-profit insurance contracts* written in the fund which represents an appropriate allocation of the firm's *resilience capital requirement*, to the extent that it is covered by the fund's *long-term admissible assets*.

1.3.25  
PRA

R

For the purpose of determining the value of a fund's *long-term admissible assets* in accordance with ■ INSPRU 1.3.24 R (1)(a), no value is to be attributed to:

- (1) debts owed by *reinsurers*; or
- (2) *claims*; or
- (3) tax recoveries; or
- (4) claims against *compensation funds*;

to the extent already offset in the calculation of *technical provisions*.

1.3.26  
PRA

R

In making a determination in accordance with ■ INSPRU 1.3.24 R (2), a *firm* must allocate *long-term admissible assets* of an appropriate nature and term to any *non-profit insurance contracts* written in the *with-profits fund*.

1.3.27

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1.3.28  
PRA

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A *firm* needs to obtain an *implicit item waiver* from the PRA in order to bring in an amount under ■ INSPRU 1.3.24 R (1)(b). For *guidance* on applying for an *implicit item waiver* in respect of future surpluses relating to *with-profits funds* see ■ GENPRU 2 Annex 8 G. The amount of any *implicit item* allocated to a *with-profits fund* may be defined in the terms of any *waiver* granted.

**Regulatory value of liabilities**

1.3.29  
PRA

R

For the purposes of ■ INSPRU 1.3.23 R (2)(a), the *regulatory value of liabilities* of a *with-profits fund* is equal to the sum of:

- (1) the *mathematical reserves*, in respect of the fund's *with-profits insurance contracts*, including the value of any provisions reflecting bonuses allocated at the *actuarial valuation date*; and
- (2) the *regulatory current liabilities* of the fund (see ■ INSPRU 1.3.30 R).

1.3.30  
PRA

R

For the purposes of ■ INSPRU 1.3.29 R (2), the *regulatory current liabilities* of a *with-profits fund* are equal to the sum of the following amounts to the extent that they relate to that fund:

- (1) accounting liabilities (including *long-term insurance liabilities* which have fallen due before the end of the *financial year*);
- (2) liabilities from *deposit back arrangements*; and
- (3) any provision for adverse variations (determined in accordance with ■ INSPRU 3.2.17 R).

1.3.31  
PRA

G

The amount of *regulatory current liabilities* for a *with-profits fund* refers to the sum of the amounts in (1) and (2) in respect of the fund:

- (1) the amount of 'Total other insurance and non-insurance liabilities'; and
- (2) the amount of 'Cash bonuses which had not been paid to *policyholders* prior to the end of the financial year';

as disclosed at lines 49 and 12 respectively of the appropriate Form 14 ('Long-term business liabilities and margins') for that fund as part of the Annual Returns required to be deposited with the PRA under IPRU(INS) rule 9.6R(1).

**Calculation of realistic excess capital**

1.3.32  
PRA

R

A firm must calculate the *realistic excess capital* for each of its *with-profits funds* by deducting B from A, where:

- (1) A is the *realistic value of assets* of the fund (see ■ INSPRU 1.3.33 R); and
- (2) B is the sum of:
  - (a) the *realistic value of liabilities* of the fund (see ■ INSPRU 1.3.40 R); and
  - (b) the *risk capital margin* for the fund (see ■ INSPRU 1.3.43 R).

1.3.33

PRA

R

Realistic value of assets

- (1) For the purposes of ■ INSPRU 1.3.32 R (1), the *realistic value of assets* of a *with-profits fund* is the sum of:
  - (a) the amount of the fund's *regulatory value of assets* determined in accordance with ■ INSPRU 1.3.24 R, but with no value given to any *implicit items* and excluding the regulatory value of any *shares* in a *related undertaking* which carries on *long-term insurance business*;
  - (b) the amount of the fund's excess *admissible assets* (see ■ INSPRU 1.3.36 R);
  - (c) the present value of future profits (or losses) on any *non-profit insurance contracts* written in the *with-profits fund* (see ■ INSPRU 1.3.37 R);
  - (d) the value of any *derivative* or *quasi-derivative* held in the fund (see ■ GENPRU 1.3.41 R) to the extent its value is not reflected in (a), (b) or (c);
  - (e) any amount determined under (2); and
  - (f) the amount of any prepayments made from the fund.
- (2) Where any equity *shares* held (directly or indirectly) by a *firm* (A):
  - (a) are *shares* in a *related undertaking* (B) which carries on *long-term insurance business*; and
  - (b) have been identified by A under ■ INSPRU 1.3.21 R as *long-term insurance assets* which are held in the *with-profits fund* for which the realistic value is to be determined under (1);the amount required under (1)(e) is the relevant proportion of the value of all B's equity *shares* as determined in (3).
- (3) For the purposes of (2):
  - (a) the relevant proportion is the proportion of the total number of equity *shares* issued by B which are held (directly or indirectly) by A;
  - (b) the value of all B's equity *shares* must be taken as D deducted from C, where C is equal to the sum of:
    - (i) the shareholder net assets of B;
    - (ii) any surplus assets in the *non-profit funds* of B;
    - (iii) any additional amount arising from the present value of future profits (or losses) on any *non-profit insurance contracts* written by B (calculated on a basis consistent with ■ INSPRU 1.3.37 R), excluding any amount arising from business that is written in a *with-profits fund*; and

- (iv) where B has any *with-profits funds*, the present value of projected future transfers out of those funds to shareholder funds of B;
- and D is equal to the sum of:
  - (v) the *long-term insurance capital requirement* in respect of any *non-profit insurance contracts* written in a *non-profit fund* of B;
  - (vi) where B is a *regulatory basis only life firm*, the amount of the *resilience capital requirement* in respect of any *non-profit insurance contracts* written in a *non-profit fund* of B;
  - (vii) any part of the *with-profits insurance capital component* of B, or of B's *long-term insurance capital requirement*, where B is a *regulatory basis only life firm*, or *resilience capital requirement* in respect of B's *with-profits insurance contracts*, that is not covered from the assets of the *with-profits fund* from which it arises after deducting from those assets the amount calculated under (iv); and
  - (viii) any assets of B that back its regulatory capital requirements and that are valued in (iii) in the calculation of the present value of future profits of *non-profit insurance business* written by B.

(4) The methods and assumptions used in the calculations under (3)(b)(iii) and (iv) must follow a consistent approach to that set out in ■ INSPRU 1.3.37 R.

1.3.34  
PRA

G

In ■ INSPRU 1.3.33 R (1)(d), where a *derivative* or *quasi-derivative* has a positive asset value, credit should be given within the *realistic value of assets*. If the *derivative* or *quasi-derivative* has a negative asset value it should be valued within realistic liabilities as an element of *realistic current liabilities* (see ■ INSPRU 1.3.40 R (3)).

1.3.35  
PRA

G

Where a *firm* identifies *shares* in a *related undertaking* which carries on *long-term insurance business* as *shares* held in one of its *with-profits funds*, ■ INSPRU 1.3.33 R (1)(e), ■ INSPRU 1.3.33 R (2) and ■ INSPRU 1.3.33 R (3) bring in a realistic valuation of the *related undertaking* equal to its net assets plus the present value of future profits, less its regulatory capital requirements (see ■ INSPRU 1.3.33 R (3)(b)(v), ■ INSPRU 1.3.33 R (3)(b)(vi) and ■ INSPRU 1.3.33 R (3)(b)(vii)). Where the *related undertaking* has taken the present value of future profits arising from its contracts into consideration in covering its regulatory capital requirements (for example, its *risk capital margin*, under ■ INSPRU 1.3.45 R (2)(c), ■ INSPRU 1.3.33 R (3)(b)(iii) requires a *firm* to exclude those future profits in valuing the *related undertaking*. The subtraction of the capital requirements in the calculation provides a straightforward method of allowing for the change in the *related undertaking's* value in stress conditions, as the value of the *related undertaking* is not subject to the realistic stress tests of the *risk capital margin*. In calculating the present value of future profits on *non-profit insurance business* written in the *related*

*undertaking* under ■ INSPRU 1.3.33 R (3)(b)(iii), a *firm* may value the release of capital requirements as the business runs off (see ■ INSPRU 1.3.38 G). ■ INSPRU 1.3.33 R (3)(b)(viii) ensures that any such capital is not double-counted.

1.3.36

PRA

R

Excess *admissible assets* of a *with-profits fund* means *admissible assets* which exceed any of the percentage limits referred to in ■ INSPRU 2.1.22 R.

1.3.37

PRA

R

A *firm* must calculate the present value of future profits (or losses) on *non-profit insurance contracts* written in the *with-profits fund* using methodology and assumptions which:

- (1) are based on current estimates of future experience;
- (2) involve reasonable (but not excessively prudent) adjustments to reflect risk and uncertainty;
- (3) allow for a market-consistent valuation of any guarantees or options within the contracts valued;
- (4) are derived from current market yields, having regard to International Financial Reporting Standard 4: Insurance Contracts, as if it were being applied to determine the value under that standard for the first time;
- (5) have regard to generally accepted actuarial practice and generally accepted industry standards appropriate for *firms* carrying on *long-term insurance business*;
- (6) are consistent with the allocation, made in accordance with ■ INSPRU 1.3.22 R, of any aggregate amounts as between the *with-profits insurance contracts* and the *non-profit insurance contracts* written in the fund;
- (7) allow for any tax that would be payable out of the *with-profits fund* in respect of the contracts valued; and
- (8) are consistent with the allocation, made in accordance with ■ INSPRU 1.3.26 R, of *long-term admissible assets* as between the *with-profits insurance contracts* and any *non-profit insurance contracts* written in the fund.

1.3.38

PRA

G

In calculating the present value of future profits (or losses) for *non-profit insurance business* required by ■ INSPRU 1.3.33 R (1)(c), to the extent that the *long-term insurance capital requirement* is covered by the *with-profits fund's long-term admissible assets*, a *firm* may take into consideration any release of this item as the relevant *policies* go off the books.

1.3.39

PRA

G

Annuities do not typically fall to be valued on a market-consistent basis under ■ INSPRU 1.3.37 R (3) as they are not "options and guarantees" as defined for accounting purposes. This is because they do not have "time value" in the option-pricing meaning

of that term. However where, atypically, annuities do fall to be valued on a market-consistent basis under ■ INSPRU 1.3.37 R (3), the discount rate used should be appropriate to the characteristics of the liability, including its illiquidity. The appropriate interest rate, therefore, would not typically be the risk-free rate. Where illiquid assets are used to closely match similar illiquid liabilities, as could be the case in annuities business, it would be appropriate to look at the liquidity premium that is implicit in the market value of the assets as a proxy for the liquidity premium that should be included in a market consistent valuation of the liabilities. However, care should be exercised in doing this. Assets and liabilities are rarely perfectly matched and an appropriate margin needs to be included in the valuation to cover the risk of unexpected mismatch.

**1.3.39A**  
**PRA**

**G**

In view of ■ INSPRU 1.3.39 G, it is likely that the discount rate to be applied to the market-consistent valuation of those annuities that fall within the scope of ■ INSPRU 1.3.37 R (3) would not be significantly different from that which applies to other annuities (to which a discount rate based on the return on the matching assets less an allowance for risk which is reasonable but not excessively prudent, in accordance with ■ INSPRU 1.3.37 R (2), might be applied).

**1.3.39B**  
**PRA**

**G**

In determining current market yields for the purpose of ■ INSPRU 1.3.37 R (4), a *firm* is required to have regard to IFRS 4 as if it were being applied to determine the value under that standard for the first time, that is, without reference to existing practices. Paragraph 27 of the standard is likely to be of particular relevance. In general, a *firm* should only include an allowance for future investment margins if its assumptions are limited to no more than a risk-free rate and the discount rate is set consistently. However, this does not preclude a *firm* from using a replicating portfolio of assets to determine the discount rate for the liability with suitable adjustments for differences in their characteristics (for the example of annuity business, see ■ INSPRU 1.3.39 G). In setting assumptions for future investment returns, a *firm* should also consider sections BC134 to BC144 of the Basis for Conclusions in IFRS 4.

**Realistic value of liabilities: general**

**1.3.40**  
**PRA**

**R**

For the purposes of ■ INSPRU 1.3.32 R (2)(a), the *realistic value of liabilities* of a *with-profits fund* is the sum of:

- (1) the *with-profits benefits reserve* of the fund;
- (2) the *future policy related liabilities* of the fund; and
- (3) the *realistic current liabilities* of the fund.

**1.3.41**  
**PRA**

**G**

All liabilities arising under, or in connection with, *with-profits insurance contracts* written in the fund should be included in the *realistic value of liabilities* referred to in ■ INSPRU 1.3.40 R, including those in respect of guarantees and the value of options.

**1.3.42**  
**PRA**

**G**

Detailed *rules* and *guidance* for the calculation of the three elements referred to in ■ INSPRU 1.3.40 R are contained below in this section:

- (1) ■ INSPRU 1.3.116 R to ■ INSPRU 1.3.135 G refer to the *with-profits benefits reserve*;

- (2) ■ INSPRU 1.3.136 G to ■ INSPRU 1.3.189 G refer to the *future policy related liabilities*; and
- (3) ■ INSPRU 1.3.190 R and ■ INSPRU 1.3.191 R refer to the *realistic current liabilities*.

**Risk capital margin**

1.3.43

PRA

R

- (1) A firm must calculate a *risk capital margin* for each of its *with-profits funds* in accordance with (2) to (6).
- (2) The firm must identify relevant assets (■ INSPRU 1.3.45 R) which, in the most adverse scenario, will have a value (■ INSPRU 1.3.46 R) which is equal to the *realistic value of liabilities* of the fund under that scenario.
- (3) The most adverse scenario means the single event comprising that combination of the scenarios in ■ INSPRU 1.3.44 R which gives rise to the largest positive value that results from deducting B from A, where:
  - (a) A is the value of relevant assets which will produce the result described in (2); and
  - (b) B is the *realistic value of liabilities* of the fund.
- (4) The *risk capital margin* for the fund is the result of deducting C from A, where C is the sum of:
  - (a) B; and
  - (b) any amount included within relevant assets under ■ INSPRU 1.3.45 R (2)(c).
- (5) In calculating the value of relevant assets for the purpose of determining the most adverse scenario in (3), a firm must not adjust the valuation of any asset taken into consideration under ■ INSPRU 1.3.33 R (1)(e) (*related undertakings carrying on long-term insurance business*) or ■ INSPRU 1.3.45 R (2)(c) (present value of future profits arising from insurance contracts written outside the *with-profits fund*).
- (6) In calculating the *realistic value of liabilities* of a fund under any scenario, a firm is not required to adjust the best estimate provision made under ■ INSPRU 1.3.190 R (1) in respect of a *defined benefits pension scheme* in accordance with ■ INSPRU 1.3.191 R .

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63

1.3.44

PRA

R

For the purposes of ■ INSPRU 1.3.43 R (3), the scenarios are one scenario selected from each of the following:

- (1) in respect of UK and other assets within ■ INSPRU 1.3.62 R (1)(a):

- (a) the range of *market risk* scenarios identified in accordance with ■ INSPRU 1.3.68 R (1) (equities);
  - (b) the range of *market risk* scenarios identified in accordance with ■ INSPRU 1.3.68 R (2) (real estate); and
  - (c) the range of *market risk* scenarios identified in accordance with ■ INSPRU 1.3.68 R (3) (fixed interest securities);
- (2) in respect of non-UK assets within ■ INSPRU 1.3.62 R (1)(b):
- (a) the range of *market risk* scenarios identified in accordance with ■ INSPRU 1.3.73 R (1) (equities);
  - (b) the range of *market risk* scenarios identified in accordance with ■ INSPRU 1.3.73 R (2) (real estate); and
  - (c) the range of *market risk* scenarios identified in accordance with ■ INSPRU 1.3.73 R (3) (fixed interest securities);
- (3) the range of credit risk scenarios identified in accordance with ■ INSPRU 1.3.78 R (1) (bond or debt items);
- (4) the range of credit risk scenarios identified in accordance with ■ INSPRU 1.3.78 R (2) (*reinsurance* items or analogous non-*reinsurance* financing agreements);
- (5) the range of credit risk scenarios identified in accordance with ■ INSPRU 1.3.78 R (3) (other items including *derivatives* and *quasi-derivatives*); and
- (6) the persistency risk scenario identified in accordance with ■ INSPRU 1.3.100 R.

1.3.45

PRA

R

- (1) In ■ INSPRU 1.3.43 R, in relation to a *with-profits fund*, the relevant assets means a range of assets which meets the following conditions:
- (a) the range is selected on a basis which is consistent with the *firm's* regulatory duty to treat its *customers* fairly;
  - (b) the range must include assets from within the *with-profits fund* the value of which is greater than or equal to the *realistic value of liabilities* of the fund;
  - (c) the range is selected in accordance with (2); and
  - (d) no asset of the *firm* may be allocated to the range of assets identified in respect of more than one *with-profits fund*.
- (2) The range of assets must be selected from the assets specified in (a) to (c), in the order specified:

- (a) assets that have a realistic value under ■ INSPRU 1.3.33 R;
  - (b) where a *firm* has selected all the assets within (a), any *admissible assets* that are not identified as held within the *with-profits fund*; and
  - (c) where a *firm* has selected all the assets within (a) and (b), any additional assets.
- (3) But a *firm* must not bring any amounts into account under (2)(b) or (2)(c) in respect of any *with-profits fund* if that would result in the *firm* exceeding its overall maximum limit (determined according to whether the *firm* has only one *with-profits fund* or more than one such fund).
- (4) A *firm* exceeds its overall maximum limit for amounts brought into account under (2)(b) where:
- (a) in the case of a *firm* with a single *with-profits fund*, the amount the *firm* brings into account in respect of that fund;
  - (b) in the case of a *firm* with two or more *with-profits funds*, the aggregate of the amounts the *firm* brings into account in respect of each of those funds;
- exceeds the sum of the *firm's* shareholder net assets and the surplus assets in the *firm's non-profits funds*, less any regulatory capital requirements in respect of business written outside its *with-profits funds*.
- (5) A *firm* exceeds its overall maximum limit for amounts brought into account under (2)(c) where:
- (a) in the case of a *firm* with a single *with-profits fund*, the amount the *firm* brings into account in respect of that fund;
  - (b) in the case of a *firm* with two or more *with-profits funds*, the aggregate of the amounts the *firm* brings into account in respect of each of those funds;
- exceeds 50% of the present value of future profits arising from *insurance contracts* written by the *firm* outside its *with-profits funds*.

1.3.46

PRA

R

In valuing the relevant assets identified under ■ INSPRU 1.3.43 R (2), a *firm* must use the same methods of valuation as in ■ INSPRU 1.3.33 R, except that:

- (1) the value of any *admissible assets* not identified as held within the *with-profits fund* (■ INSPRU 1.3.45 R (2)(b)) must be as determined under ■ GENPRU 1.3; and

(2) the value of any asset which forms part of the range of assets as a result of ■ INSPRU 1.3.45 R (2)(c) must be determined on a basis consistent with that described in ■ INSPRU 1.3.37 R.

1.3.47  
PRA

G

The purpose of the *risk capital margin* for a *with-profits fund* is to cover adverse deviation from:

- (1) the fund's *realistic value of liabilities*;
- (2) the value of assets identified, in accordance with ■ INSPRU 1.3.43 R (2), to cover the amount in (1) and the fund's *risk capital margin*;

arising from the effects of *market risk*, credit risk and persistency risk. Other risks are not explicitly addressed by the *risk capital margin*.

1.3.48  
PRA

G

The amount of the *risk capital margin* calculated by the *firm* for a *with-profits fund* will depend on the *firm's* choice of assets held to cover the fund's *realistic value of liabilities* and the margin. ■ INSPRU 1.3.43 R requires the relevant assets to be sufficient, in the most adverse scenario, to cover the *realistic value of liabilities* in the event that scenario was to arise.

1.3.49  
PRA

G

■ INSPRU 1.3.45 R (2)(c) allows *firms* to bring the economic value of *non-profit insurance business* written outside a *with-profits fund* into the assets available to cover the *risk capital margin*. To place a prudent limit on the amount of future profits taken into consideration a maximum of 50% of the present value of *non-profit insurance business* can be taken into the calculation (■ INSPRU 1.3.45 R (5)). Where a contract is written in a *non-profit fund* but the assets arising from that contract are invested in a *with-profits fund* which is subject to charges for investment management or other services which benefit the *non-profit fund*, such charges can be taken into consideration in calculating the present value of future profits of the *non-profit insurance business*. Where a proportion of the present value of future profits on *non-profit insurance business* written outside a *with-profits fund* is brought in as an asset, no stress tests apply to this asset (see ■ INSPRU 1.3.43 R (5)) as the amount taken into consideration is limited to 50% of the total present value.

1.3.50  
PRA

G

A *firm* using a stochastic approach in ■ INSPRU 1.3.169 R (1) should keep recalibration in the post-stress scenarios to the minimum required to reflect any change in the underlying risk-free yields. A *firm* using the market costs of hedging approach, as in ■ INSPRU 1.3.169 R (2), may assume in estimating the market cost of hedging in the post-stress scenarios that market volatilities are unchanged.

1.3.51  
PRA

G

In the scenario tests set out in ■ INSPRU 1.3.62 R to ■ INSPRU 1.3.103 G, *firms* are required to test for worst case scenarios across a range of assumptions. The tests are, with the exception of the credit risk test, two-sided, requiring both increases and decreases in the assumptions. The PRA does not expect a *firm* to investigate every possible stress, but a *firm* should be able to demonstrate that it is reasonable to assume that it has successfully identified the single event that determines the *risk capital margin* for the *firm's* business, as required by ■ INSPRU 1.3.43 R (3).

1.3.51A

PRA

G

In the scenario tests set out in ■ INSPRU 1.3.62 R to ■ INSPRU 1.3.103 G, a *firm* is required to assess the changed value of its assets and liabilities in the economic conditions of the most adverse scenario. A *firm* is required to assess the changed value of each relevant asset (as defined in ■ INSPRU 1.3.45 R), notwithstanding any uncertainty about the appropriate valuation basis for that asset. In valuing an asset in the most adverse scenario, a *firm* should have regard to the economic substance of the asset, rather than its legal form, and assess its value accordingly. Consider, for example, a convertible bond that is close to its conversion date and where the conversion option has value. The value of the convertible bond in the most adverse scenario is likely to be sensitive primarily to equity market scenarios and to a lesser extent to interest rate scenarios. The *firm* should value the asset according to its expected market value in the economic conditions underlying the most adverse scenario.

**Management actions**

1.3.52

FCA PRA

R

In calculating the *risk capital margin* for a *with-profits fund*, a *firm* may reflect, in its projections of the value of assets and liabilities under the scenarios in ■ INSPRU 1.3.44 R, the *firm's* prospective management actions (■ INSPRU 1.3.53 R).

1.3.53

FCA PRA

R

Prospective management actions refer to the foreseeable actions that would be taken by the *firm's* management, taking into account:

- (1) an appropriately realistic period of time for the management actions to take effect; and
- (2) the *firm's* PPFM and its regulatory duty to treat its *customers* fairly.

1.3.54

FCA PRA

G

The management actions in ■ INSPRU 1.3.53 R may include, but are not limited to, changes in future bonus rates, reductions in *surrender values*, changes in asset dispositions (taking into account the associated selling costs) and changes in the amount of charges deducted from asset shares for *with-profits insurance contracts*.

1.3.55

FCA PRA

G

A *firm* should use reasonable assumptions in incorporating management actions into its projections of *claims* such that the mitigating effects of the management actions are not overstated. In modelling management actions, a *firm* should ensure consistency with its PPFM and take into account its regulatory duty to treat its *customers* fairly.

1.3.56

FCA PRA

G

In accordance with ■ INSPRU 1.3.17 R, a *firm* should make and retain a record of the approach used, in particular the nature and effect of anticipated management actions (including, where practicable, the amount by which the actions would serve to reduce the projected values of assets and liabilities).

1.3.57

FCA PRA

G

A *firm* which deducts charges in respect of any adverse experience or cost of capital to *with-profits insurance contracts* should keep a record under ■ INSPRU 1.3.17 R of the amount of any such charges to its *customers* and of how it has ensured their fair treatment.

**Policyholder actions**

1.3.58  
FCA PRA

**R**

In calculating the *risk capital margin* for a *with-profits fund*, a *firm* must reflect, in its projections of the value of assets and liabilities under the scenarios in ■ INSPRU 1.3.44 R, a realistic assessment of the actions of its *policyholders* (see ■ INSPRU 1.3.59 R).

1.3.59  
FCA PRA

**R**

*Policyholder* actions refer to the foreseeable actions that would be taken by the *firm's policyholders*, taking into account:

- (1) the experience of the *firm* in the past; and
- (2) the changes that may occur in the future if options and guarantees become more valuable to *policyholders* than in the past.

1.3.60  
FCA PRA

**G**

A *firm* should use realistic assumptions in incorporating *policyholder* actions into its projections of *claims* such that any mitigating effects of *policyholder* actions are not overstated and any exacerbating effects of *policyholder* actions are not understated. In modelling *policyholder* actions, a *firm* should ensure consistency with its *PPFM* and take into account its regulatory duty to treat its *customers* fairly in determining the options and information that would be available to *policyholders*.

1.3.61  
FCA PRA

**G**

In calculating the persistency scenario in ■ INSPRU 1.3.100 R, a *firm* needs to make assumptions regarding the future termination rates exhibited by *policies*, at points described in particular in ■ INSPRU 1.3.101 R. Such assumptions should be realistic. However, the *firm* must have regard to the economic scenarios being projected. For example, if the value of an option became significantly greater in a future scenario than in the recent past, then the behaviour of *policyholders* in taking up the option is likely to differ in this future scenario compared with the recent past.

**Market risk scenario**

1.3.62  
PRA

**R**

- (1) For the purposes of ■ INSPRU 1.3.44 R, the ranges of *market risk* scenarios that a *firm* must assume are:
  - (a) for exposures to *UK* assets and for exposures to non-*UK* assets within (2), the ranges of scenarios set out in ■ INSPRU 1.3.68 R; and
  - (b) for exposures to other non-*UK* assets, the ranges of scenarios set out in ■ INSPRU 1.3.73 R.
- (2) The exposures to non-*UK* assets within this paragraph are:
  - (a) exposures which do not arise from a significant territory outside the *United Kingdom* (■ INSPRU 1.3.63 R); or
  - (b) exposures which do arise from a significant territory outside the *United Kingdom* but which represent less than 0.5% of the *realistic value of assets* of the *with-profits fund*, measured by *market value*.

**1.3.63** PRA R For the purposes of this section in relation to a *with-profits fund*, a significant territory is any country or territory in which more than 2.5% of the fund's *realistic value of assets (by market value)* are invested.

**1.3.63A** PRA G Guidance on how a *firm* should determine where particular assets are invested is provided in ■ INSPRU 3.1.13B G.

**1.3.64** PRA G In determining its most adverse scenario, a *firm* applying ■ INSPRU 1.3.68 R and ■ INSPRU 1.3.73 R should consider separately possible movements in UK and non-UK markets. It should not assume that market prices in different markets move in a similar way at the same time. A *firm* should also allow for the effect of the other components of the single event comprising the combination of scenarios applicable under ■ INSPRU 1.3.43 R.

**1.3.65** PRA G In relation to the *market risk* scenarios in ■ INSPRU 1.3.68 R and ■ INSPRU 1.3.73 R, the effect of ■ INSPRU 1.3.52 R and ■ INSPRU 1.3.58 R is that a *firm* may reflect management actions and must make a realistic assessment of *policyholder* actions in projecting the assets and liabilities in its calculation of the *risk capital margin* for a *with-profits fund* within the *firm*.

**1.3.66** G [deleted]

**1.3.67** PRA G The relevant assets identified under ■ INSPRU 1.3.43 R (2) to calculate the *risk capital margin* may, in certain circumstances, include up to 50% of the present value of future profits arising from *insurance contracts* written by the *firm* outside its *with-profits funds*. ■ INSPRU 1.3.43 R (5) exempts such an asset from the *market risk* stress tests.

**Market risk scenario for exposures to UK assets and certain non-UK assets**

**1.3.68** PRA R The range of *market risk* scenarios referred to in ■ INSPRU 1.3.62 R (1)(a) is:

- (1) a rise or fall in the *market value* of equities of up to the greater of:
  - (a) 10%; and
  - (b) 20%, less the *equity market adjustment ratio* (see ■ INSPRU 1.3.71 R);
- (2) a rise or fall in real estate values of up to 12.5%; and
- (3) a rise or fall in yields on all fixed interest securities of up to 17.5% of the long-term gilt yield.

**1.3.69** PRA R For the purposes of ■ INSPRU 1.3.68 R, a *firm* must:

- (1) assume that yields on equities and real estate remain unchanged from those applicable at market levels before applying each scenario; and

- (2) model a rise or fall in equity, real estate and fixed interest markets as if the movement occurred instantaneously.

1.3.70  
PRA

G

For example, where the long-term gilt yield is 6%, a change of 17.5% in that yield would amount to a change of 1.05 percentage points. For the purpose of the scenarios in ■ INSPRU 1.3.68 R (3), the *firm* would assume a fall or rise of up to 1.05 percentage points in yields on all fixed interest securities.

#### Equity market adjustment ratio

1.3.71  
PRA

R

The equity market adjustment ratio referred to in ■ INSPRU 1.3.68 R (1)(b) is:

- (1) if the ratio calculated in (a) and (b) lies between 80% and 100%, the result of 100% less the ratio (expressed as a percentage) of:
  - (a) the current value of the FTSE Actuaries All Share Index; to
  - (b) the average value of the FTSE Actuaries All Share Index over the preceding 90 calendar days;
- (2) 0%, if the ratio calculated in (1)(a) and (b) is more than 100%; and
- (3) 20%, if the ratio calculated in (1)(a) and (b) is less than 80%.

1.3.72  
PRA

R

In ■ INSPRU 1.3.71 R (1)(b), the average value of the FTSE Actuaries All Share Index over any period of 90 calendar days means the arithmetic mean based on levels at the close of business on each of the days in that period on which the London Stock Exchange was open for trading.

#### Market risk scenario for exposures to other non-UK assets

1.3.73  
PRA

R

The range of *market risk* scenarios referred to in ■ INSPRU 1.3.62 R (1)(b) is:

- (1) an appropriate rise or fall in the *market value* of equities listed in that territory (■ INSPRU 1.3.75 G), which must be at least equal to the percentage determined in ■ INSPRU 1.3.68 R (1);
- (2) a rise or fall in real estate values in that territory of up to 12.5%; and
- (3) a rise or fall in yields on all fixed interest securities of up to 17.5% of the nearest equivalent (in respect of the method of calculation) of the long-term gilt yield.

1.3.74  
PRA

**R** For the purposes of ■ INSPRU 1.3.73 R, a *firm* must:

- (1) assume that yields on equities and real estate remain unchanged from those applicable at market levels before applying each scenario; and
- (2) model a rise or fall in equity, real estate and fixed interest markets as if the movement occurred instantaneously.

1.3.75  
PRA

**G** For the purposes of ■ INSPRU 1.3.73 R (1), an appropriate rise or fall in the *market value* of equities to which a *firm* has exposure in a significant territory must be determined having regard to:

- (1) an appropriate equity market index (or indices) for that territory; and
- (2) the historical volatility of the equity market index (or indices) selected in (1).

1.3.76  
PRA

**G** For the purpose of ■ INSPRU 1.3.75 G (1), an appropriate equity market index (or indices) for a territory should be such that:

- (1) the constituents of the index (or indices) are reasonably representative of the nature of the equities to which the *firm* is exposed in that territory which are included in the relevant assets identified in accordance with ■ INSPRU 1.3.43 R (2); and
- (2) the frequency of, and historical data relating to, published values of the index (or indices) are sufficient to enable an average value(s) and historical volatility of the index (or indices) to be calculated over at least the three preceding *financial years*.

**Credit risk scenarios**

**General**

1.3.77  
PRA

- G**
- (1) The purpose of the credit risk scenarios in ■ INSPRU 1.3.78 R to ■ INSPRU 1.3.99 G is to show the financial effect of specified changes in the general credit risk environment on a *firm's* direct (*counterparty*) and indirect credit risk exposures. The scenarios apply in relation to corporate bonds, debt, *reinsurance* and other exposures, including *derivatives* and *quasi-derivatives*. This is thus quite separate from any reference to allowance for credit risk in ■ INSPRU 3.1.
  - (2) In the case of bonds and debts, the scenarios are described in terms of an assumed credit rating dependent on the widening of credit spreads - changes in bond and debt credit spreads will have a direct impact on the value of bond and debt assets. Credit ratings are intended to give an indication of the security of the income and capital payments for a bond - the higher the credit rating, the more secure the payments. The reaction of credit spreads to developments in markets for credit risk varies by credit rating and so the scenarios to be assumed for bonds and debts depend on their ratings. The credit spreads on bonds and debt represent compensation to the investor for the risk of default and downgrade, but also for illiquidity, price volatility and the uncertainty of recovery rates relative to government bonds. Credit spreads on bonds tend to widen during

an economic recession to reflect the increased expectations that corporate borrowers may default on their obligations or be subject to rating downgrades.

- (3) Changes in bond and debt credit spreads will also be indicative of a change in direct *counterparty* exposure in relation to *reinsurance* and other exposures including *derivatives* and *quasi-derivatives*.
- (4) In addition, changes in bond and debt credit spreads may indirectly impact on credit exposures, for example by affecting the payments anticipated under credit *derivative* instruments.
- (5) A *firm* will also need to allow for the effect of other components of the single event comprising the combination of scenarios applicable under ■ INSPRU 1.3.43 R in assessing exposure to credit risk. For example, in the case of an equity put *option* and a fall in equity market values, the resulting increase in the level of exposure to the *firm's counterparty* for the *option* combined with a change in the quality of the *counterparty* should be allowed for.

1.3.78  
PRA

**R** For the purposes of ■ INSPRU 1.3.44 R, the range of credit risk scenarios that a *firm* must assume is:

- (1) changes in value resulting from an increase in credit spreads by an amount of up to the spread stress determined according to ■ INSPRU 1.3.84 R in respect of any bond or debt item;
- (2) changes in value determined according to ■ INSPRU 1.3.94 R in respect of any *reinsurance* item or any analogous non-*reinsurance* financing agreement item; and
- (3) changes in value determined according to ■ INSPRU 1.3.98 R for any other item (including any *derivative* or *quasi-derivative*).

1.3.79  
PRA

**R** For the purposes of ■ INSPRU 1.3.78 R, a *firm* must make appropriate allowance for any loss mitigation techniques to the extent that they are loss mitigation techniques relied on for the purpose of ■ INSPRU 2.1.8 R in accordance with ■ INSPRU 2.1.16 R and ■ INSPRU 2.1.18 R.

1.3.80  
PRA

**G** The change in asset or liability values to be determined in relation to a credit risk scenario for the purposes of ■ INSPRU 1.3.43 R and ■ INSPRU 1.3.44 R is the change in value which would arise on the occurrence of the relevant credit risk scenario as a result of bond, debt, *reinsurance* or other exposures whether or not there is a direct *counterparty* exposure.

1.3.81  
PRA

**R** Where a bond or a debt item or *reinsurance* asset is currently in default, it may be ignored by a *firm* for the purpose of applying ■ INSPRU 1.3.78 R.

1.3.82  
PRA

**G** Where a bond or a debt item or a *reinsurance* asset is currently in default and has been specifically provisioned, in accordance with relevant accounting standards, a *firm* is

not required to increase the existing default provisions to reflect a worsening of recovery rates.

1.3.83  
PRA

**R** Where the credit risk scenarios in ■ INSPRU 1.3.78 R to ■ INSPRU 1.3.99 G require a *firm* to assume a change in current credit spread, or a direct change in market value, the *firm* must not change the risk-free yields used to discount future cash flows in calculating the revised *realistic value of liabilities* and *realistic value of assets* ( ■ INSPRU 1.3.43 R (2)) resulting from those credit risk scenarios.

**Spread stresses to be assumed for bonds and debt**

1.3.84  
PRA

- R**
- (1) In ■ INSPRU 1.3.78 R (1) the spread stress which a *firm* must assume for any bond or debt item is:
    - (a) for any bond or debt item issued or guaranteed by an organisation which is in accordance with ■ INSPRU 1.3.87 R a credit risk scenario exempt organisation in respect of that item, zero basis points; and
    - (b) for any other bond or debt item:
      - (i) Y if the credit rating description of that other bond or debt item determined by reference to ■ INSPRU 1.3.89 R is not "Highly speculative or very vulnerable"; and
      - (ii) otherwise the larger of Y and Z.
  - (2) For the purpose of (1)(b):
    - (a) Y is the product of the spread factor for that bond or debt item and the square root of S, where:
      - (i) the spread factor for a bond or debt item is the spread factor shown in the final column of Table ■ INSPRU 1.3.90 R, in the row of that Table corresponding to the credit rating description of the bond or debt item determined for the purpose of this *rule* by reference to ■ INSPRU 1.3.89 R; and
      - (ii) subject to (3), S is the current credit spread for a bond or debt item, expressed as a number of basis points, which the *firm* must determine as the current yield on that bond or debt item in excess of the current gross redemption yield on the government bond most similar to that bond or debt item in terms of currency of denomination and equivalent term; and
    - (b) Z is the change in credit spread expressed as a number of basis points that would result in the current market value of the bond or debt falling by 5%.

- (3) Where, for the purposes of (2)(a)(ii), there is no suitable government bond, the *firm* must use its best estimate of the gross redemption yield that would apply for a notional government bond similar to the bond or debt item in terms of currency of denomination and equivalent term.

1.3.85

PRA

R

For the purpose of ■ INSPRU 1.3.84 R (1)(a), a guarantee must be direct, explicit, unconditional and irrevocable.

1.3.86

PRA

G

- (1) As an example, a bond item has the credit rating description "exceptional or extremely strong" and currently yields 49 basis points in excess of the most similar government bond. The spread factor for that bond item is 3.00 by reference to Table ■ INSPRU 1.3.90 R. Since  $S$  is 49, the square root of  $S$  is 7 and the spread stress for that item is 3 times 7, that is, 21 basis points. The *firm* must consider the impact of an increase in spreads by up to 21 basis points for that item.
- (2) As a further example, a bond item has the credit rating description "highly speculative or very vulnerable". For this bond,  $S$  is 400, being the current spread for that bond expressed as a number of basis points. The spread factor for the bond is 24.00. So the *firm* must consider the impact of an increase in spreads by up to 24.00 times 20 i.e. 480 basis points for that item. The bond is however of short duration and the reduction in market value resulting from an additional spread of 480 basis points is less than 5 per cent of its current market value. A 5 per cent reduction in its market value would result from a spread widening of 525 basis points. The *firm* must consider the impact of an increase in spreads by up to 525 basis points for that item by virtue of its credit rating description.
- (3) The calculation of the credit spread on commercial floating rate notes warrants particular consideration. Suppose, for example, that a notional floating rate note guaranteed by the UK government would have a market consistent price of  $X$ . This price can be estimated based on an assumed distribution of future payments under the floating rate note, and the current forward gilt curve. Suppose further that the market price of the commercial floating rate note is  $Y$ , where  $Y$  is less than  $X$ . A *firm* could calculate what parallel upward shift in the forward gilt curve would result in the notional government-backed floating rate note having a market price of  $Y$  for an unchanged assumed distribution of future payments. The size of the resulting shift could then be taken as the credit spread on the commercial floating rate note.
- (4) In arriving at the estimated gross redemption yield in ■ INSPRU 1.3.84 R (3), the *firm* may have regard to any appropriate swap rates for the currency of denomination of the bond or debt item, adjusted to take appropriate account of observed differences between swap rates and the yields on government bonds.

1.3.87

PRA

R

For the purposes of this section:

- (1) an organisation is a credit risk scenario exempt organisation in respect of an item if the organisation is:
- (a) the European Central Bank; or

- (b) any central government or central bank which, in relation to that item, satisfies the conditions in (2); or
  - (c) a multilateral development bank which is listed in (3); or
  - (d) an international organisation which is listed in (4);
- (2) the conditions in (1)(b) are that, for any claim against the central government or central bank denominated in the currency in which the item is denominated:
- (a) a credit rating is available from at least one listed rating agency nominated in accordance with ■ INSPRU 1.3.92 R; and
  - (b) the credit rating description in the first column of Table ■ INSPRU 1.3.90 R corresponding to the lowest such credit rating is either "exceptionally or extremely strong" or "very strong";
- (3) for the purposes of (1)(c) the listed multilateral development banks are:
- (a) the International Bank for Reconstruction and Development;
  - (b) the International Finance Corporation;
  - (c) the Inter-American Development Bank;
  - (d) the Asian Development Bank;
  - (e) the African Development Bank;
  - (f) the Council of Europe Development Bank;
  - (g) the Nordic Investment Bank;
  - (h) the Caribbean Development Bank;
  - (i) the European Bank for Reconstruction and Development;
  - (j) the European Investment Bank;
  - (k) the European Investment Fund; and
  - (l) the Multilateral Investment Guarantee Agency;
- (4) for the purposes of (1)(d) the listed international organisations are:
- (a) the *EU*;
  - (b) the International Monetary Fund; and
  - (c) the Bank for International Settlements.

Under ■ INSPRU 1.3.87 R (2), a *firm* needs to take account of the currency in which the claim is denominated when it is considering claims on or guaranteed by a central government or central bank. It is possible, for example, that a given central bank would be a credit risk scenario exempt organisation in respect of claims on it denominated in its domestic

currency, while not being a credit risk scenario exempt organisation in respect of claims on it denominated in a currency other than its domestic currency - the central government or central bank may have been assigned different credit assessments depending on the currency in which the claim on it is denominated.

1.3.89

PRA

R

- (1) For the purposes of this section, the credit rating description of a bond or debt item is to be determined in accordance with (2) and (3).
- (2) If the item has at least one credit rating nominated in accordance with ■ INSPRU 1.3.92 R ("a rated item"), its credit rating description is:
  - (a) where it has only one nominated credit rating, the general description given in the first column of Table ■ INSPRU 1.3.90 R corresponding to that rating; or
  - (b) where it has two or more nominated credit ratings and the two highest nominated ratings fall within the same general description given in the first column of that Table, that description; or
  - (c) where it has two or more nominated credit ratings and the two highest nominated ratings do not fall within the same general description given in the first column of that Table, the second highest of those two descriptions.
- (3) If the item is not a rated item, its credit rating description is the general description given in the first column of Table ■ INSPRU 1.3.90 R that most closely corresponds to the *firm's* own assessment of the item's credit quality.
- (4) An assessment under (3) must be made by the *firm* for the purposes of the credit risk scenario having due regard to the seniority of the bond or debt and the credit quality of the bond or debt issuer.

1.3.90

PRA

R

**Table : Listed rating agencies, credit rating descriptions, spread factors**

Credit Rating Description	Listed rating agencies				Spread Factor
	A. M. Best Company	Fitch Ratings	Moodys Investors Service	Standard & Poors Corporation	
Exceptional or ex-	aaa	AAA	Aaa	AAA	3.00

Credit Rating Description	Listed rating agencies				Spread Factor
<b>tremely strong</b>					
<b>Very strong</b>	aa	AA	Aa	AA	5.25
<b>Strong</b>	a	A	A	A	6.75
<b>Adequate</b>	bbb	BBB	Baa	BBB	9.25
<b>Speculative or less vulnerable</b>	bb	BB	Ba	BB	15.00
<b>Very speculative or more vulnerable</b>	B	B	B	B	24.00
<b>Highly speculative or very vulnerable</b>	Below B	Below B	Below B	Below B	24.00

1.3.91

PRA

G

Where listed rating agencies provide ratings by sub-category then all ratings should be allocated to the main ratings category (e.g. ratings sub-category A+ or A- would be allocated to the assigned ratings category "Strong").

1.3.92

PRA

R

For the purposes of ■ INSPRU 1.3.87 R and ■ INSPRU 1.3.89 R, a *firm* may, subject to (1) to (5), nominate for use credit ratings produced by one or more of the rating agencies listed in ■ INSPRU 1.3.93 R:

- (1) if the *firm* decides to nominate for use for an item the credit rating produced by one or more rating agencies, it must do so consistently for all similar items;
- (2) the *firm* must use credit ratings in a continuous and consistent way over time;
- (3) the *firm* must nominate for use only credit ratings that take into account both principal and interest;
- (4) if the *firm* nominates for use credit ratings produced by one of the listed rating agencies then the *firm* must use solicited credit ratings produced by that listed rating agency; and

- (5) the *firm* may nominate for use unsolicited credit ratings produced by one or more of the listed rating agencies except where there are reasonable grounds for believing that any unsolicited credit ratings produced by the agency are used so as to obtain inappropriate advantages in the relationship with rated parties.

1.3.93

PRA

R

In this section, a listed rating agency is:

- (1) A.M. Best Company; or
- (2) Fitch Ratings; or
- (3) Moody's Investors Service; or
- (4) Standard & Poor's Corporation.

**Credit risk scenario for reinsurance**

1.3.94

PRA

R

- (1) The contracts of *reinsurance* or analogous non-*reinsurance* financing agreements to which ■ INSPRU 1.3.78 R (2) applies are those:
  - (a) into which the *firm* has entered;
  - (b) which represent an economic asset under the single event applicable under ■ INSPRU 1.3.43 R (3); and
  - (c) which are material (individually or in aggregate).
- (2) For the purposes of (1), no account is to be taken of *reinsurance* or analogous non-*reinsurance* financing arrangements between *undertakings* in the same *group* where:
  - (a) the ceding and accepting *undertakings* are regulated by the *PRA*, *FCA* or a regulatory body in a *designated State or territory* for insurance (including *reinsurance*);
  - (b) no subsequent cessions of the ceded risk which are material (individually or in aggregate) are made to subsequent accepting *undertakings* by accepting *undertakings* (including subsequent accepting *undertakings*) other than to subsequent accepting *undertakings* which are in the same *group*; and
  - (c) for any subsequent cession or cessions of the ceded risk which are material (individually or in aggregate) each of the ceding and accepting *undertakings* (including subsequent accepting *undertakings*) is regulated by the *PRA*, *FCA* or a regulatory body in a *designated State or territory* for insurance (including *reinsurance*).

(3) The change in value which a *firm* must determine for a contract of *reinsurance* or an analogous non-*reinsurance* financing agreement is the *firm's* best estimate of the change in realistic value which would result from changes in credit risk market conditions consistent, subject to (4), with the changes in credit spreads determined in accordance with ■ INSPRU 1.3.78 R (1).

(4) For the purpose of (3), 5% should be replaced by 10% in ■ INSPRU 1.3.84 R (2)(b).

1.3.95

PRA

G

(1) *Reinsurance* and analogous non-*reinsurance* financing agreements entered into by the *firm*, either with or acting as a *reinsurer*, must be included within the scope of the scenario. The combined rights and obligations under a contract of *reinsurance* or an analogous non-*reinsurance* financing agreement may represent an economic asset or liability. The value placed by the *firm* on the *reinsurance* item or non-*reinsurance* financing item should allow for a realistic assessment of the risks transferred and the risks of *counterparty* default associated with the item. In the case of analogous non-*reinsurance* financing agreements, references to terms such as "*reinsurer*", "*ceding undertakings*" and "*accepting undertakings*" include *undertakings* which by analogy are *reinsurers*, *ceding* or *accepting undertakings*. Analogous non-*reinsurance* financing agreements include contingent loans, securitisations and any other arrangements in respect of *contracts of insurance* that are analogous to contracts of *reinsurance* in terms of the risks transferred and the finance provided.

(2) In assessing values in accordance with ■ INSPRU 1.3.94 R, a *firm* may consider it appropriate to determine values by drawing an analogy with the approach in respect of bond and debt items set out in ■ INSPRU 1.3.84 R. (This might be the case if, in economic terms, the item being valued sufficiently resembles a bond or debt item - an alternative approach might otherwise be preferred). If the *firm* does consider it appropriate to draw an analogy, the "credit spread" assumed should be consistent with the assumed default probabilities and the values placed on the *reinsurance* asset for the purposes of determining the *realistic values of assets and liabilities*. A *firm* may regard it as appropriate to have regard to any financial strength ratings applicable to the *reinsurer*, but if so should apply the same principles set out in ■ INSPRU 1.3.92 R for the nomination of financial strength ratings. Table ■ INSPRU 1.3.97 G provides *guidance* as to the allocation of spread factors which a *firm* may, by analogy, deem appropriate to apply. Appropriate allowance should be made for any change in the extent of the *counterparty* exposure under the assumed scenario.

(3) The changes in credit risk spreads determined for bond and debt items in accordance with ■ INSPRU 1.3.78 R (1) are required to result in a reduction in market value for some items of 5% of their current value through the operation of ■ INSPRU 1.3.84 R (2)(b). For *reinsurance* contracts and analogous non-*reinsurance* financing agreements, determining the change in value by reference to ■ INSPRU 1.3.94 R (3) requires a *firm* to consider the possibility of *counterparty* default in changed credit risk market conditions. Where in the changed credit risk market conditions assumed to apply the *firm's* assessment of the *counterparty* risk would result in the asset being considered equivalent to "Highly speculative or very vulnerable", the reduction in value required is at least 10% of its current value. ■ INSPRU 1.3.94 R (4) relates to this requirement.

**1.3.96**  
**PRA**

**G**

A financial strength rating of a *reinsurer* refers to a current assessment of the financial security characteristics of the *reinsurer* with respect to its ability to pay *claims* under its *reinsurance* contracts and treaties in accordance with their terms.

**1.3.97**  
**PRA**

**G**

Table: Listed rating agencies, financial strength descriptions and spread factors

Financial Strength Description	A. M. Best Company	Fitch Ratings	Moody's Investors Service	Standard & Poors Corporation	Spread Factor
Superior, extremely strong	A++	AAA	Aaa	AAA	3.00
Superior, very strong	A+	AA	Aa	AA	5.25
Excellent or strong	A, A-	A	A	A	6.75
Good	B++, B+	BBB	Baa	BBB	9.25
Fair, marginal	B, B-	BB	Ba	BB	15.00
Marginal, weak	C++, C+	B	B	B	24.00
Unrated or very weak	Unrated or below C++, C+	Unrated or below B	Unrated or below B	Unrated or below B	24.00

**Credit risk scenario for other exposures (including any derivative or quasi-derivative)**

**1.3.98**  
**PRA**

**R**

For the purposes of **INSPRU 1.3.78 R (3)**, the change in value which must be determined for any other item (including any *derivative* or *quasi-derivative*) which represents an economic asset under the single event applicable under **INSPRU 1.3.43 R (3)** is the *firm's* best estimate of the change in the realistic value of that item which would result from changes in credit risk market conditions consistent with the changes in credit spreads determined in accordance with **INSPRU 1.3.78 R (1)** and the changes in value determined in accordance with **INSPRU 1.3.78 R (2)**.

**1.3.99**  
**PRA**

**G**

In applying **INSPRU 1.3.98 R**, a *firm* should assess the total impact on the value of the item resulting from the assumed changed credit risk market conditions. The total change in value may result from the interaction of a number of separate influences. For example, a widening of credit spreads may imply an impact on the amount exposed to *counterparty* default as well as on the likelihood of that default. Each factor influencing the change in value needs separate consideration. It should be assumed, both for determining amounts exposed to *counterparty* default and the likelihood of such default that there will be no change in the likelihood of default in relation to an item issued by or guaranteed by an organisation which is in respect of that item a credit risk scenario exempt organisation (**INSPRU 1.3.87 R**, **INSPRU 1.3.77 G (5)**) is also relevant in this context.

**Persistency risk scenario**

**1.3.100** **R** For the purposes of the persistency risk scenario in ■ INSPRU 1.3.44 R (6), a **PRA** *firm* must allow for the effects of an increase or a decrease in persistency experience of its *with-profits insurance contract* by adjusting the termination rates in each year of projection by 32.5% of the termination rates assumed in the calculation of the *realistic value of liabilities* in ■ INSPRU 1.3.40 R.

**1.3.101** **R** The termination rates referred to in ■ INSPRU 1.3.100 R are the rates of **PRA** termination (including the paying-up of *policies*, but excluding deaths, maturities and retirements) other than on dates specified by the *firm* where:

- (1) a guaranteed amount applies as the minimum amount which will be paid on *claim*; or
- (2) any payments to the *policyholder* cannot be reduced at the discretion of the *firm* by its applying a market value adjustment.

**1.3.102** **R** For the purposes of ■ INSPRU 1.3.100 R, the increase or decrease in **PRA** termination rates must be applied to the projection of terminations up to *policy* guarantee dates and between *policy* guarantee dates, but not to the assumptions as to the proportion of *policyholders* taking up the guarantees at *policy* guarantee dates.

**1.3.103** **G** ■ INSPRU 1.3.100 R to ■ INSPRU 1.3.102 R require *firms* to apply a persistency stress test to **PRA** the *realistic value of liabilities*. Where a *firm* brings the present value of *non-profit insurance business* in a *with-profits fund* into the calculation of the *realistic value of assets* (see ■ INSPRU 1.3.33 R) there is no requirement to stress this asset for changes in persistency assumptions.

**Realistic value of liabilities: detailed provisions**

**1.3.104** **G** ■ INSPRU 1.3.40 R sets out the three elements comprising the *realistic value of liabilities* for **PRA** a *with-profits fund*. The remainder of this section contains general *rules* and *guidance* on determining the *realistic value of liabilities* plus further detail relating to each of those elements separately, as follows:

- (1) general *rules* and *guidance* in ■ INSPRU 1.3.105 R to ■ INSPRU 1.3.115 G;
- (2) *with-profits benefits reserve* in ■ INSPRU 1.3.116 R to ■ INSPRU 1.3.135 G;
- (3) *future policy related liabilities* in ■ INSPRU 1.3.136 G to ■ INSPRU 1.3.189 G; and
- (4) *realistic current liabilities* in ■ INSPRU 1.3.190 R and ■ INSPRU 1.3.191 R.

**Methods and assumptions: general**

1.3.105

PRA

R

In calculating the *realistic value of liabilities* for a *with-profits fund*, a *firm* must use methods and assumptions which:

- (1) are appropriate to the business of the *firm*;
- (2) are consistent from year to year without arbitrary changes (that is, changes without adequate reasons);
- (3) are consistent with the method of valuing assets (■ GENPRU 1.3);
- (4) make full provision for tax payable out of the *with-profits fund*, based on current legislation and practice, together with any known future changes, and on a consistent basis with the other methods and assumptions used;
- (5) take into account discretionary benefits which are at least equal to, and charges which are no more than, the levels required for the *firm* to fulfil its regulatory duty to treat its *customers* fairly;
- (6) take into account prospective management actions (■ INSPRU 1.3.53 R) and *policyholder* actions (■ INSPRU 1.3.59 R);
- (7) provide for shareholder transfers out of the *with-profits fund* as a liability of the fund;
- (8) have regard to generally accepted actuarial practice; and
- (9) are consistent with the *firm's PPFM*.

1.3.106

PRA

G

More specific *rules* and *guidance* are set out below on some aspects of the methods and assumptions to be used in calculating the *realistic value of liabilities* for a *with-profits fund*. In contrast to the *mathematical reserves* requirements in ■ INSPRU 1.2.10 R (4) and ■ INSPRU 1.2.13 R, there is no requirement to include margins for adverse deviation of relevant factors in calculating the *realistic value of liabilities*. Assumptions need be no more prudent than is necessary to achieve a best estimate, taking into account the *firm's PPFM* and its regulatory duty to treat its *customers* fairly. Where there is no requirement for a *PPFM*, for example non-UK business, a *firm* should use assumptions that are consistent with the *firm's* documented approach to treating its *customers* fairly. A *firm* may judge that a margin should be included in its calculations to avoid an understatement of the *realistic value of liabilities* as a result of uncertainty, for example, either in its method or in its data.

1.3.107

PRA

G

The amount and timing of tax charges affect the amount of assets available to meet *policyholder* liabilities. ■ INSPRU 1.3.105 R (4) requires *firms* to provide fully for all tax payable out of the *with-profits fund* on a basis consistent with the other assumptions and methods used in deriving the realistic balance sheet. So, for example, all projections which underlie the realistic valuation of assets or liabilities must allow for taxation. The approach adopted should not give any credit for any reduction in tax deriving from future expenses or deficits which is attributable to future new business. For assets backing capital requirements it is not necessary to take into consideration future tax

charges on investment income generated by those assets. However, *firms* should consider this aspect in their capital planning.

1.3.108

[intentionally blank]

**Valuation of contracts: General**

1.3.109

**R**

**PRA**

(1) A *firm* must determine the amount of the *with-profits benefits reserve* or the *future policy related liabilities* for a *with-profits fund* by carrying out a separate calculation in relation to each *with-profits insurance contract* or for each group of similar contracts.

(2) Appropriate approximations or generalisations may be made where they are likely to provide the same, or a higher, result than a separate calculation for each contract.

(3) A *firm* must set up additional reserves on an aggregated basis for general risks which are not specific to individual contracts or a group of similar contacts where the *firm* considers the *realistic value of liabilities* may otherwise be understated.

1.3.110

**R**

**PRA**

For the purpose of ■ INSPRU 1.3.109 R (1), a group of similar contracts is such that the conditions in ■ INSPRU 1.3.109 R (2) are satisfied.

1.3.111

**G**

**PRA**

Where a *firm* has grouped individual contracts for the purpose of calculating the *mathematical reserves* for a *with-profits fund* (in accordance with ■ INSPRU 1.2.22 R), the *firm* is not required to use the same grouping of contracts in calculating the *with-profits benefits reserve* or *future policy related liabilities* for that fund.

1.3.112

**G**

**PRA**

In contrast to ■ INSPRU 1.2.24 R for the *mathematical reserves*, treating individual contracts as an asset is not prohibited if, and to the extent that, this treatment does not conflict with a *firm's* regulatory duty to treat its *customers* fairly.

1.3.113

**G**

**PRA**

In calculating the *with-profits benefits reserve*, an overall (grouped or pooled) approach may be appropriate under either of the two methods set out in ■ INSPRU 1.3.116 R. In particular, the calculation of aggregate retrospective reserves (see ■ INSPRU 1.3.118 R) and the projection of future cash flows (see ■ INSPRU 1.3.128 R) based on suitable specimen *policies* is permitted.

1.3.114

**G**

**PRA**

In calculating the *future policy related liabilities*, the grouping of *policies* for valuing the costs of guarantees, options or smoothing, and their representation by representative *policies*, is acceptable provided the *firm* can demonstrate that the grouping of *policies* does not materially misrepresent the underlying exposure and does not significantly misstate the costs. A *firm* should exercise care in grouping *policies* in order to ensure that the risk exposure is not inappropriately distorted by, for example, forming groups containing *policies* with guarantees that are "in the money" and *policies* with guarantees well "out of the money". A *firm* should also have regard to the effects of *policyholder* behaviour over time on the spread of the outstanding guarantees or options.

1.3.115  
PRA

G

Where a *firm* groups similar *policies* for the purpose of calculating the *with-profits benefits reserve* or the *future policy related liabilities*, the *firm* should carry out sufficient validation to be reasonably sure that the grouping of *policies* has not resulted in the loss of any significant attributes of the portfolio being valued.

**With-profits benefits reserve**

1.3.116  
PRA

R

A *firm* must calculate a with-profits benefits reserve for a with-profits fund using either:

- (1) a retrospective calculation under ■ INSPRU 1.3.118 R (the retrospective method); or
- (2) a prospective calculation under ■ INSPRU 1.3.128 R of all future cash flows expected to arise under, or in respect of, each of the *with-profits insurance contracts* written in that fund (the prospective method).

1.3.117  
PRA

R

Subject to ■ INSPRU 1.3.105 R (2), a *firm* may use different methods under ■ INSPRU 1.3.116 R for different types or generations of *with-profits insurance contracts*.

**Retrospective method**

1.3.118  
PRA

R

In the retrospective method of calculating a *with-profits benefits reserve*, a *firm* must calculate either the aggregate of the retrospective reserves in respect of each *with-profits insurance contract* or, to the extent permitted by ■ INSPRU 1.3.109 R and ■ INSPRU 1.3.110 R, the total retrospective reserve in respect of each group of *with-profits insurance contracts*.

1.3.119  
PRA

R

In calculating the retrospective reserve for a *with-profits insurance contract*, or the total retrospective reserve in respect of a group of *with-profits insurance contracts*, a *firm* must take account of at least the following:

- (1) *premiums* received from the *policyholder*;
- (2) any expenses incurred or charges made (including *commissions*);
- (3) any partial benefits paid or due;
- (4) any investment income on, and any increases (or decreases) in, asset values;
- (5) any tax paid or payable;
- (6) any amounts received (or paid) under contracts of *reinsurance* or analogous non-*reinsurance* financing agreements, where relevant to retrospective reserves;

- (7) any shareholder transfers and any associated tax paid or payable; and
- (8) any permanent enhancements to (or deductions from) the retrospective reserves made by the *firm*.

**1.3.120**  
**PRA**

**G**

In taking account of amounts in ■ INSPRU 1.3.119 R (6), due regard should be had to the specific details of each relevant contract of *reinsurance* or analogous non-*reinsurance* financing agreement and the relationship between the amounts received (or paid) and the value of the benefit granted (or received) under the arrangement. This should take into consideration, for example, the risk of default and differences in the *firm's* realistic assessment of the risks transferred and the contractual terms for such transfer of risk. Analogous non-*reinsurance* financing agreements include contingent loans, securitisations and any other arrangements in respect of *contracts of insurance* that are analogous to contracts of *reinsurance* in terms of the risks transferred and the finance provided.

**1.3.121**  
**PRA**

**G**

Where allowance is made for shareholder transfers, this should be in respect of the accrued bonus entitlement reflected in the retrospective reserve. This would include both *annual bonuses* already declared and accrued *final bonus*. However, shareholder transfers in respect of surplus yet to be credited to retrospective reserves should not be charged to those reserves until the corresponding surplus is credited.

**1.3.122**  
**PRA**

**R**

**In calculating retrospective reserves, a *firm* must have regard to its regulatory duty to treat its *customers* fairly and must ensure that its approach is consistent with its *Principles and Practices of Financial Management*.**

**1.3.123**  
**PRA**

**R**

**In calculating retrospective reserves, a *firm* must ensure its treatment of past cash flows, and of any future cash flows, is consistent with those cash flows valued in its prospective calculation of the *future policy related liabilities* for that fund in accordance with the *rules* in ■ INSPRU 1.3.136 G to ■ INSPRU 1.3.189 G.**

**1.3.124**  
**PRA**

**G**

An example of ■ INSPRU 1.3.123 R concerns future shareholder transfers. A *firm* must make adequate provision for future shareholder transfers within the *future policy related liabilities* (see ■ INSPRU 1.3.165 R). The basis of provisioning needs to be consistent with the amounts accrued within retrospective reserves and the amounts already transferred out of the *with-profits fund*.

**1.3.125**  
**PRA**

**G**

Another example of the application of ■ INSPRU 1.3.123 R relates to the reference in ■ INSPRU 1.3.119 R (8) to past permanent enhancements to (or deductions from) retrospective reserves made by *firms*. This item may include past miscellaneous surplus (or losses) which have been credited to (or debited from) retrospective reserves. Any other enhancements (or deductions) made on a temporary basis and any future surplus (or losses) that *firms* intend to credit to (or debit from) retrospective reserves should be included under the *future policy related liabilities* (see ■ INSPRU 1.3.137 R).

**1.3.126**  
**PRA**

**G**

*Firms* characteristically use a range of calculation methods to determine retrospective reserves. A *firm's* definition and calculation of retrospective reserves will depend on a number of factors. These include: the *firm's* practice; its administration and accounting

systems; the extent of its historical records; and the composition of its with-profits portfolio. The *rules* and *guidance* for the retrospective method are drawn up to be sufficiently flexible to accommodate the diversity of calculation methods used by *firms*, rather than to enforce any particular method of calculation of retrospective reserves. ■ INSPRU 1.3.119 R simply sets minimum standards that all retrospective methods must meet.

**1.3.127**  
**PRA**

**G**

For the purposes of ■ INSPRU 1.3.119 R (2) and ■ INSPRU 1.3.128 R (2), the phrases 'charges made' or 'charges to be made' refer to circumstances where types of risk (such as mortality risk, longevity risk and investment risk) are met by the *firm* or *with-profits fund* in return for a charge deducted by the *firm* from the *with-profits benefits reserve*.

**Prospective method**

**1.3.128**  
**PRA**

**R**

In the prospective method of calculating a *with-profits benefits reserve*, a *firm* must take account of at least the following cash flows:

- (1) future *premiums*;
- (2) expenses to be incurred or charges to be made, including *commissions*;
- (3) benefits payable (■ INSPRU 1.3.129 R);
- (4) tax payable;
- (5) any amounts to be received (or paid) under contracts of *reinsurance* or analogous non-*reinsurance* financing agreements, where relevant to *with-profits insurance contracts* being valued; and
- (6) shareholder transfers.

**1.3.129**  
**PRA**

**R**

For the purposes of ■ INSPRU 1.3.128 R (3), benefits payable include:

- (1) all guaranteed benefits, including guaranteed amounts payable on death and maturity, guaranteed *surrender values* and paid-up values;
- (2) vested, declared and allotted bonuses to which *policyholders* are entitled; and
- (3) future *annual* and *final bonuses* at least equal to the levels required for the *firm* to fulfil its regulatory duty to treat its *customers* fairly.

**1.3.130**  
**PRA**

**R**

A *firm* must value the cash flows listed in ■ INSPRU 1.3.128 R using best estimate assumptions of future experience, having regard to generally accepted actuarial practice and taking into account the *firm's PPFM* and its regulatory duty to treat its *customers* fairly.

**1.3.131** **G** The prospective method sets the *with-profits benefits reserve* at the net present value of future cash flows listed in ■ INSPRU 1.3.128 R.  
**PRA**

**1.3.132** **G** In contrast to ■ INSPRU 1.2.10 R (4) and ■ INSPRU 1.2.13 R relating to the methods and assumptions used to value the *mathematical reserves*, there is no requirement to value future cash flows using assumptions that include margins for adverse deviation. Also there are no detailed *rules* as to the future yields on assets, discount rates, *premium* levels, expenses, tax, mortality, morbidity, persistency and *reinsurance*. A *firm* should make its own assessment as to the amount of these future cash flows including bonuses and discretionary surrender or transfer values. A *firm* should make a realistic assessment of longevity risk and asset default risk (including default risk arising under contracts of *reinsurance* or analogous non-*reinsurance* financing agreements) within the best estimate assumptions of future experience required by ■ INSPRU 1.3.130 R.  
**PRA**

**1.3.133** **G** In valuing the future cash flows listed in ■ INSPRU 1.3.128 R, the *firm* should use a projection term which is long enough to capture all material cash flows arising from the contract or groups of contracts being valued. If the projection term does not extend to the term of the last *policy*, the *firm* should check that the shorter projection term does not significantly affect the results.  
**PRA**

**1.3.134** **R** Where a *firm* expects to pay additional benefits that are not included in the cash flows listed in ■ INSPRU 1.3.128 R, it must make adequate provision for these benefits in calculating the *future policy related liabilities* in accordance with the *rules* in ■ INSPRU 1.3.136 G to ■ INSPRU 1.3.189 G.  
**PRA**

**1.3.135** **G** The prospective assessment of the *with-profits benefits reserve* will usually be on a deterministic basis. A *firm* will have to make further provision in the *future policy-related liabilities* for, for example, the costs of potential asset fluctuations or *policy* options.  
**PRA**

**Future policy related liabilities**

**1.3.136** **G** Overview of liabilities

**PRA** ■ INSPRU 1.3.137 R lists the *future policy related liabilities* for a *with-profits fund* that form part of a *firm's realistic value of liabilities* in ■ INSPRU 1.3.40 R. Detailed *rules* and *guidance* relating to particular types of liability and asset are set out in ■ INSPRU 1.3.139 R to ■ INSPRU 1.3.168 G. These are followed by *rules* and *guidance* that deal with certain aspects of several liabilities (that is, liabilities relating to guarantees, options and smoothing):

- (1) ■ INSPRU 1.3.169 R to ■ INSPRU 1.3.186 G refer to valuing the costs of guarantees, options and smoothing; and
- (2) ■ INSPRU 1.3.187 R to ■ INSPRU 1.3.189 G refer to the treatment of surplus on guarantees, options and smoothing.

**1.3.137** **R** The *future policy related liabilities* for a *with-profits fund* are equal to the sum of amounts, as they relate to that fund, in respect of (1) to (11) to the extent each is valued as a liability less the sum of amounts, as they  
**PRA**

relate to that fund, in respect of (1) to (11) to the extent each is valued as an asset:

- (1) past miscellaneous surplus (or deficit) planned to be attributed to the *with-profits benefits reserve* (see ■ INSPRU 1.3.139 R);
- (2) planned enhancements to the *with-profits benefits reserve* (see ■ INSPRU 1.3.141 R);
- (3) planned deductions for the costs of guarantees, options and smoothing from the *with-profits benefits reserve* (see ■ INSPRU 1.3.144 R);
- (4) planned deductions for other costs deemed chargeable to the *with-profits benefits reserve* (see ■ INSPRU 1.3.146 R);
- (5) future costs of contractual guarantees (other than financial options) (see ■ INSPRU 1.3.148 R);
- (6) future costs of non-contractual commitments (see ■ INSPRU 1.3.154 R);
- (7) future costs of financial options (see ■ INSPRU 1.3.156 G);
- (8) future costs of smoothing (see ■ INSPRU 1.3.158 R);
- (9) financing costs (see ■ INSPRU 1.3.162 R);
- (10) any other further liabilities required for the *firm* to fulfil its regulatory duty to treat its *customers* fairly; and
- (11) other *long-term insurance liabilities* (see ■ INSPRU 1.3.165 R).

1.3.138

PRA

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Some of the elements of the calculation set out in ■ INSPRU 1.3.137 R may have already been taken into consideration in the calculation of the *with-profits benefits reserve*, either under the retrospective method (see ■ INSPRU 1.3.118 R onwards) or the prospective method (see ■ INSPRU 1.3.128 R onwards). Where this is the case, the adjustments made under ■ INSPRU 1.3.137 R should be such that no double-counting arises.

**Past miscellaneous surplus (or deficit) planned to be attributed to the with-profits benefits reserve**

1.3.139

PRA

R

In calculating the *future policy related liabilities* for a *with-profits fund*, a *firm* must allow for past miscellaneous surplus (or deficit) which it intends to attribute to the *with-profits benefits reserve* for that fund but which has not yet been permanently credited to (or debited from) the *with-profits benefits reserve* for that fund.

**1.3.140** PRA G Past miscellaneous surplus (or deficit) already permanently credited to (or debited from) the *with-profits benefits reserve* will have been included in the calculation of the *with-profits benefits reserve* in accordance with ■ INSPRU 1.3.119 R (8).

**Planned enhancements to the with-profits benefits reserve**

**1.3.141** PRA R In calculating the *future policy related liabilities* for a *with-profits fund*, a *firm* must make provision for any future planned enhancements to the *with-profits benefits reserve* for that fund that cannot be financed out of the resources of the *with-profits benefits reserve* and future *premiums*.

**1.3.142** PRA G For the purposes of ■ INSPRU 1.3.141 R, planned enhancements to the *with-profits benefits reserve* will arise when a *firm* has a contractual obligation, or a non-contractual commitment (arising from its regulatory duty to treat *customers* fairly), to enhance *claims* on some classes of *policy* (perhaps in the form of specially enhanced future bonus rates). In such circumstances, the present value of the costs of paying out a target asset share that is more than the projected *with-profits benefits reserve* for those classes of *policy* for which this practice is applicable should be included in the amount of the *future policy related liabilities*. For example, a *firm* may have a non-contractual commitment (arising from its regulatory duty to treat *customers* fairly) to pay enhanced benefits but have discretion not to make such payments in adverse circumstances. Such planned enhancements should be provided for in the realistic balance sheet, but allowance should be made for management action in the calculation of the *risk capital margin*.

**1.3.143** PRA G The valuation of *claims* in excess of targeted asset shares in respect of guarantees, options and smoothing, including those arising under guaranteed annuity rates, should be carried out in accordance with ■ INSPRU 1.3.169 R to ■ INSPRU 1.3.186 G.

**Planned deductions for the costs of guarantees, options and smoothing from the with-profits benefits reserve**

**1.3.144** PRA R Where a *firm* expects to deduct future charges from the *with-profits benefits reserve* for a *with-profits fund* to cover the costs of guarantees, options or smoothing for that fund, the *firm* must take credit for these future charges in calculating the *future policy related liabilities* for that fund.

**1.3.145** PRA G In calculating *future policy related liabilities* for a *with-profits fund*, a *firm* should take credit under ■ INSPRU 1.3.137 R (3) for the present value of the future "margins" available in respect of charges deducted to cover the costs of guarantees, options and smoothing. ■ INSPRU 1.3.188 R requires *firms* that accumulate the charges made less costs incurred to provide for any surplus on the experience account as a realistic liability. Any such provision should be made under ■ INSPRU 1.3.137 R (5), ■ INSPRU 1.3.137 R (7) or ■ INSPRU 1.3.137 R (8) depending on the nature of the charges made, and has no effect on the amount calculated under ■ INSPRU 1.3.144 R.

**Planned deductions for other costs deemed chargeable to the with-profits benefits reserve**

**1.3.146** PRA R Where a *firm* expects to deduct future charges (other than those valued in ■ INSPRU 1.3.144 R) from the *with-profits benefits reserve* for a *with-profits*

*fund*, the *firm* must take credit for these future charges in calculating the *future policy-related liabilities* for that fund.

1.3.147  
PRA

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A *firm* should take credit for the present value of the other future "margins" available. The circumstances where such margins may arise include:

- (1) where a *firm* is targeting *claims* at less than 100% of the *with-profits benefits reserve*, the amount of such shortfall; and
- (2) where a *firm* expects to deduct any future charges (other than those for guarantees, options and smoothing) from the *with-profits benefits reserve*.

**Future costs of contractual guarantees (other than financial options)...**

1.3.148  
PRA

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A *firm* must make provision for the costs of paying excess *claim* amounts for a *with-profits fund* where the *firm* expects that the amount in (1) may be greater than the amount in (2), calculated as at the date of *claim*:

- (1) the value of guarantees arising under a *policy* or group of *policies* in the fund; and
- (2) the fund's *with-profits benefits reserve* allocated in respect of that *policy* or group of *policies*.

1.3.149  
PRA

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For the purposes of ■ INSPRU 1.3.148 R, the future costs of guarantees cannot be negative.

1.3.150  
PRA

G

In carrying out projections to calculate the cost of guarantees under ■ INSPRU 1.3.137 R the opening liability should be set equal to the *with-profits benefit reserve* (see ■ INSPRU 1.3.118 R), adjusted for miscellaneous surplus or deficits (see ■ INSPRU 1.3.137 R (1)) and planned enhancements (see ■ INSPRU 1.3.141 R).

1.3.151  
PRA

G

In projecting forward the *with-profits benefits reserve*, adjusted as in ■ INSPRU 1.3.150 G, to the date of *claim* for the purposes of ■ INSPRU 1.3.148 R, the *firm* should use market consistent assumptions for the expected future *premium* and investment income (including realised and unrealised gains or losses), expenses and *claims*, any charges to be deducted, tax and any other item of income or outgo. This projection should be carried out on the same basis as is described in ■ INSPRU 1.3.130 R.

1.3.152  
PRA

G

■ INSPRU 1.3.169 R to ■ INSPRU 1.3.186 G contain further *rules* and *guidance* on the valuation of guarantees, options and smoothing.

1.3.153  
PRA

G

Some examples of contractual guarantees are:

- (1) for conventional *with-profits insurance contracts*, guaranteed sums assured and bonuses on death, maturity or retirement; and
- (2) for *accumulating with-profits policies*, guarantees at a point in time or guaranteed minimum bonus rates.

**Future costs of non-contractual commitments**

1.3.154  
FCA PRA

R

A *firm* must make provision for future costs in addition to those in ■ INSPRU 1.3.148 R where the *firm* expects to pay further amounts to meet non-contractual commitments to *customers* or pay other benefits that need to be provided to fulfil a *firm's* regulatory duty to treat its *customers* fairly.

1.3.155  
FCA PRA

G

Some examples of these non-contractual commitments are:

- (1) statements by the *firm* regarding the ability of *policies* to cover defined amounts, such as the repayment of a mortgage;
- (2) statements by the *firm* regarding regular withdrawals from a *policy* being without penalty;
- (3) guaranteed annuity and cash option rates being provided beyond the strict interpretation of the *policy*; and
- (4) the costs of any promises to *customers* or other benefits that need to be provided to fulfil a *firm's* regulatory duty to treat its *customers* fairly.

**Future costs of financial options**

1.3.156  
PRA

G

Financial options include guaranteed annuity and cash option rates.

1.3.157  
PRA

G

■ INSPRU 1.3.169 R to ■ INSPRU 1.3.186 G contain further *rules* and *guidance* on the valuation of options.

**Future costs of smoothing**

1.3.158  
PRA

R

A *firm* must make provision for future smoothing costs of a *with-profits fund* where the *firm* expects that the *claims* paid on a *policy* or group of *policies* in the fund will vary from the greater of:

- (1) the value of guarantees determined in ■ INSPRU 1.3.148 R in respect of that *policy* or group of *policies*; and
- (2) the fund's *with-profits benefits reserve* allocated in respect of that *policy* or group of *policies* which must be enhanced as described in ■ INSPRU 1.3.141 R;

calculated as at the date of claim.

1.3.159  
PRA

R

For the purposes of ■ INSPRU 1.3.158 R, smoothing costs are defined as the present value of the difference between projected *claims* and the projected *with-profits benefit reserve* after enhancements (■ INSPRU 1.3.141 R), other than payouts on guarantees (■ INSPRU 1.3.148 R).

1.3.160  
PRA

R

Subject to ■ INSPRU 1.3.188 R, the future costs of smoothing can be negative.

**1.3.161**  
**PRA**

**G**

■ INSPRU 1.3.169 R to ■ INSPRU 1.3.186 G contain further *rules* and *guidance* on the valuation of the future costs of smoothing.

**Financing costs**

**1.3.162**  
**PRA**

**R**

A *firm* must provide for future liabilities to repay financing costs of a *with-profits fund* where the *firm* expects to have to meet such liabilities and to the extent that these liabilities are not already provided for by amounts included in the fund's *realistic current liabilities* (■ INSPRU 1.3.190 R and ■ INSPRU 1.3.191 R). The amount of the liabilities to repay financing costs must be assessed on a market-consistent basis.

**1.3.163**  
**PRA**

**G**

In ■ INSPRU 1.3.162 R, financing costs refer to the future costs incurred by way of capital, interest and fees payable to the provider. A *firm* should make a realistic assessment of the requirement to repay such financing in its expected future circumstances (which may be worse than currently). Having taken account of its particular circumstances:

- (1) where a *firm* has no liability to repay such financing, it should not include such repayment as a liability;
- (2) where a *firm* has a reduced liability to repay such financing, it should include a reduced repayment as a liability.

**1.3.164**  
**PRA**

**G**

In ■ INSPRU 1.3.162 R, financing includes *reinsurance* financing arrangements and analogous non-*reinsurance* financing arrangements, such as contingent loans, securitisations and any other arrangements in respect of *contracts of insurance* that are analogous to contracts of *reinsurance* in terms of the risks transferred and the finance provided.

**Other long-term insurance liabilities**

**1.3.165**  
**PRA**

**R**

A *firm* must provide for any other *long-term insurance liabilities* arising from or in connection with *with-profits insurance contracts* in a *with-profits fund*, to the extent that adequate provision has not been made in the *with-profits benefits reserve* or in any other part of the *future policy related liabilities* for that fund.

**1.3.166**  
**PRA**

**G**

Some examples of these other long-term insurance liabilities are:

- (1) pension and other mis-selling reserves;
- (2) provisions for tax; and
- (3) provisions for future shareholder transfers.

**1.3.167**  
**PRA**

**G**

In determining the realistic liability for taxation *firms* should apply the general principles set out in ■ INSPRU 1.3.105 R and the *guidance* given in ■ INSPRU 1.3.107 G.

**1.3.168**  
**PRA**

**G**

■ INSPRU 1.3.105 R requires *firms* to provide for shareholder transfers out of the *with-profits fund* as a liability of the fund. The provision should be consistent with

the methods and assumptions used in valuing the other realistic liabilities. So, for example, where the *with-profits benefits reserve* includes amounts that would be paid to *policyholders* through future bonuses, provision should also be made for future shareholder transfers associated with those bonuses.

**Valuing the costs of guarantees, options and smoothing**

1.3.169  
PRA

**R**

For the purposes of ■ INSPRU 1.3.137 R (5), ■ INSPRU 1.3.137 R (7) and ■ INSPRU 1.3.137 R (8), a *firm* must calculate the costs of any guarantees, options and smoothing using one or more of the following three methods:

- (1) a stochastic approach using a market-consistent asset model ( ■ INSPRU 1.3.170 R);
- (2) using the market costs of hedging the guarantee or option;
- (3) a series of deterministic projections with attributed probabilities.

1.3.170  
PRA

**R**

The market-consistent asset model in ■ INSPRU 1.3.169 R (1):

- (1) means a model that delivers prices for assets and liabilities that can be directly verified from the market; and
- (2) must be calibrated to deliver market-consistent prices for those assets that reflect the nature and term of the *with-profits insurance liabilities* of the *with-profits fund*.

1.3.171  
PRA

**G**

Deterministic approaches will not usually capture the time value of the option generated by a guarantee. In order to calculate this value properly, *firms* are expected either to use market option values where these are readily available or to undertake a stochastic approach using a market-consistent asset model.

1.3.172  
PRA

**G**

The *PRA* considers stochastic modelling to be preferable for material groups or classes of *with-profits insurance contracts* unless it can be shown that more simplistic or alternative methods are both appropriate and sufficiently robust.

1.3.173  
PRA

**G**

Where the guarantee or option is relatively simple in nature, is capable of being hedged, and has a value unlikely to be affected by management actions (■ INSPRU 1.3.185 R) (for example, a guaranteed annuity rate option) then the cost of the guarantee or option would be the market cost of hedging the guarantee. Where that is generally the case but, in respect of a minor part of a portfolio, no market exists for hedging the option generated by the guarantee, a *firm* should take the value of the nearest equivalent benefit or right for which a market exists and record how it has adjusted the valuation to reflect the original option. Where the market value of the hedge is used *firms* should also make provisions for the credit risk arising from the hedge, both that arising from exposure to a *counterparty* and that arising from credit risk in the underlying instrument. The extent to which the guarantee or option is capable of being hedged depends on a *firm's* assumptions regarding future investment mix, persistency, annuitant mortality and take-up rates. While the *PRA* recognises that the hedge may not be perfectly matched to the underlying guarantee or option, a *firm* should ensure that hedge is reasonably well matched having regard to the sensitivity of the guarantee or option to the *firm's* choice of key assumptions.

1.3.174  
PRA

G

Where a *firm* has large cohorts of guarantees and uses stochastic or deterministic approaches, a *firm* should have regard to whether the cost of the guarantees determined under those approaches bears a reasonable relationship to the market cost of hedging those guarantees (where it exists).

1.3.175  
PRA

G

In determining the costs of smoothing, a *firm* should consider:

- (1) the consistency of its assumptions (including the exercise of management discretion over bonus rates); and
- (2) where targeted payouts currently exceed retrospective reserves in respect of those *claims*, the assumptions used in reducing the excess, if applicable, having regard to the *firm's* PPFM and its regulatory duty to treat its *customers* fairly.

**Stochastic approach**

1.3.176  
PRA

G

For the purposes of ■ INSPRU 1.3.169 R (1), a stochastic approach would consist of an appropriate market-consistent asset model for projections of asset prices and yields (such as equity prices, fixed interest yields and property yields), together with a dynamic model incorporating the corresponding value of liabilities and the impact of any foreseeable actions to be taken by management. Under the stochastic approach, the cost of the guarantee, option or smoothing would be equal to the average of these stochastic projections.

1.3.177  
PRA

G

In performing the projections of assets and liabilities under the stochastic approach in ■ INSPRU 1.3.169 R (1), a *firm* should have regard to the aspects in (1) and (2).

- (1) The projection term should be long enough to capture all material cash flows arising from the contract or groups of contracts being valued. If the projection term does not extend to the term of the last *policy*, the *firm* should check that the shorter projection term does not significantly affect the results.
- (2) The number of projections should be sufficient to ensure a reasonable degree of convergence in the results, including the determination of the result of the *risk capital margin*. The *firm* should test the sensitivity of the results to the number of projections.

1.3.178  
PRA

G

The PRA considers a holistic approach to stochastic modelling to be preferable so as to value all items of costs together rather than using separate methods for different items of the *realistic value of liabilities*. This approach requires the projection of all material cash flows arising under the contract or group of contracts for each stochastic projection, rather than only those arising from the guarantee or option within the contract. The advantages of this approach are that it ensures greater consistency in the valuation of different components of the contract and explicitly takes into account the underlying hedges or risk mitigation between components of the contract or group of contracts being valued. Where a *firm* can use a stochastic approach to value simultaneously all components of the contract or group of contracts, the *firm* should adopt this approach where practical and feasible.

1.3.179  
PRA

G

Where a stochastic approach is used, a *firm* should make and retain a record under ■ INSPRU 1.3.17 R of the nature of the asset model and of the assumptions used (including

the volatility of asset values and any assumed correlations between asset classes or between asset classes and economic indicators, such as inflation).

**1.3.180**  
**PRA**

**G**

In calibrating asset models for the purposes of ■ INSPRU 1.3.170 R, a *firm* should have regard to the aspects in (1), (2) and (3).

- (1) Few (if any) asset models can replicate all the observable *market values* for a wide range of asset classes. A *firm* should calibrate its asset models to reflect the nature and term of the fund's liabilities giving rise to significant guarantee and option costs.
- (2) A *firm* will need to apply judgement to determine suitable estimates of those parameters which cannot be implied from observable market prices (for example, long-term volatility). A *firm* should make and retain a record under ■ INSPRU 1.3.17 R of the choice of parameters and the reasons for their use.
- (3) A *firm* should calibrate the model to the current risk-free yield curve. Risk-free yields should be determined after allowing for credit and all other risks arising. *Firms* may have regard to any standards and guidance adopted or issued by the Board of Actuarial Standards on the calculation of the risk-free yield but should not assume a higher yield than suggested by any such standards and guidance.

**Deterministic approach**

**1.3.181**  
**PRA**

**R**

**For the purposes of the deterministic approach in ■ INSPRU 1.3.169 R (3), a *firm* must calculate a series of deterministic projections of the values of assets and corresponding liabilities, where each deterministic projection corresponds to a possible economic scenario or outcome.**

**1.3.182**  
**PRA**

**G**

A *firm* should determine a range of scenarios or outcomes appropriate to both valuing the costs of the guarantee, option or smoothing and the underlying asset mix, together with the associated probability of occurrence. These probabilities of occurrence should be weighted towards adverse scenarios to reflect market pricing for risk. The costs of the guarantee, option or smoothing should be equal to the expected cost based on a series of deterministic projections of the values of assets and corresponding liabilities. In using a series of deterministic projections, a *firm* should consider whether its approach provides a suitably robust estimate of the costs of the guarantee, option or smoothing.

**1.3.183**  
**PRA**

**G**

In performing the projections of assets and liabilities under the deterministic approach in ■ INSPRU 1.3.169 R (3), a *firm* should have regard to the aspects in (1) and (2).

- (1) The projection term should be long enough to capture all material cash flows arising from the contract or group of contracts being valued. If the projection term does not extend to the term of the last contract, the *firm* should check that the shorter projection term does not significantly affect the results.
- (2) The series of deterministic projections should be numerous enough to capture a wide range of possible outcomes and take into account the probability of each outcome's likelihood. The costs will be understated if only relatively benign or limited economic scenarios are considered.

1.3.184  
PRA

G

Where a series of deterministic projections is used, a *firm* should make and retain a record under ■ INSPRU 1.3.17 R of the range of projections and how the probabilities attributed to each projection or outcome were determined (including the period of reference for any relevant data on past experience).

**Management and policyholder actions**

1.3.185  
PRA

R

In calculating the costs of any guarantees, options or smoothing, a *firm*:

- (1) may reflect its prospective management actions (within the meaning of ■ INSPRU 1.3.53 R); and
- (2) must reflect a realistic assessment of the *policyholder* actions (within the meaning of ■ INSPRU 1.3.59 R);

in its projections of the value of assets and liabilities.

1.3.186  
PRA

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For the purposes of ■ INSPRU 1.3.185 R, the related *guidance* in ■ INSPRU 1.3.54 G to ■ INSPRU 1.3.57 G (management actions) and in ■ INSPRU 1.3.60 G (policyholder actions) applies.

**Treatment of surplus on guarantees, options and smoothing**

1.3.187  
PRA

R

■ INSPRU 1.3.188 R applies to *firms* calculating the costs of guarantees, options and smoothing to be included in the *future policy-related liabilities* in accordance with ■ INSPRU 1.3.137 R (5), ■ INSPRU 1.3.137 R (7) and ■ INSPRU 1.3.137 R (8).

1.3.188  
PRA

R

Where a *firm* accumulates past experience and deducts or is otherwise able to take credit for charges for guarantees or options or smoothing, the future costs of guarantees or options or smoothing (as appropriate) must not be less than the greater of:

- (1) the prospective calculation of the future cost of guarantees (see ■ INSPRU 1.3.148 R) or options (see ■ INSPRU 1.3.156 G) or smoothing (see ■ INSPRU 1.3.158 R) (as appropriate); and
- (2) the sum of:
  - (a) the accumulated charges (after deduction of past costs) for guarantees or options or smoothing (as appropriate); and
  - (b) the prospective calculation of the future charges deducted for guarantees or options or smoothing (see ■ INSPRU 1.3.144 R) (as appropriate).

1.3.189  
PRA

G

The extent to which the amount in ■ INSPRU 1.3.188 R (2) exceeds the amount in ■ INSPRU 1.3.188 R (1) will determine the surplus available to support actions that would be taken by the *firm's* management. The purpose of ■ INSPRU 1.3.188 R is to ensure that any resulting surplus at the valuation date arising from the accumulation of charges less costs remains available to support foreseeable actions that would be taken by the

*firm's* management. Any additional liability arising from ■ INSPRU 1.3.188 R is added to the liabilities under ■ INSPRU 1.3.137 R (5), ■ INSPRU 1.3.137 R (7) and ■ INSPRU 1.3.137 R (8), but has no impact on the adjustment for planned deductions for the costs of guarantees, options and smoothing ( ■ INSPRU 1.3.137 R (3) and ■ INSPRU 1.3.144 R).

**Realistic current liabilities**

1.3.190

PRA

R

For the purposes of ■ INSPRU 1.3.40 R (3), the *realistic current liabilities* of a *with-profits fund* are equal to the sum of the following amounts:

- (1) the *firm's* best estimate provision for those liabilities for which prudent provision is made in *regulatory current liabilities* (see ■ INSPRU 1.3.30 R); and
- (2) to the extent that amounts have not been provided in (1), any tax and any other costs arising either in respect of excess *admissible assets* (within the meaning of ■ INSPRU 1.3.36 R) or on the recognition of future shareholder transfers.

1.3.191

PRA

R

For the purpose of assessing the best estimate provision to be made under ■ INSPRU 1.3.190 R (1) in respect of a *defined benefit occupational pension scheme*, a *firm* must use either its *defined benefit liability* or its *deficit reduction amount*, consistent with the *firm's* election under INSPRU 1.3.5BR(2).

## 1.4 Equalisation provisions

### Application

1.4.1  
PRA

**R** ■ INSPRU 1.4 applies to an *insurer* carrying on *general insurance business* unless it is:

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*.

1.4.2  
PRA

**G** The scope of ■ INSPRU 1.4.11 R to ■ INSPRU 1.4.37 G (non-credit equalisation provisions) is not restricted to *firms* subject to the relevant *EU* directives.

1.4.3  
PRA

**G** The requirements of this section apply to a *firm* on a solo basis.

1.4.4  
PRA

**G** This section sets out *rules* and *guidance* on the calculation of the amount of the *equalisation provisions* that are required to be maintained by *firms* that carry on non-credit *insurance business* or credit *insurance business*.

1.4.5  
PRA

**G** *Credit* or *non-credit equalisation provisions* form part of the *technical provisions* that a *firm* is required to establish under ■ INSPRU 1.1.12 R (1). They help to smooth fluctuations in loss ratios in future years for business where *claims* in any future year may be subject to significant deviation from recent or average *claims* experience, or where trends in experience may be subject to change. Such volatile *claims* experience might arise in the case, for example, of insurance against losses caused by major catastrophes such as hurricanes or earthquakes.

1.4.6  
PRA

**G** In general terms, ■ INSPRU 1.4 sets out *rules* and *guidance* as to:

- (1) the circumstances in which a *firm* is required to maintain *equalisation provisions*;
- (2) the methods to be used in calculating the amount of each provision;

(3) the geographical location of the business relevant to certain calculations for different types of *firm* - this is summarised in the Table in ■ INSPRU 1.4.7 G.

1.4.7  
PRA

G

**Table: Scope of *insurance business* to be included in calculations**

Type Of Firm	Credit Equalisation Provision		Non Credit Equalisation Provision
	Threshold in IN-SPRU 1.4.4 G	Provision in IN-SPRU 1.4.43 R	Threshold in IN-SPRU 1.4.18 R (2) and provision in INSPRU 1.4.17 R
<i>UK insurer</i>	World-wide	World-wide	World-wide
<i>Pure reinsurer with head office outside United Kingdom</i>	UK	World-wide	UK
<i>Pure reinsurer with head office in United Kingdom</i>	World-wide	World-wide	World-wide
<i>Non-EEA direct insurers</i>	<i>EEA-deposit insurer</i> UK	UK	UK
	<i>Swiss general insurer</i> UK	UK	UK
	<i>UK-deposit insurer</i> All EEA	World-wide	UK
	<i>All other non-EEA direct insurers</i> UK	World-wide	UK

1.4.8  
PRA

G

The *First Non-Life Directive* (as amended) and the *Reinsurance Directive* require the calculation of *credit equalisation provisions*. *Non-credit equalisation provisions* are a domestic *United Kingdom* requirement. For insurance regulatory purposes under *EU Directives*, *credit equalisation provisions* are classified as liabilities.

1.4.9  
PRA

G

However, *firms* are permitted to include *equalisation provisions* within their financial resources when demonstrating compliance with non-Directive capital requirements. Hence *equalisation provisions* are deducted from the available *capital resources* of a *firm* for the purpose of meeting its *minimum capital requirement* for *general insurance business*; but, in the calculation of a *firm's enhanced capital requirement* for *general insurance business* under ■ INSPRU 1.1.72C R, its *equalisation provisions* (if any) are added back to its *capital resources*.

1.4.10  
PRA

G

Under International Accounting Standards (IAS), which will apply to the financial statements of some *insurers* from 2005, there will be no requirement to treat *equalisation provisions* as liabilities in *insurers'* published financial statements. However, they will continue to be treated as liabilities for the purposes of demonstrating compliance with Directive capital requirements.

1.4.11

PRA

**R**

**Non-credit equalisation provision**

Firms carrying on non-credit insurance business

- (1) ■ INSPRU 1.4.11 R to ■ INSPRU 1.4.37 G apply to any *firm*, other than an *assessable mutual*, which carries on the business of *effecting* or *carrying out general insurance contracts* falling within any description in column 2 in Table ■ INSPRU 1.4.12 R ("*non-credit insurance business*").
- (2) A *firm* falling within (1) must classify all of its non-credit *insurance business* into separate *insurance business groupings*, as specified in Table ■ INSPRU 1.4.12 R.

1.4.12

PRA

**R**

**Table : Groupings of non-credit *insurance business***

<i>Insurance Business Grouping</i>	<i>General Insurance Contracts</i>
<p><b>A</b></p> <p><i>Contracts of insurance which fall within general insurance business classes 4, 8 or 9, other than:</i></p> <ul style="list-style-type: none"> <li>(a) <i>contracts of insurance under non-proportional reinsurance treaties; and</i></li> <li>(b) <i>contracts of insurance against nuclear risks</i></li> </ul>	
<p><b>B</b></p> <p><i>Contracts of insurance which fall within general insurance business class 16(a), other than:</i></p> <ul style="list-style-type: none"> <li>(a) <i>contracts of insurance under non-proportional reinsurance treaties; and</i></li> <li>(b) <i>contracts of insurance against nuclear risks</i></li> </ul>	
<p><b>C</b></p> <p><i>Contracts of insurance which fall within general insurance business classes 5, 6, 11 or 12, other than:</i></p> <ul style="list-style-type: none"> <li>(a) <i>contracts of insurance against nuclear risks; and</i></li> </ul>	

<i>Insurance Business Grouping</i>	General Insurance Contracts
(b)	<i>reinsurance contracts corresponding to contracts in (a).</i>
<b>D</b>	<i>Contracts of insurance against nuclear risks.</i>
<b>E</b>	<i>Contracts of insurance under non-proportional reinsurance treaties and which fall within general insurance business classes 4, 8, 9 or 16(a) other than contracts of insurance against nuclear risks.</i>

**1.4.13** PRA R For the purposes of ■ INSPRU 1.4.11 R to ■ INSPRU 1.4.37 G, a *firm* with its head office in the *United Kingdom* must take account of non-credit *insurance business* carried on by it world-wide.

**1.4.14** PRA R For the purposes of ■ INSPRU 1.4.11 R to ■ INSPRU 1.4.37 G, a *firm* with its head office outside the *United Kingdom* need only take account of non-credit *insurance business* carried on by it from a *branch* in the *United Kingdom*.

**1.4.15** PRA G The *insurers* affected by ■ INSPRU 1.4.11 R include pure reinsurers, UK-deposit insurers, EEA-deposit insurer, and Swiss general insurers.

**1.4.16** PRA G For *insurers* (including *pure reinsurers*) with a head office in the *United Kingdom*, the calculations must be made in respect of world-wide business.

**Requirement to maintain non-credit equalisation provision**.....

**1.4.17** PRA R In respect of each *financial year*, a *firm* must, unless ■ INSPRU 1.4.18 R applies:

- (1) calculate the amount of its *non-credit equalisation provision* as at the end of that year in accordance with ■ INSPRU 1.4.20 R; and
- (2) maintain a *non-credit equalisation provision* calculated in accordance with ■ INSPRU 1.4.20 R for the following *financial year*.

**1.4.18** PRA R (1) ■ INSPRU 1.4.17 R does not apply to any *firm* in respect of any *financial year* if, as at the end of that year:

- (a) no *non-credit equalisation provision* has been brought forward from the preceding *financial year*; and
  - (b) the amount of the *annualised net written premiums* for all the non-credit *insurance business* carried on by it in the *financial year* is less than the threshold amount.
- (2) The threshold amount in respect of any *financial year* is the higher of:
- (a) 1,500,000 Euro; and
  - (b) 4% of *net written premiums* in that *financial year* in respect of all its *general insurance business*, if this amount is less than 2,500,000 Euro.

1.4.19

PRA

G

For *non-EEA insurers*, the calculation of the threshold amount in ■ INSPRU 1.4.18 R (2) is limited by ■ INSPRU 1.4.14 R to the business of the *firm* carried on in the *United Kingdom*. Such a *firm* may do little *UK non-credit insurance business*, and so would not be required to set up a *non-credit equalisation provision* under ■ INSPRU 1.4, but may do significant business outside the *United Kingdom* characterised by high-impact, low-frequency *claims*. Such a *firm* is required by ■ INSPRU 1.5.41 R to hold adequate world-wide financial resources to avoid internal-contagion strain on the *branch* in the *United Kingdom*. In determining the adequacy of its financial resources, the *firm* should undertake stress and scenario testing of its underwriting and other risks as set out in ■ GENPRU 1.2.

**Calculating the amount of the provision**

1.4.20

PRA

R

- (1) Unless ■ INSPRU 1.4.22 R applies, the amount of a *firm's non-credit equalisation provision* as at the end of a *financial year* is the higher of:
- (a) zero; and
  - (b) whichever is the lower of:
    - (i) the aggregate of the amounts of the maximum provision for each *insurance business grouping* as at the end of that *financial year*; and
    - (ii) the sum of A and B.
- (2) For the purposes of (1)(b)(ii):
- (a) A is the amount of the *non-credit equalisation provision*, if any, brought forward from the *financial year* immediately preceding that in respect of which the calculation is being performed; and
  - (b) B is:

- (i) the aggregate of the amounts of the provisional transfers-in for each *insurance business grouping*; minus
  - (ii) the aggregate of the amounts of the provisional transfers-out for each *insurance business grouping*.
- (3) For any *insurance business grouping*:
- (a) the amount of the maximum provision in (1)(b)(i) is to be determined in accordance with ■ INSPRU 1.4.24 R;
  - (b) the amount of the provisional transfers-in in (2)(b)(i) is to be determined in accordance with ■ INSPRU 1.4.26 R; and
  - (c) the amount of the provisional transfers-out in (2)(b)(ii) is to be determined in accordance with ■ INSPRU 1.4.29 R.

1.4.21

PRA

G

If provisional transfers-out are in excess of provisional transfers-in, the *non-credit equalisation provision* as calculated in accordance with ■ INSPRU 1.4.20 R in respect of a particular *financial year* may be less than that calculated for the preceding *financial year* although, by virtue of ■ INSPRU 1.4.20 R (1)(a), it cannot be negative.

1.4.22

PRA

R

- (1) The amount of a *firm's non-credit equalisation provision* as at the end of a *financial year* is zero if:
- (a) as at the end of that year, the *firm* meets either of the conditions specified in (2) and (3); and
  - (b) the *annualised net written premiums* for all the non-credit *insurance business* carried on by the *firm* in that year are less than the threshold amount.
- (2) The first condition is that the *firm* carried on non-credit *insurance business* in the first *financial year* of the relevant period and, for each of any two or more *financial years* of that period, the *annualised net written premiums* for business of that description were less than the threshold amount.
- (3) The second condition is that the *firm* did not carry on non-credit *insurance business* in the first *financial year* of the relevant period and the average of the *annualised net written premiums* for business of that description carried on by the *firm* in each *financial year* of the relevant period was less than the threshold amount.
- (4) For the purposes of this *rule*:
- (a) the threshold amount is the amount determined in accordance with ■ INSPRU 1.4.18 R (2); and
  - (b) the relevant period is the period of four *financial years* ending immediately before the beginning of the *financial year* in (1).

1.4.23  
PRA

G

If ■ INSPRU 1.4.22 R applies, a *firm* may need to make sufficient transfers from its *non-credit equalisation provision* to bring the *non-credit equalisation provision* for that *financial year* to zero.

**The calculation: the maximum provision**

1.4.24  
PRA

R

- (1) For the purposes of the calculation required by ■ INSPRU 1.4.20 R, the amount of the maximum provision for any *insurance business grouping* is to be determined in accordance with (2) to (5).
- (2) Unless (4) applies, the amount of the maximum provision for the grouping, as at the end of a *financial year*, is the amount determined by multiplying X and Y.
- (3) For the purposes of (2):
  - (a) X is the percentage specified in Table ■ INSPRU 1.4.25 R in relation to the grouping; and
  - (b) Y is the average of the amount of the *annualised net written premiums* for non-credit *insurance business* in the grouping carried on by the *firm* in each *financial year* of the relevant period.
- (4) Where Y is a negative amount, the maximum provision for that *insurance business grouping* is zero.
- (5) For the purposes of (3)(b), the relevant period is the five-year period comprising:
  - (a) the *financial year* in (2); and
  - (b) the previous four *financial years*.

1.4.25  
PRA

R

Table : Calculation of maximum provision for any *insurance business grouping*

Insurance Business Grouping	Percentage of average annualised net written premiums
A	20
B	20
C	40
D	600
E	75

1.4.26  
PRA

**R**

**The calculation: provisional transfers-in**

- (1) For the purposes of the calculation required by ■ INSPRU 1.4.20 R, the amount of the provisional transfers-in for any *insurance business grouping* is to be determined in accordance with (2).
- (2) The amount of the provisional transfers-in for the grouping, as at the end of a *financial year*, is the amount determined by multiplying X and Y.
- (3) For the purposes of (2):
  - (a) X is the percentage specified in Table ■ INSPRU 1.4.27 R in relation to the grouping; and
  - (b) Y is the amount of the *net written premiums* for non-credit *insurance business* in the grouping that was carried on by the *firm* in the *financial year* in (2), including adjustments in respect of previous *financial years*.

1.4.27  
PRA

**R**

Table : Provisional transfers-in for any *insurance business grouping*

Insurance Business Grouping	Percentage of net written premiums
A	3
B	3
C	6
D	75
E	11

1.4.28  
PRA

**G**

Since each *insurance business grouping* should be assessed individually, negative *net written premiums* in relation to any *insurance business grouping* should be transferred in to the *non-credit equalisation provision*.

**The calculation: provisional transfers-out**

1.4.29  
PRA

**R**

- (1) For the purposes of the calculation required by ■ INSPRU 1.4.20 R, the amount of the provisional transfers-out for any *insurance business grouping* is to be determined in accordance with (2).
- (2) The amount of the provisional transfers-out for the grouping, as at the end of a *financial year*, is the lower of:
  - (a) the amount of the maximum provision for the grouping under ■ INSPRU 1.4.24 R for that *financial year*; and
  - (b) the abnormal loss for the grouping under ■ INSPRU 1.4.30 R for that *financial year*.

1.4.30

PRA

**R** For each *insurance business grouping*, the abnormal loss as at the end of a *financial year* in relation to which an *equalisation provision* is calculated is:

- (1) (for business within the *insurance business grouping* accounted for on an accident year basis) the amount, if any, by which the amount of net *claims* incurred exceeds the greater of:
  - (a) zero; and
  - (b) the percentage of *net earned premiums* in that *financial year* specified in the Table in ■ **INSPRU 1.4.31 R**; or
  
- (2) (for business within the *insurance business grouping* accounted for on an underwriting year basis) the amount, if any, by which the amount of net *claims* paid (plus adjustment for change in net *technical provisions*, other than any change in provisions for *claims* handling expenses or equalisation) exceeds the greater of:
  - (a) zero; and
  - (b) the percentage of *net written premiums* in that *financial year* specified in the Table in ■ **INSPRU 1.4.31 R**.

1.4.31

PRA

**R** Table : Abnormal loss for any *insurance business grouping*

Insurance Business Grouping	Percentage of net written premiums
A	72.5
B	72.5
C	95
D	25
E	100

**Adjustments to calculations**

1.4.32

PRA

**R** Transfers of business from the firm

- (1) This *rule* applies to modify the application of ■ **INSPRU 1.4.24 R** and ■ **INSPRU 1.4.26 R** in any case where a *firm* has transferred to another *undertaking* any rights and obligations under *general insurance contracts* falling within any *insurance business grouping*.
  
- (2) As at the end of the *financial year* in which the transfer takes place, *net written premiums* in respect of the transferred contracts in any grouping must be deducted from total *net written premiums* for that grouping before calculating the

maximum provision under ■ INSPRU 1.4.24 R or provisional transfers-in under ■ INSPRU 1.4.26 R.

1.4.33  
PRA

**R** If all the rights and obligations of a *firm* in relation to non-credit *insurance business* in any *insurance business grouping* have been transferred, the maximum provision for the grouping under ■ INSPRU 1.4.24 R is zero.

**Transfers of business to the firm**

1.4.34  
PRA

**R** (1) This rule applies to modify the application of ■ INSPRU 1.4.24 R, ■ INSPRU 1.4.26 R and ■ INSPRU 1.4.29 R in any case where another *undertaking* has transferred to a *firm* any rights and obligations under *general insurance contracts* falling within any *insurance business grouping*.

(2) As at the end of the *financial year* in which the transfer takes place a sum equal to that part of the consideration for the transfer that relates to business in an *insurance business grouping* must be:

- (a) excluded from *net written premiums* before performing the calculations required by ■ INSPRU 1.4.24 R (maximum provision) and ■ INSPRU 1.4.26 R (provisional transfers in);
- (b) included in *net premiums* (written or earned) before performing the calculation required by ■ INSPRU 1.4.30 R (abnormal loss); and
- (c) excluded from *net claims* (paid or incurred) before performing the calculation required by ■ INSPRU 1.4.30 R (abnormal loss).

1.4.35  
PRA

**G** For the purposes of ■ INSPRU 1.4.34 R, the consideration payable should be apportioned between *insurance business groupings* according to the groupings within which the *general insurance contracts* which are the subject of the acquisition fall. In appropriate cases, apportionment may reflect the split of liabilities acquired, including *unearned premium*.

1.4.36  
PRA

**G** Where business is accounted for on an accounting year basis, in any year following the transfer, *net earned premiums* must include an appropriate amount in respect of the transfer.

1.4.37  
PRA

**G** ■ INSPRU 1.4.32 R to ■ INSPRU 1.4.34 R apply to transfers by way of transfer under Part VII of the *Act* and by novation.

**Credit equalisation provisions**

1.4.38  
PRA

**R** Firms carrying on credit insurance business

■ INSPRU 1.4.39 R to ■ INSPRU 1.4.47 G apply to any *firm* which carries on the business of *effecting* or *carrying out general insurance contracts* falling within *general insurance business class 14* (which business is referred to in ■ INSPRU 1.4 as "*credit insurance business*"), unless it is:

- (1) a *non-directive insurer*; or
- (2) a *pure reinsurer* which became a *firm in run-off* before 31 December 2006 and whose *Part 4A permission* has not subsequently been varied to add back the *regulated activity of effecting contracts of insurance*.

1.4.39  
PRA

**R** For the purposes of ■ INSPRU 1.4.43 R and ■ INSPRU 1.4.44 R, a *firm* whose head office is in the *United Kingdom* must take account of the credit *insurance business* carried on by it world-wide.

1.4.40  
PRA

- R**
- (1) For the purposes of ■ INSPRU 1.4.43 R:
    - (a) a *Swiss general insurer* or an *EEA-deposit insurer* must take account of the credit *insurance business* carried on by it in the *United Kingdom*; and
    - (b) any other *firm* whose head office is outside the *United Kingdom* (including a *UK-deposit insurer*) must take account of the credit *insurance business* carried on by it world-wide.

- (2) For the purposes of ■ INSPRU 1.4.44 R:
  - (a) a *UK-deposit insurer* need only take account of the credit *insurance business* carried on by it in all *EEA States*, taken together; and
  - (b) any other *firm* whose head office is outside the *United Kingdom* (including an *EEA-deposit insurer* and a *Swiss general insurer*) need only take account of the credit *insurance business* carried on by it in the *United Kingdom*.

1.4.41  
PRA

**G** For *firms* whose head office is in the *United Kingdom* both calculations must be made in respect of world-wide business.

1.4.42  
PRA

**G** The requirements of ■ INSPRU 1.4.39 R and ■ INSPRU 1.4.40 R are summarised in the table in ■ INSPRU 1.4.7 G.

**Requirement to maintain credit equalisation provision**

1.4.43  
PRA

**R** In respect of each *financial year*, a *firm* must, unless ■ INSPRU 1.4.44 R applies:

- (1) calculate the amount of its *credit equalisation provision* as at the end of that year in accordance with ■ INSPRU 1.4.45 R; and
- (2) maintain a *credit equalisation provision* calculated in accordance with ■ INSPRU 1.4.45 R for the following *financial year*.

1.4.44

PRA

R

■ INSPRU 1.4.43 R does not apply to a *firm* in respect of any *financial year* if, as at the end of that year, the *annualised net written premiums* for its credit *insurance business* are less than 4% of annualised *net written premiums* in that *financial year* in respect of all its *general insurance business*, if this amount is less than 2,500,000 Euro.

**Calculating the amount of the provision**

1.4.45

PRA

R

(1) The amount of a *firm's credit equalisation provision* as at the end of a *financial year* ("*financial year A*") is the higher of:

(a) zero; and

(b) whichever is the lower of:

(i) 150% of the highest amount of *net written premiums* for credit *insurance business* carried on by the *firm* in *financial year A* or in any of the previous four *financial years*; and

(ii) the amount of the *credit equalisation provision* brought forward from the preceding *financial year*, after making either of the adjustments in (2).

(2) The adjustments are:

(a) the deduction of the amount of any technical deficit arising in *financial year A*; or

(b) the addition of the lower of:

(i) 75% of the amount of any technical surplus arising in *financial year A*; and

(ii) 12% of the amount of the *net written premiums* for credit *insurance business* carried on by the *firm* in *financial year A*.

(3) For the purposes of (2) the amount of technical deficit or technical surplus is to be determined in accordance with ■ INSPRU 1.4.46 R.

1.4.46

PRA

R

For the purposes of the adjustments in ■ INSPRU 1.4.45 R (2), technical surplus (or technical deficit) in respect of credit *insurance business* is the amount by which the aggregate of *net earned premiums* and other technical income exceeds (or falls short of) the sum of net *claims* incurred, *claims management costs* and any technical charges.

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1.4.47

PRA

G

The calculation of technical surplus or technical deficit should be made before tax and before any transfer to or from the *credit equalisation provision*. Investment income should not be included in these calculations.

1.4.48  
PRA

**R**

**Euro conversion**

For the purposes of ■ INSPRU 1.4, the exchange rate from the Euro to the pound sterling for each year beginning on 31 December is the rate applicable on the last day of the preceding October for which the exchange rates for the currencies of all the European Union member states were published in the Official Journal of the European Union.

1.4.49  
PRA

**R**

**Application of INSPRU 1.4 to Lloyd's**

■ INSPRU 1.4 applies to the *Society* in accordance with ■ INSPRU 8.1.2 R:

- (1) with the modification set out in ■ INSPRU 1.4.50 R; and
- (2) except ■ INSPRU 1.4.11 R to ■ INSPRU 1.4.37 G.

1.4.50  
PRA

**R**

The *Society* must calculate a *credit equalisation provision* for the aggregate *insurance business* of all *members*; it is not required to calculate a *credit equalisation provision* separately for the business of each *member*.

1.4.51  
PRA

**R**

The *Society* must allocate the result of ■ INSPRU 1.4.50 R between itself and each of the *members* on a fair and reasonable basis.

1.5 Internal-contagion risk

Application

1.5.1

R

■ INSPRU 1.5 applies to an *insurer*.

FCA PRA

1.5.2

R

■ INSPRU 1.5 does not apply, to the extent stated, to any *insurer* in (1) to (4):

PRA

- (1) none of the provisions apply to *non-directive friendly societies*;
- (2) none of the provisions apply to *firms* which qualify for authorisation under Schedule 3 or 4 of the *Act*;
- (3) [deleted]
- (4) ■ INSPRU 1.5.41 R to ■ INSPRU 1.5.57 R (*UK branches of certain non-EEA insurers*) do not apply to:
  - (a) *UK insurers*; or
  - (b) *non-EEA insurers* whose *insurance business* in the *United Kingdom* is restricted to *reinsurance*; or
  - (c) *EEA-deposit insurers*; or
  - (d) *Swiss general insurers*.

1.5.2A

R

■ INSPRU 1.5 does not apply, to the extent stated, to any *insurer* in ■ (1) to ■ (3):

FCA

- (1) none of the provisions apply to *non-directive friendly societies*;
- (2) none of the provisions, apart from ■ INSPRU 1.5.33 R (payment of financial penalties) apply to *firms* which qualify for authorisation under Schedule 3 or 4 of the *Act*;
- (3) ■ INSPRU 1.5.33 R (payment of financial penalties) does not apply to *mutuals*.

<p><b>1.5.3</b> FCA PRA</p>	<p><b>G</b></p>	<p>The scope of application of ■ INSPRU 1.5 is not restricted to <i>firms</i> that are subject to the relevant <i>EU</i> directives.</p>
<p><b>1.5.4</b> FCA PRA</p>	<p><b>R</b></p>	<p>In its application to a <i>firm</i> with its head office in the <i>United Kingdom</i>, this section applies to the whole of the <i>firm's</i> business carried on world-wide.</p>
<p><b>1.5.5</b> PRA</p>	<p><b>R</b></p>	<p>In the application of this section to activities carried on by a <i>non-EEA insurer</i>:</p> <ol style="list-style-type: none"> <li>(1) ■ INSPRU 1.5.13 R to ■ INSPRU 1.5.15 G and ■ INSPRU 1.5.41 R apply in relation to the whole of its business carried on world-wide;</li> <li>(2) all other provisions of this section apply only in relation to:             <ol style="list-style-type: none"> <li>(a) in the case of any <i>UK-deposit insurer</i>, activities carried on from <i>branches</i> in any <i>EEA State</i>; and</li> <li>(b) in any other case, activities carried on from a <i>branch</i> in the <i>United Kingdom</i>.</li> </ol> </li> </ol>
<p><b>1.5.5A</b> FCA</p>	<p><b>R</b></p>	<p>In the application of this section to activities carried on by a <i>non-EEA insurer</i>:</p> <ol style="list-style-type: none"> <li>(1) ■ INSPRU 1.5.13 R to ■ INSPRU 1.5.13B G apply in relation to the whole of its business carried on world-wide;</li> <li>(2) all other provisions of this section apply only in relation to:             <ol style="list-style-type: none"> <li>(a) in the case of any <i>UK-deposit insurer</i>, activities carried on from <i>branches</i> in any <i>EEA State</i>; and</li> <li>(b) in any other case, activities carried on from a <i>branch</i> in the <i>United Kingdom</i>.</li> </ol> </li> </ol>
<p><b>1.5.6</b> PRA</p>	<p><b>G</b></p>	<p>The adequacy of a <i>firm's</i> financial resources needs to be assessed in relation to all the activities of the <i>firm</i> and the risks to which they give rise.</p>
<p><b>1.5.7</b> FCA PRA</p>	<p><b>G</b></p>	<p>The requirements of this section apply to a <i>firm</i> on a solo basis.</p>
<p><b>1.5.8</b> FCA PRA</p>	<p><b>G</b></p>	<p><b>Purpose</b> .....</p> <p>This section sets out requirements for a <i>firm</i> relating to 'internal-contagion risk'. This is the risk that losses or liabilities from one activity might deplete or divert financial resources held to meet liabilities from another activity. It arises where the two activities are carried on within the same <i>firm</i>. It may also arise from the combination of activities within the same <i>group</i>, but this aspect of internal-contagion risk falls outside the scope of this section. Requirements relevant to <i>group</i> contagion risk are set out in ■ INSPRU 6.</p>

**1.5.9** FCA PRA G Internal-contagion risk includes in particular the risk that arises where a *firm* carries on:

- (1) both insurance and non-insurance activities; or
- (2) two or more different types of insurance activity; or
- (3) insurance activities from offices or *branches* located in both the *United Kingdom* and overseas.

**1.5.10** FCA PRA G This section requires *firms* other than *pure reinsurers* to limit non-insurance activities to those that directly arise from their *insurance business*, e.g. investing assets, employing insurance staff etc. It also requires that an adequate provision be established for non-insurance liabilities. *pure reinsurers* must limit their activities to the business of *reinsurance* and related operations.

**1.5.11** FCA PRA G This section also sets out requirements for the separation of different types of insurance activity. However, in most circumstances the combination of different types of insurance activity within the same *firm* is a source of strength. Adequate pooling and diversification of insurance risk is fundamental to sound business practice. The requirements, therefore, only apply in two specific cases where without adequate protection the combination might operate to the detriment of *policyholders*. They apply where a *firm* carries on both:

- (1) *general insurance business* and *long-term insurance business*;
- (2) linked and non-linked *insurance business*.

**1.5.12** FCA PRA G Finally, the section sets out requirements to protect *policyholders* of *branches* of non-EEA *firms* where these are supervised by the *appropriate regulator*. These apply only to a non-EEA *firm* that has established a *branch* in the *United Kingdom*.

**Requirements: Non-insurance activities**

**Restriction of business**

**1.5.13** FCA PRA R (1) A *firm* other than a *pure reinsurer* must not carry on any commercial business other than *insurance business* and activities directly arising from that business.

(2) (1) does not prevent a *friendly society* which was on 15 March 1979 carrying on *long-term insurance business* from continuing to carry on savings business.

**1.5.13A** FCA PRA R A *pure reinsurer* must not carry on any business other than the business of *reinsurance* and related operations.

**1.5.13B** FCA PRA G In ■ INSPRU 1.5.13A R related operations include, for example, activities such as provision of statistical or actuarial advice, risk analysis or research for its clients. It may also include a *holding company* function and activities with respect to financial sector activities within the meaning of Article 2, point 8, of the *Financial Groups Directive*. But it does not allow the carrying on of, for example, unrelated banking and financial activities.

1.5.14  
PRA

R

**Financial limitation of non-insurance activities**

A *firm* must limit, manage and control its non-insurance activities so that there is no significant risk arising from those activities that it may be unable to meet its liabilities as they fall due.

1.5.15  
PRA

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For the purpose of ■ INSPRU 1.5.14 R a *firm* should consider how the financial impact of non-insurance activities might diverge from expectations. However, it need only take into account unexpected variations in amount and timing in so far as they are reasonably possible and may take into account effective mitigating factors.

**Requirements: long-term insurance business**

1.5.16  
FCA PRA

G

■ INSPRU 1.5.18 R, ■ INSPRU 1.5.21 R, ■ INSPRU 1.5.30 R and ■ INSPRU 1.5.31 R require a *firm* to identify the assets attributable to the receipts of the *long-term insurance business*, called *long-term insurance assets*, and only to apply those assets for the purpose of that business. This has the effect of prohibiting a *composite firm* from using *long-term insurance assets* to meet *general insurance liabilities*. It also keeps *long-term insurance assets* separate from shareholder funds.

**Permissions not to include both types of insurance**

1.5.17  
FCA PRA

G

- (1) Under section 19 of the *Act*, a *firm* may not carry on a *regulated activity* unless it has *permission* to do so (or is exempt in relation to the particular activity). Both *general insurance business* and *long-term insurance business* are *regulated activities* and *permission* will extend to the *effecting* or *carrying out* of one or more particular *classes of contracts of insurance*.
- (2) A *firm's permission* can be varied so as to add other *classes*. The *permission* of an existing *composite firm* may be varied by adding *classes* of both *general insurance business* and *long-term insurance business*.
- (3) It is the policy of the *appropriate regulator*, in compliance with *EU* directives on insurance, not to grant or vary *permission* if that would allow a newly established *firm*, or an existing *firm* engaging solely in *general insurance business* or solely in *long-term insurance business*, to engage in both *general insurance business* and *long-term insurance business*. This does not apply where a *firm's permission* to carry on *long-term insurance business* is or is to be restricted to *reinsurance*. It also does not apply where a *firm's permission* to carry on *general insurance business* is or is to be restricted to *effecting* or *carrying out* *accident* or *sickness contracts of insurance* (see article 18(2) of the *Consolidated Life Directive*).
- (4) Where a *firm's permission* extends to *effecting* or *carrying out* *life and annuity contracts of insurance* this will normally include *permission* to *effect* or *carry out* *accident contracts of insurance* or *sickness contracts of insurance* on a supplementary basis (see article 2(1)(c) of the *Consolidated Life Directive*).

**Separately identify and maintain long term insurance assets**

1.5.18

FCA PRA

R

A firm carrying on long-term insurance business must identify the assets relating to its long-term insurance business which it is required to hold by virtue of :

- (1) in the case of a pure reinsurer:
  - (a) ■ INSPRU 1.1.20 R or ■ INSPRU 1.1.21 R; and
  - (b) ■ INSPRU 3.1.61A R; and
- (2) in any other case:
  - (a) ■ INSPRU 1.1.20 R or ■ INSPRU 1.1.21 R; and
  - (b) ■ INSPRU 3.1.57 R and ■ INSPRU 3.1.58 R.

1.5.19

FCA PRA

G

- (1) ■ INSPRU 1.1.16 R requires a firm to establish adequate technical provisions for its long-term insurance contracts. ■ INSPRU 1.1.20 R requires a firm which is not a composite firm to hold admissible assets of a value at least equal to the amount of the technical provisions and its other long-term insurance liabilities. ■ INSPRU 1.1.21 R ensures that a composite firm identifies separate admissible assets with a value at least equal to the technical provisions for long-term insurance business and its other long-term insurance liabilities as well as holding other admissible assets of a value at least equal to the amount of its technical provisions for general insurance business and its other general insurance liabilities.
- (2) In the case of a firm carrying on long-term insurance business which is not a pure reinsurer, there are excluded from the scope of ■ INSPRU 1.1.20 R and ■ INSPRU 1.1.21 R property-linked liabilities and index-linked liabilities and the assets held to cover them under ■ INSPRU 3.1.57 R and ■ INSPRU 3.1.58 R. The latter two rules do not apply to a pure reinsurer (see ■ INSPRU 3.1.58A R). However, a pure reinsurer is required by ■ INSPRU 3.1.61A R to invest all its assets in accordance with the requirements of that rule.
- (3) The overall impact of these provisions in ■ INSPRU 1.1 and ■ INSPRU 3.1, when read together with ■ INSPRU 1.5.18 R, is that any firm writing long-term insurance business must identify separately assets of a value at least equal to the amount of its long-term insurance business technical provisions, including those in respect of any property-linked liabilities or index-linked liabilities, and its other long-term insurance liabilities.

1.5.20

FCA PRA

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■ INSPRU 1.5.18 R does not prohibit a firm from identifying other assets as being available to meet the liabilities of its long-term insurance business. It may transfer such other assets to a long-term insurance fund (see ■ INSPRU 1.5.21 R and ■ INSPRU 1.5.22 R ) and the transfer will take effect when it is recorded in the firm's accounting records (see ■ INSPRU 1.5.23 R). After the transfer takes effect, a firm may not transfer the assets out of a long-term insurance fund except where they represent an established surplus (see ■ INSPRU 1.5.27 R).

1.5.21

FCA PRA

R

- (1) A *firm's* long-term insurance assets are the items in (2), adjusted to take account of:
  - (a) outgo in respect of the *firm's long-term insurance business*; and
  - (b) any transfers made in accordance with ■ INSPRU 1.5.27 R.
- (2) The items are:
  - (a) the assets identified under ■ INSPRU 1.5.18 R (including assets into which those assets have been converted) but excluding any assets identified as being held to cover liabilities in respect of subordinated debt;
  - (b) any other assets identified by the *firm* as being available to cover its *long-term insurance liabilities* (including assets into which those assets have been converted) including, if the *firm* so elects, assets which are excluded under (a) ;
  - (c) *premiums* and other receivables in respect of *long-term insurance contracts*;
  - (d) other receipts of the *long-term insurance business*; and
  - (e) all income and capital receipts in respect of the items in (2).

1.5.22

FCA PRA

R

- (1) Unless (2) applies, all the *long-term insurance assets* of the *firm* constitute its long-term insurance fund.
- (2) Where a *firm* identifies particular *long-term insurance assets* in connection with different parts of its *long-term insurance business*, the assets identified in relation to each such part constitute separate long-term insurance funds of the *firm*.

1.5.23

FCA PRA

R

A *firm* must maintain a separate accounting record in respect of each of its *long-term insurance funds* (including any *with-profits fund*).

1.5.24

FCA PRA

G

*Firms* must ensure that *long-term insurance assets* are separately identified and allocated to a *long-term insurance fund* at all times. Assets in external accounts, for example at banks, custodians, or brokers should be segregated in the *firm's* books and records into separate accounts for *long-term insurance business* and *general insurance business*. Where a *firm* has more than one *long-term insurance fund*, a separate accounting record must be maintained for each fund. Accounting records should clearly document the allocation.

1.5.25

FCA PRA

G

Where the surplus arising from business is shared between *policyholders* and shareholders in different ways for different blocks of business, it may be necessary to maintain a separate fund to ensure that *policyholders* are, and will be, treated fairly. For example, if a proprietary company writes some business on a with-profits basis, this should be written in a *with-profits fund* separate from any business where the surplus arising from that business is wholly owned by shareholders.

1.5.26

FCA PRA

G

Where a *firm* merges separate funds for different types of business, it will need to ensure that the merger will not result in *policyholders* being treated unfairly. When considering merging the funds, the *firm* should consider the impact on its *PPFM* (see ■ COBS 20.3 ) and on its obligations to notify the *appropriate regulator* (see ■ SUP 15.3). In particular, a *firm* would need to consider how any *inherited estate* would be managed and how the fund would be run in future, such that *policyholders* are treated fairly.

1.5.27

FCA PRA

R

**A *firm* may not transfer assets out of a *long-term insurance fund* unless:**

- (1) the assets represent an *established surplus*; and
- (2) no more than three months have passed since the determination of that surplus.

1.5.28

FCA PRA

G

As a result of ■ INSPRU 1.5.27 R (2), an *actuarial investigation* undertaken to determine an *established surplus* remains in-date for three months from the date as at which the determination of the surplus was made. However, even where the investigation is still in-date, the *firm* should not make the transfer unless there is sufficient surplus at the time of the transfer to allow it to be made without breach of ■ INSPRU 1.1.20 R or ■ INSPRU 1.1.21 R of the *PRA Handbook* .

1.5.29

FCA PRA

G

■ INSPRU 1.1.27 R and ■ INSPRU 1.1.28 R provide further constraints on the transfer of assets out of a *with-profits fund*. ■ INSPRU 1.1.27 R requires a *firm* to have *admissible assets* in each of its *with-profits funds* to cover the *technical provisions* and other *long-term insurance liabilities* relating to all the business in that fund. ■ INSPRU 1.1.28 R requires a *realistic basis life firm* to ensure that the *realistic value of assets* for each of its *with-profits funds* is at least equal to the *realistic value of liabilities* of that fund.

#### **Exclusive use of long-term insurance assets**

1.5.30

FCA PRA

R

- (1) A *firm* must apply a *long-term insurance asset* only for the purposes of its *long-term insurance business*.
- (2) For the purpose of (1), applying an asset includes coming under any obligation (even if only contingently) to apply that asset.

1.5.31

FCA PRA

R

**A *firm* must not agree to, or allow, any mortgage or charge on its *long-term insurance assets* other than in respect of a *long-term insurance liability*.**

1.5.32

FCA PRA

G

The purposes of the *long-term insurance business* include the payment of *claims*, expenses and liabilities arising from that business, the acquisition of lawful access to fixed assets to be used in that business and the investment of assets. The payment of liabilities may include repaying a loan but only where that loan was incurred for the purpose of the *long-term insurance business*. The purchase or investment of assets may include an exchange at fair *market value* of assets (including *money*) between the *long-term insurance fund* and other assets of the *firm*. A *firm* may also lend *securities* held in a *long-term insurance fund* under a *stock lending* transaction or transfer assets as *collateral* for a *stock lending* transaction where the *firm* is the borrower, where such lending or transfer is for the benefit of the *long-term insurance business*.

1.5.33  
FCA PRA

R

**Payment of financial penalties**

If the *FCA* or *PRA* imposes a financial penalty on a *long-term insurer*, the *firm* must not pay that financial penalty from a *long-term insurance fund*.

1.5.34  
FCA

G

■ INSPRU 1.5.2A R states that this provision applies to all *firms*, except *mutuals*, and includes *firms* qualifying for authorisation under Schedule 3 or 4 to the *Act*.

**Requirements: property-linked funds**

1.5.35  
FCA PRA

G

■ INSPRU 3.1.57 R requires a *firm* to cover, as closely as possible, its *property-linked liabilities* by the property to which those liabilities are linked. In order to comply with this *rule*, a *firm* should identify the assets it holds to cover *property-linked liabilities* and should not apply those assets (as long as they are needed to cover the *property-linked liabilities*) for any purpose other than to meet those liabilities.

1.5.36  
FCA

R

A *firm* must select, allocate and manage the assets to which its *property-linked liabilities* are linked taking into account:

- (1) the *firm's* contractual obligations to holders of *property-linked policies*; and
- (2) its regulatory duty to treat *customers* fairly, including in the way it makes discretionary decisions as to how it selects, allocates and manages assets.

1.5.37  
FCA

G

*Property-linked liabilities* may be linked either to specified assets (with no contractual discretion given to the *firm* as to the choice of assets) or to assets of a specified kind where the selection of the actual assets is left to the *firm*.

**Requirements: UK branches of certain non-EEA firms**

1.5.38  
PRA

G

The purpose of the *rules* and *guidance* set out in ■ INSPRU 1.5.38 G to ■ INSPRU 1.5.57 R is to protect against the risk that the financial resources required in respect of the activities of the *United Kingdom* (or *EEA*) *branch(es)* might be depleted by the other activities of the *non-EEA direct insurer*.

1.5.39  
PRA

G

By virtue of ■ INSPRU 1.5.2 R (4), the *rules* in ■ INSPRU 1.5.41 R to ■ INSPRU 1.5.57 R apply to *non-EEA direct insurers* except for *Swiss general insurers* and *EEA-deposit insurers*. Responsibility for determining the adequacy of the world-wide financial resources of *Swiss general insurers* or *EEA-deposit insurers* rests exclusively with the Swiss authorities or the authorities in the *EEA State* (other than the *United Kingdom*) in which the deposit was made.

1.5.40  
PRA

G

- (1) ■ INSPRU 1.5.41 R requires a *non-EEA direct insurer* to hold adequate world-wide resources to meet the needs of the world-wide business without the need to rely on *UK* or *EEA branch* assets other than to meet *branch liabilities*.

- (2) ■ INSPRU 1.5.42 R to ■ INSPRU 1.5.47 R require *non-EEA direct insurers* to calculate a local *MCR* and to hold assets representing that requirement in the *EEA* or the *United Kingdom*.
- (3) ■ INSPRU 1.5.48 R to ■ INSPRU 1.5.52 R require *non-EEA direct insurers* to hold a minimum level of assets in the *United Kingdom* or *EEA*.
- (4) ■ INSPRU 1.5.54 R requires the deposit of a minimum level of assets in the *United Kingdom*.
- (5) ■ INSPRU 1.5.56 R and ■ INSPRU 1.5.57 R require *non-EEA direct insurers* to keep adequate accounting records in the *United Kingdom*.

**Worldwide financial resources**

1.5.41  
PRA

R

- (1) A *non-EEA direct insurer* must maintain adequate worldwide financial resources, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.
- (2) For the purpose of (1):
  - (a) a *UK-deposit insurer* must not rely upon the assets held under ■ INSPRU 1.1.20 R as available to meet liabilities other than those arising from the activities of its *branches* in *EEA States*;
  - (b) other *non-EEA direct insurers* to whom (1) applies must not rely upon the assets held under ■ INSPRU 1.1.20 R as available to meet liabilities other than those arising from the activities of any *UK branch*.

**UK or EEA MCR to be covered by admissible assets**

1.5.42  
PRA

R

A *non-EEA direct insurer* must:

- (1) calculate a *UK* or *EEA MCR* in accordance with ■ INSPRU 1.5.44 R to ■ INSPRU 1.5.47 R; and
- (2) hold *admissible assets* (in addition to those required under ■ INSPRU 1.1.20 R) to represent its *UK* or *EEA MCR* calculated under (1).

1.5.43  
PRA

R

The assets held under ■ INSPRU 1.5.42 R (2) must be identified and valued as if the *non-EEA direct insurer* was a *firm* with its head office in the *United Kingdom*.

PAGE 119  
1.5.44  
PRA

R

For the purposes of ■ INSPRU 1.5.42 R, a *non-EEA direct insurer* (except a *UK-deposit insurer*) must calculate a *UK MCR*:

- (1) for *long-term insurance business*, in accordance with ■ GENPRU 2.1.36 R but only in relation to business carried on by the *firm* in the *United Kingdom*;

1.5.45

PRA

R

For a *composite firm*, the UK MCR is the sum of the amounts arrived at under ■ INSPRU 1.5.44 R (1) and ■ INSPRU 1.5.44 R (2).

1.5.46

PRA

R

For the purposes of ■ INSPRU 1.5.42 R, a *UK-deposit insurer* must calculate an *EEA MCR*:

- (1) for *long-term insurance business*, in accordance with ■ GENPRU 2.1.36 R but only in relation to business carried on by the *firm* in all *EEA States*, taken together;
- (2) for *general insurance business*, in accordance with ■ GENPRU 2.1.34 R but only in relation to business carried on by the *firm* in all *EEA States*, taken together.

1.5.47

PRA

R

For a *composite firm*, the *EEA MCR* is the sum of the amounts arrived at under ■ INSPRU 1.5.46 R (1) and ■ INSPRU 1.5.46 R (2).

#### Localisation of assets

1.5.48

PRA

R

A *non-EEA direct insurer* (except a *UK-deposit insurer*) must hold:

- (1) *admissible assets* which are required to cover its *technical provisions* in accordance with ■ INSPRU 1.1.20 R (1) or ■ INSPRU 1.1.21 R (1)(a) and (2)(a); and
- (2) other *admissible assets* not required to cover *property-linked liabilities* or *index-linked liabilities* in accordance with ■ INSPRU 3.1.57 R or ■ INSPRU 3.1.58 R which represent its *UK MCR* as calculated in accordance with ■ INSPRU 1.5.44 R;

as follows:

- (a) (where the assets cover the *technical provisions* and the *guarantee fund*) in the *United Kingdom*;
- (b) (where the assets represent the amount of the *UK MCR* in excess of the *guarantee fund*) in any *EEA State*.

1.5.49

PRA

R

A *UK-deposit insurer* must hold:

- (1) *admissible assets* which are required to cover its *technical provisions* in accordance with ■ INSPRU 1.1.20 R (1) or ■ INSPRU 1.1.21 R (1)(a) and ■ INSPRU 1.1.21 R (2)(a); and
- (2) other *admissible assets* not required to cover *property-linked liabilities* or *index-linked liabilities* in accordance with

■ INSPRU 3.1.57 R or ■ INSPRU 3.1.58 R which represent its *EEA MCR* as calculated in accordance with ■ INSPRU 1.5.46 R;

as follows:

- (a) (where the assets cover the *technical provisions* and the *guarantee fund*) within the *EEA* states where the *firm* carries on *insurance business*;
- (b) (where the assets represent the amount of the *EEA MCR* in excess of the *guarantee fund*) in any *EEA State*.

1.5.50  
PRA

**R** ■ INSPRU 1.5.48 R and ■ INSPRU 1.5.49 R do not apply to assets covering *technical provisions* which are debts owed by *reinsurers*.

1.5.51  
PRA

**G** The *admissible assets* in excess of the *technical provisions* and *UK* or *EEA MCR* may be held outside the *EEA*.

1.5.52  
PRA

**R** For the purpose of ■ INSPRU 1.5.48 R and ■ INSPRU 1.5.49 R:

- (1) a *tangible asset* is to be treated as held in the country or territory where it is situated;
- (2) an *admissible asset* consisting of a claim against a debtor is to be regarded as held in any country or territory where it can be enforced by legal action;
- (3) a *security* which is *listed* is to be treated as held in any country or territory where there is a *regulated market* in which the security is dealt; and
- (4) a *security* which is not *listed* is to be treated as held in the country or territory in which the *issuer* has its head office.

1.5.53  
PRA

**G** ■ INSPRU 3.1.53 R to INSPRU 3.1.55R (currency matching of assets and liabilities) apply to the assets held to match insurance liabilities calculated under ■ INSPRU 1.1.12 R or ■ INSPRU 1.1.16 R.

**Deposit of assets as security**

1.5.54  
PRA

**R** A *non-EEA direct insurer* must keep assets of a value at least equal to one quarter of the *base capital resources requirement* on deposit in the *United Kingdom* with a *BCD credit institution*.

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121

1.5.55  
PRA

**G** The assets deposited as security may count towards the assets required under ■ INSPRU 1.5.48 R and ■ INSPRU 1.5.49 R. If, after the deposit is made, the value of the deposited assets falls below one quarter of the *base capital resources requirement*, the *firm* should deposit further *admissible assets* in order to comply with ■ INSPRU 1.5.48 R and ■ INSPRU 1.5.49 R. Deposited assets may be exchanged for other *admissible assets* and

excess assets may be withdrawn, provided that the exchange or deposit does not cause a breach of ■ INSPRU 1.5.48 R or ■ INSPRU 1.5.49 R.

**Branch accounting records in the United Kingdom**

1.5.56  
PRA

R

A *non-EEA direct insurer* must maintain at a place of business in the *United Kingdom* adequate records relating to:

- (1) the activities carried on from its *United Kingdom branch*; and
- (2) if it is an *EEA-deposit insurer*, the activities carried on from the *branches* in other *EEA States*.

1.5.57  
PRA

R

The records maintained as required by ■ INSPRU 1.5.56 R must include a record of:

- (1) the income, expenditure and liabilities arising from activities of the *branch* or *branches*; and
- (2) the assets identified under ■ INSPRU 1.1.20 R as available to meet those liabilities.

**Application of INSPRU 1.5 to Lloyd's**

1.5.58  
FCA PRA

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■ INSPRU 1.5 applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, ■ INSPRU 8.1.4 R; and
- (2) for the *Society*, ■ INSPRU 8.1.2 R.

1.5.59  
FCA PRA

R

The *Society* and *managing agents* must take all reasonable steps to ensure that:

- (1) a *corporate member* does not carry on any commercial business other than *insurance business* and activities arising directly from that business; and
- (2) *individual members* do not, in their capacity as *underwriting members*, carry on any commercial business other than *insurance business* and activities arising directly from that business.

1.5.60  
PRA

R

A *managing agent* must not permit both *general insurance business* and *long-term insurance business* to be carried on together through any *syndicate* managed by it.



## 1.6 Insurance Special Purpose Vehicles

### Application and Purpose

1.6.1  
PRA

R

(1) ■ INSPRU 1.6.5 R to ■ INSPRU 1.6.12 R apply to a *UK ISPV*.

(2) ■ INSPRU 1.6.13 G to ■ INSPRU 1.6.18 G apply to an *insurer* which has a contract of *reinsurance* with an *ISPV*.

1.6.2  
PRA

G

An *ISPV* is a special purpose vehicle which assumes risks from *insurance undertakings* or *reinsurance undertakings* and which fully funds its exposure to such risks through the proceeds of a debt issuance or some other financing mechanism where the repayment rights of the providers of such debt or other financing mechanism are subordinated to the *reinsurance* obligations of that vehicle. The special feature of an *ISPV*, when compared to other *reinsurers*, is that it is fully funded to meet its *reinsurance* liabilities. It is, therefore, not subject to insurance risk to the same extent as other *reinsurers*. The *Reinsurance Directive* permits *ISPVs* to be subject to different rules to those applying to other *reinsurers*.

1.6.3  
PRA

G

To satisfy the definition of an *ISPV* under the *Reinsurance Directive* the *ISPV* must be fully funded. The *PRA* considers that to be fully funded an *ISPV* must have actually received the proceeds of the debt issuance or other mechanism by which it is financed. The *PRA* would not, therefore, grant a *Part 4A permission* to an *ISPV* where part of the financing for its *reinsurance* liabilities was on a contingent basis, for example, a standby facility or letter of credit.

1.6.4  
PRA

G

The purpose of ■ INSPRU 1.6 is:

(1) to set out the *rules* applying to *UK ISPVs* in respect of:

- (a) their assets and liabilities; and
- (b) their contractual arrangements; and

(2) to set out the conditions that must be met in order for an *insurer* to claim credit for *reinsurance* with an *ISPV*.

### Assets and liabilities

1.6.5  
PRA

R

A *UK ISPV* must ensure that at all times its assets are equal to or greater than its liabilities.

**1.6.5A**  
**PRA**

**G**

The purpose of ■ INSPRU 1.6.5 R is to ensure that a *UK ISPV* may be viewed as a going concern at all times.

**1.6.6**  
**PRA**

**G**

In addition to liability under its contracts of *reinsurance*, an *ISPV* will incur liability for other expenses, for example, staff and accommodation costs, *claims* handling arrangements and professional advisers' fees. ■ INSPRU 1.6.5 R requires a *UK ISPV* to ensure that it always has sufficient assets to meet its liabilities.

**1.6.7**  
**PRA**

**R**

**A *UK ISPV* must invest its assets in accordance with the requirements set out in INSPRU 3.1.61AR.**

**1.6.8**  
**PRA**

**R**

**A *UK ISPV*'s assets must be held by, or on behalf of:**

- (1) the *UK ISPV*; or
- (2) the *insurance undertaking* or *reinsurance undertaking* which cedes to the *UK ISPV* the risks in respect of which the relevant assets are held.

**Contractual arrangements**

**1.6.9**  
**PRA**

**R**

**A *UK ISPV* must include in each of its contracts of *reinsurance* terms which secure that its aggregate maximum liability at any time under those contracts of *reinsurance* does not exceed the amount of its assets at that time.**

**1.6.10**  
**PRA**

**G**

■ INSPRU 1.6.9 R requires that a *UK ISPV*'s contracts of *reinsurance* should include terms that secure that its maximum *reinsurance* liability is capped at a level that is no greater than the *ISPV*'s assets. In the *PRA*'s view, this is a necessary condition of the *ISPV* being fully funded, as it means that the *ISPV* should not find that its assets are insufficient to meet its *reinsurance* liabilities.

**1.6.11**  
**PRA**

**R**

**A *UK ISPV* must ensure that under the terms of any debt issuance or other financing arrangement used to fund its *reinsurance* liabilities the rights of the providers of that debt or other financing are fully subordinated to the claims of creditors under its contracts of *reinsurance*.**

**1.6.12**  
**PRA**

**R**

**A *UK ISPV* must only enter into contracts or otherwise assume obligations which are necessary for it to give effect to the *reinsurance* arrangements which represent the special purpose for which it has been established.**

**Reinsurance with an ISPV**

**1.6.13**  
**PRA**

**G**

As a result of ■ GENPRU 1.3.55 R, ■ GENPRU 2 Annex 7 R, ■ INSPRU 1.1.92A R and ■ INSPRU 1.2.28 R an *insurer* may not:

- (1) treat amounts recoverable from an *ISPV* as:
  - (a) an *admissible asset*, or

- (b) *reinsurance* for the purposes of calculating its *mathematical reserves*, or
- (c) *reinsurance* reducing its *MCR*, or

(2) otherwise ascribe a value to such amounts,

unless it first obtains a *waiver* from the *PRA*. ■ INSPRU 1.6.14 G to ■ INSPRU 1.6.18 G set out the information which the *PRA* will expect to receive as part of the application for the *waiver*. Those paragraphs also set out the factors, in addition to the statutory tests under sections 138A and 138B of the *Act*, to which the *PRA* will have regard in deciding:

- (i) whether to grant such a *waiver* (assuming the sections 138A and 138B conditions are met); and
- (ii) the amount recoverable from the *ISPV* which it will allow the *insurer* to bring into account for these purposes.

1.6.14

PRA

G

Where the *ISPV* is a *UK ISPV*, the *PRA* will wish to be satisfied that the *UK ISPV* complies with ■ INSPRU 1.6.5 R to ■ INSPRU 1.6.12 R. The *PRA* may rely on information supplied in connection with its application for *authorisation*. However, if the application for a *waiver* is made some time after *authorisation* was granted, the *PRA* may request confirmation that there has been no material change to the information originally supplied.

1.6.15

PRA

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Where the *ISPV* is not a *UK ISPV*, the *PRA* will expect to receive confirmation that the *ISPV* has received an official authorisation in accordance with article 46 of the *Reinsurance Directive* in the *EEA State* in which it has been established. In addition, it will need details of the debt issuance or other financing mechanism by which the *ISPV's reinsurance* liabilities are funded. The *PRA* will also expect to receive information about the *ISPV's* key management and control functions, including details of the *ISPV's* auditors and arrangements for *claims* handling, and any material *outsourcing* agreements. The *PRA* will also need information about the structure of any *group* of which the *ISPV* is a member.

1.6.16

PRA

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No credit may be taken for a contract of *reinsurance* with an *ISPV* unless the contract meets the risk transfer principle set out in ■ INSPRU 1.1.19A R. The *PRA* will require evidence that the contract of *reinsurance* and the extent of the credit that the *firm* proposes to take for it satisfy the risk transfer principle.

1.6.17

PRA

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The *PRA* will require information about the impact of the *ISPV* arrangement on the ceding *firm's* individual capital assessment carried out in accordance with ■ INSPRU 7.1. This should include evidence that all residual risks associated with the arrangement (including credit, market, liquidity and operational risks) are reflected in that assessment.

1.6.18

PRA

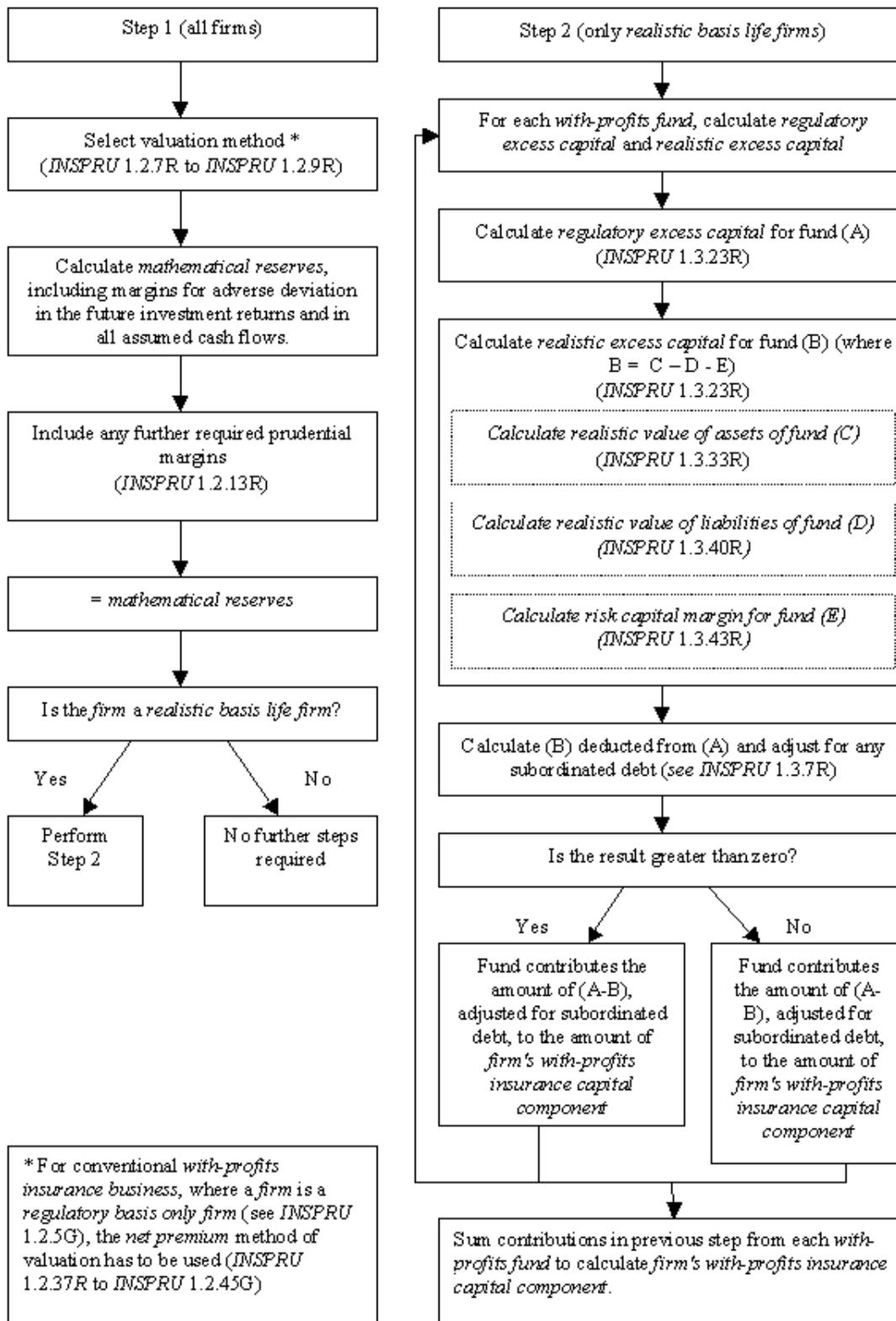
G

The *PRA* will also expect to receive an analysis of the potential for risk to revert to the *firm* or any of its *associates* under realistic adverse scenarios or for liabilities to arise in respect of the risks transferred for which no provision has been made.



**INSPRU 1.2 (Mathematical reserves) and INSPRU 1.3 (With-profits insurance capital component)**

**PRA**



## Chapter 2

# Credit risk in insurance

## 2.1 Application

### 2.1.1

PRA

**R** ■ INSPRU 2.1 applies to an *insurer* unless it is:

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*.

### 2.1.2

PRA

**R** All of ■ INSPRU 2.1, except ■ INSPRU 2.1.20 R and ■ INSPRU 2.1.23 R to ■ INSPRU 2.1.32 G, applies to:

- (1) an *EEA-deposit insurer*; and
- (2) a *Swiss general insurer*;

but only in respect of the activities of the *firm* carried on from a *branch* in the *United Kingdom*.

### 2.1.3

PRA

**G** The scope of application of ■ INSPRU 2.1 is not restricted to *firms* that are subject to relevant *EU* directives.

### 2.1.4

PRA

- R**
- (1) This section applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.
  - (2) Where a *firm* carries on both *long-term insurance business* and *general insurance business*, this section applies separately to each type of business.

### Purpose

### 2.1.5

PRA

**G** The purpose of this section is to protect *policyholders* and potential *policyholders* by setting out the requirements applicable to a *firm* in respect of credit risk. Credit risk is incurred whenever a *firm* is exposed to loss if a *counterparty* fails to perform its contractual obligations including failure to perform them in a timely manner. Credit risk may therefore have an impact upon a firm's ability to meet its valid *claims* as they fall due. Credit risk can also arise from underlying causes that have an impact upon the creditworthiness of all *counterparties* of a particular description or geographical location. A detailed explanation of credit risk is given at ■ SYSC 15.1.4 G.

2.1.6

PRA

G

The requirements in this section address both current and contingent exposure to credit risk. *PRIN* and *SYSC* require a *firm* to establish adequate internal systems and controls for exposure to credit risk. This section requires a *firm* to restrict its exposure to different *counterparties* and assets to prudent levels and to ensure that those exposures are adequately diversified. It also requires a *firm* to make deductions from the value of assets in respect of exposures to one asset, *counterparty* or group of closely related *counterparties* in excess of prescribed limits.

2.1.7

PRA

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This section also sets limits on the *market risk* arising from holding assets including securities issued or guaranteed by *counterparties*. This *market risk* is incurred whenever a *firm* is exposed to loss if an asset were to reduce in value or even become worthless. These *market risk* limits are set out in this section rather than the *market risk* sections in *INSPRU* because they are closely linked to the *counterparty* limits set out in this section.

### Overall limitation of credit risk

2.1.8

PRA

R

Taking into account relevant risks, a *firm* must restrict its *counterparty* exposures and asset exposures to prudent levels and ensure that those exposures are adequately diversified.

2.1.9

PRA

R

- (1) For the purposes of ■ *INSPRU 2.1*, *counterparty* exposure is the amount a *firm* would lose if a *counterparty* were to fail to meet its obligations (either to the *firm* or to any other *person*) and if simultaneously securities issued or guaranteed by the *counterparty* were to become worthless.
- (2) For the purposes of ■ *INSPRU 2.1*, asset exposure is the amount a *firm* would lose if an asset or class of identical assets (whether or not held directly by the *firm*) were to become worthless.
- (3) For the purposes of (1) and (2), the amount of loss is the amount, if any, by which the *firm's* capital resources (as calculated in accordance with the *capital resources table* but without making any deduction for assets in excess of *market risk* and *counterparty* limits) would decrease as a result of the *counterparty* failing to meet its obligations and the *securities* or assets becoming worthless.
- (4) In determining the amount of loss in accordance with (3), the *firm* must take into account decreases in its capital resources that would result not only from its own direct exposures but also from:
  - (a) exposures held by any of its *subsidiary undertakings*; and
  - (b) synthetic exposures arising from *derivatives* or quasi-derivatives held or entered into by the *firm* or any of its *subsidiary undertakings*.
- (5) If a *firm* elects under ■ *INSPRU 2.1.35 R* to make a deduction in respect of *collateral*, the *firm* must deduct from the amount of loss determined in accordance with (3) so much of the value of that *collateral* as:

## 2.1.10

PRA

G

Exposure is defined in terms of loss (which is decrease in capital). It does not include exposures arising from assets that are not represented in capital or exposures which if crystallised in a loss would be offset by a consequent gain, reduction in liabilities or release of provisions, but only in so far as that gain, reduction or release would itself lead to an offsetting increase in *capital resources*. Examples include:

- (1) exposure from the holding of assets to which the *firm* has attributed no value;
- (2) exposure from the holding of assets that the *firm* has deducted from *capital resources*; and
- (3) exposure in respect of which (and to the extent that) the *firm* has established a provision.

## 2.1.11

PRA

G

In assessing the adequacy of diversification required by ■ INSPRU 2.1.8 R, a *firm* should take into account concentrations of exposure including those arising from:

- (1) different types of exposure to the same *counterparty*, such as *deposits*, loans, securities, *reinsurance* and *derivatives*;
- (2) links between *counterparties* such that default by one might have an impact upon the creditworthiness of another; and
- (3) possible changes in circumstance that would have an impact upon the creditworthiness of all *counterparties* of particular description or geographical location.

## 2.1.12

PRA

G

A *firm* should consider how the spreading of credit risk will impact on overall *counterparty* quality.

## 2.1.13

PRA

G

In assessing its exposure to a *counterparty* for the purpose of ■ INSPRU 2.1.8 R, a *firm* should take into account:

- (1) the period for which the exposure to that *counterparty* might continue;
- (2) the likelihood of default during that period by the *counterparty*; and
- (3) the loss that might result in the event of default.

2.1.14

PRA

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In assessing the loss that might result from the default of a *counterparty* for the purposes of ■ INSPRU 2.1.8 R, a *firm* should take into account the circumstances that might lead to default and, in particular, how these might have an impact upon:

- (1) the amount of exposure to the *counterparty*; and
- (2) the effectiveness of any loss mitigation techniques employed by the *firm*.

2.1.15

PRA

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Often the same circumstances which lead to the crystallisation of contingent credit exposure, e.g. a significant *claims* event or a significant movement in interest, currency or asset values, also lead to an increase in the risk of default by the *counterparty*. In particular, if a *reinsurer* or *derivative counterparty* is being relied upon to provide protection against the consequences of an event or circumstance, a *firm* should take into account how that event or circumstance might have an impact upon the creditworthiness of the *reinsurer* or *derivative counterparty*.

2.1.16

PRA

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For the purposes of ■ INSPRU 2.1.8 R and of determining *counterparty* exposure and asset exposure in accordance with ■ INSPRU 2.1.9 R and *reinsurance* exposure in accordance with ■ INSPRU 2.1.25 R, a *firm* must only rely upon a loss mitigation technique where it has good reason to believe that, taking into account the possible circumstances of default, it is likely to be effective.

2.1.17

PRA

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Loss mitigation techniques include:

- (1) the right, upon default, to preferential access to some or all of the *counterparty's* assets, for example by exercising rights of set off, holding *collateral* or assets deposited back, or exercising rights under fixed or floating charges;
- (2) rights against third parties upon default by the *counterparty*, such as guarantees, credit insurance and credit *derivatives*; and
- (3) where the *counterparty* is a *reinsurer*, having back-up or flexible *reinsurance* which covers the gap in coverage left by the *reinsurer's* default, for example 'top and drop' *reinsurance*.

2.1.18

PRA

R

For the purposes of ■ INSPRU 2.1.8 R and of determining *counterparty* exposure and asset exposure in accordance with ■ INSPRU 2.1.9 R and *reinsurance* exposure in accordance with ■ INSPRU 2.1.25 R, a *firm* must not rely upon preferential access to assets unless it has taken into account appropriate professional advice as to its effectiveness.

2.1.19

PRA

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In particular, a *firm* should consider whether any preferential access to a *counterparty's* assets would be effective even if the *counterparty* were wound up by a court or other legal process or it were to be subject to any other insolvency process. A *firm* should also consider, where it is relying upon a right against a third party, whether, in the circumstances of the *counterparty's* default, the creditworthiness of that third party might be impaired.

2.1.20

PRA

R

**Large exposure limits**

- (1) A *firm* must take reasonable steps to limit its *counterparty* exposure or asset exposure to:
- (a) a single *counterparty*;
  - (b) each of the *counterparties* within a group of closely related counterparties; and
  - (c) an asset or class of identical assets;
- to a level where, if a total default were to occur, the *firm* would not become unable to meet its liabilities as they fall due.
- (2) In (1), a total default occurs where:
- (a) the single *counterparty* or all of the *counterparties* within the group of closely related *counterparties* fail to meet its or their obligations and simultaneously any securities issued or guaranteed by it or any of them become worthless; or
  - (b) the asset becomes worthless or all of the assets within the identical class become worthless at the same time.
- (3) (1) does not apply to:
- (a) a *reinsurance* exposure; or
  - (b) a *counterparty* exposure or asset exposure to an *approved credit institution*.

2.1.21

PRA

G

In assessing its exposure to a *counterparty* or group of closely related *counterparties*, a *firm* should consider exposures from different sources including *deposits*, loans, *securities* and *derivatives*.

**Market risk and counterparty limits**

2.1.22

PRA

R

- (1) A *firm* must calculate the amount of the deduction from total capital required by stage L in the *capital resources table* in respect of assets in excess of *market risk* and *counterparty* limits as the aggregate amount by which its *counterparty* exposures and asset exposures exceed the relevant limits set out in (3).
- (2) Except where the contrary is expressly stated in *INSPRU*, whenever:
- (a) a *rule* in *INSPRU* refers to assets of a *firm*, or of any part of a firm, or of any fund or part of a fund within a *firm*, which are assets of a kind referred to in any of the limits in (3); and
  - (b) the *firm's counterparty* exposure (or aggregate exposure arising from the *counterparty* exposures to each member of

a group of closely related persons) or asset exposure in respect of those assets exceeds any of the limits in (3);

the *firm* must deduct from the measure of the value of those assets (as determined in accordance with ■ GENPRU 1.3) the amount by which that exposure exceeds the relevant limit in (3), or that portion of the deduction that relates to the part of the *firm* or fund or part of a fund in question.

- (3) The limits referred to in (1) and (2) are the following, expressed as a percentage of the *firm's* business amount:
- (a) for a *counterparty* exposure to an individual, unincorporated body of individuals or the aggregate exposure arising from the *counterparty* exposures to each member of a group of closely related individuals or unincorporated bodies of individuals:
    - (i) % for that part of the exposure that arises from unsecured debt;
    - (ii) 1% for the whole exposure (after deduction of the excess arising from the limit in (a)(i));
  - (b) for a *counterparty* exposure to an *approved counterparty* or the aggregate exposure arising from the *counterparty* exposures to each member of a group of closely related *approved counterparties*:
    - (i) 40% for that part of the exposure arising from *covered bonds*;
    - (ii) 5% for that part of the exposure not arising from *covered bonds* or, if the *counterparty* is an *approved credit institution*, from short term deposits; this limit is increased to 10% if the total of such exposures which are greater than 5% arising from applying a 10% limit, when taken together with any exposures arising from *covered bonds* which are within the 40% limit in (i), does not exceed 40%;
    - (iii) 20% or 2 million, if larger, for the whole exposure (but excluding any exposure arising from *covered bonds* and after deduction of the excess arising from the limit in (b)(ii));
  - (c) for a *counterparty* exposure to a *person*, or the aggregate exposure arising from the *counterparty* exposures to each member of a group of closely related *persons*, who do not fall into the categories of *counterparty* to whom (a) and (b) apply:
    - (i) 1% for that part of the exposure arising from unsecured debt; this limit is increased to 2.5% in the case of an exposure to a *regulated institution*;

- (ii) 1% for that part of the exposure arising from *shares* and other variable yield participations, bonds, *debt securities* and other *money market instruments* and capital market instruments from the same *counterparty* that are not dealt in on a *regulated market*, or a beneficial interest in a *collective investment scheme* to which ■ INSPRU 2.1.39 R applies; the limit for that part of the exposure arising from *debt securities* (other than hybrid securities) issued by the same *regulated institution* is increased to 5%;
  - (iii) 5% for the whole exposure (after deduction of the excesses arising from the limits in (c)(i) and (ii));
  - (d) 5% for the aggregate of all *counterparty* exposures that fall within (c)(i) whether or not they arise from *persons* who are closely related, but excluding amounts that are in excess of the limit in (c)(i);
  - (e) 10% for the aggregate of all *counterparty* exposures and asset exposures that fall within (c)(ii) above or (j) below, whether or not they arise from *persons* who are closely related, but excluding amounts that are in excess of the limit in (c)(ii) above or, in the case of an asset exposure, (j) below;
  - (f) 5% for the aggregate of all *counterparty* exposures arising from unsecured loans, other than those falling within (3)(b);
  - (g) 3% for the asset exposure arising from all cash in hand;
  - (h) 10% for the asset exposure (including an exposure arising from a reversionary interest) arising from any one piece of land or building, or a number of pieces of land or buildings close enough to each other to be considered effectively as one investment;
  - (i) 5% for the asset exposure arising from a beneficial interest in any single *non-UCITS retail scheme* or *recognised scheme* which does not fall within the *UCITS Directive*; and
  - (j) 1% for the asset exposure arising from a beneficial interest in any single *collective investment scheme* which does not fall within the *UCITS Directive* and is not a *non-UCITS retail scheme* or a *recognised scheme*.
- (4) In (3) a *firm's* business amount means the sum of:
- (a) the *firm's* total gross *technical provisions* (that is, calculated gross of *reinsurance*);
  - (b) the amount of its other liabilities (except those included in the calculation of capital resources in accordance with the *capital resources table*); and

- (c) such amount as the *firm* may select not exceeding, in the case of a *firm* which is not a *participating insurance undertaking*, the amount of the *firm's* total capital after deductions as calculated at stage M of the *capital resources table* or, in the case of a *firm* which is a *participating insurance undertaking*, the amount calculated in accordance with (5A) or, in either case, if higher:
- (i) in the case of a *firm* carrying on *general insurance business*, the amount of its *general insurance capital requirement*; and
  - (ii) in the case of a *firm* carrying on *long-term insurance business*, the amount of its *long-term insurance capital requirement* and, where it is a *regulatory basis only life firm*, the amount of its *resilience capital requirement*.
- (5) For the purpose of (4)(a), a *firm's* total gross *technical provisions* exclude *technical provisions* in respect of *index-linked liabilities* or *property-linked liabilities*, except that where the *linked long-term contract of insurance* in question includes a guarantee of investment performance or some other guaranteed benefit, the total gross *technical provisions* include the *technical provisions* in respect of that guaranteed element.
- (5A) For the purpose of (4)(c), a *firm* which is a *participating insurance undertaking* must calculate the amount of the *firm's group capital resources* less the difference between:
- (a) the *firm's group capital resources requirement*; and
  - (b) the *firm's capital resources requirement*.
- (5B) In (3)(b)(ii) short term *deposit* means a *deposit* which may be withdrawn at the discretion of the lender without penalty or loss of accrued interest by giving notice of withdrawal of one month or less.
- (6) In (3)(c)(ii) hybrid security means a *debt security*, other than an *approved security*, the terms of which provide, or have the effect that, the holder does not, or would not, have an unconditional entitlement to payment of interest and repayment of capital in full within 75 years of the date on which the *security* is being valued.
- (7) In (3)(a)(i) and (3)(c)(i) an unsecured debt is any debt in respect of which the conditions in ■ INSPRU 2.1.35 R or ■ INSPRU 2.1.36 R and ■ INSPRU 2.1.37 R are not satisfied or, if satisfied only in relation to part of the debt, that part of the debt which is not covered by collateral or a guarantee, letter of credit or credit derivative in accordance with those *rules*.

2.1.22A

PRA

R

■ INSPRU 2.1.22 R does not apply to a *pure reinsurer*.

### Large exposure calculation for reinsurance exposures

2.1.23

PRA

R

A *firm* must notify the PRA in accordance with ■ SUP 15.7 as soon as it first becomes aware that:

- (1) a *reinsurance* exposure to a *reinsurer* or group of closely related *reinsurers* is reasonably likely to exceed 100% of its *capital resources*; or
- (2) if (1) does not apply, that it has exceeded this limit.

2.1.24

PRA

R

Upon notification under ■ INSPRU 2.1.23 R, a *firm* must:

- (1) demonstrate that prudent provision has been made for the *reinsurance* exposure in excess of the 100% limit, or explain why in the opinion of the *firm* no provision is required; and
- (2) explain how the *reinsurance* exposure is being safely managed.

2.1.25

PRA

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- (1) For the purposes of ■ INSPRU 2.1, a *reinsurance* exposure is the amount of loss which a *firm* would suffer if a *reinsurer* or group of closely related *reinsurers* were to fail to meet its or their obligations under contracts of *reinsurance* reinsuring any of the *firm's* contracts of insurance.
- (2) For the purposes of (1), the amount of loss is the amount, if any, by which the *firm's* capital resources (as calculated in accordance with the *capital resources table* but without making any deduction for assets in excess of *market risk* and *counterparty* limits) would decrease as a result of the *reinsurer* or group of closely related *reinsurers* failing to meet its or their obligations under the contracts of *reinsurance*.
- (3) If a *firm* elects under ■ INSPRU 2.1.35 R to make a deduction in respect of *collateral*, the *firm* must deduct from the amount of loss determined in accordance with (2) so much of the value of that *collateral* as:
  - (a) would be realised by the *firm* were it to exercise its rights in relation to the *collateral*; and
  - (b) does not exceed any of the relevant limits in ■ INSPRU 2.1.22 R (3).

2.1.26

PRA

R

A *firm* must, in determining its *reinsurance* exposures for the purposes of ■ INSPRU 2.1, aggregate any *reinsurance* exposure where the identity of the *reinsurer* is not known by the *firm* with the highest *reinsurance* exposure where it does know the identity of the *reinsurer*.

- 2.1.27**  
**PRA** **G** ■ INSPRU 2.1.8 R provides that, taking into account relevant risks, a *firm* must restrict to prudent levels, and adequately diversify, its exposure to *counterparties*.
- 2.1.28**  
**PRA** **A** (1) In each *financial year*, a *firm* should restrict the *gross earned premiums* which it pays to a *reinsurer* or group of closely related *reinsurers* to the higher of:
- (a) 20% of the *firm's* projected *gross earned premiums* for that *financial year*; or
- (b) 4 million.
- (2) Compliance with this provision may be relied upon as tending to establish compliance with ■ INSPRU 2.1.8 R.
- 2.1.29**  
**PRA** **R** A *firm* must notify the *PRA* immediately in accordance with ■ SUP 15.7 if it has exceeded, or anticipates exceeding, the limit expressed in ■ INSPRU 2.1.28 E.
- 2.1.30**  
**PRA** **R** Upon notification under ■ INSPRU 2.1.29 R, a *firm* must explain to the *PRA* how, despite the excess *reinsurance* concentration, the credit risk is being safely managed.
- 2.1.31**  
**PRA** **G** For the purposes of ■ INSPRU 2.1.24 R and ■ INSPRU 2.1.30 R, a *firm's* explanation of how a *reinsurance* exposure is being safely managed should also describe the *reinsurance* market in which the exposure has occurred, and the nature of the *reinsurance* contract. If appropriate, the *firm* should also provide a detailed plan and timetable explaining how the excess exposure will be reduced to an acceptable level. The explanation should be approved by a person at the *firm* of appropriate seniority.
- 2.1.32**  
**PRA** **G** Where a *firm* can demonstrate that the arrangement does not give rise to unacceptable levels of credit risk it is unlikely that further action will be required.
- Exposures excluded from limits**  
.....
- 2.1.33**  
**PRA** **R** In ■ INSPRU 2.1.20 R and ■ INSPRU 2.1.22 R, references to a *counterparty* exposure or an asset exposure do not include such an exposure arising from:
- (1) [deleted]
- (2) *premium* debts;
- (3) advances secured on, and not exceeding the *surrender value* of, *long-term insurance contracts* of the *firm*;
- (4) rights of salvage or subrogation;
- (5) *deferred acquisition costs*;

- (6) assets held to cover *index-linked liabilities* or *property-linked liabilities*, except that where the *linked long-term contract of insurance* in question includes a guarantee of investment performance or some other guaranteed benefit, ■ INSPRU 2.1.20 R and ■ INSPRU 2.1.22 R will nevertheless apply to assets held to cover that guaranteed element;
- (7) *moneys* due from, or guaranteed by, a *Zone A country*;
- (8) an *approved security*;
- (9) a holding in a *collective investment scheme* falling within the *UCITS Directive*.

2.1.34  
PRA

**R** In ■ INSPRU 2.1.22 R references to a *counterparty* exposure or an asset exposure do not include such an exposure resulting from debts arising from *reinsurance* ceded and the *reinsurer's* share of *technical provisions*.

2.1.35  
PRA

**R** If:

- (1) a *firm* has a *counterparty* exposure, an asset exposure or a *reinsurance* exposure in respect of which it has rights over *collateral* (except where that *collateral* is a letter of credit see ■ INSPRU 2.1.36 R and ■ INSPRU 2.1.37 R); and
- (2) the assets constituting that *collateral* would, if owned by the *firm*, be admissible assets;

the *firm* may, in determining the amount of that exposure, deduct the value of that *collateral* in accordance with ■ INSPRU 2.1.9 R (5) or, in the case of a *reinsurance* exposure, ■ INSPRU 2.1.25 R (3).

2.1.36  
PRA

**R** If a *firm* has a *counterparty* exposure, asset exposure or *reinsurance* exposure the whole or any part of which is:

- (1) guaranteed by a *credit institution* or an *investment firm* subject in either case to the *Capital Adequacy Directive* or supervision by a third country (non-EEA) supervisory authority with a Capital Adequacy Directive-equivalent regime; or
- (2) adequately mitigated by a credit *derivative*;

the *firm* may, for the purposes of ■ INSPRU 2.1.20 R, ■ INSPRU 2.1.22 R and ■ INSPRU 2.1.23 R, treat that exposure, or that part of the exposure which is so guaranteed or mitigated, as an exposure to the guarantor or derivative *counterparty*, rather than to the original *counterparty*, asset or *reinsurer*.

2.1.37  
PRA

**R** For the purposes of ■ INSPRU 2.1.36 R, references to an exposure being guaranteed include an exposure secured by a letter of credit, but to fall

within ■ INSPRU 2.1.36 R the guarantee or letter of credit must be direct, explicit, unconditional and irrevocable.

2.1.38

PRA

G

The portion of exposure which is guaranteed or mitigated by a credit *derivative* is itself, as an exposure to the guarantor or derivative *counterparty*, subject to the limits in ■ INSPRU 2.1.20 R and ■ INSPRU 2.1.22 R.

2.1.39

PRA

R

For the purposes of ■ INSPRU 2.1.20 R and ■ INSPRU 2.1.22 R, *units* in a *collective investment scheme* that does not fall within the *UCITS Directive* must be treated as a *counterparty* exposure to the *issuer* of the units in that scheme if the issuer and those *units* are to be regarded as constituting a single risk because they are so interconnected that, if the *issuer* were to experience financial problems, this would be likely to affect the value of the *units*.

2.1.39A

PRA

G

Where the value of *units* in a *collective investment scheme* other than one falling within the *UCITS Directive* would be likely to be adversely affected by financial problems experienced by the *issuer* of those *units*, for the purposes of ■ INSPRU 2.1.20 R and ■ INSPRU 2.1.22 R, the *units* must be treated as a *counterparty* exposure to the *issuer*, with the result that the exposure is subject to the limit in ■ INSPRU 2.1.22 R (3)(c)(ii). In all other cases, the *units* would fall to be treated as an asset exposure, with the result that they are subject to the relevant limit under ■ INSPRU 2.1.22 R (3)(i) or ■ (j).

#### Meaning of closely related

2.1.40

PRA

R

For the purposes of ■ INSPRU 2.1, a group of *persons* is closely related if it consists solely of two or more *persons* who, unless it is shown otherwise, constitute a single risk because as between any two of them one or other of the following relationships apply:

- (1) one of them, directly or indirectly, has control, as defined in ■ INSPRU 2.1.41 R, over the other or they are both controlled by the same third party; or
- (2) there is no relationship of control as defined in ■ INSPRU 2.1.41 R but they are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other would be likely to encounter repayment difficulties.

2.1.41

PRA

R

For the purposes of ■ INSPRU 2.1.40 R, control means the relationship between a *parent undertaking* and a *subsidiary undertaking*, as defined in Article 1 of the Consolidated Accounts Directive (83/349/EEC), or a similar relationship between any natural or legal person and an *undertaking*.

#### Meaning of reinsurance

2.1.41A

PRA

R

For the purposes of ■ INSPRU 2.1, references to *reinsurance* include analogous non-*reinsurance* financing agreements, including contingent loans, securitisations and any other arrangements in respect of *contracts*

*of insurance* that are analogous to contracts of *reinsurance* in terms of the risks transferred and the finance provided and references to *reinsurer* shall be construed accordingly.

#### Application of INSPRU 2.1 to Lloyd's

2.1.42

PRA

R

Subject to ■ INSPRU 2.1.43 R, ■ INSPRU 2.1 applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, ■ INSPRU 8.1.4 R; and
- (2) for the *Society*, ■ INSPRU 8.1.2 R.

2.1.43

PRA

R

■ INSPRU 2.1.23 R to ■ INSPRU 2.1.32 G (Large exposure calculation for reinsurance exposures) do not apply to the *Society*.

#### Overall limitation of credit risk

2.1.44

PRA

G

For Lloyd's, *counterparty* exposure is:

- (1) for *managing agents*, the amount by which the net assets managed by or under the direction of a *managing agent* in respect of a *syndicate* together with any relevant *balancing amount* would decrease if the *counterparty* were to default;
- (2) for the *Society*, the amount by which its net assets (which include those of its subsidiary undertakings) would decrease if the *counterparty* were to default; and
- (3) for the *Society's* management of each *member's funds at Lloyd's*, the amount by which the *member's* net assets would decrease if the *counterparty* were to default.

#### Large exposures

2.1.45

PRA

R

For the purposes of ■ INSPRU 2.1.20 R (Large exposure limits: counterparty exposure and asset exposure), the *Society* may determine the exposure to any letters of credit, guarantees or *members' life* assurance policies as an exposure of the *members* in aggregate.

2.1.46

PRA

R

For the purposes of ■ INSPRU 2.1.22 R (Large exposure limits: market risk and counterparty limits), the *Society* must calculate the amount of and deduct from *capital resources*:

- (1) an exposure (expressed as a percentage of the relevant *member's capital resources* held as *funds at Lloyd's*), other than to the assets identified in ■ INSPRU 2.1.46 R (2)(a) to ■ INSPRU 2.1.46 R (2)(c), of a *member's capital resources* held as *funds at Lloyd's* to a *counterparty*, in excess of the limits in ■ INSPRU 2.1.22 R;

- (2) an exposure in excess of 20% (expressed as a percentage of the aggregate of *capital resources* held as *funds at Lloyd's*) of the aggregate of *capital resources* held as *funds at Lloyd's* to a single issuer of:
  - (a) letters of credit;
  - (b) guarantees; or
  - (c) *members'* life assurance policies;
  
- (3) an exposure of its own to a *counterparty*, in excess of the limits in ■ INSPRU 2.1.22 R, expressed as a percentage of the *Society's* own assets.

2.1.47  
PRA

**R** For the purposes of ■ INSPRU 2.1.22 R (Large exposure limits: market risk and *counterparty* limits), *managing agents* must calculate the amount of and deduct from *capital resources* an exposure (expressed as a percentage of the *admissible assets* held in respect of the relevant *syndicate*) of *admissible assets* held in respect of a *syndicate* to a *counterparty* in excess of the limits in ■ INSPRU 2.1.22 R.

2.1.48  
PRA

**R** If the exposures of *capital resources* held as *funds at Lloyd's* for *members* in the aggregate do not exceed the limits in ■ INSPRU 2.1.22 R (3)(c), then, for each *individual member*, that limit may be replaced by 10%.

**Exposures excluded from the large exposure limits**

2.1.49  
PRA

**R** For *managing agents*, in ■ INSPRU 2.1.33 R and ■ INSPRU 2.1.35 R, references to an exposure do not include exposure arising from *balancing amounts*.

## 2.2 Asset-related Capital Requirement

### Application

2.2.1

PRA

R

■ INSPRU 2.2 applies to an *insurer* unless it is:

- (1) a *non-directive friendly society*; or
- (2) a *Swiss general insurer*; or
- (3) an *EEA-deposit insurer*; or
- (4) an *incoming EEA firm*; or
- (5) an *incoming Treaty firm*.

2.2.2

PRA

G

The scope of application of ■ INSPRU 2.2 is not restricted to *firms* that are subject to the relevant *EU* directives.

2.2.3

PRA

R

■ INSPRU 2.2 applies to a *firm* only in relation to its *general insurance business*.

2.2.4

PRA

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.

2.2.5

PRA

G

The requirements in ■ INSPRU 2.2 apply to a *firm* on a solo basis.

### Purpose

2.2.6

PRA

G

■ GENPRU 2.1.13 R requires that a *firm* must maintain at all times *capital resources* equal to or in excess of its *capital resources requirement*. ■ GENPRU 2.1.17 R provides that for a *firm* carrying on *general insurance business* the *firm's capital resources requirement* is the *minimum capital requirement*.

2.2.7

PRA

G

The PRA will use the *enhanced capital requirement* as the benchmark for *individual capital guidance* for a *firm* carrying on *general insurance business*, other than a *non-directive insurer*. The *enhanced capital requirement* is the sum of the *asset-related capital requirement* and the *insurance-related capital requirement* less the *firm's* equalisation provisions. This section sets out *rules* and *guidance* relating to the

*asset-related capital requirement*. Rules and guidance relating to the *insurance-related capital requirement* are set out in ■ INSPRU 1.1.

2.2.8

PRA

G

The *asset-related capital requirement* is a measure of the capital that a *firm* should hold against the risk of loss if another party fails to perform its financial obligations to the *firm* or from adverse movements in the value of assets.

2.2.9

PRA

G

The *asset-related capital requirement* is calculated by applying capital charge factors, expressed as a percentage, to different categories of a *firm's* assets. A *firm* should refer to ■ GENPRU 1.3 which sets out how a *firm* must recognise and value assets and liabilities.

### Calculation of asset-related capital requirement

2.2.10

PRA

R

A *firm* must calculate its *asset-related capital requirement* in accordance with ■ INSPRU 2.2.11 R.

2.2.11

PRA

R

- (1) The value of each of the *firm's* assets of a kind listed in the table in ■ INSPRU 2.2.16 R must be multiplied by the corresponding capital charge factor.
- (2) If any amount which is to be multiplied by a capital charge factor is a negative amount, that amount shall be treated as zero.
- (3) No account shall be taken of:
  - (a) the value of any asset which is not an *admissible asset*;
  - (b) the amount (if any) by which the value of any assets exceeds the limits on exposures to a type of asset or *counterparty* as set out in ■ INSPRU 2.1.22 R.
- (4) Where a *firm* has entered into a *derivative*, then for the purposes of applying the appropriate capital charge factor as set out in ■ INSPRU 2.2.16 R, it must treat the value of the *derivative* and the value of the asset associated with the *derivative* as a single asset of a type and value which most closely reflects the economic risk to the *firm* of the combined rights and obligations associated with the *derivative* and the asset associated with the *derivative*.
- (5) The amounts resulting from multiplying each of the asset items referred to in (1) by the corresponding capital charge factor must be aggregated.
- (6) The *asset-related capital requirement* is the amount resulting from the aggregation in (5).

2.2.12

PRA

G

*Options*: some *derivatives* may allow a *firm* an *option* whether to buy or sell a particular asset. If an *option* has a positive market value (that is, in-the-money) it is likely that the *firm* will exercise the *option* in the future and the current value of the *derivative* and associated asset will generally acquire new characteristics and volatility (a 'synthetic asset').

For instance, an *option* to acquire *shares* at a price below their current market value is likely to be exercised and the appropriate *asset-related capital requirement* calculation would be to combine the cash cost of acquiring the number of *shares* covered by the *option* with the value of the *derivative* and apply a factor of 16% to that combined value. If an *option* has no market value (that is, out-of-the-money) then it is unlikely that a *firm* would exercise the *option* in which case the appropriate *asset-related capital requirement* charge would be zero in respect of the *derivative*, and the corresponding capital charge contained in Table ■ INSPRU 2.2.16 R in relation to the asset associated with the *derivative*.

## 2.2.13

PRA

G

*Futures* and swaps: *futures* or swaps may not allow the *firm* such an option in which case the appropriate asset-related capital charge factor to apply is the one corresponding to the asset that would be held on fulfilment of the contract and the value to which this should be applied would be the value of the asset held after the contract is fulfilled.

## 2.2.14

PRA

R

- (1) The asset-related capital charge factor for money market funds set out in the Table ■ INSPRU 2.2.16 R must be applied to exposures to funds that meet the definition in (2).
- (2) In ■ INSPRU 2.2 an investment in a money market fund means a participation in a *collective investment scheme* which satisfies the following conditions:
  - (a) the primary investment objective of the *collective investment scheme* is:
    - (i) to maintain the net asset value of the *collective investment scheme* constant at par (net of earnings); or
    - (ii) to maintain the net asset value of the *collective investment scheme* at the value of investors' initial capital plus earnings;
  - (b) in order to pursue its primary investment objective the *collective investment scheme* invests exclusively in cash or in short term instruments with characteristics similar to cash or both; and
  - (c) the *collective investment scheme* undertakes to abide by the following conditions:
    - (i) not to allow the assets held in the *collective investment scheme* to exceed a weighted average maturity of 60 days;
    - (ii) not to invest in equity or securities with characteristics similar to equity; and
    - (iii) on a basis of marking-to-market at least weekly, not to permit the value of each *collective investment scheme* unit at any point in time to move by more than 50 basis points (0.5% of total *collective investment scheme* value).

2.2.15

PRA

R

In ■ INSPRU 2.2.16 R an insurance dependant means a *regulated related undertaking* which is an *insurance undertaking* or an *insurance holding company*.

2.2.16

PRA

R

Table: Asset-related capital charge factors

Asset item		ECR asset-related capital charge factor
<b>Investments</b>	<b>Land and Buildings</b>	<b>7.5%</b>
	<i>Investments in group undertakings and participating interests</i>	
	<i>Shares in group undertakings excluding participating interests</i>	<b>0%</b>
	<i>Insurance dependants</i>	<b>0%</b>
	<i>Other</i>	<b>7.5%</b>
	<i>Debt securities issued by, and loans to, group undertakings</i>	<b>3.5%</b>
	<i>Participating interests</i>	<b>7.5%</b>
	<i>Debt securities issued by, and loans to, undertakings in which the insurer has a participating interest</i>	<b>3.5%</b>
	<b>Other financial investments</b>	
	<i>Shares and other variable-yield securities and units in unit trusts</i>	<b>16.0%</b>
	<i>Money market funds</i>	<b>0%</b>
	<i>Debt securities and other fixed income securities</i>	
	<i>Approved securities</i>	<b>3.5%</b>
	<i>Other</i>	<b>3.5%</b>
	<i>Participation in investment pools</i>	<b>16.0%</b>
	<i>Loans secured by mortgages</i>	<b>2.5%</b>
	<i>Other loans</i>	<b>2.5%</b>
	<i>Deposits with approved credit institutions and approved financial institutions</i>	<b>0%</b>
	<i>Other</i>	<b>7.5%</b>
	<i>Deposits with ceding undertakings</i>	<b>3.5%</b>
<b>Reinsurers' share of tech-</b>	<b>Provision for unearned premium</b>	<b>2.5%</b>
	<b>Claims outstanding</b>	<b>2.5%</b>

Asset item		ECR asset-related capital charge factor
<i>nical provisions</i>	Other	2.5%
Debtors	Debtors arising out of direct insurance operations	4.5%
	Debtors arising out of <i>reinsurance</i> operations	3.5%
	Debtors arising out of <i>reinsurance</i> operations	2.5%
	Other debtors	1.5%
Other Assets	Called up <i>share capital not paid</i>	0%
	Tangible assets	7.5%
	Cash at bank and in hand	0%
Prepayments and accrued income	Other	0%
	Accrued interest and rent	0%
	<i>Deferred acquisition costs</i>	0%
	Other prepayments and accrued income	0%

**Application of INSPRU 2.2 to Lloyd's**

2.2.17

PRA

R

■ INSPRU 2.2 applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, ■ INSPRU 8.1.4 R; and
- (2) for the *Society*, ■ INSPRU 8.1.2 R

2.2.18

PRA

R

This chapter applies to the *Society* for each *member*, including the capital charge relating to *central assets*, to the extent that those assets are held to support a particular *member*.

# Chapter 3

## Market risk

## 3.1 Market risk in insurance

### 3.1.1

FCA PRA

R

■ INSPRU 3.1 applies to an *insurer*, unless it is:

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*.

### 3.1.2

PRA

G

■ INSPRU 3.1 applies to *pure reinsurers*, with the exception of ■ INSPRU 3.1.53 R, ■ INSPRU 3.1.57 R and ■ INSPRU 3.1.58 R.

### 3.1.3

PRA

R

- (1) ■ INSPRU 3.1 applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.
- (2) Where a *firm* carries on both *long-term insurance business* and *general insurance business*, ■ INSPRU 3.1 applies separately to each type of business.

### Purpose

### 3.1.4

PRA

G

This section sets out *rules* and *guidance* relating to *market risk*. Under ■ INSPRU 1.1.20 R and ■ INSPRU 1.1.21 R, a *firm* is required to hold *admissible assets* of a value sufficient to cover its *technical provisions* and its other *long-term insurance* or *general insurance liabilities*. In addition, ■ INSPRU 1.1.34 R sets the requirement that a *firm* must hold assets of appropriate amount, currency, term, safety and yield, to ensure that the cash inflows from those assets will be sufficient to meet expected cash outflows from its insurance liabilities as they are due.

### 3.1.5

PRA

G

*Market risk* is the risk that as a result of market movements a *firm* may be exposed to fluctuations in the value of its assets, the amount of its liabilities, or the income from its assets. Sources of general *market risk* include movements in interest rates, equities, exchange rates and real estate prices. It is important to note that none of these sources of risk is independent of the others. For example, fluctuations in interest rates often have an impact upon equity and currency values and vice versa. Giving due consideration to these correlations is an important aspect of the prudent management of *market risk*.

## 3.1.6

PRA

G

A *firm* may also be exposed to specific *market risk*, which is the risk that the *market value* of a specific asset, or income from that asset, may fluctuate for reasons that are not dependent on general market movements. The limits in ■ INSPRU 2.1.22 R cover *market risk* as well as *counterparty risk*.

## 3.1.7

FCA PRA

G

■ INSPRU 3.1 addresses the impact of *market risk* on *insurance business* in the ways set out below:

- (1) Any *firm* that carries on *long-term insurance business* which is a *regulatory basis only life firm* must comply with the *resilience capital requirement*. This requires the *firm* to hold capital to cover *market risk*. The *resilience capital requirement* is dealt with in ■ INSPRU 3.1.9 G to ■ INSPRU 3.1.26 R.
- (2) For a *firm* that carries on *long-term insurance business*, the assets that it must hold must be of a value sufficient to cover the *firm's technical provisions* and other *long-term insurance liabilities*. ■ INSPRU 1.2 contains *rules and guidance* as to the methods and assumptions to be used in calculating the *mathematical reserves*. One of these assumptions is the assumed rate of interest to be used in calculating the present value of future payments by or to a *firm*. ■ INSPRU 3.1.28 R to ■ INSPRU 3.1.48 G set out the methodology to be used in relation to *long-term insurance liabilities*.
- (3) *Firms* carrying on either *long-term insurance business* or *general insurance business* are also subject to currency risk. That is, the risk that fluctuations in exchange rates may impact adversely on a *firm*. ■ INSPRU 3.1.49 G to ■ INSPRU 3.1.56 G set out the requirements a *firm* must meet so as to cover this risk.
- (4) For a *firm* carrying on general *insurance business*, the *Enhanced Capital Requirement* already captures some elements of *market risk*. In addition, the requirements as to the assumed rate of interest used in calculating the present value of *general insurance liabilities* are contained in the *insurance accounts rules*, and these requirements are outlined in ■ INSPRU 3.1.27 G.
- (5) *Firms* carrying on *long-term insurance business* that have *property-linked liabilities* or *index-linked liabilities* must cover these liabilities by holding appropriate assets. ■ INSPRU 3.1.57 R and ■ INSPRU 3.1.58 R set out these cover requirements.
- (6) The *Reinsurance Directive* applies to *pure reinsurers* "prudent person" investment principles in relation to the investment of their assets. ■ INSPRU 3.1.61A R sets out these principles.

### Definitions

## 3.1.8

PRA

R

For the purposes of ■ INSPRU 3.1:

- (1) **real estate means an interest in land, buildings or other immovable property;**
- (2) **a significant territory is any country or territory in which more than 2.5% of a *firm's long-term insurance assets* (by *market value*),**

excluding assets held to cover *index-linked liabilities* or *property-linked liabilities* (see ■ INSPRU 3.1.57 R and ■ INSPRU 3.1.58 R), are invested;

- (3) the long term gilt yield means the annualised equivalent of the fifteen year gilt yield for the *United Kingdom* Government fixed-interest *securities* index jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries; and
- (4) the member states of the European Union which have adopted the Euro as the official currency may be treated as a single territory.

#### Resilience capital requirement (only applicable to the long-term insurance business of regulatory basis only life firms)

3.1.9

PRA

G

The *resilience capital requirement* forms part of the calculation of the *capital resources requirement* for *regulatory basis only life firms*. ■ GENPRU 2.1.23 R specifies that the CRR for a *regulatory basis only life firm* is equal to the MCR in ■ GENPRU 2.1.25 R. The *resilience capital requirement* forms part of the MCR for a *regulatory basis only life firm* (see ■ GENPRU 2.1.25 R (2)(b)).

3.1.10

PRA

R

- (1) A *regulatory basis only life firm* must calculate a *resilience capital requirement* in accordance with (2) to (5).
- (2) The *firm* must identify relevant assets (see ■ INSPRU 3.1.10A R) which, after applying the scenarios in (3), have a value that is equal to the *firm's long-term insurance liabilities* under those scenarios.
- (3) For the purpose of (2), the scenarios are:
  - (a) for those relevant assets invested in the *United Kingdom*, the *market risk* scenario set out in ■ INSPRU 3.1.16 R;
  - (b) subject to (c) and to ■ INSPRU 3.1.26 R, for those relevant assets invested outside of the *United Kingdom*, the *market risk* scenario set out in ■ INSPRU 3.1.23 R; and
  - (c) where the relevant assets in (b) are:
    - (i) held to cover *index-linked liabilities* or *property-linked liabilities*; or
    - (ii) not invested in a significant territory outside the *United Kingdom*;

the *market risk* scenario set out in ■ INSPRU 3.1.16 R.

- (4) The *resilience capital requirement* is the result of deducting B from A, where:

- (a) A is the value of the relevant assets which will produce the result described in (2); and
- (b) B is the *firm's long-term insurance liabilities*.

(5) In calculating the value of the *firm's long-term insurance liabilities* under any scenario, a *firm* is not required to adjust the provision made under ■ GENPRU 1.3.4 R in respect of a *defined benefits pension scheme*.

3.1.10A

PRA

R

In ■ INSPRU 3.1.10 R relevant assets means a range of assets which must be selected by the *firm* from the assets specified in (1) and (2) in the order specified:

- (1) its *long-term insurance assets*; and
- (2) only where the *firm* has selected all the assets within (1), its shareholder assets, other than assets of an amount and kind required:
  - (a) to cover its liabilities arising outside its *long-term insurance funds*; or
  - (b) to meet any regulatory capital requirements in respect of business written outside its *long-term insurance funds*.

3.1.11

PRA

G

The purpose of the *resilience capital requirement* is to cover adverse deviation from:

- (1) the value of *long-term insurance liabilities*;
- (2) the value of assets held to cover *long-term insurance liabilities*; and
- (3) the value of assets held to cover the resilience capital requirement;

arising from the effects of *market risk* for equities, real estate and fixed interest securities. Other risks are not explicitly addressed by the *resilience capital requirement*.

3.1.12

PRA

G

The amount of the *resilience capital requirement* calculated by the *firm* will depend on the *firm's* choice of assets held to cover the *resilience capital requirement*. The *resilience capital requirement* is held to cover not only the shortfall between the change in the value of *long-term insurance liabilities* and the change in the value of the assets identified to cover those liabilities, but also the change in the value of the assets identified to cover the *resilience capital requirement* itself.

PAGE  
5

3.1.13

PRA

G

As part of the assessment of the financial resources a *firm* needs to hold to comply with the *overall financial adequacy rule*, the *general stress and scenario testing rule* requires a *firm* to carry out stress tests and scenario analyses appropriate to the major sources of risk to its ability to meet its liabilities as they fall due identified in accordance with the *overall Pillar 2 rule*. In considering the stress tests and scenario analyses relevant to the major sources of risk in the category of *market risk*, a *firm* should consider the extent to which the *market risk* scenarios set out in ■ INSPRU 3.1.16 R to ■ INSPRU 3.1.26 R are

appropriate to the nature of its asset portfolio. A *firm* may judge that given the nature of its portfolio, a more severe stress should be adopted. The *firm* may also wish to bring in other asset classes, such as index-linked bonds, which should be stressed on appropriate bases, and to consider the impact of currency mismatching and any *derivative* positions held.

## 3.1.13A

PRA

G

In the *market risk* scenarios set out in ■ INSPRU 3.1.16 R to ■ INSPRU 3.1.26 R, a *firm* is required to assess the changed value of its assets and liabilities in the economic conditions of the scenarios set out in ■ INSPRU 3.1.16 R and ■ INSPRU 3.1.23 R. A *firm* is required to assess the changed value of each relevant asset (as defined in ■ INSPRU 3.1.10A R), notwithstanding any uncertainty about the appropriate valuation basis for that asset. In valuing an asset in the specified scenarios, a *firm* should have regard to the economic substance of the asset, rather than its legal form, and assess its value accordingly. Consider, for example, a convertible bond that is close to its conversion date and where the conversion option has value. The value of the convertible bond in the specified scenarios is likely to be sensitive primarily to equity market scenarios and to a lesser extent to interest rate scenarios. The *firm* should value the asset according to its expected market value in the economic conditions underlying the specified scenarios.

## 3.1.13B

PRA

G

In determining where particular assets are invested for the purpose of determining which *market risk* scenario should be applied to those assets, or whether a country or territory in which a *firm* has invested part of its *long-term insurance assets* is a significant territory, a *firm* should generally treat:

- (1) a *security* dealt in on a *regulated market* as invested in any country or territory in which a *regulated market* on which the *security* is dealt is situated;
- (2) a *security* which is not dealt in on a *regulated market* as invested in the country or territory in which the *issuer* has its head office;
- (3) an asset consisting of a claim against a debtor as invested in any country or territory where it can be enforced by legal action;
- (4) real estate as invested in the country or territory in which the land, buildings or other immovable property is situated;
- (5) a tangible asset as invested in the country or territory where it is situated; and
- (6) a *derivative* or *quasi-derivative* as invested in the country or territory in which the assets to which the *firm* is exposed by reason of having entered into the *derivative* or *quasi-derivative* are situated.

Where, however, the nature of a *firm's* investment is such that the economic risks to which it is principally exposed are risks relating to assets invested in, or the currency of, a different country or territory to that in which are invested the assets directly invested in by the *firm*, then the *firm* should consider whether it would be more reasonable to treat the assets as invested in that other country or territory. For example, if a *firm* has invested in the *securities* of a *collective investment scheme* which are dealt in on a *regulated market* in country A, but the scheme principally invests in real estate situated in country B, the *firm* should consider whether its principal exposure is in fact to the country in which the underlying assets are situated (that is, country B). Another example might be where a *firm* has invested in a bond or other fixed interest *security*

that is denominated in the currency of a country or territory other than that in which the *security* would be treated as invested under (1) or (2) above. The *firm* may wish to consider whether that bond or fixed interest *security* should be treated as invested in the country or territory of the currency of denomination.

3.1.14

[intentionally blank]

3.1.15

PRA

G

Where the *resilience capital requirement* is affected by the presence of *derivative* or *quasi-derivative* instruments, the *firm* will need to consider whether the protection afforded is of suitable length or security. The *firm* should include the exposure to *counterparties* in the credit considerations of ■ INSPRU 3.1.41 R both before and after calculating the resilience capital requirement. If the *derivative* protection is very short term the *firm* should consider whether issues arise under ■ INSPRU 1.2.26 R (Avoidance of future valuation strain); when a *derivative* expires the financial position of the *firm* may deteriorate as a result of, for example, falls in asset values. Unless the *firm* holds a further reserve, the *firm* is likely to need to have either undertaken a fresh protection strategy or carried through the alternative to the *derivative* protection (such as selling equities in place of a put *option*) if the existing protection expires before the financial year end. If the existing *derivative* protection continues beyond the time of financial year end the *firm* must have sufficient confidence that it can renew its *derivative* protection or an alternative to achieve the same effect.

3.1.16

PRA

R

#### Market risk scenario for assets invested in the United Kingdom

In ■ INSPRU 3.1.10 R (3)(a), the *market risk* scenario for assets invested in the *United Kingdom* and for assets (including assets invested outside the *United Kingdom*) held to cover *index-linked liabilities* or *property-linked liabilities* which a *firm* must assume is:

- (1) a fall in the *market value* of equities of at least 10% or, if greater, the lower of:
  - (a) a percentage fall in the *market value* of equities which would produce an earnings yield on the FTSE Actuaries All Share Index equal to 4/3 rds of the long-term gilt yield; and
  - (b) a fall in the *market value* of equities of 25% less the *equity market adjustment ratio* (see ■ INSPRU 3.1.19 R);
- (2) a fall in real estate values of 20% less the *real estate market adjustment ratio* for an appropriate real estate index (see ■ INSPRU 3.1.21 R);
- (3) (a) the more onerous of either a fall or rise in yields on all fixed interest securities by the percentage point amount determined in (b);
  - (b) for the purpose of (a), the percentage point amount is equal to 20% of the long-term gilt yield.

3.1.17  
PRA

**R** For the purposes of ■ INSPRU 3.1.16 R (1) and ■ INSPRU 3.1.16 R (2), a *firm* must:

- (1) assume that earnings for equities and rack rents for real estate fall by 10%, but dividends for equities remain unaltered (see ■ INSPRU 3.1.36 R to ■ INSPRU 3.1.38 R); and
- (2) model a fall in equity and real estate markets as if the fall occurred instantaneously.

3.1.18  
PRA

**G** An example of ■ INSPRU 3.1.16 R (3) is that, where the long-term gilt yield is currently 6%, a *firm* would assume an increase of 20% in that yield, that is, a change of 1.2 percentage points. For the purpose of the scenario in ■ INSPRU 3.1.16 R (3)(a), the *firm* would assume a fall or rise of 1.2 percentage points in yields on all fixed interest securities.

#### Equity market adjustment ratio

3.1.19  
PRA

**R** The equity market adjustment ratio referred to in ■ INSPRU 3.1.16 R (1)(b) is:

- (1) if the ratio calculated in (a) and (b) lies between 75% and 100%, the result of 100% less the ratio (expressed as a percentage) of:
  - (a) the current value of the FTSE Actuaries All Share Index; to
  - (b) the average value of the FTSE Actuaries All Share Index over the preceding 90 calendar days;
- (2) 0%, if the ratio calculated in (1)(a) and (b) is more than 100%; and
- (3) 25%, if the ratio calculated in (1)(a) and (b) is less than 75%.

3.1.20  
PRA

**R** In ■ INSPRU 3.1.19 R, the average value of the FTSE Actuaries All Share Index over any period of 90 calendar days means the arithmetic mean based on levels at the close of business on each of the days in that period on which the London Stock Exchange was open for trading.

#### Real estate market adjustment ratio

3.1.21  
PRA

**R** The real estate market adjustment ratio for a real estate index referred to in ■ INSPRU 3.1.16 R (2) and ■ INSPRU 3.1.23 R (2) is:

- (1) if the ratio calculated in (a) and (b) lies between 90% and 100%, the result of 100% less the ratio (expressed as a percentage) of:
  - (a) the current value of the real estate index; to
  - (b) the average value of that real estate index over the three preceding *financial years*;

- (2) 0%, if the ratio calculated in (1)(a) and (b) is more than 100%;  
and
- (3) 10%, if the ratio calculated in (1)(a) and (b) is less than 90%.

3.1.22

PRA

G

For the purpose of calculating the *real estate market adjustment ratio* in ■ INSPRU 3.1.21 R, a *firm* should select an appropriate index of real estate values such that:

- (1) the constituents of the index are reasonably representative of the nature and territory of the real estate included in the range of assets identified in accordance with ■ INSPRU 3.1.10 R; and
- (2) the frequency of, and historical data relating to, published values of the index are sufficient to enable an average value(s) of the index to be calculated over the three preceding *financial years*.

3

#### Market risk scenario for assets invested outside the United Kingdom

3.1.23

PRA

R

In ■ INSPRU 3.1.10 R (3)(b), subject to ■ INSPRU 3.1.26 R, the *market risk* scenario for assets invested outside the *United Kingdom* (other than assets held to cover *index-linked liabilities* or *property-linked liabilities*) which a *firm* must assume is, for each significant territory in which assets are invested outside the *United Kingdom*:

- (1) an appropriate fall in the *market value* of equities invested in that territory, which is at least equal to the percentage fall determined in ■ INSPRU 3.1.16 R;
- (2) a fall in real estate values in that territory of 20% less the real estate market adjustment ratio for an appropriate real estate index for that territory (see ■ INSPRU 3.1.21 R); and
- (3) (a) the more onerous of either a fall or a rise in yields on all fixed interest securities by the percentage point amount determined in (b);  
(b) for the purpose of (a), the percentage point amount is equal to 20% of the nearest equivalent (in respect of the method of calculation) to the long term gilt yield.

3.1.24

PRA

R

For the purposes of ■ INSPRU 3.1.23 R (1), an appropriate fall in the *market value* of equities invested in a significant territory must be determined having regard to:

- (1) an appropriate equity market index for that territory; and
- (2) the historical volatility of the equity market index selected in (1).

3.1.25

PRA

G

For the purpose of ■ INSPRU 3.1.24 R (1), an appropriate equity market index for a territory is such that:

- (1) the constituents of the index are reasonably representative of the nature of the equities held in that territory which are included in the range of assets identified in accordance with ■ INSPRU 3.1.10 R; and
- (2) the frequency of, and historical data relating to, published values of the index are sufficient to enable an average value(s) and historical volatility of the index to be calculated over at least the three preceding *financial years*.

3.1.26

FCA PRA

R

Where the assets of a *firm* invested in a significant territory of a kind referred to in ■ INSPRU 3.1.23 R (1), ■ INSPRU 3.1.23 R (2) or ■ INSPRU 3.1.23 R (3)(a) represent less than 0.5% of the *firm's long-term insurance assets* (excluding assets held to cover *index-linked liabilities* or *property-linked liabilities*), measured by *market value*, the *firm* may assume for those assets the *market risk* scenario for assets of that kind invested in the *United Kingdom* set out in ■ INSPRU 3.1.16 R instead of the *market risk* scenario set out in ■ INSPRU 3.1.23 R.

#### Interest rates: general insurance liabilities

3.1.27

PRA

G

The rates of interest to be used for the calculation of the present values of *general insurance liabilities* are specified in the *insurance accounts rules*, except where benefits resulting from a *claim* must be paid in the form of an annuity, in which case the rules require calculation by recognised actuarial methods. In the case of *claims* not payable in the form of an annuity, the *insurance accounts rules* state that the rate of interest to be used must not exceed the lowest of:

- (1) a rate prudently estimated by the *firm* to be earned by assets of the *firm* that are appropriate in magnitude and nature to cover the provisions for *claims* being discounted, during the period necessary for the payment of such *claims*;
- (2) a rate justified by the performance of such assets over the preceding five years; and
- (3) a rate justified by the performance of such assets during the year preceding the balance sheet date.

#### Interest rates: long-term insurance liabilities

3.1.28

PRA

R

- (1) The rates of interest required by ■ INSPRU 1.2.33 R to be used by a *firm* for the calculation of the present value of a *long-term insurance liability* must not exceed 97.5% of the risk-adjusted yield (see ■ INSPRU 3.1.30 R to ■ INSPRU 3.1.48 G) that is expected to be achieved on:
  - (a) the assets allocated to cover that liability;
  - (b) the reinvestment of sums expected to be received from those assets (see ■ INSPRU 3.1.45 R to ■ INSPRU 3.1.48 G); and

(c) the investment of future *premium* receipts (see ■ INSPRU 3.1.45 R to ■ INSPRU 3.1.48 G).

(2) (1) does not apply to a *long-term insurance contract* in respect of which the *firm* has calculated a negative value for the *mathematical reserves* in accordance with ■ INSPRU 1.2.24 R.

3.1.29

PRA

R

For the purposes of ■ INSPRU 3.1.28 R, the rates of interest assumed must allow appropriately for the rates of tax that apply to the investment return on policyholder assets. The rates of tax assumed must be such that the *firm's* total implied liability for tax arising from the allocation of assets to liabilities is not less than the *firm's* actual expected liability for tax for the period in respect of which tax is to be assessed.

3.1.29A

PRA

G

■ INSPRU 3.1.28 R only applies to a *long-term insurance contract* in respect of which a *firm* has calculated *mathematical reserves* with a positive value. A *firm* may, however, also have *long-term insurance contracts* where the value of future cash inflows under and in respect of the contract exceeds that of outflows, allowing the *firm* to calculate a negative value for the *mathematical reserves* for that contract (see ■ INSPRU 1.2.24 R). In calculating the present value of future net cash flows under and in respect of the contract, the *firm* must include margins for adverse variation in accordance with ■ INSPRU 1.2.13 R. These margins should include margins for *market risk* and, where relevant, credit risk. For those margins to be sufficiently prudent as required by ■ INSPRU 1.2.13 R, the rate of interest used may need to be higher than that which would apply under ■ INSPRU 3.1.28 R.

### Risk-adjusted yield

3.1.30

PRA

R

A risk-adjusted yield on an asset must be calculated by:

- (1) taking the asset together with any covering *derivatives*, forward transactions and *quasi-derivatives*;
- (2) assuming that the factors which affect the yield will remain unchanged after the valuation date (see ■ INSPRU 3.1.33 R);
- (3) valuing the asset (together with any offsetting transaction) in accordance with ■ GENPRU 1.3 (Valuation);
- (4) making reasonable assumptions as to whether, and if so when, any options or other rights embedded in the asset (or in any offsetting transaction) will be exercised.

3.1.31

PRA

G

Examples of calculating a combined yield for the purposes of ■ INSPRU 3.1.30 R (1):

- (1) 1000 1 *shares* (fully paid) of ABC plc covered by a sold *future* on the *shares*. Calculating the combined yield effectively results in a position that behaves like cash (with dividend income but no capital gain or loss on the value of the assets); and

- (2) where a covering *derivative* contains an *option* exercisable by the *firm* (e.g. a bought put *option* or receiver swaption), the calculation of the risk adjusted yield should take into account the fact that on the valuation assumptions any time value will reduce over time (known as the 'wasting' nature of the time value of the *option*), for example, an at-the money *option* will expire worthless and hence the covering *derivative* will effectively be a negative yielding asset. There are various ways of allowing for this, for example a *firm* could treat the covering *derivative* and the asset as a single asset and calculate an internal rate of return on this combined asset. Alternatively, an explicit reserve could be set up equal and opposite to the time value of the covering *derivative* which would be written off in the same way as the time value on the covering *derivative*.

## 3.1.32

PRA

G

The requirements in relation to offsetting transactions are set out in ■ INSPRU 3.2. The options and other rights referred to in ■ INSPRU 3.1.30 R (4) include those exercisable by the *firm* as well as those exercisable by other parties.

## 3.1.33

PRA

R

For the purpose of ■ INSPRU 3.1.30 R (2), the factors that affect yield should be ascertained as at the valuation date (that is, the date to which present values of cash flows are being calculated). All changes known to have occurred by that date must be taken into account including:

- (1) changes in the rental income from real estate;
- (2) changes in dividends or audited profit on equities;
- (3) known or forecast changes in dividends which have been publicly announced by the issuer by the valuation date;
- (4) known or forecast changes in earnings which have been publicly announced by the issuer by the valuation date;
- (5) alterations in capital structure; and
- (6) the value (at the most recent date at or before the valuation date for which it is known) of any determinant of the amount of any future interest or capital payment.

## 3.1.34

PRA

R

The risk-adjusted yield is either:

- (1) (for equities and real estate) a running yield (see ■ INSPRU 3.1.36 R to ■ INSPRU 3.1.38 R, ■ INSPRU 3.1.41 R and ■ INSPRU 3.1.44 R); or
- (2) (for all other assets) the internal rate of return (see ■ INSPRU 3.1.39 R, ■ INSPRU 3.1.41 R and ■ INSPRU 3.1.44 R).

## 3.1.35

PRA

R

The risk-adjusted yield on a basket of assets is the arithmetic mean of the risk-adjusted yield on each asset weighted by that asset's *market value*.

**The running yield for real estate**

3.1.36

PRA

R

For real estate the running yield is the ratio of:

- (1) the rental income arising from the real estate over the previous 12 months; to
- (2) the *market value* of the real estate.

**The running yield for equities**

3.1.37

PRA

R

For equities the running yield is:

- (1) the dividend yield, if the dividend yield is more than the earnings yield;
- (2) otherwise, the sum of the dividend yield and the earnings yield, divided by two.

3.1.38

PRA

R

For the purposes of ■ INSPRU 3.1.37 R:

- (1) the dividend yield is the ratio (expressed as a percentage) of dividend income over the previous 12 months from the equities for which the running yield is being calculated ("the relevant equities") to the *market value* of those equities;
- (2) the earnings yield is the ratio (expressed as a percentage) of the audited profit (including exceptional items and extraordinary items) for the preceding *financial year* of the issuer of the relevant equities to the *market value* of those equities;
- (3) the earnings yield must be calculated in accordance with whichever is most appropriate (to the issuer of the relevant equities) of *United Kingdom*, US or international generally accepted accounting practice.

**The internal rate of return**

3.1.39

PRA

R

The internal rate of return on an asset is the annual rate of interest which, if used to calculate the present value of future income (before deduction of tax) and of repayments of capital (before deduction of tax) would result in the sum of those amounts being equal to the *market value* of the asset.

3.1.40

PRA

G

The risk adjusted yield for a *collective investment scheme* may be determined as the weighted average of the yields on each of the investments held by the *collective investment scheme*.

**Credit risk**

3.1.41

PRA

R

In both the running yield and internal rate of return the yield must be reduced to exclude that part of the yield that represents compensation for credit risk arising from the asset.

**3.1.42** **G** An allowance for credit risk should be made for all securities except risk-free securities.  
**PRA**

**3.1.43** **G** Provision for credit risk for credit-rated securities may be made by reference to historic default rates of securities with a similar credit rating. However, allowance should be made both for any recent or expected changes in market conditions that may invalidate historic default rates and for the likelihood that the credit ratings on securities may deteriorate or (following such deterioration) that the issuer may default.  
**PRA**

**3.1.44** **R** Provision for credit risk for securities that are not credit-rated must be made on principles at least as prudent as those adopted for credit-rated securities.  
**PRA**

#### **Investment and reinvestment**

**3.1.45** **R** Except as provided in ■ INSPRU 3.1.46 R:  
**PRA**

- (1) the risk-adjusted yield assumed for the investment or reinvestment of sterling sums (other than sums expected to be received within the next three years) must not exceed the lowest of:
  - (a) the higher of:
    - (i) the long-term gilt yield; and
    - (ii) the greater of:
      - (A) the forward gilts yield; and
      - (B) the forward rate on sterling interest rate swaps, reduced to exclude that part of the rate that represents compensation for credit risk;
 

where the forward yields and forward rates corresponding to the time when the sums are expected to be received are weighted so as to reflect the investment and reinvestment characteristics of the liabilities covered;
  - (b) 3% per annum, increased by two thirds of the excess, if any, of the percentage in (a) over 3% per annum; and
  - (c) 6.5% per annum; and
- (2) the risk-adjusted yield assumed for the investment or reinvestment of those sterling sums expected to be received within the next three years must not exceed the risk-adjusted yield on the assets actually held adjusted linearly over the three-year period to the risk-adjusted yield determined under (1).

3.1.46

PRA

R

For the *with-profits insurance contracts of a realistic basis life firm*, the risk-adjusted yield assumed for the investment or reinvestment of sums denominated in sterling must be no more than the greater of:

- (1) the forward gilts yield; and
- (2) the forward rate on sterling interest rate *swaps*, reduced to exclude that part of the rate that represents compensation for credit risk;

where the forward yields and forward rates corresponding to the times when the sums are expected to be received are weighted so as to reflect the investment and reinvestment characteristics of the liabilities covered .

3.1.47

PRA

R

The risk-adjusted yield assumed for the investment or reinvestment of sums denominated in a currency other than sterling must be at least as prudent as in ■ INSPRU 3.1.45 R and ■ INSPRU 3.1.46 R taking into account the yields on government securities denominated in that currency.

3.1.47A

PRA

R

For the purpose of ■ INSPRU 3.1.47 R the yields on the government securities must be reduced to exclude that part of the yield that represents compensation for credit risk unless the following conditions are satisfied in relation to the issuer of those securities:

- (1) a credit rating is available from at least one of the rating agencies listed in ■ INSPRU 1.3.93 R; and
- (2) the credit rating description in the first column of Table ■ INSPRU 1.3.90 R corresponding to the lowest such credit rating is either exceptional or extremely strong or very strong.

3.1.48

PRA

G

The purpose of ■ INSPRU 3.1.45 R to ■ INSPRU 3.1.47 R is to help protect against 'reinvestment risk'. Reinvestment risk is the risk that, when the sums are actually received, interest rates (and so yields available on assets) might have fallen below current expectations.

### Currency risk

3.1.49

PRA

G

Fluctuations in foreign exchange rates may impact adversely upon a *firm*, including where it holds an open position in a foreign currency. This is where future cash outflows (that is liabilities) in one currency are matched by future cash inflows (that is assets) in a different currency. The circumstances in which this could arise include where the *firm*:

- (1) has entered into contracts for the purchase or sale of foreign currency; or
- (2) has entered into *contracts of insurance* under which *claims* are payable in, or determined by reference to a value or price expressed in, a foreign currency; or
- (3) holds assets denominated in a foreign currency.

**Cover for spot and forward currency transactions**3.1.50  
PRA

R

A *firm* must cover a contract providing for the purchase or sale of foreign currency by:

- (1) holding the currency that must be paid by the *firm* under the contract; or
- (2) being subject to an offsetting transaction.

3.1.51  
PRA

G

The requirements in relation to cover and offsetting transactions are set out in ■ INSPRU 3.2.

**Currency matching of assets and liabilities**3.1.52  
PRA

G

■ INSPRU 1.1.34 R requires a *firm* to cover its liabilities with assets that enable it to match, in timing, amount and currency, the cash inflows and outflows from those assets and liabilities. This permits some currency mismatching of assets and liabilities, but only if sufficient excess assets are held to cover the exposure arising from such mismatching. The level of permitted currency mismatching is also limited by ■ INSPRU 3.1.53 R.

3.1.53  
PRA

R

- (1) Subject to ■ INSPRU 3.1.54 R, a *firm* must hold *admissible assets* in each currency of an amount equal to at least 80% of the amount of its liabilities in that currency arising under or in connection with *contracts of insurance* (but excluding, for a *firm* that carries on *general insurance business*, any *non-credit equalisation provision*), except where the amount of those assets does not exceed 7% of the assets in other currencies.
- (2) In (1) references to an asset in a currency are to an asset which is expressed in or capable of being realised (without exchange risk) in that currency, and an asset is capable of being so realised if it is reasonably capable of being realised in that currency without risk that changes in exchange rates would reduce the cover for liabilities in that currency.

3.1.53A  
PRA

G

For the purpose of ■ INSPRU 3.1.53 R, a *firm* may allocate the total *credit equalisation provisions* to different currencies in proportion to the split by currency of the *technical provisions* for *credit insurance business* established in accordance with ■ GENPRU 1.3.4 R. Alternatively, another allocation which the *firm* is able to justify as broadly appropriate may be used.

3.1.54  
PRA

R

■ INSPRU 3.1.53 R does not apply to:

- (1) a *pure reinsurer*; or
- (2) assets held to cover *index-linked liabilities* or *property-linked liabilities*.

3.1.55

PRA

R

For the purpose of ■ INSPRU 3.1.53 R, the currency of the liability under a *contract of insurance* is the currency in which the cover under the *contract of insurance* is expressed or, if the contract does not specify a currency:

- (1) the currency of the country or territory in which the risk is situated; or
- (2) if the *firm* on reasonable grounds so decides, the currency in which the *premium* payable under the contract is expressed; or
- (3) if, taking into account the nature of the risks insured, the *firm* considers it more appropriate:
  - (a) the currency (based on past experience) in which it expects the *claims* to be paid; or
  - (b) if there is no past experience, the currency of the country or territory in which the *firm* or relevant branch is established:
    - (i) for contracts covering risks falling within general insurance business classes 4, 5, 6, 7, 11, 12 and 13 (producer's liability only); and
    - (ii) for contracts covering risks falling within any other general insurance business class where, in accordance with the nature of the risks, the *firm's* liabilities are liabilities to be provided in a currency other than that which would result from the application of (1) or (2); or
- (4) (where a *claim* has been notified to the *firm* and the *firm's* liability in respect of that *claim* is payable in a currency other than that which would result from the application of (1), (2) or (3)) the currency in which the *claim* is to be paid; or
- (5) (where a *claim* is assessed in a currency known to the *firm* in advance and is a currency other than that which would result from the application of (1), (2), (3) or (4)) the currency in which the *claim* is to be assessed.

3.1.56

PRA

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The reasonable grounds in ■ INSPRU 3.1.55 R (2) include if, from the time the contract is entered into, it appears likely that a *claim* will be paid in the currency of the *premium* and not in the currency of the country in which the risk is situated.

#### Covering linked liabilities

3.1.57

FCA PRA

R

A *firm* must cover its *property-linked liabilities* with:

- (1) (as closely as possible) the assets to which those liabilities are linked; or
- (2) a property-linked *reinsurance* contract; or

PAGE  
17

(3) a combination of (1) and (2).

3.1.58

FCA PRA

R

A *firm* must cover its *index-linked liabilities* with:

(1) either:

(a) the assets which represent that index; or

(b) assets of appropriate security and marketability which correspond, as closely as possible, to the assets which are comprised in, or which form, the index or other reference of value to which those liabilities are linked; or

(2) a portfolio of assets whose value or yield is reasonably expected to correspond closely with the *index-linked liability*; or

(3) an index-linked *reinsurance* contract; or

(4) an index-linked *approved derivative*; or

(5) an index-linked *approved quasi-derivative*; or

(6) a combination of any of (1) to (5).

3.1.58A

PRA

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■ INSPRU 3.1.57 R and ■ INSPRU 3.1.58 R do not apply to a *pure reinsurer*.

3.1.59

FCA PRA

G

For the purposes of ■ INSPRU 3.1.57 R and ■ INSPRU 3.1.58 R, a *firm* is not permitted to hold different assets and to cover the mismatch by holding excess assets.

3.1.60

FCA PRA

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If a *firm* has incurred a *policy* liability which cannot be exactly matched by appropriate assets (for example the Limited Price Index (LPI)), the *firm* should seek to match assets that at least cover the liabilities. For example, an LPI limited to 5% per annum may be matched by an RPI bond or a fixed interest investment matching cash flows increasing at 5% per annum compound. Orders made by the Department for Work and Pensions under section 148 of the Social Security Administration Act 1992, and which are limited to 5% per annum, may also be matched by a fixed interest investment matching cash flows increasing at 5% per annum compound (see also ■ INSPRU 3.1.61A G).

3.1.61

FCA PRA

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In selecting the appropriate cover, the *firm* should ensure that both credit risk, and the risk that the value or yield in the assets will not, in all circumstances, match fluctuations in the relevant index, are within acceptable limits. *Rules* and *guidance* relating to credit risk are set out in ■ INSPRU 2.1.

3.1.61-A

FCA PRA

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Where liabilities are linked to orders made under section 148 of the Social Security Administration Act 1992, *firms* are required by COBS 21.3.5R to notify the *PRA* before effecting any such business and to explain how the risks associated with this business will be safely managed. This requirement does not apply in respect of liabilities for which a limited revaluation premium has been paid to the Department for Work and Pensions so that the liability for revaluation, while still linked to section 148

orders, is limited to 5%. The risks may be mitigated by holding assets to cover an alternative index which is reasonably expected to at least cover the section 148 order (e.g. RPI plus a margin) over the duration of the link. The *firm's* exposure to an order under section 148 exceeding this index should be appropriately limited by putting a cap on the liabilities linked to the order so that risks are within acceptable limits.

### Pure reinsurers

3.1.61A

FCA PRA

R

A *pure reinsurer* must invest its assets in accordance with the following requirements:

- (1) the assets must take account of the type of business carried out by the *firm*, in particular the nature, amount and duration of expected *claims* payments, in such a way as to secure the sufficiency, liquidity, security, quality, profitability and matching of its investments;
- (2) the *firm* must ensure that the assets are diversified and adequately spread and allow the *firm* to respond adequately to changing economic circumstances, in particular developments in the financial markets and real estate markets or major catastrophic events; the *firm* must assess the impact of irregular market circumstances on its assets and must diversify the assets in such a way as to reduce such impact;
- (3) investment in assets which are not admitted to trading on a *regulated market* must be kept to prudent levels;
- (4) investment in *derivatives* and *quasi-derivatives* must contribute to a reduction of investment risks or facilitate efficient portfolio management and such investments must be valued on a prudent basis, taking into account the underlying assets, and included in the valuation of the *firm's* assets. The *firm* must avoid excessive risk exposure to a single *counterparty* and to other *derivative* or *quasi-derivative* operations;
- (5) the assets must be properly diversified in such a way as to avoid:
  - (a) excessive reliance on any one particular asset, *issuer* or *group* of *undertakings*; and
  - (b) accumulations of risk in the portfolio as a whole.

Investments in assets issued by the same *issuer* or by *issuers* belonging to the same *group* must not expose the *firm* to excessive risk concentration; and
- (6) (5) does not apply to investment in government bonds.

### Application of INSPRU 3.1 to Lloyd's

3.1.62

FCA PRA

R

■ INSPRU 3.1 applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents* ■ INSPRU 8.1.4 R, subject to ■ INSPRU 3.1.65 R below; and
- (2) for the *Society*, ■ INSPRU 8.1.2 R.

### Resilience capital requirement (applicable to long-term business only)

3.1.63

PRA

R

*Managing agents* must calculate the amount of the *resilience capital requirement* for the *long-term insurance business* carried on through the *syndicates* they manage.

3.1.64

PRA

R

The *Society* must determine the *resilience capital requirement* for the *insurance business* of each *member* under ■ INSPRU 3.1.10 R as the *member's* proportionate share of the *resilience capital requirement* calculated by the *managing agent* for the *long-term insurance business* carried on through the *syndicate*.

### Currency risk: matching of assets and liabilities

3.1.65

PRA

R

For the purposes of ■ INSPRU 3.1.53 R, a *managing agent* must ensure that:

- (1) *syndicate liabilities* are covered by matching *syndicate assets* as required by ■ INSPRU 3.1.53 R; or that
- (2) it immediately notifies to the *Society* the nature and extent of any *syndicate liabilities* not covered by matching assets under (1).

3.1.66

PRA

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On receipt of a notification by a *managing agent* under ■ INSPRU 3.1.65 R (2), the *Society* must ensure that the liabilities in respect of the *insurance business* of the members in aggregate are covered with matching assets complying with ■ INSPRU 3.1.53 R.

## 3.2 Derivatives in insurance

### Application

3.2.1

R

FCA PRA

This section applies to an *insurer*, unless it is:

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*; or
- (4) a *pure reinsurer*.

3.2.2

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FCA PRA

The scope of application of ■ INSPRU 3.2 is not restricted to *firms* that are subject to the relevant *EU* directives.

3.2.3

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FCA PRA

- (1) This section applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.
- (2) Where a *firm* carries on both *long-term insurance business* and *general insurance business*, this section applies separately to each type of business.

3.2.3A

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FCA PRA

References in this section to *GENPRU* are to *GENPRU* in the *PRA Handbook*.

### Purpose

3.2.4

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FCA PRA

■ GENPRU 2.2.17 R requires a *firm* to calculate its *capital resources* for the purpose of *GENPRU* in accordance with the *capital resources table*, subject to the limits in ■ GENPRU 2.2.32 R to ■ GENPRU 2.2.41 R. The *capital resources table* and ■ GENPRU 2.2.251 R require a *firm* to deduct from total *capital resources* the value of any asset included in an insurance fund which is not an *admissible asset* as listed in ■ GENPRU 2 Annex 7 R. ■ GENPRU 2 Annex 7 R provides that a *derivative*, *quasi-derivative* or *stock lending transaction* will only be an *admissible asset* if it is approved. This section sets out the criteria for determining when a *derivative*, *quasi-derivative* or *stock lending transaction* is approved for this purpose. ■ INSPRU 3.2.5 R to ■ INSPRU 3.2.35 R set out the criteria for *derivatives* and *quasi-derivatives*. ■ INSPRU 3.2.36 R to ■ INSPRU 3.2.41 R set out the criteria for *stock lending transactions*.

### Derivatives and quasi-derivatives

3.2.5

FCA PRA

R

For the purpose of ■ GENPRU 2 Annex 7 R (Admissible assets in insurance), and also in relation to *permitted links*, a *derivative* or *quasi-derivative* is approved if:

- (1) it is held for the purpose of efficient portfolio management (■ INSPRU 3.2.6 R to ■ INSPRU 3.2.7 R) or reduction of investment risk (■ INSPRU 3.2.8 R to ■ INSPRU 3.2.13 G);
- (2) it is covered ( ■ INSPRU 3.2.14 R to ■ INSPRU 3.2.33 G); and
- (3) it is effected or issued:
  - (a) on or under the rules of a *regulated market*; or
  - (b) off-market with an *approved counterparty* and, except for a forward transaction, on approved terms and is capable of valuation ( ■ INSPRU 3.2.34 R to ■ INSPRU 3.2.35 R).

3.2.5A

FCA PRA

G

- (1) ■ GENPRU 2 Annex 7 R (3) requires *firms* to consider first whether an asset is a *derivative* or *quasi-derivative* transaction notwithstanding that it is also capable of falling within one or more other categories in ■ GENPRU 2 Annex 7 R (1). If it is a *derivative* or *quasi-derivative* transaction it is only admissible if it satisfies the conditions for it to be approved under ■ INSPRU 3.2.5 R. *Firms* should be able to justify whether or not their assets are *derivatives* or *quasi-derivatives*.
- (2) A *quasi-derivative* is defined as a contract or asset that has the effect of a *derivative* contract. *Quasi-derivatives* may be regarded as those contracts or assets which are not *derivatives* but which effectively contain an embedded *derivative* component which significantly impacts the contracts or assets cash flow and risk profile so as to mirror the economic effect of a *derivative*. A *derivative* is defined in the *Glossary* as a *contract for differences*, a *future* or an *option* and includes a *securitised derivative*, which is an *option* or *contract for differences* that is *listed*. A *securitised derivative* may also be a *debenture*.
- (3) A deposit with interest or other return calculated by reference to an index or other factor is excluded from the definition of *contract for differences* by article 85(2) of the *Regulated Activities Order*. However, if the return on the deposit is in the nature of that on a *derivative* (for example, an *option* or a *future*) then the deposit is a *quasi-derivative*.
- (4) A holding in a fund investing in *derivatives* may or may not be a *quasi-derivative* depending on its ongoing investment policy and governance and any investment decisions from time to time which might deviate significantly from the investment policy. It should be treated as a *quasi-derivative* if its risk profile is such that the value of *units* in the fund is expected to mirror the value of a *derivative*.
- (5) The assets in the following list, which is illustrative and not exhaustive, all have features which could lead to their being assumed to be *quasi-derivatives*:

- (a) a bond whose redemption proceeds are directly linked to the performance of the FTSE 100 index but with a guaranteed minimum;
- (b) an investment fund that is managed to give high leverage that mirrors a call option;
- (c) an investment whose value it is reasonably foreseeable could become negative; and
- (d) a credit-linked note, that is, a security with an embedded credit default swap.

### Efficient portfolio management

3.2.6

FCA PRA

R

A *derivative* or *quasi-derivative* is held for the purpose of efficient portfolio management if the *firm* reasonably believes the *derivative* or *quasi-derivative* (either alone or together with any other covered transactions) enables the *firm* to achieve its investment objectives by one of the following (or, in relation to *permitted links*, in a manner which includes but is not limited to) :

- (1) generating additional capital or income in one of the ways described in ■ INSPRU 3.2.7 R; or
- (2) reducing tax or investment cost in relation to *admissible assets* or *permitted links* ; or
- (3) acquiring or disposing of rights in relation to *admissible assets* or *permitted links* , or their equivalent, more efficiently or effectively.

### Generation of additional capital or income

3.2.7

FCA PRA

R

The generation of additional capital or income falls within ■ INSPRU 3.2.6 R (1) where it arises from:

- (1) taking advantage of pricing imperfections in relation to the acquisition and disposal (or disposal and acquisition) of rights in relation to assets the same as, or equivalent to, *admissible assets* or *permitted links*; or
- (2) receiving a premium for selling a covered call *option* or its equivalent, the underlying of which is an *admissible asset* or *permitted link* , even if that additional capital or income is obtained at the expense of surrendering the chance of greater capital or income.

### Reduction of investment risk

3.2.8

FCA PRA

R

A *derivative* or *quasi-derivative* is held for the purpose of reducing investment risk if the *derivative* or *quasi-derivative* (either alone or together with other fully covered transactions) reduces any aspect of investment risk without significantly increasing any other aspect of that risk.

3.2.9

FCA PRA

R

**Significant increase in risk**

For the purposes of ■ INSPRU 3.2.8 R, an increase in risk from a *derivative* or *quasi-derivative* is significant unless:

- (1) relative to any reduction in investment risk it is both small and reasonable; or
- (2) the risk is remote.

3.2.10

FCA PRA

G

■ INSPRU 3.2.8 R does not require that a *derivative* or *quasi-derivative* has no possible adverse consequences. Often a *derivative* or *quasi-derivative* is effected to protect against a severe adverse consequence that only arises in one circumstance. In all other circumstances it may itself lead to adverse consequences, even if only because it expires worthless resulting in the loss of the purchase price. Conversely a *derivative* or *quasi-derivative* may reduce risk in a wide range of circumstances but lead to adverse consequences when a particular circumstance arises, e.g. the default of the *counterparty*. Only rarely does a *derivative* or *quasi-derivative* give rise to no adverse consequences in any circumstances. The test is merely that the increase in risk should not be significant, that is it should be both small and reasonable, or the risk should be remote.

3.2.11

FCA PRA

G

*Firms* are reminded that ■ INSPRU 2.1 (Credit risk in insurance) sets out the different types of loss mitigation techniques.

**Investment risk**

3.2.12

FCA PRA

R

For the purposes of ■ INSPRU 3.2.8 R, investment risk is the risk that the assets held by a *firm*:

- (1) (where they are *admissible assets* held by the *firm* to cover its *technical provisions*) might not be:
  - (a) of a value at least equal to the amount of those *technical provisions* as required by ■ INSPRU 1.1.20 R; or
  - (b) of appropriate safety, yield and marketability as required by ■ INSPRU 1.1.34 R (1)(a); or
  - (c) of an appropriate currency match as required by ■ INSPRU 3.1.53 R;
- (2) (where they are held to cover *index-linked liabilities*) might not be appropriate cover for those liabilities as required by ■ INSPRU 3.1.58 R; and
- (3) (where they are held to cover *property-linked liabilities*) might not be appropriately selected in accordance with contractual and constructive liabilities as required by ■ INSPRU 1.5.36 R and appropriate cover for those liabilities as required by ■ INSPRU 3.1.57 R.

## 3.2.13

FCA PRA

G

In assessing whether investment risk is reduced, the impact of a transaction on both the assets and liabilities should be considered. In particular, where the amount of liabilities depends upon the fluctuations in an index or other factor, investment risk is reduced where assets whose value fluctuates in the same way match those liabilities. In appropriate circumstances this may include:

- (1) a *derivative* or *quasi-derivative* that is linked to the same index as the liabilities from the index-linked contracts; and
- (2) a *derivative* or *quasi-derivative* whose value depends upon the factors which give rise to general insurance claims, e.g. a weather *quasi-derivative*.

**Cover**

## 3.2.14

FCA PRA

R

A *firm* must cover an obligation to transfer assets or pay monetary amounts that arises from:

- (1) a *derivative* or *quasi-derivative*; or
- (2) a contract (other than a *contract of insurance*) for the purchase, sale or exchange of assets.

## 3.2.15

FCA PRA

R

An obligation to transfer assets or pay monetary amounts (see ■ INSPRU 3.2.14 R) must be covered:

- (1) by assets, a liability or a provision (see ■ INSPRU 3.2.16 R to ■ INSPRU 3.2.24 R); or
- (2) by an offsetting transaction (see ■ INSPRU 3.2.25 R to ■ INSPRU 3.2.27 R).

## 3.2.16

FCA PRA

R

An obligation to transfer assets (other than *money*) or to pay monetary amounts based on the value of, or income from, assets is covered if the *firm* holds:

- (1) those assets; or
- (2) in the case of an index or basket of assets, a reasonable approximation to those assets.

## 3.2.17

FCA PRA

R

An obligation to pay a monetary amount (whether or not falling in ■ INSPRU 3.2.16 R) is covered if:

- (1) the *firm* holds *admissible assets* or *permitted links* that are sufficient in value so that the *firm* reasonably believes that following reasonably foreseeable adverse variations (relying solely on cashflows from, or from realising, those assets) it could pay the monetary amount in the right currency when it falls due; or

- (2) the obligation to pay the monetary amount is offset by a liability. An obligation is offset by a liability where an increase in the amount of that obligation would be offset by a decrease in the amount of that liability; or
- (3) a provision at least equal to the value of the assets in (1) is implicitly or explicitly set up. A provision is implicitly set up to the extent that the obligation to pay the monetary amount is recognised under ■ GENPRU 1.3 (Valuation) either by offset against an asset or as a separate liability. A provision is explicitly set up if it is in addition to an implicit provision.

3.2.18

FCA PRA

R

A *firm* must implicitly or explicitly set up a provision equal to the value of the assets or offsetting transactions held to cover a non-approved *derivative* or *quasi-derivative* transaction.

3.2.19

FCA PRA

G

A *firm* is required to cover a *derivative* under ■ INSPRU 3.2.14R whether it satisfies the other conditions for approval under ■ INSPRU 3.2.5R or not. Under ■ INSPRU 3.2.17R a *firm* may cover an obligation to pay a monetary amount by setting up a provision. If the *derivative* is not covered at any time by other means then a provision needs to be set up to complete the cover taking into account obligations to pay monetary amounts that would arise if, for example, an obligation to transfer assets could not be met in full. By doing so, a *derivative* becomes covered. If it satisfies the other conditions under ■ INSPRU 3.2.5R it is an *approved derivative* and may be taken into account for solvency purposes to the extent permitted by the large exposure limits and market risk and counterparty limits.

3.2.20

FCA PRA

G

Exposure to a transaction includes exposure that arises from a right at the *firm's* (or its *subsidiary undertaking's*) option to dispose of assets.

3.2.21

FCA PRA

G

Cover serves three purposes. First, it protects against exposure to loss from the transaction which is being covered. The value of the cover increases (or if the cover is a liability the amount of that liability decreases) to match any increase in obligations under the transaction.

3.2.22

FCA PRA

G

The second purpose of cover is that it prevents excessive gearing in the investment portfolio by the use of *options* and their equivalent. A *firm* is required to cover all obligations under an admissible transaction including obligations that would arise only at the option of the *firm*, e.g. the liability to pay the exercise price under a bought *option*.

3.2.23

FCA PRA

G

The third purpose of cover is that it protects against the risk that the *firm* may not be able to deliver assets (including *money* in any currency) of the right type when the obligation falls due under the transaction. An obligation to deliver assets is covered only if the *firm* holds those assets or has entered into an offsetting transaction that would deliver those assets when needed. An obligation to pay *money* is offset only if the *firm* holds cash in the right currency, its equivalent or assets that could reliably be converted into cash in the right currency.

3.2.24 FCA PRA R Cover used for one transaction must not be used for cover in respect of another transaction or any other agreement to acquire, or dispose of, assets or to pay or repay *money*.

#### Offsetting transactions

3.2.25 FCA PRA R An offsetting transaction means:

- (1) an *approved derivative*, *approved stock lending transaction* or an *approved quasi-derivative*; or
- (2) a covered transaction with an *approved counterparty* for the purchase of assets.

3.2.26 FCA PRA R A transaction offsets an obligation to transfer assets away from the *firm* only if it provides for the transfer to the *firm* of those assets, or their value, at the time, or before, the obligation falls due.

3.2.27 FCA PRA R A transaction offsets an obligation to pay a monetary amount only if it provides for that monetary amount to be paid to the *firm* at or before the earliest date on which the obligation might fall due.

#### Lending and borrowing assets

3.2.28 FCA PRA R Assets that have been lent by the *firm* are not available for cover, unless:

- (1) they are non-monetary assets that have been lent under a transaction that fulfils the conditions in ■ INSPRU 3.2.36 R; and
- (2) the *firm* reasonably believes the assets to be obtainable (by return or re-acquisition) in time to meet the obligation for which cover is required.

3.2.29 FCA PRA R Assets that have been borrowed by the *firm* are not available for cover except as allowed by ■ INSPRU 3.2.30 R.

3.2.30 FCA PRA R Borrowed *money* may be used as cover only where:

- (1) the *money* has been advanced or an *approved credit institution* has committed itself to advance the *money*; and
- (2) the borrowing is or would be covered.

3.2.31 FCA PRA G ■ INSPRU 3.2.30 R in effect allows borrowings to be used to bridge the gap between an obligation under a transaction that might fall due at one date and cash or its equivalent that would only become due at a later date. Borrowings may not be used to gear the investment portfolio.

## 3.2.32

FCA PRA

G

**Examples of cover requirements**

Examples of cover by assets for the purposes of ■ INSPRU 3.2.16 R:

- (1) a bought put *option* (or a sold call *option*) on 1000 1 *shares* (fully paid) of ABC plc is covered by an existing holding in the fund of 1000 1 *shares* (fully paid) of ABC plc;
- (2) a bought call *option* (or sold put *option*) on 1000 ordinary 1 *shares* (fully paid) of ABC plc is covered by cash (or its equivalent) which is sufficient in amount to meet the purchase price of the *shares* on exercise of the *option*;
- (3) a bought or sold *contract for differences* on short-dated sterling is covered by cash (or its equivalent), the value of which together at least match the notional principal of the contract. For example, a LIFFE short sterling contract, or a successive series of such contracts, is covered by 500,000; and
- (4) a sold *future* on the FT-SE 100 index is covered by holdings of equities, which satisfy the reasonable approximation test for cover in ■ INSPRU 3.2.16 R (2) in relation to that *future*, and the values of which together at least match the current mark to market valuation of the *future*. For example, if the multiplier per full point is 10, and if the eventual obligation under the *future* is currently 2800, the valuation of the *futures* position is  $2800 \times 10 = 28,000$ .

## 3.2.33

FCA PRA

G

Examples of cover by offsetting transactions for the purpose of ■ INSPRU 3.2.25 R would include a bought *future* which is guaranteed to deliver to the *firm* at the relevant time sufficient assets to cover liabilities under a sold call *option*.

**Off-market transactions**

## 3.2.34

FCA PRA

R

For the purpose of ■ INSPRU 3.2.5 R (3)(b), a *derivative* or *quasi-derivative* is on approved terms only if the *firm* reasonably believes that it could, in all reasonably foreseeable circumstances and under normal market conditions, readily enter into a further transaction with the *counterparty* or a third party to close out the *derivative* or *quasi-derivative* at a price not less than the value attributed to it by the *firm*, taking into account any valuation adjustments or reserves established by the *firm* under ■ GENPRU 1.3.29 R to ■ GENPRU 1.3.34 R.

## 3.2.34A

FCA PRA

G

In considering whether the first transaction could be readily closed out in all reasonably foreseeable circumstances under normal market conditions, the *firm* should satisfy itself that it cannot reasonably foresee any circumstances in which it would need to close out all or part of the contract at a few days' notice, and would not be able to do so.

## 3.2.35

FCA PRA

R

For the purpose of ■ INSPRU 3.2.5 R (3)(b), a *derivative* or *quasi-derivative* is capable of valuation only if the *firm*:

- (1) is able to value it with reasonable accuracy on a reliable basis in compliance with ■ GENPRU 1.3.4 R; and

- (2) reasonably believes that it will be able to do so throughout the life of the transaction.

3.2.35A

FCA PRA

G

The purpose of ■ INSPRU 3.2.34 R and ■ INSPRU 3.2.35 R is to ensure the appropriate application of ■ GENPRU 1.3 to *derivatives* and *quasi-derivatives* effected or issued off-market with an *approved counterparty*.

### Stock lending

3.2.36

FCA PRA

R

- (1) For the purposes of ■ GENPRU 2 Annex 7 R (Admissible assets in insurance), a *stock lending* transaction (including a *repo* transaction) is approved if:
- (a) the assets lent are *admissible assets*;
  - (b) , the *counterparty* is an *authorised person*, an *approved counterparty*, a *person* registered as a broker-dealer with the Securities and Exchange Commission of the United States of America or a bank, or a branch of a bank, supervised, and authorised to deal in investments as principal, with respect to *OTC derivatives* by at least one of the following federal banking supervisory authorities of the United States of America:
    - (i) the Office of the Comptroller of the Currency;
    - (ii) the Federal Deposit Insurance Corporation;
    - (iii) the Board of Governors of the Federal Reserve System; and
    - (iv) the Office of Thrift Supervision; and
  - (c) adequate and sufficiently immediate *collateral* ( ■ INSPRU 3.2.38 R to ■ INSPRU 3.2.41 R) is obtained to secure the obligation of the *counterparty*.
- (2) ■ INSPRU 3.2.36 R (1)(c) does not apply to a *stock lending* transaction made through Euroclear Bank SA/NV's Securities Lending and Borrowing Programme.

3.2.36A

FCA PRA

R

- (1) For the purposes of the *rules* on *permitted links*, a *stock lending* transaction (including a *repo* transaction) is approved if:
- (a) the assets lent are *permitted links*;
  - (b) the *counterparty* is an *authorised person*, an *approved counterparty*, a *person* registered as a broker-dealer with the Securities and Exchange Commission of the United States of America or a bank, or a branch of a bank, supervised, and authorised to deal in investments as principal, with respect to *OTC derivatives* by at least one of the following federal banking supervisory authorities in the United States of America:
    - (i) the Office of the Comptroller of the Currency;

- (ii) the Federal Deposit Insurance Corporation;
  - (iii) the Board of Governors of the Federal Reserve System; and
  - (iv) the Office of Thrift Supervision; and
- (c) adequately and sufficiently immediate *collateral* (■ INSPRU 3.2.38 R to ■ INSPRU 3.2.41 R) is obtained to secure the obligation of the *counterparty*; and
- (d) provided that, for the purposes of *property-linked assets* only:
- (i) where the *linked policyholder* bears the whole of the risk associated with the *stock lending* transaction, they must receive the whole of the recompense (net of fees and expenses);
  - (ii) the extent of any risk that the *linked policyholder* bears in relation to the *stock lending* transaction must be disclosed to them; and
  - (iii) where the risk associated with the *stock lending* transaction is borne outside the *linked fund*, the *linked fund* should receive a fair and reasonable recompense for the use of the *linked policyholders'* funds.

- (2) ■ INSPRU 3.2.36 R (1)(c) does not apply to a *stock lending* transaction made through Euroclear Bank SA/NVs Securities Lending and Borrowing Programme.

3.2.37

FCA PRA

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■ INSPRU 3.2.36 R refers only to *stock lending* transactions where the *firm* is the lender. There are no special *rules* for a transaction under which the *firm* borrows securities.

### Collateral

3.2.38

FCA PRA

R

For the purposes of ■ INSPRU 3.2.36 R (1)(c), *collateral* is adequate only if it:

- (1) is transferred to the *firm* or its agent or, in the case of a letter of credit, meets the conditions described in ■ INSPRU 3.2.38A R;
- (2) is, at the time of the transfer or, in the case of a letter of credit, at the time of issue, at least equal in value to the value of the securities transferred, or consideration provided, by the *firm*; and
- (3) is of adequate quality.

3.2.38A

FCA PRA

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The conditions referred to in ■ INSPRU 3.2.38 R (1) are that the letter of credit is:

- (1) direct, explicit, unconditional and irrevocable; and
- (2) issued by an *undertaking* which is:
  - (a) not a *related undertaking* of the *counterparty*; and
  - (b) either an *approved credit institution* or a bank, or a branch of a bank, whether chartered by the federal government of the United States of America or a US state, that is supervised and examined by at least one of the following US federal banking supervisory authorities:
    - (i) the Office of the Comptroller of the Currency;
    - (ii) the Federal Deposit Insurance Corporation;
    - (iii) the Board of Governors of the Federal Reserve System; and
    - (iv) the Office of Thrift Supervision.

3.2.39

FCA PRA

G

For the purposes of assessing adequate quality in ■ INSPRU 3.2.38 R (3), reference should be made to the criteria for credit risk loss mitigation set out in ■ INSPRU 2.1.16 R. The valuation rules in ■ GENPRU 1.3 apply for the purpose of determining the value of both *collateral* received, and the *securities* transferred, by the *firm*. In addition, where *collateral* takes the form of assets transferred, under the *rules* in *GENPRU* any such asset that is not an *admissible asset* (see ■ GENPRU 2 Annex 7 R) does not have a value.

3.2.40

FCA PRA

R

For the purposes of ■ INSPRU 3.2.36 R (1)(c), *collateral* is sufficiently immediate only if:

- (1) it is transferred or, in the case of a letter of credit, issued before, or at the same time as, the transfer of the *securities* by the *firm*;  
or
- (2) it will be transferred or, in the case of a letter of credit, issued, at latest, by the close of business on the day of the transfer.

3.2.41

FCA PRA

R

*Collateral* continues to be adequate only if its value is at all times at least equal to the value of the *securities* transferred by the *firm*. This will be satisfied in respect of *collateral* where the validity of the *collateral* or the *firm's* interest in the *collateral* is about to expire or has expired if sufficient *collateral* will again be transferred or issued at the latest by the close of business on the day of expiry.

3.2.42

FCA PRA

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References in ■ INSPRU 3.2.40 R (2) and ■ INSPRU 3.2.41 R to the close of business on the day of the transfer or the day of expiry are to close of business on that day in all time regions.

3.2.43

PRA

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**Application of INSPRU 3.2 to Lloyd's**

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■ INSPRU 3.2 applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, ■ INSPRU 8.1.4 R; and
- (2) for the *Society*, ■ INSPRU 8.1.2 R.

3

## Chapter 4

# Liquidity risk management



## 4.1 Application

**4.1.1** **R** ■ INSPRU 4.1 applies to an *insurer* unless ■ INSPRU 4.1.4 R applies.

**PRA**

**4.1.2** **R** All of ■ INSPRU 4.1, except ■ INSPRU 4.1.16 G, applies to:

**PRA**

- (1) an *EEA-deposit insurer*; and
- (2) a *Swiss general insurer*;

but only in respect of the activities of the *firm* carried on from a *branch* in the *United Kingdom*.

**4.1.3** **R** If a *firm* carries on:

**PRA**

- (1) *long-term insurance business*; and
- (2) *general insurance business*;

this section applies separately to each type of business.

**4.1.4** **R** This section does not apply to:

**PRA**

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*.

### Purpose

**4.1.5** **G** The purpose of this section is to amplify parts of *INSPRU* in their application to *liquidity risk* and, in so doing, to suggest minimum standards for management of that risk. The main relevant part, ■ SYSC 14 (Prudential risk management and associated systems and controls), itself amplifies *Principle 3* (Management and control) and SYSC (Senior management arrangements, Systems and Controls).

**PRA**

**4.1.6** **G** Appropriate management of *liquidity risk* will vary with the scale, nature and complexity of the *firm's* activities. Most of the material in this section is, therefore, *guidance*. The section lays out some of the main issues that the *PRA* expects a *firm* to consider in relation to *liquidity risk*. A *firm* should assess the appropriateness of any

**PRA**

particular item of *guidance* in the light of the scale, nature and complexity of its activities as well as its obligations as set out in *Principle 3* to organise and control its affairs responsibly and effectively.

4.1.7

PRA

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For *insurers*, references to *liquidity risk* in this section are intended to cover only those aspects of *liquidity risk* that do not fall under the heading of insurance risk. For such *firms*, the PRA sees the coverage of this section, broadly, as the management of risk arising from short-term cash-flows, rather than the risk arising from longer-term matching of assets and liabilities, which is part of insurance risk. *guidance* on systems and controls for managing insurance risk is set out in ■ SYSC 17 (Insurance risk systems and controls).

4.1.8

PRA

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This section addresses the need to deal both with liquidity management issues under normal market conditions, and with stressed or extreme situations resulting from either general market turbulence or firm-specific difficulties.

### Requirements

4.1.9

PRA

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High level requirements for prudential systems and controls including for *liquidity risk* are set out in ■ SYSC 14 (Prudential risk management and associated systems and controls). In particular:

- (1) ■ SYSC 14.1.18 R requires a *firm*, among other things, to take reasonable steps to ensure the establishment of a business plan and appropriate systems for the management of prudential risk; and
- (2) ■ SYSC 14.1.19 R (2) requires a *firm*, among other things, to document its policy for managing *liquidity risk*, including its appetite or tolerance for this risk and how it identifies, measures, monitors and controls this risk.

4.1.10

PRA

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This section sets out *guidance* on each of these areas, and notes a number of matters which the PRA would expect a *firm* to deal with in its *liquidity risk* policy statement as follows:

- (1) its *liquidity risk* strategy (see ■ INSPRU 4.1.12 G to ■ INSPRU 4.1.14 G), including:
  - (a) the role of marketable, or otherwise realisable, assets (see ■ INSPRU 4.1.21 G); and
  - (b) its strategy for mitigating *liquidity risk* on the liability side (see ■ INSPRU 4.1.26 G);
- (2) its method for measuring *liquidity risk* (see ■ INSPRU 4.1.44 G)

### Managing liquidity risk

4.1.11

PRA

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This section amplifies the general requirements in ■ SYSC 14 by describing the key high level arrangements that the PRA would normally expect to be in place to ensure that a *firm's liquidity risk* management system is adequate.

### Governing body and senior management oversight

4.1.12

PRA

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■ SYSC 14.1.11 G amplifies ■ SYSC 2.1.1 R and ■ SYSC 2.1.3 R which require the apportionment, and allocation, of significant responsibilities to be such that the business and affairs of the *firm* can be adequately monitored and controlled by the *directors*, relevant senior executives and *governing body* of the *firm*. Effective *liquidity risk* management entails an informed board, capable management and appropriate staffing. The *governing body* and senior management are responsible for understanding the nature and level of *liquidity risk* assumed by the *firm* and the tools used to manage that risk.

4.1.13

PRA

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In relation to *liquidity risk*, the *governing body's* responsibilities should normally include:

- (1) approving the *firm's liquidity risk* policy, which includes taking reasonable steps to ensure that it is consistent with the *firm's* expressed risk tolerance (see ■ INSPRU 4.1.15 G to ■ INSPRU 4.1.17 G);
- (2) establishing a structure for the management of *liquidity risk* including the allocation of appropriate senior managers who have the authority and responsibility to manage *liquidity risk* effectively, including the establishment and maintenance of the *firm's liquidity risk* policy;
- (3) monitoring the *firm's* overall *liquidity risk* profile on a regular basis and being made aware of any material changes in the *firm's* current or prospective *liquidity risk* profile; and
- (4) taking reasonable steps to ensure that *liquidity risk* is adequately identified, measured, monitored and controlled.

4.1.14

PRA

G

A *firm* should have an appropriate senior management structure in place to oversee the daily and long-term management of *liquidity risk* in line with the *governing body*-approved *liquidity risk* policy (see ■ INSPRU 4.1.15 G to ■ INSPRU 4.1.17 G). The PRA would normally expect the senior management to:

- (1) oversee the development, establishment and maintenance of procedures and practices that translate the goals, objectives and risk tolerances approved by the *governing body* into operating standards that are consistent with the *governing body's* intent and understood by the relevant members of a *firm's* personnel;
- (2) adhere to the lines of authority and responsibility that the *governing body* has established for managing *liquidity risk*;
- (3) oversee the establishment and maintenance of management information (see ■ INSPRU 4.1.53 G to ■ INSPRU 4.1.55 G) and other systems that identify, measure, monitor and control the *firm's liquidity risk*; and
- (4) oversee the establishment of effective *internal controls* over the *liquidity risk* management process (see ■ INSPRU 4.1.56 G to ■ INSPRU 4.1.68 G (Controlling liquidity risk)).

### Liquidity risk policy

4.1.15

PRA

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■ SYSC 3.2.17 G gives *guidance*, which amplifies ■ SYSC 3.2.6 R, on the need for a *firm* to plan its business appropriately so that it is able to identify, measure, monitor and control risks of regulatory concern. A *firm* should, therefore, have an agreed policy for the day-to-day and longer term management of *liquidity risk* which is appropriate to the nature, scale and complexity of the activities carried on.

4.1.16

PRA

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The *liquidity risk* policy should cover the general approach that the *firm* will take to *liquidity risk* management, including, as appropriate, various quantitative and qualitative targets. This general approach should be communicated to all relevant functions within the organisation and be included in the *firm's liquidity risk* policy statement.

4.1.17

PRA

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The policy for managing *liquidity risk* should cover specific aspects of *liquidity risk* management. So far as appropriate to the nature, scale and complexity of the activities carried on, such aspects might include:

- (1) the basis for managing liquidity (for example, regional or central);
- (2) the degree of concentrations, potentially affecting *liquidity risk*, that are acceptable to the *firm*;
- (3) a policy for managing the liability side of *liquidity risk* (see ■ INSPRU 4.1.26 G);
- (4) the role of marketable, or otherwise realisable, assets (see ■ INSPRU 4.1.21 G);
- (5) ways of managing both the *firm's* aggregate foreign currency liquidity needs and its needs in each individual currency;
- (6) ways of managing market access;
- (7) the use of *derivatives* to minimise *liquidity risk*; and
- (8) the management of intra-day liquidity, where this is appropriate, for instance where the *firm* is a member of or participates (directly or indirectly) in a system for the intra-day settlement of payments or transactions in investments.

### Identifying liquidity risk

4.1.18

PRA

G

In order to manage *liquidity risk* successfully, a *firm* should be aware of the ways in which its activities can affect its *liquidity risk* profile, and how outside influences may affect its liquidity position. A *firm* should consider not only its current *liquidity risk*, but how existing activities may affect its *liquidity risk* profile in the future; it should also consider the implications of new products or business lines. This section identifies the main sources of *liquidity risk* and the key factors that a *firm* might consider when analysing its *liquidity risk* profile.

4.1.19

PRA

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The *overall financial adequacy rule* states that a *firm* must maintain overall financial resources adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. The *firm* should, therefore, ensure that, overall, its financial resources are of appropriate maturity, and in a form which is sufficiently marketable or otherwise realisable, having regard to the expected timing of liabilities and the risk that liabilities may fall due earlier than expected (for which prudent

allowance must be made when assessing whether assets are of appropriate maturity or sufficiently realisable).

### Asset liquidity

4.1.20

PRA

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A *firm's* asset portfolio can provide liquidity in three major ways:

- (a) through the maturity of an asset;
- (b) the sale of an asset for cash; or
- (c) the use of an asset as *collateral* to back other transactions, such as for secured borrowing (including repos), or for deposits with insureds or cedants to back insurance or *reinsurance* transactions.

4.1.21

PRA

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A *firm* may incur *liquidity risk* where inflows from the realisation of assets (at either maturity or time of sale) are less than anticipated because of the crystallisation of credit risk or *market risk*. Inflows arising from the renewal of secured funding, including repos, are similarly affected, if the haircut (the difference between the value of an asset and the amount lent to the *firm* by the counterparty using that security as *collateral*) required by a *firm's* counterparty is larger than anticipated (see ■ INSPRU 4.1.28 G).

4.1.22

PRA

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Asset concentrations often increase these sources of *liquidity risk*. A *firm* should, therefore, identify significant concentrations within its asset portfolio, including in relation to:

- (1) individual counterparties or related groups of counterparties;
- (2) credit ratings of the assets in its portfolio;
- (3) the proportion of an issue held;
- (4) instrument types;
- (5) geographical regions; and
- (6) economic sectors.

### Marketable assets

4.1.23

PRA

G

Criteria for the marketability of its assets should be decided by the *firm* and may reflect the *firm's* access to, and expertise in, individual markets. In determining the appropriateness of the marketability or realisability of assets, a *firm* may take into account:

- (1) the depth and liquidity of the market, including:
  - (a) the speed with which assets may be realised;
  - (b) the likelihood and extent of forced-sale loss; and
  - (c) the potential for using the asset as *collateral* in secured funding and the size of the haircut (see ■ INSPRU 4.1.18 G) likely to be required by the counterparty;

- (2) the expected date of maturity, redemption, repayment or disposal;
- (3) the proportion of an issue held;
- (4) the credit ratings of the assets;
- (5) the impact of exchange rate risk on the realised value of the asset, where assets are denominated in different currencies from its liabilities; and
- (6) where applicable, the impact on certain assets' liquidity of their use as eligible *collateral* either in open-market operations conducted by, or in real-time or other payment systems operated by, a central bank.

4.1.24

PRA

G

The role of marketable, or otherwise realisable, assets in a *firm's liquidity risk* policy, in both normal and stressed conditions, should be set out in its *liquidity risk* policy statement.

4.1.25

PRA

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In considering the marketability of an asset, a *firm* should assess how its value and liquidity would be affected in a variety of scenarios (see ■ SYSC 11 (Liquidity risk management systems and controls) at ■ SYSC 11.1.18 G, ■ SYSC 11.1.20 G, ■ SYSC 11.1.21 E and ■ SYSC 11.1.22 G).

### Adjusting for the behavioural characteristics of assets

4.1.26

PRA

G

In order to manage its *liquidity risk* effectively, a *firm* should be able to adjust for the behavioural characteristics of the repayment profiles of assets, that is how their actual behaviour may vary from that suggested by their contractual terms. Such an adjustment may be necessary in order to reduce the risk of wrongly estimating the inflows in relation to, in particular:

- (1) standby facilities or other commitments that have already been drawn down;
- (2) retail and wholesale overdrafts;
- (3) mortgages; and
- (4) credit cards.

4.1.27

PRA

G

The repayment profiles should be considered under both normal market conditions and stressed conditions resulting from either general market turbulence or *firm-specific* difficulties (see ■ SYSC 11 (Liquidity risk management systems and controls) at ■ SYSC 11.1.18 G, ■ SYSC 11.1.20 G, ■ SYSC 11.1.21 E, ■ SYSC 11.1.22 G, ■ SYSC 11.1.23 G and ■ SYSC 11.1.24 E).

### Inflows from off balance sheet items

4.1.28

PRA

G

Where a *firm* has in place a committed facility for the provision of a portion of its funding, it should take care to monitor any covenants included in the agreement. It should also make efforts to retain a good relationship with the provider of the facility and, where possible without jeopardising that relationship, regularly test access to the funds. A *firm* should also assess the extent to which committed facilities can be relied upon under stressed conditions (see ■ SYSC 11.1.22 G and ■ SYSC 11.1.24 E).

### Liability liquidity

4.1.29

PRA

G

Holding marketable, or otherwise realisable, assets is not the only way for a *firm* to mitigate the *liquidity risk* it faces. There are a number of liability-side strategies that can be used to reduce a *firm's liquidity risk*, such as ensuring a spread of maturities and lengthening the term structure of its liabilities. In order to manage its *liquidity risk* effectively a *firm* should have a liability-side policy that is appropriate to the nature and scale of its activities; this policy should be described in its *liquidity risk* policy statement.

4.1.30

PRA

G

When determining the appropriate mix of liabilities, a *firm's* management should consider potential concentrations. A concentration exists when a single decision or factor could cause a significant and sudden claim on liabilities. What constitutes a liability concentration depends on the nature and scale of a *firm's* activities. A *firm* should, however, normally consider:

- (1) the term structure of its liabilities;
- (2) the credit-sensitivity of its liabilities;
- (3) the mix of secured and unsecured funding;
- (4) concentrations among its liability providers, or related groups of liability providers;
- (5) reliance on particular instruments or products;
- (6) the geographical location of liability providers; and
- (7) reliance on intra-group funding.

4.1.31

PRA

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A *firm* with credit-sensitive liabilities should be aware that, in times of market turbulence, a proportion of that funding may be withdrawn, particularly funding which is unsecured. Secured funding may also be affected, with counterparties seeking better quality *collateral* or larger haircuts (see ■ INSPRU 4.1.18 G) on *collateral*. A *firm* should recognise these characteristics of its credit-sensitive liabilities and take account of them in its stress testing and scenario analysis and *contingency funding plan* (see ■ SYSC 11 (Liquidity risk management systems and controls) at ■ SYSC 11.1.18 G, ■ SYSC 11.1.20 G, ■ SYSC 11.1.21 E, ■ SYSC 11.1.22 G, ■ SYSC 11.1.23 G and SYSC 11.1.24E).

4.1.32

PRA

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A *firm* should consider the dynamics of its *liquidity risk* including, for example, the normal level of roll-overs, and growth, of liabilities.

### Adjusting for the behavioural characteristics of liabilities

4.1.33

PRA

G

In order to meet the requirement to maintain sufficient liquid financial resources (see ■ INSPRU 4.1.16 G), a *firm* should consider the behavioural characteristics of its liabilities, that is how their actual behaviour may vary from that suggested by their contractual terms.

4.1.34

PRA

G

In assessing how to adjust for the behavioural characteristics of its liabilities in the context of *liquidity risk*, an *insurer* may take into account:

- (1) the type of *insurance business*;
- (2) the past history of volatility in the pattern of *claims* payment;
- (3) options available to *policyholders* and the circumstances in which they are likely to be exercised;
- (4) options available to the *insurer* and any incentive for the *insurer* to exercise them;
- (5) any relevant requirements to deposit *collateral* either with the insured (or cedants) under the terms of the insurance Treaty or by requirements of overseas regulators as a condition for covering risks in a particular territory; and
- (6) the other cash flow needs of the business.

#### Outflows from off balance sheet items

4.1.35

PRA

G

The contingent or optional nature of many off balance sheet instruments adds to the complexity of managing off balance sheet cash flows. In particular, in stressed conditions off balance sheet commitments may be a significant drain on liquidity.

4.1.36

PRA

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A *firm* should consider how its wholesale off balance sheet activities affect its cash flows and *liquidity risk* profile under both normal and stressed conditions. In particular, as appropriate, it should consider the amount of funding required by:

- (1) commitments given;
- (2) standby facilities given;
- (3) wholesale overdraft facilities given;
- (4) proprietary *derivatives* positions; and
- (5) liquidity facilities given for securitisation transactions.

4.1.37

PRA

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Similarly, a *firm* with retail *customers* should be able to assess the likely draw-down on retail products under a variety of circumstances and taking into account seasonal factors. In particular, as appropriate, it should consider the amount of funding required in relation to:

- (1) mortgages that have been agreed but not yet drawn down;
- (2) overdrafts; and
- (3) credit cards.

### Asset securitisations

4.1.38

PRA

G

If controlled properly, asset securitisation can be a useful tool in enhancing a *firm's* liquidity. However, features of certain securitisations, such as early amortisation triggers, as well as excessive reliance on a single funding vehicle, can increase *liquidity risk*.

4.1.39

PRA

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The implications of securitisations on a *firm's* liquidity position should be considered for both day-to-day liquidity management and its contingency planning for *liquidity risk*. A contemplated securitisation should be analysed for its impact on *liquidity risk*. A *firm* using securitisation should consider:

- (1) the volume of securities issued in connection with the securitisation that are scheduled to amortise during any particular period;
- (2) the existence of early amortisation triggers (see also ■ SYSC 11.1.22 G);
- (3) its plans for meeting its funding requirements (including their timing);
- (4) strategies for obtaining substantial amounts of liquidity at short notice (see also ■ SYSC 11.1.24 E); and
- (5) operational issues associated with the rollover of short-dated securities, particularly commercial paper.

4.1.40

PRA

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If a *firm* is a provider of liquidity facilities for securitisation transactions it should be able to assess the probability and scale of draw-down and make provision for it.

4.1.41

PRA

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A *firm* using securitisation should also be aware that its ability to securitise assets may diminish in stressed market conditions and take account of this in its stress testing and *contingency funding plan*. In addition, the time taken to organise a securitisation transaction may mean that it cannot be relied upon to provide liquidity at short notice.

### Foreign currency liquidity

4.1.42

PRA

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Foreign currency *liquidity risk* arises where a *firm* faces actual or potential future outflows in a particular currency which it may not be able to meet from likely available inflows in that currency. A *firm's* exposure to foreign currency *liquidity risk* depends on the nature, scale and complexity of its business. Where a *firm* has significant, unhedged liquidity mismatches in particular currencies, it should consider:

- (1) the volatilities of the exchange rates of the mismatched currencies;
- (2) likely access to the foreign exchange markets in normal and stressed conditions; and
- (3) the stickiness of deposits in those currencies with the *firm* in stressed conditions.

4.1.43

PRA

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A possible strategy for mitigating foreign currency *liquidity risk*, which is effective and simple, is for a *firm* to hold assets in a particular currency in an amount equal to, and realisable at maturities no later than, its liabilities in that currency. This strategy may

be worth considering particularly where, as a result of the nature, scale and complexity of its business, a *firm's liquidity risk* is relatively small.

### Intra-day liquidity

4.1.44

PRA

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■ SYSC 3.1.1 R requires a *firm* to take reasonable care to establish and maintain systems and controls appropriate to its business. This includes appropriate systems and controls over activities that give rise to significant *market*, credit, *liquidity*, insurance, operational or group risk, including over the processes of settling and paying debts and other commitments that arise from those activities.

4.1.45

PRA

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Structural and operational changes in payment systems have increased the importance of intra-day liquidity for many *firms*. Within real time gross settlement systems, for example, a *firm* needs to take appropriate steps to ensure that it has sufficient *collateral* to cover cash positions and has systems capable of monitoring intra-day liquidity positions and cash needs.

4.1.46

PRA

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A *firm* should be aware that in stressed conditions it is likely to require more intra-day liquidity than in normal market conditions, for a variety of reasons including payments due to the *firm* being delayed and wholesale depositors withdrawing from the market. A *firm* should take account of this in its stress testing and scenario analysis.

### Measuring liquidity risk

4.1.47

PRA

G

A *firm* should establish and maintain a process for the measurement of *liquidity risk*, using a robust and consistent method which should be described in its *liquidity risk* policy statement.

4.1.48

PRA

G

A number of techniques can be used for measuring *liquidity risk*, ranging from simple calculations to highly sophisticated modelling; a *firm* should use a measurement method which is appropriate to the nature, scale and complexity of its activities.

4.1.49

PRA

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The method that a *firm* uses for measuring *liquidity risk* should be capable of:

- (1) measuring the extent of the *liquidity risk* it is incurring;
- (2) dealing with the dynamic aspects of a *firm's* liquidity profile (for example, rollovers of funding and assets or new business);
- (3) assessing the behavioural characteristics of its on and off balance sheet instruments; and
- (4) where appropriate, measuring the *firm's* exposure to foreign currency *liquidity risk*.

### Monitoring liquidity risk

4.1.50

PRA

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A *firm* should establish and maintain an appropriate system for monitoring its *liquidity risk*, which should be described in its *liquidity risk* policy statement.

**4.1.51** **PRA** **G** A *firm* should establish and maintain a system of management reporting which provides clear, concise, timely and accurate *liquidity risk* reports to relevant functions within the *firm*. These reports should alert management when the *firm* approaches, or breaches, predefined thresholds or limits, including quantitative limits imposed by the *PRA* or another regulator.

**4.1.52** **PRA** **G** Where a *firm* is a member of a *group*, it should be able to assess the potential impact on it of *liquidity risk* arising in other parts of the *group*.

### Management information systems

**4.1.53** **PRA** **G** A *firm* should have adequate information systems for controlling and reporting *liquidity risk*. The management information system should be used to check for compliance with the *firm's* established policies, procedures and limits.

**4.1.54** **PRA** **G** Reports on *liquidity risk* should be provided on a timely basis to the *firm's governing body*, senior management and other appropriate personnel. The appropriate content and format of reports depends on a *firm's* liquidity management practices and the nature, scale and complexity of the *firm's* business. Reports to the *firm's* governing body may be less detailed and less frequent than reports to senior management with responsibility for managing *liquidity risk*.

**4.1.55** **PRA** **G** When considering what else might be included in *liquidity risk* management information, a *firm* should consider other types of information that may be important for understanding its *liquidity risk* profile.

### Controlling liquidity risk

**4.1.56** **PRA** **G** A *firm* should establish and maintain an appropriate system for controlling its *liquidity risk*, which should be described in its *liquidity risk* policy statement. Such a system should allow the *firm's governing body* and senior management to review compliance with established limits and operating procedures.

**4.1.57** **PRA** **G** A *firm* should have in place appropriate approval processes, limits and other mechanisms designed to provide reasonable assurance that the *firm's liquidity risk* management processes are adhered to.

**4.1.58** **PRA** **G** When revisions or enhancements to *internal controls* are warranted, a *firm* should implement them in a timely manner.

**4.1.59** **PRA** **G** The effectiveness of a *firm's liquidity risk* management system should be regularly reviewed and evaluated by individuals unconnected with day-to-day *liquidity risk* management in order to check that personnel are following established policies and procedures, and that procedures accomplish the intended objectives.

**4.1.60** **PRA** **G** In addition to the regular review and evaluation described in **INSPRU 4.1.59 G**, a *firm's* internal audit function (see **SYSC 3.2.16 G** or, as the case may be, **SYSC 6.2.1 R**) should periodically review the *liquidity risk* management process in order to identify any weaknesses or problems. Any weaknesses should be addressed by management in a timely and effective manner.

**Limit Setting**

4.1.61

PRA

G

A *firm's* senior management should decide what limits need to be set, in accordance with the nature, scale and complexity of its activities. The structure of limits should reflect the need for a *firm* to have systems and controls in place to guard against a spectrum of possible risks, from those arising in day-to-day *liquidity risk* management to those arising in stressed conditions.

4.1.62

PRA

G

■ SYSC 14.1.18 R states that a *firm* must take reasonable steps to ensure the establishment and maintenance of a business plan and appropriate systems for the management of prudential risk.

4.1.63

PRA

A

- (1) If a *firm* has *liquidity risk* that arises because it has substantial exposures in foreign currencies, the risk management systems of the *firm* referred to in ■ SYSC 14.1.18 R should include systems and procedures that are designed to ensure that the *firm* does not, except in accordance with those procedures, exceed limits that are designed to limit:
- (a) the aggregate amount of its *liquidity risk* for all exposures in foreign currencies; and
  - (b) the amount of its *liquidity risk* for each individual currency in which it has a significant exposure.
- (2) Contravention of (1) may be relied upon as tending to establish contravention of ■ SYSC 14.1.18 R.

4.1.64

PRA

G

A *firm* should periodically review and, where appropriate, adjust its limits when conditions or risk tolerances change.

4.1.65

PRA

G

Policy or limit exceptions should receive the prompt attention of the appropriate management and should be resolved according to processes described in approved policies.

**Managing market access**

4.1.66

PRA

G

A *firm* should periodically review its efforts to establish and maintain relationships with liability providers, to maintain adequate diversification of liabilities, and to ensure adequate capacity to sell assets, or use them as *collateral* in secured funding. Where possible the *firm* should aim regularly to test its access to the individual markets in assets that it holds for liquidity purposes.

4.1.67

PRA

G

Market access should be assessed under a variety of normal and stressed conditions.

4.1.68

PRA

G

In some circumstances, the disclosure of information about a *firm* may be useful in managing the public perception of its organisation and soundness. A *firm* should consider the role of disclosure in managing the *liquidity risk* to which it is exposed.

**Application of INSPRU 4.1 to Lloyd's**

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4.1.69

PRA

G

■ INSPRU 4.1 applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, ■ INSPRU 8.1.4 R; and
- (2) for the *Society*, ■ INSPRU 8.1.2 R

4.1.70

PRA

G

In accordance with ■ INSPRU 8.6.2 R, the *rules* and *guidance* in ■ INSPRU 4.1 relating to the establishment and maintenance of a business plan do not apply to the *Society*.

## Chapter 5

# Operational Risk Management



## 5.1 Application

### 5.1.1

PRA

G

■ INSPRU 5.1 applies to an *insurer* unless it is:

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*.

### 5.1.2

PRA

G

■ INSPRU 5.1 applies to:

- (1) an *EEA-deposit insurer*; and
- (2) a *Swiss general insurer*;

only in respect of the activities of the *firm* carried on from a *branch* in the *United Kingdom*.

### Purpose

### 5.1.3

PRA

G

This section provides *guidance* on how to interpret ■ SYSC 14.1.18 R and ■ SYSC 14.1.19 R (2) (which relate to the design and documentation of risk management systems) . Operational risk has been described by the Basel Committee on Banking Supervision as "the risk of loss, resulting from inadequate or failed internal processes, people and systems, or from external events". Thus this section covers management of risks concerning any of the *firm's* operations, whether caused by internal or external matters. However, it does not cover management of credit, market, liquidity and insurance risk. Examples of operational risk exposures that this section is meant to address include internal and external fraud; failure to comply with employment law or meet workplace safety standards; damage to physical assets; business disruptions and system failures; and transaction processing failures.

### 5.1.4

PRA

G

Operational risk concerns the *PRA* because inappropriate management of operational risk can adversely affect the solvency or business continuity of a *firm*, threatening the *statutory objectives* of promoting the *firm's* safety and soundness and contributing to the securing of an appropriate degree of protection for those who are or may become *policyholders* .

**5.1.5** **PRA** **G** This section contains *guidance* on how a *firm* should determine its policy for operational risk management and its processes for the identification, assessment, monitoring and control of operational risk. In addition, *guidance* is provided on record keeping in relation to operational risk.

**5.1.6** **PRA** **G** The *guidance* contained within this section is not designed to be exhaustive. When establishing and maintaining its systems and controls for operational risk, a *firm* should have regard to other parts of the *Handbook* as well as the material that is issued by other industry or regulatory bodies. In particular, a *firm* should read this section in conjunction with ■ SYSC 13 (Operational Risk Systems and Controls) which contains high level *guidance* on the management of people, processes and systems, and external events in relation to operational risk. ■ SYSC 13 also outlines some *guidance* on the areas that are covered by operational risk systems and controls (including the *PRA*'s interpretation of some frequently used risk management terms in relation to operational risk), business continuity management, outsourcing, and the role of insurance in financing operational risk. In addition, a *firm* should read ■ SYSC 14, which contains the *PRA*'s general policy on prudential systems and controls. ■ SYSC 14 contains some *rules* and *guidance* on which this section offers additional *guidance*.

**5.1.7** **PRA** **G** *Guidance* on the application of this section to a *firm* that is a member of a *group* is provided in ■ SYSC 12 (Group Risk Systems and Controls).

**5.1.8** **PRA** **G** Appropriate management of operational risk will vary with the scale, nature and complexity of a *firm*'s activities. Therefore the material in this section is *guidance*. A *firm* should assess the appropriateness of any particular item of *guidance* in the light of the scale, nature and complexity of its activities as well as its obligations as set out in *Principle 3* to organise and control its affairs responsibly and effectively.

**Operational risk policy**

**5.1.9** **PRA** **G** Much of the management of operational risk is about identifying, assessing, monitoring and controlling failures or inadequacies in a *firm*'s systems and controls. As such, a *firm* may often find that there is no clear boundary between its risk management systems for operational risk and all its other systems and controls. When drafting its operational risk policy, a *firm* should try to distinguish between its systems and controls for credit, market, liquidity and insurance risk, and its systems and controls for operational risk. Where such a distinction is not possible a *firm* should still try to identify those systems and controls that are used in the management of operational risk, even when they have other purposes as well.

**5.1.10** **PRA** **G** A *firm* should document its policy for managing operational risk. This policy should outline a *firm*'s strategy and objectives for operational risk management and the processes that it intends to adopt to achieve these objectives. In complying with ■ SYSC 14.1.19 R (2), the documented operational risk policy of a *firm* should include:

- (1) an analysis of the *firm*'s operational risk profile (see the *PRA*'s interpretation of this term in ■ SYSC 13.5.1 G (3)), including where relevant some consideration of the effects that operational risk may have on the firm, including consideration of those operational risks within a *firm* that may have an adverse impact upon the quality of service afforded to its *clients*;

- (2) the operational risks that the *firm* is prepared to accept and those that it is not prepared to accept, including where relevant some consideration of its appetite or tolerance (see ■ INSPRU 5.1.12 G) for specific operational risks;
- (3) how the *firm* intends to identify, assess, monitor, and control its operational risks, including an overview of the people, processes and systems that are used; and
- (4) where assessments of the *firm's* risk exposures are used for internal capital allocation purposes, a description of how operational risk is incorporated into this methodology.

5.1.11  
PRA

G

A *firm* may also wish to set threshold levels in its operational risk policy for particular types of operational risk (based on its risk appetite or tolerance for risk), which when exceeded trigger a response (such as the allocation of more resources to control the risk or a reappraisal of business plans).

5.1.12  
PRA

G

Given its association with a willingness to take risk, a *firm* may wish to replace the term appetite for tolerance when drafting its operational risk policy. Tolerance describes the types and degree of operational risk that a *firm* is prepared to incur (based on factors such as the adequacy of its resources and the nature of its operating environment). Tolerance may be described in terms of the maximum budgeted (that is, expected) costs of an operational risk that a *firm* is prepared to bear, or by reference to risk indicators such as the cost or number of system failures, available spare capacity and the number of failed trades.

5.1.13  
PRA

G

The term risk assessment can be used to represent both the qualitative and quantitative evaluation or measurement of operational exposures.

**Risk identification**

5.1.14  
PRA

G

In order to understand its operational risk profile, a *firm* should identify the types of operational risk that it is exposed to as far as reasonably possible. This might include, but is not limited to, consideration of:

- (1) the nature of a *firm's* customers, products and activities, including sources of business, distribution mechanisms, and the complexity and volumes of transactions;
- (2) the design, implementation, and operation of the processes and systems used in the end-to-end operating cycle for a *firm's* products and activities;
- (3) the risk culture and human resource management practices at a *firm*; and
- (4) the business operating environment, including political, legal, socio-demographic, technological, and economic factors as well as the competitive environment and market structure.

5.1.15  
PRA

G

A *firm* should recognise that it may face significant operational exposures from a product or activity that may not be material to its business strategy. A *firm* should consider the appropriate level of detail at which risk identification is to take place,

and may wish to manage the operational risks that it faces in risk categories that are appropriate to its organisational and legal structures.

5.1.16  
PRA

**G** The PRA's interpretation of the term operational exposure is provided in ■ SYSC 13.5.1 G (2).

**Risk assessment**

5.1.17  
PRA

**G** The PRA recognises that risk management systems for operational risk are still developing, and that it may be neither feasible nor appropriate to measure certain types of operational risk in a quantitative way. A *firm* may wish to take a qualitative approach to the assessment of its operational risks using, for example, relative estimates (such as high, medium, low) to understand its exposure to them.

5.1.18  
PRA

**G** In order to understand the effects of its operational exposures a *firm* should continually assess its operational risks. This might include, but is not limited to, consideration of:

- (1) actual operational losses that have occurred within a *firm*, or events that could have resulted in significant operational losses, but were avoided (for example, the waiving of financial penalties by a third party as a gesture of goodwill or where by chance the *firm* realised profits);
- (2) internal assessment of risks inherent in its operations and the effectiveness of controls implemented to reduce these risks (through activities such as self-assessment or stress testing and scenario analysis);
- (3) other risk indicators, such as *customer* complaints, processing volumes, *employee* turnover, large numbers of reconciling items, process or system failures, fragmented systems, systems subject to a high degree of manual intervention and transactions processed outside a *firm's* mainstream systems;
- (4) reported external (peer) operational losses and exposures; and
- (5) changes in its business operating environment.

5.1.19  
PRA

**G** When assessing its operational risks, a *firm* may be able to differentiate between expected and unexpected operational losses. A *firm* should consider whether it is appropriate to adopt a more quantitative approach to the assessment of its expected operational losses, for example by defining tolerance, setting thresholds, and measuring and monitoring operational losses and exposures. In contrast, a *firm* may wish to take a more qualitative approach to assessing its unexpected losses.

5.1.20  
PRA

**G** Although a *firm* may currently be unable to assess certain operational risks with a high degree of accuracy or consistency, it should, according to the nature, scale and complexity of its business, consider the use of more sophisticated qualitative and quantitative techniques as they become available.

**Risk monitoring**

5.1.21

PRA

G

In monitoring its operational risks, a *firm* should:

- (1) as appropriate, regularly report to the relevant level of management its operational exposures, loss experience (including if possible cumulative losses), and authorised deviations from the *firm's* operational risk policy;
- (2) engage in exception-based escalation to management of:
  - (a) unauthorised deviations from the *firm's* operational risk policy;
  - (b) likely or actual breaches in predefined thresholds for operational exposures and losses, where set; and
  - (c) significant increases in the *firm's* exposure to operational risk or alterations to its operational risk profile.

**Risk control**

5.1.22

PRA

G

A *firm* should control its operational risks, as appropriate, through activities for the avoidance, transfer, prevention or reduction of the likelihood of occurrence or potential impact of an operational exposure. This might include, but is not limited to, consideration of:

- (1) adjusting a *firm's* risk culture and creating appropriate incentives to facilitate the implementation of its risk control strategy (see ■ SYSC 13.6 People);
- (2) adapting internal processes and systems (see ■ SYSC 13.7 Processes and systems);
- (3) transferring or changing the operational exposure through mechanisms such as *outsourcing* (see ■ SYSC 13.9 Outsourcing) and insurance (see ■ SYSC 13.10 Insurance);
- (4) the active acceptance of a given operational risk within the *firm's* stated risk appetite or tolerance; and
- (5) providing for expected losses, and maintaining adequate financial resources against unexpected losses that may be encountered in the normal course of a *firm's* business activities.

**Record keeping**

5.1.23

PRA

G

The PRA's high level *rules* and *guidance* for record keeping are outlined in ■ SYSC 3.2.20 R (Records). Additional *rules* and *guidance* in relation to the *prudential context* are set out in ■ SYSC 14.1.51 G to ■ SYSC 14.1.64 G (Record keeping). In complying with these *rules* and all associated *guidance*, a *firm* should retain an appropriate record of its operational risk management activities. This may, for example, include records of:

- (1) the results of risk identification, measurement, and monitoring activities;
- (2) actions taken to control identified risks;

- (3) where relevant, any exposure thresholds that have been set for identified operational risks;
- (4) an assessment of the effectiveness of the risk control tools that are used; and
- (5) actual exposures against stated risk appetite or tolerance.

**Application of INSPRU 5.1 to Lloyd's**

5.1.24

PRA

G

■ INSPRU 5.1 applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, ■ INSPRU 8.1.4 R; and
- (2) for the *Society*, ■ INSPRU 8.1.2 R

5.1.25

PRA

G

In accordance with ■ INSPRU 8.5.2 G, the *rules* and *guidance* in ■ INSPRU 5.1 relating to the establishment and maintenance of a business plan do not apply to the *Society*.

5



## Chapter 6

# Group Risk: Insurance Groups



## 6.1 Application

6.1.1

PRA

R

■ INSPRU 6.1 applies to an *insurer* that is either:

- (1) a *participating insurance undertaking*; or
- (2) a member of an *insurance group* which is not a *participating insurance undertaking* and which is not:
  - (a) a *non-EEA insurer*; or
  - (b) a *friendly society*.

6.1.2

PRA

R

■ INSPRU 6.1 does not apply to:

- (1) a *non-directive friendly society*; or
- (2) a *Swiss general insurer*; or
- (3) an *EEA-deposit insurer*; or
- (4) an *incoming EEA firm*; or
- (5) an *incoming Treaty firm*.

6.1.3

PRA

G

■ INSPRU 6.1 applies to a *firm*:

- (1) on a solo basis, as an adjusted solo calculation, where that *firm* is a *participating insurance undertaking*; and
- (2) on a group basis where that *firm* is a member of an *insurance group*.

6.1.4

PRA

G

For the purposes of ■ INSPRU 6.1, an *insurer* includes a *friendly society* (other than a *non-directive friendly society*) and a *non-EEA insurer*.

6.1.5

PRA

G

### Purpose

The purpose of this section is to implement the *Insurance Groups Directive* on supplementary supervision of *firms* in an *insurance group*, as amended by the *Financial Groups Directive* and the *Reinsurance Directive*. The *Financial Groups Directive* (by

amending the *Insurance Directives* and the *Insurance Groups Directive*) introduces specific requirements for the treatment of *related undertakings* of an *insurance parent undertaking* or a *participating insurance undertaking* that are *credit institutions*, *investment firms* or *financial institutions*. The *Reinsurance Directive* (by amending the *Insurance Directives* and the *Insurance Groups Directive*) introduces supplementary supervision for *firms* that are *reinsurance undertakings* in an *insurance group*.

6.1.6  
PRA

G

■ INSPRU 6.1 sets out the *sectoral rules* for *insurers* for:

- (1) *firms* that are *participating insurance undertakings* carrying out an adjusted solo calculation as contemplated by ■ GENPRU 2.1.13 R (2)
- (2) *insurance groups*; and
- (3) *insurance conglomerates*.

6.1.6A  
PRA

G

In accordance with the definition, an *insurance holding company* ceases to be an *insurance holding company* if:

- (1) it is a *mixed financial holding company*; and
- (2) notice has been given in accordance with Article 4(2) of the *Financial Groups Directive* that the *financial conglomerate* of which it is a *mixed financial holding company* is a *financial conglomerate*;

otherwise it remains an *insurance holding company* for the purposes of this chapter.

6.1.7  
PRA

G

For a *firm* that is a *participating insurance undertaking*, the *rules* in ■ INSPRU 6.1 out the minimum capital adequacy requirements for the *firm* itself. A *firm* that satisfies the test in ■ INSPRU 6.1.9 R in relation to its *group capital resources* is deemed by ■ GENPRU 2.1.13 R (2) to be in compliance with the capital adequacy requirement set out in ■ GENPRU 2.1.13 R (1).

#### Requirement to calculate GCR and GCRR

6.1.8  
PRA

R

A *firm* must on a regular basis calculate the *group capital resources (GCR)* and *group capital resources requirement (GCRR)* of each *undertaking* referred to in ■ INSPRU 6.1.17 R.

#### Requirement to maintain group capital

6.1.9  
PRA

R

Where a *firm* is the *undertaking* referred to in ■ INSPRU 6.1.17 R (1)(c) or ■ INSPRU 6.1.17 R (2), it must maintain at all times *tier one capital resources* and *tier two capital resources* of such an amount that its *group capital resources* are equal to or exceed its *group capital resources requirement*.

6.1.10  
PRA

R

A *firm* that is both:

- (1) a *composite firm*; and

- (2) an *undertaking* referred to in ■ INSPRU 6.1.17 R (1)(c) or ■ INSPRU 6.1.17 R (2);

must comply with ■ INSPRU 6.1.9 R separately in respect of its *long-term insurance business* and its *general insurance business*.

6.1.11  
PRA

R

For the purposes of ■ INSPRU 6.1.10 R, a *firm* must include in the calculation of the *group capital resources* and *group capital resources requirement* of its *long-term insurance business* the *regulated related undertakings* and *ancillary services undertakings* that are *long-term insurance assets*.

6.1.12  
PRA

G

■ INSPRU 1.5 sets out the detailed requirements for the separation of *long-term* and *general insurance business*.

6.1.13  
PRA

G

In order to comply with ■ INSPRU 6.1.10 R, a *composite firm* will need to:

- (1) establish the *group capital resources requirement* of its *general insurance business* and its *long-term insurance business* separately; and
- (2) allocate its *group capital resources* between its *general insurance business* and its *long-term insurance business* so that:
  - (a) the *group capital resources* allocated to its *general insurance business* are equal to or in excess of the *group capital resources requirement* of its *general insurance business*; and
  - (b) the *group capital resources* allocated to its *long-term insurance business* are equal to or in excess of the *group capital resources requirement* of its *long-term insurance business*.

6.1.14  
PRA

G

Surplus *group capital resources* in the *long-term insurance business* cannot be used towards meeting the requirements of the *general insurance business* (see ■ INSPRU 6.1.41 R) but surplus *group capital resources* in the *general insurance business* may be used towards meeting the amount of the *group capital resources requirement* that relates to the *long-term insurance business*.

6.1.15  
PRA

R

- (1) Subject to ■ INSPRU 6.1.27 R, a *firm* must ensure that at all times its *capital resources* are of such an amount that the *group capital resources* of each *undertaking* referred to in ■ INSPRU 6.1.17 R (excluding those referred to in ■ INSPRU 6.1.9 R) are equal to or exceed that *undertaking's group capital resources requirement*
- (2) (1) does not apply to a *pure reinsurer* which became a *firm in run-off* before 10 December 2007 and whose *Part 4A permission* has not subsequently been varied to add back the *regulated activity of effecting contracts of insurance*.

6.1.16  
PRA

G

*Principle 4* requires a *firm* to maintain adequate financial resources, taking into account any activity of other members of the *group* of which the *firm* is a member. ■ INSPRU 6.1

sets out provisions that deal specifically with the way the activities of other members of the *group* should be taken into account. This results in the *firm* being required to hold sufficient capital resources so that the *group capital resources* are at least equal to the *group capital resources requirement*. However, the adequacy of the *group capital resources* needs to be assessed both by the *firm* and the *PRA*. *Firms* are required to carry out an assessment of the adequacy of their financial resources under the *overall financial adequacy rule*, the *overall Pillar 2 rule* and ■ GENPRU 1.2.39 R, and the *PRA* will review this and may provide individual guidance on the amount and quality of *capital resources* the *PRA* considers adequate. As part of such reviews, the *PRA* may also form a view on the appropriateness of the *group capital resources requirement* and *group capital resources*. Where necessary, the *PRA* may also give individual *guidance* on the *capital resources* a *firm* should hold in order to comply with *Principle 4* expressed by reference to ■ INSPRU 6.1.9 R and ■ INSPRU 6.1.15 R.

**Scope - undertakings whose group capital is to be calculated and maintained**

6.1.17  
PRA

R

The *undertakings* referred to in ■ INSPRU 6.1.8 R, ■ INSPRU 6.1.9 R, ■ INSPRU 6.1.10 R and ■ INSPRU 6.1.15 R are:

- (1) for any *firm* that is not within (2), each of the following:
  - (a) its *ultimate insurance parent undertaking*;
  - (b) its *ultimate EEA insurance parent undertaking* (if different); and
  - (c) the *firm* itself, if it is a *participating insurance undertaking*; and
- (2) the *firm* itself, where the *firm* is a *participating insurance undertaking* and is:
  - (a) a *non-EEA insurer*; or
  - (b) a *friendly society*.

6.1.18  
PRA

G

Article 3(3) of the *Insurance Groups Directive* allows an *undertaking* to be excluded from supplementary supervision if:

- (1) its head office is in a non-EEA State where there are legal impediments to the transfer of the necessary information; or
- (2) in the opinion of the *competent authority* responsible for exercising supplementary supervision, having regard to the objectives of supplementary supervision:
  - (a) its inclusion would be inappropriate or misleading; or
  - (b) it is of negligible interest.

PAGE  
5

6.1.19  
PRA

G

If an application is made for a *waiver*, it is the policy of the *PRA* to consider the effect, in the circumstances described in ■ INSPRU 6.1.18 G, of granting a *waiver* allowing the exclusion of a *related undertaking* from the calculation of *group capital resources* and the *group capital resources requirement* required by ■ INSPRU 6.1.8 R.

6.1.20  
PRA

G

Examples of *related undertakings* which may be excluded from supplementary supervision by Article 3(3) of the *Insurance Groups Directive* include *insurance holding companies* in the *insurance group* that are not the *ultimate insurance parent undertaking* or, if different, the *ultimate EEA insurance parent undertaking* of a *firm*.

6.1.21  
PRA

G

If more than one member of the *insurance group* is to be excluded in the circumstances described in ■ INSPRU 6.1.18 G (2)(b), they may only be excluded if, considered together, they are of negligible interest in the context of the *insurance group*.

6.1.22  
PRA

G

When giving a *waiver* in the circumstances described in ■ INSPRU 6.1.18 G, the *PRA* may impose a condition requiring the *firm* to provide information about any member of the *insurance group* excluded pursuant to a *waiver* granted in the circumstances described in ■ INSPRU 6.1.18 G.

**Optional alternative method of calculation for firms subject to supplementary supervision by another EEA competent authority**

6.1.23  
PRA

R

If the *competent authority* in an *EEA State* other than the *United Kingdom* has agreed to be the *competent authority* responsible for exercising supplementary supervision of an *insurance group* of which a *firm* is a member under Article 4(2) of the *Insurance Groups Directive*, the *firm* may prepare the calculations required under ■ INSPRU 6.1.8 R in relation to the *ultimate EEA insurance parent undertaking* in accordance with the requirements of supplementary supervision in that *EEA State*.

6.1.24  
PRA

G

The *PRA* will notify the *firm* if it has reached agreement with the *competent authority* in an *EEA State* other than the *United Kingdom* in accordance with Article 4(2) of the *Insurance Groups Directive*.

**Non-EEA ultimate insurance parent undertakings**

6.1.25  
PRA

R

Where the *ultimate insurance parent undertaking* of a *firm* has its head office in a non-*EEA State*, the *firm* may:

- (1) calculate the *group capital resources* and the *group capital resources requirement* of its *ultimate insurance parent undertaking* in accordance with accounting practice applicable for the purposes of the regulation of *insurance undertakings* in the state or territory of the head office of the *ultimate insurance parent undertaking* adapted as necessary to apply the general principles set out in Annex I (1) paragraphs B, C and D of the *Insurance Groups Directive*; and
- (2) elect (see ■ INSPRU 6.1.26 R) to carry out the calculation referred to in (1) in accordance with the accounting consolidation method set out in Annex I (3) of the *Insurance Groups Directive*.

6.1.26 PRA R A *firm* may elect to use the calculation method referred to in  
 ■ INSPRU 6.1.25 R (2) if it has made the election by written notice to the *PRA*  
 in a way that complies with the requirements for written notice in  
 ■ SUP 15.7.

6.1.27 PRA R ■ INSPRU 6.1.15 R does not apply in respect of the *group capital resources*  
 of a *firm's ultimate insurance parent undertaking* if that *ultimate insurance*  
*parent undertaking* has its head office in a non-EEA State.

**Proportional holdings**

6.1.28 PRA R Subject to ■ INSPRU 6.1.30 R and ■ INSPRU 6.1.31 R, when calculating *group*  
*capital resources* and the *group capital resources requirement* of an  
*undertaking* in ■ INSPRU 6.1.17 R, a *firm* must take only the relevant  
 proportion of the following items ("calculation items") into account:

- (1) the *solo capital resources* of a *regulated related undertaking*;
- (2) the assets of a *regulated related undertaking* which are required  
 to be deducted as part of the calculation of *group capital resources*;  
 and
- (3) the *individual capital resources requirement* of a *regulated related*  
*undertaking*.

6.1.29 PRA R In ■ INSPRU 6.1.28 R, the relevant proportion is either:

- (1) the proportion of the total number of issued *shares* in the *regulated*  
*related undertaking* held, directly or indirectly, by the *undertaking*  
 in ■ INSPRU 6.1.17 R; or
- (2) where a *consolidation Article 12(1) relationship* exists between  
*related undertakings* within the *insurance group*, such proportion  
 as the *PRA* determines in accordance with Article 28(5) of the  
*Financial Groups Directive* and Regulation 15 of the *Financial*  
*Groups Directive Regulations*.

6.1.30 PRA R Where the *undertaking* in ■ INSPRU 6.1.17 R is a *firm*, if the *individual*  
*capital resources requirement* of a *regulated related undertaking* that is a  
*subsidiary undertaking* and not an *insurer* exceeds the *solo capital*  
*resources* of that *undertaking* less the amount calculated in  
 ■ INSPRU 6.1.74 R (if any), the full amount of the calculation items of that  
*regulated related undertaking* less the amount in ■ INSPRU 6.1.74 R (3) must  
 be taken into account in the calculation of *group capital resources* and the  
*group capital resources requirement*.

6.1.31 PRA R Except where ■ INSPRU 6.1.30 R applies, if the *individual capital resources*  
*requirement* of a *regulated related undertaking* that is a *subsidiary*  
*undertaking* of the *undertaking* in ■ INSPRU 6.1.17 R exceeds its *solo capital*  
*resources*, the full amount of the calculation items of that *regulated related*

*undertaking* must be taken into account in the calculation of *group capital resources* and the *group capital resources requirement*.

6.1.32

PRA

R

For the purposes of ■ INSPRU 6.1.10 R, where a *composite firm* that is an *undertaking* in ■ INSPRU 6.1.17 R (1)(c) or (2):

- (1) holds directly or indirectly *shares* in a *regulated related undertaking*; and
- (2) the *shares* in (1) are held partly by its *long-term insurance business* and partly by its *general insurance business*;
- (3) the relevant proportion of the calculation items calculated in accordance with ■ INSPRU 6.1.29 R, subject to ■ INSPRU 6.1.30 R and ■ INSPRU 6.1.31 R, must be allocated between the *long-term insurance business* and *general insurance business* in proportion to their respective holdings, directly or indirectly, in the *shares* in that *regulated related undertaking*.

#### Calculation of the GCRR

6.1.33

PRA

R

Subject to ■ INSPRU 6.1.23 R and ■ INSPRU 6.1.25 R, a *firm* must calculate the *group capital resources requirement* of an *undertaking* in ■ INSPRU 6.1.17 R as the sum of the *individual capital resources requirement* of that *undertaking* and the *individual capital resources requirement* of each of its *regulated related undertakings*.

6.1.34

PRA

R

For the purposes of ■ INSPRU 6.1, an *individual capital resources requirement* is:

- (1) in respect of any *insurer*:
  - (a) its *capital resources requirement* calculated in accordance with ■ GENPRU 2.1; less
  - (b) where the *capital resources requirements* of both the *insurer* and its *insurance parent undertaking* that is an *insurer* include *with-profits insurance capital components*, any element of double-counting that may arise from the aggregation of the *individual capital resources requirements* for the purposes of ■ INSPRU 6.1.33 R;
- (2) in respect of an *EEA insurer* or an *EEA pure reinsurer*, the equivalent of the *capital resources requirement* as calculated in accordance with the applicable requirements in its *Home State*;
- (3) in respect of an *EEA ISPV*, the solo capital resources requirement that applies to the *ISPV* under the *sectoral rules* for the *insurance sector* of the member State of the *competent authority* that authorised the *ISPV*;

- (4) in respect of an *insurance undertaking* that is not within (1), (2) or (3) and whose head office is in a *designated State or territory*, either:
  - (a) its *proxy capital resources requirement*; or
  - (b) the solo capital resources requirement that applies to it under the *sectoral rules* for the *insurance sector* of the *designated State or territory*;
- (5) in respect of an *insurance undertaking* within (4) which is not subject to a solo capital resources requirement under the *sectoral rules* for the *insurance sector* of that *designated State or territory*, its *proxy capital resources requirement*;
- (6) in respect of an *insurance undertaking* that is not within (1) to (5), its *proxy capital resources requirement*;
- (7) in respect of an *insurance holding company*, zero;
- (8) [intentionally blank]
- (9) in respect of a *regulated entity* (excluding an *insurance undertaking*), its *solo capital resources requirement*;
- (10) in respect of an *asset management company*, the *solo capital resources requirement* that would apply to it if, in connection with its activities, it were treated as being in the *investment services sector*; and
- (11) in respect of a *financial institution* that is not a *regulated entity* (including a *financial holding company*), the *solo capital resources requirement* that would apply to it if, in connection with its activities, it were treated as being within the *banking sector*.
- (12) [deleted]

6

6.1.34A

PRA

G

For the purposes of ■ INSPRU 6.1.34 R (4)(b), where the solo capital resources requirement under the *sectoral rules* for the *insurance sector* in a *designated State or territory* is ascertained by reference to the trigger for regulatory intervention, the PRA considers that the solo capital resources requirement of the *insurance undertaking* in such a *designated State or territory* will generally correspond to the highest point at which any regulatory or corrective action is triggered or which is at least comparable to the *capital resources requirement* which would apply if the *insurance undertaking* were an *insurer*.

PAGE  
9

6.1.35

PRA

G

■ INSPRU 6.1.34R sets out the rules for calculating an *insurer's individual capital resources requirement*. Among other things, this allows the use of local rules for related entities in designated states and territories. Paragraphs 6.5 and 6.6 of ■ GENPRU 3 Annex 1R include the equivalent provisions for *related undertakings* in the *banking sector* and *investment services sector*. The provisions of paragraphs 6.4 to 6.6 extend to the calculation of *solo capital resources*, with the references to *sectoral rules* in paragraphs 1.2, 2.3 and 3.2 of

■ GENPRU 3 Annex 1R (that is, the capital resources requirement of a *related undertaking* must be met by capital resources that are eligible under the relevant *sectoral rules*).

**Calculation of GCR**

6.1.36  
PRA

**R** For the purposes of ■ INSPRU 6.1.8 R and subject to ■ INSPRU 6.1.23 R and ■ INSPRU 6.1.25 R, a *firm* must calculate the group capital resources of an *undertaking* in ■ INSPRU 6.1.17 R in accordance with the table in ■ INSPRU 6.1.43 R, subject to the limits in ■ INSPRU 6.1.45 R.

6.1.37  
PRA

**R** For the purposes of ■ INSPRU 6.1, the following expressions when used in relation to either an *undertaking* in ■ INSPRU 6.1.17 R or a *regulated related undertaking* which is not subject to the *capital resources table*, are to be construed as if that *undertaking* were required to calculate its capital resources in accordance with the *capital resources table*, but with such adjustments being made to secure that the *undertaking's* calculation of its *solo capital resources* complies with the relevant *sectoral rules* applicable to it:

- (1) *tier one capital resources*;
- (2) *tier two capital resources*;
- (3) *upper tier two capital resources*;
- (4) *lower tier two capital resources*;
- (5) *innovative tier one capital resources*; and
- (6) *core tier one capital*.

6.1.38  
PRA

**R** For the purposes of ■ INSPRU 6.1.37 R, the *sectoral rules* applicable to:

- (1) an *insurance holding company* whose main business is to acquire and hold participations in *subsidiary undertakings* which are either exclusively or mainly *reinsurance undertakings* are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as a *pure reinsurer*;
- (2) an *insurance holding company* not within (1) are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as an *insurer*;
- (3) an *asset management company* are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as an *investment firm*; and
- (4) subject to ■ INSPRU 6.1.39 R, a *financial institution*, that is not a *regulated entity*, are the *sectoral rules* that would apply to it

if, in connection with its activities, it were treated as being within the *banking sector*.

6.1.39

PRA

R

Where a *financial institution*, that is not a *regulated entity*, has invested in *tier one capital* or *tier two capital* issued by a *parent undertaking* that is:

- (1) an *insurance holding company*; or
- (2) an *insurer*;

the *sectoral rules* that apply to that *financial institution* are the *sectoral rules* for the *insurance sector*.

6.1.40

PRA

R

For the purposes of ■ INSPRU 6.1.36 R, the capital resources of a *financial institution* within ■ INSPRU 6.1.39 R that can be included in the calculations in ■ INSPRU 6.1.48 R (2), ■ INSPRU 6.1.50 R (2), ■ INSPRU 6.1.53 R (2), ■ INSPRU 6.1.55 R (2) and ■ INSPRU 6.1.57 R (2) are:

- (1) the issued *tier one capital* or *tier two capital* of that *financial institution* held, directly or indirectly, by its *parent undertaking* referred to in ■ INSPRU 6.1.39 R; and
- (2) the lower of:
  - (a) the *tier one capital* or *tier two capital* issued by the *parent undertaking* referred to in ■ INSPRU 6.1.39 R pursuant to the investment by the *financial institution*; and
  - (b) the *tier one capital* or *tier two capital* issued by the *financial institution* to raise funds for its investment in the capital resources of the *parent undertaking* referred to in (a).

6.1.41

PRA

R

(1) In calculating *group capital resources*, a *firm* must exclude the restricted assets of a *regulated related undertaking* except insofar as those assets are available to meet the *individual capital resources requirement* of that *regulated related undertaking*.

(2) In (1), "restricted assets" means assets of a *regulated related undertaking* which are subject to a legal restriction or other requirement having the effect that those assets cannot be transferred or otherwise made available to another *regulated related undertaking* for the purposes of meeting its *individual capital resources requirement* without causing a breach of that legal restriction or requirement.

6.1.42

PRA

G

For the purposes of ■ INSPRU 6.1.41 R, in respect of an *insurance undertaking* that is a member of an *insurance group*, the assets of a *long-term insurance fund* are restricted assets within the meaning of ■ INSPRU 6.1.41 R. Any excess of assets over liabilities in the *long-term insurance fund* may only be included in the calculation of the *group capital resources* up to the amount of the *undertaking's individual capital resources requirement*

which relates to the *long-term insurance business* in respect of which that *long-term insurance fund* is held.

6.1.42A  
PRA

**R** For the purposes of calculating *group capital resources*, a *firm* must exclude:

- (1) the book value of any investment by a *related undertaking* of the *undertaking* in ■ INSPRU 6.1.17 R in shares of, or loans to, an *undertaking* that is not a *related undertaking*, where that *undertaking* has invested in the *capital resources* of a *regulated related undertaking* of the *undertaking* in ■ INSPRU 6.1.17 R; and
- (2) any item of capital not in (1) to the extent that it is the result of or otherwise attributable to reciprocal financing arrangements entered into by the *undertaking* in ■ INSPRU 6.1.17 R or by a *related undertaking* of an *undertaking* in ■ INSPRU 6.1.17 R.

6.1.42B  
PRA

**G** The *Insurance Groups Directive* gives an example of reciprocal financing as when an *insurance undertaking*, or any of its *related undertakings*, holds shares in, or makes loans to, another *undertaking* which, directly or indirectly, holds an element eligible for the solvency margin of the first undertaking. However, there are other instances of reciprocal financing, for example where a *group undertaking* provides a guarantee to an *undertaking* outside the *group*, in whole or partial reliance on which the non-*group undertaking* invests in or provides any kind of financial accommodation to support the *capital resources* of a *group undertaking* whose *capital resources* are relevant to the *group capital resources* calculation. ■ INSPRU 6.1.42AR (2) requires that *firms* exclude from *group capital resources* those items of capital resulting from or attributable to such reciprocal financing arrangements.

6.1.43  
PRA

**R** Table: Group capital resources

	Stage	Related text
Total group tier one capital	A	INSPRU 6.1.48 R
Total group tier two capital	B	INSPRU 6.1.50 R
Group capital resources before deductions	C=(A+B)	
Total deductions of in-admissible assets	D	INSPRU 6.1.59 R
Total deductions under the requirement deduction method from group capital resources	E	INSPRU 6.1.62 R

Stage	Related text
Total deductions of ineligible surplus capital* F	INSPRU 6.1.65 R
Deduction of assets in excess of market risk and counterparty exposure limits* G	INSPRU 6.1.70 R
Group capital resources $H=(C-(D+E+F^*+G^*))$	
* = section (F) of the table (the deductions for ineligible surplus capital) and section (G) of the table (assets in excess of market risk and counterparty exposure limits) only apply and are required to be calculated for the purposes of the adjusted solo calculation of an <i>undertaking</i> in INSPRU 6.1.17 R that is a <i>participating insurance undertaking</i> .	

**Notification of issuance of capital instruments**

6.1.43A  
PRA

R

This section applies to a *firm* if another member of its *group* intends to issue a *capital instrument* on or after 1 March 2012 for inclusion in the *group capital resources* of the *firm* or its *ultimate EEA insurance parent undertaking*.

6.1.43B  
PRA

R

A *firm* must notify the PRA in writing of the intention of another member of its *group* which is not a *firm* to issue a *capital instrument* which it intends to include within its *group capital resources*, or the *group capital resources* of its *ultimate EEA insurance parent undertaking*, as soon as it becomes aware of the intention of the *group undertaking*. When giving notice, a *firm* must:

- (1) provide details of the amount of capital to be raised through the intended issue and whether the capital is intended to be issued to external investors or within its *group*;
- (2) identify the stage of the *capital resources table* the *capital instrument* is intended to fall within;
- (3) include confirmation from a *senior manager* of the *firm* responsible for authorising the inclusion of the issue within *group capital resources* that the *capital instrument* complies with the *rules* applicable to instruments included in the stage of the *capital resources table* identified in (2); and
- (4) provide details of any features of the *capital instrument* which are novel, unusual or different from a *capital instrument* of a similar nature previously issued by the *firm* or widely available in the market or not specifically contemplated by ■ GENPRU 2.2.

This *rule* does not apply to a *firm* if a *group undertaking* intends to issue a *capital instrument* listed in ■ INSPRU 6.1.43E R.

6.1.43C  
PRA

R

A *firm* must provide a further notification to the *PRA* in writing including all the information required in ■ INSPRU 6.1.43BR (1) to ■ (4) as soon as any changes are proposed to the intended date of issue, amount of issue, type of investors, stage of capital or any other feature of the *capital instrument* to that previously notified to the *PRA* .

6.1.43D  
PRA

R

If a *group undertaking* proposes to establish a debt securities program for the issue of *capital instruments* which the *firm* intends to include within its *group capital resources* or the *group capital resources* of its *ultimate EEA insurance parent undertaking*, it must:

- (1) notify the *PRA* of the establishment of the program; and
- (2) provide the information required by ■ INSPRU 6.1.43BR (1) to ■ (4)

as soon as it becomes aware of the proposed establishment. The *PRA* must be notified of any changes, in accordance with ■ INSPRU 6.1.43C R.

6.1.43E  
PRA

R

The *capital instruments* to which ■ INSPRU 6.1.43B R does not apply are;

- (1) ordinary *shares* issued by a *group undertaking* which
  - (a) are the most deeply subordinated *capital instrument* issued by that *group undertaking*;
  - (b) meet the criteria set out in ■ GENPRU 2.2.83 R (2) and ■ (3); and
  - (c) are the same as ordinary *shares* previously issued by that *group undertaking*;
- (2) debt instruments issued from a debt securities program established by a *group undertaking*, provided that program was notified to the *PRA* prior to its first draw down in accordance with ■ INSPRU 6.1.43D R; and
- (3) *capital instruments* which are not materially different in terms of their characteristics and eligibility for inclusion in a particular tier of capital to *capital instruments* previously issued by that *group undertaking* and included in the *group capital resources* of the *firm* or the *group capital resources* of its *ultimate EEA insurance parent undertaking*.

6.1.43F  
PRA

R

A *firm* must notify the *PRA* in writing, no later than the date of issue, of the intention of a *group undertaking* to issue a *capital instrument* listed in ■ INSPRU 6.1.43E R which the *firm* intends to include within its *group capital resources* or the *group capital resources* of its *ultimate EEA insurance parent undertaking*. When giving notice a *firm* must

- (1) provide the information set out at ■ INSPRU 6.1.43BR (1) to ■ (3); and
- (2) confirm that the terms of the *capital instrument* have not changed since the previous issue of that type of *capital instrument* by that *group undertaking*.

**Calculation of GCR - Limits on the use of different forms of capital**

6.1.44

PRA

G

As the various components of capital differ in the degree of protection that they offer the *insurance group*, restrictions are placed on the extent to which certain types of capital are eligible for inclusion in the *group capital resources* of the *undertaking* in ■ INSPRU 6.1.17 R. These restrictions are set out in ■ INSPRU 6.1.45 R.

6.1.45

PRA

R

- (1) For the purposes of ■ INSPRU 6.1.9 R, ■ INSPRU 6.1.10 R and ■ INSPRU 6.1.15 R, a *firm* must ensure that at all times its *tier one capital resources* and *tier two capital resources* are of such an amount that the *group capital resources* of the *undertaking* in ■ INSPRU 6.1.17 R comply with the following limits:
  - (a)  $(P - Q) = (R - S)$ ;
  - (b)  $(P - Q + T - W) = (R - S)$ ;
  - (c)  $V = P$ ;
  - (d)  $Q$  15% of  $P$ ;
  - (e)  $T$   $P$ ; and
  - (f)  $W$   $P$
- (2) For the purposes of ■ INSPRU 6.1.9 R and ■ INSPRU 6.1.10 R, a *firm* must ensure that at all times its *tier one capital resources* and *tier two capital resources* are of such an amount that its *group capital resources* comply with the following limit, subject to (4)
 
$$(P - Q + T) = 1/3 X + (R - S - U - X).$$
- (3) For the purposes of (1) and (2):
  - (a)  $P$  is the *total group tier one capital* of the *undertaking* in ■ INSPRU 6.1.17 R;
  - (b)  $Q$  is the sum of the *innovative tier one capital resources* calculated in accordance with ■ INSPRU 6.1.53 R;
  - (c)  $R$  is the *group capital resources requirement* of the *undertaking* in ■ INSPRU 6.1.17 R;
  - (d)  $S$  is the sum of all the *with-profits insurance capital components* of an *undertaking* in ■ INSPRU 6.1.17 R that is an *insurer* and each of its *regulated related undertakings* that is an *insurer*;

6

- (e) T is the *total group tier two capital* of the *undertaking* in ■ INSPRU 6.1.17 R;
  - (f) U is the sum of all the *resilience capital requirements* of an *undertaking* in ■ INSPRU 6.1.17 R that is an *insurer* and each of its *regulated related undertakings* that is an *insurer*;
  - (g) V is the sum of all the *core tier one capital* calculated in accordance with ■ INSPRU 6.1.55 R;
  - (h) W is the sum of the *lower tier two capital resources* calculated in accordance with ■ INSPRU 6.1.57 R; and
  - (i) X is the MCR of the *firm* less its *resilience capital requirement*, if any.
- (4) For the purposes of (2):
- (a) ■ INSPRU 6.1.45 R (1)(a) does not apply;
  - (b) the *innovative tier one capital* of the *firm* or its *regulated related undertakings* that meets the conditions for it to be *upper tier two capital* may be included as *upper tier two capital* for the purpose of the calculation in ■ INSPRU 6.1.50 R; and
  - (c) the *firm* must exclude from the calculation of (P - Q + T) in (2) the higher of:
    - (i) any amount by which the *total group tier two capital* exceeds the *group capital resources* of the *firm* less any *innovative tier one capital* excluded by (b); and
    - (ii) any amount by which the sum of *lower tier two capital resources* calculated in accordance with ■ INSPRU 6.1.57 R exceeds one third of the *group capital resources* of the *firm* less any *innovative tier one capital* excluded by (b).

6.1.46

PRA

G

The amount of any capital item excluded from *group capital resources* under ■ INSPRU 6.1.45 R (1)(d) may form part of *total group tier two capital* calculated in accordance with ■ INSPRU 6.1.50 R subject to the limits in ■ INSPRU 6.1.45 R (1)(e) and ■ INSPRU 6.1.45R (1)(f).

6.1.47

PRA

R

For the purposes of ■ INSPRU 6.1.10 R, a *firm* must ensure that the *tier one capital resources* and *tier two capital resources* of each of its *long-term insurance business* and its *general insurance business* are of such an amount that the *group capital resources* of each its *long-term insurance business* and its *general insurance business* comply with the limits in ■ INSPRU 6.1.45 R separately for each type of business.

**Calculation of GCR - Total group tier one capital**

6.1.48  
PRA

**R** For the purposes of ■ INSPRU 6.1.43 R, the *total group tier one capital* of an *undertaking* in ■ INSPRU 6.1.17 R is the sum of:

- (1) the *tier one capital resources* of the *undertaking* in ■ INSPRU 6.1.17 R; and
- (2) subject to ■ INSPRU 6.1.40 R, the *tier one capital resources* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in ■ INSPRU 6.1.49 R.

6.1.49  
PRA

**R** The deduction referred to in ■ INSPRU 6.1.48 R is the sum of:

- (1) the book value of the investment by the *undertaking* in ■ INSPRU 6.1.17 R in the *tier one capital resources* of each of its *related undertakings* that is a *regulated related undertaking*; and
- (2) the book value of the investments by *related undertakings* of the *undertaking* in ■ INSPRU 6.1.17 R in the *tier one capital resources* of the *undertaking* in ■ INSPRU 6.1.17 R and each of its *related undertakings* that is a *regulated related undertaking*.

**Calculation of GCR - Total group tier two capital**

6.1.50  
PRA

**R** For the purposes of ■ INSPRU 6.1.43 R, the *total group tier two capital* of an *undertaking* in ■ INSPRU 6.1.17 R is the sum of:

- (1) the *upper tier two capital resources* and the *lower tier two capital resources* of that *undertaking*; and
- (2) subject to ■ INSPRU 6.1.40 R, the *upper tier two capital resources* and the *lower tier two capital resources* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in ■ INSPRU 6.1.51 R.

6.1.51  
PRA

**R** The deduction referred to in ■ INSPRU 6.1.50 R is the sum of:

- (1) the book value of the investments by the *undertaking* in ■ INSPRU 6.1.17 R in the *upper tier two capital resources* and the *lower tier two capital resources* of each of its *related undertakings* that is a *regulated related undertaking*; and
- (2) the book value of the investments by *related undertakings* of the *undertaking* in ■ INSPRU 6.1.17 R in the *upper tier two capital resources* and the *lower tier two capital resources* of the *undertaking* in ■ INSPRU 6.1.17 R and each of its *related undertakings* that is a *regulated related undertaking*.

6.1.52  
PRA

G

For the purposes of ■ INSPRU 6.1.50 R (2), the limits in ■ GENPRU 2.2.37 R apply to the *upper tier two capital resources* and the *lower tier two capital resources* of any *regulated related undertaking* that is an *insurer*. Similar limits may apply to other *regulated related undertakings* under the relevant *sectoral rules*.

**Calculation of GCR - Innovative tier one capital resources, lower tier two capital resources and core tier one capital**

6.1.53  
PRA

R

For the purposes of ■ INSPRU 6.1.45 R (4)(b), the *innovative tier one capital resources* is the sum of:

- (1) the *innovative tier one capital resources* of the *undertaking* in ■ INSPRU 6.1.17 R; and
- (2) subject to ■ INSPRU 6.1.40 R, the *innovative tier one capital resources* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in ■ INSPRU 6.1.54 R.

6.1.54  
PRA

R

The deduction referred to in ■ INSPRU 6.1.53 R is the sum of:

- (1) the book value of the investments by the *undertaking* in ■ INSPRU 6.1.17 R in the *innovative tier one capital resources* of each of its *related undertakings* that is a *regulated related undertaking*; and
- (2) the book value of the investments by *related undertakings* of the *undertaking* in ■ INSPRU 6.1.17 R in the *innovative tier one capital resources* of the *undertaking* in ■ INSPRU 6.1.17 R and each of its *related undertakings* that is a *regulated related undertaking*.

6.1.55  
PRA

R

For the purposes of ■ INSPRU 6.1.45 R (3)(g), the *core tier one capital* is the sum of:

- (1) the *core tier one capital* of the *undertaking* of ■ INSPRU 6.1.17 R; and
- (2) subject to ■ INSPRU 6.1.40 R, the *core tier one capital* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in ■ INSPRU 6.1.56 R.

6.1.56  
PRA

R

The deduction referred to in ■ INSPRU 6.1.55 R is the sum of:

- (1) the book value of the investments by the *undertaking* in ■ INSPRU 6.1.17 R in the *core tier one capital* of each of its *related undertakings* that is a *regulated related undertaking*; and

6.1.57  
PRA

**R** (2) the book value of the investments by *related undertakings* of the *undertaking* in ■ INSPRU 6.1.17 R in the *core tier one capital* of the *undertaking* in ■ INSPRU 6.1.17 R and each of its *related undertakings* that is a *regulated related undertaking*.

For the purposes of ■ INSPRU 6.1.45 R (3)(h), the *lower tier two capital resources* is the sum of:

- (1) the *lower tier two capital resources* of the *undertaking* in ■ INSPRU 6.1.17 R; and
- (2) subject to ■ INSPRU 6.1.40 R, the *lower tier two capital resources* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in ■ INSPRU 6.1.58 R.

6.1.58  
PRA

**R** The deduction referred to in ■ INSPRU 6.1.57 R is the sum of:

- (1) the book value of the investments by the *undertaking* in ■ INSPRU 6.1.17 R in the *lower tier two capital resources* of each of its *related undertakings* that is a *regulated related undertaking*; and
- (2) the book value of the investments by *related undertakings* of the *undertaking* in ■ INSPRU 6.1.17 R in the *lower tier two capital resources* of the *undertaking* in ■ INSPRU 6.1.17 R and each of its *related undertakings* that is a *regulated related undertaking*.

**Calculation of GCR - Inadmissible assets**

6.1.59  
PRA

**R** For the purpose of ■ INSPRU 6.1.43 R, a *firm* must deduct from the group capital resources before deduction (calculated at stage C in the table in ■ INSPRU 6.1.43 R) of the *undertaking* in ■ INSPRU 6.1.17 R, the value of all assets of the *undertaking* in ■ INSPRU 6.1.17 R and each of its *regulated related undertakings* that are not admissible assets as set out in ■ INSPRU 6.1.60 R.

6.1.60  
PRA

**R** For the purposes of ■ INSPRU 6.1.59 R, an asset is not an admissible asset if:

- (1) in respect of a *regulated related undertaking* or *undertaking* in ■ INSPRU 6.1.17 R that is an *insurer* (other than a *pure reinsurer*), it is not an *admissible asset* as listed in ■ GENPRU 2 Annex 7 R;
- (2) in respect of a *regulated related undertaking* or *undertaking* in ■ INSPRU 6.1.17 R that is a *pure reinsurer*, the holding of the asset is inconsistent with compliance by that *undertaking* with ■ INSPRU 3.1.61A R; or

- (3) in respect of a *regulated related undertaking* or *undertaking* in ■ INSPRU 6.1.17 R that is not an *insurer*, it is an asset of the *undertaking* that is not admissible for the purpose of calculating that *undertaking's solo capital resources* in accordance with the *sectoral rules* applicable to it.

6.1.61  
PRA

**R** For the purposes of ■ INSPRU 6.1.60 R (3), the *sectoral rules* applicable to:

- (1) an *asset management company* are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as an *investment firm*; and
- (2) a *financial institution* that is not a *regulated entity* are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as being within the *banking sector*.

**Calculation of GCR - Deductions under requirement deduction method from group capital resources**

6.1.62  
PRA

**R** For the purposes of ■ INSPRU 6.1.43 R, a *firm* must deduct from the group capital resources before deduction (calculated at stage C in the table in ■ INSPRU 6.1.43 R) of an *undertaking* in ■ INSPRU 6.1.17 R, the sum of the value of the direct or indirect investments by the *undertaking* in ■ INSPRU 6.1.17 R in each of its *related undertakings* which is an *ancillary services undertaking*, calculated in accordance with ■ INSPRU 6.1.63 R.

6.1.63  
PRA

**R** The value of an investment in an *undertaking* referred to in ■ INSPRU 6.1.62 R is the higher of the book value of the direct or indirect investment by the *undertaking* in ■ INSPRU 6.1.17 R and the notional capital resources requirement of that *undertaking*.

6.1.64  
PRA

**R** For the purposes of ■ INSPRU 6.1.63 R, the notional capital resources requirement is:

- (1) for an *ancillary insurance services undertaking*, zero;
- (2) for any other *ancillary services undertaking*, the *capital resources requirement* that would apply to that *undertaking*, if it were a *regulated related undertaking*, in accordance with the *sectoral rules* applicable to a *regulated related undertaking* whose activities are closest in nature and scope to the activities of that *undertaking*.

**Calculation of GCR - Deductions of ineligible surplus capital**

6.1.65  
PRA

**R** Where the *undertaking* in ■ INSPRU 6.1.17 R is a *participating insurance undertaking*, the *firm* must, for the purposes of ■ INSPRU 6.1.43 R, deduct from its group capital resources before deduction (calculated at stage C in the table in ■ INSPRU 6.1.43 R) the sum of the ineligible surplus capital

of each of its *regulated related undertakings* that is an *insurance undertaking*, calculated in accordance with ■ INSPRU 6.1.67 R.

6.1.66

PRA

G

The purpose of ■ INSPRU 6.1.65 R is to ensure that, where the *undertaking* in ■ INSPRU 6.1.17 R is a *firm*, *group capital resources* are not overstated by the inclusion of capital that, although surplus to the requirements of the relevant *regulated related undertaking* that is an *insurance undertaking*, cannot practically be transferred to support requirements arising elsewhere in the group. Therefore, ineligible surplus capital in a *regulated related undertaking* that is an *insurance undertaking* is deducted in arriving at *group capital resources*. Surplus capital in such a *regulated related undertaking* is regarded as transferable only to the extent that:

- (1) it can be transferred without the *regulated related undertaking* breaching its own limits on the use of different forms of capital;
- (2) it does not contain assets that are restricted within the meaning of ■ INSPRU 6.1.41 R; and
- (3) in the case of a *regulated related undertaking* that has a *long-term insurance business*, it does not contain any assets allocated to the *capital resources* of that *undertaking* for the purposes of the *capital resources* of its *long-term insurance business* meeting the *capital resources requirement* of its *long-term insurance business*.

6.1.67

PRA

R

- (1) For the purposes of ■ INSPRU 6.1.65 R, the ineligible surplus capital of a *regulated related undertaking* that is an *insurance undertaking* is calculated by deducting B from A where:
  - (a) A is the *regulatory surplus value* of that *insurance undertaking* less any restricted assets of the *insurance undertaking* that have been excluded under ■ INSPRU 6.1.41 R; and
  - (b) B is the transferable capital of that *undertaking*.

- (2) If A minus B is negative, the ineligible surplus capital is zero.

6.1.68

PRA

R

For the purposes of ■ INSPRU 6.1.67 R (1)(b), the transferable capital is calculated by deducting the sum of the following from the *tier one capital resources* of the *regulated related undertaking* that is an *insurance undertaking*:

- (1) any restricted assets of that *insurance undertaking* that have been excluded under ■ INSPRU 6.1.41 R;
- (2) any *tier one capital resources* of that *insurance undertaking* that have been allocated towards meeting the *individual capital resources requirement* of its *long-term insurance business*; and
- (3) the higher of:

- (a) 50% of the *individual capital resources requirement* of the *general insurance business* of that *insurance undertaking*; and
- (b) the *individual capital resources requirement* of the *general insurance business* of that *insurance undertaking* less the difference between E and F where:
  - (i) E is its *tier two capital resources*; and
  - (ii) F is the amount of its *tier two capital resources* that have been allocated towards meeting the *individual capital resources requirement* of its *long-term insurance business*.

Examples of transferable and ineligible surplus capital:

6.1.69

PRA

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Example 1

Share capital	Audited reserves	FFA	Tier two	Requirement
30	20	0	40	50

- (i) Under ■ INSPRU 6.1.68 R, transferable capital = *tier one capital resources* of 50, less the sum of:
  - (1) restricted assets excluded under ■ INSPRU 6.1.41 R = (none);
  - (2) *tier one capital resources* allocated to the *long-term insurance business* = (none); and
  - (3) higher of (50% of 50 = 25 and 50 - 40 = 10) = (25) = (50 - 25) = 25
- (ii) Under ■ INSPRU 6.1.67 R, ineligible surplus capital = *regulatory surplus value* (40) less restricted assets excluded under ■ INSPRU 6.1.41 R (0) less transferable capital (25) = 15.

Example 2

Share capital	Audited reserves	FFA (of which 5 is restricted)	Tier two	Requirement (of which 4 relates to the <i>long-term insurance business</i> )
30	20	10	40	50

- (i) Under ■ INSPRU 6.1.68 R, transferable capital = *tier one capital resources* of 60, less the sum of:
  - (1) restricted assets excluded under ■ INSPRU 6.1.41 R = (5);
  - (2) *tier one capital resources* allocated to the *long-term insurance business* = (5); and

(3) the higher of (50% of 45 = 22.5; and 45 - 40 = 5) = (22.5) = 60 - 32.5 = 27.5

(ii) Under I ■ INSPRU 6.1.67 R, ineligible surplus capital = *regulatory surplus value* (50) - restricted assets excluded under ■ INSPRU 6.1.41 R of (5) - transferable capital (27.5) = 17.5.

Example 3

Share capital	Audited re-serves	FFA (of which 0 is restricted)	Tier two (40, of which 5 is excluded at the solo level - see below)	Requirement (of which 25 relates to the <i>long-term insurance business</i> )
20	10	20	35	50

The requirement relating to the *long-term insurance business* is met by the FFA of 20 and *tier two capital resources* of 5. Of the remaining *tier two capital resources* of 35, 5 is excluded at the solo level because the *tier one capital resources* allocated to the *general insurance business* are 30.

(i) Under ■ INSPRU 6.1.68 R, transferable capital = *tier one capital resources* of 50, less the sum of:

(1) restricted assets excluded under ■ INSPRU 6.1.41 R = (none);

(2) *tier one capital resources* allocated to the *long-term insurance business* = (20); and

(3) the higher of (50% of 25 = 12.5; and 25 - (35 - 5) = -5) = (12.5) = 50 - 32.5 = 17.5.

(ii) Under ■ INSPRU 6.1.67 R, ineligible surplus capital = *regulatory surplus value* (35) - restricted assets excluded under ■ INSPRU 6.1.41 R of (0) - transferable capital (17.5) = 17.5.

**Calculation of GCR - Assets in excess of market risk and counterparty exposure limits**

6.1.70  
PRA

R

Subject to ■ INSPRU 6.1.70A R, where the *undertaking* in ■ INSPRU 6.1.17 R is a *participating insurance undertaking*, the *firm* must deduct from its group capital resources before deduction (calculated at stage C in the table in ■ INSPRU 6.1.43 R) the assets in excess of *market risk* and *counterparty* exposure limits calculated in accordance with ■ INSPRU 6.1.74 R.

PAGE 23  
6.1.70A  
PRA

R

Where the *undertaking* in ■ INSPRU 6.1.17 R is a *pure reinsurer* that is a *participating insurance undertaking*, the *firm* must calculate assets in accordance with ■ INSPRU 6.1.74A R and deduct from its group capital resources before deduction (calculated at stage C in the table in ■ INSPRU 6.1.43 R) those assets the holding of which is inconsistent with compliance by that *undertaking* with ■ INSPRU 3.1.61A R.

6.1.71  
PRA

G

For the purposes of ■ INSPRU 6.1.43 R, where the *undertaking* in ■ INSPRU 6.1.17 R is a *participating insurance undertaking*, the investments referred to in ■ INSPRU 6.1.48 R and ■ INSPRU 6.1.50 R are not subject to the *market risk* and *counterparty* exposure limits.

6.1.72  
PRA

R

The *firm* (A) must, subject to ■ INSPRU 6.1.73 R, include in the calculation in ■ INSPRU 6.1.74 R or, where A is a *pure reinsurer*, ■ INSPRU 6.1.74A R each *related undertaking* (B) that is:

- (1) a *regulated related undertaking* that is a *subsidiary undertaking*; or
- (2) a *related undertaking* where the *firm* has elected to value the *shares* held in that *undertaking* by the *firm* in accordance with ■ GENPRU 1.3.47 R for the purposes of calculating the *tier one capital resources* of the *firm*.

6.1.73  
PRA

R

The *related undertakings* in ■ INSPRU 6.1.72 R need only be included in the calculation in ■ INSPRU 6.1.74 R or ■ INSPRU 6.1.74A R if:

- (1) where B is a *regulated related undertaking*, the *solo capital resources* of that *undertaking* exceed its *individual capital resources requirement*; or
- (2) where B is an *undertaking* in ■ INSPRU 6.1.72 R (2), its assets that fall within one or more of the categories in ■ GENPRU 2 Annex 7 R exceed its accounting liabilities.

6.1.74  
PRA

R

A's assets in excess of the *market risk* and *counterparty* exposure limits are calculated as follows:

- (1) Subject to (2), a *firm* must apply the *market risk* and *counterparty* exposure limits in ■ INSPRU 2.1.22 R (3) to:
  - (a) where B is an *insurer* (other than a *pure reinsurer*), the *admissible assets* of B;
  - (b) where B is a *pure reinsurer*, the assets of that *undertaking* less those assets identified in ■ INSPRU 6.1.60 R (2) as not being admissible; and
  - (c) where B is a *regulated related undertaking* that is not an *insurer*, the assets of that *undertaking* less those assets identified in ■ INSPRU 6.1.60 R (3) as not being admissible assets.
- (2) The *market risk* and *counterparty* exposure limits do not need to be applied to an *undertaking* in ■ INSPRU 6.1.72 R (2).

- (3) Where the assets of B in ■ INSPRU 6.1.74 R (1) exceed the limits in ■ INSPRU 2.1.22 R (3), the assets of B in excess of the limits must be deducted by the *firm* from B's *solo capital resources* for the purposes of ■ INSPRU 6.1.30 R.
- (4) After the application of (1) and (2), the surplus assets of B are aggregated with the *admissible assets* of A, where the surplus assets of B are:
  - (a) where B is a *firm* (other than a *pure reinsurer*), the *admissible assets* of B that represent the amount by which the *capital resources* of B exceed its *capital resources requirement*, subject to ■ INSPRU 6.1.77 R, and limited to the amount of transferable capital calculated in accordance with ■ INSPRU 6.1.68 R;
  - (b) where B is a *regulated related undertaking* that is not in (a), the assets of the *undertaking* in ■ INSPRU 6.1.74 R (1)(b) or ■ INSPRU 6.1.74 R (1)(c) that represent the amount by which the *solo capital resources* of B exceed its *individual capital resources requirement* and, where B is an *insurance undertaking* that is not in (a), limited to the amount of transferable capital calculated in accordance with ■ INSPRU 6.1.68 R; and
  - (c) where B is an *undertaking* in ■ INSPRU 6.1.72 R (2), the assets of the *undertaking* which represent those assets that fall within one or more of the categories in ■ GENPRU 2 Annex 7 R which exceed its accounting liabilities.
- (5) The *market risk* and *counterparty* exposure limits are then applied to the aggregate of A's *admissible assets* and the surplus assets in ■ INSPRU 6.1.74 R (4).

6.1.74A

PRA

R

A must apply ■ INSPRU 3.1.61A R to the aggregate of:

- (1) the assets of A, less any assets already identified in ■ INSPRU 6.1.60 R (2) as not being admissible; and
- (2) the surplus assets of B calculated in accordance with ■ INSPRU 6.1.74 R (1) to ■ INSPRU 6.1.74 R (4) as if that *rule* applied to B.

6.1.75

PRA

R

- (1) Subject to (2), A must then deduct the amount by which the *admissible assets* aggregated in accordance with ■ INSPRU 6.1.74 R (5) exceed the *market risk* and *counterparty* exposure limits from A's group capital resources before deduction (calculated at stage C in the table in ■ INSPRU 6.1.43 R) in accordance with ■ INSPRU 6.1.70 R.

- (2) Where A is a *pure reinsurer*, A must then deduct the amount of any assets identified by ■ INSPRU 6.1.74A R as not complying with ■ INSPRU 3.1.61A R in accordance with ■ INSPRU 6.1.70A R.

6.1.76

PRA

R

In relation to any of its *regulated related undertakings* that is not an *insurer*, A may modify the calculation in ■ INSPRU 6.1.74 R by:

- (1) omitting the calculation in ■ INSPRU 6.1.74 R (1) and ■ INSPRU 6.1.74 R (3); and
- (2) aggregating all of the assets of B identified in ■ INSPRU 6.1.74R (1)(c) as *admissible assets* with the *admissible assets* of A in ■ INSPRU 6.1.74 R (4).

6.1.77

PRA

R

The *admissible assets* of either A or B that are part of a *long-term insurance fund* of A or B are excluded for the purposes of the calculation in ■ INSPRU 6.1.74 R and ■ INSPRU 6.1.74A R except insofar as those assets are available to meet the liabilities and *capital resources requirement* of that *long-term insurance fund*.

6.1.78

PRA

R

If B is itself either a *participating insurance undertaking* or an *insurance parent undertaking*, the *admissible assets* of B for the purposes of ■ INSPRU 6.1.74 R (1) must be calculated as in ■ INSPRU 6.1.75 R but as if B were A.

## Chapter 7

# Individual Capital Assessment



## 7.1 Application

7.1.1

PRA

R

■ INSPRU 7.1 applies to an insurer unless it is:

- (1) a *non-directive friendly society*; or
- (2) a *Swiss general insurer*; or
- (3) an *EEA-deposit insurer* ; or
- (4) an *incoming EEA firm* ; or
- (5) an *incoming Treaty firm*.

7.1.2

PRA

R

Subject to ■ INSPRU 7.1.3 R, ■ INSPRU 7.1 applies to managing agents and to the Society in accordance with:

- (1) for *managing agents*, ■ INSPRU 8.1.4 R; and
- (2) for the *Society*, ■ INSPRU 8.1.2 R.

7.1.3

PRA

R

*Managing agents* must carry out assessments of capital adequacy for each *syndicate* they manage by reference to all open *syndicate years* taken together.

7.1.3A

FCA PRA

G

A *firm* should refer to ■ GEN 2.2.23 R to ■ GEN 2.2.25 G (cutover: application of provisions made by both the *FCA* and the *PRA*) when applying the *rules* and *guidance* in ■ INSPRU 7. In particular:

- (1) ■ INSPRU 7.1.16 G to ■ 7.1.18 Gand ■ INSPRU 7.1.20 G are made by the *FCA* for the purpose of applying this *guidance* to *insurers* pursuant to the *statutory objectives*; and
- (2) certain *rules* and *guidance* in ■ INSPRU 7.1 are also made by the *FCA* for the purpose of their application to *dormant account operators*. These provisions are ■ INSPRU 7.1.4 G to ■ 7.1.21 G, ■ INSPRU 7.1.25 G to ■ 7.1.27 G, ■ INSPRU 7.1.29 G to ■ 7.1.73 G and ■ 7.1.91 G? ■ 7.1.99 G.

**Purpose**

7.1.4

FCA PRA

G

*Principle 4* requires a *firm* to maintain adequate financial resources. ■ GENPRU 2 deals specifically with the adequacy of the *capital resources* element of a *firm's* financial resources.

7.1.5

FCA PRA

G

The adequacy of a *firm's capital resources* needs to be assessed both by the firm and the *appropriate regulator*. In ■ GENPRU 2.1, the *appropriate regulator* sets minimum *capital resources requirements* for firms.

7.1.6

FCA PRA

G

The *appropriate regulator* also assesses whether the minimum *capital resources requirements* are appropriate by reviewing:

- (1) a *firm's* own assessment of its capital needs; and
- (2) the processes and systems by which that assessment is made.

7.1.7

FCA PRA

G

In assessing whether the minimum *capital resources requirements* are appropriate, the *appropriate regulator* is principally concerned with capital resources as calculated in accordance with ■ GENPRU 2.2.17 R. However, in carrying out its own assessment of its capital needs, a *firm* may take into account other capital available to it (see ■ GENPRU 1.2.30 R and ■ GENPRU 1.2.36 R), although it should be able to explain and justify its reliance on these other forms of capital.

7.1.8

FCA PRA

G

There are two main aims in this section:

- (1) to enable *firms* to understand the issues which the *appropriate regulator* would expect to see assessed and the systems and processes which the *appropriate regulator* would expect to see in operation for ICAs by *firms* to be regarded as thorough, objective and prudent; and
- (2) to enable *firms* to understand the *appropriate regulator's* approach to assessing whether the minimum *capital resources requirements* of ■ GENPRU 2.1 are appropriate and what action may be taken if the *appropriate regulator* concludes that those requirements are not appropriate to a *firm's* circumstances.

**General approach**

7.1.9

FCA PRA

G

The *rules* in ■ GENPRU 1.2 require a *firm* to identify and assess risks to its being able to meet its liabilities as they fall due, to assess how it intends to deal with those risks and to quantify the financial resources it considers necessary to mitigate those risks. To meet these requirements, a *firm* should consider:

- (1) the extent to which capital is an appropriate mitigant for the risks identified; and
- (2) assess the amount and quality of capital required.

7.1.9A

FCA PRA

G

This section sets out in greater detail the approach to be taken by a *firm* when carrying out the assessment of capital described in the preceding paragraph. This is the assessment referred to as an *individual capital assessment*. ■ GENPRU 1.2.42 R is a general requirement

for a *firm* to carry out stress tests and scenario analyses taking into account an appropriate range of adverse circumstances and events relevant to the *firm's* business and risk profile and to estimate the financial resources it would need to continue to meet the *overall financial adequacy rule* in the stress scenarios considered. As part of its obligations under ■ GENPRU 1.2.42 R, the *firm* must carry out stress tests and scenario analyses to estimate the financial resources it would need to support its business plans and continue adequately to cover its *CRR* and meet the *overall financial adequacy rule* over a time horizon of 3 to 5 years. This is a separate requirement from that to carry out an *ICA*, and *guidance* on this requirement is provided in ■ GENPRU 1.2.73A G and ■ GENPRU 1.2.73C G. In particular, *firms* should note that there is no requirement that the level of capital required as identified by the *ICA* should be equal to, or exceed, the *CRR*.

7.1.9B  
FCA PRA

G The requirements and *guidance* in this section are drafted so as to apply to a *firm* on a solo basis. As noted in ■ GENPRU 1.2.17 G, however, in some cases the requirements in ■ GENPRU 1.2 apply on a consolidated basis. In these cases, a *firm* should read and apply this section making appropriate adjustments to reflect the application of the ■ GENPRU 1.2 requirements on a consolidated basis.

7.1.10  
FCA PRA

G A *firm* may choose to carry out its *ICA* in another way than through the use of stress tests and scenario analyses. The method should be proportionate to the size and nature of its business.

7.1.11  
FCA PRA

G In accordance with ■ GENPRU 1.2.60 R, these assessments must be documented so that they can be easily reviewed by the *appropriate regulator* as part of the *appropriate regulator's* assessment of the adequacy of the *firm's capital resources*.

7.1.12  
FCA PRA

G The *appropriate regulator* may ask for the results of these assessments to be provided to it together with a description of the processes by which the assessments have been made, the range of results from each stress test or scenario analysis performed and the main assumptions made. The *appropriate regulator* may also carry out a more detailed examination of the details of the *firm's* processes and calculations.

7.1.13  
FCA PRA

G Based upon this information and other information available to it, the *appropriate regulator* will consider whether the *capital resources requirement* applicable to the firm is appropriate. Where relevant, the *firm's ECR* will be a key input to the *appropriate regulator's* assessment of the adequacy of the *firm's capital resources*. For *firms* carrying on *general insurance business*, the *ECR* is calculated in accordance with ■ INSPRU 1.1.72C R. For *realistic basis life firms*, the *ECR* forms part of the *CRR* and is calculated in accordance with ■ GENPRU 2.1.38 R.

7.1.14  
FCA PRA

G *Firms* that are required to calculate an *ECR* may wish to note that the *ECR* as calculated is based upon the assumptions 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. *Firms* may find it helpful to assess the extent to which their actual business differs from these assumptions and therefore what adjustments it might be reasonable to make to the *CRR* or *ECR* to arrive at an adequate level of *capital resources*.

**Methodology of capital resources assessment**

7.1.15

FCA PRA

R

Where a *firm* is carrying out an assessment in accordance with ■ GENPRU 1.2 of the adequacy of its overall financial resources to cover the risk in the *overall financial adequacy rule*, that is, the risk of its being unable to meet its liabilities as they fall due, the assessment of the adequacy of the *firm's* capital resources must:

- (1) reflect the *firm's* assets, liabilities, intra-group arrangements and future plans;
- (2) be consistent with the *firm's* management practice, systems and controls;
- (3) consider all material risks that may have an impact on the *firm's* ability to meet its liabilities to *policyholders*; and
- (4) use a valuation basis that is consistent throughout the assessment.

**Representative of the firm's characteristics**

7.1.16

FCA PRA

G

The *ICA* should reflect both the *firm's* desire to fulfil its business objectives and its responsibility to meet liabilities to *policyholders*. This means that the *ICA* should demonstrate that the *firm* holds sufficient capital to be able to make planned investments and take on new business (within an appropriate planning horizon). It should also ensure that if the *firm* had to close to new business (if it has not already done so), it would be able to meet its existing commitments. The costs of writing new business, the expenses incurred in servicing all liabilities, including liabilities to non-*policyholders*, and the nature of intra-group arrangements and *reinsurance* arrangements should be considered as part of the assessment as well as the costs that would be incurred in the event of closure to new business.

7.1.17

FCA PRA

G

Where a *firm* has not already closed to new business, the *ICA* should be made on the basis that the *firm* closes to new business after an appropriate period. This period should allow for the time it would take for the *firm* to identify the need for closure and to implement the necessary action.

7.1.18

FCA PRA

G

Where including new business would increase the capital resources by more than any increase in the capital required, or reduce the capital required by more than any reduction in available capital, new business should be excluded. To the extent that including new business increases the required capital, a *firm* should consider whether it is appropriate to include the additional amount within the *ICA*.

7.1.19

FCA PRA

G

Any contract that the *firm* is legally obliged to renew should be considered part of the *firm's* existing liabilities and not treated as new business. Such contractual obligations include multi-year *general insurance contracts* and the exercise of options by long-term *policyholders*.

7.1.20

FCA PRA

G

For a *firm* to discharge its financial obligations to *policyholders*, it will incur certain expenses, including payments to the *firm's* own staff, contributions to any pension scheme and fees to outsourcing suppliers or service companies. All of these expenses, and risks associated with these payments, should be considered when carrying out the *ICA*. When

considering the appropriate level of expenses in a projection, the *firm* should consider the acceptability of the service provided to *policyholders* and the resources required by the senior management to manage the *firm*.

7.1.21  
FCA PRA

G

Where a *firm's* liabilities include payments which are subordinated to liabilities to *policyholders*, these payments do not need to be included within the *ICA*. However, the *ICA* should include all payments that must be made to avoid putting *policyholders'* interests at risk, including any payment on which a default might trigger the winding up of the *firm*. For example, if the principal of a loan could be recalled on default of a coupon payment, coupon payments over the lifetime of *policyholder* liabilities should be included in the *ICA*. As a further example, declared dividends should be treated as a liability. However, planned dividends that have not been declared need not be included in the *ICA*.

### Intra-group capital considerations

7.1.22  
PRA

G

It is common for *firms* whose corporate *group* consists of a number of separate legal entities to have intra-group transactions in place. Capital and risk may originate within the *firm* and be passed to another company or may originate in another company and be passed to the *firm*. The *ICA* should consider the underlying effect of intra-group arrangements.

7.1.23  
PRA

G

Risks may exist within the individual legal entity from these intra-group transactions. Intra-group transactions should not be treated differently from external transactions just because they are intra-group. However, some intra-group transactions may carry less credit risk than the equivalent external transactions if the *firm* has access to more information regarding the financial position of an internal *reinsurer*. In assessing intra-group risks, consideration should be given, but should not be limited, to:

- (1) future defaults on intra-group *reinsurance* arrangements: *Firms* should consider, for example, a test akin to the credit risk assessment undertaken on external *reinsurance* assets held or future anticipated recoveries; in other cases it may be more appropriate to perform a more explicit assessment of the *group* counterparty's own capital position, to inform the *firm's* exposure to default;
- (2) non-recoverability on intra-group loans: Even though these transactions occur within the same *group*, there is a risk that an entity may default on such intra-group payments; and
- (3) non-payment of future internal dividends or transfers: Many entities or funds within a *group* rely on these payments as a means to maintaining their solvency position. There is a risk that the entity paying the dividend or making the transfer may not be able to do so, and *ICAs* performed for separate regulated legal entities or funds within a *group* should consider these risks as appropriate.

7.1.24  
PRA

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A *firm's* capital should normally be restricted to resources within the *firm*. Where the *firm* is relying on resources outside the direct control of the *firm*, these should only be included to the extent that the *firm* has a right to call on those resources and the provider has the ability to provide those resources without recourse to the assets of the *firm* itself, in the circumstances considered as part of the *ICA*.

**Consistency with a firm's practice, systems and controls**

**7.1.25** FCA PRA G The ICA should reflect the *firm's* ability to react to events as they occur. When relying on prospective management actions, *firms* should understand the implications of taking such actions, including the financial effect, and taking into consideration any preconditions that might affect the value of management actions as risk mitigants.

**7.1.26** FCA PRA G The ICA should assume that a *firm* will continue to manage its business having regard to the PRA's and FCA's Principles for Businesses. In particular, a *firm* should take into account how the Principles for Businesses may constrain its prospective management actions, for example, the FCA's *Principle 6* (Treating Customers Fairly).

**7.1.27** FCA PRA G *Firms* should also consider whether their systems and controls provide sufficient information to permit senior management to identify the crystallisation of risks in a timely manner so as to provide them with the opportunity to respond and allow the *firm* to obtain the full value of the modelled management action. *Firms* should also analyse the wider implications of the management actions, particularly where they represent significant divergence from the business plan and use this information to consider the appropriateness of taking this action.

**7.1.28** PRA G Where the ICA assumes that the *firm* may move capital from one part of its business to another across legal or geographical boundaries, the *firm* should explain the mechanisms that it would apply and satisfy itself that it could achieve the necessary capital movements in times of distress (see ■ GENPRU 1.2.51 R). The *firm* should also consider any associated costs or restrictions in the amount of capital that would be able to be relocated.

**Considering all material risks**

**7.1.29** FCA PRA G The ICA should give the required level of confidence that the *firm's* liabilities to *policyholders* will be paid. The ICA should consider all material risks which may arise before the *policyholder* liabilities are paid (including those risks set out in ■ GENPRU 1.2.30 R).

**7.1.30** FCA PRA G *Firms* should not ignore risks simply because they relate to events that occur with an expected likelihood beyond the confidence level. However, the capital required in the face of these tail events may be reduced for the purpose of carrying out the ICA. For example, while an A-rated bond may be assumed not to default within the required confidence level, allowance should be made for the devaluation of that bond through a more likely downgrade or change in credit spreads or other method which reflects that this investment includes a default risk to the *firm*.

**7.1.31** FCA PRA G Notwithstanding ■ INSPRU 7.1.30 G, risks which have an immaterial effect on the *firm's* financial position or only occur with an extreme probability may be excluded from the ICA.

**7.1.32** FCA PRA G The number of *claims*, the amount paid and the timing of a *firm's* liabilities may be uncertain. The ICA should consider risks which result in a change in the cost of those liabilities.

7.1.33

FCA PRA

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The assets that a *firm* holds will include assets to back both the liabilities and any capital requirement. These assets carry risk, both in their own right and to the extent that they do not match the liabilities that they are backing. The risk associated with these assets should be considered over the full term for which the *firm* expects to carry the liabilities.

7.1.34

FCA PRA

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Where the *firm* is relying on systems and controls in order to mitigate risks, the *firm* should consider the risk of those systems and controls failing at the confidence level at which the *ICA* is being carried out.

7.1.35

FCA PRA

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If a *firm* summarises cash flows over part of the lifetime of the portfolio using a balance sheet but is exposed to risks which emerge after the balance sheet date, then these longer-dated risks may be captured by adjusting the assumptions used in the closing balance sheet.

### Valuation basis

7.1.36

FCA PRA

G

The valuation of the assets and of the liabilities should reflect their economic substance. A realistic valuation basis should be used for assets and liabilities taking into account the actual amounts and timings of cash flows under any projections used in the assessment.

7.1.37

FCA PRA

G

In carrying out the *ICA*, wherever possible the value of assets should be marked to market. Where marking to market is not possible, the *ICA* should use a method suitable for assessing the underlying economic benefit of holding each asset.

7.1.38

FCA PRA

G

The methods and assumptions used in valuing the liabilities should contain no explicit margins for risk, nor should the approach be optimistic. The valuation of liabilities should be consistent with the valuation of assets. To the extent the market price includes an implicit allowance for risk, this should be included within the valuation.

7.1.39

FCA PRA

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The methodology used to place a value on an asset or a liability following a risk event should be consistent with the methodology used prior to the risk event.

7.1.40

FCA PRA

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Approximate valuation methods may be used by the *firm* for minor lines of business or to capture less material types of risk. However, the *firm* should avoid methods which under-estimate the risk in aggregate.

7.1.41

FCA PRA

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The *firm* should carry out a broad reconciliation of key parts of any balance sheet used in the *ICA* with the corresponding entry from audited results.

### ICA submitted to appropriate regulator: confidence level

7.1.42

FCA PRA

R

Where the *appropriate regulator* requests a *firm* to submit to it a written record of the *firm's* assessments of the adequacy of its capital resources carried out in accordance with ■ INSPRU 7.1.15 R, those assessments must include an assessment comparable to a 99.5% confidence level over a one year timeframe that the value of assets exceeds the value of liabilities,

whether or not this is the confidence level otherwise used in the *firm's* own assessments.

7.1.43

FCA PRA

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In considering the value of liabilities for the purpose of ■ INSPRU 7.1.42 R, *firms* should have regard to the guidance in ■ INSPRU 7.1.21 G, ■ INSPRU 7.1.26 G and ■ GENPRU 1.2.27 G to ■ GENPRU 1.2.29 G.

7.1.44

FCA PRA

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The *appropriate regulator* requires *firms* to submit a capital assessment calibrated to a common confidence level, as set out in ■ INSPRU 7.1.42 R, to enable the *appropriate regulator* to assess whether the minimum *capital resources requirements* in ■ GENPRU 2.1 are appropriate. This then allows the *appropriate regulator* to give a consistent level of *individual capital guidance* across the industry.

7.1.45

FCA PRA

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If a *firm* selects a longer time horizon than one year it may choose to use a lower confidence level than 99.5%. In such a case, the *firm* should be prepared to justify its choice and explain why this confidence interval is appropriate and how it is comparable to a 99.5% confidence level over a one year timeframe. An assessment based on a longer timeframe should also demonstrate that there are sufficient assets to cover liabilities at all future dates. This may be illustrated by future annual balance sheets.

### Measurement

7.1.46

FCA PRA

G

In determining the strength of the *ICA*, a *firm* should consider all risks in aggregate making appropriate allowance for diversification such that the assessment meets the required confidence level overall. The *firm* should be able to describe and explain each of the main diversification benefits allowed for.

7.1.47

FCA PRA

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For risks that can be observed to crystallise over a short period of the order of a year, the confidence level may be measured with reference to the probability distribution for the impact of the risks over one year. For example, catastrophic events such as hurricanes can be measured in this way by estimating the ultimate capital cost.

7.1.48

FCA PRA

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For risks that are not observable over a short period (such as long-tailed liability business or annuitant mortality), the confidence level may be measured with reference to the probability distribution for the emergence of that risk over the lifetime of the liabilities.

### Documenting ICAs submitted to the appropriate regulator

7.1.49

FCA PRA

R

The written record of a *firm's individual capital assessments* carried out in accordance with ■ INSPRU 7.1.15 R submitted by the *firm* to the *appropriate regulator* must:

- (1) in relation to the assessment comparable to a 99.5% confidence level over a one year timeframe that the value of assets exceeds the value of liabilities, document the reasoning and judgements underlying that assessment and, in particular, justify:
  - (a) the assumptions used;
  - (b) the appropriateness of the methodology used; and

(c) the results of the assessment; and

(2) identify the major differences between that assessment and any other assessments carried out by the *firm* using a different confidence level.

7.1.50  
PRA

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A *firm's* management should determine their own risk appetite or confidence level and a risk measure that they believe is suitable for the management of the business. The *appropriate regulator* expects that the *firm's* capital resources assessment under ■ GENPRU 1.2 which it uses in the management of its business may well be at a different confidence level than the 99.5% one required by ■ INSPRU 7.1.42 R for a number of reasons, for example, because its view of capital adequacy is different, or to satisfy the demands of rating agencies, or to meet the proposition to *policyholders* as to the strength of the *firm*. A *firm* will maintain its own written assessment of the adequacy of its financial resources, as required by ■ GENPRU 1.2, through the written record requirement of ■ GENPRU 1.2.60 R.

7.1.51  
PRA

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■ INSPRU 7.1.49 R (2) recognises that a *firm* may carry out a number of different assessments of the adequacy of its capital resources, using different confidence levels, in reaching its overall assessment of the adequacy of its financial resources under ■ GENPRU 1.2. The purpose of asking the *firm* to identify the major differences between those assessments and the assessment documented under ■ INSPRU 7.1.49 R (1) is to enable the *appropriate regulator* better to understand the *firm's* approach to capital adequacy and risk management in running its business. Understanding the written record made under ■ GENPRU 1.2.60 R is therefore key to the *appropriate regulator's* understanding of the *firm's* risk and capital management processes.

7.1.52  
PRA

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The written record of any other assessment by the *firm* required by ■ GENPRU 1.2.60 R is not itself part of the submission to the *appropriate regulator*, but the *appropriate regulator* is interested in the connection between that other assessment, as documented in the written record required by ■ GENPRU 1.2.60 R, and the assessment documented under ■ INSPRU 7.1.49 R (1) in terms of the *firm's* compliance with ■ GENPRU 1.2, and the use of capital measures within the *firm*.

7.1.53  
PRA

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For the purpose of the written record submitted to the *appropriate regulator*, the submitted comparison should include:

- (1) A description of any direct difference in the strength of the *firm's* own assessment compared to the assessment submitted to the *appropriate regulator*. This is likely to be expressed as a different confidence level to the assessment undertaken to a 99.5% confidence level or the targeting of a defined margin about the 99.5% assessment.
- (2) A description of any major differences in the definition of the assets or liabilities, the management actions used, the risks considered or the valuation methodology and assumptions included within the assessment.

7.1.54  
PRA

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Some *firms* may not undertake an assessment at a separate confidence level because they consider that a 99.5% confidence level is appropriate to manage their business

and meets the requirements of ■ GENPRU 1.2. In the case of these *firms*, no analysis of the major differences is required to be submitted.

**Justifying assumptions used**

7.1.55 **G** *Firms* should provide evidence to support the choice of assumptions used within the *ICA*.

**PRA**

7.1.56 **G** Where the choice of assumptions is supported by data, the *firm* should consider the relevance of that data to the *firm's* current and future circumstances and the robustness of any estimates derived.

**PRA**

7.1.57 **G** Where the choice of assumptions is supported by expert judgement, the *firm* should consider the nature and value of the expertise being used to support this judgement and any biases that may exist. Where possible, the *firm* should use data to test and support these expert judgements.

**PRA**

**Approach taken for significant assumptions**

7.1.58 **G** *Firms* should be able to demonstrate how they have identified the most financially significant assumptions and calculate the sensitivity of the *ICA* to changes in these assumptions. The choice of assumption may be decided using the results of sensitivity testing.

**PRA**

7.1.59 **G** *Firms* may seek to justify their assumptions by considering the process used to determine those assumptions from relevant data. Alternatively, where historical data is either limited or not considered to be indicative of likely future experience, *firms* may justify their assumptions by reference to the suitability of the calibration for the purpose of the *ICA*. However, relatively more attention should be given to the justification where the choice of assumption has a more significant effect on the *ICA*.

**PRA**

7.1.60 **G** Where there is a concentration of business from a single source (for example, a single sales channel or cedant), consideration should be given to the greater impact of a risk crystallising, compared to that for a well-diversified portfolio.

**PRA**

**Justification of prospective management actions**

7.1.61 **G** Where projection of the value of assets and liabilities reflects the *firm's* prospective management actions, the *firm* should justify the choice of prospective management actions and the assumptions used.

**PRA**

7.1.62 **G** Where the prospective management action is identical to those used in another regulatory assessment of solvency (e.g. calculation of the *WPICC* for *realistic basis life firms*), no further justification is required.

**PRA**

7.1.63 **G** Where the prospective management action is not similar to those used in another regulatory assessment of solvency, or uses different assumptions, the *firm* should show the financial impact of the management action.

**PRA**

**Regular review of assumptions**

7.1.64  
PRA

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*Firms* should regularly review key parameters, both to ensure their continued applicability and to reduce uncertainty over the current level of capital required. *Firms* using assumptions that are very different from past experience should present robust arguments in support of the differences.

**Methodology**

7.1.65  
PRA

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The methodology used within the *ICA* should allow the *firm* to quantify the financial effect of material risks at the required confidence level. The methodology used should also reflect the nature of the *firm's* business and be consistent with the way in which the *firm* identifies and manages risk.

7.1.66  
PRA

G

*Firms* should be able to explain their rationale for choosing their approach to risk and assessment of capital required. There are no simple classifications of approach to risk and capital assessment, so the rationale should be considered in the context of a number of defining characteristics in the structure of the capital model.

7.1.67  
PRA

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Generally, larger *firms* would be expected to take a more sophisticated approach to capital modelling than smaller ones.

**Stress tests and scenario analyses**

7.1.68  
PRA

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Where a *firm* chooses to carry out its *ICA* through the use of stress testing and scenario analysis, such testing should reflect the potential range of outcomes for the risks being quantified, consistent with the prescribed confidence level for the *ICA*.

7.1.69  
PRA

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The overall assessment of capital required may require the aggregation of results from the stress and scenario testing. The *firm* should explain its choice of aggregation approach and its understanding of the implications of combining the individual risks. The *firm* should be satisfied that the resultant capital provides the required degree of confidence, given the variability of the underlying risks and the uncertainty associated with modelling those risks. A useful component of this process is the characterisation and explanation of a range of possible circumstances that could give rise to a loss of this magnitude.

**Documenting the results**

7.1.70  
PRA

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The conclusion of the *ICA* should consider whether the *firm* has adequate capital to meet its assessment of the required capital. Furthermore, the *firm* should consider any implications for its approach to risk management arising from the work carried out. The *ICA* should be supported by an explanation of the material sources of risk and financial impact of the management actions that the *firm* may take to manage those risks. Where possible, the reasonableness of the results should be supported by considering other evidence of the capital needed.

7.1.71  
PRA

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The objective of capital modelling is to consider all possible outcomes, however unlikely any one outcome might be, and set capital as protection against all but the most extreme losses. It is therefore important to focus not only on the assumptions and methodology used to quantify individual risks, but also on the approach to aggregating the capital required for each risk.

**7.1.72** **G** However the risks have been aggregated to give the *firm's* capital requirement, checks should be made as to the reasonableness of the outcome. It should be possible to characterise scenarios, or combinations of loss events, that would result in a loss of similar magnitude to that indicated by the *ICA*. *Firms* should consider a range of scenarios that could give rise to such a loss.

**PRA**

**7.1.73** **G** The results of the *ICA* should be supplemented by analysis of the sources of the risks to which the *firm* is exposed, discussion of the events which are most likely to threaten the financial stability of the *firm* and the potential mitigating actions which are available to senior management.

**PRA**

**Additional guidance for Lloyd's**

**7.1.74** **G** Responsibility for:

**PRA**

- (1) managing the risks associated with the *insurance business*; and
- (2) holding the *capital resources* that support those risks;

is divided between *managing agents* and the *Society*. To clarify the respective responsibilities of *managing agents* and the *Society* for ensuring the adequacy of financial resources, the *PRA* distinguishes between the *managing agents'* responsibility to carry out capital adequacy assessments of the *capital resources* held at *syndicate* level for each *syndicate* that they manage, and the *Society's* responsibility to carry out an assessment for each *member*.

**7.1.75** **R** In carrying out *ICAs* in respect of the *insurance business* carried on through each *syndicate* (the *syndicate ICA*), *managing agent* must consider the risks, controls and the financial resources relevant to each *syndicate*.

**PRA**

**7.1.76** **R** When carrying out the *syndicate ICA*, *managing agents* must not take into account risks to which a *member* may be exposed or controls from which a *member* may benefit:

**PRA**

- (1) because that *member* carries on *insurance business* through another *syndicate* or more than one *syndicate year* (whether or not managed by the same *managing agent*); or
- (2) because that *member's* financial resources include *funds at Lloyd's* or *central assets*.

**7.1.77** **R** The *Society* must have regard to *syndicate ICAs* in arriving at its own capital assessment for each *member*.

**PRA**

**7.1.78** **G** In assessing the adequacy of the *capital resources* supporting the *insurance business* of each *member*, the *Society* should consider the risks, controls and financial resources relevant to the totality of the *member's insurance business*, including:

**PRA**

- (1) the adequacy of *syndicate ICAs*;
- (2) the *member's* share of *syndicate ICAs*;

- (3) adjustments in respect of risks and controls relating to *funds at Lloyd's*, *central assets* and the interaction of risks underwritten by the *member* through different *syndicates* and in respect of different *syndicate years*; and
- (4) the ongoing validity of any relevant assumptions it makes.

7.1.79

PRA

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In taking account of a *syndicate ICA* under ■ INSPRU 7.1.77 R:

- (1) if the *Society* considers a *syndicate ICA* to be adequate, it should use the *managing agent's* risk and capital assessments in carrying out its *ICA* in relation to any *member* of that *syndicate*, or it should be able to justify why it will not; and
- (2) if the *Society* considers a *syndicate ICA* to be less than adequate, the *Society* should increase the *syndicate ICA* so that it is adequate for the purpose of carrying out its *ICA* in relation to the *members* of that *syndicate*.

7.1.80

PRA

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The assessment of capital adequacy for a *member* will rarely equal the proportionate share of a *syndicate ICA* (or sum of those shares, where the *member* participates on more than one *syndicate*) as attributed to that *member*, because, in determining the capital assessments for each *member*, the *Society* may make adjustments to take account of:

- (1) risks and controls associated with *funds at Lloyd's* and *central assets*, which can increase the assessment for that *member*;
- (2) diversification effects, including as a result of *members'* participations on more than one *syndicate year*, which can reduce the assessment for that *member*; and
- (3) its own assessment of *syndicate* risks, which can be higher than the *managing agent's* and so increase the assessment for that *member*.

7.1.81

PRA

G

*Capital resources* to meet each *syndicate ICA* could be:

- (1) held within a *syndicate* and managed by the *managing agent*; or
- (2) held and managed by the *Society*; or
- (3) not needed in full, because of effects such as diversification that the *Society* takes into account.

7.1.82

PRA

G

The *balancing amount* is a function of the relationship between the *syndicate ICA* and the amount of assets held within the *syndicate*. As illustrations:

- (1) if the *syndicate* holds no *capital resources* (but its liabilities are fully covered by relevant assets), the *balancing amount* equals the *syndicate ICA* (as there are no capital resources at *syndicate* level, all the *capital resources* must be held as *funds at Lloyd's* or *central assets*);
- (2) if *capital resources* held at *syndicate* level are negative (i.e. if relevant assets do not fully cover liabilities for the *syndicate*), the *balancing amount* should

be higher than the *syndicate ICA* by an amount corresponding to the negative *capital resources* held by *managing agents* on behalf of the *syndicate*; and

- (3) conversely, if a *syndicate* holds positive *capital resources* for the *syndicate*, the *balancing amount* should be lower than the *syndicate ICA* by a corresponding amount.

7.1.83  
PRA

**R** *Managing agents* must periodically notify the *Society* of the *syndicate ICA* and the *balancing amount* in respect of each *syndicate*.

7.1.84  
PRA

**R** For the purpose of assessing the adequacy of *capital resources* held as *funds at Lloyd's* and *central assets*, the *Society* must have regard to *balancing amounts* notified to it by *managing agents*.

7.1.85  
PRA

**R** After notification of a *balancing amount* by a *managing agent*, the *Society* must:

- (1) confirm to the *managing agent* that *capital resources* held as *funds at Lloyd's* and *central assets* are adequate to support the *balancing amount*; or
- (2) notify the *managing agent* that it cannot give that confirmation.

7.1.86  
PRA

**G** *Managing agents* should submit *syndicate ICAs* and notify *balancing amounts* to the *Society* as part of the annual capital-setting process at *Lloyd's*. The submission of the *syndicate ICA* and the notification of the *balancing amount* should be made in good time for the *Society* to review them and place appropriate reliance on them when it determines the capital assessments for each *member*.

7.1.87  
PRA

**G** When communicating the *syndicate ICA* and *balancing amount* for each *syndicate* to the *Society*, *managing agents* should agree with the *Society* an allocation of the *syndicate ICA* between *syndicate years*. The purpose of the allocation is to ensure that there is an appropriate matching of assets to risk and liabilities and an equitable treatment between the *members* reflecting the provision of capital in each *syndicate year*.

7.1.88  
PRA

**G** For the purposes of complying with their obligations under *INSPRU*, *managing agents* may assume that any *balancing amount* confirmed by the *Society* under **INSPRU 7.1.85 R** is supported by *capital resources* held as *funds at Lloyd's* and *central assets*.

7.1.89  
PRA

**R** If a *managing agent* has, at any time, a significant doubt about the adequacy of a *syndicate ICA* or *balancing amount* with respect to *syndicate risks* and controls, it must notify the *Society* immediately.

PAGE 15  
7.1.90  
PRA

**R** If the *Society* has, at any time, a significant doubt about the adequacy of any *member's capital resources* held by it in support of any *balancing amount*, it must notify the relevant *managing agent* immediately.

**Appropriate regulator assessment process - all firms**

7.1.91  
FCA PRA

G

In assessing the adequacy of a *firm's capital resources*, the *appropriate regulator* draws on more than just a review of the submitted *ICA*. Use is made of wider supervisory knowledge of a *firm* and of wider market developments and practices. When forming a view of any *individual capital guidance* to be given to a *firm*, the review of the *firm's ICA* along with the regulator's risk assessment and any other issues arising from day-to-day supervision will be considered.

7.1.92  
FCA PRA

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The *appropriate regulator* will take a risk-based and proportionate approach to the review of a *firm's ICA*, focusing on the *firm's* approach to dealing with the key risks it faces. Any *individual capital guidance* given will reflect the judgements reached through the regulator's review process as well as the review of the *firm's ICA*.

7.1.93  
FCA PRA

G

A *firm* should not expect the *appropriate regulator* to accept as adequate any particular model that the *firm* develops or that the results from the model are automatically reflected in any *individual capital guidance* given to the *firm* for the purpose of determining adequate *capital resources*. However, the *appropriate regulator* will take into account the results of any sound and prudent model when giving *individual capital guidance* or considering applications for a waiver under sections 138A and 138B of the *Act* of the *capital resources requirement* in ■ GENPRU 2.1.

7.1.94  
FCA PRA

G

Where the *appropriate regulator* considers that a *firm* will not comply with ■ GENPRU 1.2.26 R (adequate financial resources, including *capital resources*) by holding the *capital resources* required by ■ GENPRU 2.1, the *appropriate regulator* may give the *firm individual capital guidance* advising it of the amount and quality of *capital resources* which the *appropriate regulator* considers it needs to hold in order to meet that *rule*.

7.1.95  
FCA PRA

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In giving *individual capital guidance*, the *appropriate regulator* seeks a balance between delivering consistent outcomes across the *individual capital guidance* it gives to all *firms* and recognising that such guidance should reflect the individual features of the *firm*. Comparison with the assumptions used by other *firms* will be used to trigger further enquiry. Debate will be sought where good arguments are made for a particular result that differs markedly from those of a *firm's* peers. The *appropriate regulator* also takes account of the quality of the wider risk management around the development of the numbers used in the *ICA*. The aim is to deliver *individual capital guidance* that comes closest to ensuring that there is no significant risk that a *firm* is unable to pay its liabilities as they fall due.

7.1.96  
FCA PRA

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Following an internal validation process, the *appropriate regulator* will write to the Board of the *firm* being assessed providing both quantitative and qualitative feedback on the results of the *appropriate regulator's* assessment. This letter will notify the *firm* of the *individual capital guidance* considered appropriate. The letter will include reasons for any capital add-ons identified, where applicable.

7.1.97  
FCA PRA

G

If a *firm* considers that the individual capital guidance is inappropriate to its circumstances, then the *firm* should inform the *appropriate regulator* that it does not intend to follow that *guidance*. Informing the *appropriate regulator* of such an intention would be expected if a *firm* is to comply with *Principle 11* (Relations with regulators).

7.1.98

FCA PRA

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The *appropriate regulator* expects most disagreements about the adequacy of capital will be resolved through further analysis and discussion. The *appropriate regulator* may consider the use of its powers under section 166 of the *Act* (Reports by skilled persons) to assist in such circumstances. If the *appropriate regulator* and the *firm* still do not agree on an adequate level of capital, then the *appropriate regulator* may consider using its powers under section 55J of the *Act* to, on its own initiative, vary a *firm's Part 4A permission* so as to require it to hold capital in accordance with the *appropriate regulator's* view of the capital necessary to comply with ■ GENPRU 1.2.26 R. ■ SUP 7 provides further information about the *appropriate regulator's* powers under section 55J.

7.1.99

FCA PRA

G

Where a *firm* considers that the *capital resources requirements* of ■ GENPRU 2.1 require the holding of more capital than is needed for the *firm* to comply with ■ GENPRU 1.2.26 R then the *firm* may apply to the *appropriate regulator* for a *waiver* of the requirements in ■ GENPRU 2.1 under sections 138A and 138B of the *Act*. In addition to the statutory tests under sections 138A and 138B in deciding whether to grant a *waiver* and, if granted, its terms, the *appropriate regulator* will consider the thoroughness, objectivity and prudence of a *firm's ICA* and the extent to which the *guidance* in this section has been followed. The *appropriate regulator* will not grant a *waiver* that would cause a breach of the minimum capital requirements under the *Insurance Directives* or *Reinsurance Directive*.



## Chapter 8

# General provisions applying INSPRU and GENPRU to Lloyd's

## 8.1 Application

### 8.1.1

FCA PRA

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■ INSPRU 8.1 applies to:

- (1) the *Society*;
- (2) *managing agents*.

### 8.1.2

FCA PRA

R

If a provision in *INSPRU* or *GENPRU* applies to the *Society* "in accordance with" this *rule*, the *Society* must:

- (1) manage each *member's funds at Lloyd's*;
- (2) manage its *central assets*; and
- (3) supervise the *insurance business* carried on by each *member* at Lloyd's;

so as to achieve in relation to those assets and that *insurance business* the same effect as the relevant *INSPRU* or *GENPRU* provision would have (that is, conforming with the requirements of any *rule* and taking appropriate account of any applicable *guidance*,) when applied to a *firm* or to the *insurance business* of a *firm*.

### 8.1.3

FCA PRA

G

The *Society* is subject to *INSPRU* and *GENPRU rules* in respect of the *insurance business* of each Lloyd's *member*. These include *rules* in respect of:

- (1) the calculation of the *capital resources requirements* for each *member*;
- (2) the financial resources it manages on behalf of *members*; and
- (3) the *Society's* own financial resources.

### 8.1.4

FCA PRA

R

If a provision in *INSPRU* or *GENPRU* applies to a *managing agents* "in accordance with" this *rule*, the *managing agent* must, in relation to each *syndicate* managed by it and for each *syndicate year*, manage:

- (1) the *syndicate assets*; and

(2) the *insurance business* carried on by the *members* of the *syndicate* through that *syndicate*;

so as to achieve in relation to those assets and that *insurance business* the same effect as the relevant *INSPRU* or *GENPRU* provision would have (that is, conforming with the requirements of any *rule* and taking appropriate account of any applicable *guidance*) when applied to a *firm* or to the *insurance business* of a *firm*.

8.1.5

FCA PRA

G

*Syndicate membership* may change from year to year or it may remain constant. *Managing agents* are required to apply *INSPRU* and *GENPRU* to the *insurance business* carried on through each *syndicate* for each *syndicate year*. This should ensure that *INSPRU* and *GENPRU* are applied to Lloyd's in a way that is consistent with the provision of capital to support the *insurance business* underwritten.

8.1.6

PRA

G

Where common systems and controls or processes are appropriate for all the *insurance business* carried on through more than one *syndicate year*, a single response may be adequate for all *syndicate years*. However, in some cases it will be important to consider the business of each open *syndicate year* separately, particularly for quantitative *rules*. For example, it is important that *managing agents* separately assess the financial resources (including capital) that are required and are available to support the *insurance business* carried on through each *syndicate year*, where the *syndicate membership* changes from year to year. This is because each *member's* assets are only available to support its own business, so the assets supporting one year of account may not be available to support another. For example, if a *managing agent* were to assess the financial requirements of two or more *syndicate years* together where the capital structure had changed, there would be a risk that the *managing agent* might take account of diversification effects that were not reflected in the capital supporting the *insurance business*.

8.1.7

PRA

G

There is no requirement on *managing agents* to carry out separate individual capital assessments for *syndicates* for each *syndicate year*. *Managing agents* are required to carry out individual capital assessments for each *syndicate* as if that *syndicate* were a *firm*; this would normally be on the basis of a going concern but, just as in a *firm*, account needs to be taken of any restrictions on the availability of assets (e.g. deposits with cedants), and some account needs to be taken of changes in the capital participation in the *syndicate*. The *Society* is responsible for the individual capital assessment for each *member*, which must take into account the assessments made by *managing agents* of any *syndicates* on which the *member* participates. ■ *INSPRU* 7.1 contains *rules* and guidance on the assessment of capital adequacy for *firms* and ■ *INSPRU* 7.1.74 G to ■ *INSPRU* 7.1.90 R provide for the application of ■ *INSPRU* 7.1 to the *Society* and *managing agents*.

8.1.8

PRA

G

The assessment which a *firm* makes should be based upon its future business plans and projections. This is the main area where the *firm's* assessment may diverge from its prescribed *capital resources requirement* which, necessarily, is based upon historic data.

8.1.9

PRA

G

Key *INSPRU* and *GENPRU* requirements for Lloyd's

Key *INSPRU* and  
*GENPRU* require-  
ments

*INSPRU*

*GENPRU*

Risk management, systems and  
controls

Key <i>INSPRU</i> and <i>GENPRU</i> requirements	<i>INSPRU</i>	<i>GENPRU</i>
The <i>Society</i> to establish and maintain systems and controls to address risks affecting the Lloyd's market	INSPRU 8.2	
The <i>Society</i> to manage prudential, credit, market, liquidity and operational risks affecting <i>funds at Lloyd's</i> and <i>central assets</i>	INSPRU 4.1, INSPRU 5.1, INSPRU 8.2 & INSPRU 8.5	
<i>Managing agents</i> to establish and maintain systems and controls for the management of prudential, credit, market, liquidity, operational, and insurance risks affecting each <i>syndicate</i>	INSPRU 4.1, INSPRU 5.1, INSPRU 8.2 & INSPRU 8.5	
Adequacy of financial resources		
The <i>Society</i> to ensure that <i>members'</i> financial resources are adequate		GENPRU 1.2 & GENPRU 1.5
<i>Members</i> taken together to maintain adequate financial resources in respect of the <i>insurance business</i> conducted at Lloyd's		GENPRU 1.5
<i>Managing agents</i> to ensure that financial resources are adequate for each <i>syndicate</i>		GENPRU 1.2 & GENPRU 1.5
Valuation		
The <i>Society</i> and <i>managing agents</i> to apply generally accepted accounting principles to valuing assets, liabilities, equity and income statement items for the purposes of the <i>rules</i> and <i>guidance</i> in <i>GENPRU</i> , <i>INSPRU</i> and <i>IPRU (INS)</i> unless the contrary is expressly stated	INSPRU 3.1 & INSPRU 3.2	GENPRU 1.3 & GENPRU 1.5
Capital resources requirements		
The <i>Society</i> to calculate the <i>MCR</i> in respect of the <i>general insurance business</i> of each <i>member</i>		GENPRU 2.1 & GENPRU 2.3
The <i>Society</i> to calculate the <i>CRR</i> (higher of <i>MCR</i> and		GENPRU 2.1 & GENPRU 2.3

Key <i>INSPRU</i> and <i>GENPRU</i> requirements	<i>INSPRU</i>	<i>GENPRU</i>
<i>ECR</i> ) in respect of the <i>long-term insurance business</i> of each <i>member</i>		
Capital resources		
The <i>Society</i> and <i>managing agents</i> to calculate <i>capital resources</i> in accordance with the <i>rules</i> and <i>guidance</i> in <i>GENPRU</i>		GENPRU 2.2 & GENPRU 2.3
Adequacy of capital resources		
<i>Managing agents</i> to assess the adequacy of <i>capital resources</i> held at <i>syndicate</i> level in respect of <i>insurance business</i> carried on through each <i>syndicate</i> (annual ICA for each <i>syndicate</i> )	INSPRU 7.1	
The <i>Society</i> to assess the adequacy of <i>capital resources</i> available to support each <i>member's insurance business</i> (ICA for each <i>member</i> ), both at <i>syndicate</i> level (taking account of <i>syndicate ICAs</i> ), and as <i>funds at Lloyd's</i>	INSPRU 7.1	

## 8.2 Special provisions for Lloyd's

### Management of insurance business

- 8.2.1 **R** Neither the *Society* nor *managing agents* may permit a *member* to carry on any *insurance business* except as a participant on one or more *syndicates*.  
PRA

### Obligations under INSPRU and GENPRU

- 8.2.2 **R** The *Society* must ensure that all participants in the Lloyd's market are made aware of their obligations under *INSPRU* and *GENPRU*.  
FCA PRA

### Management of risk

- 8.2.3 **R** The *Society* must establish and maintain systems and controls to enable it appropriately to address the risks to which the Lloyd's market is exposed.  
PRA

- 8.2.4 **R** The systems and controls in ■ INSPRU 8.2.3 R must include systems and controls to enable the *Society* to ensure that any assumptions made in calculating a *member's capital resources* or in determining the individual capital assessment for each *member* are regularly reviewed and that appropriate action is taken if any assumption is no longer valid.  
PRA

- 8.2.5 **R** The *Society* must take all reasonable steps, including establishing and maintaining adequate systems and controls to enable it:
- (1) to manage the risks to which *funds at Lloyd's* and *central assets* are exposed; and
  - (2) to ensure that *funds at Lloyd's* and *central assets* are adequate to support all *balancing amounts*.

- 8.2.6 **R** A *managing agent* must establish and maintain adequate systems and controls to manage the risks to which the *insurance business* carried on through each *syndicate* it manages is exposed.  
PRA

- 8.2.7 **G** In complying with ■ INSPRU 8.2.6 R, *managing agents* should have particular regard to:
- (1) transactions which may give rise to a conflict of interest, such as those to which the *counterparties* are:

- (a) other members of the *managing agent's* own *group*;
  - (b) any *members* of any *syndicates* managed by the *managing agent*; or
  - (c) any entity that is part of a *group* to which one or more *members* of any *syndicates* managed by the *managing agent* belong; and
- (2) transactions involving:
- (a) the provision of capital;
  - (b) the provision of *reinsurance*; or
  - (c) the provision of other services.

8.2.8

PRA

R

In complying with ■ INSPRU 8.2.6 R a *managing agent* need not take account of risks associated with assets that are not *syndicate assets*.

8.2.9

PRA

R

The *Society* must take reasonable steps to ensure that systems and controls established and maintained by *managing agents* are adequate to ensure that risks to which the *insurance business* carried on through each *syndicate* is exposed do not have a detrimental effect on *funds at Lloyd's* or *central assets*.

8.2.10

PRA

G

*Managing agents* and the *Society* each hold and manage some of the financial resources held to support the *insurance business* carried on through *syndicates*. In particular:

- (1) the *Society* holds and manages *funds at Lloyd's* and *central assets* which must be held to support *balancing amounts*. The *Society* is required to manage the risks that affect *funds at Lloyd's* and *central assets* directly, once the effects of any aggregation and diversification have been taken into account;
- (2) *managing agents* hold and manage some of the financial resources in respect of the *insurance business* carried on through each *syndicate* that they manage. *Managing agents* are required to manage all risks affecting a *syndicate* except for the risk that *funds at Lloyd's* and *central assets* are not available to support the *balancing amount*.

8.2.11

FCA PRA

R

The *Society* must establish and maintain effective arrangements to monitor and manage risk arising from:

- (1) conflicts of interest (including in relation to (2) to (4));
- (2) inter-*syndicate* transactions, including *reinsurance to close* and *approved reinsurance to close*;
- (3) related party transactions; and
- (4) transactions between *members* and itself.

8.2.12

FCA PRA

R

The arrangements in ■ INSPRU 8.2.11 R must enable the *Society* to identify any significant overstatement of financial resources resulting from any

transaction falling within ■ INSPRU 8.2.11 R (2) to ■ INSPRU 8.2.11 R (4), including as a result of:

- (1) any differences in the amounts recorded as due or payable by each party to any such transaction; or
- (2) any actual or likely disputes between the parties to any such transaction.

8.2.13

FCA PRA

R

If the *Society* identifies a significant overstatement of the kind referred to in ■ INSPRU 8.2.12 R, it must ensure that an appropriate adjustment is made, including if appropriate by a deduction from or reduction in the value attributed to:

- (1) the *capital resources* of any *member* concerned; or
- (2) the *Society's capital resources*.

#### Approved reinsurance to close

8.2.14

PRA

G

As defined in the *Glossary*, "approved reinsurance to close" excludes:

- (1) *reinsurance* between parties other than *members*; and
- (2) balance transfers between *syndicate years* of *syndicates* having only one *member*, which have no effect on the overall liabilities of that *member*.

8.2.15

PRA

G

The "approved" status of an *approved reinsurance to close* does not alter the legal status or effect of the original *contract of insurance*, or the liability of a reinsured *member* to the *policyholder* under or in respect of the original *contract of insurance*.

8.2.16

PRA

R

Notwithstanding that the liability of a reinsured *member* to a *policyholder* is unaffected by an *approved reinsurance to close* as described in ■ INSPRU 8.2.15 G, for the purposes of INSPRU and GENPRU only:

- (1) for an *approved reinsurance to close* which is not to a *subsidiary* of the *Society*:
  - (a) a *contract of insurance* reinsured under an *approved reinsurance to close* must be treated as if the reinsuring *member* and not the reinsured *member* had effected the original *contract of insurance*; and
  - (b) any payment received by a *member* as consideration for or in connection with an *approved reinsurance to close* must be treated as a *Lloyd's member's contribution* and not as *premium* or as a *reinsurance recovery*;

- (2) for an *approved reinsurance to close* to a *subsidiary* of the *Society*, a *contract of insurance* reinsured under that *approved reinsurance to close* must be treated as if the reinsured *member* had not effected the original *contract of insurance* but:
- (a) for the purposes of the calculation of the *Society GICR*, *general insurance business* carried on by *members* and *former underwriting members* which has been reinsured to a *subsidiary* of the *Society* under an *approved reinsurance to close* must be treated as reinsured to a third party; and
  - (b) for the purposes of the calculation of the *capital resources requirement* of a *subsidiary* of the *Society*, the *approved reinsurance to close* must be treated as a *reinsurance*.

**Provision of information by managing agents**

8.2.17 FCA PRA R A *managing agent* must, as soon as possible, give the *Society* any information the *managing agent* has concerning material risks to *funds at Lloyd's* or *central assets*.

8.2.18 FCA PRA R A *managing agent* need not comply with ■ INSPRU 8.2.17 R if the *managing agent* knows that the *Society* already has the relevant information.

**Insurance receivables to be carried to trust funds**

8.2.19 FCA PRA R The *Society* must take all reasonable steps to ensure that each *member*:

- (1) executes the appropriate *Lloyd's trust deeds*; and
- (2) carries to the appropriate *Lloyd's trust fund* all amounts received or receivable by the *member*, or on its behalf, in respect of any *insurance business* carried on by it.

8.2.20 FCA PRA R The *Society* must carry all amounts it receives on behalf of any *member* in respect of that *member's insurance business* to the appropriate *Lloyd's trust fund*.

8.2.21 FCA PRA R A *managing agent* must carry all amounts it receives on behalf of any *member* in respect of that *member's insurance business* to the appropriate *Lloyd's trust fund*.

8.2.22 FCA PRA R In complying with ■ INSPRU 8.2.19 R to ■ INSPRU 8.2.21 R, the *Society* and *managing agents* must take all reasonable steps to ensure that amounts received or receivable by a *member* in respect of *general insurance business* and *long-term insurance business* are carried to separate *Lloyd's trust funds*.

**Amendments to byelaws, trust deeds and standard form letters of credit and guarantees**

8.2.23  
FCA PRA

R

The *Society* must, as soon as it is practical to do so, notify the *appropriate regulator* of its intention to approve the form of any new *Lloyd's trust deed*.

8.2.24  
FCA PRA

R

The *Society* must, as soon as it is practical to do so, notify the *appropriate regulator* of its intention to make any amendment which may alter the meaning or effect of any *byelaw*, including:

- (1) any *Lloyd's trust deed*;
- (2) any standard form letter of credit prescribed by the *Society* from time to time; or
- (3) any standard form guarantee agreement prescribed by the *Society* from time to time.

8.2.25  
FCA PRA

R

The *Society* must provide the *appropriate regulator* with full details of:

- (1) the form of any new *Lloyd's trust deed* it intends to approve, as described in ■ INSPRU 8.2.23 R and
- (2) any amendments falling within ■ INSPRU 8.2.24 R.

8.2.26  
FCA PRA

R

The *Society* must consult interested parties in relation to any new *Lloyd's trust deed* and in relation to any amendment falling within ■ INSPRU 8.2.24 R.

8.2.27  
FCA PRA

G

Except in urgent cases, the *Society* should consult in relation to any new *Lloyd's trust deed* or amendments before the new deed or amendments take effect.

8.2.28  
FCA PRA

R

The information provided to the *appropriate regulator* by the *Society* under ■ INSPRU 8.2.25 R must include:

- (1) a statement of the purpose of any proposed amendment or new *Lloyd's trust deed* and the expected impact, if any, on *policyholders, managing agents, members, and potential members*; and
- (2) a description of the consultation undertaken under ■ INSPRU 8.2.26 R including a summary of any significant responses to that consultation.

8.2.29  
FCA PRA

G

The *appropriate regulator* would normally expect to receive the information required under ■ INSPRU 8.2.25 R and ■ INSPRU 8.2.28 R not less than three months in advance of the proposed change.

## 8.3 The Central Fund

### Application

8.3.1 **R** This section applies to the *Society*.

**PRA**

### Purpose

8.3.2 **G** The *rules* and *guidance* in this section are intended to promote confidence in the market at Lloyd's, and to protect certain *consumers* of services provided by the *Society* in carrying on, or in connection with or for the purposes of, its *regulated activities*. They do this by:

**PRA**

- (1) giving guidance to the *Society* about the protection that the *Central Fund* should provide for policyholders; and
- (2) enabling the *PRA* to keep under review the protection the *Central Fund* provides for policyholders.

### Enabling Provision

8.3.3 **D** The directions in this section are given under section 318 of the *Act* (Exercise of powers through Council) for the purpose of achieving the objective specified, as required by section 318(2) of the *Act*.

**PRA**

8.3.4 **D** The directions given in this section are given in relation to the exercise of the powers by the *Society* in respect of the *Central Fund* and are given with a view to achieving the objective of ensuring that the *Society* in making payments or in providing any other financial assistance from the *Central Fund* does so on a basis which takes no account of amounts of compensation which policyholders may receive under the provisions of the *compensation scheme* in respect of *protected claims* against *members*.

**PRA**

8.3.5 **G** The *Society* should seek to ensure that the *Central Fund* provides protection for policyholders so as to minimise the need for Lloyd's policyholders to have recourse to the *compensation scheme*.

**PRA**

8.3.6 **G** The *Society* should seek, and take appropriate account of, the *PRA*'s views on all proposed changes in its arrangements relating to the *Central Fund*.

**PRA**

8.3.7 **D** The *Society* must, in the exercise of its powers to make payments from the *Central Fund* or to provide other forms of financial assistance from the *Central Fund*, ensure that in calculating and determining the amount of any such payment or the amount of any other financial assistance, it takes no account of the amounts

**PRA**

of compensation which policyholders may receive under the provisions of the compensation scheme in respect of protected claims against *members*.



## 8.4 Capacity Transfer Market

### Application

8.4.1

**R**

This section applies to the *Society*.

FCA PRA

### Purpose

8.4.2

**G**

The *rules* and *guidance* in this section are intended to promote confidence in the market at Lloyd's, and to protect certain *consumers* of services provided by the *Society* in carrying on, or in connection with or for the purposes of, its *regulated activities*. They do this by ensuring that the *Society* appropriately and effectively regulates the *capacity transfer market* so that it operates in a fair and transparent manner.

FCA PRA

### Requirement to make byelaws governing conduct in the capacity transfer market

8.4.3

**R**

The *Society* must make appropriate *byelaws* governing conduct in the *capacity transfer market*.

FCA PRA

8.4.4

**G**

The *byelaws* referred to in ■ INSPRU 8.4.3 R should:

FCA PRA

- (1) ensure that adequate and effective arrangements are in place to enable *members* and *persons* applying to be admitted as *members* to enter into transactions to transfer *syndicate* capacity and settle these transactions in a timely manner;
- (2) give clear and comprehensive guidance about the dissemination of information that is, or may be, relevant to the price of *syndicate* capacity and the transparency of the *capacity transfer market*; and
- (3) prohibit unfair and abusive practices (including market manipulation), the misuse of information not generally available, and the dissemination of false or misleading information.

8.4.5

**G**

The *Society* should have adequate and effective arrangements to:

FCA PRA

- (1) record and monitor transactions in the *capacity transfer market*, and maintain adequate audit trails; and
- (2) suspend or annul transactions where appropriate.

**8.4.6**

**FCA PRA**

**G**

The *Society* should regularly review the *byelaws* referred to in ■ INSPRU 8.4.3 R, taking account of the standards of conduct required in other *UK* financial markets.

**8.4.7**

**FCA PRA**

**G**

The *Society* should consult *members* and *underwriting agents* before it finalises material changes in the *byelaws* referred to in ■ INSPRU 8.4.3 R, and should have timely and effective arrangements for notifying them of changes in these *byelaws*.

## 8.5 Former underwriting members

### Application

8.5.1 **R** This section applies to the *Society*.

**PRA**

### Purpose

8.5.2 **G** The *rules* and *guidance* in this section are intended to promote confidence in the market at Lloyd's and to protect certain *consumers* of services provided by the *Society* in carrying on or in connection with or for the purposes of its *regulated activities* by:

**PRA**

- (1) protecting policyholders against the risk that *former underwriting members* may not be able to meet any liabilities to carry out *contracts of insurance* that they underwrote at Lloyd's; and
- (2) enabling the *PRA* to impose requirements under section 320(3) of the *Act* (Former underwriting members) if it considers this appropriate to protect policyholders.

### Requirements relating to former underwriting members

8.5.3 **R** The *Society* must draw sections 320 to 322 of the *Act* (Former underwriting members, Requirements imposed under section 320, Rules applicable to former underwriting members) to the attention of any *person* ceasing to be an *underwriting member* on or after *commencement*.

**PRA**

8.5.4 **R** The *Society* must require any *person*, other than a *body corporate*, ceasing to be an *underwriting member* on or after *commencement* to:

**PRA**

- (1) notify the *Society* of any change in his address within one month of the change;
- (2) in the case of a natural person, to make arrangements for the *Society* to be notified in the event of his death.



## 8.6 Prudential risk management and associated systems and controls

### Application of SYSC 14

8.6.1  
PRA

**R** Subject to ■ INSPRU 8.6.2 R, ■ SYSC 14 (Prudential risk management and associated systems and controls) applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, ■ INSPRU 8.1.4 R; and
- (2) for the *Society*, ■ INSPRU 8.1.2 R.

8.6.2  
PRA

**R** The requirement in ■ SYSC 14.1.18 R to take reasonable steps to ensure the establishment and maintenance of a business plan does not apply to the *Society*.

### Application of SYSC 11, 15 and 16

8.6.3  
PRA

**R** Subject to ■ INSPRU 8.6.5 R, ■ SYSC 11 (Liquidity risk management systems and controls), ■ SYSC 15 (Credit risk management systems and controls) and ■ SYSC 16 (Market risk management systems and controls) apply to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, ■ INSPRU 8.1.4 R; and
- (2) for the *Society*, ■ INSPRU 8.1.2 R

### Application of SYSC 17

8.6.4  
PRA

**R** Subject to ■ INSPRU 8.6.5 R, ■ SYSC 17 (Insurance risk systems and controls) applies to *managing agents* in accordance with ■ INSPRU 8.1.4 R.

8.6.5  
PRA

**R** In accordance with ■ INSPRU 8.6.2 R, the *rules* and *guidance* in ■ SYSC 11, ■ SYSC 15, ■ SYSC 16 and ■ SYSC 17 relating to the establishment and maintenance of a business plan do not apply to the *Society*.

## Chapter 9

# Actions for damages



## 9.1 Actions for damages

9.1.1

FCA

R

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

## Prudential sourcebook for Insurers

### INSPRU TP Transitional provisions

Application		
1.1	R	<i>INSPRU</i> TP 1 applies to an insurer unless it is:
[FCA] [PRA]		<ol style="list-style-type: none"> <li>(1) a <i>non-directive friendly society</i>; or</li> <li>(2) an <i>incoming EEA firm</i>; or</li> <li>(3) an <i>incoming Treaty firm</i>.</li> </ol>
		<b>Version of IPRU to be used</b>
1.2	R	Any reference in <i>INSPRU</i> TP to <i>IPRU(INS)</i> is to the version in force on 30 December 2004.
[FCA] [PRA]		
		<b>Duration of transitional</b>
1.3	R	<i>INSPRU</i> TP 1 applies until the relevant <i>rule</i> is revoked.
[FCA] [PRA]		
		<b>Continuing effect of waivers</b>
1.4	R	A <i>rule</i> in <i>INSPRU</i> listed in the Table at <i>INSPRU</i> TP Table 2 is disappplied, or is modified in its application, to a <i>firm</i> :
[FCA] [PRA]		<ol style="list-style-type: none"> <li>(1) in order to produce the same effect, including any conditions, as a <i>waiver</i> had on the corresponding <i>rule</i> in <i>IPRU(INS)</i>;</li> <li>(2) for the same period as the <i>waiver</i> would have lasted, if shorter than the period in <i>INSPRU</i> TP 1.3;</li> </ol>
		provided the conditions set out in <i>INSPRU</i> TP 1.5 are satisfied.
1.5	R	The conditions referred to in <i>INSPRU</i> TP 1.4 are:

Application		
[FCA] [PRA]		<p>(1) the <i>rule</i> is shown in the Table at <i>INSPRU</i> TP Table 2 as corresponding with the <i>rule</i> in <i>IPRU(INS)</i> in relation to which the <i>waiver</i> was granted to the <i>firm</i>;</p> <p>(2) the <i>waiver</i> was current as respects the <i>firm</i> immediately before 31 December 2004; and</p> <p>(3) there is no specific transitional <i>rule</i> relating to the <i>waiver</i>.</p>
1.6	R	<i>INSPRU</i> TP 1.4 does not have effect if, and to the extent that, it would be inconsistent with any <i>EU</i> law obligation of the <i>United Kingdom</i> .
[FCA] [PRA]		
1.7	R	A <i>firm</i> which has the benefit of a <i>waiver</i> to which <i>INSPRU</i> TP 1.4 applies must:
[FCA] [PRA]		<p>(1) notify the <i>appropriate regulator</i> immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the <i>waiver</i>;</p> <p>(2) maintain a written record of the <i>rule</i> in <i>INSPRU</i> to which it considers the <i>waiver</i> applies; and</p> <p>(3) make the record available to the <i>appropriate regulator</i> on request.</p>

**INSPRU TP Table 2**

Rules in INSPRU	Corresponding rules in IPRU (INS)
2.1.22	4.14(1)
[PRA]	
3.1.34	5.11
[PRA]	
3.1.39	5.11
[PRA]	5.11(4)
	5.11(5)
	5.11(9)
	5.11(11)

Rules in INSPRU	Corresponding rules in IPRU (INS)
3.1.58	2.3(2)
[FCA] [PRA]	
1.1.51	2.4(6)
[PRA]	
1.1.56	2.4(1)
[PRA]	
1.1.66	Appendix 2.1 2.4(1)(b)
[PRA]	Appendix 2.2 2.4(1)(b)
	5.9(1)
1.2.40	5.9(2)
[PRA]	
1.2.41	5.9(2)
[PRA]	
1.2.43	5.10
[PRA]	
1.2.74	5.16
6.1.17	10.1
[PRA]	10.2
	10.2(1)
	10.2(2)
	10.2(3)
6.1.23	10.2
[PRA]	10.2(1)
	10.2(2)
	10.2(3)

## 3 PRU waivers

**Application**

3.1 R *INSPRU* TP 3 applies to an *insurer* unless it is:

[FCA]  
[PRA]

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*.

**Version of PRU to be used**

3.2 R A reference in *INSPRU* TP 3 to *PRU* is to the version in force on 30 December 2006.

[FCA]  
[PRA]

**Duration of transitional**

3.3 R *INSPRU* TP 3 applies until the relevant *INSPRU rule* is revoked.

[FCA]  
[PRA]

**Continuing effect of waivers**

3.4 R A *rule* in *INSPRU* is disapplied, or is modified in its application, to a *firm*:

[FCA]  
[PRA]

- (1) in order to produce the same effect, including any conditions, as a *waiver* had on the *rule* in *PRU*;
- (2) for the same period as the *waiver* would have lasted, if shorter than the period in *INSPRU* TP 3.3;

provided the conditions set out in *INSPRU* TP 3.5 are satisfied.

3.5 R The conditions referred to in *INSPRU* TP 3.4 are:

[FCA]  
[PRA]

- (1) the *rule* in *PRU* in relation to which the *waiver* was granted to the *firm* was redesignated as the relevant *rule* in *INSPRU* by the Prudential Sourcebook for Insurers Instrument 2006;
- (2) the *waiver* was current as respects the *firm* immediately before 31 December 2006; and
- (3) there is no specific transitional *rule* relating to the *waiver*.

3.6 R *INSPRU* TP 3.4 does not have effect if, and to the extent that, it would be inconsistent with any *EU* law obligation of the *United Kingdom*.

[FCA]  
[PRA]

3		PRU waivers
3.7	R	A <i>firm</i> which has the benefit of a <i>waiver</i> to which <i>INSPRU</i> TP 3.4 applies must:
[FCA] [PRA]		
	(1)	notify the <i>appropriate regulator</i> immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the <i>waiver</i> ;
	(2)	maintain a written record of the <i>rule</i> in <i>INSPRU</i> to which it considers the <i>waiver</i> applies; and
	(3)	make the record available to the <i>appropriate regulator</i> on request.

4		EEA pure reinsurers
<b>Application</b>		
4.1	R	<i>INSPRU</i> TP 4 applies to a <i>pure reinsurer</i> :
	(1)	whose head office is in an <i>EEA State</i> other than the <i>United Kingdom</i> ; and
	(2)	which is not an <i>incoming Treaty firm</i> .
<b>Duration of transitional</b>		
4.2	R	<i>INSPRU</i> TP 4 has effect in relation to a <i>firm</i> until 10 December 2008 or, if earlier, the date on which it becomes:
	(1)	an <i>incoming EEA firm</i> by reason of having exercised its right to carry on the <i>regulated activity</i> of <i>effecting or carrying out contracts of insurance</i> in the <i>United Kingdom</i> in accordance with Schedule 3 to the <i>Act</i> (EEA Passport Rights); or
	(2)	an <i>incoming Treaty firm</i> by reason of having exercised its right to carry on the <i>regulated activity</i> of <i>effecting or carrying out contracts of insurance</i> in the <i>United Kingdom</i> in accordance with Schedule 4 to the <i>Act</i> (Treaty Rights).
<b>50% premiums and claims uplift for classes 11, 12 and 13; credit equalisation provision</b>		
4.3	R	The following <i>rules</i> or paragraphs of a <i>rule</i> do not apply to a <i>firm</i> :
	(1)	<i>INSPRU</i> 1.1.56 R (1);
	(2)	<i>INSPRU</i> 1.1.60 R (1); and
	(3)	<i>INSPRU</i> 1.4.39 R to <i>INSPRU</i> 1.4.46 R.

5		Pure reinsurance groups
<b>Application</b>		

5		Pure reinsurance groups
5.1	R	<i>INSPRU</i> TP 5 applies to a <i>pure reinsurer</i> whose <i>ultimate EEA insurance parent undertaking</i> is the <i>parent undertaking</i> of a group comprised solely of <i>reinsurance undertakings</i> .
		<b>Duration of transitional</b>
5.2	R	<i>INSPRU</i> TP 5 applies until 10 December 2007.
		<b>Group capital resources requirement</b>
5.3	R	A <i>firm</i> need not comply with <i>INSPRU</i> 6.1.15 R.
6		Admissible assets
		<b>Application</b>
6.1	R	<i>INSPRU</i> TP 6 applies to an <i>insurer</i> which is not a <i>pure reinsurer</i> .
		<b>Duration of transitional</b>
6.2	R	<i>INSPRU</i> TP 6 applies until 30 December 2007.
		<b>GENPRU 2 Annex 7R</b>
6.3	R	(1) In determining whether its assets are <i>admissible assets</i> , instead of applying <i>GENPRU 2 Annex 7 R</i> , a <i>firm</i> may elect to treat as an <i>admissible asset</i> an asset that would have been an <i>admissible asset</i> for the purposes of the Integrated Prudential Sourcebook (PRU) as it was in force on 30 December 2006.
		(2) (1) does not apply when determining whether a <i>derivative</i> or <i>quasi-derivative</i> is an <i>approved derivative</i> or <i>approved quasi-derivative</i> .
		(3) If a <i>firm</i> applies (1) to any of its assets, it must do so for all of its assets except <i>derivatives</i> and <i>quasi-derivatives</i> .
7		Mathematical reserves
		<b>Application</b>
7.1	R	<i>INSPRU</i> TP 7 applies to an <i>insurer</i> to which <i>INSPRU</i> 1.2 applies.
		[PRA]
		<b>Duration of transitional</b>
7.2	R	<i>INSPRU</i> TP 7 applies until the relevant <i>rule</i> is revoked.
		[PRA]
7.3	R	<i>INSPRU</i> 1.2.79A R does not apply in respect of <i>reinsurance</i> and analogous non- <i>reinsurance</i> financing agreements entered into and the terms of which came into effect before 10 December 2009, provided that immediately before
		[PRA]

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**7** Mathematical reserves

6 October 2010 the *firm* had the benefit of INSPRU 1.2.79 R (2) in relation to those *reinsurance* or analogous non-*reinsurance* financing agreements.



## Prudential sourcebook for Insurers

### Schedule 1 Record keeping requirements

#### Schedule 1.1 G

**FCA** **PRA**

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

#### Schedule 1.2 G

**FCA** **PRA**

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

#### Schedule 1.3 G

Table

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
INSPRU 1.2.20 R [FCA] [PRA]	<i>Mathematical reserves</i>	(1) The methods and assumptions used in establishing the <i>firm's mathematical reserves</i> , including the margins for adverse deviation, and the reasons for their use (2) The nature of, reasons for, and effect of, any change in approach, including the amount by which the change in approach increases or decreases its <i>mathematical reserves</i>	Not specified	An appropriate period
INSPRU 1.3.17 R, INSPRU 1.3.19 R [FCA] [PRA]	Calculation of <i>with-profits insurance capital component</i>	(1) The methods and assumptions used in making any calculation required for the purposes of	Not specified	An appropriate period

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
		INSPRU 1.3 (and any subsequent changes) and the reasons for their use (2) Any change in practice (in particular changes in those items which will or may be significant in relation to the eventual <i>claim</i> values) and the nature of, reasons for, and effect of, any change in approach with respect to those methods and assumptions		
INSPRU 1.5.23 R [FCA] [PRA]	<i>Long-term insurance funds</i>	A separate accounting record in respect of each of a <i>firm's long-term insurance funds</i>	Not specified	Not specified
INSPRU 1.5.56 R, INSPRU 1.5.57 R [PRA]	<i>Branch accounting records in the United Kingdom</i>	A record of the activities carried on from a <i>non-EEA direct insurer's United Kingdom branch</i> and, if it is an <i>EEA-deposit insurer</i> , from its <i>branches</i> in other <i>EEA states</i> including a record of: (1) the income, expenditure and liabilities arising from activities of the <i>branch</i> or <i>branches</i> (2) the assets identified under INSPRU 1.1.20 R as available to meet those liabilities	Not specified	Not specified

## Prudential sourcebook for Insurers

### Schedule 2 Notification and reporting requirements

#### Schedule 2.1 G

**FCA** **PRA**

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

#### Schedule 2.2 G

**FCA** **PRA**

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

#### Schedule 2.3 G

**FCA** **PRA**

Table

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
INSPRU 2.1.23 R  [PRA]	That a <i>reinsurance</i> exposure to a <i>reinsurer</i> or group of closely related <i>reinsurers</i> is reasonably likely to exceed, or has exceeded, 100% of the <i>firm's capital resources</i> excluding <i>capital resources</i> held to cover <i>property-linked liabilities</i>	Fact that the limit is reasonably likely to be, or has been, exceeded  Note: upon notification under INSPRU 2.1.23 R the <i>firm</i> must: (1) demonstrate that prudent provision has been made for the <i>reinsurance</i> exposure in excess of the 100% limit, or explain why in the opinion if the <i>firm</i> no provision is required, and (2) explain how the <i>reinsurance</i> exposure is being safely managed (see INSPRU 2.1.24R)	(1) A reasonable likelihood that the limit will be exceeded, or (2) if (1) does not apply, the limit being exceeded	As soon as the <i>firm</i> first becomes aware of the matter required to be notified

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
INSPRU 2.1.29 R [PRA]	That the <i>firm</i> has exceeded, or anticipates exceeding, the limit expressed in INSPRU 2.1.28 E (in each <i>financial year</i> a <i>firm</i> should restrict the <i>gross earned premiums</i> which it pays to a <i>reinsurer</i> or group of closely related <i>reinsurers</i> to the higher of (a) 20% of the <i>firm's</i> projected <i>gross earned premiums</i> for that <i>financial year</i> and (b) £4 million)	Fact that the limit has been exceeded, or that the <i>firm</i> anticipates exceeding the limit  Note: upon notification under INSPRU 2.1.29 R the <i>firm</i> must explain to the <i>appropriate regulator</i> how, despite the excess <i>reinsurance</i> concentration, the credit risk is being safely managed (see INSPRU 2.1.30 R)	The limit being exceeded, or an anticipation that the limit will be exceeded	Immediately
INSPRU 3.1.65 R [PRA]	<i>Syndicate</i> liabilities not covered by matching <i>syndicate assets</i> as required by INSPRU 3.1.53 R	Nature and extent of <i>syndicate</i> liabilities not covered by matching <i>syndicate assets</i> as required by INSPRU 3.1.53 R	<i>Syndicate</i> liabilities are no longer covered by matching <i>syndicate assets</i> as required by INSPRU 3.1.53 R	Immediately
INSPRU 6.1.43B R	Intention of a <i>group undertaking</i> to issue a <i>capital instrument</i> for inclusion in <i>group capital resources</i>	Fact of intention and details of intended amount, issue date, type of investor, stage of capital, features of instrument and confirmation of compliance with <i>rules</i>	Intention to issue	As soon as proposed issue becomes known to <i>firm</i>
INSPRU 6.1.43C R	Proposed changes to details of the issue of a <i>capital instrument</i> notified under INSPRU 6.1.43B R	Proposed change and all information required under INSPRU 6.1.43B R (1) to INSPRU 6.1.43B R (4)	Intention to change any details of the issue previously notified to the <i>appropriate regulator</i>	As soon as the changes are proposed
INSPRU 6.1.43D R	Proposed establishment of a debt securities program by a <i>group undertaking</i>	All information required by INSPRU 6.1.43B R (1) to INSPRU 6.1.43B R (4)	Intention to establish	As soon as proposed establishment becomes known to <i>firm</i>
INSPRU 6.1.43F R	Issue of <i>capital instruments</i> by a <i>group undertaking</i> under INSPRU 6.1.43E R	All information required under INSPRU 6.1.43B R (1) to INSPRU 6.1.43B R (3) and confirmation that no changes have been made to the terms of the instrument since the previous issue of a similar instrument	Intention to issue	No later than date of issue

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
INSPRU 7.1.83 R [PRA]	<i>Syndicate ICA</i> and <i>balancing amount</i> in respect of each <i>syndicate</i>	<i>Syndicate ICA</i> and <i>balancing amount</i> in respect of each <i>syndicate</i>	Notification should be made periodically	As part of the annual capital-setting process, in good time for the <i>Society</i> to review and place appropriate reliance on them when determining capital assessments for each <i>member</i>
INSPRU 7.1.89 R [PRA]	Significant doubt about the adequacy of a <i>syndicate ICA</i> or <i>balancing amount</i> with respect to <i>syndicate</i> risks and controls	Revised <i>syndicate ICA</i> and <i>balancing amount</i>	The <i>managing agent</i> considers that <i>syndicate ICA</i> and <i>balancing amount</i> communicated in the capital setting process are no longer adequate in the light of the risks to which the <i>syndicate</i> business is exposed	Immediately
INSPRU 8.2.17 R [PRA]	Information the <i>managing agent</i> has concerning material risks to <i>funds at Lloyd's</i> or <i>central assets</i>	All information concerning relevant risk	Receipt of information	As soon as possible
INSPRU 8.2.23 R [FCA] [PRA]	Intention to approve the form of any new <i>Lloyd's trust deed</i>	Fact of intention	Intention to approve	As soon as practical
INSPRU 8.2.24 R [FCA] [PRA]	Intention to make any amendment which may alter the meaning or effect of any <i>byelaw</i> (including <i>Lloyd's trust deeds</i> , standard form letters of credit and guarantees)	Fact of intention	Intention to amend	As soon as practical
INSPRU 8.2.25 R [FCA] [PRA]	Full details of form of new <i>Lloyd's trust deed</i> or amendments to <i>byelaw</i> (including <i>Lloyd's trust deeds</i> , standard form letters of credit and guarantees)	(1) Statement of purpose of amendment or new form and expected impact, if any, on <i>policyholders, managing agents, members</i> and potential <i>members</i> , and (2) Description of the consultation undertaken and summary of significant responses to consultation	Not specified	Normally not less than three months in advance of proposed change



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## Prudential sourcebook for Insurers

### Schedule 3 Fees and other requirement payments

G

FCA PRA

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



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## Prudential sourcebook for Insurers

### Schedule 4 Powers exercised

#### Schedule 4.1 G

The following powers and related provisions in the *Act* have been exercised by the *FSA* to make the rules in *INSPRU*:

Section 138 (General rule-making power)

Section 141 (Insurance business rules)

Section 149 (Evidential provisions)

Section 150(2) (Actions for damages)

Section 156 (General supplementary powers)

Section 316(1) (Direction by Authority)

Section 318(1) (Exercise of powers through Council)

#### Schedule 4.2 G

The following power in the *Act* has been exercised by the *FSA* to give the *guidance* in *INSPRU*:

Section 157(1) (Guidance)



## Prudential sourcebook for Insurers

### Schedule 5 Rights of action for damages

#### Schedule 5.1 G

**FCA**

The table below sets out the *rules* in *INSPRU* contravention of which by an *authorised person* may be actionable under section 138D(2) of the *Act* (Actions for damages) by a *person* who suffers loss as a result of the contravention.

#### Schedule 5.2 G

**FCA**

If a "Yes" appears in the column headed "For *private person*", the *rule* may be actionable by a *private person* under section 138D(2) (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.

#### Schedule 5.3 G

**FCA**

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(2)		
		For <i>private person</i>	Removed	For other <i>person</i>
All <i>rules</i> in <i>INSPRU</i>	No	Yes (INSPRU 9.1.1R)	No	



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## Prudential sourcebook for Insurers

### Schedule 6 Rules that can be waived

#### G

**FCA** **PRA**

The rules in *INSPRU* can be waived by the *appropriate regulator* under sections 138A and 138B of the *Act* (Modification or waiver of rules), except for ■ *INSPRU* 9.1.1 R (Actions for damages). However, if the *rules* incorporate requirements laid down in European directives, it will not be possible for the *appropriate regulator* to grant a *waiver* that would be incompatible with the *United Kingdom's* responsibilities under those directives. It therefore follows that if a *rule* in *INSPRU* contains provisions which derive partly from a directive, and partly not, the *appropriate regulator* will be able to consider a *waiver* of the latter requirements only, unless the directive provisions are optional rather than mandatory.

# Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries

# Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries

<b>MIPRU 1</b>	<b>Application and general provisions</b>
1.1	Application
1.2	Actions for damages
<b>MIPRU 2</b>	<b>Insurance mediation activity: responsibility, knowledge, ability and good repute</b>
2.1	Application and purpose
2.2	Allocation of the responsibility for insurance mediation activity
2.3	Knowledge, ability and good repute
<b>MIPRU 3</b>	<b>Professional indemnity insurance</b>
3.1	Application and purpose
3.2	Professional indemnity insurance requirements
<b>MIPRU 4</b>	<b>Capital resources</b>
4.1	Application and purpose
4.2	Capital resources requirements
4.2A	[Not yet in force]
4.2B	[Not yet in force]
4.2C	[Not yet in force]
4.2D	[Not yet in force]
4.3	Calculation of annual income
4.4	Calculation of capital resources
<b>MIPRU 5</b>	<b>Insurance undertakings and home finance providers using insurance or home finance mediation services</b>
5.1	Application and purpose
5.2	Use of intermediaries
	<b>Transitional Provisions and Schedules</b>
<b>TP 1</b>	<b>Transitional Provisions</b>
<b>Sch 1</b>	<b>Record keeping requirements</b>

Sch 2	Notification requirements
Sch 3	Fees and other required payments
Sch 4	Powers exercised
Sch 5	Rights of actions for damages
Sch 6	Rules that can be waived



# Chapter 1

## Application and general provisions



## 1.1 Application

### Application

---

1.1.1

FCA PRA

G

This sourcebook applies to a *firm* with *Part 4A permission* to carry on:

- (1) *insurance mediation activity*;
- (2) *home finance mediation activity*;
- (3) *home financing*;
- (4) *home finance administration*; and
- (5) *insurance business*;

as specified in the beginning of each of the remaining chapters.



## 1.2 Actions for damages

1.2.1

FCA

R

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



## Chapter 2

# Insurance mediation activity: responsibility, knowledge, ability and good repute

## 2.1 Application and purpose

2.1.1

FCA PRA

R

**Application**  
This chapter applies to a *firm* with *Part 4A permission* to carry on *insurance mediation activity*.

2.1.2

FCA PRA

G

**Purpose**  
The main purpose of this chapter is to implement in part the provisions of the *Insurance Mediation Directive* as these apply to *firms* regulated by the *appropriate regulator*.

## 2.2 Allocation of the responsibility for insurance mediation activity

### Responsibility for insurance mediation activity

2.2.1

FCA PRA

R

A *firm*, other than a sole trader, must allocate the responsibility for the *firm's insurance mediation activity* to a director or senior manager.

[Note: Article 3(1), fourth paragraph, of the *Insurance Mediation Directive* ]

2.2.2

FCA PRA

R

The *firm* may allocate the responsibility for its *insurance mediation activity* to an *approved person* (or *persons*) performing:

- (1) a *governing function* (other than the *non-executive director function*); or
- (2) the *apportionment and oversight function*; or
- (3) the *significant management function* in so far as it relates to *dealing in investments as principal*, disregarding article 15 of the *Regulated Activities Order* (Absence of holding out etc) (or agreeing to do so) or an activity which is not *designated investment business*.

2.2.3

FCA PRA

G

- (1) Typically a *firm* will appoint a *person* performing a *governing function* (other than the *non-executive director function*) to direct its *insurance mediation activity*. Where this responsibility is allocated to a *person* performing another function, the *person* performing the *apportionment and oversight function* with responsibility for the apportionment of responsibilities must ensure that the *firm's insurance mediation activity* is appropriately allocated.
- (2) The descriptions of *significant influence functions*, other than the *required functions*, do not extend to activities carried on by an *insurance intermediary* with *permission* only to carry on *insurance mediation activity* and whose principal purpose is to carry on activities other than *regulated activities* (see ■ SUP 10A.1.18 R). In this case, the *firm* may allocate the responsibility for the *firm's insurance mediation activity* to one or more of the *persons* performing the *apportionment and oversight function* who will be required to be an *approved person*.
- (3) In the case of a *sole trader*, the *sole trader* will be responsible for the *firm's insurance mediation activity*.

2.2.4

FCA

G

Where a *firm* has appointed an *appointed representative* to carry on *insurance mediation activity* on its behalf, the *person* responsible for the *firm's insurance mediation activity* will also be responsible for the *insurance mediation activity* carried on by an *appointed representative*.

2.2.5

FCA

G

The *FCA* will specify in the *Financial Services Register* the name of the *persons* to whom the responsibility for the *firm's insurance mediation activity* has been allocated by inserting after the relevant *controlled function* the words "(insurance mediation)". In the case of a *sole trader*, the *FCA* will specify in the *Financial Services Register* the name of the *sole trader* as the 'contact person' in the *firm*.

## 2.3 Knowledge, ability and good repute

### 2.3.1

FCA PRA

R

A *firm* (other than a *connected travel insurance intermediary*) must establish on reasonable grounds that:

- (1) a reasonable proportion of the *persons* within its management structure who are responsible for *insurance mediation activity*; and
- (2) all other *persons* directly involved in its *insurance mediation activity*;

demonstrate the knowledge and ability necessary for the performance of their duties; and

- (3) all the *persons* in its management structure and any staff directly involved in *insurance mediation activity* are of good repute.

[Note: Article 4(1) and (2) of the *Insurance Mediation Directive*]

### 2.3.2

FCA

G

In determining a *person's* knowledge and ability, the *firm* should have regard to matters including, but not limited to, whether the :

- (1) has demonstrated by experience and training that he is able or will be able to perform his duties related to the *firm's insurance mediation activity*; and
- (2) satisfies the relevant requirements in the FCA's Training and Competence sourcebook and the Senior Management Arrangements, Systems and Controls sourcebook.

### 2.3.2A

PRA

G

In determining a *person's* knowledge and ability, the *firm* should have regard to matters including, but not limited to, whether the *person*:

- (1) has demonstrated by experience and training that he is able or will be able to perform his duties related to the *firm's insurance mediation activity*; and
- (2) satisfies the relevant requirements in the Senior Management Arrangements, Systems and Controls sourcebook (■ SYSC).

2.3.3

FCA PRA

R

In considering a *person's* repute the *firm* must ensure that the *person*:

- (1) has not been convicted of any serious criminal offences linked to crimes against property or other crimes related to financial activities (other than spent convictions under the Rehabilitation of Offenders Act 1974 or any other national equivalent); and
- (2) has not been adjudged bankrupt (unless the bankruptcy has been discharged);

under the law of any part of the *United Kingdom* or under the law of a country or territory outside the *United Kingdom*.

[Note: Article 4(2) of the *Insurance Mediation Directive*]

2.3.4

FCA PRA

G

The *firm* should give particular consideration to offences of dishonesty, fraud, financial crime or other offences under legislation relating to banking and financial services, companies, insurance and consumer protection.

2.3.5

FCA PRA

G

*Firms* are reminded that *Principle 3* requires *firms* to take reasonable care to organise and control their affairs responsibly and effectively. *Principle 3* is amplified by the *rule* which requires *firms* to take reasonable care to establish and maintain such systems and controls as are appropriate to its business (■ SYSC 3.1.1 R and ■ SYSC 4.1.1 R ). A *firm's* systems and controls should enable it to satisfy itself of the suitability of anyone who acts for it (■ SYSC 3.2.13 G and ■ SYSC 5.1.2 G). This includes the assessment of an individual's honesty and competence. In addition, the *competent employees rule* (■ SYSC 3.1.6 R and ■ SYSC 5.1.1 R) sets out a high-level competence requirement which every *firm* should follow.

## Chapter 3

# Professional indemnity insurance

## 3.1 Application and purpose

### Application

3.1.1

FCA PRA

R

This chapter applies to a *firm* with *Part 4A permission* to carry on any of the activities:

- (1) *insurance mediation activity*;
- (2) *home finance mediation activity*;

unless any of the following exemptions apply:

- (3) in relation to *insurance mediation activity*, this chapter does not apply to a *firm* if another *authorised person* which has net tangible assets of more than £10 million provides a comparable guarantee; for this purpose:
  - (a) if the *firm* is a member of a *group* in which there is an *authorised person* with net tangible assets of more than £10 million, the comparable guarantee must be from that *person*;
  - (b) A 'comparable guarantee' means a written agreement on terms at least equal to those in a contract of professional indemnity insurance (see ■ MIPRU 3.2.4 R) to finance the claims that might arise as a result of a breach by the *firm* of its duties under the *regulatory system* or civil law.
- (4) in relation to *home finance mediation activity*, this chapter does not apply to a *firm* if:
  - (a) it has net tangible assets of more than £1 million; or
  - (b) the comparable guarantee provisions of (3) apply (as if the *firm* was carrying on *insurance mediation activity*) but substituting £1 million for £10 million in (3)(a) and (b);
- (5) This chapter does not apply to:
  - (a) an *insurer*; or
  - (b) a *managing agent*; or

- (c) a *firm* to which IPRU(INV) 13.1.4(1) (Financial resource requirements for personal investment firms: requirement to hold professional indemnity insurance) applies; or
  - (d) an *exempt CAD firm* to which IPRU(INV) 9.2.5R (Initial capital and professional indemnity insurance requirements - exempt CAD firms that are also IMD insurance intermediaries) applies.
- (6) in relation to *home finance mediation activity*, this chapter does not apply to an *authorised professional firm*:
- (a) that is required by another *rule* to hold professional indemnity insurance (see IPRU(INV) 2.3.1R); and
  - (b) whose *home finance mediation activity*, is incidental to its main business.

## 3.1.2

FCA PRA

G

The definition of *insurance mediation activity* is any of several activities 'in relation to a *contract of insurance*' which includes a contract of reinsurance. This chapter, therefore, applies to a reinsurance intermediary in the same way as it applies to any other *insurance intermediary*.

### Purpose

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## 3.1.3

FCA

G

The purposes of this chapter are to:

- (1) implement article 4.3 of the *Insurance Mediation Directive* in so far as it requires *insurance intermediaries* to hold professional indemnity insurance, or some other comparable guarantee, against any liability that might arise from professional negligence; and
- (2) meet the *statutory objectives* of consumer protection and protecting and enhancing the integrity of the *UK financial system* by ensuring that *firms* have adequate resources to protect themselves, and their *customers*, against losses arising from breaches in its duties under the *regulatory system* or civil law.

## 3.1.3A

PRA

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The purposes of this chapter are to:

- (1) implement article 4.3 of the *Insurance Mediation Directive* in so far as it requires *insurance intermediaries* to hold professional indemnity insurance, or some other comparable guarantee, against any liability that might arise from professional negligence; and
- (2) meet the *statutory objective* of promoting the safety and soundness of *PRA-authorised persons* by ensuring that *firms* have adequate resources to protect themselves against losses arising from breaches in its duties under the *regulatory system* or civil law.

## 3.1.4

FCA PRA

G

Any breach in the duty of a *firm* or of its agents under the *regulatory system* or civil law can give rise to claims being made against the *firm*. Professional indemnity insurance has an important role to play in helping to finance such claims. In so doing, this chapter

amplifies *threshold condition 4* (Adequate resources). This *threshold condition* provides that a *firm* must have, on a continuing basis, resources that are, in the opinion of the *appropriate regulator*, adequate in relation to the *regulated activities* that the *firm* carries on.

3.1.5  
FCA PRA

G

Under *Principles 3* and *4* a *firm* is required to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems and to maintain adequate financial resources. Under *Principle 9* a *firm* is obliged to take reasonable care to ensure the suitability of its *advice on investments* and discretionary decisions for any *customer* who is entitled to rely upon its judgement.

3.1.5A  
PRA

G

Under *Principles 3* and *4* a *firm* is required to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems and to maintain adequate financial resources.

3.1.6  
FCA PRA

G

Although financial resources and appropriate systems and controls can generally mitigate operational risk, professional indemnity insurance has a role in mitigating the risks a *firm* faces in its day to day operations, including those arising from not meeting the legally required standard of care when *advising on investments*. The purpose of this chapter is to ensure that a *firm* has in place the type, and level, of professional indemnity insurance necessary to mitigate these risks.



### 3.2 Professional indemnity insurance requirements

3.2.1

FCA PRA

R

A *firm* must take out and maintain professional indemnity insurance that is at least equal to the requirements of this section from:

- (1) an *insurance undertaking* authorised to transact professional indemnity insurance in the *EEA*; or
- (2) a *person* of equivalent status in:
  - (i) a *Zone A country*; or
  - (ii) the Channel Islands, Gibraltar, Bermuda or the Isle of Man.

[Note: Article 4(3) of the *Insurance Mediation Directive*]

3.2.2

FCA PRA

G

The minimum *limits of indemnity* for a *firm* whose *Part 4A permission* covers both *insurance mediation activity* and *home finance mediation activity* is the higher of the *limits of indemnity* for these activities. If the *firm* opts for a single comparable guarantee to finance the claims which might arise as a result of both activities, the requirements for *insurance mediation activity* apply.

3.2.3

FCA PRA

G

A non-*EEA firm* (such as a captive insurance company outside the *EEA*) will be able to provide professional indemnity insurance only if it is authorised to do so in one of the specified countries or territories.. The purpose of this provision is to balance the level of protection required for the *policyholder* against a reasonable level of flexibility for the *firm*.

#### Terms to be incorporated in the insurance

3.2.4

FCA PRA

R

The contract of professional indemnity insurance must incorporate terms which make provision for:

- (1) cover in respect of claims for which a *firm* may be liable as a result of the conduct of itself, its *employees* and its *appointed representatives* (acting within the scope of their appointment);
- (2) the minimum *limits of indemnity* per year set out in this section;
- (3) an excess as set out in this section;

- (4) appropriate cover in respect of legal defence costs;
- (5) continuous cover in respect of claims arising from work carried out from the date on which the *firm* was given *Part 4A permission* for the *insurance mediation activity* or *home finance mediation activity* concerned; and
- (6) cover in respect of *Ombudsman* awards made against the *firm*.

3.2.5  
FCA PRA

G

A *firm* is responsible for the conduct of all of its *employees*. The *firm's employees* include, but are not limited to, its *partners*, *directors*, individuals that are self-employed or operating under a contract hire agreement and any other individual that is employed in connection with its business.

3.2.6  
FCA PRA

G

A *firm* is responsible for the conduct of all of its *appointed representatives*.

#### Minimum limits of indemnity: insurance intermediary

3.2.7  
FCA PRA

R

If the *firm* is an *insurance intermediary*, then the minimum *limits of indemnity* are:

- (1) for a single claim, €1,120,200 ; and
- (2) in aggregate, €1,680,300 or, if higher, 10% of annual income up to £30 million.

[Note: Article 4(3) of the *Insurance Mediation Directive*]

3.2.7A  
FCA PRA

G

Article 4(7) of the *Insurance Mediation Directive* requires the *limits of indemnity* to be reviewed every five years to take into account movements in European consumer prices. These limits will therefore be subject to further adjustments on the basis of index movements advised by the European Commission.

3.2.8  
FCA PRA

R

If a *policy* is denominated in any currency other than euros, a *firm* must take reasonable steps to ensure that the *limits of indemnity* are, when the *policy* is effected and at *renewal*, at least equivalent to those required.

#### Minimum limits of indemnity: home finance intermediary

3.2.9  
FCA PRA

R

If the *firm* is a *home finance intermediary*, then the minimum *limit of indemnity* is the higher of 10% of *annual income* up to £1 million, and:

- (1) for a single claim, £100,000; or
- (2) in aggregate, £500,000.

#### Excess

3.2.10  
FCA PRA

R

In this chapter, "*client assets*" includes a *document* only if it has value, or is capable of having value, in itself (such as a bearer instrument).

**3.2.11** **R** For a *firm* which does not hold *client money* or other *client* assets, the excess must not be more than the higher of:

**FCA** **PRA**

- (1) £2,500; and
- (2) 1.5% of *annual income*.

**3.2.12** **R** For a *firm* which holds *client money* or other *client* assets, the excess must not be more than the higher of:

**FCA** **PRA**

- (1) £5,000; and
- (2) 3% of annual income.

**Policies covering more than one firm**

**3.2.13** **R** If a *policy* provides cover to more than one *firm*, then:

**FCA** **PRA**

- (1) the *limits of indemnity* must be calculated on the combined *annual income* of all the *firms* named in the *policy*; and
- (2) each *firm* named in the *policy* must have the benefit of the relevant minimum *limits of indemnity*.

**Additional capital**

**3.2.14** **R** If a *firm* seeks to have an excess which is higher than the relevant limit, it must hold additional capital as calculated in accordance with the appropriate table below:

**FCA** **PRA**

Table: Calculation of additional capital for firm not holding client money or other client assets (£000's)

Income	Excess obtained up to and including:														
	More than	Up to	2.5	5	10	15	20	25	30	40	50	75	100	150	200+
0	100	0	5	9	12	14	17	19	23	26	33	39	50	59	
100	200	0	7	12	16	19	22	25	30	34	43	51	64	75	
200	300	0	7	12	16	20	24	27	32	37	47	56	71	84	
300	400	0	0	12	16	21	24	28	34	39	50	60	77	91	
400	500	0	0	11	16	21	24	28	34	40	53	63	81	96	
500	600	0	0	10	16	20	24	28	35	41	54	65	84	100	
600	700	0	0	0	15	20	24	28	35	41	55	67	87	104	
700	800	0	0	0	14	19	24	28	35	42	56	68	89	107	
800	900	0	0	0	13	18	23	27	35	42	56	69	91	109	
900	1000	0	0	0	0	17	22	27	34	41	57	70	92	111	

Income		Excess obtained up to and including:													
1000	1500	0	0	0	0	0	0	21	26	34	41	57	71	97	118
1500	2000	0	0	0	0	0	0	0	0	30	38	56	71	98	121
2000	2500	0	0	0	0	0	0	0	0	24	33	53	69	99	126
2500	3000	0	0	0	0	0	0	0	0	0	28	50	68	101	130
3000	3500	0	0	0	0	0	0	0	0	0	0	47	67	101	132
3500	4000	0	0	0	0	0	0	0	0	0	0	43	65	101	133
4000	4500	0	0	0	0	0	0	0	0	0	0	39	62	101	134
4500	5000	0	0	0	0	0	0	0	0	0	0	0	58	99	134
5000	6000	0	0	0	0	0	0	0	0	0	0	0	54	97	133
6000	7000	0	0	0	0	0	0	0	0	0	0	0	0	91	131
7000	8000	0	0	0	0	0	0	0	0	0	0	0	0	84	126
8000	9000	0	0	0	0	0	0	0	0	0	0	0	0	75	120
9000	1000	0	0	0	0	0	0	0	0	0	0	0	0	0	113
1000	1000	0	0	0	0	0	0	0	0	0	0	0	0	0	0
1000	n/a	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Table: Calculation of additional capital for firm holding client money or other client assets (£000's)

Income															
More than	Up to	5	10	15	20	25	30	40	50	75	100	150	200+		
0	100	0	4	7	9	12	14	18	21	28	34	45	54		
100	200	0	7	11	14	17	20	25	29	38	46	59	70		
200	300	0	7	11	14	17	20	25	30	40	49	64	77		
300	400	0	0	9	13	16	19	25	30	40	50	67	81		
400	500	0	0	0	11	14	18	24	29	40	51	68	83		
500	600	0	0	0	8	12	15	22	28	40	51	69	85		
600	700	0	0	0	0	9	13	20	26	39	50	69	86		
700	800	0	0	0	0	6	10	17	24	38	49	69	87		
800	900	0	0	0	0	0	7	15	22	36	48	69	87		
900	1,000	0	0	0	0	0	0	12	19	34	47	68	87		
1,000	1,500	0	0	0	0	0	0	0	16	32	45	67	86		
1,500	2,000	0	0	0	0	0	0	0	0	18	34	59	81		
2,000	2,500	0	0	0	0	0	0	0	0	0	19	48	71		
2,500	3,000	0	0	0	0	0	0	0	0	0	6	37	64		

Income													
3,000	3,500	0	0	0	0	0	0	0	0	0	0	26	55
3,500	4,000	0	0	0	0	0	0	0	0	0	0	14	45
4,000	4,500	0	0	0	0	0	0	0	0	0	0	1	33
4,500	5,000	0	0	0	0	0	0	0	0	0	0	0	21
5,000	6,000	0	0	0	0	0	0	0	0	0	0	0	8
6,000	7,000	0	0	0	0	0	0	0	0	0	0	0	0
7,000	8,000	0	0	0	0	0	0	0	0	0	0	0	0
8,000	9,000	0	0	0	0	0	0	0	0	0	0	0	0
9,000	10,000	0	0	0	0	0	0	0	0	0	0	0	0
10,000	10,000	0	0	0	0	0	0	0	0	0	0	0	0
10,000	n/a	0	0	0	0	0	0	0	0	0	0	0	0

3

3.2.15

FCA PRA

R

The *rule* on the items which are eligible to contribute to the capital resources of a *firm* applies (see ■ MIPRU 4.4.2 R).



## Chapter 4

# Capital resources

## 4.1 Application and purpose

### Application

#### 4.1.1

FCA PRA

R

This chapter applies to a *firm* with *Part 4A permission* to carry on any of the following activities, unless an exemption in this section applies:

- (1) *insurance mediation activity*;
- (2) *home finance mediation activity*;
- (3) *home financing* ;
- (4) *home finance administration* .

#### 4.1.2

FCA PRA

G

As this chapter applies only to a *firm* with *Part 4A permission* , it does not apply to an *incoming EEA firm* (unless it has a *top-up permission*). An incoming EEA firm includes a firm which is passporting into the United Kingdom under the *Insurance Mediation Directive* .

#### 4.1.3

FCA PRA

G

The definition of *insurance mediation activity* refers to several activities 'in relation to a *contract of insurance*' which includes a contract of reinsurance. This chapter, therefore, applies to a reinsurance intermediary in the same way as it applies to any other *insurance intermediary*.

### Application: banks, building societies, insurers and friendly societies

#### 4.1.4

FCA PRA

R

This chapter does not apply to:

- (1) a *bank*; or
- (2) a *building society*; or
- (3) a solo consolidated *subsidiary* of a *bank* or a *building society* ; or
- (4) an *insurer*; or
- (5) a *friendly society*.

4.1.5 G The capital resources of the *firms* above are calculated in accordance with the appropriate prudential sourcebook.

FCA PRA

#### **Application: firms carrying on designated investment business only**

4.1.6 R This chapter does not apply to a *firm* whose *Part 4A permission* is limited to *regulated activities* which are *designated investment business*.

FCA PRA

4.1.7 G A *firm* which carries on *designated investment business*, and no other *regulated activity*, may disregard this chapter. For example, a *firm* with *permission* limited to *dealing in investments as agent* in relation to *securities* is only carrying on *designated investment business* and the Interim Prudential sourcebook for investment businesses or the Prudential sourcebook for Banks, Building Societies and Investment Firms, as appropriate, will apply. However, if its *permission* is varied to enable it to arrange motor insurance as well, this activity is not *designated investment business* so the *firm* will be subject to the higher of the requirements in this chapter and those sourcebooks (see ■ MIPRU 4.2.5 R).

FCA PRA

#### **Application: credit unions**

4.1.8 R This chapter does not apply to:

PRA

- (1) a 'small *credit union*', that is one with:
  - (a) assets of £5 million or less; and
  - (b) a total number of members of 5,000 or less (see ■ CREDS 5.3.13 R) ; or
- (2) a *credit union* whose *Part 4A permission* includes *mortgage lending* or *mortgage administration* (or both) but not *insurance mediation activity* or *mortgage mediation activity*.

4.1.9 G (1) For *credit unions* to which this chapter applies and which are not *CTF providers*, the capital requirements will be the higher of the requirements in this chapter and in the Credit Unions sourcebook (see ■ MIPRU 4.2.6 R).

PRA

- (2) For *credit unions* to which this chapter applies and which are *CTF providers* with permission to carry on *designated investment business*, the capital requirements will be the highest of the requirements in this chapter, those in the Credit Unions sourcebook and in the Interim Prudential sourcebook for investment businesses (see ■ MIPRU 4.2.6 R).
- (3) A *credit union* cannot carry on *home purchase activities* or *reversion activities* because the Credit Unions Act 1979 (in relation to *Great Britain credit unions*) and the Credit Unions (Northern Ireland) Order 1985 (in relation to *Northern Ireland credit unions*) restricts the circumstances whereby *credit unions* can hold land.

#### **Application: professional firms**

4.1.10 R (1) This chapter does not apply to an *authorised professional firm*:

FCA

- (a) whose main business is the practice of its profession; and

(b) whose *regulated activities* covered by this chapter are incidental to its main business.

(2) A *firm's* main business is the practice of its profession if the proportion of income it derives from professional fees is, during its annual accounting period, at least 50% of the *firm's* total income (a temporary variation of not more than 5% may be disregarded for this purpose).

(3) Professional fees are fees, commissions and other receipts receivable in respect of legal, accountancy, actuarial, conveyancing and surveying services provided to clients but excluding any items receivable in respect of *regulated activities*.

#### Application: Lloyd's managing agents

4.1.11

**R**

This chapter does not apply to a managing agent.

PRA

4.1.12

**G**

The reason for excluding *managing agents* from the provisions of this chapter is twofold: first, a *member* will have accepted full responsibility for those activities under the *Society's managing agent* agreement. Secondly, the *member* is itself subject to capital requirements which are equivalent to those applying to an *insurer* (to which this chapter is also disappplied).

PRA

#### Application: social housing firms

4.1.13

**G**

There are special provisions for a *social housing firm* when it is carrying on *home financing* or *home finance administration* (see ■ MIPRU 4.2.7 R).

FCA

#### Purpose

4.1.14

**G**

This chapter amplifies *threshold condition 4* (Adequate resources) by providing that a *firm* must meet, on a continuing basis, a basic solvency requirement and a minimum capital resources requirement. This chapter also amplifies *Principle 4* which requires a *firm* to maintain adequate financial resources by setting out capital requirements for a *firm* according to the *regulated activity* or activities it carries on.

FCA

PRA

4.1.15

**G**

Capital has an important role to play in protecting consumers and complements the roles played by professional indemnity insurance and *client money* protection (see the *client money rules*). Capital provides a form of protection for situations not covered by a *firm's* professional indemnity insurance and it provides the funds for the *firm's* PII excess, which it has to pay out of its own finances (see ■ MIPRU 3.2.11 R and ■ MIPRU 3.2.12 R for the relationship between the *firm's* capital and its excess).

FCA

PRA

4.1.16

**G**

More generally, having adequate capital gives the *firm* a degree of resilience and some indication to consumers of creditworthiness, substance and the commitment of its owners. It reduces the possibility of a shortfall of funds and provides a cushion against disruption if the *firm* ceases to trade.

FCA

PRA

4.1.17

FCA PRA

G

There is a greater risk to consumers, and a greater adverse impact on market confidence, if a *firm* holding *client money* or other *client* assets fails. For this reason, the capital resources *rules* in this chapter clearly distinguish between *firms* holding *client* assets and those that do not.

**Purpose: social housing firms**

4.1.18

FCA

G

*Social housing firms* undertake small amounts of home finance business even though their main business consists of activities other than *regulated activities*. Their *home financing* is only done as an adjunct to their primary purpose (usually the provision of housing) and is substantially different in character to that done by commercial lenders. Furthermore, they are *subsidiaries* of local authorities or registered social landlords which are already subject to separate regulation. The FCA does not consider that it would be proportionate to the risks involved with such business to impose significant capital requirements for these *firms*. The capital resources requirement for *social housing firms* therefore simply provides that, where their *Part 4A permission* is limited to *home financing* and *home finance administration*, their net tangible assets must be greater than zero.

4.1.19

FCA

G

A registered social landlord is a non-profit organisation which provides and manages homes for rent and sale for people who might not otherwise be able to rent or buy on the open market. It can be a housing association, a housing society or a non-profit making housing company. The Homes and Communities Agency and the Tenant Services Authority were set up by Parliament in 2008 and cooperate in providing financial assistance for social housing.

## 4.2 Capital resources requirements

### General solvency requirement

4.2.1

FCA PRA

R

A *firm* must at all times ensure that it is able to meet its liabilities as they fall due.

### General capital resource requirement

4.2.2

FCA PRA

R

A *firm* must at all times maintain capital resources equal to or in excess of its relevant capital resources requirement.

### Capital resources: relevant accounting principles

4.2.3

FCA PRA

R

A *firm* must recognise an asset or liability, and measure its amount, in accordance with the relevant accounting principles applicable to it for the purpose of preparing its annual financial statements unless a *rule* requires otherwise.

### Capital resources: client assets

4.2.4

FCA PRA

R

In this chapter, "*client assets*" includes a *document* only if it has value, or is capable of having value, in itself (such as a bearer instrument)

### Capital resources requirement: firms carrying on regulated activities including designated investment business

4.2.5

FCA PRA

R

The capital resources requirement for a *firm* (other than a *credit union*) carrying on *regulated activities*, including *designated investment business*, is the higher of:

- (1) the requirement which is applied by this chapter according to the activity or activities of the *firm* (treating the relevant *rules* as applying to the *firm* by disregarding its *designated investment business*); and
- (2) the financial resource requirement which is applied by the Interim Prudential sourcebook for investment businesses or the Prudential sourcebook for Banks, Building Societies and Investment Firms.

**Capital resources requirement: credit unions**

4.2.6  
PRA

**R** The capital resources requirement for a *credit union* to which this chapter applies is the highest of:

- (1) the requirement which is applied to *firms* carrying on mediation activities only (see ■ MIPRU 4.2.11 R) treating that *rule* as applying to the *credit union* by disregarding activities which are not *insurance mediation activity* or *mortgage mediation activity*;
- (2) the amount which is applied by the Credit Unions sourcebook; and
- (3) if the *credit union* is a *CTF provider* that has a *permission* to carry on *designated investment business*, the amount which is applied by Chapter 8 of the Interim Prudential sourcebook for investment businesses.

**Capital resources requirement: social housing firms**

4.2.7  
FCA

**R** The capital resources requirement for a *social housing firm* whose *Part 4A permission* is limited to carrying on the *regulated activities* of:

- (1) *home financing*; or
- (2) *home finance administration* (or both);

is that the *firm's* net tangible assets must be greater than zero.

4.2.8  
FCA

**G** If a *social housing firm* is carrying on *home financing* or *home finance administration* (and no other *regulated activity*), its net tangible assets must be greater than zero. However, if it carries on *insurance mediation activity* or *home finance mediation activity*, there is no special provision and the capital resources requirement for *firms* carrying on *designated investment business* or mediation activities only applies to it as appropriate.

**Capital resources requirement: application according to regulated activities**

4.2.9  
FCA PRA

**R** Unless any of the *rules* on capital resources for *firms* carrying on *designated investment business*, for *credit unions* or for *social housing firms* apply, the capital resources requirement for a *firm* varies according to the *regulated activity* or activities it carries on.

4.2.10  
FCA PRA

**R** Table: Application of capital resources requirements

	Regulated activities	Provisions
1.	(a) <i>insurance mediation activity</i> ; or  (b) <i>home finance mediation activity</i> (or both); and no other <i>regulated activity</i> .	MIPRU 4.2.11 R

	Regulated activities	Provisions
2.	(a) <i>home financing</i> ; or  (b) <i>home financing and home finance administration</i> ; and no other regulated activity.	MIPRU 4.2.12 R to MIPRU 4.2.17 E
3.	<i>home finance administration</i> ; and no other regulated activity.	MIPRU 4.2.18 R to MIPRU 4.2.19 R
4.	<i>insurance mediation activity</i> ; and  (a) <i>home financing</i> ; or  (b) <i>home finance administration</i> (or both).	MIPRU 4.2.20 R
5.	<i>home finance mediation activity</i> ; and  (a) <i>home financing</i> , or  (b) <i>home finance administration</i> (or both).	MIPRU 4.2.21 R
6.	Any combination of regulated activities not within rows 1 to 5.	MIPRU 4.2.22 R

#### Capital resources requirement: mediation activity only

4.2.11

FCA PRA

R

- (1) If a *firm* carrying on *insurance mediation activity* or *home finance mediation activity* (and no other regulated activity) does not hold *client money* or other *client* assets in relation to these activities, its capital resources requirement is the higher of:
- (a) £5,000; and
  - (b) 2.5% of the *annual income* from its *insurance mediation activity* or *home finance mediation activity* (or both).
- (2) If a *firm* carrying on *insurance mediation activity* or *home finance mediation activity* (and no other regulated activity) holds *client money* or other *client* assets in relation to these activities, its capital resources requirement is the higher of:
- (a) £10,000; and

- (b) 5% of the *annual income* from its *insurance mediation activity* or *home finance mediation activity* (or both).

**Capital resources requirement: home financing and home finance administration (but not home finance administration only)**

4.2.12

R

FCA PRA

- (1) The capital resources requirement for a *firm* carrying on *home financing*, or *home financing and home finance administration* (and no other *regulated activity*) is the higher of:
- (a) £100,000; and
- (b) 1% of:
- (i) its total assets plus total undrawn commitments and unreleased amounts under the *home reversion plan*; less:
- (ii) excluded loans or amounts plus intangible assets (see Note 1 in the table in ■ MIPRU 4.4.4 R).
- (2) Undrawn commitments and unreleased amounts means the total of those amounts which a *customer* has the right to draw down or to receive from the *firm* but which have not yet been drawn down or received, excluding those under an agreement:
- (a) which has an original maturity of up to one year; or
- (b) which can be unconditionally cancelled at any time by the lender or provider.

4.2.13

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FCA PRA

When considering what is an undrawn commitment or unreleased amount, the *appropriate regulator* takes into account an amount which a *customer* has the right to draw down or to receive under a *home finance transaction*, but which has not yet been drawn down or received, whether the commitment or obligation is revocable or irrevocable, conditional or unconditional.

4.2.14

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FCA PRA

When calculating total assets, the *firm* may exclude a loan or plan which has been transferred to a third party only if it meets the following conditions:

- (1) the first condition is that the loan or the plan has been transferred in a legally effective manner by:
- (a) novation; or
- (b) legal or equitable assignment; or
- (c) sub-participation; or
- (d) declaration of trust; and
- (2) the second condition is that the *home finance provider*:

## 4.2.15

FCA PRA



- (a) retains no material economic interest in the loan or the plan; and
- (b) has no material exposure to losses arising from it.

- (1) When seeking to rely on the second condition, a *firm* should ensure that the loan or plan qualifies for the 'linked presentation' accounting treatment under Financial Reporting Standard 5 (Reporting the substance of transactions) issued in April 1994, and amended in December 1994 and September 1998 (if applicable to the *firm*).
- (2) Compliance with (1) may be relied upon as tending to establish compliance with the second condition.

## 4.2.16

FCA PRA



The requirement that the loan qualifies for the 'linked presentation' accounting treatment under FRS 5 is aimed at those *firms* which report according to FRS 5. Other *firms* which report under other standards, including International Accounting Standards, need not adopt FRS 5 in order to meet the second condition.

## 4.2.17

FCA PRA



- (1) When seeking to rely on the second condition, a *firm* should not provide material credit enhancement in respect of the loan or plan unless it deducts the amount of the credit enhancement from its capital resources before meeting its capital resources requirement.
- (2) Credit enhancement includes:
  - (a) any holding of subordinated loans or notes in a transferee that is a special purpose vehicle; or
  - (b) over collateralisation by transferring loans or plans to a larger aggregate value than the *securities* to be issued; or
  - (c) any other arrangement with the transferee to cover a part of any subsequent losses arising from the transferred loan or plan.
- (3) Contravention of (1) may be relied upon as tending to establish contravention the second condition.

## 4.2.18

FCA PRA



**Capital resources requirement: home finance administration only**

The capital resources requirement for a *firm* carrying on *home finance administration* only, which has all or part of the *home finance transactions* that it administers on its balance sheet, is the amount which is applied to a *firm* carrying on *home financing* or *home financing and home finance administration* (and no other *regulated activity*) (see ■ MIPRU 4.2.12 R).

4.2.19

FCA PRA

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The capital resources requirement for a *firm* carrying on *home finance administration* only, which has all the *home finance transactions* that it administers off its balance sheet, is the higher of:

- (1) £100,000; and
- (2) 10% of its *annual income*.

#### Capital resources requirement: insurance mediation activity and home financing or home finance administration

4.2.20

FCA PRA

R

The capital resources requirement for a *firm* carrying on *insurance mediation activity* and *home financing* or *home finance administration* is the sum of the requirements which are applied to the *firm* by :

- (1) the capital resources *rule* for a *firm* carrying on *insurance mediation activity* or *home finance mediation activity* (and no other *regulated activity*) (see ■ MIPRU 4.2.11 R); and
- (2) (a) the capital resources requirement *rule* for a *firm* carrying on *home financing* or *home financing* and *home finance administration* (and no other *regulated activity*) (see ■ MIPRU 4.2.12 R); or
  - (b) if, in addition to its *insurance mediation activity*, the *firm* carries on *home finance administration* with all the assets that it administers off balance sheet, the capital resources *rule* for such a *firm* (see ■ MIPRU 4.2.19 R).

#### Capital resources requirement: home finance mediation activity and home financing or home finance administration

4.2.21

FCA PRA

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- (1) If a *firm* carrying on *home finance mediation activity* and *home financing* or *home finance administration* does not hold *client money* or other *client assets* in relation to its *home finance mediation activity*, the capital requirement is the amount applied to a *firm*, according to the activities carried on by the *firm*, by:
  - (a) the capital resources requirement *rule* for a *firm* carrying on *home financing* or *home financing* and *home finance administrator* (and no other *regulated activity*) (see ■ MIPRU 4.2.12 R); or in the case of a *firm* carrying on *home financing* which is not connected to *regulated mortgage contracts* or *home finance administration* which is not connected to *regulated mortgage contracts*, the amount applied to a *firm* under ■ MIPRU 4.2.12 R; or
  - (b) if, in addition to its *home finance mediation activity*, the *firm* carries on *home finance administration* with all the assets that it administers off balance sheet, the capital resources *rule* for such a *firm* (see ■ MIPRU 4.2.19 R).

- (2) If the *firm* holds *client money* or other *client* assets in relation to its *home finance mediation activity*, the capital resources requirement is:
- (a) the amount calculated under (1); plus
  - (b) the amount which is applied to a *firm* carrying on *insurance mediation activity* or *home finance mediation activity* (and no other *regulated activity*) that holds *client money* or other *client* assets in relation to these activities (see ■ MIPRU 4.2.11 R (2)).

#### Capital resources requirement: other combinations of activities

4.2.22

FCA PRA

R

The capital resources requirement for a *firm* carrying any other combination of *regulated activities* is the amount which is applied to a *firm* carrying on *insurance mediation activity* and *home financing* or *home finance administration* (see ■ MIPRU 4.2.20 R).



**4.2A [Not yet in force]**



**4.2B** [Not yet in force]



**4.2C [Not yet in force]**



**4.2D [Not yet in force]**

## 4.3 Calculation of annual income

### Annual income

4.3.1

FCA PRA

R

This section contains provisions relating to the calculation of *annual income* for the purposes of:

- (1) the *limits of indemnity* for professional indemnity insurance; and
- (2) the capital resources requirements.

4.3.2

FCA PRA

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'Annual income' is the annual income given in the *firm's* most recent annual financial statement from the relevant *regulated activity* or activities.

4.3.3

FCA PRA

R

For a *firm* which carries on *insurance mediation activity* or *home finance mediation activity*, *annual income* is the amount of all brokerage, fees, *commissions* and other related income (for example, administration charges, overrides, profit shares) due to the *firm* in respect of or in relation to those activities.

4.3.4

FCA PRA

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- (1) The purpose of the *rule* on *annual income* that applies to *insurance intermediaries* and *mortgage intermediaries* is to ensure that the capital resources requirement is calculated on the basis only of brokerage and other amounts earned by a *firm* which are its own income.
- (2) *Annual income* includes *commissions* and other amounts the *firm* may have agreed to pay to other *persons* involved in a transaction, such as sub-agents or other intermediaries.
- (3) A *firm's annual income* does not, however, include any amounts due to another *person* (for example, the product provider) which the *firm* has collected on behalf of that other *person*.

4.3.5

FCA PRA

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If a *firm* is a *principal*, its *annual income* includes amounts due to its *appointed representative* in respect of activities for which the *firm* has accepted responsibility.

4.3.6

FCA PRA

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If a *firm* is a *network*, it should include the relevant income due to all of its *appointed representatives* in its *annual income*.

4.3.7

FCA PRA

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**Annual income for home finance administration**

For the purposes of the calculation of the capital resources of a *firm* carrying on *home finance administration* only with all the assets it administers off balance sheet, *annual income* is the sum of:

- (1) revenue (that is, *commissions*, fees, net interest income, dividends, royalties and rent); and
- (2) gains;
- (3) arising in the course of the ordinary activities of the *firm*, less profit:
  - (a) on the sale or termination of an operation;
  - (b) arising from a fundamental reorganisation or restructuring having a material effect on the nature and focus of the *firm's* operation; and
  - (c) on the disposal of fixed assets, including *investments* held in a long-term portfolio.

4.3.8

FCA PRA

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**Annual income: periods of less than 12 months**

If the *firm's* most recent annual financial statement does not cover a 12 *month* period, the *annual income* is taken to be the amount in the statement converted, proportionally, to a 12 *month* period.

4.3.9

FCA PRA

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**Annual income: no financial statements**

If the *firm* does not have annual financial statements, the *annual income* is to be taken from the forecast or other appropriate accounts which the *firm* has submitted to the *appropriate regulator*.



## 4.4 Calculation of capital resources

### The calculation of a firm's capital resources

4.4.1

FCA PRA

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- (1) A *firm* must calculate its capital resources only from the items which are eligible to contribute to a *firm's* capital resources from which it must deduct certain items (see ■ MIPRU 4.4.4 R).
- (2) If the *firm* is subject to the Interim Prudential sourcebook for investment businesses, the Prudential sourcebook for Banks, Building Societies and Investment Firms or the Credit Unions sourcebook , the capital resources are the higher of:
  - (a) the amount calculated under (1); and
  - (b) the financial resources calculated under those sourcebooks.

4.4.2

FCA PRA

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Table: Items which are eligible to contribute to the capital resources of a firm

Item	Additional explanation
1. <i>Share capital</i>	<p>This must be fully paid and may include:</p> <ul style="list-style-type: none"> <li>(1) <i>ordinary share capital</i>; or</li> <li>(2) <i>preference share capital</i> (excluding <i>preference shares</i> redeemable by shareholders within two years).</li> </ul>
2. <i>Capital other than share capital</i> (for example, the capital of a <i>sole trader</i> , <i>partnership</i> or <i>limited liability partnership</i> )	<p>The capital of a <i>sole trader</i> is the net balance on the <i>firm's</i> capital account and current account. The capital of a <i>partnership</i> is the capital made up of the <i>partners'</i>:</p> <ul style="list-style-type: none"> <li>(1) <i>capital account</i>, that is the account:                             <ul style="list-style-type: none"> <li>(a) into which capital contributed by the <i>partners</i> is paid; and</li> </ul> </li> </ul>

Item	Additional explanation
	<p>(b) from which, under the terms of the <i>partnership</i> agreement, an amount representing capital may be withdrawn by a <i>partner</i> only if:</p> <p>(i) he ceases to be a <i>partner</i> and an equal amount is transferred to another such account by his former <i>partners</i> or any <i>person</i> replacing him as their <i>partner</i>; or</p> <p>(ii) the <i>partnership</i> is otherwise dissolved or wound up; and</p> <p>(2) current accounts according to the most recent financial statement.</p> <p>For the purpose of the calculation of capital resources, in respect of a <i>defined benefit occupational pension scheme</i>:</p> <p>(1) a <i>firm</i> must derecognise any <i>defined benefit asset</i>;</p> <p>(2) a <i>firm</i> may substitute for a <i>defined benefit liability</i> the <i>firm's deficit reduction amount</i>, provided that the election is applied consistently in respect of any one financial year.</p>
3. Reserves (Note 1)	<p>These are, subject to Note 1, the audited accumulated profits retained by the <i>firm</i> (after deduction of tax, dividends and proprietors' or <i>partners</i>' drawings) and other reserves created by appropriations of share premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a <i>parent undertaking</i>.</p> <p>For the purposes of calculating capital resources, a <i>firm</i> must make the following adjustments to its reserves, where appropriate:</p> <p>(1) a <i>firm</i> must deduct any unrealised gains or, where applicable, add back in any unrealised losses on debt instruments held, or formerly held, in the available-for-sale financial assets category;</p> <p>(2) a <i>firm</i> must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;</p>

Item	Additional explanation
	<p>(3) in respect of a <i>defined benefit occupational pension scheme</i>:</p> <p>(a) a <i>firm</i> must derecognise any <i>defined benefit asset</i>;</p> <p>(b) a <i>firm</i> may substitute for a <i>defined benefit liability</i> the <i>firm's deficit reduction amount</i>, provided that the election is applied consistently in respect of any one financial year.</p>
4. Interim net profits (Note 1)	If a <i>firm</i> seeks to include interim net profits in the calculation of its capital resources, the profits have, subject to Note 1, to be verified by the <i>firm's</i> external auditor, net of tax, anticipated dividends or proprietors' drawings and other appropriations.
5. Revaluation reserves	
6. General/ collective provisions (Note 1)	These are provisions that a <i>firm</i> carrying on <i>home financing</i> or <i>home finance administration</i> holds against potential losses that have not yet been identified but which experience indicates are present in the <i>firm's</i> portfolio of assets. Such provisions must be freely available to meet these unidentified losses wherever they arise. Subject to Note 1, general/collective provisions must be verified by external auditors and disclosed in the <i>firm's</i> annual report and accounts.
7. Subordinated loans	Subordinated loans must be included in capital on the basis of the provisions in this chapter that apply to subordinated loans.
Note:	
1	Reserves must be audited and interim net profits, general and collective provisions must be verified by the <i>firm's</i> external auditor unless the <i>firm</i> is exempt from the provisions of Part VII of the Companies Act 1985 (section 249A (Exemptions from audit)) or, where applicable, Part 16 of the Companies Act 2006 (section 477 (Small companies: Conditions for exemption from audit)) relating to the audit of accounts .

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

4.4.4

FCA PRA

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## Table: Items which must be deducted from capital resources

1	<i>Investments in own shares</i>
2	Intangible assets (Note 1)
3	Interim net losses (Note 2)
4	Excess of drawings over profits for a <i>sole trader</i> or a <i>partnership</i> (Note 2)
Notes	<p>Notes 1. Intangible assets are the full balance sheet value of goodwill (but not until 14 January 2008 - see transitional provision 1), capitalised development costs, brand names, trademarks and similar rights and licences.</p> <p>2. The interim net losses in row 3, and the excess of drawings in row 4, are in relation to the period following the date as at which the capital resources are being computed.</p>

**Personal assets**

4.4.5

FCA PRA

R

In relation to a *sole trader's firm* or a *firm* which is a *partnership*, the *sole trader* or a *partner* in the *firm* may use personal assets to meet the general solvency requirement and the general capital resource requirement, to the extent necessary to make up any shortfall in meeting those requirements, unless:

- (1) those assets are needed to meet other liabilities arising from:
  - (a) personal activities; or
  - (b) another business activity not regulated by the *appropriate regulator*; or
- (2) the *firm* holds *client money* or other *client* assets.

4.4.6

FCA PRA

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A *sole trader* or a *partner* may use any personal assets, including property, to meet the capital requirements of this chapter, but only to the extent necessary to make up a shortfall.

4.4.7

FCA PRA

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**Subordinated loans**

A subordinated debt must not form part of the capital resources of the *firm* unless it meets the following conditions:

- (1) (for a *firm* which carries on *insurance mediation activity* , *home finance mediation activity* (or both) but not *home financing* or *home finance administration* ) it has an original maturity of:
  - (a) at least two years; or
  - (b) it is subject to two years' notice of repayment;
- (2) (for all other *firms*) it has an original maturity of:
  - (a) at least five years; or
  - (b) it is subject to five years' notice of repayment;
- (3) the claims of the subordinated creditors must rank behind those of all unsubordinated creditors;
- (4) the only events of default must be non-payment of any interest or principal under the debt agreement or the winding up of the *firm*;
- (5) the remedies available to the subordinated creditor in the event of non-payment or other default in respect of the subordinated debt must be limited to petitioning for the winding up of the *firm* or proving the debt and claiming in the liquidation of the *firm*;
- (6) the subordinated debt must not become due and payable before its stated final maturity date except on an event of default complying with (4);
- (7) the agreement and the debt are governed by the law of England and Wales, or of Scotland or of Northern Ireland;
- (8) to the fullest extent permitted under the rules of the relevant jurisdiction, creditors must waive their right to set off amounts they owe the *firm* against subordinated amounts owed to them by the *firm*;
- (9) the terms of the subordinated debt must be set out in a written agreement or instrument that contains terms that provide for the conditions set out in this *rule*; and
- (10) the debt must be unsecured and fully paid up.

4.4.8

FCA PRA

R

- (1) This *rule* applies to a *firm* which:
  - (a) carries on:

- (i) *insurance mediation activity*; or
- (ii) *home finance mediation activity* (or both); and

- (b) in relation to those activities, holds *client money* or other *client assets*;

but is not carrying on *home financing* or *home finance administration*.

- (2) In calculating its capital resources, the *firm* must exclude any amount by which the aggregate amount of its subordinated loans and its redeemable preference *shares* exceeds the amount calculated as follows:

four times (a - b - c);

where:

a	=	items 1 to 5 in the Table of items which are eligible to contribute to a <i>firm's</i> capital resources (see MIPRU 4.4.2 R)
b	=	the <i>firm's</i> redeemable preference <i>shares</i> ; and
c	=	the amount of its intangible assets (but not goodwill until 14 January 2008 - see transitional provision 1).

#### 4.4.9

FCA PRA

G

If a *firm* wishes to see an example of a subordinated loan agreement which would meet the required conditions, it should refer to the Forms page.

#### 4.4.10

FCA PRA

R

#### Reversion providers: additional requirement for instalment reversions

- (1) If the *reversion provider* agrees under the terms of an *instalment reversion plan* to pay the *reversion occupier* for the *qualifying interest in land* over a period of time, then the *provider* must:
  - (a) take out and maintain adequate insurance from an *insurance undertaking* authorised in the *EEA* or a *person* of equivalent status in:
    - (i) a *Zone A country*; or
    - (ii) the Channel Islands, Gibraltar, Bermuda or the Isle of Man; or
  - (b) enter into a written agreement with a *credit institution*;

to meet these obligations in the event that the *reversion provider* is unable to do so.

- (2) This rule does not apply if:
- (a) the *instalment reversion plan* is linked to an *investment* and it is reasonably anticipated that the amounts due to the *reversion occupier* under the plan will be paid out of the proceeds of the *investment* to the *occupier* by a *product provider* other than the *reversion provider*; or
  - (b) the *reversion provider* acquires its interest in the property in steps proportionate to the instalments paid.

## 4.4.11

FCA PRA

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The additional requirement for *reversion providers* aims to protect the *reversion occupier* against the insolvency of the *reversion provider* where the *reversion occupier* has agreed to receive the price for the part of the *qualifying interest in land* sold in instalments rather than in a lump sum. The requirement does not arise, for example, in relation to reversions linked to annuities as the *reversion occupier* has no credit risk on the *reversion provider*. Also, the requirement does not arise in relation to 'mini-reversions' (or 'staged reversions') as under these plans the *reversion occupier* continues to own the *qualifying interest in land*.

#### Regulated sale and rent back agreements: additional requirement

## 4.4.12

FCA PRA

R

If a *SRB agreement provider* agrees, under the terms of a *regulated sale and rent back agreement*, to account to the *SRB agreement seller* for any monetary sum, whether after a qualifying period, over a period of time, on the occurrence of a contingent event or otherwise, the provider must:

- (1) take out and maintain adequate insurance from an *insurance undertaking* authorised in the *EEA* or a *person* of equivalent status in:
  - (a) a *Zone A country*; or
  - (b) the Channel Islands, Gibraltar, Bermuda, or the Isle of Man; or
- (2) enter into a written agreement with a *credit institution*;

to meet these obligations in the event that the *SRB agreement provider* is unable to do so.

## 4.4.13

FCA PRA

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An example of where this additional requirement would apply would be a term of a *regulated sale and rent back agreement* under which the *SRB agreement seller* was to receive from the *SRB agreement provider* a refund of an agreed percentage of the discount on the sale price of the property to which the agreement relates after an agreed qualifying period.



## Chapter 5

# Insurance undertakings and home finance providers using insurance or home finance mediation services



## 5.1 Application and purpose

### Application

5.1.1  
FCA

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This chapter applies to a *firm* with a *Part 4A permission* to carry on:

- (1) *insurance business*; or
- (2) *home financing*;
- (3) and which uses, or proposes to use, the services of another person consisting of:
  - (a) *insurance mediation*; or
  - (b) *insurance mediation activity*; or
  - (c) *home finance mediation activity*.

### Purpose

5.1.2  
FCA

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The purpose of this chapter is to implement article 3.6 of the *Insurance Mediation Directive* in relation to *insurance undertakings*. The provisions of this chapter have been extended to *home finance providers* in relation to *insurance mediation activity*, and to *insurance undertakings* and *home finance providers* in relation to *home finance mediation activity*, to ensure that *firms* using these services are treated in the same way and to ensure that *clients* have the same protection. To avoid the loss of protection where an intermediary itself uses the services of an *unauthorised person*, this chapter also ensures that each person in the chain of those providing services is authorised.

5.1.3  
FCA

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This chapter supports the more general duties in *Principles 2* and *3*, and the relevant *rule* in the Senior Management Arrangements, Systems and Controls sourcebook (see ■ SYSC 3.1.1 R and ■ SYSC 4.1.1 R).

5.2 Use of intermediaries

5.2.1

FCA PRA

R

A *firm* must not use, or propose to use, the services of another person consisting of:

- (1) *insurance mediation*; or
- (2) *insurance mediation activity*; or
- (3) *home finance mediation activity*;

unless ■ MIPRU 5.2.2 R is satisfied.

[Note: Article 3(6) of the *Insurance Mediation Directive*]

5.2.1A

FCA PRA

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The *appropriate regulator* regards a *firm* as 'using' the services of, in particular, its immediate counterparty (typically the intermediary that passed the business to the *firm*) and of all other *persons* who have been granted the right or authority directly by the *firm* to effect a *contract of insurance* or *enter into a home finance transaction*.

5.2.2

FCA PRA

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For the purposes of ■ MIPRU 5.2.1 R, the person, in relation to the activity must:

- (1) have *permission*; or
- (2) be an *exempt person*; or
- (3) be an *exempt professional firm*; or
- (4) be registered in another *EEA State* for the purposes of the *Insurance Mediation Directive* ; or
- (5) in relation to *insurance mediation activity*, not be carrying this activity on in the *EEA*; or
- (6) in relation to *home finance mediation activity*, not be carrying this activity on in the *United Kingdom*.

[Note: Article 3(6) of the *Insurance Mediation Directive*]

5.2.3

FCA PRA



- (1) A *firm* should:
- (a) before using the services of the intermediary, check:
    - (i) the *Financial Services Register*; or
    - (ii) in relation to *insurance mediation* carried on by an *EEA firm*, the register of its *Home State regulator*;  
  
for the status of the person; and
  - (b) use the services of that person only if the relevant register indicates that the person is registered for that purpose.
- (2) (a) Checking the *Financial Services Register* before using the services of the intermediary and using the services of that person only if the *Financial Services Register* indicates that the person is registered for that purpose may be relied on as tending to establish that:
- (i) the person, in relation to the activity, has *permission*;  
or
  - (ii) the person, in relation to *insurance mediation activity*, also is an *exempt person* or an *authorised professional firm*.
- (b) In relation to *insurance mediation* carried on by an *EEA firm*, checking the register of the *firm's Home State regulator* and using the services of the *EEA firm* only if the register indicates that the *firm* is registered for that purpose may be relied on as tending to establish that the *firm* is registered for the purposes of the *Insurance Mediation Directive* .

5.2.4



[deleted]

5.2.5



[deleted]

5.2.6

FCA PRA



The *Financial Services Register* can be accessed through the *FCA* website under the link [www.fsa.gov.uk/register/home.do](http://www.fsa.gov.uk/register/home.do)

# Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries

## MIPRU TP 1 Transitional Provisions

FCA PRA

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	MIPRU 4.4.4 R and MIPRU 4.4.8 R (3)	R	[expired]		
2	MIPRU 5.2.2 R and MIPRU 5.2.4 R	R	MIPRU 5.2.2 R and MIPRU 5.2.4 R have effect in respect of the use by a <i>firm</i> of the services of another <i>person</i> consisting of <i>insurance mediation</i> and provided from an establishment in an <i>EEA State</i> that has not implemented Article 3 (Registration) of the <i>Insurance Mediation Directive</i> , as if the condition in paragraph (4) of MIPRU 5.2.2 R and the condition in paragraph (2) of MIPRU 5.2.4 R were a condition that the <i>firm</i> has no reason to doubt the good repute, competence and financial standing of that <i>person</i> .	from 14 January 2005 until the implementation of Article 3 of the <i>Insurance Mediation Directive</i> by the relevant <i>EEA State</i>	14 January 2005
3	MIPRU 3.2.7 R	R	The new <i>limits of indemnity</i> apply to a professional indemnity policy or a comparable guarantee agreement commenced, renewed or extended with effect from or after 1 March 2009. Any other existing non-annual arrangements must be aligned with the new <i>limits of indemnity</i> before 1 March 2010.	1 March 2009 to 28 February 2010	1 March 2009



# Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries

## Schedule 1 Record keeping requirements

### Sch 1.1 G

**FCA** **PRA**

There are no record keeping requirements in *MIPRU*.



# Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries

## Schedule 2 Notification requirements

### Sch 2.1 G

**FCA** **PRA**

There are no notification requirements in *MIPRU*



# Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries

## Schedule 3 Fees and other required payments

### Sch 3.1 G

**FCA** **PRA**

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



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# Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries

## Schedule 4 Powers exercised

### Sch 4.1 G

The following powers and related provisions in or under the *Act* have been exercised by the *FSA* to make the *rules* in *MIPRU*:

Section 138 (General rule-making power)

Section 149 (Evidential provisions)

Section 150(2) (Actions for damages)

Section 156 (General supplementary powers)

### Sch 4.2 G

The following powers in the *Act* have been exercised by the *FSA* to give the *guidance* in *MIPRU*:

Section 157(1) (Guidance)



# Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries

## Schedule 5 Rights of actions for damages

### Sch 5.1 G

**FCA**

The table below sets out the *rules* in *MIPRU* 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.

### Sch 5.2 G

**FCA**

If a 'Yes' appears in the column headed 'For private person', the *rule* may be actionable by a 'private person' under section 138D of the Act (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 No 2256)). A 'Yes' in the column headed 'Removed' indicates that the *appropriate regulator* 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.

### Sch 5.3 G

**FCA**

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.

### G

**FCA**

Table

Chapter/Appendix	Section/Annex	Right of action under section 138D		
		For private person	Removed	For other person
All <i>rules</i> in <i>MIPRU</i> with the status letter "E"		No	No	No
All other <i>rules</i> in <i>MIPRU</i>		No	Yes, MIPRU 1.2.1 R	No



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## Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries

### Schedule 6 Rules that can be waived

#### Sch 6.1 G

**FCA** **PRA**

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

# Prudential sourcebook for UCITS Firm

## Prudential sourcebook for UCITS Firm

<b>UPRU 1</b>	<b>UCITS firms</b>
1.1	Introduction
1.2	Purpose
<b>UPRU 2</b>	<b>Prudential requirements</b>
2.1	Financial resources and financial resources requirements
2.2	Method of calculation of financial resources
2.3	Application of certain rules in the interim prudential sourcebook for investment businesses
2.4	Records
	<b>Transitional Provisions and Schedules</b>
<b>TP 1</b>	<b>Transitional Provisions for UPRU</b>
Sch 1	Record keeping requirements
Sch 2	Notification requirements
Sch 3	Fees and other required payments
Sch 4	Powers exercised
Sch 5	Rights of action for damages
Sch 6	Rules that can be waived

# Chapter 1

## UCITS firms

## 1.1 Introduction

### Application

1.1.1

FCA

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This sourcebook and any provisions of the Interim Prudential sourcebook for investment businesses incorporated into this sourcebook by reference, apply to every *UCITS firm*.

1.1.2

FCA

G

Firms are reminded that a *UCITS management company* can be either:

- (1) a *UCITS firm*; or
- (2) a *UCITS investment firm*.

1.1.3

FCA

G

This sourcebook only applies to *UCITS firms*. *UCITS investment firms* are *BIPRU limited licence firms* and the prudential requirements for those *firms* are set out in the Prudential sourcebook for banks, building societies and investment firms and the General prudential sourcebook. The difference between the two types of *UCITS management companies* is that a *UCITS investment firm* in addition to carrying on the activities permitted by Article 6(2) of the *UCITS Directive* (scheme management), may also carry on the activities permitted by Article 6(3) such as portfolio management.



## 1.2 Purpose

### 1.2.1

FCA

G

- (1) The purpose of this sourcebook is to amplify *Principle 4* (Financial prudence) which requires a *firm* to maintain adequate financial resources to meet its *designated investment business* commitments and to withstand the risks to which its business is subject. This assists in the achievement of the *statutory objectives* of consumer protection and protecting and enhancing the integrity of the *UK financial system*.
- (2) This sourcebook also implements certain requirements of the *UCITS Directive* which among other matters imposes capital requirements on a *UCITS management company*.



## Chapter 2

# Prudential requirements

## 2.1 Financial resources and financial resources requirements

### Financial resources

2.1.1  
FCA

R

A *firm* must ensure that it has at all times *financial resources* which equal or exceed the applicable *financial resources requirement*.

### Financial resources requirement

2.1.2  
FCA

R

The *financial resources requirement* for a *firm* is the higher of:

- (1) subject to a maximum requirement of €10,000,000:
  - (a) *initial capital* requirement of €125,000; plus
  - (b) if the *funds under management* exceed €250,000,000, an additional amount of 0.02% of the excess; or
- (2) 13/52 of its annual audited fixed expenditure.

### Annual fixed expenditure

2.1.3  
FCA

R

For the purposes of this sourcebook, a *firm's* annual fixed expenditure is:

- (1) the sum of the amounts described as total expenditure in the four *quarterly financial returns* up to (and including) that prepared at the *firm's* most recent *accounting reference date*, less the following items (if they are included within that expenditure):
  - (a) staff bonuses, except to the extent that they are guaranteed;
  - (b) *employees'* and *directors'* shares in profits, except to the extent that they are guaranteed;
  - (c) other appropriations of profits;
  - (d) shared *commission* and fees payable which are directly related to *commission* and fees receivable which are included within total revenue;
  - (e) interest charges in respect of borrowings made to finance the acquisition of the *firm's* *readily realisable investments*;

- (f) interest paid to *customers on client money*;
  - (g) interest paid to *counterparties*;
  - (h) fees, brokerage and other charges paid to *clearing houses, exchanges and intermediate brokers* for the purposes of *executing*, registering or clearing transactions;
  - (i) foreign exchange losses;
  - (j) other variable expenditure; or
- (2) where the previous accounting period does not include twelve months' trading, an amount calculated in accordance with (1) pro-rated to an equivalent annual amount; or
- (3) where a *firm* has not prepared four *quarterly financial returns* since the commencement of its *permitted business*, an amount based on forecast expenditure included in the budget for the first twelve months' trading, as submitted with its application for authorisation.

## 2.1.4

FCA

G

A *firm's financial resources requirement* will be recalculated annually when its fourth *quarterly financial return* is prepared. The *firm* should maintain *financial resources* sufficient to meet its new *financial resources requirement* from the date on which the fourth *quarterly financial return* is prepared (and no later than 80 business days after the *accounting reference date*). The expenditure based requirement applicable at the *accounting reference date* will be based on the four *quarterly financial returns* prepared up to and on that date.

**2.2 Method of calculation of financial resources**

2.2.1  
FCA

**R**

PART I			
A firm must calculate its <i>financial resources</i> as shown below, subject to the detailed requirements set out in Part II.			
Financial resources	Category	Part II	
Para			
<b>TIER 1</b>			
(1) Paid-up share capital (excluding preference shares)	A	2	
(2) Share premium account			
(3) Audited reserves		3	
(4) Non-cumulative preference shares			
(5) <i>Eligible LLP members' capital</i>		4	
(6) Investments in own shares	B		
(7) Intangible assets		5	
(8) Material current year losses		6	
(8A) <i>Excess LLP members' drawings</i>			
(9) Material holdings in credit and financial institutions		7	
<b>Initial capital = (A-B) =</b>	<b>C</b>	<b>1(b)</b>	
<b>TIER 2</b>			<b>1</b>
(10) Revaluation reserves	D		
(11) Fixed term cumulative preference share capital		1(a)	

PART I			
(12)	Long-term Qualifying Subordinated Loans		1(a); 8
(13)	Other cumulative preference share capital and debt capital		
(14)	Qualifying arrangements		9
Own funds = (C+D) =		E	
TIER 3			
(15)	Illiquid assets	F	11
Financial resources = (E - F) =		G	

## PART II

## DETAILED REQUIREMENTS

## 1 Ratios

## (Items 11 and 12)

- (a) the total of fixed term cumulative preference shares (item 11) and long-term *qualifying subordinated loans* (item 12) that may be included in Tier 2 capital is limited to 50 per cent of Tier 1 capital ;
- (b) Tier 1 capital must equal or exceed €125,000 at all times; and
- (c) Tier 2 capital must not exceed 100 per cent of Tier 1 capital.

## 2 Non corporate entities

- (a) In the case of partnerships or sole traders, the following terms should be substituted, as appropriate, for items 1 to 4 in Tier 1 capital:
  - (i) partners' capital accounts (excluding loan capital);
  - (ii) partners' current accounts (excluding unaudited profits and loan capital);
  - (iii) proprietor's account (or other term used to signify the sole trader's capital but excluding unaudited profits).
- (b) Loans other than *qualifying subordinated loans* shown within partners' or proprietors' accounts must be classified as Tier 2 capital under item 13.
- (c) For the calculation of *financial resources*, partners' current accounts figures are subject to the following adjustments in respect of a *defined benefit occupational pension scheme*:
  - (i) a *firm* must derecognise any *defined benefit* asset:

- (ii) a firm may substitute for *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

#### Note

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

### 3 Audited Reserves

For the calculation of *financial resources*, the following adjustments apply to the audited reserves figure:

- (a) a firm must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (b) in respect of a *defined benefit occupational pension scheme*, a firm must derecognise any *defined benefit asset*;
- (c) a firm may substitute for a *defined benefit liability* the firm's *deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

#### Note

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

- (d) a firm must not include any unrealised gains from investment property.

#### Note

Unrealised gains from investment property should be reported as part of revaluation reserves.

- (e) where applicable, a firm must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

### 4 Eligible LLP members' capital (Item 5)

Members' capital of a *limited liability partnership* may only be included in Tier 1 of the calculation (see item 5) if the conditions in *IPRU(INV)*

Annex A 2.2R (Specific conditions for eligibility) and IPRU(INV) Annex A 2.3R (General conditions for eligibility) are satisfied.

#### 5 Intangible assets (Item 7)

Intangible assets comprise:

- (a) formation expenses to the extent that these are treated as an asset in the *firm's* accounts;
- (b) goodwill, to the extent that it is treated as an asset in the *firm's* accounts; and
- (c) other assets treated as intangibles in the *firm's* accounts.

#### 6 Material current year losses (Item 8)

Losses in current year operating figures must be deducted when calculating Tier 1 capital if such losses are material. For this purpose profits and losses must be calculated quarterly, as appropriate. If this calculation reveals a net loss it shall only be deemed to be material for the purposes of this Table if it exceeds 10 per cent of the *firm's* Tier 1 capital.

#### 7 Material holdings in credit and financial institutions (Item 9)

Material holdings comprise:

- (a) where the *firm* holds more than 10 per cent of the equity share capital of the institution, the value of that holding and the amount of any subordinated loans to the institution and the value of holdings in *qualifying capital items* or *qualifying capital instruments* issued by the institution;
- (b) in the case of holdings other than those mentioned in (a) above, the value of holdings of equity share capital in, and the amount of subordinated loans made to, such institutions and the value of holdings in *qualifying capital items* or *qualifying capital instruments* issued by such institutions to the extent that the total of such holdings and subordinated loans exceeds 10 per cent of the *firm's own funds* calculated before the deduction of item 9.

#### 8 Long term *qualifying subordinated loans* (Item 12)

Loans having the characteristics prescribed by IPRU(INV) 5.2.5(1) R may be included in item 12, subject to the limits set out in paragraph (1) above.

#### 9 Qualifying arrangements (Item 14)

A *firm* may only include a *qualifying undertaking* or other arrangement in item 14 if it is a *qualifying capital instrument* or a *qualifying capital item*.

#### 10 Interim profits

*Non-trading book* interim profits may only be included in Tier 1 of the calculation if they have been independently verified by the *firm's* external auditors.

For this purpose, the auditor should normally undertake at least the following:

- (a) satisfy himself that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records;
- (b) review the accounting policies used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the *firm* in drawing up its annual financial statements;
- (c) perform analytical review procedures on the results to date, including comparisons of actual performance to date with budget and with the results of prior periods;
- (d) discuss with management the overall performance and financial position of the *firm*;
- (e) obtain adequate comfort that the implications of current and prospective litigation, all known claims and commitments, changes in business activities and provisions for bad and doubtful debts have been properly taken into account in arriving at the interim profits; and
- (f) follow up problem areas of which the auditors are already aware in the course of auditing the *firm's* financial statements.

A *firm* wishing to include interim profits in Tier 1 capital in a *financial return* should submit to the *FCA* with the *financial return* a verification report signed by its auditor which states whether the interim results are fairly stated.

Profits on the sale of capital items or arising from other activities which are not directly related to the *designated investment business* of the *firm* may also be included within the calculation of *financial resources* if they can be separately verified by the *firm's* auditors. In such a case, such profits can form part of the *firm's* Tier 1 capital as audited profits.

#### 11 Illiquid assets (Item 15)

Illiquid assets comprise:

- (a) tangible fixed assets;

Note

In respect of tangible fixed assets purchased under finance leases the amount to be deducted as an illiquid asset shall be limited to the excess of the asset over the amount of the related liability shown on the balance sheet.

- (b) holdings in, including subordinated loans to, *credit* or *financial institutions* which may be included in the *own funds* of such *institutions* unless they have been deducted under item 9;

- (c) any *investment* in undertakings other than *credit institutions* and other *financial institutions* where such *investments* are not readily realisable;
- (d) any deficiency in net assets of a *subsidiary*;
- (e) deposits not available for repayment within 90 days or less (except for payments in connection with margined futures or options contracts);

**Note**

Where cash is placed on deposit with a maturity of more than 90 days but is repayable on demand subject to the payment of a penalty, then this is not required to be deducted as an illiquid asset but a deduction is required for the amount of the penalty.

- (f) loans, other debtors and accruals not falling due to be repaid within 90 days or which are more than one month overdue by reference to the contractual payment date;
- (g) physical stocks;
- (h) prepayments to the extent that the period of prepayment exceeds thirteen weeks; and
- (i) if not otherwise covered, any holding in eligible capital instruments of an insurance undertaking, insurance holding company, or reinsurance undertaking that is a *subsidiary* or *participation*. Eligible capital instruments include ordinary share capital, cumulative preference shares, perpetual securities and long-term subordinated loans, that are eligible for insurance undertakings under *GENPRU 2* or, as the case may be, *INSPRU 7*.

## 2.3 Application of certain rules in the interim prudential sourcebook for investment businesses

### 2.3.1

FCA

R

- (1) The following *rules* in the Interim Prudential sourcebook for investment businesses apply to a *firm* in respect of *qualifying subordinated loans, qualifying undertakings* and records:
  - (a) ■ IPRU(INV) 5.2.5(1), (2) and (4) to (7) R; and
  - (b) ■ IPRU(INV) 5.2.6(3) R .
- (2) References in those *rules* to:
  - (a) ■ IPRU(INV) Table 5.2.2(1) R are to be construed as references to ■ UPRU Table 2.2.1 R;
  - (b) ■ IPRU(INV) 5.2.3(1) R are to be construed as references to ■ UPRU 2.1.1 R; and
  - (c) ■ IPRU(INV) 5.2.1(2) are to be construed as references to ■ UPRU 2.1.1 R.



## 2.4 Records

2.4.1

FCA

**R**

A *firm* must ensure that proper accounting records are kept in English to show and explain the *firm's own account transactions*.



## Prudential sourcebook for UCITS Firm

### UPRU TP 1 Transitional Provisions for UPRU

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
[deleted]	[deleted]	[deleted]	[deleted]	[deleted]	[deleted]



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## Prudential sourcebook for UCITS Firm

### Schedule 1 Record keeping requirements

#### Sch 1.1 G

**FCA**

Handbook refer- ence	Subject of record	Contents of record	When record must be made	Retention peri- od
UPRU 2.4.1 R	accounting records	proper accounting records to show and explain the <i>firm's own account transactions</i>	not specified	not specified



## Prudential sourcebook for UCITS Firm

### Schedule 2 Notification requirements

#### Sch 2 G

There are no reporting requirements in this sourcebook.



## Prudential sourcebook for UCITS Firm

### Schedule 3 Fees and other required payments

#### Sch 3 G

There are no requirements for fees or other payments in this sourcebook.



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## Prudential sourcebook for UCITS Firm

### Schedule 4 Powers exercised

#### Sch 4.1 G

The following powers and related provisions in or under the *Act* have been exercised by the *FSA* to make the *rules* in *UPRU*:

Section 138 (General rule-making power)

Section 140 (Restrictions on managers of authorised unit trust schemes)

Section 156 (General supplementary powers)

Section 242 (Applications for authorisation of unit trust schemes)

Section 247 (Trust scheme rules)

Section 248 (Scheme particulars rules)

Regulations 6 (*FSA* rules) and 12 (Applications for authorisation) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228)

#### Sch 4.2 G

The following powers in the *Act* have been exercised by the *FSA* to give the *guidance* in *UPRU*:

Section 157(1) (Guidance)



## Prudential sourcebook for UCITS Firm

### Schedule 5 Rights of action for damages

#### Sch 5.1 G

**FCA**

The table below sets out the rules in this sourcebook 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.

1. If a Yes appears in the column headed For private person, the rule may be actionable by a private person under Section 138D unless a Yes appears in the column headed Removed. 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.
2. In accordance with The Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001\2256), a private person is:
  - (1) any individual, except when acting in the course of carrying on a regulated activity; and
  - (2) any person who is not an individual, except when acting in the course of carrying on business of any kind;

but does not include a government, a local authority or an international organisation.
3. The column headed "For other person?" indicates whether the rule is actionable by a person other than a private person, in accordance with those Regulations. If so, an indication of the type of person by whom the rule is actionable is given.

#### Sch 5.2 G

**FCA**

Actions for damages: the Prudential sourcebook for UCITS Firms

Right of action under Section 138D					
Chapter/Appendix	Section/Annex	Paragraph	For private person	Removed	For other person?
All rules in this sourcebook			No	No	No



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## Prudential sourcebook for UCITS Firm

### Schedule 6 Rules that can be waived

#### Sch 6.1 G

##### FCA

1. The rules in this sourcebook can be *waived* by the *FCA* under Sections 138A and 138B or 250 of the *Act* (Modification or waiver of rules) or regulation 7 of the *OEIC Regulations* (Modification or waiver of *FCA* rules).
2. Although the *FCA* has the formal power of *waiver* under the *Act* in relation to these *rules*, much of this sourcebook implements the requirements of the *UCITS Directive* by ensuring that *UCITS firms* as *UCITS management companies* comply with such requirements. Accordingly, while formal power may exist to waive such *UCITS Directive* derived rules, the *FCA's* ability to do so is severely constrained.

# **Interim Prudential Sourcebook**

## **Friendly Societies**



# THE INTERIM PRUDENTIAL SOURCEBOOK FOR FRIENDLY SOCIETIES

## GUIDANCE: THE PURPOSE OF THE PRUDENTIAL RULES FOR FRIENDLY SOCIETIES AND AN OVERALL DESCRIPTION

- 1      The prudential rules for a *friendly society* are to be seen in the context of the Principles for Businesses. These are high level obligations applying to all authorised persons and are set out in the High Level Standards part of the *Handbook* (PRIN).
- PRA**
- 2      So far as a *friendly society* is concerned, the Principles for Businesses are particularly relevant to its internal systems and controls. Principle 3, for example, requires a firm to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. Principle 4 requires a firm to maintain adequate financial resources.
- PRA**
- 3      In addition to the general obligations placed on a *friendly society*, certain staff of all authorised persons are subject to a number of high level obligations, referred to as Statements of Principle. The FSA has issued a Code of Practice to help determine whether an approved person's conduct has complied with a Statement of Principle. The Statements and the Code are set out in the High Level Standards part of the Handbook (APER).
- PRA**
- 4      One of the features of a *contract of insurance* is the long period of risk the contract may cover. The prudential rules for *friendly societies* seek to protect the *policyholder* against the risk that a *friendly society* will fail to meet a valid claim as it falls due.
- PRA**
- 6      Chapter 2 covers compliance and supervision of *registered branches* and *subsidiaries* and jointly controlled bodies.
- PRA**
- 7      Chapter 3 focuses on systems and controls. *Friendly societies* should also refer to the provisions on senior management arrangements, systems and controls in the High Level Standards part of the *Handbook* (SYSC) and to Annex 3 of *IPRU(FSOC)*.
- PRA**
- 8      The rules in Chapter 4 set out the *required margins of solvency* for a *friendly society* having regard to the type of its business.
- PRA**
- 9      The extent to which an asset may be taken into account for prudential purposes, and the method of valuing it, is determined in accordance with the rules in the Appendices. It is a fundamental part of the approach to prudential regulation for *friendly societies* that the rules limit the assets which are 'admissible' for solvency purposes and specify the methods of valuation. Similarly, the amount of a liability is determined in accordance with the rules in the Appendices.
- PRA**
- 11     As part of the continuing supervision of a *friendly society*, the rules in Chapter 5 require the
-

**PRA** *friendly society* to prepare certain accounts and statements in accordance with the rules and deposit them with the *PRA*.

12 Chapter 7 contains the definitions used throughout *IPRU(FSOC)* and some general provisions.

**PRA**

13 Chapter 8 contains transitional provisions.

**PRA**

14 The Appendices are part of the rules.

**PRA**

15 *Guidance* is set out in the Annexes and *friendly societies* may also wish to refer to the guidance in *IPRU(INS)*, *GENPRU* and *INSPRU*.

**PRA**

# INTERIM PRUDENTIAL SOURCEBOOK FOR FRIENDLY SOCIETIES

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| <b>Appendix 1</b>  | <b>Long-term insurance business: margin of solvency</b>  |
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| <b>Appendix 3</b>  | <b>[deleted]</b>   |
| <b>Appendix 4</b>  | <b>Asset valuation rules</b><br><br>Annex A: [deleted]<br><br>Annex B: Assets to be taken into account only to a specified event |
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## List of Annexes

### *FSA Guidance Notes*

- Annex 1**                    **Guidance on corporate governance of friendly societies**  
**[Deleted]**
- Annex 2**                    **Guidance on officers' liability insurance**
- Annex 3**                    **Part I: Guidance on systems of accounting, control of business and inspection and report**  
  
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Attachment A - Business Planning  
  
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- Annex 4**                    **Guidance on margins of solvency and the guarantee fund**
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# 1 Chapter 1: Application

## APPLICATION

1.1 These rules apply to a *non-directive friendly society* which has permission under the *Act* to effect or carry out *contracts of insurance*.

FCA PRA

1.1A The rules in Chapters 1, 2, 3 (with the exception of rule 3.1(7)), rule 4.20, rule 5.1A, Chapters 7 and 8 also apply to a *directive friendly society* which has permission under the *Act* to effect or carry out *contracts of insurance*.

FCA PRA

*Actions for damages*

1.2 Section 138D(2) of the *Act* does not apply.<sup>1</sup>

FCA PRA

*Restriction of business to insurance*

1.3 [deleted]

<sup>1</sup> A private person therefore has no right of action under this section against a *friendly society* for breach of the prudential rules.



## 2 Chapter 2: Integrity, Skill, Care and Diligence

### LEGAL COMPLIANCE

2.1 A *friendly society* must take reasonable steps to ensure that –

- |     |     |
|-----|-----|
| FCA | PRA |
|-----|-----|
- (a) it does not carry on activities beyond its powers;
  - (b) it and its *registered branches* comply with –
    - (i) any requirements of or under the *1992 Act* or the *Act* which relate to the conduct of its *insurance business*, and
    - (ii) any requirement (whether of the law of any part of the United Kingdom or of the law of another *EEA State*) which gives effect to the *insurance Directives* or is otherwise applicable to the insurance activities of the *friendly society*.

### SUPERVISION OF SUBSIDIARIES AND JOINTLY-CONTROLLED BODIES

2.2 (1) A *friendly society* must supervise the activities –

- |     |     |
|-----|-----|
| FCA | PRA |
|-----|-----|
- (a) of any *subsidiary* or of any body of which the *friendly society* has joint control; and
  - (b) of any *registered branch* of the *friendly society*;
- with due care and diligence, having due regard to the interests of its *policyholders* and without detriment to the conduct of the *friendly society's* activities.

2.3 (1) A *friendly society* should ensure that its *subsidiaries, jointly controlled bodies, or registered branches* are –

- |     |     |
|-----|-----|
| FCA | PRA |
|-----|-----|
- (a) directed and managed with prudence, integrity and adequate professional skill; and
  - (b) comply with any applicable requirements of or under the *Act* and the *1992 Act*.
- (2) Contravention of (1) may be relied upon as tending to establish contravention of rule 2.2.



### 3 Chapter 3: Management and Control

#### ACCOUNTING RECORDS AND SYSTEMS OF CONTROL

- 3.1 (1) Every *friendly society* must and must procure that every *registered branch* –
- |     |     |
|-----|-----|
| FCA | PRA |
|-----|-----|
- (a) keep (or keeps) adequate accounting records; and
- (b) establish and maintain (or establishes and maintains) adequate systems of control of its business and records and of inspection and report.
- (2) The accounting records must be sufficient to –
- (a) comply with the requirements of section 68 of the *1992 Act*; and
- (b) enable the *friendly society* acting through the *committee* properly to discharge the duties imposed on it and them by or under the *1974 Act*,
- as the case may be.
- (3) The systems of control which are to be established and maintained by a *friendly society* or a *registered branch* are systems for the control of the conduct of their activities in accordance with the *Act* and the *1992 Act* and the decisions of the *committee*, and for the control of the accounting and other records of its activities.
- (4) The system of inspection and report which is to be established and maintained by a *friendly society* or *registered branch* is a system of inspection on behalf of and report to the *committee* on the operation of the systems of control required by (1)(b).
- (5) The systems of control and of inspection and report must be adequate to enable the *committee* properly to discharge the duties imposed on it by or under the *Act*, the *1992 Act* or the *1974 Act* and the functions of direction of the affairs of the *friendly society* or *registered branch*. No such system of control will be treated as adequate unless there is kept available to the *committee* a detailed statement in writing of the system as in operation for the time being.
- (6) Without prejudice to the generality of (5), the systems of control and of inspection and report must be such as to secure that the activities of the *friendly society* or *registered branch* are so conducted and its records so kept that –
- (a) the information necessary to enable the *committee* to discharge its duties and functions is sufficiently accurate, and is available with sufficient regularity or at need and with sufficient promptness, for those purposes; and

- (b) the information regularly obtained by or furnished to the *appropriate regulator* under or for the purposes of this *Act* or the *1992 Act* is sufficiently accurate for the purpose for which it is obtained or furnished and is furnished at the regularity required by or under the *Act* or the *1992 Act*.
- (7) Every *non-directive friendly society* must within the period of 6 months beginning with the end of each *financial year* make and send to the *appropriate regulator* a statement of their opinion whether the requirements of this rule have been complied with in respect of that year by the *friendly society* and the statement must be signed by the chairman on behalf of the *committee* and by the chief executive.<sup>3</sup>

**3.2** [deleted]<sup>3</sup>

<sup>3</sup>See SUP 16.3.6 to 16.3.10R for rules on the submission of periodic reports.

## 4 Chapter 4: Financial Prudence

### I. MARGINS OF SOLVENCY

#### *Basic requirement<sup>4</sup>*

- 4.1 PRA
- (1) Subject to (3), a *friendly society* (other than a *flat rate benefits business friendly society*) must maintain a *margin of solvency* equal to or greater than the *required margin of solvency* calculated in accordance with rules 4.2 to 4.10.
  - (2) Where a *friendly society* carries on both *long-term insurance business* and *general insurance business*, (1) has effect as if the requirement to maintain a margin of solvency were a requirement to maintain separate margins in respect of the two kinds of business.
  - (3) As long as the society maintains an excess of the value of its assets over the amount of its liabilities, (1) does not apply to a *non-directive friendly society* which does not have permission to effect *contracts of insurance* and is only carrying out contracts of *long-term or general insurance business* which were effected before 13 September 1993 (or effected pursuant to the terms of such a contract).
  - (4) A margin of solvency is the excess of the value of the *friendly society's* assets over the amount of its liabilities, that value and amount being determined in accordance with the *asset valuation rules* and *liability valuation rules* and rule 4.7.

<sup>4</sup>The requirement for a plan for the restoration of a sound financial position to be submitted by a *friendly society* which breaches this rule is in SUP, App II

#### *Calculating the required margin of solvency*

- 4.2 PRA
- (1) Subject to (2) to (7), the *required margin of solvency* must be determined –
    - (a) with respect to a *friendly society* which carries on *long-term insurance business*, in accordance with Appendix 1; and
    - (b) with respect to a *friendly society* which carries on *general insurance business*, by taking the greater of:
      - (i) the higher of the two sums resulting from the application of the method of calculation set out in Part I of Appendix 2, and
      - (ii) the sum resulting from the application of the method of calculation set out in Part II of Appendix 2.
  - (2) For a *contract of insurance* to which rule 7.6(a) applies, the *required margin of solvency* must be determined by taking the aggregate of the results arrived at by applying –

- (a) in the case of so much of the contract as is within any *class of long-term insurance business*, the appropriate method under Appendix 1 for that *class*; and
  - (b) in the case of so much of the contract as is within *general insurance business class 1 or 2*, the method of calculation set out in (1)(b).
- (3) Where a *friendly society* carries on *long-term insurance business* and owing to the nature of that business more than one *required margin of solvency* is produced in respect of that business by the operation of these rules, the margins in question must be aggregated.
- (4) Where a *friendly society* carries on both *long-term insurance business* and *general insurance business* and is accordingly required to maintain separate margins of solvency in respect of the two kinds of business –
  - (a) the provisions in (1) to (3) apply for determining the *required margin of solvency* for each kind of business separately; and
  - (b) assets other than those representing the funds maintained by the *friendly society* in respect of its *long-term insurance business*, if they are not included among the assets covering the liabilities and the *required margin of solvency* relating to the *friendly society's general insurance business*, may be included among the assets taken into account in covering the liabilities and the *required margin of solvency* for the *friendly society's long-term insurance business*.
- (5) Subject to (6), in each case in which (1)(b) applies, if the *required margin of solvency* under (1)(b) is lower than the *required margin of solvency* of the preceding *financial year*, then the *required margin of solvency* must be adjusted so it is at least equal to the *required margin of solvency* of the preceding *financial year* multiplied by the ratio of the amount of the *technical provisions* for *claims* outstanding at the end of the preceding *financial year* and the amount of the *technical provisions* for *claims* outstanding at the beginning of the preceding *financial year*.
- (6) For the purpose of (5) –
  - (a) *technical provisions* must not be discounted, or reduced, to take account of investment income, unless –
    - (i) they relate to risks in *classes 1 or 2*; or
    - (ii) they are reduced to reflect the discounting of annuities; and
  - (b) *technical provisions* must be calculated net of reinsurance; but
  - (c) the ratio must not be higher than 1.

- (7) Where the nature or quality of reinsurance relied on to reduce the *required margin of solvency* changes significantly during the *financial year*, a *friendly society* must notify the *PRA* forthwith of the change.

*The guarantee fund<sup>5</sup>*

4.3 A *non-directive incorporated friendly society* must ensure that its *margin of solvency* does not fall below the *guarantee fund*.

PRA

*Calculating the guarantee fund*

4.4 (1) Subject to (2) to (5), one-third of the *required margin of solvency* constitutes the *guarantee fund*.

PRA

(2) In the case of a *friendly society* which is a *non-directive incorporated friendly society* the *guarantee fund* must not be less than an amount (the *minimum guarantee fund*) arrived at in accordance with rule 4.5 for *long-term insurance business* and rule 4.6 for *general insurance business*, whether the *required margin of solvency* is greater or less than that amount.

(3) In the case of *long-term insurance business*, items that are not *implicit items* must be at least large enough to cover either the *minimum guarantee fund* or 50% of the *guarantee fund*, whichever is the greater.

(4) In the case of *general insurance business*, the unpaid initial fund of a *friendly society* and, in the case of a *friendly society* with variable contributions, any claim which the *friendly society* has against its members by way of a call for supplementary contributions for a *financial year* may not be taken into account in complying with (1).

<sup>5</sup>The requirement for a short term plan to be submitted by a *friendly society* which breaches this rule is imposed by *SUP*, App 2

- (5) In the case of *long-term insurance business*, the unpaid initial fund of a *friendly society* and *implicit items* which relate to future profits and *zillmerising* may not be taken into account in complying with (1).

*Minimum guarantee fund: long-term insurance business*

4.5 (1) [deleted]

PRA

(2) For a *non-directive incorporated friendly society*, in the *financial year* during which the *friendly society* first obtains permission under the *Act* to carry on *long-term insurance business*, the *minimum guarantee fund* is the amount in column 2 of the table, which corresponds to the *friendly society's annual contribution income* in respect of that business in the last preceding *financial year*, as shown in column 1 of the table.

Contribution Income (in Euro)	Minimum guarantee fund (in Euro)
1,000,000 or less	115,000

1,000,001 - 1,500,000	230,000
1,500,001 - 2,000,000	350,000
2,000,001 - 2,500,000	460,000
2,500,001 - 3,000,000	580,000
3,000,001 or more	700,000

But where the *friendly society* had no *annual contribution income* in respect of *long-term insurance business* in the last preceding *financial year* or has not been in existence long enough to have a preceding *financial year*, the *minimum guarantee fund* is 115,000 Euro.

- (3) In any subsequent *financial year* during which a *non-directive incorporated friendly society* has permission to carry on *long-term insurance business*, the *minimum guarantee fund* is the greater of either –
- (a) the amount in column 2 of the table in (2) that corresponds to the *friendly society's annual contribution income* in respect of *long-term insurance business* in the last preceding *financial year*; or
  - (b) the amount of the *minimum guarantee fund* required to be maintained by the *friendly society* in the last preceding *financial year*.
- (4) Where a *non-directive incorporated friendly society* obtains permission under the *Act* (or has obtained permission under the *Act* or authorisation under its predecessor legislation) to carry on *long-term insurance business*–
- (a) of a *class* additional to that in respect of which it already has permission; or
  - (b) in a part of the United Kingdom additional to that in respect of which it already has permission,
- a *minimum guarantee fund* of 700,000 Euro must be maintained by that *friendly society* for the whole of its *long-term insurance business* (that is to say, not only for the additional business carried on but also for the business previously carried on).

*Minimum guarantee fund: general insurance business*

4.6

(1) [deleted]

PRA

(2) For *non-directive incorporated friendly societies*, the *minimum*

*guarantee fund for general insurance business* is 260,000 Euro.

(3) [deleted]

(4) [deleted]

(5) [deleted]

*Valuation of solvency margins*

4.7

PRA

- (1) Where a *friendly society* has assets equal to or in excess of its liabilities as valued in accordance with the *asset valuation rules* and *liability valuation rules*, then (2) to (5) have effect for determining the extent to which the value of the assets exceeds the amount of liabilities in connection with the *margin of solvency*, the *required margin of solvency*, the *guarantee fund* and the *minimum guarantee fund*.
- (2) In the case of a *friendly society* with variable contributions carrying on *general insurance business*, any claim which a *friendly society* has against its members by way of a call for supplementary contributions for a *financial year* must be treated as having no value.
- (3) The items which relate to future surpluses, *zillmerising* and hidden reserves (referred to as implicit items) must be treated as having no value. A *friendly society* which applies for a waiver of this rule under section 138A of the *Act* with respect to future profits must submit with the application for waiver:
- (a) an actuarial report substantiating the likelihood of the emergence of the future profits in the future; and
  - (b) a plan as to how it intends to comply with the future limits on, and termination of use of, implicit items for future profits required by the Life Directive (2002/83/EC).
- (4) The unpaid initial fund of a *friendly society* must be treated as having no value.
- (5) Subject to (6), in the case of a *friendly society* which discounts or reduces its *technical provisions* for *claims* outstanding to take account of investment income as permitted by article 60(1)(g) of the *Insurance Accounts Directive*, the *margin of solvency* must be reduced by the difference between: -
- (a) the undiscounted *technical provisions* for *claims* outstanding or the *technical provisions* for *claims* outstanding before deductions; and
  - (b) the discounted *technical provisions* for *claims* outstanding or the *technical provisions* for *claims* outstanding after deductions.

For these purposes, *technical provisions* must be calculated net of *reinsurance*.

- (6) (5) does not apply to risks in *classes 1 or 2* or in respect of the discounting of annuities.
- (7) For the purposes of the rules in Chapter 4 and the definition of *non-directive friendly society*, the exchange rate from the Euro to the pound sterling for each year beginning on 31 December is the rate applicable on the last day of the preceding October for which the exchange rates for the currencies of all the European Union member states were published in the Official Journal of the European Union.

4.8 – 4.10 [Moved to Annex 4]

PRA

## II. ADEQUACY OF ASSETS

4.11 Except for rule 4.24, which applies to all *friendly societies*, the remaining rules in this chapter do not apply to *registered friendly societies*.

FCA PRA

4.12 (1) A friendly society must secure-

FCA PRA

- (a) that its liabilities under *contracts of insurance*, other than liabilities in respect of *linked benefits*, are covered by assets of appropriate safety, yield and marketability having regard to the *classes of business carried on*; and
- (b) without prejudice to the generality of (a), that its investments are appropriately diversified and adequately spread and that excessive reliance is not placed on investments of any particular category or description.
- (2) A *friendly society* which has entered into a *linked long-term contract* must secure that, as far as practicable, its liabilities under the contract in respect of *linked benefits* are covered as follows-
- (a) if those benefits are linked to the value of units in an undertaking for collective investments in transferable *securities* or to the value of assets contained in an internal fund, by those units or assets;
- (b) if those benefits are linked to a share index or other reference value not mentioned in (a), by units which represent that reference value, or by assets of appropriate safety, yield and marketability which correspond, as nearly as may be, to the assets on which that reference value is based<sup>6</sup>.
- (3) A *friendly society* which has entered into a *linked long-term contract* must also secure that its liabilities under the contract in respect of

*linked benefits* which are not covered by contracts of reinsurance are covered by assets of a description contained in COBS 21.3.1R.

- (4) In (3), "*linked long-term contract*" does not include a *pension fund management contract* unless it is combined with a *contract of insurance* covering either conversation of capital or payment of a minimum interest.

### III. ADEQUACY OF PREMIUMS

4.13 [deleted]

### IV. CURRENCY MATCHING AND LOCALISATION

4.14 [deleted]

4.15 [deleted]

4.16 [deleted]

4.17 [deleted]

4.18 [deleted]

4.19 [deleted]

<sup>6</sup>See paragraph 2 of Guidance Note 4.4 *IPRU (INS)*.

### V. SEPARATION BETWEEN LONG-TERM INSURANCE BUSINESS ASSETS AND OTHER ASSETS

4.20 A *friendly society* which has permission to carry on *long-term insurance business* must –

FCA | PRA

- (a) secure that the assets representing the funds maintained by the *friendly society* in respect of its *long-term insurance business* are only applicable for the purposes of that business; and
- (b) ensure that adequate arrangements are in force for securing that transactions affecting the assets of the *friendly society* (other than transactions outside its control) do not operate unfairly between the assets representing the funds maintained by the *friendly society* in respect of its *long-term insurance business* and the other assets of the *friendly society*.

4.21 [deleted]

4.22 [deleted]

4.23 [deleted]

VI. LIQUIDITY

4.24 **A *friendly society* must maintain liquid assets sufficient to meet its liabilities as they become due.**

PRA

## 5 Chapter 5: Prudential Reporting

### ANNUAL ACTUARIAL INVESTIGATION

5.1

PRA

(1) **A friendly society which is a non-directive incorporated friendly society (other than a flat rate benefits business friendly society), must cause an investigation to be made, in accordance with the methods and assumptions determined by the friendly society, by the person or persons who for the time being are appointed to perform the actuarial function under the rules in SUP into the financial condition of the friendly society in respect of its long-term insurance business as at the end of each financial year.**

(2) **When such an investigation has been made, or when at any other time an investigation into the financial condition of the friendly society in respect of its long-term insurance business has been made with a view to the distribution of profits, or the results of which are made public the friendly society must –**

(a) **cause an abstract of the report of the investigation to be made; and**

(b) **deposit three copies of that abstract with the PRA within 6 months of the end of the financial year to which it relates,**

**and one of those copies must be signed as required by rule 5.12. The copies must be sent to Insurance Returns, Regulatory Data Group, Statistics and Regulatory Data Division (HO5 A-B), Bank of England, Threadneedle Street, London EC2R 8AH (and must not be addressed to the friendly society's normal supervisory contact).**

(3) **An investigation under this rule must include –**

(a) **a determination of the liabilities of the friendly society attributable to its long-term insurance business; and**

(b) **a valuation of any excess over those liabilities of the assets representing the fund or funds maintained by the friendly society in respect of that business and, where any rights of any long-term policyholders to participate in profits relate to particular parts of such a fund, a determination of any excess of assets over liabilities in respect of each of those parts.**

(4) **Rules 5.5 to 5.12 apply in respect of the abstract required by (2)(a) (referred to as the “FSC1 return”).**

(5) **A friendly society that submits an FSC1 return in respect of the financial year ending on 31 December 2003 must also send to its normal supervisory contact at the PRA, by 30 June 2004, Form 60 and associated Forms 11 and 12 as amended by the Interim Prudential Sourcebook for Friendly Societies (Solvency I Directive) Instrument 2003 and the Interim Prudential Sourcebook for Friendly Societies**

(Amendment of Form 12) Instrument 2004.

- 5.1A (1) **A *directive friendly society* must comply with rules 9.1 to 9.36, 9.37, and 9.39 of *IPRU (INS)* as if references to an *insurer* in those rules included a *directive friendly society*.**
- PRA
- (2) **In relation to a *directive friendly society*, references in Form 13, 14, and 15 in Appendix 9.1 of *IPRU (INS)* to the *insurance accounts rules* must be taken as referring to the *Accounts Regulations*.**

#### TRIENNIAL ACTUARIAL INVESTIGATION

- 5.2 (1) **Subject to (1A) and at least once in every *period* of 3 years, a *friendly society* (other than a *flat rate benefits business friendly society*) which –**
- PRA
- (a) **is a *non-directive unincorporated friendly society* must cause an investigation to be made by the *appropriate actuary* into the financial condition of the *friendly society* in respect of its *insurance business*; and**
- (b) **is a *non-directive incorporated friendly society* must cause an investigation to be made by the *appropriate actuary* into the financial condition of the *friendly society* in respect of its *general insurance business*.**
- (1A) (1)(a) **does not apply to a *partnership pension society*.**
- (2) **Subject to (8) or (9), when an investigation under this rule has been made, the *friendly society* must –**
- (a) **cause an abstract of the actuary's report of the investigation to be made; and**
- (b) **deposit three copies of that abstract with the *PRA* within 6 months of the end of the *period* to which it relates,**
- and one of those copies must be signed as required by rule 5.20. The copies must be sent to Insurance Returns, Regulatory Data Group, Statistics and Regulatory Data Division (HO5 A-B), Bank of England, Threadneedle Street, London EC2R 8AH (and must not be addressed to the *friendly society's* normal supervisory contact).**
- (3) **Subject to (4), a *friendly society* must deposit with the *PRA*, not later than 6 months after each anniversary of the date to which the accounts of the *friendly society* were made up for the purposes of the last investigation into its financial condition under this rule –**
- (a) **a certificate given by the *appropriate actuary*, in the format of Form FSC4, that there has been no material change in its financial condition in respect of its insurance business since it**

sent the last abstract under (2); or

- (b) a statement by the *appropriate actuary* that he is unable to give such a certificate.<sup>7</sup>
- (4) A *friendly society* is not under the duty imposed by (3)(b) if, before a date by which a certificate or statement must be deposited, a further investigation under this rule has been carried out and the requisite abstract has been deposited with the *PRA*.
- (5) If a *friendly society* deposits with the *PRA* a statement under (3)(b), the *friendly society* must cause an investigation to be carried out under this rule, and in such a case –
  - (a) the date to which the *friendly society's* accounts are made up for the purposes of the investigation must be the latest anniversary of the date to which its accounts were made up for the purposes of the last investigation under this rule; and
  - (b) the abstract required by (2) must be deposited with the *PRA* within 6 months of the date by which that statement was required to be deposited under (3).
- (6) An investigation under this rule into the financial condition of a *friendly society* which falls within (1)(a) must include –
  - (a) a valuation of the liabilities of the *friendly society* attributable to its *insurance business*; and
  - (b) a determination of any excess over the liabilities so attributable of the assets representing the fund or funds maintained by the *friendly society* in respect of its *insurance business* and, where any rights of any long-term *policyholders* to participate in profits relate to particular parts of such a fund, a determination of any excess of assets over liabilities in respect of each of those parts.
- (7) An investigation under this rule into the financial condition of a *friendly society* falling within (1)(b) must include –
  - (a) a valuation of the liabilities of the *friendly society* attributable to its *general insurance business*; and
  - (b) a determination of any excess over the liabilities so attributable of the assets representing the fund or funds maintained by the *friendly society* in respect of that business.
- (8) A *non-directive unincorporated friendly society* must complete an abstract in the Form required under rule 5.13 (referred to as the “FSC2 return”).
- (9) A *non-directive incorporated friendly society* (other than a *flat rate benefits business friendly society*) which is carrying on *general insurance business* must complete an abstract in the Form required

under rules 5.14 to 5.19 (referred to as the “FSC3 return”).

(10) **A *friendly society* that submits an FSC3 return in respect of the *financial year* ending on 31 December 2003 must also send to its normal supervisory contact at the *PRA*, by 30 June 2004: -**

- (a) **Forms 11 and 12 as amended by the Interim Prudential Sourcebook for Friendly Societies (Solvency I Directive) Instrument 2003 and the 31 December 2010 22 Interim Prudential Sourcebook for Friendly Societies (Amendment of Form 12) Instrument 2004; and**
- (b) **the amounts at line 12 of amended Form 15 and line 61 of amended Form 13, if these lines contain amounts different from the amounts at the same lines of the un-amended forms.**

<sup>7</sup>Ibid.

#### ***Correction of abstracts***

5.3

**PRA**

- (1) **If within 24 months of the date of deposit, the *PRA* notifies the *friendly society* that any Form (including any supplementary note to a Form) included in the FSC1, FSC2 or FSC3 return appears to it to be inaccurate or incomplete, the *friendly society* must consider the matter and within one month of the date of notification it must correct any inaccuracies and make good any omissions and deposit the relevant parts of the documents again.**
- (2) **One of the copies referred to in (1) must be signed –**
  - (a) **by the *appropriate actuary* if the Form is the actuary’s certificate;**
  - (b) **by the auditor if the Form is the auditor’s report;**
  - (c) **in the case of all other Forms by the chief executive, the secretary and one *committee* member of the *friendly society* (or two members of the *committee* if the offices of chief executive and secretary are held by the same person).**

#### ***The FSC1 return***

5.5

**PRA**

- (1) **The FSC1 return must include:**
  - (a) **Form FSC1**
  - (b) **a balance sheet;**
  - (c) **revenue accounts;**
  - (d) **a valuation abstract;**

- (e) a certificate and a statement that the *friendly society* consents to the FSC1 return being placed on its *public file*; and
- (f) a report of the auditors.

(2) Rules 5.6 to 5.12 apply to the preparation of the FSC1 return.

*Balance sheet*

5.6

PRA

- (1) The balance sheet must consist of Forms 9, 13, 14, 15 and 17 (as appropriate) prepared in accordance with the instructions in Appendix 6.
- (2) Form 13 must be completed in respect of –
  - (a) the total *long-term insurance business* assets of the *friendly society*; and
  - (b) the *long-term insurance business* assets appropriated by it in respect of each separate *long-term insurance business* fund or group of funds for which separate assets have been appropriated.
- (3) A separate Form 13 must be completed in respect of its total assets other than *long-term insurance business* assets and its corresponding liabilities must be shown in Form 15.
- (4) Form 14 must be completed in respect of –
  - (a) the total *long-term insurance business liabilities* and margins of the *friendly society*; and
  - (b) the *long-term insurance business liabilities* and margins for each separate *long-term insurance business* fund or group of funds for which separate assets have been appropriated.

5.7

PRA

For each Form 13 which a *friendly society* is required to complete in accordance with rule 5.6(2) and (3), it must complete Form 17 in respect of the same business; except that where in respect of that Form all amounts required to be shown would be zero and no supplementary note would be required, Form 13 may instead be accompanied by a supplementary note to that effect and Form 17 may be omitted.

*Revenue Account*

5.8

PRA

- (1) The revenue account must consist of Forms 40, 40A, 40B and 40C (as appropriate) prepared in accordance with the instructions in Appendix 8 and so that –
  - (a) a separate Form 40 is prepared in respect of each *long-term insurance business* fund, Form 40A for each other revenue account fund and Form 40B for each management fund

maintained;

- (b) where there is more than one fund for ordinary *long-term insurance* business or for *industrial assurance business*, the *friendly society* must also complete a summary Form for ordinary *long-term insurance business* or for *industrial assurance business*, as the case may require; and
  - (c) where there is more than one fund for other revenue account funds the *friendly society* must also complete a summary Form.
- (2) The revenue account must also include Forms 41 to 45 prepared separately in respect of ordinary *long-term insurance business* and *industrial assurance business* and in accordance with the instructions in Appendix 8.

*Valuation abstract*

- 5.9 The valuation abstract must consist of Forms 46 to 49, 51 to 58, 60, 11, 12 and 61A (as appropriate) prepared in accordance with the instructions in Appendix 9.

PRA

*Certificate*

- 5.10 A *friendly society* must ensure that a certificate is given in the terms, as appropriate, of Form 61B.

PRA

*Auditor's Report*

- 5.11 (1) The auditor's report in Form 61C must state whether in his opinion the balance sheet, revenue accounts, valuation abstract and certificate (Forms 9 to 45, 48, 49, 56, 58 and 60, including any supplementary notes) and information relating thereto have been properly prepared and presented in accordance with the rules in chapters 4 & 5.
- (1A) To the extent that the auditor's opinion relates to matters covered by the investigation in rule 5.1
- (a) the *friendly society* must ensure that the auditor takes appropriate advice from a suitably qualified *actuary* who is independent of the *friendly society*;
  - (b) the auditor's report in Form 61C must include a statement that the auditor has taken such advice.
- (2) [deleted]
- (3) In giving the opinion in Form 61C, where the auditor undertaking the central audit has relied on work done at the branches by other firms of accountants, he must state that he has relied on other accountants for this work. In this case, he must ensure that a list of these firms is appended together with details of the particular branches for which they

undertook the audit.

- (4) Where the auditor refers in his report or any note attached thereto to any uncertainty, the report must state whether, in the auditor's opinion, that uncertainty is material to determining whether the *friendly society* has available assets in excess of its *required minimum margin*.

#### *Signatures*

5.12 (1) [deleted]

PRA

- (2) The auditor must sign the report in Form 61C.
- (3) The FSC1 Return must be signed, in Form 61B, by the chief executive, the secretary and one *committee* member of the *friendly society* (or two members of the *committee* if the offices of chief executive and secretary are held by the same person).

#### *FSC2 Return*

5.13 (1) The FSC2 return must include –

PRA

- (a) Forms FSC2, 9, 9A, 9B and 9C; and
  - (b) a statement that the *friendly society* consents to the FSC2 return being placed on its *public file*.
- (2) Form 9A must provide a synopsis of the report by the *appropriate actuary* into the investigation into the financial condition of the *friendly society* in respect of its *insurance business* including the statements, information and comments set out in that Form, together with the *appropriate actuary's* assessment of the 31 December 2010 25 financial viability of the *friendly society* and any changes that are necessary or desirable and the likely consequences of taking no action.
  - (3) The *appropriate actuary* must give and sign a certificate in the terms, as appropriate, of Form 9B.
  - (4) Form 9C must be signed by the chief executive, the secretary and one *committee* member of the *friendly society* (or two members of the *committee* if the offices of chief executive and secretary are held by the same person).

#### *FSC3 return*

5.14 (1) The FSC3 return must include:

PRA

- (a) Form FSC3
- (b) a balance sheet;

- (c) a revenue account;
- (d) a certificate by the *appropriate actuary*; and
- (e) a report of the auditors.
- (f) a statement that the *friendly society* consents to the FSC3 return being placed on its *public file*.

(2) Rules 5.15 to 5.19 apply to the preparation of the FSC3 return.

*Balance sheet*

- 5.15 (1) The balance sheet must consist of Forms 9, 11, 12, 13, 14, 15 and 17 (as appropriate) prepared in accordance with the instructions in Appendix 6.
- PRA
- (2) Form 13 must be completed in respect of *general insurance business assets*. Where a *friendly society* also carries on *long-term insurance business*, a separate Form 13 must be completed by the *friendly society* in respect of its *long-term insurance business assets* and its corresponding liabilities and margins must be shown in Form 14.

*Revenue Account and Additional Information*

- 5.16 (1) The revenue account must comply with the instructions in Appendix 7 and must be as set out in Form 20 and a *friendly society* must complete a separate account in Form 20 in respect of each *class of general insurance business* and a summary account in that Form in respect of the whole of the *general insurance business* carried on by it.
- PRA
- (2) A *friendly society* must in respect of each *class of general insurance business*, and in accordance with the instructions in Appendix 7, complete Forms 21 to 23.
- (3) Form 23A must be completed, in accordance with the instructions in Appendix 7, by a *friendly society* in respect of its *general insurance business*.

*Actuary's Certificate*

5.17 The *appropriate actuary* must give a certificate in the terms, as appropriate, of Form 23B.

PRA

*Auditor's Report*

5.18 (1) The auditor's report in Form 23C must state whether in his opinion the balance sheet, revenue accounts and *general insurance business* statements (Forms 9 to 23 including any supplementary notes) and information relating thereto have been properly prepared and presented in accordance with the rules and guidance in this part of the

PRA

*IPRU(FSOC).*

- (2) In giving this opinion, the auditor must state whether he has relied on the identity and value of any *implicit items* valued in accordance with a waiver under section 138A of the *Act*. Where the auditor undertaking the central audit has relied on work done at the branches by other firms of accountants, he must state that he has relied on other accountants for this work. In this case, he must ensure that a list of these firms is appended together with details of the particular branches for which they undertook the audit.
- (3) Where the auditor refers in his report or any note attached thereto to any uncertainty, the report must state whether, in the auditor's opinion, that uncertainty is material to determining whether the *friendly society* has available assets in excess of its *required minimum margin*.

*Signatures*

- 5.19 (1) The *appropriate actuary* must sign the certificate in Form 23B.
- PRA (2) The auditor must sign the report in Form 23C.
- (3) The FSC3 Return must be signed, in Form 23D, by the chief executive, the secretary and one *committee* member of the *friendly society* (or two members of the *committee* if the offices of chief executive and secretary are held by the same person).

*Completion of Forms*

- 5.20 Rules 5.21 to 5.24 apply to the completion of any Form to be included in the *FSC return*.

PRA

*Headings*

- 5.21 The *friendly society's* register number is to be entered on every page in the relevant box. Boxes marked 'period ended 31 December' must be completed so as to show, in numerals, the date of the last day of the *period* to which the *FSC return* relates. Boxes marked "OB/IB" must be completed to indicate whether the Form is completed in respect of ordinary assurance business (OB) or industrial assurance (IB). No entry must be made in a box which is shaded or is not labelled.

PRA

*Information to be fairly stated*

- 5.22 Every Form (including supplementary notes to Forms) required to be prepared under the rules in this chapter must fairly state the information provided in it on the basis required by the rules.

PRA

*Valuation of assets and liabilities*

- 5.23 Unless the context otherwise requires, the value or amount given for an asset or a liability of the *friendly society* included in any Form (or supplementary note to a Form) must be the value or amount of that asset or liability as

PRA

determined in accordance with the *asset valuation rules* and *liability valuation rules* in Appendices 4 and 5.

*Presentation of amounts*

5.24

Some Forms permit amounts to be entered in £000 but advantage may be taken of this only if none of the entries in the relevant Form is less than £500. All entries in a Form must be in the same monetary units. Negative amounts must be shown between round brackets.

PRA

*Intra-group transactions*

5.25

(1) If, during the *financial year* in question, a *friendly society*, has agreed to, or carried out, a *material connected-party transaction*, it must provide a brief description of that transaction by way of supplementary note to Form 20 or Form 40.

PRA

(2) The description to be provided in accordance with (2) must state –

- (a) the names of the transacting parties;
- (b) a description of the relationship between the parties;
- (c) a description of the transaction;
- (d) the amounts involved;
- (e) any other elements of the transaction necessary for an understanding of its effect upon the financial position or performance of the *friendly society*; and
- (f) amounts written off in the period in respect of *debts* due to or from *connected parties*.

(3) Transactions with the same *connected party* may be disclosed on an aggregated basis unless separate disclosure is needed for a proper understanding of the effect of the transactions upon the financial position or performance of the *friendly society*.

5.26

[deleted]

## **6 Chapter 6**

[deleted]



## 7 Chapter 7: Definitions

### PART I DEFINITIONS

7.1 In this Part of the *IPRU(FSOC)*, unless the contrary intention appears, the following definitions apply –

FCA	PRA
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**Accounts Regulations** means the Friendly Societies (Accounts and Related Provisions) Regulations 1994, S.I. 1994/1983;

**accumulating with-profits policy** means a *with-profits policy* which has a readily identifiable current benefit, whether or not this benefit is currently realisable, which is adjusted by an amount explicitly related to the amount of any *premium* payment and to which additional benefits are added in respect of participation in profits by additions directly related to the current benefit, or a policy with similar characteristics;

**1974 Act** means the Friendly Societies Act 1974;

**1992 Act** means the Friendly Societies Act 1992;

**Accounts Directives** means Council Directives 78/660/EEC for companies, 91/674/EEC for insurance companies, 86/635/EEC for banks and 83/349/EEC for consolidated accounts;

**ancillary risk**, in relation to a *friendly society* with permission under the *Act* to insure a principal risk belonging to one *class of general insurance business*, means a risk included in another such *class* which is –

- (a) connected with the principal risk;
- (b) concerned with the object which is covered against the principal risk; and
- (c) the subject of the same contract insuring the principal risk;

**annual contribution income** means, in relation to a *friendly society's long-term insurance business*, the income of the *friendly society* in a *financial year* without any deduction for reinsurance cessions;

**annuities on human life** does not include superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment, or of the dependants of such persons;

**approved counterparty** means any of the following –

- (a) an *approved credit institution*
- (b) a person who is exempt pursuant to section 43 of the Financial Services Act 1986
- (c) a person who is permitted under the *Act* to conduct investment business of a kind which includes entering into *unlisted derivative contracts* as principal; or
- (d) in respect of a transaction involving a new issue of *securities* which are to be *listed*, the *issuer* or an *approved investment firm* acting on behalf of the *issuer*;

**approved credit institution** means an institution recognised or permitted under the law of an *EEA State* to carry on any of the activities set out in Annex 1 to the *Banking Consolidation Directive*;

**approved derivative contract** has the meaning given in 13(6) of Appendix 4;

**approved investment firm** means an investment firm as defined in article 2 of Council Directive 93/22/EEC of 10 May 1993 on investment services in the *securities* field;

**approved securities** means any of the following –

- (a) any *securities* issued or guaranteed by, or the repayment of the principal of which, or the interest on which is guaranteed by, and any loans to or deposits with, any of the following, namely, any government, public or local authority or nationalised industry or undertaking, which belongs to Zone A as defined in the *Banking Coordination Directive*; and
- (b) any loan to, or deposit with, an *approved financial institution*;

**asset valuation rules** are the rules in Appendix 4;

**associate** means –

- (a) the wife or husband or *minor son* or *daughter* of that person;
- (b) the trustees of any settlement under which that person has a life interest in possession, or, in Scotland, a life interest;
- (c) any *company* of which that person is a director; or
- (d) any person who is an employee or partner of that person; and

if that person is a *company* –

- (i) any director of that *company*,
- (ii) any subsidiary undertaking of that company, or
- (iii) any director or employee of any such *subsidiary undertaking*; and

if that person has made an agreement or arrangement with any other person –

- (iv) with respect to the acquisition, holding or disposal of *shares* or other interests in the *company* concerned or another *company* of which it is a *subsidiary undertaking*, or business, identifying monetary amounts and the percentages of premiums.
- (v) under which they undertake to act together in exercising their voting power in relation to the *company* concerned or another *company* of which it is such an undertaking,

that other person;

**business amount** means –

- (a) for a *friendly society* carrying on only *general insurance business*, the *general insurance business amount*;
- (b) for a *friendly society* carrying on only *long-term insurance business*, the *long-term insurance business amount*; and
- (c) for a *friendly society* carrying on both *general insurance business* and *long-term insurance business*, in the case of its *general insurance business assets*, the *general insurance business amount* and in the case of its *long-term insurance business assets*, the *long-term insurance business amount*;

**charges for management** means amounts chargeable in respect of the management of an *internal linked fund* in accordance with the rules of the *friendly society* and the conditions of those *contracts of insurance* under which *property linked benefits* are linked to the value of the fund or units of the fund;

**claim** means a claim against a *friendly society* under a contract of insurance;

**claims-made policy** means a contract of liability insurance which provides that no liability is incurred by the *friendly society* in respect of an incident unless –

- (a) the incident is notified to the *friendly society* (or its agent or representative), and
- (b) such notification is received by the *friendly society* (or its agent or representative) before the end of a specified *period* which is no longer than three years following the final date for which cover is provided under the contract;

**claims management costs** refers to those *claims management costs* required by the *Accounts Regulations* (note (4) to the income and expenditure account format) to be included in *claims* incurred other than those which, whether or not incurred through the employment of the *friendly society's* own staff, are directly attributable to particular *claims*;

**class**, in relation to *insurance business*, means a class of *long-term insurance business* or a class of *general insurance business* listed in Part III of chapter 7;

**collective investment scheme** has the meaning given in section 235 of the *Act*;

**commission payable** means the amounts recorded during a *financial year* of a *friendly society* as due to intermediaries and cedants in respect of the inception, amendment or renewal of *contracts of insurance*, whether or not paid during that year;

**commitment** means a commitment represented by *insurance business* of any of the *classes* of *long-term insurance business* specified in Part III of chapter 7

**committee** means the committee of management or other directing body of a *friendly society* or *registered branch*;

**company** includes a body corporate;

**connected**, in relation to two bodies corporate (A and B), means that:

- (a) B is a *related undertaking* of A;
- (b) B is a *participating undertaking* in A; or

(c) B is a *related undertaking* of a *participating undertaking* in A;

**connected individual** of a *friendly society* means a person who –

- (a) controls, or is a partner of a person who controls, the *friendly society*; or
- (b) is a member of the *committee* of the *friendly society* or the wife or husband or a *minor son* or *daughter* of such a member,

and for the purposes of the above a person controls a *company* if he is –

- (c) a person in accordance with whose directions or instructions the *committee* is accustomed to act; or
- (d) a person who either alone or with any *associate* or *associates* is entitled to exercise, or control the exercise of, 15 % or more of the voting power at any general meeting of the *friendly society*;

**connected-party transaction** means the transfer of assets or liabilities or the performance of services by, to or for a *connected* person irrespective of whether or not a price is charged;

**contract for differences** means a contract which falls within article 85 of the Financial Services and Markets Act (Regulated Activities) Order 2001;

**counterparty** in relation to a *friendly society* means –

- (a) any one individual;
- (b) any one unincorporated body of persons;
- (c) any one *company* not being a member of a *group*;
- (d) any group of *companies* excluding any *companies* within the *group* which are *subsidiary undertakings* of the *friendly society*; or
- (e) any government of a State together with all the public bodies, local authorities or nationalised industries of that State,

in which the *friendly society* has made investments or against whom it has rights whether in pursuance of a contract entered into by the *friendly society* or otherwise;

**court** except in relation to the winding-up of an *incorporated friendly society*, means –

- (a) in the case of a body whose registered office is situated in England and Wales or in Northern Ireland, the county *court* for the district in which the office is situated;
- (b) in the case of a body whose registered office is situated in Scotland, the sheriff in whose jurisdiction the office is situated; and, in relation to the winding-up of an *incorporated friendly society*, means the court which has jurisdiction under the applicable winding-up legislation to wind-up the *friendly society*;

**daughter** includes stepdaughter;

**debt** includes an obligation to pay a sum of money under a negotiable instrument;

<b>debt security</b> includes bonds, notes, debentures and debenture stock;
<b>debts due or to become due</b> includes any <i>debts</i> which would become due if the <i>friendly society</i> were to exercise any right to which it is entitled to require payment or repayment of the same;
<b>deferred acquisition costs</b> means those items referred to at G II under the heading "Assets" in Part I of Schedule 2 to the <i>Accounts Regulations</i> ;
<b>dependant</b> of a <i>friendly society</i> means –  (a) a <i>subsidiary</i> of that <i>friendly society</i> ; or  (b) a body jointly controlled by that <i>friendly society</i> and another person, within the meaning of section 13 of the <i>1992 Act</i> ,  the value of whose <i>shares</i> is taken to be the value of its <i>surplus assets</i> under paragraph 3(1) or (2)(a) of Appendix 4;
<b>deposit back arrangement</b> , in relation to a contract of reinsurance, means an arrangement whereby an amount is deposited by the reinsurer with the cedant;
<b>derivative contract</b> means a <i>contract for differences</i> , a <i>futures contract</i> or an <i>option</i> and includes a contract under which the amount payable by either party is calculated by reference to the amortised value of any property;
<b>direct insurance business</b> has the meaning given in IPRU(INS);
<b>diversified contract for differences</b> means a <i>contract for differences</i> whose value does not depend to a significant extent on fluctuations in the value of, or the income from, assets of any of the descriptions in B19 to B28, B30 or B32 to B38 of Part II of this Annex and <i>undiversified contract for differences</i> must be construed accordingly;

<b>EEA insurer</b> has the meaning given in IPRU(INS);
<b>EEA State in which a risk or commitment is situated</b> in relation to a <i>contract of insurance</i> means –  (a) where the person who entered into the contract with the <i>friendly society</i> on any date is an individual, the <i>EEA State</i> where he has his habitual place of residence on that date; and  (b) in any other case, the <i>EEA State</i> where the establishment of that person is situated on that date;
<b>equivalent securities</b> means <i>securities</i> issued by the same <i>issuer</i> being of an identical type and having the same nominal value, description and amount;
<b>established surplus</b> has the meaning given in 6(7) of Appendix 5;
<b>excess concentration with a number of counterparties</b> has the meaning given in B17 of Annex B to Appendix 4;
<b>exposure</b> –  (a) in relation to assets, means an amount determined in accordance with B4 to B12 of

Annex B to Appendix 4;

- (b) in relation to a *counterparty*, means an amount determined in accordance with B13 to B17 of Annex B to Appendix 4;

**financial year** means the period of 12 months ending with 31 December and the initial *financial year* of a *friendly society* must be such period as expires at the end of the calendar year in which it is registered under the *1974 Act* or incorporated under the *1992 Act* and the final *financial year* of the *friendly society* must be such shorter period than 12 months as expires on the date as at which the *friendly society* makes up its final accounts;

**fixed interest securities** means *securities* which under their terms of issue provide for fixed amounts of interest;

**FSC return** means any of FSC1 return, FSC2 return and FSC3 return;

**Futures contract** means a contract which falls within article 84 of the Financial Services and Markets Act (Regulated Activities) Order 2001;

**general insurance business** means *insurance business* of any of the *classes* of general insurance specified in Part III of chapter 7;

**general insurance business amount** means the higher of –

(a) the total of:

(i) the *friendly society's insurance liabilities* (net of reinsurance ceded) in respect of *general insurance business* less *debts*:-

(A) which are due from *dependants* to which paragraph B11C of Part 1 of Annex B of Appendix 4 relates,

(B) which are not reinsurance which has already been netted off the *friendly society's insurance liabilities*, and

(C) which are included in *general insurance business assets*;

which amount is to be zero where the *debts* are greater than the *friendly society's insurance liabilities*, and

(ii) an amount equal to whichever is the greater of 400,000 Euro or 20% of the *general premium income*; or

(b) such other amount as the *friendly society* may select not exceeding:-

(i) the value of its *general insurance business assets* as determined in accordance with the asset valuation rules;

(ii) excluding *debts* due from *dependants* to which paragraph B11C of Part 1 of Annex B of Appendix 4 relates and *reinsurance recoveries*; and

(iii) less *debts* due to *dependants* of the *friendly society* included in *general insurance business liabilities* (excluding *reinsurance recoveries*, other than amounts due or that relate to claims already paid by the *dependant*) except that for a *dependant* to which paragraph B11C of Part 1 of Annex B of Appendix 4 does not relate, the amount deducted will not exceed the

*dependant's surplus assets (or proportional share);*

**general insurance business assets** means assets of a *friendly society* or *insurance company* which are, for the time being, identified as representing the *general insurance business* fund or funds maintained by that body in respect of its *general insurance business*, and

**general insurance business liabilities** means liabilities of the body which are attributable to its general insurance business;

**general premium income** means, in any year, the net amount, after deduction of any *premiums* payable for reinsurance, of the *premiums receivable* in that year in respect of all *insurance business* other than *long-term insurance business*;

**gross premiums**, in relation to a *friendly society* and a financial year –

- (a) means *premiums* after deduction of discounts, refunds and rebates of *premium* but before deduction of *premiums* for reinsurance ceded and before deduction of *commission payable* by the *friendly society*; and
- (b) includes *premiums receivable* by the *friendly society* under reinsurance contracts accepted by the *friendly society*;

**gross premiums earned** in respect of a *financial year* means such proportion of *gross premiums receivable* as is attributable to risk borne by the *friendly society* during that *financial year*;

**group** has the meaning given in section 262(1) of the Companies Act 1985 where applicable, otherwise section 474(1) of the Companies Act 2006;

**guarantee fund** has the meaning given in rule 4.4(1);

**hybrid linked contract** means a *contract of insurance* the effecting of which constitutes the carrying on of *long-term insurance business* and which contains an option or options such that at some future time the contract may, according to how such option or options are exercised, constitute either a *linked contract* or a *non-linked contract*;

**implicit items** has the meaning given in rule 4.7(3);

**incepted** refers to the time when the liability to risk of a *friendly society* under a *contract of insurance* commenced and, for this purpose, a contract providing continuous cover is deemed to commence on each anniversary date of the contract;

**initial margin** in respect of a *derivative contract* or a contract or *asset* having the effect of a *derivative contract* means assets which, before or at the time the contract is entered into, are transferred by the *friendly society* subject to a condition that such assets (or, where the assets transferred are *securities, equivalent securities*) will be returned to the *friendly society* on completion of that contract;

**insurance company** means a person or body of persons (whether incorporated or not) carrying on *insurance business* other than a *friendly society*;

**insurance Directives** means –

- (a) the *first non-life Directive*, the *second non-life Directive* and the *third non-life Directive*, and such other Directives as make provision with respect to the business of direct insurance other than long-term assurance; and
- (b) the *Consolidated Life Directive*, and such other Directives as make provision with respect to the business of direct long-term assurance;

**insurance holding company** means a parent undertaking whose main business is to acquire and hold *participations in subsidiary undertakings*, where

- (a) those *subsidiary undertakings* are exclusively or mainly *insurance undertakings*;
- (b) at least one of those *subsidiary undertakings* is a *UK insurer* or an *EEA firm* that is a *regulated insurance entity*; and
- (c) it is not a *mixed financial holding company*.

**insurance liabilities** means amounts calculated in accordance with *liability valuation rules* in respect of those items shown at C and D under the heading "Liabilities" in Part I of Schedule 2 to the *Accounts Regulations*;

**intermediary** means a person who in the course of any business or profession invites other persons to make offers or proposals or to take other steps with a view to entering into *contracts of insurance* with a *friendly society*, other than a person who only publishes such invitations on behalf of, or to the order of, some other person;

**internal linked fund** means an account to which a *friendly society* appropriates certain *linked assets* and which may be sub-divided into units the value of which is determined by the *friendly society* by reference to the value of those *linked assets*;

**issuer** in respect of a *collective investment scheme* means the manager or operator of the scheme and in respect of an interest in a limited partnership means the partnership;

**jointly controlled body** is to be construed in accordance with section 13 of the *1992 Act*;

**liability valuation rules** are the rules in Appendix 5;

**linked assets** means, in relation to a *friendly society*, *long-term insurance business assets* of the *friendly society* which are, for the time being, identified in the records of the *friendly society* as being assets by reference to the value of which *property linked benefits* are to be determined;

**linked benefits**, in relation to a *linked long-term contract*, means benefits payable to the *policyholder* which are determined by reference to the value of or the income from property of any description (whether or not specified in the contract) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified);

**linked contract** means a contract falling within *class III*, and *non-linked contract* must be construed accordingly;

**linked long-term contract** means a *contract of insurance*, the effecting of which constitutes the carrying on of *long-term insurance business*, and under which *linked benefits* are payable;

**listed** means, in relation to an investment –

- (a) that the investment is included in an *official list*, or
- (b) that facilities have been granted for dealing in that investment on a *regulated market*, and *unlisted* must be construed accordingly;

**long-term insurance business** means *insurance business* of any of the *classes* of long-term insurance specified in Part III of chapter 7;

**long-term insurance business amount** means the higher of –

- (a) the total of:
  - (i) the *friendly society's insurance liabilities* in respect of *long-term insurance business* (net of reinsurance ceded and the amount of any deposit back under a *deposit-back arrangement* in relation to a contract of reinsurance in respect of *long-term insurance business*;
    - (A) excluding *property linked liabilities*; and
    - (B) less:
      - (i) the amount of any *debt*, that is a *long-term insurance business asset* (excluding reinsurance ceded which has already been deducted from the *friendly society's insurance liabilities*), due from a *dependant* to which paragraph B11C of Part 1 of Annex B of Appendix 4 relates, and
      - (ii) the amount of any *implicit item* valued in accordance with a waiver under section 148 of the *Act*;
  - (which amount is to be zero where the result is negative); and
  - (ii) the amount of the *required minimum margin* for its *long-term insurance business* determined in accordance with rules 4.2 and 4.5 and Appendix 1 (or, in the case of a *friendly society* whose head office is not in the United Kingdom, that amount which would apply if its head office were in the United Kingdom); or
- (b) such other amount as the *friendly society* may select not exceeding the value of its assets determined in accordance with the *asset valuation rules*,
  - (i) excluding:
    - (A) reinsurance recoveries;
    - (B) assets required to match property linked liabilities;
    - (C) *debts* due from *dependants* of the *friendly society* to which paragraph B11C of Part 1 of Annex B of Appendix 4 relates; and
    - (D) if the *friendly society* is a *general insurer*, *general insurance business assets*, and
  - (ii) less:
    - (A) if the *friendly society* is a *general insurer*, *debts* due to *dependants of the friendly society* included in *long-term insurance business liabilities*

(excluding reinsurance recoveries (other than amounts due or that relate to claims already paid by the dependant)), or

- (B) if the *friendly society* is not a *general insurer*, debts due to dependants of the *friendly society* (excluding *reinsurance recoveries* (other than amounts due or that relate to claims already paid by the *dependant*)),

but for the purposes of (ii) above, for *dependants* to which paragraph B11C of Part 1 of Annex B of Appendix 4 does not relate, the amount deducted will not exceed the *dependant's surplus assets* (or *proportional share*);

except that for the purposes of determining the *permitted asset exposure limit* under paragraph B3 of Annex B of Appendix 4, *index linked liabilities* must also be excluded from (a)(i) and assets required to match such liabilities must be also excluded from (b);

**long-term insurance business assets** means assets of a *friendly society* or *insurance company* which are, for the time being, identified as representing the *long-term insurance business* fund or funds maintained by that body in respect of its *long-term insurance business*; and

**long-term insurance business liabilities** means liabilities of the body which are attributable to its long-term insurance business;

**long-term gilt yield** means the annualised equivalent of the 15 year medium coupon yield for United Kingdom Government fixed-interest *securities* jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries;

**long-term liabilities** means liabilities of a *friendly society* arising under or in connection with contracts for *long-term insurance business* including *liabilities* arising from *deposit back arrangements*;

**management expenses** means all expenses, other than commission, incurred in the administration of a *friendly society* or its business;

**margin of solvency** has the meaning given in rule 4.1(4);

**market value** means the market value as determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to societies;

**material connected-party transaction** means a *connected-party transaction* for which (together with any similar transactions):

- (a) the price actually paid or received for the transfer of assets or liabilities or the performance of services; or
- (b) the price which would have been paid or received had that transaction been negotiated at arm's length between unconnected parties,

exceeds:

- (c) in the case of a *friendly society* that carries on either general insurance business or long-term insurance business, but not both, 5% of the general business amount or long-term business amount, as applicable; or
- (d) in the case of a *friendly society* that carries on both types of business either –

- (i) 5% of the *long-term business amount* where the transaction is in connection with the *friendly society's long-term business*; and
- (ii) in other cases, 5% of the *general business amount*;

**mathematical reserves** means the provision made by a *friendly society* to cover liabilities (excluding liabilities which have fallen due and liabilities arising from *deposit back arrangements*) arising under or in connection with contracts for *long-term insurance business*;

**memorandum** has the meaning given by paragraph 4(3) of Schedule 3 to the 1992 Act;

**minimum guarantee fund** has the meaning given in rule 4.4(2);

**minor**, in relation to Scotland, means not having attained the age of sixteen;

**modifications**, in relation to *enactments*, includes additions, omissions and amendments;

**non-directive incorporated friendly society** means a *non-directive friendly society* which is an *incorporated friendly society*;

**non-directive registered friendly society** means a *non-directive friendly society* which is a *registered friendly society*;

**non-linked contract** see *linked long term contract*;

**non-profit policy** see *with-profits policy*;

**notional required minimum margin** means:

- (a) in the case of an *insurance undertaking* (other than a *pure reinsurer*) that has its head office in a designated state or territory, the amount of the required minimum margin or general insurance capital requirement, or the equivalent requirement under the regulatory requirements of that state or territory;
- (b) in the case of a *pure reinsurer* that has its head office in a *designated state or territory*, the amount that would be the *required minimum margin or general insurance capital requirement*, or the equivalent requirement under the regulatory requirements of that state or territory, if the regulatory requirements of that state or territory applicable to undertakings carrying on *direct insurance business* were applied to the *pure reinsurer* (whether they are or not); and
- (c) in all other cases, the amount of the *required minimum margin or general insurance capital requirement* that would apply if the *insurance undertaking* were an *insurer* (other than a *pure reinsurer*), with its head office in the *United Kingdom* (whether it is or not)

**officer** means –

- (a) in relation to a registered friendly society or a registered branch –
  - (i) a trustee;

- (ii) the treasurer, secretary and chief executive (however described);
  - (iii) a member of the *committee*; and
  - (iv) a person appointed by the *friendly society* or branch to sue or be sued on its behalf; or
- (b) in relation to an *incorporated friendly society*, a member of the *committee*, the chief executive (however described) and the secretary;

**option** means an *option* which falls within article 83 of the Financial Services and Markets Act (Regulated Activities) Order 2001 or a *warrant*;

**ordinary long term insurance business** means long-term *insurance business* which is not industrial assurance business;

**participating undertaking** means an *undertaking* which is either a *parent undertaking* or other undertaking which holds a participation in or is linked by a consolidation Article 12(1) relationship with the undertaking in question

**participation** means:

- (a) the holding of a participating interest within the meaning of section 421(2) of the *Act*, or
- (b) the holding, directly or indirectly, of 20% or more of the voting rights or capital;

**partnership pension society** means an unincorporated *friendly society*, which satisfies the following conditions –

- (a) the purpose of the society is to effect or carry out unit-linked contracts to pay *annuities on human life*, which are approved by the Commissioners for HM Revenue and Customs under Section 620 of the Income and Corporation Taxes Act 1988;
- (b) the assets of each member of the society are separately identifiable;
- (c) the assets of each member of the society are invested solely or primarily by him or in accordance with his instructions;
- (d) the value of each member of the society's assets is dependent entirely on the performance of those assets;
- (e) no member of the society has a contract which comprises, or includes, a cash guarantee; and
- (f) no member of the society has a contract which is an annuity in payment.

**pension fund management contract** means a contract to manage the investments of pension funds (other than funds solely for the benefit of the officers or employees of the person effecting or carrying out the contract and their dependants or, in the case of a *company*, partly for the benefit of officers or employees and their dependants of its *subsidiary* or holding company or a *subsidiary* of its holding company);

**period** means –

- (a) for the purposes of completion of the FSC2 or FSC3 return, the date since the last

<p>return or three years if there was no previous actuarial investigation; and</p> <p>(b) for the purpose of completion of the FSC1 return the <i>financial year</i> to which the return relates;</p>
<p><b>permanent health contract</b> means a contract falling within <i>class IV</i>;</p>
<p><b>permitted asset exposure limit</b> for assets of any of the descriptions in Part II of Annex B of Appendix 4 is the percentage of the <i>business amount</i> set out opposite the relevant paragraph; in the case of an asset which is not covered by any of the descriptions in Part II of Annex B of Appendix 4 (other than a <i>derivative contract</i>), the permitted asset exposure limit is nil;</p>
<p><b>permitted counterparty exposure limit</b> means –</p> <p>(a) where the <i>counterparty</i> is an individual or an unincorporated body of persons, 5% of the <i>business amount</i>;</p> <p>(b) where the <i>counterparty</i> is a <i>counterparty</i> of the type mentioned in (e) in the definition of <i>counterparty</i>, 5% of the <i>business amount</i>;</p> <p>(c) where the counterparty is a body corporate or group, each of</p> <p>(i) 20% of the <i>business amount</i> or £2 million, whichever is the larger,</p> <p>(ii) 10% of the <i>business amount</i> where the <i>exposure</i> arises otherwise than by reason that <i>debts</i> are due, or are to become due, as a result of <i>short term deposits</i> made with an <i>approved credit institution</i>, and</p> <p>(iii) 5% of the <i>business amount</i> where the <i>exposure</i> is other than to bodies which are <i>approved counterparties</i>;</p> <p>(a) satisfies the conditions in 13(6) to 13(8) of Appendix 4 except that the references in 13 of Appendix 4 to "an asset for the valuation of which provision is made in this chapter" is construed as reference to <i>permitted connected property</i>;</p>
<p><b>premium</b> includes a contribution in respect of an insurance benefit and the consideration for the granting of an annuity;</p>
<p><b>proper valuation</b> means, in relation to land, a valuation made by a qualified valuer not more than three years before the <i>relevant date</i> which determined the amount which would be realised at the time of the valuation on an open market sale of the land free from any mortgage or charge;</p>
<p><b>property linked benefits</b> means benefits other than index linked benefits –</p> <p>(a) provided for under a <i>linked long-term contract</i>; and</p> <p>(b) determined by reference to the value of, or income from, property of any description (whether specified in the contract or not);</p>
<p><b>property linked contract</b> means a linked contract conferring property linked benefits;</p>
<p><b>property linked liabilities</b> means insurance liabilities in respect of property linked benefits;</p>
<p><b>proportional share</b> means, in relation to a <i>related undertaking</i>, the percentage which is the percentage holding (directly or indirectly) in the <i>related undertaking's</i> capital;</p>

**provision of insurance** by a directive friendly society in the United Kingdom or any other EEA State means –

- (a) the covering (otherwise than by way of reinsurance) of a risk situated there through an establishment in another *EEA State* ('the provision of general insurance'); and
- (b) the covering (otherwise than by way of reinsurance) of a *commitment* situated there through an establishment in another *EEA State* ('the provision of long-term insurance');

**proxy capital resources requirement** means the *solo capital resources requirement* to which an *undertaking* would have been subject if it had a *permission* for each activity it carries on anywhere in the world, so far as that activity is a *regulated activity*.

**public file**, in relation to a *friendly society*, means the file relating to the *friendly society* which the *FCA* is required to maintain under section 104 of the *1992 Act*;

**qualified valuer**, in relation to any particular type of land in any particular area, means a person who is a fellow or professional associate of the Royal Institution of Chartered Surveyors or a fellow or associate of the Incorporated Society of Valuers and Auctioneers or a fellow or associate of the Rating and Valuation Association and either –

- (a) has knowledge of and experience in the valuation of that particular type of land in that particular area; or
- (b) has knowledge of and experience in the valuation of land and has taken advice from a valuer who he is satisfied has knowledge of and experience in the valuation of that particular type of land in that particular area;

**readily realisable** in relation to a *listed* investment means a *listed* investment in respect of which 9(4) of Appendix 4 does not apply or, by virtue of 9(5) of Appendix 4, is to be taken not to apply;

**receivable** in relation to a *friendly society*, a *period*, a *financial year* and a *premium* means, unless otherwise specified, such amounts as become due to the *friendly society*, whether or not received by the *friendly society* during that *period* or *financial year*, including (where appropriate) income which has accrued, except that in Appendix 2, "receivable" only includes amounts *receivable* in respect of *contracts of insurance* *incepted* in that *period* or *financial year*;

**recoverable**, in relation to a *friendly society* and a *financial year*, means recorded in the *friendly society's* books as due in that year, whether or not the *friendly society* has received any payment;

**reference period**, in relation to a *friendly society*, means the three last preceding *financial years*;

**registered address**, in relation to a member of an *incorporated friendly society*, has the meaning given in paragraph 14(6) of Schedule 3 to the *1992 Act*;

**registered branch** means a branch of a *registered friendly society* which is separately registered within the meaning of the *1974 Act*;

**regulated institution** means any of the following –

- (a) an EEA insurer or UK insurer;
- (b) an approved credit institution;
- (c) a *friendly society* which is authorised to carry on *insurance business*; and
- (d) an approved investment firm;

**regulated market** means a market which is characterised by –

- (a) regular operation;
- (b) the fact that regulations issued or approved by the appropriate authority of the state where the market is situated –
  - (i) define the conditions for the operation of and access to the market,
  - (ii) define the conditions to be satisfied by a financial instrument in order for it to be effectively dealt in on the market, and
  - (iii) require compliance with reporting and transparency requirements comparable to those laid down in articles 20 and 21 of the Council Directive 93/22/EEC of 10 May 1993 on investment Services in the securities field; and
- (c) in the case of a market situated outside the *EEA States*, the fact that the financial instruments dealt in are of a quality comparable to those in a *regulated market* in the United Kingdom;

**regulated related undertaking** means a *related undertaking* that is any of the following:

- (a) a *regulated entity*;
- (b) an *insurance undertaking* which is not a *regulated insurance entity*;
- (c) an *asset management company*;
- (d) a *financial institution* which is neither a *credit institution* nor an *investment firm*;
- (e) a *financial holding company*; or
- (f) an *insurance holding company*.

**reinsurance business** means the effecting and carrying out of contracts of reinsurance;

**related undertaking** means in relation to an *undertaking 'U'*:

- (a) any *subsidiary undertaking* of U;
- (b) any *undertaking* in which U or any of U's *subsidiary undertakings* holds a participation;
- (c) any *undertaking* linked to U by a *consolidation Article 12(1) relationship*; or
- (d) any *undertaking* linked by a *consolidation Article 12(1) relationship* to an *undertaking* in (a), (b) or (c).

**relevant capital sum** means –

- (a) subject to (b) and (c):
  - (i) for whole life assurances, the sum assured,
  - (ii) for policies where a sum is payable on maturity (including policies where a sum is also payable on earlier death), the sum payable on maturity,
  - (iii) for deferred annuities, the capitalised value of the annuity at the vesting date (or the cash option if it is greater),
  - (iv) for capital redemption contracts, the sums payable at the end of the contract period, and
  - (v) for *linked long-term contracts*, notwithstanding (i) to (iv), the lesser of:
    - (A) the amount for the time being payable on death, and
    - (B) the aggregate of the value for the time being of the units allocated to the contract (or, where entitlement is not denoted by means of units, the value for the time being of any other measure of entitlement under the contract equivalent to units) and the total amount of the *premiums* remaining to be paid during such part of the term of the contract as is appropriate for *zillmerising*, or, if such *premiums* are payable beyond the age of seventy five, until that age,
- excluding in all cases any vested reversionary bonus,
- (b) notwithstanding (a), where, under a contract relating to any such business as is mentioned in (a), the payment of *premiums* is to stop before the sum assured becomes due, the *mathematical reserves* appropriate for that contract at the end of the *premium-paying term*; and
- (c) notwithstanding (a), for temporary assurances, the sum assured on the *valuation date*;

**relevant date** means, in relation to the valuation of any asset for any purpose for which the *asset valuation rules* apply, the date when the asset falls to be valued for that purpose;

**relevant regulatory requirements** means:

- (a) in the case of a related undertaking that is an insurance undertaking, established in a designated state or territory, at the option of the friendly society:
  - (i) the regulatory requirements of that state or territory applicable to an undertaking carrying on direct insurance business (even if 31 December 2010 50 it only carries on reinsurance business or is an insurance holding company), or
  - (ii) the requirements referred to in (b);
- (b) in the case of any other *insurance undertaking* or *insurance holding company*, the rules in *IPRU(INS)* applicable to an *insurer* (other than a *pure reinsurer*) with its head office in the United Kingdom (whether or not it is such an *insurer*)

**required margin of solvency** has the meaning given in rule 4.2

**required minimum margin** means the greater of the appropriate required margin of solvency and the amount of the appropriate minimum guarantee fund;

**securities** includes *shares*, *debt securities*, Treasury Bills, Tax Reserve Certificates and Certificates of Tax Deposit;

**settlement date** means any date on which the fulfilment of an obligation under a *derivative contract* is or may be required;

**share** has the meaning given in section 1161(2) of the Companies Act 2006;

**short term deposit** means a sum of money which may be withdrawn at the discretion of the lender without penalty or loss of accrued interest by giving notice of withdrawal of one month or less;

**son** includes stepson;

**subsidiary** is construed in accordance with section 13 of the *1992 Act*;

**subsidiary undertaking** has the meaning given in section 1162 of the Companies Act 2006;

**surplus assets** has the meaning given in paragraph 3(3) of Appendix 4;

**taxes included in premiums** has the same meaning as the words "taxes pertaining to the *premiums*" in the third indent of the first sub-paragraph of article 16(3) of the *first non-life Directive*;

**valuation date**, in relation to an actuarial investigation, means the date to which the investigation relates;

**variation margin** means –

- (a) in respect of a *derivative contract*, or a contract having the effect of a *derivative contract*, assets (other than assets transferred by way of *initial margin*) which, at the *relevant date*, have been transferred by, to, or for the benefit of, the *friendly society* in pursuance of a condition in that contract or a related contract; and
- (b) in respect of an asset having the effect of a *derivative contract*, assets which, at the *relevant date*, have been transferred by, to, or for the benefit of, the *friendly society* in pursuance of a contractual right conferred, or obligation imposed, by the holding of the asset having the effect of a *derivative contract*;

**warrant** means an instrument which falls within article 79 of the Financial Services and Markets Act (Regulated Activities) Order 2001 (SI 2001, No 544);

**weighted average of the yield** has the meaning given in 19(5)(d) of Appendix 9;

**with-profits fund** for the purposes of Chapter 5 and Appendices 6 to 10 means:

- (a) a *long-term insurance fund* (or that part of such a fund) in which *policyholders* are eligible to participate in any *established surplus*; and
- (b) where it is a *friendly society's* usual practice to restrict *policy-holders'* participation in any *established surplus* to that arising from only a part of the fund (or part fund) falling within (a), that part (or that part of the part fund);

***with-profits policy*** means a contract falling within a *class* of long-term insurance which is eligible to participate in any part of any *established surplus*, and non-profit policy must be construed accordingly;

***working day*** means any day other than Saturday, Sunday, Good Friday, Christmas Day and any day which is a bank holiday in any part of the United Kingdom under section 1 of the Banking and Financial Dealings Act 1971;

***zillmerising*** means the method known by that name for modifying the net *premium* reserve method of valuing a long-term policy by increasing the part of the future *premiums* for which credit is taken so as to allow for initial expenses.

## PART II – GENERAL PROVISIONS

7.2 **A word or phrase which is printed in italics is used in the defined sense. If a defined term does not appear in the IPRU (FSOC) glossary listed in part 1 of Chapter 7, the definition appearing in the main Handbook Glossary applies.**

FCA | PRA

7.3 **Unless the context otherwise requires, a word or phrase which is defined in a related enactment bears the same meaning as in that enactment.**

FCA | PRA

7.4 **Unless the context requires, a word which is related to a defined word is construed by reference to the defined word.**

FCA | PRA

7.5 **In IPRU (FSOC), the cross referencing within Forms follows the sequence "Form.Line.Column".**

FCA | PRA

***Subsidiary and ancillary provisions***

7.6 **For the purposes of IPRU (FSOC):**

FCA | PRA

- (a) **a *contract of insurance* is to be treated as falling within a *class* of *long-term insurance business* notwithstanding the fact that it contains supplementary provisions falling within *class 1* (accident) or *class 2* (sickness) if:**
  - (i) **its principal object is that of a contract falling within a *class* of *long-term insurance business*, and**

(ii) it is effected or carried out by a *friendly society* which has permission to effect or carry out contracts falling within *class I (life and annuity)*; and

(b) a *contract of insurance* whose principal risk falls within any of *classes 1, 2 or 16* is to be treated as falling within that *class* and no other, notwithstanding the fact that it also covers *ancillary risks*.

### PART III – CLASSES OF LONG-TERM INSURANCE BUSINESS

FCA	PRA
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Number	Description	Nature of business
I	Life and annuity	Effecting or carrying out <i>contracts of insurance</i> on human life or contracts to pay <i>annuities on human life</i> , but excluding (in each case) contracts within <i>class III</i> .
II	Marriage and birth	Marriage or the formation of a civil partnership and birth: Effecting or carrying out <i>contracts of insurance</i> to provide a sum on marriage or the formation of a civil partnership or on the birth of a child, being contracts expressed to be in effect for a period of more
III	Linked long term	Effecting or carrying out <i>contracts of insurance</i> on human life or contracts to pay <i>annuities on human life</i> where the benefits are wholly or partly to be determined by reference to the value of, or the income from, property of any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified).
IV	Permanent health	Effecting or carrying out <i>contracts of insurance</i> providing specified benefits against risks of persons becoming incapacitated in consequence of sustaining injury as a result of an accident or of an accident of a specified class or of sickness or infirmity, being contracts that –  (a) are expressed to be in effect for a period of not less than five years, or until the normal retirement age for the persons concerned, or without limit of time; and  (b) either are not expressed to be terminable by the <i>friendly society</i> , or are expressed to be so terminable only in special circumstances mentioned in the contract.
V	Tontines	Effecting or carrying out tontines.
VI	Capital redemption	Effecting or carrying out capital redemption contracts.
VII	Pension fund management	Effecting or carrying out –  (a) <i>pension fund management contracts</i> ; or  (b) contracts of the kind mentioned in (a) that are combined with <i>contracts of insurance</i> covering either conservation of capital or

		payment of a minimum interest.
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## CLASSES OF GENERAL INSURANCE BUSINESS

FCA	PRA
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Number	Description	Nature of business
1	Accident	<p>Effecting or carrying out <i>contracts of insurance</i> providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of the person insured or, in the case of a contract made by virtue of section 140, 140A or 140B of the Local Government Act 1972, a person for whose benefit the contract is made –</p> <p>(a) sustaining injury as the result of an accident or of an accident of a specified class, or</p> <p>(b) dying as the result of an accident or of an accident of a specified class, or</p> <p>(c) becoming incapacitated in consequence of disease or of disease of a specified class,</p> <p>inclusive of contracts relating to industrial injury and occupational disease but exclusive of contracts falling within <i>class 2</i> or within <i>class IV</i>.</p>
2	Sickness	<p>Effecting or carrying out <i>contracts of insurance</i> providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of the two) against risks of loss to the persons insured attributable to sickness or infirmity, but exclusive of contracts falling within <i>class IV</i>.</p>
16	Miscellaneous financial loss	<p>Effecting or carrying out <i>contracts of insurance</i> against any of the following risks, namely –</p> <p>(a) risks of loss to the persons insured attributable to them being unemployed;</p> <p>(b) risks of loss to the persons insured attributable to them being in distressed circumstances; or</p> <p>(c) risks of loss to the persons insured attributable to sickness or infirmity,</p> <p>but not including of contracts falling within <i>class 2</i> or <i>class IV</i>.</p>

## 8 Chapter 8: Transitional provisions

### GUIDANCE

FCA	PRA
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GEN (the part of the *Handbook* in High Level Standards which has the title General Provisions) contains some technical transitional provisions that apply throughout the *Handbook* and which are designed to ensure a smooth transition at commencement of the *Act*. These include transitional provisions relevant to record keeping and notification rules.

*SUP* contains transitional provisions which carry forward written concessions relating to pre-commencement provisions.

**Table 1**

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: Dates in force	(6) Handbook provision: coming into force
2 <b>PRA</b>	<i>Rules in IPRU (FSOC)</i>	G	Further transitional provisions concerning waivers and written concessions are contained in <i>GENPRU</i>	See <i>GENPRU</i>	See <i>GENPRU</i>
3	<i>IPRU (FSOC) Rule 5.1A</i>	R	(1) This paragraph and Table 2 below apply to a <i>directive friendly society</i> .  (2) <i>IPRU (FSOC) rule 5.1A</i> is modified so that a <i>directive friendly society</i> must comply with <i>IPRU (INS) rule 9.6(1)</i> varied as set out in Table 2.	From 31 December 2004 to 30 December 2007	31 December 2004
4	<i>IPRU (FSOC) rules 4.21, 4.22, 7.1 (Definitions), Appendix 3 paragraphs 9 and 12</i>	R	For the period given in column (5), for the purposes of the <i>rules</i> specified in column (2), a <i>directive friendly society</i> must apply the definition of <i>permitted derivative contract</i> as it takes effect in relation to a <i>non-directive incorporated friendly society</i> .	31 December 2004 to 30 December 2005	31 December 2004
5	<i>IPRU (FSOC) rules 4.21, 4.22, 7.1 (Definitions), Appendix 3 paragraphs 9</i>	R	(1) This paragraph applies to a contract concluded on or before 30 December 2005 which satisfies the definition of <i>permitted derivative contract</i> as	31 December 2004 until the relevant <i>rule</i> is revoked	31 December 2004

and 12	it takes effect in relation to a <i>non-directive incorporated friendly society</i> .	(2) In relation to a contract to which this paragraph applies, for the purposes of the <i>rules</i> specified in column (2), a <i>directive friendly society</i> may continue to apply the definition of <i>permitted derivative contract</i> as it takes effect in relation to a <i>non-directive incorporated friendly society</i> .
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## Table 2

This Table belongs to *IPRU (FSOC) Chapter 8, Table 1, paragraph 3*

<i>Financial year ending on or after</i>	Deposit period following the <i>financial year end</i>	
	Where the deposit is made electronically	Otherwise
31 December 2004	6 months	6 months
31 December 2005	6 months	6 months
31 December 2006	4 months	3 months and 15 days
31 December 2007	3 months	2 months and 15 days

## Appendix 1:

### Long-Term Insurance Business Margin of Solvency

#### Long-term classes I and II

1. PRA
- (1) For *long-term insurance business* of class I or II the *required margin of solvency* must be determined by taking the aggregate of the results arrived at by applying the calculation described in (2) ("the first calculation") and the calculation described in (3), (4) and (5) ("the second calculation").
- (2) For the first calculation –
- (a) a sum equal to 4% of the *mathematical reserves* for direct insurance business and reinsurance acceptances without any deduction for reinsurance cessions must be taken;
  - (b) the amount of the *mathematical reserves* at the end of the last preceding *financial year* after the deduction of reinsurance cessions must be expressed as a percentage of the amount of those *mathematical reserves* before any such deduction; and
  - (c) the sum mentioned in (a) must be multiplied –
    - (i) where the percentage arrived at under (b) is greater than 85% by that greater percentage, and
    - (ii) in any other case, by 85%.
- (3) For the second calculation –
- (a) subject to (4) and (5), a sum equal to 0.3% of the capital at risk for contracts on which the capital at risk is not a negative figure must be taken;
  - (b) the amount of the capital at risk at the end of the last preceding *financial year* for contracts on which the capital at risk is not a negative figure, after the deduction of reinsurance cessions, must be expressed as a percentage of the amount of that capital at risk before any such deduction; and
  - (c) the sum arrived at under (a) must be multiplied –
    - (i) where the percentage arrived at under (b) is greater than 50% by that greater percentage, and
    - (ii) in any other case, by 50%.
- (4) Where a contract provides for benefits payable only on death within a specified period and is valid for a period of not more than three years from the date when the contract was first made, the percentage to be taken for the purposes of (3)(a) must be 0.1%; and where the period of validity from that date is more than three years but not more than five

years, the percentage to be so taken must be 0.15%.

- (5) For the purposes of (4), the period of validity of the contract evidencing a group policy is the period from the date when the *premium rates* under the contract were last reviewed for which the *premium rates* are guaranteed.
- (6) For the purposes of the second calculation, the capital at risk is –
- (a) in any case in which an amount is payable in consequence of death other than a case falling within (b), the amount payable on death; and
- (b) in any case in which the benefit under the contract in question consists of the making, in consequence of death, of the payment of an annuity, payment of a sum by instalments or any other kind of periodic payments, the present value of that benefit,

less in either case the *mathematical reserves* in respect of the relevant contracts.

- (7) When the amount of the *mathematical reserves* referred to in (2)(a), or the amount of the capital at risk referred to in (3)(a), is to be calculated for the purposes of determining the margin of solvency, the day as on which that amount is calculated must be the same as that on which the margin of solvency is determined; and the *mathematical reserves* referred to in (6) must also be calculated as on that day when the capital at risk in question is that referred to in (3)(a), but must be calculated as at the end of the last preceding *financial year* when the capital at risk in question is that referred to in (3)(b).

*Long-term classes III and VII*

2.

PRA

- (1) For *long-term insurance business* of class III or VII the margin of solvency must be determined in accordance with (2) to (5).
- (2) In so far as a *friendly society* bears an investment risk, the first calculation must be applied.
- (3) In so far as –
- (a) a *friendly society* bears no investment risk; and
- (b) the allocation to cover *management expenses* in the relevant contract has a fixed upper limit which is effective as a limit for a period exceeding five years,
- the first calculation must be applied, but as if 1(2)(a) contained a reference to 1% instead of 4%.
- (4) In so far as –
- (a) a *friendly society* bears no investment risk; and

(b) the allocation to cover *management expenses* in the relevant contract does not have a fixed upper limit which is effective as a limit for a period exceeding five years, the *margin of solvency* is an amount equivalent to 25% of the preceding *financial year's* net administrative expenses pertaining to such business.

(5) Where a *friendly society* covers a death risk, a sum arrived at by applying the second calculation (disregarding 1(4) and (5)) must be added to the *margin of solvency*, including a *margin of solvency* of zero, arrived at under (2), (3) or (4).

*Long-term classes IV and VI*

3. (1) For *long-term insurance business* of class IV, the *margin of solvency* must be determined by applying the first calculation plus the sum arrived at by applying rule 4.2(1)(b) as though it were *general insurance business* of class 2.
- PRA
- (2) For *long-term insurance business* of class VI, the *margin of solvency* must be determined by applying the first calculation.
- (3) If both (1) and rule 4.2(2)(b) apply, a single combined *margin of solvency* must be calculated under rule 4.2(1)(b) in respect of the class IV business and subsidiary provisions in classes 1 and 2.

*Long-term class V*

4. For *long-term insurance business* of class V the margin of solvency must be 1% of the assets of the relevant tontine.

PRA



## Appendix 2:

### General Insurance Business Solvency Margin

#### PART I: THE PREMIUMS BASIS

1. **The *gross premiums receivable* (or contributions, as the case may be) in respect of the *friendly society's* entire *general insurance business* for the last preceding *financial year* must be aggregated and the method of calculation set out in 2 to 14 applied.**  
**PRA**
- 1A. **The *gross premiums earned* (or contributions, as the case may be) in respect of the *friendly society's* entire *general insurance business* for the last preceding *financial year* must be aggregated and the method of calculation set out in 2 to 14 applied.**  
**PRA**
2. **From each of the aggregates arrived at under 1 and 1A there must be deducted –**  
**PRA**
  - (a) any taxes included in the *premiums*; and
  - (b) any levies that are related to *premiums* and are recorded in the *friendly society's* books as payable in the last preceding *financial year* in respect of *general insurance business*.
3. **The amount arrived at under 2 must be multiplied by twelve and divided by the number of months in the *financial year*.**  
**PRA**
4. **If the amount arrived at under 3 is more than 61.3 million Euro, it must be divided into two portions, the former consisting of 61.3 million Euro and the latter comprising the excess.**  
**PRA**
5. **Where there has been a division into two portions pursuant to 4, there must be calculated and added together 18% and 16% of the two portions respectively; and where there has been no such division, there must be calculated 18% of the amount arrived at under 3.**  
**PRA**
6. **In the case of *general insurance business* consisting of health insurance based on actuarial principles, 5 applies with the substitution of 6% for 18% and 5 and one third % for 16%, but only if all the necessary conditions are satisfied.**  
**PRA**
7. **For the purposes of 6, the necessary conditions are as follows –**  
**PRA**
  - (a) the *gross premiums* paid are calculated on the basis of sickness tables appropriate to *insurance business*;
  - (b) the reserves include provision for increasing age or, in the case of *class IV*, either the reserves include provision for increasing age, or the business is conducted on a group basis;

- (c) an additional *premium* is collected in order to set up a safety margin of an appropriate amount;
- (d) the contract does not allow the *friendly society* to cancel the contract after the end of the third year of the contract; and
- (e) the contract provides for the possibility of increasing *premiums* or reducing payments during its currency.

8. **Where 6 applies to a *friendly society* whose *general insurance business* consists partly of health insurance based on actuarial principles and partly of other business, the procedure provided in 1 to 6 must operate separately for each part of the *general insurance business*, so as to produce a sum under 6 for the health insurance and a sum under 5 for the other business.**

PRA

9. (1) **If the provision for *claims* outstanding at the end of the last preceding *financial year* exceeds the provision for *claims* outstanding at the beginning of the *financial year* two years prior to the last preceding *financial year*, then the amount of the excess must be added to the amount of *claims* paid in the 3 year period.**
- (2) **If the provision for *claims* outstanding at the beginning of the *financial year* two years prior to the *financial year in question* exceeds the provision for *claims* outstanding at the end of the *financial year in question*, then the amount of the excess must be deducted from the amount of *claims* paid in the 3 year period.**

PRA

10. (1) **For the purposes of 9, the “amount of *claims* paid”, in relation to a *friendly society* and a *financial year*, is the amount that is recorded in the *friendly society's* books at the end of the *financial year* as paid by it (whether or not payment has been effected in that year) in full or partial settlement of –**

PRA

(a) the *claims* described in (2); and

(b) the expenses described in (3),

less any *recoverable* amounts within the meaning of (4).

- (2) **The *claims* mentioned in (1) are *claims* including *claims* relating to business accounted for over a longer period than a *financial year*.**
- (3) **The expenses mentioned in (1) are expenses (such as, for example, legal or medical costs) which are incurred by the *friendly society*, whether through the employment of its own staff or otherwise, and are directly attributable to the settlement of individual *claims*, whether or not the individual *claims* in question are those mentioned in (1).**
- (4) ***Recoverable* amounts for the purposes of (1) are amounts *recoverable* by the *friendly society* in respect of the *claims* mentioned in (1) or other *claims*, including amounts *recoverable* from third parties and amounts *recoverable* from other *insurance undertakings* but excluding amounts *recoverable* in respect of reinsurance ceded by the *friendly society*.**

11. (1) For the purposes of 9, the “provisions for *claims* outstanding”, in relation to a *friendly society* and a *financial year*, is the amount set aside by the *friendly society* as at the beginning or end of the *financial year* as being an amount likely to be sufficient to meet –
- PRA
- (a) the *claims* described in (2); and
- (b) the expenses described in (3),
- less any recoverable amounts within the meaning of (4).
- (2) The *claims* mentioned in (1) are *claims* in respect of incidents occurring –
- (a) in the case of an amount set aside as at the beginning of the *financial year*, before the beginning of that year; and
- (b) in the case of an amount set aside as at the end of a *financial year*, before the end of that year,
- being *claims* which have not been treated as *claims* paid and including *claims* relating to business accounted for over a longer period than a *financial year*, *claims* the amounts of which have not been determined and *claims* arising out of incidents that have not been notified to the *friendly society*.
- (3) The expenses mentioned in (1) are expenses (such as, for example, legal or medical costs) which are likely to be incurred by the *friendly society*, whether through the employment of its own staff or otherwise and are directly attributable to the settlement of individual *claims*, whether or not the individual *claims* in question are those mentioned in (1).
- (4) *Recoverable* amounts for the purposes of (1) are amounts estimated by the *friendly society* to be *recoverable* by it in respect of the *claims* mentioned in (1), including amounts *recoverable* from third parties and amounts *recoverable* from other *insurance undertakings* but excluding amounts *recoverable* in respect of reinsurance ceded by the *friendly society*.
12. From the amount determined under 9(1) or (2) there must be deducted the total sum *recoverable* in respect of that amount under reinsurance contracts ceded during the relevant period.
- PRA
13. The amount determined under 12 must be expressed as a percentage of the amount determined under 9(1) or (2).
- PRA
14. The sum arrived at under 5 or 6 or the aggregate of the sums arrived at under 5 and 6, as the case may be, must be multiplied –
- PRA
- (a) where the percentage arrived at under 13 is greater than 50% but not greater than 100%, by the percentage so arrived at;

- (b) where the percentage so arrived at is greater than 100%, by 100%; and
- (c) in any other case, by 50%.

## **PART II: THE CLAIMS BASIS**

15. If a *friendly society* has not been in existence long enough to acquire a *reference period*, this Part II does not apply to the *friendly society*, and Part I must be applied.
- PRA
16. (1) If the provision for *claims* outstanding at the end of the *reference period* exceeds the provision for *claims* outstanding at the beginning of the *reference period*, the amount of the excess must be added to the *amount of claims* paid in the *reference period*.
- PRA
- (2) If the provision for *claims* outstanding at the beginning of the *reference period* exceeds the provision for *claims* outstanding at the end of the *reference period*, the amount of the excess must be deducted from the amount of *claims* paid in the *reference period*.
- (3) For the purposes of this paragraph, the expressions "amount of *claims* paid" and provision for *claims* outstanding have, in relation to a *reference period*, the same meaning as they have in 9 in relation to a *financial year*.
17. The aggregate obtained under 16(1) or (2) must be divided by the number of months in the *reference period* and multiplied by twelve.
- PRA
18. If the amount arrived at under 17 is more than 42.9 million Euro, it must be divided into two portions, the former consisting of 42.9 million Euro and the latter comprising the excess.
- PRA
19. Where there has been a division into two portions pursuant to 18, there must be calculated and added together 26% and 23% of the two portions respectively; and where there has been no such division, there must be calculated 26% of the amount arrived at under 17.
- PRA
20. In the case of *general insurance business* consisting of health insurance based on actuarial principles, 19 applies with the substitution of "8 2/3%" for "26%" and "7 2/3%" for "23%", but only if all the necessary conditions are satisfied.
- PRA
21. The necessary conditions for the purposes of 20 are the same as those set out in 7.
- PRA
22. In a case of the kind mentioned in 8, that paragraph applies (with the necessary modifications) so as to produce separate sums under 19 and 20.
- PRA
23. The sum arrived at under 19 or 20 or the aggregate of the sums arrived at under 19 and 20, as the case may be, must be multiplied by the same percentage as is applicable for the purposes of 14.
- PRA

## **Appendix 3:**

[deleted]



## Appendix 4:

### Asset Valuation Rules

#### *Interpretation*

1 (1) [deleted]

**PRA** (2) For the purposes of this Appendix and Appendix 6, a *debt* owed to (or an obligation to be fulfilled for the benefit of) a *friendly society* must be regarded as being secured only to the extent that it is –

(a) secured by –

(i) a letter of credit established with an *approved credit institution*; or

(ii) a guarantee provided by an *approved credit institution*,

and the sum of the aggregate amount available under all letters of credit established for the benefit of the *friendly society* with the same *counterparty*, the aggregate amount of all guarantees issued for the benefit of the *friendly society* by that *counterparty* and the amount of any *exposure* of the *friendly society* to that *counterparty* does not exceed the *permitted counterparty exposure limit* for that *counterparty*; or

(b) secured by assets for the valuation of which provision is made in this Appendix and –

(i) the value of such assets (after deducting reasonable expenses of sale and the amount of any other *debt* or obligation secured thereon having priority to or ranking equally with the *debt* or obligation) is sufficient to enable the *debt* or obligation to be discharged in full;

(ii) the value of the assets when aggregated with the *friendly society's exposure* to assets of the same description does not exceed the *permitted asset exposure limit* for assets of that description (as set out in Part II of Annex B); and

(iii) where the assets give rise to *exposure* to a *counterparty*, the *exposure* of the *friendly society* to that *counterparty*, when added to the sum of the aggregate amount available under all letters of credit established for the benefit of the *friendly society* with that *counterparty*, and the aggregate amount of all guarantees issued for the benefit of the *friendly society* by that *counterparty*, does not exceed the *permitted counterparty exposure limit* for that *counterparty*.

(3) For the purposes of (2) –

- (a) the aggregate amount available under letters of credit established with a *counterparty* must be taken not to exceed the sum of the aggregate amount of all *debts* and the aggregate value of all obligations in respect of which those letters of credit were established;
- (b) the aggregate amount of guarantees issued by a *counterparty* must be taken not to exceed the sum of the aggregate amount of all *debts* and the aggregate value of all obligations so guaranteed; and
- (c) assets which are securing any other *debt* owed to (or obligation to be fulfilled for the benefit of) the *friendly society* must be treated as if they were assets of the *friendly society*.

*Application*

2

PRA

- (1) Subject to rule 4.12(1), this Appendix (the ‘asset valuation rules’) applies with respect to the determination of the value of assets of a *friendly society* for the purposes of chapters 4 and 5.
- (2) Where a *friendly society* has entered into any contracts for the payment of *property linked benefits*, 3 to 15 do not apply with respect to the determination of the value of the *linked assets* to the extent that they are held in compliance with the requirements of rule 4.12(2) and (3) to match liabilities in respect of such benefits under such contracts and the value of such assets must be determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for *insurance business*.
- (3) Any asset to which 2 to 15 apply (other than cash) for the valuation of which no provision is made in those paragraphs must be left out of account for the purposes specified in (1).
- (4) Where in all the circumstances of the case it appears that any asset is of a lesser value than the amount calculated in accordance with the *asset valuation rules*, such lesser value must be the value of the asset.
- (5) For the purposes of (4), in determining whether it appears that an asset is of a lesser value than the amount calculated in accordance with the *asset valuation rules*, regard must be had to the underlying security and in, the case of bonds, *debt securities* and other money and capital market instruments, the credit rating of the *issuer*, including whether the *issuer* belongs to Zone A as defined in the Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions and, where the *issuer* is an international organisation, whether it includes at least one *EEA State* among its members.
- (6) Notwithstanding (1) (but subject to the conditions set out in (7) and subject to (10)) and in relation to an actuarial investigation of its *long-term insurance business* only, a *friendly society* may elect to assign to any of its assets the value given to the asset in question in the books or other records of the *friendly society*.

- (7) The conditions referred to in (6) are –
- (a) that the election must not enable the *friendly society* to bring into account any asset for the valuation of which no provision is made in this Appendix;
  - (b) that the value assigned to the aggregate of the assets must not be higher than the aggregate of the value of those assets as determined in accordance with the *asset valuation rules*.
- (8) Where a *friendly society* has entered into a contract for the conversion of currency which satisfies the conditions set out in (9), then for any of the purposes for which the *asset valuation rules* apply, the *friendly society* must treat the conversion as having been made on the *relevant date*.
- (9) The conditions referred to in (8) are that –
- (a) either –
    - (i) the contract provides for the conversion into another currency of an amount representing the sale of an asset which has, on the *relevant date*, been sold but not delivered, or
    - (ii) the contract provides for the purchase of currency for the purpose of settling the purchase of an asset which has, on the *relevant date*, been purchased but not delivered;
  - (b) the conversion is to take place during a period which is –
    - (i) where the contract is in connection with the delivery of a *listed security* or a *security admitted to trading*, a period commencing on the date of the contract and extending for the usual period of settlement as laid down by the rules of the relevant stock exchange or *regulated market*; or
    - (ii) where the contract is in connection with the delivery of any other asset, a period commencing on the date of the contract and extending for *twenty working days* thereafter; and
  - (c) the contract is *listed* or has been entered into with an *approved counterparty*.
- (10) a *friendly society* must derecognise any *defined benefit asset*.

*Shares in a related undertaking*

3

PRA

- (1) Where any *shares* are held by a *friendly society* in a *related undertaking*, which is a *regulated related undertaking* the value of the *shares* may be taken as, and in any event must not exceed, the value (or, where the shareholding, whether held directly or indirectly, is less

than 100%, the relevant *proportional share* of the value), determined in accordance with this Appendix (other than paragraph 15(1)(a) to (c)), of the *surplus assets* of the *regulated related undertaking*.

- (2) Where any *shares* are held by a *friendly society* in a *related undertaking* which is not a *regulated related undertaking*, the value of the *shares* must not exceed the greater of:
- (a) the value (or, where the shareholding, whether held directly or indirectly, is less than 100%, the relevant *proportional share* of the 31 December 2010 value), determined in accordance with this Appendix (other than 15(1)(a) to (c)), of the *related undertaking's surplus assets*; and
  - (b) the value of those *shares* as determined under paragraph 9 reduced:
    - (i) by an appropriate amount, to the extent that the *shares* cannot effectively be made available or realised to meet losses (if any) arising in the *friendly society*,
    - (ii) by an appropriate amount, to the extent needed to exclude value attributable to goodwill generated from business with the *friendly society* or any *related undertaking* of the *friendly society* that is a *regulated related undertaking*, and
    - (iii) by the amount by which the value of any *shares* held by the *related undertaking* in a *related undertaking* of the *friendly society* which is a *regulated related undertaking* exceeds the value (or *proportional share*), determined in accordance with this Appendix (other than 15(1)(a) to (c)), of the *surplus assets* of the *related undertaking*.
- (3) The surplus assets of a *related undertaking* are its total assets excluding:
- (a) the assets that are selected to cover liabilities and, in the case of a *related undertaking* which is a *regulated related undertaking*, to cover its regulatory requirement;
  - (b) the regulatory requirement of a *regulated related undertaking* is:
    - (i) in respect of an *insurance undertaking*, the *notional required minimum margin*;
    - (ii) in respect of a *regulated entity* with its head office in the *EEA* (excluding an *insurance undertaking*), the *solo capital resources requirement* calculated in accordance with the *sectoral rules* for the *financial sector* applicable to it;
    - (iii) in respect of a *regulated entity* not within (ii) (excluding an *insurance undertaking*), its *proxy capital resources*

*requirement;*

- (iv) in respect of *asset management company*, the *solo capital resources requirement* that would apply to it if, in connection with its activities, it were treated as an *investment firm* for the purposes of calculating the *solo capital resources requirement*;
  - (v) in respect of a *financial institution* (including a *financial holding company*) which is not a *regulated entity*, the *solo capital resources requirement* that would apply to it if, in connection with its activities, it were treated as being within the *banking sector*; and
  - (vi) in respect of an insurance holding company, zero.
- (c) assets that are interests directly or indirectly held in the *related undertaking's* own capital (as defined in the *relevant regulatory requirements* for that undertaking);
  - (d) where the *related undertaking* carries on *long-term insurance business*, profit reserves and future profits;
  - (e) assets which represent either a *long-term insurance fund* or a fund the allocation of which as between *policy holders* and other purposes has yet to be determined;
  - (f) amounts due, or to become due, in respect of *share capital*, or other contributions from members of the *related undertaking*, subscribed or called for but not fully paid up; and
  - (g) assets that cannot effectively be made available or realised to meet losses (if any) arising in the *friendly society*, including assets that represent capital not owned, directly or indirectly, by the *friendly society*.
- (4) The assets selected in (3)(a) to be excluded from the total assets:
- (a) where the *related undertaking* is an *insurance undertaking*, must be identified and valued in accordance with *relevant regulatory requirements* as to the value, admissibility, nature, location or matching that apply to the assets available to cover its liabilities (determined under the *relevant regulatory requirements*) and the *notional required minimum margin*;
  - (b) where the *group undertaking* is a *regulated related undertaking* (excluding an *insurance undertaking*), must be identified and valued in accordance with the relevant *sectoral rules* applicable to the *regulated related undertaking* as to cover its liabilities and the applicable regulatory requirement identified in paragraph 3(3)(b);
  - (c) where the *group undertaking* is not a *regulated related undertaking*, must be of a value at least equal to the amount of

its liabilities, determining that value and that amount in accordance with this Appendix (other than 15(1)(a) to (c)) and Appendix 5; and

- (d) in all cases, must not include:
- (i) assets falling within (3)(c), or
  - (ii) assets falling within (3)(f) where the amount is due, or to become due, from a *related undertaking*; but
- (e) notwithstanding (a), (b) and (c), a liability of a *related undertaking* which is a *debt* due to the *friendly society* is not required to be determined at an amount which is higher than the value placed on that *debt* as an asset of the *friendly society*.
- (5) For the purposes of (4), the *relevant regulatory requirements* must be treated as if paragraphs 15(1)(a) to (c) (or their equivalent in a *designated State or 31 December 2010 73 territory*) do not apply for the purpose of valuing *shares* in *related undertakings* that are not *dependants*.
- (6) For the purposes of this Appendix, any value attributed to any *shares* held directly or indirectly in a *related undertaking* which is an *ancillary insurance service undertaking*, an *ancillary investment services undertaking* or an *ancillary banking services undertaking*, calculated in accordance with paragraph 3, must be deducted from the assets of the *friendly society*.

*Value of non capital interests in a group undertaking*

4A

(1) A *friendly society* must notify the PRA of:

PRA

- (a) any *related undertaking* which:
- (i) no *participation* is held in by another *related undertaking*; and
  - (ii) is not a *subsidiary undertaking*; but
  - (iii) is linked by a *consolidation Article 12(1) relationship* with another *related undertaking*; and
- (b) the value of that *undertaking* calculated on the basis of paragraph 3.
- (2) For the purposes of this Appendix, the *related undertaking* referred to in (1)(a)(iii)'s proportional share of the value of the *related undertaking* in (1)(a) is determined in accordance with Article 28(5) of the *Financial Groups Directive*.

*Debts due or to become due from a related undertaking*

4

The value of any *debt* due, or to become due, from a *related undertaking* must not exceed the amount reasonably expected to be recovered in respect of the

PRA

*debt* taking into account only the value of:

- (a) the assets identified in 3(3)(a) and, in the case of a *related undertaking* which is an *insurance undertaking*, to cover the *required minimum margin* that would apply if the undertaking were a *directive friendly society* (other than a *flat rate benefits business friendly society*) to which *IPRU(FSOC)* applies (whether it is or not); and
- (b) any security held in respect of the *debt*.

*Assets sold to or purchased from an approved credit institution or an approved investment firm subject to an agreement for resale or repurchase*

5

PRA

(1) Where a *friendly society* has sold *securities* to or purchased *securities* from an *approved credit institution* or an *approved investment firm* and such sale or purchase was made subject to an agreement that the *approved credit institution* or *approved investment firm* would, either on demand by the *friendly society* or within six months of such sale or purchase, subsequently sell to or purchase from the *friendly society* *equivalent securities*, then if at the *relevant date* such subsequent sale or purchase has not taken place and the conditions specified in (2) and either (3) or (4) (as appropriate) are satisfied, the *friendly society* –

(a) must value –

(i) *securities* sold by it under such agreement as if such *securities* had been retained by it, and

(ii) assets provided by it as consideration for the purchase of *securities* under such agreement as if such consideration had not been provided by it; and

(b) must not ascribe a value to –

(i) any consideration received for the sale of *securities* under such agreement (or any assets purchased by it with such consideration) up to the limit of the value of the *securities* sold, or

(ii) any *securities* purchased by it under such agreement (or any assets purchased with the proceeds of the sale of any such *securities*) up to the limit of the consideration (valued in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to *friendly societies*) provided by it.

(2) The condition specified in this paragraph is that, where at any time after the sale or purchase of *securities* by the *friendly society* under an agreement described in (1) either –

(a) the amount of the consideration received by the *friendly society* for the sale of the *securities* fell below the value of the *securities*

sold by it; or

- (b) the value of the *securities* purchased by the *friendly society* fell below the value of the consideration provided by it,

by more than 2.5% of the value of the *securities* sold or purchased (as the case may be), the *friendly society* demanded additional consideration whose amount was equal to the shortfall and such demand was complied with before the end of the *working day* next following the day on which such shortfall occurred.

- (3) The conditions specified in this paragraph are that, if the *friendly society* purchases *securities* from an *approved credit institution* or an *approved investment firm* and the consideration provided by the *friendly society* is other than by way of sale of *securities* –

- (a) the *securities* purchased are –

- (i) *approved securities*,
- (ii) *listed securities*, or
- (iii) *securities* issued by an *approved credit institution*; and

- (b) the *securities* purchased do not include –

- (i) *securities* (other than *approved securities*) issued by the same *counterparty* whose aggregate value amounts to more than 15% of the value of the *securities* purchased, or
- (ii) if the condition in (b)(i) is not satisfied, *securities* whose value when aggregated with the *friendly society's* existing *exposure* to assets of the same description or to the same *counterparty* would exceed the appropriate *permitted asset exposure limit* or *permitted counterparty exposure limit* as determined in accordance with 15 and Annex B.

- (4) The conditions specified in this paragraph are that, if the *friendly society* sells *securities* to an *approved credit institution* or an *approved investment firm* –

- (a) the consideration provided by the approved credit institution or approved investment firm is –

- (i) cash,
- (ii) *approved securities*,
- (iii) *listed securities*,
- (iv) *securities* issued by an *approved credit institution*,

- (v) a charge over assets set out in (i) to (iv),
  - (vi) a letter of credit established with an *approved credit institution*, or
  - (vii) a guarantee provided by an *approved credit institution*; and
- (b) the consideration does not include –
- (i) except to the extent that the condition in (b)(ii) is satisfied, consideration whose amount when aggregated with the *friendly society's* existing *exposure* to assets of the appropriate description or to the relevant *counterparty* would exceed the appropriate *permitted asset exposure limit* or *permitted counterparty exposure limit* as determined in accordance with 15 and Annex B, or
  - (ii) consideration of more than 15% of the aggregate amount of which takes the form of *securities* (other than *approved securities*) issued by, letters of credit established with, guarantees provided by, cash deposited with, a charge over cash deposited with or a charge over *securities* issued by, the same *counterparty*; and
- (c) the consideration to be provided by the *friendly society* for the subsequent purchase of *equivalent securities* is-
- (i) where the consideration for the original purchase by the *approved credit institution* or *approved investment firm* was (wholly or in part) cash, cash denominated in the same currency, and
  - (ii) where the consideration was (wholly or in part) *securities*, *securities* equivalent to the *securities* provided by way of consideration.
- (5) For the purposes of this paragraph, where the *friendly society* has received consideration in respect of a sale of the kind described in (1), in addition to any other *exposure* to assets or to a *counterparty* –
- (a) if such consideration takes the form of a letter of credit established with, or a guarantee provided by, an *approved credit institution*, it must be considered to give rise to *exposure* to that institution by the amount of the consideration;
  - (b) if such consideration takes the form of a charge over *securities*, it must be considered to give rise to *exposure* to *securities* of the same description and to the *issuer* of those *securities* by the amount of the consideration; and
  - (c) if such consideration takes the form of cash deposited with another party for the benefit of the *friendly society*, or a charge

over cash deposited with another party, it must be considered to give rise to *exposure* to that party by the amount of the consideration.

- (6) For the purposes of this paragraph, the amount of any consideration must be –
- (a) where the consideration is a letter of credit established with an *approved credit institution*, the lower of the amount made available under the letter of credit and the value of the assets sold;
  - (b) where the consideration is a guarantee provided by an *approved credit institution*, the lower of the amount of the guarantee and the value of the assets sold;
  - (c) where the consideration takes the form of assets of any of the types mentioned in (4)(a)(i) to (iv), or a charge over such assets, the value of the assets as determined in accordance with the *asset valuation rules*; and
  - (d) where the consideration takes the form of a Talisman short term certificate, the value of the *securities* represented by that certificate.
- (7) Where a *friendly society* has entered into a number of agreements described in (1), for the purposes of (3) and (4) of this paragraph –
- (a) any or all agreements under which the subsequent sale or purchase has not taken place at the *relevant date* may be treated as one agreement; and
  - (b) in such case, the 15% limits referred to in (3)(b)(i) and (4)(b)(ii) must be calculated by reference to the aggregate of the value of the *securities* purchased under (3) and the amount of any consideration under (4).

*Debts and other rights*

6

PRA

- (1) The value of any *debt* due, or to become due, to a *friendly society*, other than a *debt* to which 4, 11 or 13 applies or to which (2), (3), (4) or (6) of this rule applies, must be –
- (a) in the case of a *debt* which is due, or will become due, within twelve months of the *relevant date* (including any *debt* which would become due within that period if the *friendly society* were to exercise any right to which it is entitled to require payment of the same), the amount which can reasonably be expected to be recovered in respect of that *debt*; and
  - (b) in the case of any other *debt*, the amount which would reasonably be paid by way of consideration for an immediate assignment of the *debt*,

in either case due account being taken of the terms and conditions for payment of the *debt* and, where the *debt* is secured, the nature and quality of the security.

- (2) Any *debt* due, or to become due, to a *friendly society* under a letter of credit must be left out of account for the purposes for which the *asset valuation rules* apply.
- (3) In the case of *long-term insurance business* carried on by a *friendly society*, the value of any *debt* due, or to become due, to the *friendly society* which is secured on a policy of insurance issued by the *friendly society* and which (together with any other *debt* secured on that policy) does not exceed the amount payable on a surrender of that policy at the *relevant date* must be the amount of that *debt*.
- (4) Subject to (5), the value of any rights of the *friendly society* under a contract of reinsurance to which it is a party must be the amount which can reasonably be expected to be recovered in respect of those rights.
- (5) (4) does not apply to –
  - (a) rights under a contract of reinsurance in respect of *long-term insurance business* except to the extent that *debts* are due under such contracts; or
  - (b) *debts* to which 4 applies which are due or are to become due.
- (6) Any *debt* due, or to become due, to a *friendly society* –
  - (a) from an *intermediary* in respect of money advanced on account of commission to which that *intermediary* is not absolutely entitled at the *relevant date*; or
  - (b) which is a *debt* owed in respect of *premiums* (due account being taken of rebates, refunds and commissions payable) which is recorded in the *friendly society's* accounting records as due and payable and has been outstanding for more than three months,  
  
must be left out of account for the purposes of the *asset valuation rules*.
- (7) The value of any right to recover assets transferred by way of *initial margin* in respect of a *derivative contract* or a contract or asset having the effect of a *derivative contract* must be determined –
  - (a) where the *initial margin* was a payment in cash, as if there were a *debt* owed to the *friendly society* for that amount; and
  - (b) where the *initial margin* took the form of a transfer of *securities*, as if there were a *debt* owed to the *friendly society* of an amount equal to the value of such *securities* as determined in accordance with the *asset valuation rules*.

- (8) The value of any rights arising under a *derivative contract* to which 13 does not apply, or under a contract or asset having the effect of such a contract, must be the value of any right to recover assets transferred by way of *initial margin* together with the value of any other unconditional right to receive a specified amount.
- (9) This rule must not apply to any rights (other than *debts due*) in respect of –
- (a) investments in *related undertakings*;
  - (b) *securities* or beneficial interests in a limited partnership;
  - (c) units or other beneficial interests in a *collective investment scheme*;
  - (d) a *derivative contract*, except as provided under (7) or (8); or
  - (e) a contract or asset which has the effect of a *derivative contract* except as provided under (7) or (8) or under 14(4) or (5).

*Land*

7

PRA

- (1) The value of any land of a *friendly society* (other than land held by the *friendly society* as security for a *debt* or to which (2) or 12 applies) must be not greater than the amount which (after deduction of the reasonable expenses of sale) would be realised if the land were sold at a price equal to the most recent *proper valuation* of that land which has been provided to the *friendly society* and any such land of which there is no *proper valuation* must be left out of account for the purposes for which the *asset valuation rules* apply.
- (2) The value of any interest in land which is determinable upon the death of any person or upon the happening of some other future event or at some future time must be the amount which would reasonably be paid by way of consideration for an immediate transfer thereof.

*Equipment*

8

PRA

- (1) The value of any computer equipment of a *friendly society* –
- (a) in the *financial year* of the *friendly society* in which it is purchased, must not be greater than three-quarters of the cost thereof to the *friendly society*;
  - (b) in the first *financial year* thereafter, must not be greater than one-half of that cost;
  - (c) in the second *financial year* thereafter, must be not greater than one-quarter of that cost; and
  - (d) in any subsequent *financial year*, must be left out of account for the purposes for which the *asset valuation rules* apply.

- (2) The value of any office machinery (other than computer equipment), furniture, motor vehicles and other equipment of a *friendly society*, must be, in the *financial year* of the *friendly society* in which it is purchased, not greater than one-half of the cost thereof and must be, in any subsequent *financial year*, left out of account for the purposes for which the *asset valuation rules* apply.

*Securities and beneficial interests in limited partnerships*

9

PRA

- (1) Subject to (2), this paragraph applies to the valuation of investments comprising *securities* and beneficial interests in limited partnerships and, for the purposes of (6), investments includes loans.
- (2) This paragraph does not apply to the valuation of *securities* which are –
- (a) *derivative contracts*;
  - (b) [deleted]
  - (c) units or other beneficial interests in *collective investment schemes*, except as provided in 10(2); or
  - (d) contracts or assets having the effect of *derivative contracts*, except as provided in 14(4).
- (3) Subject to (6), the value of an investment to which this rule applies must be –
- (a) where the investment is transferable and (4) does not apply, the *market value*;
  - (b) where the investment is transferable and (4) applies, the lower of –
    - (i) the *market value*, and
    - (ii) the amount which would reasonably be expected to be received by way of consideration for an assignment or transfer of the investment at a date not later than twelve months after the relevant date, it being assumed that negotiations for the assignment or transfer commenced on the *relevant date* and the assignment or transfer was made other than to the *issuer* or to an *associate* or an *associate company* of the issuer or of the *friendly society*; or
  - (c) where the investment is not transferable –
    - (i) the amount payable on redemption on the *relevant date* or the most recent date before the *relevant date* on which the *issuer* of 31 December 2010 80 the investment could have been required to redeem the investment, or

- (ii) where the investment cannot be redeemed, the amount which would reasonably be paid by way of compensation for the surrender of the interest in the investment.
- (4) Subject to (5), this paragraph applies where it is not reasonable to assume that, had negotiations for the assignment or transfer of the investment commenced not more than seven *working days* before the *relevant date*, the investment could have been assigned or transferred on the *relevant date* for an amount not less than 97.5% of the *market value* other than to the *issuer* or to an *associate* or an *associate company* of the *issuer* or of the *friendly society*.
- (5) (4) must be taken not to apply if it applies by reason only that –
- (a) the *listing* or *admission to trading* of the investment has been temporarily suspended following receipt of price sensitive information by the stock exchange on which the investment is *listed*, or *admitted to trading* or the *regulated market* on which facilities for dealing have been granted; or
  - (b) the extent of the holding would prevent an orderly disposal of the investment for an amount equal to or greater than 97.5% of the *market value*.
- (6) Where a *friendly society* has made more than one *unlisted* investment (other than a number of investments exclusively comprising loans) and the value of such investments when taken together is greater than the aggregate of the values of each investment valued separately, then such higher value may be ascribed to the investments if it is reasonable to assume that none of the investments would be assigned or transferred separately.

*Beneficial interests in collective investments schemes*

10

PRA

- (1) Subject to (3), this rule applies to holdings of units, or other beneficial interests in –
- (a) a scheme falling within the *UCITS Directive*;
  - (b) an authorised unit trust scheme or a recognised scheme within the meaning of the *Act* (not falling within (a)); or
  - (c) any other collective investment scheme where –
    - (i) the scheme does not employ *derivative contracts* unless they are contracts to which 13 applies,
    - (ii) the scheme does not employ contracts or assets having the effect of *derivative contracts* unless they have the effect of *derivative contracts* to which 13 applies, and
    - (iii) the property of the scheme does not include assets other than those for the valuation of which provision is made in

the *asset valuation rules*.

- (2) The value of units or other beneficial interests in a *collective investment scheme* to which this rule applies must be –
- (a) where the *issuer* can be required to purchase the units or other beneficial interests from the holder upon the holder giving notice of one month or less, the price at which the *issuer* would have purchased the units or other beneficial interests on the *relevant date* or the most recent date before the *relevant date* on which it could have been required to make such a purchase; or
  - (b) where the *issuer* cannot be required to purchase the units or other beneficial interests as set out in (a), a value determined in accordance with 9.
- (3) Other than as provided in 14(4), this rule must not apply to units or other beneficial interests in a *collective investment scheme* which has the effect of a *derivative contract*.

*Deferred acquisition costs*

11

PRA

In the case of *general insurance business*, the value of *deferred acquisition costs* must be the value as determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate to *friendly societies*.

*Reversionary interests etc.*

12

PRA

The value of any *long-term insurance business asset* of a *friendly society* consisting of an interest in property which is a remainder, reversionary interest, right of fee subject to a life rent or other future interest, whether vested or contingent must be the amount which would reasonably be paid by way of consideration for an immediate transfer or assignment of it.

*Derivative contracts*

13

PRA

- (1) The value of rights (other than rights to recover assets transferred by way of *initial margin*) under a *derivative contract* to which this rule applies must be –
- (a) in the case of a *listed derivative contract*, the *market value*; and
  - (b) in the case of an *unlisted derivative contract*, the amount which would reasonably be paid by way of consideration for closing out that contract,
- in either case taking into account the *market value* of any assets which, at the *relevant date*, have been transferred by way of *variation margin*.
- (2) This rule applies to an *approved derivative contract* which is covered and –

- (a) which is held in connection with a contract or asset of the type described in (3) for the purposes of reduction of investment risks or efficient portfolio management; or
  - (b) which has effect as if so held for such purposes.
- (3) The contract or asset described in this paragraph must be either –
- (a) an *approved derivative contract* or a contract or asset having the effect of an *approved derivative contract* which, when taken together with the *approved derivative contract* the rights under which are being valued in accordance with this rule, would have the effect that the *friendly society* either holds an asset for the valuation of which provision is made in this chapter or holds an *approved derivative contract* in connection with such an asset; or
  - (b) an asset for the valuation of which provision is made in this chapter, being neither a *derivative contract* nor a contract or asset having the effect of a *derivative contract*.
- (4) For the purposes of this rule an *approved derivative contract* is covered if it does not require a significant provision to be made in respect of it pursuant to 3 of Appendix 5.
- (5) For the purposes of determining in accordance with (4) whether a required provision is significant, regard must be had to the obligations of the *friendly society* under the contract and the volatility of the assets identified by the *friendly society* as being suitable to cover such obligations, and the required provision in respect of any one *derivative contract* must be deemed to be significant if –
- (a) the aggregate provision required in respect of all contracts having a similar effect is significant; or
  - (b) the aggregate provision required in respect of all contracts with which it is connected is significant.
- (6) In this rule, an ‘approved derivative contract’ is a *derivative contract* entered into by a *directive friendly society* which –
- (a) either is *listed* or has been entered into with an *approved counterparty*;
  - (b) the *friendly society* reasonably believes may be readily closed out; and
  - (c) is either a *contract for differences* to which (7) applies or a *futures contract* or an *option* to either of which (8) applies.
- (7) This paragraph applies to

- (a) a *contract for differences* under which the amount payable by either party is calculated solely by reference to fluctuations in any of the following –
    - (i) the value of an asset for the valuation of which provision is made in this chapter,
    - (ii) the amount of income from such an asset over a defined period,
    - (iii) an index of such assets, being an index in respect of which a *derivative contract* is *listed*, or
    - (iv) a national index of retail prices published by or under the authority of a government of a State belonging to Zone A as defined in Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions, or an arithmetic average thereof; and
  - (b) a contract under which the amount payable by either party is calculated by reference to the difference between the *market value* and the amortised value of any asset for the valuation of which provision is made in this Appendix.
- (8) This paragraph applies to a *futures contract* or an *option* which in either case provides for the acquisition or disposal of assets for the valuation of all of which provision is made in this Appendix at a price which is determined by one or more of the following methods –
- (a) for each date on which the contract may be completed or the *option* exercised, the price is a fixed amount under the terms of the contract or *option*;
  - (b) it is determined by reference to the *market value* or the amortised value of an asset for the valuation of which provision is made in this chapter or the amount of income over a defined period from such an asset;
  - (c) it is determined by reference to an index of the kind mentioned in (7)(a)(iii) or (iv).

*Contracts and assets having the effect of derivatives*

14

PRA

- (1) Subject to (3), for the purposes of this Appendix, a contract has the effect of a *derivative contract* if it is a contract (other than a *derivative contract*) which provides whether upon the exercise of a right by the *friendly society* or otherwise –
  - (a) for payment (at any time) of amounts which are determined by fluctuations in –
    - (i) the value of property of any description,

- (ii) an index of the value of property of any description,
    - (iii) income from property of any description, or
    - (iv) an index of income from property of any description;
  - (b) for delivery of an asset (other than an asset for the valuation of which provision is made in 8) to or by the *friendly society*; or
  - (c) for the conversion of an asset held by the *friendly society* or another party to –
    - (i) an asset of a different type, or
    - (ii) a different asset of the same type.
- (2) Subject to (3), for the purposes of this Appendix an asset has the effect of a *derivative contract* if the asset is an asset (other than an *approved security* or an asset falling within 10(1)(a)) and the holding of the asset confers contractual rights or imposes contractual obligations to make or accept payment, delivery or conversion as set out in (1)(a) to (c).
- (3) A contract or asset does not have the effect of a *derivative contract* by reason only that –
- (a) it provides for the unconditional delivery of assets, or for the payment for unconditional delivery of assets, such delivery or payment to be made within a period not exceeding the period commencing at the date of the contract and extending –
    - (i) in the case of a *listed security* or a *security admitted to trading*, for the usual period for delivery or payment as determined by the rules of the stock exchange or *regulated market* on which the *securities* are *listed* or *admitted to trading*, or facilities for dealing have been granted, or
    - (ii) in any other case, for twenty *working days*;
  - (b) it is a contract of the type described in 2(8) in respect of which the conditions set out in 2(9) have been satisfied; or
  - (c) it is a transaction to which 5(1) applies.
- (4) Rights in respect of a contract or asset whose effect is that of a *derivative contract* to which 13 applies must –
- (a) where the asset is a security, be valued in accordance with 9;
  - (b) where the asset comprises units or other beneficial interests in a *collective investment scheme*, be valued in accordance with 10; and

- (c) where the asset is a *debt* or other right, be valued in accordance with 6.
- (5) Rights in respect of a contract or asset whose effect is that of a *derivative contract* to which 13 does not apply must have a value determined in accordance with 6(8).
- (6) For the purposes of determining whether a contract or asset has the effect of a *derivative contract* to which 13 applies, it must be deemed to have the effect of a *derivative contract* which is *listed* or transacted with an *approved counterparty* if it is itself *listed* or so transacted.

*Assets to be taken into account only to a specified extent*

15

PRA

- (1) Subject to (2) to (6), the aggregate value of the assets of a *non-directive incorporated friendly society* as determined in accordance with the *asset valuation rules* must, for any of the purposes for which the *asset valuation rules* apply, be reduced by an amount representing the aggregate of –
  - (a) the amount by which the society is exposed to assets of any description in excess of the *permitted asset exposure limit* for assets of that description;
  - (b) the amount by which the society is exposed to a *counterparty* in excess of the *permitted counterparty exposure limit* for such *counterparty*;
  - (c) the amount by which the society has an *excess concentration with a number of counterparties*;
  - (d) the value of any assets transferred to or for the benefit of the society in pursuance of a condition in a *derivative contract* to which 13 does not apply or a related contract; and
  - (e) the value of any assets transferred to or for the benefit of the society in pursuance of a contract whose effect is that of a *derivative contract* to which 13 does not apply or a related contract,

as determined in accordance with Annex B.
- (2) Where a *non-directive incorporated friendly society* is exposed to assets of any description in excess of the *permitted asset exposure limit* for such assets, the reduction required to be made by (1)(a) must be made –
  - (a) by deducting (as far as possible) the amount of the excess from the assets of that description held by the society; and
  - (b) where the society does not hold sufficient assets of that description to eliminate the excess (or does not hold any assets of that description) by making an appropriate deduction from the aggregate value of the assets which the society would otherwise

be permitted to take into account for any of the purposes for which the *asset valuation rules* apply.

- (3) Where a society is required to make a reduction in accordance with (1)(b), (c), (d) or (e), the reduction must be made by making a deduction from the aggregate value of the assets which the society would otherwise be permitted to take into account for any of the purposes for which the *asset valuation rules* apply.
- (4) Where a *non-directive incorporated friendly society* carrying on *long-term insurance business* has attributed assets partly to a *long-term insurance business* fund and partly to its other assets, any reduction required to be made by this rule must be made in the same proportion as the attribution.
- (5) Assets of a *friendly society* comprising –
- (a) *approved securities* or any interest accrued thereon;
  - (b) *debts* to which 6(3) applies;
  - (c) rights to which 6(4) applies;
  - (d) *debts* in respect of *premiums*;
  - (e) moneys due from, or guaranteed by, the government of any State which belongs to Zone A as defined in Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions;
  - (f) *shares* in or *debts due or to become due* from a dependant *falling* within 3;
  - (g) holdings in a scheme falling within the *UCITS Directive*; or
  - (h) *deferred acquisition costs*,
- must not be taken into account in any of the calculations described in (1).
- (5A) Assets of *dependants* of the *friendly society* that are *debts* due or to become due from the *friendly society* or from a *dependant* of the *friendly society* must not be taken into account in any of the calculations described in (1).
- (6) Where a *friendly society* has entered into any contracts providing for the payment of *index linked benefits*, the provisions of (1)(a) must not apply to assets of that *friendly society* to the extent that they are held to match liabilities in respect of such benefits.

**Annex A to Appendix 4:  
Valuation of *Dependants***

[Deleted]

## Annex B to Appendix 4:

### Assets to be Taken Into Account Only to a Specified Extent

#### PART I: THE METHOD OF CALCULATION OF EXCESS EXPOSURE

B1 [deleted]

B2 [deleted]

B3 [deleted]

#### *Calculation of exposure to assets*

B4 A value must be ascribed to assets of each description which must be an amount determined in accordance with the *asset valuation rules* or, PRA where the assets are of a description for the valuation of which no provision is made in those rules, an amount which would reasonably be paid by way of consideration for an immediate assignment or transfer of such assets. The amount by which the *friendly society* is exposed to assets of each description must be determined by adjusting the value of the assets in accordance with B5 to B11A.

#### *Adjustments in respect of futures contracts*

B5 The value ascribed under B4 in respect of assets of each description must be increased or decreased by the value of assets of that PRA description which the *friendly society* is deemed to have acquired or disposed of pursuant to a *futures contract*.

B6 For the purposes of B5, the *friendly society* must be deemed to have PRA acquired or disposed of assets pursuant to a *futures contract* if, at the *relevant date*, it has entered into (and not closed out) a *futures contract* which –

- (a) provides for the acquisition of assets by the *friendly society*;
- (b) is *listed* and provides for the disposal of assets by the *friendly society*; or
- (c) is not *listed* but provides for the disposal of assets by the *friendly society* to an *approved counterparty* and it is prudent to assume that such disposal will take place within one year of the *relevant date*.

#### *Adjustments in respect of options*

B7 The figure arrived at under B4 to B6 in respect of assets of each PRA description must be increased or decreased by the value of assets of that description which the *friendly society* is deemed to have acquired or disposed of pursuant to an *option*.

**B8** For the purposes of B7, the *friendly society* must be deemed to have acquired or disposed of assets pursuant to an *option* if, at the *relevant date*, it is a party to an *option* and it is prudent to assume that the *option* will be exercised and the *option* is one which –

**PRA**

- (a) provides for the acquisition of assets by the *friendly society*;
- (b) is *listed* and provides for the disposal of assets by the *friendly society*; or
- (c) is not *listed* but provides for the disposal of assets by the *friendly society* to an *approved counterparty* and it is prudent to assume that such disposal will take place within one year of the *relevant date*.

*Adjustments in respect of initial margins*

**B9** The figure arrived at under B4 to B8 in respect of assets of each description must be increased by an amount representing the value of any assets of that description which have been transferred by the *friendly society* by way of *initial margin*.

**PRA**

*Adjustments in respect of an undiversified contract for differences or a contract or asset having the effect of a derivative contract*

**B10** The amount arrived at in accordance with B4 to B9 must be increased or decreased by an amount representing the value of assets which the *friendly society* is deemed to have acquired or disposed of under –

**PRA**

- (a) an *undiversified contract for differences*; or
- (b) a contract or asset other than a *diversified contract for differences* which has the effect of a *derivative contract*.

**B11** For the purposes of B10, the *friendly society* must be deemed to have achieved the effect of such contract by entering into appropriate *futures contracts* or *options*. The assets deemed to be acquired or disposed of must be dealt with in accordance with the provisions in B5 and B7 respectively.

**PRA**

*Adjustment in respect of subsidiary undertakings*

**B11A** Subject to B11B and B11C, the amount of the *friendly society's* exposure to assets arrived at under B4 to B11 must be increased by an amount representing the exposure, if any, of the *friendly society's* dependants to assets of that description.

**PRA**

**B11B** For the purposes of B11A, the exposure of each *dependant* must be calculated by applying B4 to B11 to that *dependant* as if it were a *friendly society* to which those provisions apply (whether it is or not).

**PRA**

**B11C** In relation to a *dependant*:

**PRA**

- (a) which is an *insurance undertaking*; or
- (b) for which 15(1)(a) to (c) have (notwithstanding 3(4)(a)) been applied when valuing the assets selected under 3(3)(a),

11A applies only in relation to the *dependant's surplus assets* (or *proportional share*).

*Excess asset exposure*

**B12** The amount by which the *friendly society* is exposed to assets of a particular description in excess of the *permitted asset exposure limit* must be calculated by subtracting the *permitted asset exposure limit* for assets of that description from the corresponding amount of the *exposure*, calculated in accordance with B4 to B11A. For this purpose, *exposure* to assets must be excluded to the extent that such *exposure* has caused the recognition of excess *exposure* to assets of a different description. If the figure arrived at is negative, it must be taken to be zero.

PRA

*Calculation of exposure to a counterparty*

**B13** Subject to B14 to B15A, the value of all investments (determined in accordance with 9 of Appendix 4) issued by any one *counterparty* and the value of all rights (determined in accordance with 6, 13 and 14 of Appendix 4) against that *counterparty*, in each case up to the amount of the appropriate *permitted asset exposure limit*, must be aggregated. Where the *counterparty* is an *issuer* of a *collective investment scheme* falling within 10(1)(c) of Appendix 4, the value of units or other beneficial interest in the *collective investment scheme* must be included.

PRA

**B14** Where a *friendly society* has rights in respect of an obligation to be fulfilled by a *counterparty* and –

PRA

- (a) the obligation is a secured obligation which –
  - (i) is secured by cash deposited with, or a letter of credit established with, or *securities* issued by, or a guarantee provided by, an *approved credit institution* or an *approved financial institution*; and
  - (ii) is due to be fulfilled within 12 months of the *relevant date*; or
- (b) the obligation is a secured obligation which is secured by *listed securities* which are *readily realisable* or by *approved securities* which in either case –
  - (i) have been deposited with an *approved credit institution*, an *approved financial institution* or an *approved investment firm*; and

- (ii) are beneficially owned by the *counterparty* but will not be available for the benefit of creditors generally in the event of the winding-up of the *counterparty*,

the aggregation required by B13 need not include the value of such rights.

**B15** If the *friendly society* has liabilities to the *counterparty* which may be offset against the above mentioned assets in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for *friendly societies*, then such liabilities may be offset for the purposes of the aggregation required by B13.

PRA

**B15A** Subject to B15B, the amount arrived at under B13 to B15 must be increased by the amount by which any *dependant* of the *friendly society* is exposed to the same *counterparty*.

PRA

**B15B** In relation to a *dependant*:

PRA

- (a) which is an *insurance undertaking*; or
- (b) for which 15(1)(a) to (c) have (notwithstanding 3(4)(a)) been applied when valuing the assets selected under 3(3)(a),

B15A applies only in relation to the *dependant's surplus assets (or proportional share)*.

#### *Excess counterparty exposure*

**B16** The amount by which the *friendly society* is exposed to a *counterparty* in excess of the *permitted counterparty exposure limit* must be calculated by subtracting from the amount of the *exposure* to such *counterparty* the amount of the *permitted counterparty exposure limit* for such *counterparty*. If the figure arrived at is negative, it must be taken to be zero. If the *friendly society* is exposed to a *counterparty* in excess of the *permitted counterparty exposure limit* in more than one of the circumstances set out in (c) of the definition of *permitted counterparty exposure limit*, it must make the deduction required under 15(1)(b) of Appendix 4 only in respect of the circumstances leading to the greatest excess *exposure*.

PRA

#### *Excess concentration with a number of counterparties*

**B17** Where there is *exposure* to a *counterparty* of the type mentioned in (c)(ii) of the definition of *permitted counterparty exposure limit*, 40% of the *business amount* must be deducted from the aggregate of such *exposures*. The amount so arrived at is the excess concentration with a number of counterparties. Where this amount is negative, it must be taken to be zero. For the purposes of this paragraph –

PRA

- (a) *exposure* to a *counterparty* must be taken into account only up to the level of the *permitted counterparty exposure limit* for that *counterparty*;

- (b) *exposure to a counterparty* must not be taken into account if it does not exceed 5% of the *business amount*; and
- (c) *exposure to a counterparty* must not be taken into account if the corresponding *permitted counterparty exposure limit* does not exceed 5% of the *business amount*.

## PART II: DESCRIPTION OF ASSET AND CORRESPONDING BUSINESS AMOUNT

B18	A piece of land or a number of pieces of land (or one or more interests in such pieces of land) to which in the most recent <i>proper valuation</i> of such pieces of land an aggregate value is ascribed which is greater than the aggregate of the value of each of such pieces of land or interests valued separately.	5%
PRA		
B19	A reversionary interest or a remainder not falling within B18.	1%
PRA		
B20	All <i>debts due or to become due</i> from any one individual (other than a <i>connected individual</i> of the <i>friendly society</i> ), being <i>debts</i> which are fully secured on any dwelling or any land appurtenant (or in Scotland, appertaining) thereto owned or to be purchased by the individual and used or to be used by him for his own residence.	1%
PRA		
B21	All <i>debts due or to become due</i> from any one individual, other than <i>debts</i> specified in B20.	0.25%
PRA		
B22	All unsecured <i>debts</i> (other than <i>debts</i> arising under the terms of <i>debt securities</i> or <i>debts</i> from a <i>regulated institution</i> ) <i>due or to become due</i> from any one <i>counterparty</i> other than an individual, body corporate or group.	1%
PRA		
B23	All unsecured <i>debts</i> (other than <i>debts</i> arising under the terms of <i>debt securities</i> or <i>debts</i> from a <i>regulated institution</i> ) <i>due or to become due</i> from any one <i>company</i> , taken together with all such <i>debts due or to become due</i> from a connected company of that <i>company</i> .	1%
PRA		
B24	All unsecured <i>debts</i> (other than <i>debts</i> arising under the terms of <i>debt securities</i> or <i>debts</i> from an <i>approved counterparty</i> ) <i>due or to become due</i> from any one <i>regulated institution</i> , taken together with (where that institution is a <i>company</i> ) all such <i>debts due or to become due</i> from a connected company of that institution.	2.5%
PRA		
B25	All <i>debts</i> , other than <i>debts</i> arising under the terms of <i>debt securities</i> , <i>due or to become due</i> from any one <i>counterparty</i> which is not an <i>approved counterparty</i> taken together with all such <i>debts due or to become due</i> from any connected company (other than an <i>approved counterparty</i> ) of that	5%
PRA		

	<i>counterparty.</i>	
B26	All <i>debts</i> , other than short-term deposits with an <i>approved credit institution</i> or <i>debts</i> arising under the terms of <i>debt securities, due or to become due</i> from any one <i>approved counterparty</i> , taken together with all such <i>debts due or to become due</i> from any connected company of that <i>approved counterparty</i> .	10%
	<b>PRA</b>	
B27	All <i>debts due or to become due</i> from an <i>approved credit institution</i> (or a <i>connected company</i> of that institution) taken together unless –	20%
	<b>PRA</b>	
	(a) the <i>friendly society</i> has notified the <i>PRA</i> that it places deposits with that institution; and	
	(b) the total amount of <i>debts due or to become due</i> does not exceed £2 million.	
B28	The aggregate of <i>debts</i> of the descriptions in B21, B22 and B23.	5%
	<b>PRA</b>	
B29	All investments of a kind which may be valued in accordance with 9 of Appendix 4 (other than secured <i>debt securities, debt securities</i> issued by a <i>regulated institution</i> or investments which are <i>listed</i> and <i>readily realisable</i> ) issued by any one <i>issuer</i> taken together with-	1%
	<b>PRA</b>	
	(a) all units or other beneficial interests in a <i>collective investment scheme</i> falling within 10(1)(c) of Appendix 4 issued by that <i>issuer</i> ; and	
	(b) all investments of the kinds mentioned in this paragraph issued by a <i>connected company</i> of that <i>issuer</i> .	
B30	The aggregate of assets of any of the descriptions in B19 and B29.	10%
	<b>PRA</b>	
B31	All <i>shares</i> and hybrid <i>securities</i> issued by any one <i>issuer</i> taken together with all such <i>securities</i> issued by a <i>connected company</i> of that <i>issuer</i> . <sup>8</sup>	2.5%
	<b>PRA</b>	
B31A	In the case of a <i>friendly society</i> effecting or carrying out <i>with-profits policies</i> and holding <i>shares</i> as <i>long-term insurance business assets</i> , for <i>shares</i> that are ordinary <i>listed shares</i> in the issuer, the <i>permitted asset exposure limit</i> in B31 may exceed 2.5% of the <i>long-term insurance business amount</i> to a maximum of 5% of the <i>long-term insurance business amount</i> or the formula result, whichever is lower, where –	
	<b>PRA</b>	

- (a) the 'formula result' means 0.8 multiplied by M/T multiplied by P, expressed as a percentage of the *long-term insurance business amount*, where –
- (i) M = the aggregate market capitalisation of the ordinary *listed* shares in the *issuer*,
  - (ii) T = the aggregate market capitalisation of all *securities* in the Financial Times Stock Exchange All Share Index, and
  - (iii) P = the value of the assets supporting the *friendly society's long-term insurance business* fund, determined in accordance with the *asset valuation rules*; and
- (b) 'value of the assets' means the value of the assets –
- (i) less the amount of the *friendly society's mathematical reserves for linked long-term contracts* and *non-profit policies* net of reinsurance, and
  - (ii) if the *friendly society* does not effect or carry out *general insurance contracts*, plus the *friendly society's net assets* outside the *friendly society's long-term insurance business fund*.

B32	All <i>securities</i> issued by any one <i>issuer</i> which is not an <i>approved counterparty</i> taken together with (where that <i>issuer</i> is a company) all <i>securities</i> issued by a <i>connected company</i> , other than an <i>approved counterparty</i> , of that <i>issuer</i> .	5%
PRA		
B33	All <i>securities</i> issued by any one <i>counterparty</i> .	10%
PRA		
B34	All holdings in any one authorised unit trust scheme or recognised scheme.	5%
PRA		
B35	All cash.	3%
PRA		
B36	All computer equipment.	5%
PRA		
B37	All office machinery (other than computer equipment) taken together with all furniture, motor vehicles and other equipment.	2.5%
PRA		

<sup>8</sup>The amendment to paragraph B31 comes into force on 31 December 2002.

## Appendix 5:

### Liability Valuation Rules

#### *Application*

- 1 (1) This Appendix (the 'liability valuation rules') applies with respect to the determination of the amount of liabilities of a *friendly society* for the purposes of chapters 4 and 5.

PRA

#### *Long-term and general insurance business*

- 2 (1) Subject to the provisions below, the amount of liabilities of a *friendly society* in respect of *long-term insurance business* and *general insurance business* and other lawful activities must be determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for *insurance business*.
- (2) In determining under (1) the amount of liabilities of a *friendly society*, all contingent and prospective liabilities must be taken into account.
- (3) A *friendly society* may substitute for a *defined benefit liability* its *deficit reduction amount*.

PRA

#### *Provision for adverse changes*

- 3 (1) A *friendly society* which has or may have (following the exercise of any right by the *friendly society* or any other party) an obligation to which this rule applies to deliver assets or make a payment must –
- (a) at all times identify the assets held by it which it considers to be the most suitable to cover such obligation; and
- (b) make prudent provision for the effect on the amount of its excess assets of adverse variations between the value of the assets identified and the value of the assets which it is or may be obliged to deliver or the amount of the payment which it is or may be obliged to make.
- (2) For the purposes of (1) the *friendly society* must take into account all reasonably foreseeable adverse variations and must have particular regard to past volatility in the value of the assets concerned (or assets of a similar nature) and the possibility of adverse changes in such volatility in the future.
- (3) For the purposes of this rule "the amount of its excess assets" means the difference between the aggregate value of its assets (other than *linked assets* to the extent that they are held to match *property linked liabilities*) determined in accordance with Appendix 4 and the amount of its liabilities (other than *property linked liabilities* or liabilities for which provision is made in accordance with this rule).
- (4) Subject to (5), this rule applies to an obligation –

PRA

- (a) under a contract relating to investments of the kinds mentioned in item B under the heading "Assets" in Part I of Schedule 2 to *Accounts Regulations* (whether such contract constitutes an asset or liability of the *friendly society*);
  - (b) undertaken for the purposes of, or in connection with the making of, investments of the kind mentioned in (a); or
  - (c) under a contract providing for the purchase, sale or exchange of currency.
- (5) This rule does not apply to a contract to the extent that it relates to, or is for the purposes of the making of an investment in, or is in connection with the making of an investment in, a building which is to be occupied by the *friendly society* and used by the *friendly society* for the conduct of its business.

*Provision for related undertakings*

3A

PRA

- (1) Except to the extent that provision for the deficit has been made (whether in the calculation of *surplus assets* or otherwise) in another *related undertaking* the value of whose *shares* is taken to be the value of its *surplus assets* under paragraph 3(1) or (2) of Appendix 4 (but only to the extent of the *friendly society's proportional share* of that *undertaking*), a *friendly society* must make provision in respect of a *related undertaking* that is a *regulated related undertaking*:
- (a) where the *related undertaking* is also a *subsidiary undertaking* of the *friendly society*, for the whole of any *solvency deficit*; and
  - (b) in any other case, for the *friendly society's proportional share* of any such deficit.
- (2) For the purposes of (1), the identification and valuation of assets of *regulated related undertaking* available to cover liabilities and the regulatory requirement, set out in paragraph 3(3)(b) of Appendix 4 must be determined in accordance with paragraph 3(4) of Appendix 4.

*General insurance business liabilities*

4

PRA

The amount of *insurance liabilities* which are *general insurance business liabilities* must be determined in accordance with the regulations set out in Part VI of Schedule 6 to the *Accounts Regulations*.

*Long-term insurance business liabilities*

5

PRA

- (1) The determination of the amount of *long-term liabilities* (other than liabilities which have fallen due for payment before the *valuation date*) must be made on actuarial principles which must have due regard to the reasonable expectations of *policyholders* and must make proper provision for all liabilities on prudent assumptions that must include appropriate margins for adverse deviation of the relevant factors.

- (2) The determination must take account of all prospective liabilities as determined by the policy conditions for each existing contract, taking credit for *premiums* payable after the *valuation date*.
- (3) Without prejudice to the generality of (1), the amount of the *long-term liabilities* must be determined in compliance with each of 6 to 16 and must take account, inter alia, the following factors:
  - (a) all guaranteed benefits, including guaranteed surrender values;
  - (b) vested, declared or allotted bonuses to which *policyholders* are already either collectively or individually contractually entitled;
  - (c) all options available to the *policyholder* under the terms of the contract;
  - (cc) discretionary charges and deductions, in so far as they do not exceed the reasonable expectations of *policyholders*;
  - (d) expenses, including commissions; and
  - (e) any rights under contracts of reinsurance in respect of *long-term insurance business*.

*Method of calculation*

6

PRA

- (1) Subject to (2), (3) and (4), the amount of the *long-term liability* must be determined separately for each contract by a prospective calculation.
- (2) A retrospective calculation may be applied to determine the liabilities where a prospective method cannot be applied to a particular type of contract or benefit, or where it can be demonstrated that the resulting amount of liabilities would be no lower than would be required by a prudent prospective calculation.
- (3) Appropriate approximations or generalisations may be made where they are likely to provide the same, or a higher, result than individual calculations of the same amount of the liabilities in respect of each contract.
- (4) Where necessary, additional amounts must be set aside on an aggregated basis for general risks which are not individualised.
- (5) The method of calculation of the amount of the liabilities and the assumptions used must not be subject to discontinuities from year to year arising from arbitrary changes and must be such as to recognise the distribution of profits in an appropriate way over the duration of each policy.
- (6) The liabilities for contracts under which the *policyholder* is eligible to participate in any *established surplus* must have regard to the level of the *premiums* under the contracts, to the assets held in respect of those liabilities, and to the custom and practice of the *friendly society* in the manner and timing of the distribution of profits or the granting of

discretionary additions, as the case may be.

- (7) In this paragraph 'established surplus' means an excess of assets representing the whole or a particular part of the fund or funds maintained by the *friendly society* in respect of its *long-term insurance business* over the liabilities, or a particular part of the liabilities, of the *friendly society* attributable to that business as shown by an investigation to which rule 5.1 or 5.2 applies.

*Avoidance of future valuation strain*

- 7 The amount of the liability determined in respect of a group of contracts must not be less than such amount as, if the assumptions adopted for the valuation were to remain unaltered and were fulfilled in practice, would enable liabilities similarly determined at all times in the future to be covered from resources arising solely from the contracts and the assets covering the amount of the liability determined at the current valuation.

PRA

*Valuation of future premiums*

- 8 (1) Where further specified *premiums* are payable by the *policyholder* under a contract (not being a *linked long-term contract*) under which the *policyholder* is eligible to participate in any *established surplus* and benefits (other than benefits arising from a distribution of surplus) are determined from the outset in relation to the total *premiums* payable thereunder, then, subject to (4) and 9 –

PRA

- (a) where the *premiums* under the contract are at a uniform rate throughout the period for which they are payable, the *premiums* to be valued must not be greater than such level *premiums* as, if payable for the same period as the actual *premiums* under the contract and calculated according to the rates of interest and rates of mortality or disability which are to be employed in calculating the liability under the contract, would have been sufficient at the outset to provide for the benefits under the contract according to the contingencies upon which they are payable, exclusive of any additions for profits, expenses or other charges;
- (b) where the *premiums* under the contract are not at a uniform rate throughout the period for which they are payable, the *premiums* to be valued must not be greater than such *premiums* as would be determined on the principles set out in (a) modified as appropriate to take account of the variations in the *premiums* payable by the *policyholder* in each year,

save that a *premium* to be valued must in no year be greater than the amount of the *premium* payable by the *policyholder*.

- (2) Where the terms of the contract have changed since the contract was first made (the terms of the contract being taken to change for the purposes of this paragraph if the change is indicated in an endorsement on the policy but not if a new policy is issued), then, for the purposes of (1) one of the following assumptions must be made, namely that –

- (a) the change from the date it occurred was provided for in the contract when it was made;
  - (b) the terms of the contract are those which apply from the date of the change except that a single *premium* is payable, at the date of the change, of an amount equal to the liability under the policy immediately before the change, calculated on a basis consistent with the *liability valuation rules* and with the *premiums* actually payable from the date of the change; or
  - (c) the contract is in two parts, the first of which is for the benefits purchased by the actual *premiums* payable from the date of the change under the *friendly society's* scales of *premiums* at that date, and the second of which is for all other benefits under the policy for which no *premiums* are payable after that date.
- (3) Where under a contract (not being a *linked long-term contract*) the *policyholder* is eligible to participate in any *established surplus*, and
- (a) each *premium* paid increases the benefits (other than benefits arising from a distribution of surplus) provided under the contract; or
  - (b) the amount of a *premium* payable in future is not determinable until it comes to be paid,

future *premiums* and the corresponding liability may be left out of account so long as adequate provision is made against any risk that the increase in the liabilities of the *friendly society* resulting from the payment of future *premiums* might exceed the amount of the *premiums*.

- (4) An alternative valuation method to that described in (1) to (3) may be used where it can be demonstrated that the alternative method results in reserves no less, in aggregate, that would result from use of the method described in (1) to (3).

#### *Acquisition expenses*

9

PRA

- (1) In order to take account of acquisition expenses, the maximum annual *premium* to be valued under 8 may (subject to (2)) be increased by an amount not greater than the equivalent, taken over the whole period of *premium* payments and calculated according to the rates of interest and rates of mortality or disability employed in valuing the contract, of 3.5% (or the defined percentage, if it is lower than 3.5%) of the *relevant capital sum* under the contract.
- (2) For the purposes of (1) "the defined percentage" is the percentage arrived at by taking (for all contracts of the same type as the contract in question for which an adjustment is made) the average of the percentages of the *relevant capital sum* under each such contract that represent the acquisition costs incurred which, after allowing for the effects of taxation, might reasonably be recovered from the *premiums* payable under the contract.

- (3) The increase permitted by (1) must be subject to the limitation that the amount of a future *premium* valued must not in any event be greater than the amount of the *premium* actually payable by the *policyholder*.

*Rates of interest*

10

PRA

- (1) The rates of interest to be used in calculating the present value of future payments by or to a *friendly society* must be no greater than the rates of interest determined from a prudent assessment of the yields on existing assets attributed to the *long-term insurance business* and, to the extent appropriate, the yields which it is expected will be obtained on sums to be invested in the future.
- (2) For the purposes of (1), the assumed yield on an asset attributed to the *long-term insurance business*, before any adjustment to take account of the effect of taxation, must not exceed the yield on that asset calculated in accordance with (3) to (7), reduced by 2.5% of that yield.
- (3) For the purpose of calculating the yield on an asset –
- (a) the asset must be valued in accordance with the *asset valuation rules*, excluding any provision under which assets may be taken at lower book values for the purposes of an investigation to which rule 5.1 or rule 5.2 applies; and
  - (b) the future income from the asset required to be taken into account (whether interest, dividends or repayment of capital) must be reduced by a proportion corresponding to such part of any *excess exposure* to assets of that description, calculated in accordance with B11 of Annex B to Appendix 4, as may reasonably be attributed to such assets.
- (4) For *fixed interest securities* the yield on an asset, subject to (7), must be that annual rate of interest which, if used to calculate the present value of future payments of interest before the deduction of tax and the present value of repayments of capital, would result in the sum of those amounts being equal to the value of the asset.
- (5) For *variable interest investments* (that is to say, investments which are not *fixed interest securities*) that are equity *shares* other than those within (5A) or land, the yield on an asset, subject to (7), must be the ratio to the value of the asset of the income before deduction of tax which would be received in the period of twelve months following the *valuation date* on the assumption that the asset will be held throughout that period and that the factors which affect income will remain unchanged, so however that account must be taken of any changes in those factors known to have occurred by the *valuation date* and in particular, without prejudice to the generality of the foregoing, of –
- (a) any known changes in the rental income from property or in dividends on equity *shares*;
  - (b) any forecast changes in dividends which have been publicly

announced by the *valuation date*;

- (c) the effect of any alterations in capital structure; and
- (d) the value (at the most recent date for which it is known at the *valuation date*) of any determinant of the amount of any future interest payment, the said value being deemed to remain unaltered for all subsequent dates.

(5A) For variable interest investments that are equity *shares* in *companies* subject to, or drawing up accounts as if subject to, legislation implementing the *Accounts Directives*, or which draw up a set of accounts in accordance with International Accounting Standards Committee accounting standards or US generally accepted accounting practice, the yield on an asset, subject to (7A), must be the ratio to the value of the asset of –

- (a)  $A + B$ ; or
- (b) 2 times A,

whichever is lower,

where A = the income which would be received if it were calculated in accordance with (5),

and B = half the excess (if any) of the relevant amount over A, but B must not be less than zero.

(5B) For the purposes of (5A), the ‘relevant amount’ in relation to equity *shares* is the issuing *company’s* profits after taxation from its ordinary activities for the most recent financial year ending on or before the *valuation date* which is reported in accounts in accordance with (5C) which are publicly available, in so far as attributable to those equity *shares*, so however, without prejudice to the generality of the foregoing, that account is taken of the effect of any alterations in capital structure.

(5C) For the purposes of (5B), the issuing *company’s* profits after taxation from its ordinary activities for the relevant financial year must be derived from accounts drawn up in accordance with legislation implementing the *Accounts Directives* or, if accounts are not drawn up in accordance with the *Accounts Directives*, from accounts drawn up in accordance with International Accounting Standards Committee accounting standards or US generally accepted accounting practice.

(5D) Where (5A) applies, and a *company’s* accounting period is longer or shorter than a year, the amount of profits or losses for that period must be annualised, and the annualised figure must be used to calculate the yield.

(5E) If the requirements in (5B) and (5C) are not, or cannot be, met, then the relevant amount is zero.

- (6) Subject to (6a), for variable interest investments (that is to say, investments which are not *fixed interest securities*) other than equity *shares* or land, the yield on an asset, subject to (7), must be that annual rate of interest which, if used to calculate the present value of future payments of interest, before deduction of tax, and the present value of repayments of capital, where applicable, would result in the sum of these amounts being equal to the value of the asset, on the assumption that –
- (a) the value of any determinant of the amount of the next interest rate payment and capital repayment made during the following twelve months will be the value of that determinant at the most recent date for which it is known at the *valuation date*;
  - (b) the amount of future interest payments and capital repayments will take account, where appropriate, of –
    - (i) the right of either party to have the investment repaid, and
    - (ii) an assumed yield on other comparable investments made in the future not exceeding an amount determined in accordance with (8) to (10); and
  - (c) indices and all other factors which affect future income payments or capital repayment will remain unchanged after the *valuation date*.
- (6A) For investments in *collective investment schemes* given a value as an asset in accordance with paragraph 10 of Appendix 4, the yield may be determined as the weighted average of the yields (as determined by this rule) on each of the investments held by the *collective investment scheme*.
- (7) In calculating the yield on an asset under this rule –
- (a) if the asset does not consist of equity *shares* or land –
    - (i) a prudent adjustment must be made to exclude that part of the yield estimated to represent compensation for the risk that the income from the asset might not be maintained or that capital repayments might not be received as they fall due; and
    - (ii) in making that adjustment, regard must be had wherever possible to the yields on risk-free investments of a similar term in the same currency;
  - (b) for assets which are equity *shares* or land, adjustments to yields must be made as appropriate to exclude that part, if any, of the yield from each category of asset that is needed to compensation for the risk that the aggregate income from that category of asset, taking one year with another, might not be maintained; for the purposes of this paragraph, a "category of

**asset" comprises assets of a similar nature, type and degree of risk.**

- (7A) Notwithstanding (7)(b), for equity *shares* within (5A), adjustments to yields must be made as appropriate to exclude that part, if any, of the yield from each 'category of asset' that is needed to compensate for the risk that the aggregate profits earned by a *company* might not be maintained; and for the purposes of this paragraph, category of asset has the same meaning as in (7)(b).**
- (8) To the extent that it is necessary to make an assumption about the yields which will be obtained on sums to be invested in future, the yield must be determined in accordance with (9) and (10).**
- (9) Where the liabilities are denominated in sterling, the yield assumed, before any adjustments to take account of the effect of taxation –**
- (a) on any investment to be made more than three years after the *valuation date*, must not exceed the lowest of –**
- (i) the long-term gilt yield current on the *valuation date*,**
- (ii) 3% per annum, increased by two-thirds of the excess, if any, of the long-term gilt yield current on the *valuation date* over 3% per annum, or**
- (iii) 6.5% per annum,**
- where "the long-term gilt yield" means the annualised equivalent of the 15 year yield for United Kingdom Government *fixed-interest securities* 31 December 2010 103 jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries; and**
- (b) on any investment to be made at any time not more than three years after the *valuation date* must not exceed the assumed yield determined under (2) adjusted linearly over the said three years to the yield determined in accordance with (a).**
- (10) Where the liabilities are denominated in currencies other than sterling, the yield must be determined on assumptions that are as prudent as those made under (9).**
- (11) In no case must a rate of interest determined for the purposes of (1) exceed, the adjusted overall yield on assets calculated as the weighted average of the reduced yields on the individual assets arrived at under (2); and when that weighted average is calculated –**
- (a) the weight given to each investment must be its value as an asset determined in accordance the *asset valuation rules*, excluding any provision under which assets may be taken at lower book values for the purposes of any investigation to which rule 5.1 or rule 5.2 applies; and**

(b) except in relation to the rate of interest used in valuing payments of *property linked benefits*, both the yield and the value of any *linked assets* (as so defined) must be omitted from the calculation.

(12) For the purpose of determining the rates of interest to be used in valuing a particular category of contracts the assets may, where appropriate, be notionally apportioned between different categories of contracts.

*Rates of mortality and disability*

11 The amount of the liability in respect of any category of contract must, where relevant, be determined on the basis of prudent rates of mortality and disability and any other decrement that take into account –

PRA

(a) where the *policyholder* is an individual, the state in which he has his habitual residence; and

(b) where the *policyholder* is not an individual, the state in which the establishment of the *policyholder* to which the *commitment* covered by the contract relates is situated.

*Expenses*

12 (1) Provision for expenses, whether implicit or explicit, must be not less than the amount required, on prudent assumptions, to meet the total net cost, after taking account of the effect of taxation, that would be likely to be incurred in fulfilling contracts if the *friendly society* were to cease to transact new business twelve months after the *valuation date*.

PRA

(2) The provision mentioned in (1) must have regard to, among other things, the *friendly society's* actual expenses in the last twelve months before the *valuation date* and to the effects of inflation on future expenses on prudent assumptions as to the future rates of increase in prices and earnings.

*Options*

13 (1) Provision must be made on prudent assumptions to cover any increase in liabilities caused by *policyholders* exercising *options* under their contracts.

PRA

(2) Where a contract includes an *option* whereby the *policyholder* could secure a guaranteed cash payment within twelve months following the *valuation date*, the provision for that *option* must be such as to ensure that the value placed on the contract is not less than the amount required to provide for the payments that would have to be made if the *option* were exercised.

(3) Where a contract includes an option whereby the *policyholder* could secure a cash payment but (2) does not apply, the provision for that option must be such as to ensure that, if the assumptions adopted for the valuation of the contract are fulfilled in practice –

- (a) the resulting value (and therefore the provision) is not less than the amount required to provide for the payment which would have to be made if the option were exercised; and
  - (b) the payment when it falls due is covered from resources arising solely from the contract and from the assets covering the amount of the liability determined at the current valuation.
- (4) For the purposes of (3) the amount of a cash payment secured by the exercise of an option is assumed to be –
- (a) in the case of an *accumulating with-profits policy*, the lower of –
    - (i) the amount which would reasonably be expected to be paid if the option were exercised, having regard to the representations of the *friendly society*; and
    - (ii) that amount, disregarding all discretionary adjustments; and
  - (b) in the case of any other policy to which this paragraph applies, the amount which would reasonably be expected to be paid if the option were exercised, having regard to the representations of the *friendly society*, without taking into account any expectations regarding future distributions of profits or the granting of discretionary additions in respect of an *established surplus* or in anticipation of such additions.

*Contracts not to be treated as assets*

14 No contract for *long-term insurance business* must be treated as an asset.

PRA

*No credits for profits from voluntary discontinuance*

15 Allowance must not be made in the valuation for the voluntary discontinuance of any contract if the amount of the liability so determined would thereby be reduced.

PRA

*Nature and term of assets*

16 The determination of the amount of *long-term liabilities* must take into account the nature and term of the assets representing those liabilities and the value placed upon them and must include prudent provision against the effects of possible future changes in the value of the assets on –

PRA

- (a) the ability of the *friendly society* to meet its obligations arising under contracts for *long-term insurance business* as they arise; and
- (b) the adequacy of the assets to meet the liabilities as determined in accordance with 6 to 15.



## Appendix 6:

### Balance Sheet (Forms 9 to 17)

1 All the Forms included in the part of the *FSC return* to which this Appendix relates (Forms 9 to 17) must be completed as required by this Appendix.

PRA

#### *Currency*

2 A supplementary note to Form FSC1 or Form FSC3 (as appropriate) must be included in the *FSC return* stating the bases of conversion employed for –

PRA

- (a) amounts of *premiums* and other income *receivable* in a currency other than sterling; and
- (b) the amounts of *claims* and other expenditure payable in a currency other than sterling.

#### *Presentation of Amounts*

3 (1) Where in any Form an amount which is shown as brought forward from a previous period differs from the corresponding amount shown as carried forward from that period and the difference is not due solely to the fact that a different rate has been used to express other currencies in sterling, an explanation of the reason for the difference must be given by way of a supplementary note to that Form.

PRA

- (2) Except to the extent permitted by (3), amounts due to or from the *friendly society* must be shown gross.
- (3) In calculating amounts due from or to the *friendly society* (other than for the completion of Form 17),
  - (a) amounts due from any person may, unless expressly provided otherwise, be included net of amounts which are due to that person, provided that such amounts may be set-off against each other under generally accepted accounting practice; and
  - (b) amounts due to any person may, unless expressly provided otherwise, be included net of amounts due from that person, provided that such amounts may be set-off against each other under generally accepted accounting practice.
- (4) If the amounts shown include amounts calculated on the basis set out in (3), a supplementary note to Form 13 to that effect must be provided.

4 In Form 9 –

PRA

- (a) for a *friendly society* carrying on only *long-term insurance business*, lines 11 to 13 may be omitted;
- (b) for a *friendly society* carrying on only *general insurance business*, lines

21 to 44 may be omitted;

- (c) the *implicit items* at lines 11a, 31, 32 and 33 are those admitted under rule 4.8 to 4.10;
- (d) the entry at lines 51 and 52 must not include provision for any liability to tax on capital gains referred to in 9(2)(b); and
- (e) in the FSC1 return the entries at lines 11 to 13 may be a prudent estimate with reference to the last periodic investigation into the financial condition of the *friendly society* in respect of its *general insurance business*.

*Margin of solvency for general insurance*

5 (1) Amounts included in Forms 11 and 12 in respect of –

PRA

- (a) gross premiums receivable,
- (b) *claims* paid,
- (c) *claims* outstanding, and
- (d) reinsurance recoveries,

must be determined in accordance with rule 4.6 and Appendix 2.

(2) Where any amount included in Form 11 or 12 pursuant to (1) above differs from the aggregate of the corresponding amounts included in Forms 21 and 22, there must be stated by way of supplementary note to Form 11 or 12, as the case may be,

- (a) the amount of such difference, and
- (b) an explanation for such difference.

*Investment*

6 In Form 13 –

PRA

- (a) a Form 13 must be completed for the total *long-term insurance business* assets of the *friendly society* and for each fund or group of funds for which separate assets are appropriated. The words "Total *long-term insurance business assets*" or the name of the fund must be shown against the heading "Category of assets";
- (b) a separate Form 13 must be completed in respect of the total assets of the *friendly society* other than any *long-term insurance business assets*. The words "Total other than *long-term insurance business assets*" must be shown against the heading "Category of assets";
- (c) in lines 11 to 86: for the purpose of classifying (but not valuing) assets, headings and descriptions used in the Form, whenever

they also occur in the balance sheet format prescribed by the *Accounts Regulations*, must have the same meaning as in those *Accounts Regulations*; assets must be valued in accordance with the *asset valuation rules*; and assets of any particular description must be shown after deduction of assets of that description which (for any reason) fall to be left out of account under 15(2)(a) of Appendix 4;

- (d) the aggregate value of those investments which are:
- (i) *unlisted* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with 9 of Appendix 4, or
  - (ii) *listed* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with 9 of Appendix 4 and which are not *readily realisable*, or
  - (iii) units or other beneficial interests in *collective investment schemes* falling within 10(1)(c) of Appendix 4, or
  - (iv) reversionary interests or remainders in property other than land or buildings,

must be stated by way of a supplementary note to this Form, together with a description of such investments;

- (e) the aggregate value of those investments falling within lines 46 or 48 which are hybrid *securities* must be stated by way of a supplementary note to this Form; and
- (f) lines 60 to 63 and 85 relate only to *general insurance business*

*Counterparty exposure*

- 7
- (1) There must be given by way of a supplementary note to Form 13 –
- PRA
- (a) the maximum extent to which, in accordance with any investment guidelines operated by the *friendly society*, it was permitted to be exposed to any one *counterparty* during the period;
  - (b) the maximum extent to which, in accordance with such guidelines, it was permitted to be exposed to any one *counterparty*, other than by way of *exposure* to an *approved counterparty*, during the period; and
  - (c) an account of any occasions during the period on which either of those amounts was exceeded.
- (2) In each case where the *exposure* of the *friendly society* to a *counterparty* (calculated in accordance with Annex B of Appendix 4) at the end of the period exceeds 5% of its *long-term insurance business* or *general insurance business amount*, as appropriate, the amount of that *exposure* and the nature of the assets held which give rise to that

*exposure*, must be stated by way of a note to Form 13.

*Provision for adverse changes*

- 8
- PRA**
- There must be stated by way of a note to Form 14 (and in Form 15 in respect of any *general insurance business*) the methods and assumptions used to determine the amount of any provision made pursuant to 4 in Appendix 5 or, if there is no such provision, the methods and assumptions used to determine that no provision is required.

*Liabilities*

- 9
- PRA**
- (1) Form 14 must be completed for the total *long-term insurance business liabilities* and margins of the *friendly society* and for each fund or group of funds for which separate assets are appropriated. The words "Total *long-term insurance business assets*" or the name of the fund must be shown against the heading "Category of assets".
- (2) Subject to (4) and (5), the following information must be given by way of a supplementary note to Form 14 or 15 –
- (a) in the case of any charge over the assets of the *friendly society* (including any arrangement whatsoever, whether contractual or otherwise, which operates to secure the prior claim of any person over general creditors to any assets on a winding up of a *friendly society*), the particulars specified in (3) or a statement that there are no such charges;
  - (b) the total potential liability, and the amount provided for that liability, to taxation on capital gains which might arise if the *friendly society* disposed of its assets, or a statement that there is no such potential liability;
  - (c) a brief description of any other liabilities being contingent liabilities not included in Form 14 or 15 (other than liabilities arising under an inwards *contract of insurance*) including, where practicable, the amounts or estimated amounts of those liabilities, or a statement that there are no such contingent liabilities;
  - (d) a brief description of any guarantee, indemnity or other contractual *commitment*, effected by the *friendly society* other than in the ordinary course of its *insurance business*, in respect of the existing or future liabilities of any *associate bodies*, including –
    - (i) the maximum liability of the *friendly society* specified in such guarantee, indemnity or contractual *commitment*, or a statement that no such amount is specified,
    - (ii) the amount of any provision made in respect of such liability, and

- (iii) the amount reported under (c) in respect of such liability, or a statement that there are no such guarantees, indemnities or contractual *commitments*; and
  - (e) a description of any other uncertainty where such a description is, in the opinion of the *committee*, necessary for a proper understanding of the financial position of the *friendly society*.
- (3) The particulars referred to in (2)(a) are –
- (a) the nature of the charge, including a brief description of the terms which are relevant to securing the prior claim of any person to assets which are subject to the charge;
  - (b) for each line in Form 13, the amount included in respect of assets which are subject to the charge; and
  - (c) for each line in Form 14 or 15, the amount included in respect of liabilities which are secured by the charge.
- (4) (2)(a) and (c) may be disregarded by a *friendly society* in the case of –
- (a) one or more charges over assets which are attributable to either the *long-term insurance business assets* or the *general insurance business assets* and whose aggregate value (as shown on Form 13) does not exceed 2.5% of the long-term or *general insurance business amount*, as the case may be;
  - (b) one or more contingent liabilities whose aggregate value does not exceed 2.5% of the long-term or *general insurance business amount*, as the case may be.
- (5) (2)(d) may be disregarded by a *friendly society* in respect of one or more guarantees, indemnities or contractual *commitments* where the aggregate of the maximum liabilities specified in such guarantees, indemnities or contractual *commitments* does not exceed 2.5% of the *long-term* or *general insurance business amount*, as the case may be.

*Derivative contracts*

10

PRA

- (1) Form 17 must be completed in respect of the total *long-term insurance business assets* and in respect of the total other than *long-term insurance business assets* of the *friendly society*. Form 17 must also be completed for each fund or group of funds for which separate assets are appropriated. The words "*Total long-term insurance business assets*" or "*Total other than long-term insurance business assets*" or the name of the fund must be shown against the heading "Category of assets".
- (2) Any *derivative contract* entered into by the *friendly society* –
- (a) the value of which is taken into account for the purpose of calculating benefits payable to *policyholders* and members

under *property linked contracts*; or

- (b) in order to match its liabilities in respect of the payment of *index-linked benefits*,

must be excluded from Form 17. Rights to recover assets transferred by way of *initial margin* must not be shown on Form 17.

- (3) *Derivative contracts* must be analysed according to the description of assets shown in the second column to Form 17 which represents the principal subject of the contract, and must be reported as assets in column 1 of Form 17 if their value (gross of *variation margin*) to the *friendly society* is positive and as liabilities in column 2 of Form 17 if their value (gross of *variation margin*) to the *friendly society* is negative.
- (4) All amounts included in lines 11 to 35 of Form 17 in respect of *derivative contracts* must be determined without making any allowance for *variation margin* and the effect of any *variation margin* upon those amounts must be shown at line 41.
- (5) Amounts in respect of a *derivative contract* may only be included net of amounts in respect of any other *derivative contract* if –
- (a) obligations of the *friendly society* under the contracts may be set-off against each other under generally accepted accounting practice; and
- (b) such other contract has the effect (in whole or in part) of closing out the obligations of the *friendly society* under the first mentioned contract.
- (6) Where, in respect of any *derivative contract* included in Form 17, assets have been transferred to or for the benefit of a *friendly society* by way of *variation margin* there must be stated by way of a supplementary note to Form 17 –
- (a) the aggregate amount of any liability to repay such assets or equivalent assets;
- (b) for each line in Form 13, the amount included in respect of such assets; and
- (c) to what extent any amounts included in Form 13 have taken account of any requirement to repay such assets or equivalent assets.
- (7) If –
- (a) the aggregate value of rights, under contracts or in respect of assets, either of which have the effect of *derivative contracts*, exceeds 2.5% of the aggregate value of assets shown at line 89 of Form 13; or

- (b) the aggregate amount of liabilities under contracts or in respect of assets, either of which have the effect of *derivative contracts*, exceeds 2.5% of the aggregate of the amounts shown in lines 17 to 39 of Form 14 or lines 31 to 51 of Form 15, as appropriate,

the corresponding value, if not zero, must be stated by way of a supplementary note to Form 17 for each line in Forms 13, 14 and 15 and (6) applies to the *friendly society* as if such contracts had been included in Form 17.

- (8) Every *friendly society* must, in respect of the period, annex to Form 17 a supplementary note comprising a brief description of
- (a) any investment guidelines operated by the *friendly society* for the use of *derivative contracts* (including a contract or asset which, wholly or in part, has the effect of a *derivative contract*);
  - (b) any provision made by such guidelines for the use of contracts under which the *friendly society* had a right or obligation to acquire or dispose of assets which was not, at the time when the contract was entered into, reasonably likely to be exercised and, if so, the circumstances in which, pursuant to that provision, such contracts would be used;
  - (c) the extent to which the *friendly society* was during the period a party to any contracts of the kind described in (b);
  - (d) the extent to which any of the amounts recorded in Form 13 would be changed if assets which the *friendly society* had a right or obligation to acquire or dispose of under *derivative contracts* outstanding at the end of the period (being in the case of *options*, only those *options* which it is prudent to assume would be exercised) had been so acquired or disposed of;
  - (e) how different the information provided pursuant to (d) would have been if such *options* as were outstanding at the end of the period had been exercised in such a way as to change the amounts referred to in (d) to the maximum extent;
  - (f) how different the information provided pursuant to (d) and (e) would have been if, instead of applying to contracts outstanding at the end of the period, they had applied to *derivative contracts* outstanding at such other time during the period as would have changed the amounts referred to in (d) and (e) to the maximum extent;
  - (g) the maximum loss which would be incurred by the *friendly society* on the failure by any one other person to fulfil its obligations under *derivative contracts* outstanding at the end of the period, both under existing market conditions and in the event of other foreseeable market conditions, together with an assessment of whether such maximum loss would have been materially different at any other time during the period;

- (h) the circumstances surrounding the use of any *derivative contract* held at any time during the period which did not fall within 13(2) of Appendix 4, or (where appropriate) within the definition of *permitted derivative contract*; and
  - (i) the total value of any fixed consideration received by the *friendly society* (whether in cash or otherwise) during the period in return for granting rights under *derivative contracts* and a summary of contracts under which such rights have been granted.
- (9) For the purposes of 10, a *friendly society* which is a party to –
- (a) a *contract for differences*; or
  - (b) any other contract which is to be, or may be, settled in cash,
- must be taken to have a right or obligation to acquire or dispose of the assets underlying the contract.

## Appendix 7:

### General Insurance Business: Revenue Account and Additional Information (Forms 20 to 23A)

- 1 All the Forms included in the part of the FSC3 Return to which this Appendix relates (Forms 20 to 23A) are to be completed as required by this Appendix.
- PRA**
- Premiums*
- 2 In all Forms to which this Appendix relates, amounts required to be shown in respect of *premiums* must be shown before deduction for commissions.
- PRA**
- 3 For the purposes of Form 23 –
- PRA**
- (a) *gross premiums* earned in respect of a period must be such proportion of *gross premiums* written as is attributable to risks borne by the *friendly society* during that period; and
- (b) the reinsurers' share of *premiums* earned must be attributed to the same period as the corresponding *gross premiums* earned, so as to calculate the net earned *premium* for the period.
- Unearned premiums*
- 4 In Form 21, the basis on which unearned *premiums* are calculated and the reason for adopting this basis must be stated by way of supplementary note.
- PRA**
- Acquisition costs*
- 5 The basis used for the determination of amounts for acquisition costs (other than commission) payable in the period in question and carried forward to the next period, as shown at line 22 of Form 22, must be stated by way of a supplementary note to that Form.
- PRA**
- Claims*
- 6 In all Forms to which this Appendix relates, amounts required to be shown for *claims* must not include amounts in respect of *claims management costs*.
- PRA**
- 7
- PRA**
- (1) In Form 23, where an amount or number is required to be shown for *claims* in respect of a period, that amount or number must be determined on the basis of *claims* arising from incidents occurring during that period.
- (2) For the purposes of (1), an incident giving rise to a claim under a *claims-made policy* must be deemed to occur on the earlier of -
- (a) the date on which it is notified in accordance with the terms of that policy; or
- (b) the date on which the period for which cover is provided under that policy expires.

### *Reinsurance*

- 8 **Where the reinsurers' share of *claims* incurred (as stated in Form 22) includes amounts expected to be recovered from reinsurers more than twelve months after the payment of the underlying gross *claims* by the *friendly society*, the amount of such recoveries must be stated by way of note to Form 22.**

PRA

### *Administration*

- 9 **Where arrangements have been made for the provision of management services to a *friendly society* by another organisation, there must be given by way of supplementary note to Form 20 a summary of the arrangements in force including details of the organisation providing the service.**

PRA

### *Claims management costs*

- 10 (1) **In Form 22, the basis used for the determination of amounts for *claims management costs* payable in the period in question and carried forward to the following period must be stated by way of note.**

PRA

- (2) **If, in respect of any class of general insurance business –**
- (a) **no amount for *claims management costs* is shown as being carried forward to the following period, and**
  - (b) **an amount for net *claims* is shown as being carried forward to that period,**

**the reason for anticipating that there will be no *claims management costs* incurred during the following period must be included in the note required by (1).**

- (3) **If, within a *class of general insurance business*, a *friendly society* has ceased to effect new contracts of insurance (that is any *contract of insurance* effected by the *friendly society* other than in fulfilment of its obligations under subsisting contracts) during the period in question, the basis upon which any additional costs arising as a result of such cessation have been determined or the reason for anticipating that no such additional costs will be incurred must be included in the note required by (1).**

- (4) **Where the amount in respect of *claims management costs* carried forward included in any Form 22 has been determined after taking into account the expected investment return, the following must be stated by way of supplementary note –**

- (a) **the rates of investment return assumed; and**
- (b) **the average interval between the end of the period in question and the date by which the *claims management costs* are expected to be expended.**

### *Provision for unexpired risks*

- 11 (1) **The amount included for the provision for unexpired risks in any Form 22 prepared in respect of a *class of general insurance business* must**

PRA

include any amount determined to be a necessary provision in relation to the reasonable expectations of the *friendly society's* policyholders and must further be determined without taking into account any surplus expected to arise on the unexpired risks falling within other *classes of general insurance business*.

- (2) Where in determining the amount of the overall provision for unexpired risks (line 13 in Form 15 less line 62 of Form 13) credit has been taken for any aggregate surplus expected to arise on the unexpired risks falling in any *class of general insurance business*, the amount of that credit must be included as a negative amount at line 19 of Form 22 for that *class of general insurance business*.
- (3) Where the amount included at column 3 of line 19 (provision for unexpired risks) in any Form 22 has been determined after taking into account the expected investment return, the following must be stated by way of supplementary note –
  - (a) the provision for unexpired risks before taking such investment return into account;
  - (b) the rates of investment return assumed; and
  - (c) the average interval between the end of the period in question and the date at which *claims* are expected to be settled in cash.

#### *Cessation of business*

12

If the *friendly society* has not effected any new contracts of insurance (that is any *contract of insurance* effected by the *friendly society* other than in fulfilment of its obligations under subsisting contracts of insurance) of any one or more *classes of general insurance business* during the period, the date on which the last new contract of each such *class* was effected must be stated by way of supplementary note to Form 20.

PRA

#### *General insurance business statement*

13

The following information must be given in Form 23A –

PRA

- (a) the date to which the investigation relates;
- (b) the date to which the latest previous investigation under rule 5.2; and
- (c) a synopsis of the report by the *appropriate actuary* on his investigation into the financial condition of the *friendly society* in respect of its *general insurance business*, including the actuary's assessment of the financial viability of the *friendly society* and his interpretation of the reasonable expectations of its members.



## Appendix 8:

### Long-Term Insurance Business: Revenue Account, Other Revenue Account and Additional Information (Forms 40 To 45)

1 Forms 40 to 45 are to be completed as required by this Appendix.

PRA

2 (1) All amounts must be shown in sterling and, except for valuation unit prices, may only be shown to the nearer £1,000 in the circumstances described in rule 5.25.

PRA

(2) A note must be included in the *FSC return* stating the bases of conversion for amounts in currencies other than sterling in accordance with 2 of Appendix 6.

(3) Valuation unit prices must be shown to the same accuracy as used in the valuation.

3 Where a *friendly society* maintains more than one *long-term insurance business* fund, other revenue account fund or members surplus and savings accounts, a statement must be annexed to Forms 40, 40A and 40C giving the principles and methods applied to apportioning the investment income, increase or decrease in the value of assets brought into account, expenses and taxation between the different funds and accounts.

PRA

4 The box marked “Name of Fund/Summary” in each Form must be completed by the inclusion of a discrete name or number to identify each fund or, if the Form relates to a part of the fund, the fund of which it is part. Where there is only one fund for ordinary *long-term insurance business* or for *industrial assurance business* or for some other revenue account fund, as the case maybe, the number “1” must be shown in the box marked “No. of Fund/Summary”. Where the Form is a summary Form the number “99” must be inserted in that box. The box marked “No. of part of fund” must show a discrete number for each part of a fund or the figure “0” if the Form is a statement of the whole fund.

PRA

5 In Form 40 –

PRA

(a) any item of income which cannot properly be allocated to lines 11, 12, 13, 14, or 14a must be entered in line 15, and similarly, any item of expenditure which cannot properly be allocated to lines 21, 22, 23 or 24 must be entered in line 25. Particulars of such items must be specified in a supplementary note;

(b) where a *friendly society* decides to allocate to the *long-term insurance business* the whole or any part of investment income and/or net capital gains arising from assets not attributable to its *long-term insurance business*, the amounts in question must be shown as a transfer in line 14a or 26 and particulars must be specified in a supplementary note;

(c) the entry at line 12 is to exclude value re-adjustments on investments and gains on the realisation of investments, which must be shown in lines 13 or

14 as appropriate;

- (d) the entry at line 11 is to exclude any change in the provision for unearned *premiums*; and
- (e) the entry at line 21 is to exclude *claims management costs*, which must be included in line 21 of Form 40B, and any change in the provisions of *claims*.

6 Where arrangements have been made for the provision of management services to a *friendly society* by another organisation, there must be given by way of supplementary note to Form 40B a summary of the arrangements in force including details of the organisation providing the service.

PRA

7 Societies conducting combined sickness and savings business must, in respect of members surplus and savings accounts, complete separate Forms 40C for the transactions which have been classified as relating to *long-term insurance business* and for the transactions which have been classified as not relating to *long-term insurance business*.

PRA

8 Forms 41 to 45 are to be completed separately in respect of each fund for which a separate *long-term insurance business* revenue account fund is required to be prepared in Forms 40.

PRA

9 In Form 41, in dividing the *management expenses* between lines 43, 44 and 45;

PRA

- (a) costs of a non-recurring nature, such as those incurred in developing new systems, new premises, or the costs of corporate re-structuring, must normally be shown in line 45;
- (b) the costs incurred in writing new business (or in obtaining incremental (but not indexed) *premiums* on existing business), such as underwriting, policy issue, setting up (or amending) records and the maintenance and development of the sales and marketing organisation must be reported in line 43; and
- (c) the balancing item will be expenses related to the ongoing costs throughout the year of maintaining the business in force (including any investment management costs) and must be reported in line 44.

10 In Form 43 –

PRA

- (a) the basis on which assets have been valued must be stated in a supplementary note;
- (b) the aggregate value of rights (gross of *variation margin*) and the aggregate amount of liabilities (gross of *variation margin*) under *derivative contracts* (or in respect of contracts or assets which have the effect of a *derivative contract*) must be stated in a supplementary note. The corresponding figures net of *variation margin* must also be stated. For this purpose, rights and liabilities must not be set off against one another unless
  - (i) such rights and liabilities may be set off against each other in accordance with generally accepted accounting principles, and

- (ii) such set off results (in whole or in part) from the closing out of obligations under a contract; and
- (c) where there is a liability to repay *variation margin* and there are no arrangements for netting of amounts outstanding or the arrangements would not permit the accounting of such amounts on a net basis in accordance with generally accepted accounting principles it must be so stated in a supplementary note.

**11 In Form 44 –**

- PRA**
- (a) double counting of items arising from cross investment between *internal linked funds* is to be eliminated;
  - (b) any item of income which cannot properly be allocated to lines 11, 12 or 13 must be entered in line 14, and similarly, any item of expenditure which cannot properly be allocated to lines 21, 22, 23, 24 or 25 must be entered in line 26 and particulars of such items must be specified in a supplementary note; and
  - (c) the gross value of units created must be shown in line 11 and the gross value of units cancelled must be shown in line 21.

**12 In Form 45 –**

- PRA**
- (a) Column 3 must show the provision for tax on unrealised capital gains as a percentage of the taxable unrealised capital gain. Similarly, column 4 must show the provision for tax on realised capital gains as a percentage of the taxable realised capital gain;
  - (b) the liquidity percentage in column 5 must be the sum of the values of *approved securities*, short-term deposits and cash held by the fund, less any liabilities included in column 6 or 7 of Form 43 shown as a percentage of the *net asset value* in column 8 of Form 43; and
  - (c) where there is more than one series of units for any *internal linked fund* the valuation price of each series of unit must be given in column 6 together with the name of that series of unit.

**13 In Forms 43 and 45, self-invested *internal linked funds* (where the *policyholder* selects the investments to which his or her policy is linked) or adviser *internal linked funds* (where a financial adviser selects the investments to which a policy is linked) may be aggregated if (in either case) they meet the following conditions:**

- PRA**
- (a) there is a precise matching of the assets of the fund with the corresponding unit liabilities;
  - (b) there is no negative liquidity in the fund (that is, the sum of the values of approved securities, short-term deposits and cash held in the fund exceeds the total of the liabilities in columns 6 and 7 of Form 43); and
  - (c) the *policyholder* is periodically (at least annually) provided (by the *friendly society* or the financial adviser) with the information on the investments that would otherwise be provided in the return if the funds were not aggregated,

**whether in the format of the relevant Forms or not.**

## Appendix 9:

### Abstract of Actuarial Investigation (Forms 46 to 61A)

The following information must be given in Form 61A of the *FSC return* and

- (i) the answers must be numbered to accord with the corresponding numbers of this Appendix;
- (ii) all amounts must be shown in sterling and, except for valuation unit prices, may only be shown to the nearer £1,000 in the circumstances described in rule 5.25;
- (iii) valuation unit prices must be shown to the same accuracy as used in the valuation; and
- (iv) yields must be shown as percentages to two decimal places.

1. The *valuation date*.

PRA

2. The date to which the latest previous investigation under rule 5.1 related.

PRA

3. A statement that the valuation has been made in conformity with 5 in Appendix 5 or, where this was not the case, such qualification, amplification or explanation as necessary.

PRA

4. (1) Subject to (2), for each category of *non-linked contract* which –

PRA

- (a) comprises *accumulating with-profit policies*, a full description of the benefits, including –
  - (i) the circumstances in which, and method by which, an adjustment to the identifiable current benefit attributable to a policy could be made on the payment of any claim, including by full or partial surrender, or upon the determination of the amount of any charges deducted under the policy together with a description of the *friendly society's* policy and past practice in this regard;
  - (ii) where the discounted value of the liability in respect of current benefits including vested bonuses shown in column 12 of Form 52 is less than the full amount of the current benefit shown in column 11 and the discounted value assumes the exercise of any discretionary adjustments of the type referred to in (a)(i), a general description of such adjustments made during the period;
  - (iii) any guaranteed investment returns or bonus rates;

- (iv) any guaranteed surrender values; and
  - (v) any material options;
- (b) comprises policies (other than those included in (a) ) which provide for benefits to be determined on the basis of interest accrued (at a rate to be determined from time to time) in respect of *premiums* paid, a full description of the benefits, including –
- (i) the method used to calculate surrender values;
  - (ii) any guaranteed investment returns;
  - (iii) rates of interest applied during the period;
  - (iv) any guaranteed surrender values; and
  - (v) any material options; and
- (c) does not fall within (a) or (b) and which is not sufficiently described by the entry in column 1 of Form 51, a full description of the benefits, including any *premium* rate guarantees and material options.

(2) Information required under (1) need not be provided for any category of contract –

- (a) where no contracts were effected by the *friendly society* during the period; and
- (b) which has been included in Forms 51 or 52 under the miscellaneous headings specified in 20(3)(e)(vi) and 20(3)(e)(x).

5. (1) Subject to (4), for each category of *linked long-term contract* –

PRA

- (a) the name given to that category;
- (b) the type of contract, classified according to the categories set out in 20(3)(a), (b), (c), (d) and (e);
- (c) a statement of the frequency of *premiums*;
- (d) a brief description of the benefits under the contract, including any eligibility to participate in profits, any guarantees and any material options;
- (e) details of any guaranteed investment returns;
- (f) a description of the way in which the *friendly society* recovers out of policies its costs (including acquisition expenses and commission, renewal expenses and commission and the costs attributable to the provision of policy benefits). Where the policy provides for the allocation of units, the annual rate of any management charges must be given. Where the amount of

***premiums* deemed to be invested after allowing for the effect of any charges is greater than the amount of the *premiums*, an explanation must be given;**

- (g) details of any restrictions on increases in charges;
  - (h) the method used to calculate surrender or transfer values;
  - (i) whether benefits are (or may be) determined (whether wholly or in part) by reference to the value of an *internal linked fund* or to the value of assets or an index. Where the link is to the value of assets or an index, those assets or that index must be specified and details of the relationship between their value and benefits payable to *policyholders* must be given;
  - (j) a brief description of any other features of the contract not disclosed which are material to the method and basis of valuation;
  - (k) whether the contract was open to new business in the period to the *valuation date*; and
  - (l) any increases in the rates of charges applied generally to contracts during the period, including charges for the provision of policy benefits met by the cancellation of units notionally allocated to contracts.
- (2) Where the terms and conditions and the method and basis for determining the amount of the *long-term liabilities* are not materially different for a number of categories of contract, only one description need be given pursuant to (1), provided that the name of each such category is given in the *friendly society's* response to (1)(a).
- (3) For each category of *linked long-term contract* which contains a with-profits option, the information required by 4(1)(a) must also be given.
- (4) Information required under (1)(a) to (k) and (3) need not be provided for any category of contract
- (a) where no contracts were effected by the *friendly society* during the period; and
  - (b) which has been included under the miscellaneous heading in Form 53 or 54.
- (5) A description of the method, or if there is more than one method of the methods and the types of unit to which each applies, used for the creation and cancellation of units in the *internal linked fund* and determining unit prices for the allocation of units to, and the cancellation of units from, policies.
- (6) A description of the method, or if there is more than one method of the methods and the types of unit to which each applies, used to determine the provision for tax on realised and unrealised capital gains and the

percentage or percentages of these gains deducted or provided for during the period.

- (7) Whenever units of the type referred to in 5 of Appendix 3 are held by an *internal linked fund*, or where *property linked benefits* are linked to such units, the rate of discount, commission or other allowance made to the *friendly society* on the purchase, sale or holding of units and the extent to which the *policyholder* or member benefits from such discount, commission or other allowance.

6. (1) The general principles and methods adopted in the valuation including specific reference to the following

PRA

- (a) the method by which account has been taken of *derivative contracts* or contracts or assets having the effect of *derivative contracts* in the determination of the amount of the *long-term liabilities*;
- (b) the method by which due regard has been given to the reasonable expectations of *policyholders* as required by 5 in Appendix 5 by which account has been taken of the custom and practice of the *friendly society* in the manner and timing of the distribution of profits or the grant of discretionary additions over the duration of each policy, as required by 6(6) in Appendix 5;
- (c) where the net *premium* method has been used, whether and to what extent it has been modified, for what purposes any such modification has been made and whether any modifications on account of *zillmerising* conform to 9 in Appendix 5;
- (d) whether any negative reserves arose and the steps taken to ensure that no *contract of insurance* was treated as an asset, as required by 14 in Appendix 5;
- (e) whether any specific reserve has been made for future bonuses and, if so, at what rate or rates;
- (f) the basis of the provision made for any prospective liability for tax on unrealised capital gains;
- (g) in the case of *linked long-term contracts* and contracts falling within 4(1)(a) and 4(1)(b), the basis of the reserve made for any investment performance guarantees; and
- (h) the basis of the reserve made for any guarantees and options (other than investment performance guarantees included in (g)).
- (2) For the purpose of (1) where, in determining the provisions referred to in (1)(f) or the reserves referred to in 7(7) or 7(8), account has been taken of the fact that the fund has been brought into Form 58 at book value in accordance with 2(6) of Appendix 4, that fact must be stated.

7. (1) Unless shown in Forms 51, 52, 53 or 54, the rates of interest and tables of mortality and morbidity assumed in the valuation of each category of contracts.
- PRA
- (2) If the tables used have not been published, full details of the rates of mortality or morbidity used.
- (3) A general description of how the tables of mortality and morbidity assumed in the valuation of the various categories of contract have regard to the State of the *commitment*.
- (4) Details of any allowance made for future reductions in the rates of mortality in the tables of mortality assumed in the valuation of annuity contracts.
- (5) Details of any allowance made, and the amount of any reserve held, for any possible detrimental impact of significant changes in the incidence of disease or developments in medical science on the mortality and morbidity experience of the *friendly society* in the tables of mortality and morbidity assumed in the valuation of contracts.
- (6) A description of all the scenarios of future changes in the value of assets which have been tested in order to take account of the nature (including currency) and term of the assets held in determining the amount of the *long-term liabilities* in accordance with 16 in Appendix 5 identifying that scenario which produces the most onerous requirement (whether or not a reserve is thereby required).
- (7) The amount of any reserve made pursuant to 16(a) in Appendix 5, together with a brief description of the method used and assumptions made to calculate any such reserve.
- (8) In respect of that scenario described under (6) which produces the most onerous requirement (whether or not a reserve is thereby required), the amount of any reserve made pursuant to 16(b) in Appendix 5, together with –
- (a) a description of the changed assumptions made (other than the changed interest rate stated in Form 57) in calculating such requirement;
- (b) a brief description of the method used to calculate such requirement; and
- (c) resulting from the application of such changed assumptions –
- (i) the change in the aggregate amount of the *long-term liabilities*, and
- (ii) the aggregate amount by which the assets allocated to match such liabilities in the scenario have changed in value from the amount of those assets shown in Form 13.

- (9) A general description of how the rates of interest assumed in the valuation of the various categories of contract with liabilities denominated in currencies other than sterling have taken into account the currency of the liabilities.

8. (1) In respect of *non-linked contracts* –

PRA

- (a) where appropriate, the proportion of the office *premiums* explicitly or implicitly reserved for expenses and profits for each type of insurance (as shown in column 8 of Form 51 or column 10 of Form 52);
- (b) the method by which a reserve has been made for expenses after *premiums* have ceased or where no future *premiums* are payable or where the method of valuation does not take credit for future *premiums* as an asset;
- (c) where a prospective method of valuation has not been used, details of the tests made of the adequacy of the method used; and
- (d) where in valuing contracts falling within the circumstances described in 8 of Appendix 5, future *premiums* brought into account are not in accordance with that rule, such additional information as is necessary to demonstrate whether the *mathematical reserves* determined in the aggregate for each of the main categories of contract are greater than an amount for each such category calculated in accordance with 6 to 16 in Appendix 5.
- (2) Where the *mathematical reserves* (after deduction of reinsurance cessions) determined in the aggregate for all categories of contracts referred to in (1)(d) represent less than 5% of the total *mathematical reserves* (after deduction of reinsurance cessions) for all *non-linked contracts*, it is sufficient for the actuary to state that the *mathematical reserves* for each such category of contracts are not less than the *mathematical reserves* that would be determined on a net *premium* reserving basis which, in that case, must be specified by the actuary in the abstract.

9. For each category of *linked long-term contract*: -

PRA

- (a) all assumptions made in calculating the valuation net liability in columns 12 and 13 of Form 53 and 54; and
- (b) where an explicit reserve has not been made for meeting the expenses likely to be incurred in future in fulfilling the existing contracts on the basis of specific assumptions in regard to the relevant factors, details of the basis used in testing the adequacy of the reserves to satisfy 12(1) of Appendix 5.

10. (1) The assumed levels of inflation of expenses and the basis used in the valuation to allow for such future inflation.

PRA

- (2) The aggregate amount, grossed up for taxation where appropriate, arising during the twelve months after the *valuation date* from implicit and explicit reserves made in the valuation to meet expenses in fulfilling contracts in force at the *valuation date* and a general description of the sources of such amounts.
- (3) The method and basis of calculation of the requirement (whether or not a reserve is thereby required) in respect of the expenses of continuing to transact new business during the twelve months following the *valuation date* and the amount of the reserve so calculated.
- (4) The method and basis of calculation of the requirement (whether or not a reserve is thereby required) to provide for the costs of closure to new business, if the *friendly society* were to cease to transact new business twelve months after the *valuation date* and the amount of the reserve so calculated.

11.

- (1) A schedule of the sum of the *mathematical reserves* (other than liabilities for *property linked benefits*) and the liabilities in respect of deposits received from reinsurers as shown in Form 14, analysed by reference to the currencies in which the liabilities are expressed to be payable together with the value of the assets, analysed by reference to currency, which match such liabilities.

PRA

- (2) In the schedule required by (1), liabilities totalling up to 2% of the total required to be analysed may be grouped together as "other currencies", and the assets matching those liabilities need not be analysed provided that the proportion of such liabilities which are matched by assets in the same currency is stated.

12.

- (1) For *long-term insurance business* ceded on a facultative basis to a reinsurer who is not authorised to carry on *insurance business* in the United Kingdom at any time during the period, the aggregate of *premiums* payable by the *friendly society* to all such reinsurers (divided according to *financial years*, if appropriate) and the aggregate amount deposited at the *valuation date* under any *deposit back arrangement*; and the amount of any such *premiums* payable by the *friendly society* to a reinsurer with whom the *friendly society* is connected and the aggregate amount deposited at the *valuation date* under any *deposit back arrangement*.

PRA

- (2) For each treaty of reinsurance where the *friendly society* is the cedant and under which business is in force at the *valuation date* –
  - (a) the name of the reinsurer;
  - (b) whether the reinsurer is authorised to carry on *insurance business* in the United Kingdom;
  - (c) whether the *friendly society* and the reinsurer are connected;

- (d) an indication of the nature and extent of the cover given under the treaty, including a description of any material contingencies, such as credit risk or legal risk, to which the treaty is subject;
  - (e) the *premiums* payable by the *friendly society* under the treaty during the period;
  - (f) the amount deposited at the *valuation date* in respect of the treaty under any *deposit back arrangements*;
  - (g) the extent to which provision has been made for any liability of the *friendly society* to refund any amounts of reinsurance commission in the event of lapses or surrender of the contract; and
  - (h) whether the treaty is closed to new business.
- (3) For each 'financing arrangement' –
- (a) the amount of any undischarged obligation of the *friendly society* and a brief description of the conditions for the discharge of such obligation; and
  - (b) a description of how, if at all, all such undischarged obligations have been taken into account in the valuation, including a description of the impact of the arrangement on the reported valuation result and any allowance made for material contingencies, such as credit risk or legal risk, associated with the financing arrangement for the purposes of the return.
- (4) In this paragraph –
- (a) financing arrangement means any contract entered into by the *friendly society*, in respect of *contracts of insurance* of the *friendly society*, which has the effect of increasing the amount of assets included at line 34 of Form 9, representing assets of the *friendly society* which are available to meet its *required minimum margin for long-term insurance business*, and which includes terms for –
    - (i) the transfer of assets to the *friendly society*, the creation of a *debt* to the *friendly society* or the transfer of liabilities to *policyholders* from the *friendly society* (or any combination of these), and
    - (ii) an obligation on the *friendly society* to return (with or without interest) some or all of such assets, a provision for the diminution of such *debt* or a provision for the recapture of the liabilities, in each case, in specified circumstances; and
  - (b) a reinsurer is connected with a *friendly society* if it is a *related undertaking* of the *friendly society*.

13. (1) Subject to (2), for each *with-profits fund*<sup>9</sup>, except where such information is provided elsewhere in the FSC 1 return –
- PRA**
- (a) a revenue account in the format of Form 40 with a supplementary note stating the amount, if any, of investment income relating to *linked assets* included in line 12; and
  - (b) a statement of liabilities and margins in the format of Form 14 with a supplementary note stating the amount, if any, of the increase or decrease, as the case may be, in the value of *non-linked assets*.
- (2) Where the amount (or part of the amount) of any increase or decrease in *non-linked assets* has yet to be allocated between *with-profits funds* or between one or more *with-profits funds* and other purposes, the information required by (1)(b) in aggregate for that amount or part amount, with a supplementary note which:

<sup>9</sup>*With-profits fund* includes subfunds (whether notional or real).

- (a) identifies the *with-profits funds* to which the information relates;
  - (b) provides the information in lines 11 to 49 of Form 14 separately in respect of each *with-profits fund*; and
  - (c) without prejudice to 14(2), describes the basis upon which increases or decreases in the value of *non-linked assets* are, or will be, allocated between the *with-profits funds* or between the *with-profits funds* and other purposes.
14. (1) The principles on which the distribution of profits among *policyholders* and members is based as described in any of the following documents:
- PRA**
- (a) the *memorandum*, if any, and the registered rules of the *friendly society*;
  - (b) *committee* resolutions of the *friendly society*;
  - (c) any policy or contract issued by the *friendly society*
  - (d) any advertisement issued by or on behalf of the *friendly society*;
  - (e) any document required to be issued under the rules in the Conduct of Business Sourcebook or which was required to be issued by any regulatory body recognised under the Financial Services Act 1986; and
  - (f) any other relevant document.
- (2) For each *with-profits fund*, a description of the *friendly society's* policy and (insofar as it may be relevant to *policyholders' reasonable*

expectations) its past practice as to:

- (a) how the *with-profits fund* is defined, which assets, liabilities, income and expense are allocated to it and how the amounts of such assets, liabilities, income and expense are determined;
  - (b) whether any non-profits *insurance business*, or any profit on it, is attributed to the *with-profits fund* and, if so, the nature and volume of such business;
  - (c) how assets within the *with-profits fund* are invested;
  - (d) the level of surplus or free reserves to be maintained in the *with-profits fund*; and
  - (e) the relationship between the performance of the *with-profits fund* and discretionary benefits allocated to *policyholders* including:
    - (i) whether an asset-share methodology, or equivalent methodology, is used or is to be used and, if so, how asset shares are calculated (including whether and how investment income, increases or decreases in the value of investments or other assets, expenses, miscellaneous surpluses and deficits, taxation and other items of income and expense are attributed to asset shares) and how they relate to the benefits actually allocated to *policyholders*;
    - (ii) an indication of how, under different scenarios as to the performance of the fund, discretionary benefits are to be smoothed from period to period;
    - (iii) the pattern of allocation for discretionary benefits over the life of a *with-profits policy*, including the balance between annual and terminal bonuses;
    - (iv) how fairness is maintained between different categories of policy and different categories of *policyholder* and between *policyholders* collectively and the *friendly society* itself; and
    - (v) any other factors which are material to the allocation of discretionary benefits to *policyholders*; and
    - (vi) the principles followed by the *friendly society* in setting actual proportions of profits distributed to *policyholders* and shareholders.
- (3) A description of the methods used to ensure that the aims described in (2) are achieved.
- (4) Subject to (5), if different principles or bonus policies apply to different categories of *with-profit policies* issued by the *friendly society*, the

information in (1) to (3) must be given in respect of each category.

- (5) Categories of *with-profits policies* which, apart from this paragraph would require separate information in accordance with (4) need only be listed under this paragraph, and the information in (1) to (3) need not be supplied, provided that
- (a) the aggregate amount of *established surplus* allocated to *policyholders* in all such categories is less than 10% of the aggregate amount of *established surplus* allocated to all *policyholders* (as reported at line 46 of Form 58);
  - (b) the amount of *established surplus* allocated to *policyholders* in any one such category is less than 5% of the aggregate amount of *established surplus* allocated to all *policyholders* (as reported at line 46 of Form 58); and
  - (c) none of the categories was introduced during the period.

15.

PRA

- (1) Particulars of the bonus allocated to each category of contract, including the basis of calculation and the circumstances and the form in which the bonus is payable, together with –
- (a) where the rates of bonus allocated depend on the original term of the contract or on the period of years a contract has been in force, specimen rates at 5-year intervals of original term or duration, as the case may be;
  - (b) where the rates of bonus allocated depend on the age of the life assured, specimen rates at 10-year intervals of age;
  - (c) where the rates of bonus allocated depend on the date of each previous *premium* payment, specimen rates at 5-year intervals of time since the *premium* was paid, and for *premiums* paid in each of the five years ending with the current year; and
  - (d) in all other cases, full details of the rates of bonus allocated.
- (2) Where the rates of bonus allocated depend on a formula or a series of formulae, then the formula or formulae must be listed instead of the specimen rates. Wherever appropriate, rates of bonus are to be expressed as a fraction of the attribute of the contract to which they are related, e.g. as rates per £1000 of the sum assured and existing bonuses.
- (3) Information required under (1) need not be provided for any category of contract –
- (a) where no contracts were effected by the *friendly society* during the report period; and
  - (b) which has been included under the miscellaneous heading in Forms 51, 52, 53 or 54.

16. (1) A statement of practice regarding any bonus payments (in addition to those for which the *friendly society* had become contractually liable) to be made on *claims* arising in the period up to the next investigation, including the basis of calculation and the form in which the bonus is payable, together with –
- PRA
- (a) where the rates of bonus depend on the original term of the contract or on the period of years a contract has been in force, specimen rates at 5- year intervals of original term or duration, as the case may be;
  - (b) where the rates of bonus depend on the age of the life assured, specimen rates at 10-year intervals of age;
  - (c) where the rates of bonus depend on the date of each previous *premium* payment, specimen rates at 5-year intervals of time since the *premium* was paid, and for *premiums* paid in each of the five years ending with the current year; and
  - (d) in all other cases, full details of the rates of bonus.
- (2) Where the rates of bonus depend on a formula or a series of formulae, then the formula or formulae must be listed instead of the specimen rates. Wherever appropriate, rates of bonus are to be expressed as a fraction of the attribute of the contract to which they are related, e.g. as rates per £1000 of the sum assured and existing bonuses.

*Form 46*

17. (1) A statement in Form 46 summarising changes in *long-term insurance business* for all non-group contracts. Information is to be given gross of reinsurance ceded and must be provided separately for United Kingdom and overseas business, taxable and non-taxable business, and in each case for *non-linked contracts* and *linked long-term contracts*. For group contracts only the number of contracts in force at the end of the period is to be given in a note to the appropriate statement.
- PRA
- (2) In Form 46 –
- (a) the figures for annual *premiums* must include repeated or recurrent single *premiums* where the level of *premium* is defined;
  - (b) for *hybrid-linked contracts*, movements between linked and non-linked business must be shown in lines 13 and 27 as appropriate; and
  - (c) only claim payments which result in the termination of a contract providing cover for other insured events must be shown in line 22.

*Form 47*

18. (1) Separate statements in the form set out in Form 47 analysing new *long-term insurance business* for United Kingdom business and overseas business, taxable and non-taxable business, and in each case for *non-linked contracts* and *linked long-term contracts*. New business must be
- PRA

shown gross of reinsurance ceded and must include increases to *premiums* on existing policies, and in dealing with such increases, columns 2 and 5 must be left blank.

- (2) Single *premium* contracts must consist of those contracts under which there is no expectation of continuing *premiums* being paid at regular intervals and additional single *premiums* paid in respect of existing individual contracts must be included. Regular *premium* contracts must include those contracts under which *premiums* are paid at regular intervals during the policy year, including repeated or recurrent single *premiums* where the level of *premium* is defined.
- (3) The information must be shown separately and totalled within each section in the sequence
  - (i) tax exempt business
  - (ii) taxable business.
- (4) The information must be shown separately and totalled within each section in the sequence –
  - (i) United Kingdom direct written business
  - (ii) United Kingdom reinsurance accepted
  - (iii) overseas direct written business
  - (iv) overseas reinsurance accepted.
- (5) The information is to be analysed and totalled within each type of business in the following sequence –
  - (i) life assurance and general annuity business
  - (ii) pension business
  - (iii) permanent health business
  - (iv) other business.
- (6) The information is to be further analysed and sub-totalled in the following sequence –
  - (i) *accumulating with-profit policies*
  - (ii) *non-linked with-profits policies*
  - (iii) *non-linked non-profit policies*
  - (iv) *index linked contracts*
  - (v) *other linked long-term contracts*

and where a policy falls within more than one of the categories, it must be placed in the first appropriate category.

- (7) Within each sub-division required under (5) and (6), the appropriate types of insurance from the following list are to be shown separately –
- (i) whole life assurance
  - (ii) endowment assurance
  - (iii) pure endowment assurance
  - (iv) term assurance
  - (v) other assurance (to be specified)
  - (vi) deferred annuity
  - (vii) annuity in payment
  - (viii) other annuity (to be specified)
  - (ix) permanent health insurance
  - (x) capital redemption assurance
  - (xi) annuity certain
  - (xii) group pension
  - (xiii) group life
  - (xiv) group permanent health
  - (xv) other group (to be specified).
- (8) In the case of group contracts, the information to be given is to relate to new contracts and increments under existing contracts. The amount of the increment under an existing contract must be taken to be the increase in the annual *premium* shown in Form 51, 52, 53 or 54 as appropriate, over the previous highest level shown in those Forms. Decreases in any year for an existing contract are to be ignored.

*Forms 48 and 49*

19. (1) Separate statements of *long-term insurance business assets* (other than assets held to match *property linked or index linked liabilities*) are to be given in Forms 48 and 49 in respect of each fund or group of funds for which separate assets are appropriated. The word "Total" or the name of the fund must be shown against the heading "Category of assets".
- (2) A brief description of the extent to which any of the amounts recorded in Form 48 would be changed if assets which the *friendly society* had a

right or obligation to acquire or dispose of under *derivative contracts* or contracts having the effect of *derivative contracts* outstanding at the end of the period (being in the case of *options*, only those *options* which it would have been prudent to assume would be exercised) had been so acquired or disposed of.

- (3) A brief description of how different the information provided pursuant to (2) would have been if such *options* as were outstanding at the end of the period had been exercised in such a way as to change the amounts referred to in (2) to the maximum extent.
- (4) A brief description of how different the information provided pursuant to (2) and (3) would have been if, instead of applying to contracts outstanding at the end of the period, they had applied to *derivative contracts* outstanding at such other time during the period as would have changed the amounts referred to in (2) and (3) to the maximum extent.
- (5) In Form 48 –
  - (a) the expected income is to be given as the amounts before deduction of tax which would be received in the next period on the assumption that the assets will be held throughout the period and that the factors which affect income will remain unchanged but account must be taken of any changes in those factors known to have occurred by the *valuation date* (in particular, changes of the type (a), (b), (c) or (d) denoted in 10(5) of Appendix 5). The expected income shown in this Form must be that determined before any adjustments considered necessary because of 10(6) or (7) of Appendix 5;
  - (b) where a particular asset is required to be taken into account only to a specified extent by the application of the admissibility limits, the expected income from that asset must be included only to the same extent;
  - (c) the treatment of the expected income from any asset where the payment of interest is in default and the amount of interest involved must be stated in a supplementary note;
  - (d) where the yield in column 3 for a type of asset shown in line 17, 18 or 19 of the Form (assumed to be zero for assets in line 19) is significantly different from the *weighted average of the yields* for each asset of that type determined in accordance with 10(7) of Appendix 5, then the latter yield figure must be shown in a note to the Form. For this purpose, the *weighted average of the yields* means an average yield weighted by the value of each asset of that type as entered in column 1; and
  - (e) where an entry at 13.87.1 has resulted from excess *exposure to a counterparty* or *excess concentration with a number of counterparties*, the aggregate value of the assets of the *friendly society* giving rise to *exposure to such counterparties* must be stated in a supplementary note, together with the expected

income from those assets.

- (5A) In Form 48, to the extent that paragraph 10(5A) of Appendix 5 has not been, or would otherwise not be required to be, applied to calculate the yield on equity *shares* or holdings in *collective investment schemes*, that rule may be ignored (in which case paragraph 10(5) will apply) for an amount up to the higher of £5 million or 5% of the value of equity *shares* and holdings in *collective investment schemes* required to be reported in Form 48.
- (5B) To the extent that a yield greater than zero on equity *shares* or holdings in *collective investment schemes* is not needed for the purpose of determining rates of interest under paragraph 10 of Appendix 5, paragraphs 10(5) and (5A) may be ignored for an amount of up to 1% of the value of equity *shares* and holdings in *collective investment schemes* required to be reported in Form 48, and the relevant yield will be taken as zero.
- (6) In Form 49 –
- (a) the gross redemption yield in columns 2 and 5 for each asset must be calculated as in 10(3), (4) and (6) of Appendix 5, leaving out of account any adjustment considered necessary because of 10(7) of Appendix 5. Where a number of assets with different gross redemption yields are held, the weighted average gross redemption yield must be calculated using as weights the value of the asset applicable for entry into columns 1 and 4 respectively;
- (b) the value of admissible higher yielding assets to be shown in columns 3 and 6 must be the value of admissible assets as shown in Form 13 where the gross redemption yield on those assets exceeds the gross redemption yield shown in columns 2 and 5 respectively by at least 1.5%; and
- (c) where *securities* may be redeemed over a period at the option of the guarantor or the *issuer*, they must be classified on the assumption that they will be redeemed at the latest possible date or, if it is assumed that they will be redeemed at any earlier date, a note must be provided explaining what assumption has been made.

*Forms 51, 52, 53 and 54*

20. (1) Separate statements in Forms 51, 52, 53 and 54 and separate valuation summaries must be completed in respect of each separate fund or part of a fund for which a surplus is determined under rule 5.1.
- (2) Separate totals for column 5 on Form 51 and columns 5, 6 and 7 on Forms 52, 53 and 54 must be shown for sums insured, for annuities per annum and for other measures of benefit.
- (3) In relation to Forms 51, 52, 53 and 54 –

PRA

- (a) information must be shown separately and totalled for each of the following –
  - (i) United Kingdom business
  - (ii) Overseas business;
- (b) the information must be shown on separate pages and totalled for each type of business in the following sequence –
  - (i) life assurance and general annuity business – taxable
  - (ii) life assurance and general annuity business – non-taxable
  - (iii) pension business
  - (iv) permanent health business – taxable
  - (v) permanent health business – non-taxable
  - (vi) other business;
- (c) the information is to be further analysed and sub-totalled for –
  - (i) direct written business
  - (ii) reinsurance accepted
  - (iii) reinsurance ceded

and totals net of reinsurance ceded are also to be shown, provided that where any information to be provided in accordance with (c)(iii) duplicates any information required to be provided in accordance with (d), (e) and (f) in respect of (c)(i) or (ii), then for the purpose of (c)(iii), the total of the reinsurance ceded may be shown in respect of the duplicated information;
- (d) the information must be further analysed and sub-totalled within each basis of participation in profits in the following sequence –
  - (i) *with-profits policies*
  - (ii) *non-profit policies*;
- (e) within each sub-division required under (b), (c) and (d) the appropriate types of insurance from the following list must be shown separately –
  - (i) whole life assurance
  - (ii) endowment assurance

- (iii) pure endowment assurance
- (iv) term assurance
- (v) other assurance (to be specified)
- (vi) miscellaneous assurance
- (vii) deferred annuity
- (viii) annuity in payment
- (ix) other annuity (to be specified)
- (x) miscellaneous annuity
- (xi) permanent health insurance
- (xii) capital redemption assurance
- (xiii) annuity certain,
- (xiv) group pension
- (xv) group life
- (xvi) group permanent health
- (xvii) other group (to be specified)

and particulars must also be shown of any subsidiary provisions within *general insurance business class 1 or 2*;

- (i) Forms 51 and 52 – each category of contract which is valued on a different valuation basis;
  - (ii) Form 53 – each category of contract which provides different guarantees or options, and each category of unit link. For the purpose of determining the category of the unit link, all authorised unit trusts may be considered to be one category and all *internal linked funds* may be considered to be one category;
  - (iii) Form 54 – each category of contract which provides different guarantees or options, and each category of index. Where the link is to a proportion of an index each different proportion must be treated as a different category;
- (g) any contract which consists of a combination of different types of insurance, as described in (e), must be treated as a number of separate contracts each dealing with one of the different types of insurance so combined and the amount by which the total number of contracts shown in column 4 of any valuation

summary exceeds the actual number of contracts to which that valuation summary relates must be stated in a supplementary note;

- (h) for *linked contracts* with both *property linked* and *index linked benefits*, each benefit must be shown on Form 53 or 54 as appropriate, and a note must be attached describing the manner in which details relating to the number of contracts and the amounts of benefits, *premiums* and other liabilities have been treated. Where the number of contracts is overstated in aggregate, the amount of the overstatement must be stated in a supplementary note;
- (i) for *linked contracts* which are also *accumulating with-profits policies*, that part of the benefits which are with-profits must be shown on Form 52 and the remainder of the benefits on Form 53 and/or 54 as appropriate, and a note must be attached describing the manner in which details relating to the number of contracts and the amounts of benefits, *premiums* and other liabilities have been treated. Where the 31 December 2010 136 number of contracts is overstated in aggregate, the amount of the overstatement must be stated in a supplementary note;
- (j) reserves calculated on an aggregate basis (including reserves for taxation on capital gains, for investment performance guarantees or other special reserves) or adjustments must be shown on separate lines in the *mathematical reserves* column and the particulars of such reserves or adjustments must be specified;
- (k) contracts the nature of which or the method of valuation of which makes it impossible or inappropriate to give the information in the exact form required by Forms 51, 52, 53 and 54 must be shown on a separate valuation summary with appropriately modified column headings and the reason for the modification stated in a supplementary note; and
- (l) where a net premium method of valuation is not used for contracts reported on Form 51 then, notwithstanding (k)–
  - (a) columns 7 and 8 must be left blank;
  - (b) if the method used does not separately identify suitable values to be entered in columns 9 and 10, then the total amount of *mathematical reserves* must be entered in columns 9 and 12, and columns 10 and 11 must be left blank; and
  - (c) if the method used does separately identify suitable values to be entered in columns 9 and 10, then the entry in column 11 must be the amount entered in column 10 less the amount reserved for future expenses, so that the amount in column 12 equals the

amount in column 9 less the amount in column 11.

*Forms 55 and 56*

21.

PRA

- (1) **Separate analyses of unit liabilities in Forms 55 and 56 in respect of each separate fund or part of a fund for which a surplus is determined under rule 5.1.**
- (2) **The analyses of unit liabilities must also include liability in respect of any amounts deposited with the *friendly society* under a *deposit back arrangement* which are either unit liabilities in respect of *property linked benefits* or investment liabilities in respect of *index linked benefits*.**
- (3) **In the event that the liability for a specific fund link is wholly reinsured so that entries in columns 8 and 9 of Form 55 are omitted in accordance with (4)(g), if such be the case, a statement to the effect that the provisions of rule 4.11 have been complied with in accordance with any published guidance in relation to the liabilities so reinsured.**
- (4) **In Form 55 –**
  - (a) **separate Forms must be prepared in respect of *internal linked funds* and directly held assets;**
  - (b) **separate line must be used for each asset to which benefits are linked and each different type of unit of each *internal linked fund*;**
  - (c) **columns 5, 6, 7, 8, 9 and 10 must be sub-totalled for each fund link and totalled for all links;**
  - (d) **the aggregate of the total figures shown for column 8 (excluding any amount shown in column 8 pursuant to (h) ) and 9 in each Form prepared in respect of a separate fund or part of a fund must equal the appropriate figure shown as the total of column 12 of Form 53;**
  - (e) **for links to directly held assets, column 6 must not be used;**
  - (f) **for *internal linked funds*, the total of column 5 must equal the total of column 8 of the summarised Form 43, and the total of column 6 must equal the total of column 3 of the summarised Form 43;**
  - (g) **where the liability shown in column 11 of Form 53 for a specific fund link is wholly reinsured with a reinsurer, being an insurer (other than an EEA firm) with permission under the Act to effect or carry out contracts of reinsurance or another *friendly society*, so that entries in columns 8 and 9 of this Form would otherwise be identical, the entries in respect of that fund link must be aggregated and shown on a separate line with the name of the fund link to be shown in column 1 as "wholly reinsured"; and**

- (h) any amounts included in this analysis in accordance with (2), being unit liabilities in respect of *property linked benefits* deposited with the *friendly society* under a *deposit back arrangement*, must (for each *internal linked fund* or directly held asset), be shown on a separate line with the name of the unit type to be shown in column 2 as "amounts deposited back".
- (4A) In Form 55, where the conditions in paragraph 13 of Appendix 8 are met, selfinvested *internal linked funds* and adviser *internal linked funds* may (in either case) be aggregated.
- (5) In Form 56 –
  - (a) assets and liabilities in column 2 must be listed individually except that where a group of assets of similar type is held which is intended to mirror the performance of an index, a description of the type of assets held may be given. Liabilities must be shown between round brackets and must be fully described;
  - (b) a separate sub-total of assets and liabilities must be used for each index link and for each combination of assets and liabilities matching the *friendly society's* liability under any *deposit back arrangement*. Links to different percentages of an index must be treated as different index links;
  - (c) for each index link, the sub-totalled values in column 2 (excluding those held in respect of any *deposit back arrangement*) must match the appropriate entries in column 12 of Form 54 net of reinsurance ceded;
  - (d) assets and liabilities arising from *derivative contracts* (or contracts or assets which have the effect of a *derivative contract*) must be shown separately. Amounts must be shown net of *variation margin* in column 31 December 2010 138 2 and gross of *variation margin* in column 3. Rights to recover assets transferred by way of *initial margin* must not be shown on Form 56;
  - (e) where there is a liability to repay *variation margin* and there are no arrangements for netting of amounts outstanding or the arrangements would not permit the accounting of such amounts on a net basis in accordance with generally accepted accounting practice, it must be so stated in a supplementary note to the Form; and
  - (f) any provision for adverse changes must be determined in accordance with 4 of Appendix 5 and shown in a supplementary note to the Form.

*Form 57*

22. (1) Separate statements in Form 57 for each fund or group of funds for which separate assets are appropriated in respect of all *long-term*

PRA

**liabilities except –**

- (a) the unit liabilities in respect of *property linked benefits* as shown in column 12 of Form 53;
  - (b) the investment liabilities in respect of *index linked benefits* as shown in column 12 of Form 54;
  - (c) any reserve in respect of provisions made for tax on unrealised capital gains in arriving at the valuation price of *internal linked funds*; and
  - (d) the liabilities in respect of any amounts deposited with the *friendly society* under a *deposit back arrangement* which are either unit liabilities in respect of *property linked benefits* or investment liabilities in respect of *index linked benefits*.
- (2) A general description of the method by which the yield on assets other than equity *shares* and land was adjusted in accordance with 10(7) of Appendix 5.
- (3) For assets which are equity *shares* or land, a description of the categories into which such assets were divided for the purposes of 10(7) of Appendix 5, together with the method and basis by which the yield on such assets was adjusted in accordance with that rule.
- (4) In relation to Form 57 –
- (a) a separate Form must be completed in respect of each fund or group of funds for which separate assets are appropriated. The word "Total" or the name of the fund must be shown against the heading "Category of assets";
  - (b) separate Forms must be prepared for sterling and non-sterling liabilities;
  - (c) separate Forms are required for with-profit and non-profit contracts within the following types of business –
    - (i) life assurance and annuity business
    - (ii) pension business
    - (iii) permanent health business
    - (iv) other business;
  - (d) separate Forms are required for each rate of interest used in the valuation in pursuance of 10(12) of Appendix 5 and may include all contracts valued at the same rate, subject to (b) and (c). Contracts valued at a lower rate of interest but subject to the same apportionment of assets may also be included provided that the rationale for such inclusion is given in a supplementary note. Each of the valuation rates of interest used must be shown

against the heading "Rate of interest". The highest valuation rate of interest used must be shown in line 31 or 32 as appropriate;

- (e) the Forms specified in (a), (b), (c) and (d) must exclude the liabilities described in (1)(a) to (d) and must cover at least 90% of the remaining *long-term liabilities*. The balance of the remaining *long-term liabilities* must be shown in a separate Form in which lines 31 and 32 must be left blank, and details of the contracts covered by the Form must be given in a supplementary note to the Form. The word "Balance" must be shown against the heading "Rate of interest";
- (f) a summary of all the separate Forms must be produced as a separate Form in which lines 31 and 32 must be left blank. The word "Total" must be shown against the heading "Rate of interest";
- (g) the risk adjusted yield in columns 2 and 6 for each asset included in column 1 and 5 respectively must be that calculated as in 10(3) to (6) of Appendix 5, taking account of any adjustment considered necessary because of 10(7) of Appendix 5. Where a number of assets with different risk adjusted yields are held, the weighted average risk adjusted yield must be calculated using as weights the value of the asset applicable for entry into columns 2 and 6;
- (h) the value of each asset included in column 1 must be the value attributed to it in Form 13 and the assets will be grouped according to Note 1 to Form 48 including adjustments in respect of accrued interest as required by that Note;
- (i) where the valuation has been carried out at a net rate or rates of interest the figure in line 31 must be the net rate grossed up at the corresponding effective rate of tax in respect of the highest valuation rate of interest used in the Form;
- (j) the mathematical reserve in line 33 must include any increase in reserve resulting from the bonus declaration for the year and must be net of reinsurance ceded;
- (k) the entries shown at columns 3, 4, 5 and 6 must be those applicable to the scenario described in the answer to 7(8). The entries in column 3 must be the value of the assets shown in column 1 according to the changed assumptions of that scenario. The entries in column 4 must be the value of assets on the changed assumptions for each type of asset notionally re-allocated to cover the mathematical reserve or other liability, net of reinsurance, in the resilience scenario. The entries in column 5 must equal the sum of the entries in columns 3 and 4; and
- (l) the entries in line 29, column 1 must equal the entries in line 33, column 1. The entries in line 29, column 5 must not be less than

the entries in line 33, column 5.

*Form 58*

23. (1) Separate statements of the results of the valuation in Form 58 in respect of each separate fund or part of a fund for which a surplus is determined under rule 5.1.
- PRA
- (2) In relation to Form 58 –
- (a) where interim, mortuary or terminal bonuses are determined in advance of a valuation and are paid in anticipation of surplus arising at the valuation, the amounts of such bonus actually paid in the period up to *valuation date* must be entered in lines 12 and 41. To the extent that it is the practice of the *friendly society* to make specific provision for the cost of such bonuses payable on future *claims* out of surplus arising at a valuation, such amounts must be treated as amounts allocated to *policyholders* and members at the valuation in question and included in line 44 and the actual amounts paid must not appear at lines 12 and 41 at future valuations. An appropriate note must be appended identifying the various items where necessary; and
- (b) where policies have been transferred from one fund to another, the associate transfer of reserves must not be included as a "transfer" in this Form. Where any other transfer has been made, only one positive figure must be inserted in either line 15 or line 34 (depending on the direction of the net transfer) leaving the other line blank.

*Forms 60, 11 and 12*

24. (1) A statement of the *required minimum margin* for *long-term insurance business* in Form 60 and of the *required margin of solvency* for *Class IV business* and the subsidiary provisions in Forms 11 and 12, in accordance with instruction 8 for completion of Form 60.
- PRA
- (2) If the gross annual office *premiums* for *Class IV business* and the subsidiary provisions in force on the *valuation date* do not exceed 1% of the gross annual office *premiums* in force on that date for all *long-term insurance business*, Forms 11 and 12 need not be completed provided it can be stated that the entry in line 51 of Form 60 exceeds the amount that would be obtained if Forms 11 and 12 were to be completed. In this circumstance, the method of estimating the entry in line 51 of Form 60, together with a statement of the gross annual office *premiums* in force at the *valuation date* in respect of *Class IV business* and the subsidiary provisions, must be given. When completing Forms 11 and 12, the accounting conventions appropriate for *general insurance business* should be followed, but reasonable approximations may be used if they are unlikely to result in an underestimate of the *required margin of solvency*.

# Appendix 10:

## Prudential Reporting Forms

### Contents

FSC1 Return	FSC1 Form 47	FSC3 Contents
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FSC 1 Form 15	FSC1 Form 60 (Sheet 1)	FSC3 Form 15
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FSC1 Form 40	FSC1 Form 61A	FSC3 Form 20
FSC1 Form 40A	FSC1 Form 61B	FSC3 Form 21
FSC1 Form 40B	FSC1 Form 61C	FSC3 Form 22
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**Prudential Reporting Forms**

FSC1 Return
Long Term Insurance Business: Annual Investigation
FORM FSC 1

Register Number

Year ended 31 December

Name of Society (as registered)

Registered Office

Post Code:

The information provided in this FSC1 Return (Long Term Insurance Business: Annual Investigation) and Auditor's report included herein are the form and contents of an abstract under rule 5.1(2) for use by a *non-directive incorporated friendly society* (other than a *flat rate benefits business friendly society*) in respect of its *long-term insurance business*.

One copy of the Return must be signed by the chief executive, the secretary and one *committee* member of the society (or two members of the *committee* if the offices of chief executive and secretary are held by the same person).

Three copies of this Return (including the original signed copy) must be submitted as soon as possible after 31 December and not later than the following 30 June to:-

Regulatory Data Group, Statistics and Regulatory Data Division (HO5 A-B), Bank of England, Threadneedle Street, London, EC2R 8AH

**FSC 1 – CONTENTS (SHEET 1)**

**Return under the Friendly Societies Prudential Rules**

Long term insurance business: Annual Investigation

Summary sheet of completed forms submitted

Name of Society

Period ended 31 December

Reg No	
<input style="width: 90%; height: 35px;" type="text"/>	<input style="width: 90%; height: 35px;" type="text"/>

Where appropriate, certain Forms need to be copied in order to furnish separate details of business in the same format (e.g. the same Form completed separately for tax-exempt or taxable business). Where a Form is completed, please enter the total number of such forms in the corresponding box in the third column below. Where no Form is completed, please enter NIL. Where an additional summary form has been completed, please indicate YES in the fourth column.

Form Number	Details on Form	Number completed	Summary form used
Form 9	Statement of solvency	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 13	Analysis of admissible assets	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 14	Long term insurance business : Liabilities and margins	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 15	Liabilities (other than long term insurance business)	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 17	Analysis of derivative contracts	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 40	Long term insurance business : Revenue account fund	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 40A	Other revenue account fund	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 40B	Management fund	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 40C	Members surplus and savings accounts	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 41	Analysis of premiums and expenses	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 42	Analysis of claims	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 43	Summarised balance sheet for internal linked funds	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 44	Aggregate revenue account for internal linked funds	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Form 45	Supplementary information for internal linked funds	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>

**FSC 1 – CONTENTS (SHEET 2)**

**Return under the Friendly Societies Prudential Rules**

Long term insurance business: Annual Investigation

Summary sheet of completed forms submitted

<b>Form Number</b>	<b>Details on Form</b>	<b>Number completed</b>	<b>Summary form used</b>
Form 46	Summary of changes in long term insurance business		
Form 47	Analysis of new long term insurance business		
Form 48	Expected income from admissible assets not held to match liabilities in respect of linked liabilities		
Form 49	Analysis of admissible fixed interest securities not held to match liabilities in respect of linked liabilities		
Form 51	Valuation summary of non-linked contracts (other than accumulating with-profits policies)		
Form 52	Valuation summary of accumulating with-profit policies		
Form 53	Valuation summary of property linked contracts		
Form 54	Valuation summary of index linked contracts		
Form 55	Analysis of unit liabilities and assets in respect of property linked benefits		
Form 56	Analysis of assets and liabilities in respect of index linked benefits		
Form 57	Matching Rectangle		
Form 58	Valuation result and distribution of surplus		
Form 60	Required minimum margin		
Form 61	Subsidiary provisions		
Form 61A	Descriptive section of actuarial investigation		
Form 61B	Actuary's certificate		
Form 61C	Auditor's report		
Form 61D	Signatures of officers and actuary		

**FSC 1 – FORM 9**

**Returns under the Friendly Societies Prudential Rules**  
Statement of solvency

**Name of Society**

Period ended 31 December  Reg No  Units £/£000

		1 As at the end of the year	2 As at the end of the previous year
Total available assets (Note 1)	10	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
<b>GENERAL INSURANCE BUSINESS</b>			
Other than long term insurance business assets allocated towards general insurance business required minimum margin	11	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Implicit items valued in accordance with a waiver under section 138A of the Act	11a	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Required minimum margin for general insurance business	12	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Excess (deficiency) of available assets over the required minimum margin (11+11a – 12)	13	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
<b>LONG TERM INSURANCE BUSINESS</b>			
Long term insurance business admissible assets	21	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Other than long term insurance business assets allocated towards long term insurance business required minimum margin	22	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Total mathematical reserves (after distribution of surplus) (Note 2)	23	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Other insurance and non-insurance liabilities (Note 3)	24	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Available assets for long term insurance business required minimum margin (21 + 22 – 23 – 24)	25	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
<b>Implicit items valued in accordance with a waiver under section 138A of the Act</b>			
Future profits	31	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Zillmerising	32	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Hidden reserves	33	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Total of available assets and implicit items (25 + 31 + 32 + 33)	34	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
<b>Required minimum margin</b>			
Required minimum margin for long term insurance business (Note 4)	41	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Explicit required minimum margin (1/6 x Line 41, or minimum guarantee fund if greater)	42	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Excess (deficiency) of available assets over explicit required minimum margin (25 – 42)	43	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Excess (deficiency) of available assets and implicit items over the required minimum margin (34 – 41)	44	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
<b>CONTINGENT LIABILITIES</b>			
Quantifiable contingent liabilities in respect of other than long term insurance business (Note 5)	51	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>
Quantifiable contingent liabilities in respect of long term insurance business (Note 5)	52	<input style="width: 160px; height: 25px;" type="text"/>	<input style="width: 140px; height: 25px;" type="text"/>

## FSC 1 – Notes to Form 9

**1**

The entry at line 10 must be equal to the sum of entries at line 89 in Form 13.

**2**

The entry at line 23 must be equal to the sum of lines 11, 19b and 63 in Form 14.

**3**

The entry at line 24 must be equal to the sum of lines 12 and 49 in Form 14 less line 19b in Form 14.

**4**

The entry at line 41 must be equal to the entry at line 69 in Form 60.

**5**

Particulars to be specified by way of supplementary note.

**FSC1 – FORM 9A**

[deleted]

**FSC1 – Notes to Form 9A**

[deleted]

## FSC 1 – FORM 13 (Sheet 1)

## Returns under the Friendly Societies Prudential Rules

## Analysis of admissible assets

Name of Society

--

Period ended 31 December

	Reg No	Units £/£000

Category of assets / Total

--

1 As at the end of year

2 As at the end of the previous year

## INVESTMENTS:

Land and Buildings		11			
Investments in associated bodies	UK insurance dependants	Shares	21		
		Debts securities issued by, and loans to, dependants	22		
	Other insurance dependants	Shares	23		
		Debts securities issued by, and loans to, dependants	24		
	Non insurance dependants	Shares	25		
		Debts securities issued by, and loans to, dependants	26		
	Other associated bodies	Shares	27		
		Debts securities issued by, and loans to, associated bodies	28		
	TOTAL (11 to 28)		39		
	Other financial investments	Equity shares		41	
Others shares and other variable yield securities		42			
Holdings in collective investment schemes		43			
Rights under derivative contracts		44			
Debt securities and other fixed income securities		Fixed interest	Approved Securities	45	
			Other	46	
		Variable interest	Approved securities	47	
			Other	48	
Participation in investment pools		49			
Loans secured by mortgages		50			
Other loans		Loans to public or local authorities and nationalised industries or undertakings		51	
		Loans secured by policies of insurance issued by the society		52	
		Other		53	
Deposits with approved credit institutions and approved financial institutions		Withdrawal subject to a time restriction of one month or less		54	
		Withdrawal subject to a time restriction of more than one month		55	
Other		56			

**FSC 1 – FORM 13 (Sheet 2)**

**Returns under the Friendly Societies Prudential Rules**

Analysis of admissible assets

Name of Society

--

Period ended 31 December

	Reg No	Units £/£000

Category of assets/Total

--

**1** As at the end of the year

**2** As at the end of the previous year

**INVESTMENTS AND OTHER ASSETS:**

Deposits with ceding undertakings	57		
Assets held to match linked liabilities	Index linked	58	
	Property linked	59	
Reinsurer's share of technical provisions	Provision for unearned premiums	60	
	Claims outstanding	61	
	Provision for unexpired risks	62	
	Other	63	
<b>TOTAL (41 to 63)</b>	<b>69</b>		
Debtors arising out of direct insurance operations	Policyholders	71	
	Intermediaries	72	
Debtors arising out of reinsurance operations	Due from ceding insurers and intermediaries under reinsurance business accepted	74	
	Due from reinsurers and intermediaries under reinsurance contracts ceded	75	
Other debtors	Due from dependants	Due in 12 months or less after the end of the financial year	76
		Due more than 12 months after the financial year	77
	Other	Due in 12 months or less after the end of the financial year	78
		Due more than 12 months after the end of the financial year	79
Tangible assets	80		
Cash at bank and in hand	Deposits not subject to time restriction on withdrawal, with approved credit institutions and approved financial institutions and local authorities	81	
	Cash in hand	82	
Other assets (particulars to be specified by way of supplementary note)	83		
Prepayments and accrued income	Accrued interest and rent	84	
	Deferred acquisition costs	85	
	Other prepayments and accrued income	86	

# FSC 1 – FORM 13 (Sheet 3)

## Returns under the Friendly Societies Prudential Rules

Analysis of admissible assets

Name of Society

Period ended 31 December

	Reg No	Units £/£000
	<input type="text"/>	<input type="text"/>

Category of assets / Total

**1** As at the end of the year

**2** As at the end of the previous year

Deductions (under paragraphs 15(2)(b) and 15(3) of Appendix 4) from the aggregate value of assets	87	<input type="text"/>	<input type="text"/>
Total (71 to 86 less 87)	88	<input type="text"/>	<input type="text"/>
Grand total of admissible assets (39 + 69 + 88)	89	<input type="text"/>	<input type="text"/>

### RECONCILIATION TO ASSET VALUES DETERMINED IN ACCORDANCE WITH ACCOUNTS REGULATIONS (Note 1):

Total admissible assets (as per line 89 above)	91	<input type="text"/>	<input type="text"/>
Total assets in excess of the admissibility limits of Appendix 4 (as valued in accordance with those rules before applying admissibility limits) (Note 2)	92	<input type="text"/>	<input type="text"/>
[deleted]	93	<input type="text"/>	<input type="text"/>
Other differences in the valuation of assets (other than for assets not valued above)	94	<input type="text"/>	<input type="text"/>
Assets of a type not valued above (as valued in accordance with the Accounts Regulations (Note 3)	95	<input type="text"/>	<input type="text"/>
Total assets determined in accordance with the Accounts Regulations (91 to 95)	99	<input type="text"/>	<input type="text"/>
Amounts included in line 89 attributable to debts due from associated bodies, other than those under contracts of insurance or reinsurance	100	<input type="text"/>	<input type="text"/>

## FSC 1 – Notes to Form 13

**1** The Accounts Regulations refer to the Friendly Societies (Accounts and Related Provisions) Regulations 1994.

**2** The admissibility limits are those applied under Annex B to Appendix 4.

‘Assets of a type not valued above’ refers to assets left out of account under rule 2(3) of Appendix 4.

**3** ‘Assets of a type not valued above’ refers to assets left out of account under 2(3) of Appendix 4.

## FSC 1 – FORM 14 (Sheet 1)

## Returns under the Friendly Societies Prudential Rules

## Long term insurance business liabilities and margins

Name of Society

Period ended 31 December

Reg No

Units £/£000

Category of assets/Total			1 As at the end of the year	2 As at the end of the previous year	
Mathematical reserves after distribution of surplus (Note 1)		11			
Cash bonuses which had not been paid to policyholders prior to end of the financial year (Note 2)		12			
Balance of surplus/valuation deficit ((Note 3)		13			
Long term insurance business fund carried forward (11 to 13) (Note 4)		14			
Claims outstanding which had fallen due for payment before the end of the financial year	Gross amount	15			
	Reinsurers share	16			
	Net (15 – 16)	17			
Management Fund – Balance – surplus/ (deficit) (Note 5)		19a			
Members' surplus and savings accounts	Long term insurance business after distribution of surplus (Note 1)	19b			
	Other (Note 6)	19c			
Other Revenue Account funds (Note 7)		19d			
Provisions for other risks and charges	Taxation	21			
	Other	22			
Deposits received from reinsurers		23			
Creditors and other liabilities	Arising out of insurance operations	Direct business	31		
		Reinsurance accepted	32		
		Reinsurance ceded	33		
	Debenture loans	Secured	34		
		Unsecured	35		
	Amounts owed to credit institutions		36		
		Taxation	37		
		Other	38		
	Accruals and deferred income		39		
Provision for adverse changes		41			
Total other insurance and non-insurance liabilities (17 to 41)		49			

# FSC 1 – FORM 14 (Sheet 2)

## Returns under the Friendly Societies Prudential Rules

Long term insurance business liabilities and margins

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 70%; height: 25px;" type="text"/>	<input style="width: 70%; height: 25px;" type="text"/>	<input style="width: 70%; height: 25px;" type="text"/>

Category of assets/Total

**1** As at the end of the year

**2** As at the end of the previous year

Excess of the value of net admissible assets (Note 8)	51	<input style="width: 95%; height: 25px;" type="text"/>	<input style="width: 95%; height: 25px;" type="text"/>
Total liabilities and margins	59	<input style="width: 95%; height: 25px;" type="text"/>	<input style="width: 95%; height: 25px;" type="text"/>
Amount included in line 59 attributable to liabilities to associated bodies, other than those under contracts of insurance or re-insurance	61	<input style="width: 95%; height: 45px;" type="text"/>	<input style="width: 95%; height: 45px;" type="text"/>
Amount included in line 59 attributable to liabilities in respect of property linked benefits	62	<input style="width: 95%; height: 35px;" type="text"/>	<input style="width: 95%; height: 35px;" type="text"/>
Amount of any additional mathematical reserves included in line 51 which have been taken into account in the certificate in Form 61B (Note 9)	63	<input style="width: 95%; height: 65px;" type="text"/>	<input style="width: 95%; height: 65px;" type="text"/>

## FSC 1 – Notes to Form 14

- 1** The entry at lines 11 and 19b must equal the sum of lines 21, 43, 44 and 45 of the corresponding Form or Forms 58.
- 2** The entry at line 12 must equal the total of line 42 of the corresponding Form or Forms 58.
- 3** The entry at line 13 must equal the total of line 49 of the corresponding Form or Forms 58.
- 4** The entry at line 14 must equal the total of line 59 of the corresponding Form or Forms 40.
- 5** The entry at line 19a must equal the entry at line 49 on Form 40B.
- 6** The entry at lines 19b and 19c must equal the sum of the entries at line 59 on Form 40C.
- 7** The entry at line 19d must equal the entry at line 69 on Form 40A.
- 8** The entry at line 51 must be:
  - (a) the value of the admissible assets (as included in line 89 of the appropriate Form 13) representing the long term insurance business funds, fund or group of funds to which the Form relates, less
  - (b) the amount of those funds, fund or group of funds, being the sum of the amounts shown at lines 14 and 49.
- 9** The entry at line 63 must be the amount specified in paragraphs (a)(ii) of the certificate in Form 61B, but only insofar as it relates to the fund, funds or group of funds to which this Form 14 relates.

**FSC 1 – FORM 15**

**Returns under the Friendly Societies Prudential Rules**  
 Liabilities (Other than long term insurance business)

**Name of Society**

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>	<input style="width: 80%; height: 20px;" type="text"/>

Class of Business (as in Part III of Chapter 7)

			1 As at the end of the year	2 As at the end of the previous year	
Technical provisions (gross amount)	Provision for unearned premiums (Note)	11	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
	Claims outstanding	12	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
	Provision for unexpired risks	13	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
	Other	16	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
	<b>Total (11 to 16)</b>	<b>19</b>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Provisions	Taxation	21	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
	Other	22	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Deposits received from reinsurers		31	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Creditors	Arising out of insurance operations	Direct business	41	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
		Reinsurance accepted	42	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
		Reinsurance ceded	43	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Debenture loans	Secured	44	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
		Unsecured	45	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Amounts owed to credit institutions		46	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
	Other creditors	Taxation	47	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
		Other	49	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>
Accruals and deferred income		51	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
<b>Total (19 to 51)</b>		<b>59</b>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Provision for adverse changes		61	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
<b>Total (59 + 61)</b>		<b>69</b>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	
Amounts included in line 69 attributable to liabilities to associated bodies other than those under contracts of insurance or reinsurance		71	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	

**NOTE**

The amounts shown in lines 11 to 13 and 16 must be stated gross of the reinsurer's share.

**FSC 1 – FORM 17****Returns under the Friendly Societies Prudential Rules**

Analysis of derivative contracts (other than those relating to property linked contracts or index linked benefits)

**Name of Society**

Period ended 31 December 19

	Reg No	Units £/£000
<input type="text"/>	<input type="text"/>	<input type="text"/>

Business: Long Term/Other than long term

As at the end of the year

As at the end of the previous year

Category of assets/Total

Assets

Liabilities

Assets

Liabilities

1

2

3

4

## Derivative Contracts

Futures Contracts	Fixed-interest securities	11	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Equity shares	12	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Land	13	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Currencies	14	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Other	15	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Options	Fixed-interest securities	21	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Equity shares	22	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Land	23	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Currencies	24	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Other	25	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Contracts for Differences	Fixed-interest securities	31	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Equity shares	32	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Land	33	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Currencies	34	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Other	35	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Adjustments for variation margin		41	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Total (11 to 41) (Note)		49	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

**NOTE**

The entry at line 49.1 must be included at Form 13.44.1 and the entry at line 49.2 must be included at Form 14.38.1 or 15.49.1 as appropriate.

**FSC 1 – FORM 40**

**Returns under the Friendly Societies Prudential Rules**

Long term insurance business: Revenue account fund

**Name of Society**

Period ended 31 December

	Reg No	Units £/£000	OB/IB	No of fund/ Summary	No of part of fund
Period ended 31 December	<input style="width: 60px; height: 25px;" type="text"/>				

Name of Fund/Summary

	1 This year	2 Previous year
Name of Fund/Summary	<input style="width: 200px; height: 25px;" type="text"/>	<input style="width: 150px; height: 25px;" type="text"/>

**ITEMS TO BE SHOWN NET OF  
REINSURANCE CEDED**

Earned premiums (Note 1)	11	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Investment income receivable before deduction of tax	12	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Increase (decrease) in the value of non-linked assets brought into account	13	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Increase (decrease) in the value of linked assets	14	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Amounts transferred from other revenue account funds (Note 2)	14a	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Other income (Note 2)	15	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
<b>Total income (11 to 15)</b>	<b>19</b>	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Claims incurred (Note 1)	21	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Amounts transferred to Management Fund (Note 2)	22	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Interest payable before deduction of tax	23	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Taxation	24	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Other expenditure (Note 2)	25	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Amounts transferred to other Revenue Account Funds (Note 2)	26	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
<b>Total expenditure (21 to 26)</b>	<b>29</b>	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
<b>Increase (decrease) in fund in year (19 – 29)</b>	<b>39</b>	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Fund brought forward	49	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
<b>Fund carried forward (39 + 49)</b>	<b>59</b>	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>

**NOTES**

1. The entry at 40.11.1 must equal the sum of 41.19.3 + 41.29.3  
The entry at 40.21.1 must equal 42.59.3

2. Particulars to be specified by way of note.

**FSC 1 – FORM 40A****Returns under the Friendly Societies Prudential Rules**

Other revenue account fund

**Name of Society**

--

Period ended 31 December

	Reg No	Units £/£000	OB/IB	No of fund/ Summary	No of part of fund

Name of Fund/Summary

--

**1 This year****2 Previous year**

Amounts receivable (Note)	11			
Investment income		14		
	Income			
	Value re-adjustments on investments	15		
		16		
		17		
Investment charges				
	Investment management charges, including interest			
	Value re-adjustments on investments	18		
		19		
		21		
		22		
		29		
		31		
		32		
		33		
		34		
		35		
		39		
		49		
		59		
		69		

**NOTE**

Particulars to be specified by way of note.

**FSC 1 – FORM 40B****Returns under the Friendly Societies Prudential Rules**

Management fund

**Name of Society**

Period ended 31 December

	Reg No	Units £/£000	OB/IB
	<input type="text"/>	<input type="text"/>	<input type="text"/>

		1 This year	2 Previous year
Amounts transferred from Revenue Account Funds (Note 1)	11	<input type="text"/>	<input type="text"/>
Investment Income	12	<input type="text"/>	<input type="text"/>
Other Income (Note 1)	13	<input type="text"/>	<input type="text"/>
Total Income (11 to 13)	19	<input type="text"/>	<input type="text"/>
Expenses payable (Note 2)	21	<input type="text"/>	<input type="text"/>
Amounts transferred to Revenue Account Funds (Note 1)	22	<input type="text"/>	<input type="text"/>
Increase (decrease) in fund in year (19 – 21 – 22)	29	<input type="text"/>	<input type="text"/>
Fund brought forward	39	<input type="text"/>	<input type="text"/>
Fund carried forward (29 + 39)	49	<input type="text"/>	<input type="text"/>

**NOTES**

- Particulars to be specified by way of note
- The entry at 40B.21.1 must equal 41.49.3

## FSC 1 – FORM 40C

**Returns under the Friendly Societies Prudential Rules**

Member surplus and savings accounts

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input type="text"/>	<input type="text"/>	<input type="text"/>

		<b>1</b> This year	<b>2</b> Previous year
Surplus/Bonus Credited to members (other than transfers shown in Line 13)	11	<input type="text"/>	<input type="text"/>
Contributions/Deposits	12	<input type="text"/>	<input type="text"/>
Amounts transferred from Permanent Health Long Term Insurance Benefit Funds	13	<input type="text"/>	<input type="text"/>
Amounts transferred from other Long Term Insurance Benefit Funds (Note 1)	14	<input type="text"/>	<input type="text"/>
Amounts transferred from other Revenue Account Funds (Note 1)	15	<input type="text"/>	<input type="text"/>
Other Income (Note 1)	16	<input type="text"/>	<input type="text"/>
Total Income (11 to 16)	19	<input type="text"/>	<input type="text"/>
Amounts withdrawn by members	21	<input type="text"/>	<input type="text"/>
Benefits charged and amounts transferred to other Long Term Insurance Benefit Funds (Note 1)	22	<input type="text"/>	<input type="text"/>
Amounts transferred to other revenue account funds (Note 1)	23	<input type="text"/>	<input type="text"/>
Other expenditure	24	<input type="text"/>	<input type="text"/>
Total expenditure and transfers (21 to 24)	29	<input type="text"/>	<input type="text"/>
Increase (decrease) in accounts in year (19 – 29)	39	<input type="text"/>	<input type="text"/>
Amounts credited to members brought forward	49	<input type="text"/>	<input type="text"/>
Amounts credited to members carried forward (39 + 49)	59	<input type="text"/>	<input type="text"/>

## NOTE

1. Particulars to be specified by way of note.

## FSC 1 – FORM 41

## Returns under the Friendly Societies Prudential Rules

Long term insurance business: Analysis of premiums and expenses

Name of Society

Period ended 31 December

Reg No	Units £/£000	OB/IB	No of fund/ Summary	No of part of fund
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

Name of Fund/ Summary				<b>1</b> Gross	<b>2</b> Payable to or recoverable from reinsurers	<b>3</b> Net of reinsurance
Earned premiums in the financial year	Life Assurance and General Annuity contracts	Single Premium	11	<input type="text"/>	<input type="text"/>	<input type="text"/>
		Regular Premium	12	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Pension Business contracts	Single Premium	13	<input type="text"/>	<input type="text"/>	<input type="text"/>
		Regular Premium	14	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Permanent Health Contracts	Single Premium	15	<input type="text"/>	<input type="text"/>	<input type="text"/>
		Regular Premium	16	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Other Contracts	Single Premium	17	<input type="text"/>	<input type="text"/>	<input type="text"/>
		Regular Premium	18	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Total Premiums	Single Premium	19	<input type="text"/>	<input type="text"/>	<input type="text"/>
		Regular Premium	29	<input type="text"/>	<input type="text"/>	<input type="text"/>
Total premiums at line 19 and 29 attributable to	UK Contracts	31	<input type="text"/>	<input type="text"/>	<input type="text"/>	
	Overseas Contracts	32	<input type="text"/>	<input type="text"/>	<input type="text"/>	
Expenses payable in the financial year	Commission payable in connection with acquisition of business		41	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Other commission payable		42	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Management expenses in connection with acquisition of business		43	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Management expenses in connection with maintenance of business		44	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Other management expenses		45	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Total Expenses (41 to 45)		49	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Total expenses at line 49 attributable to	UK Contracts	51	<input type="text"/>	<input type="text"/>	<input type="text"/>
Overseas Contracts		52	<input type="text"/>	<input type="text"/>	<input type="text"/>	

## NOTES

The entries at lines 11,13, 15, 17 and 19 must include all single premium amounts where there is no expectation of continuing premiums being paid at regular intervals.

The entries at lines 12, 14, 16, 18 and 29 must include premiums payable at regular intervals during the policy year, including repeated or recurrent single premiums where the level of premium is defined.

## FSC 1 – FORM 42

## Returns under the Friendly Societies Prudential Rules

Long term insurance business: Analysis of claims

Name of Society

Period ended 31 December

Reg No

Units  
£/£000

OB/IB

No of fund/  
SummaryNo of part  
of fundName of  
Fund/Summary**1** Gross**2** Recoverable  
from reinsurers**3** Net of  
reinsurance (1-2)

## CLAIMS INCURRED IN THE YEAR

Life Assurance and Annuity Contracts	On death	11			
	By way of lump sums on maturity	12			
	By way of annuity payments	13			
	By way of payments arising from other insured events	14			
	On surrender or partial surrender	15			
	Total life assurance and annuity claims (11 to 15)	19			
Pension Business Contracts	On death	21			
	By way of lump sums on vesting	22			
	By way of vested annuity payments	23			
	On surrender or partial surrender	24			
	Total pension business claims (21 to 24)	29			
Permanent Health Contracts	By way of lump sums	31			
	By way of periodical payments	32			
	Total permanent health claims (31 + 32)	39			
Other Contracts (Note 1)	By way of lump sums	41			
	By way of periodical payments	42			
	Total other contracts claims (41 + 42)	49			
Total claims (19 + 29 + 39 + 49)		59			
Total claims at line 59 attributable to:-	UK Contracts	61			
	Overseas Contracts	62			

## NOTES

1. Particulars to be specified by way of note. 2. In the case of industrial assurance, claims incurred on survival in respect of periodical endowment benefits must be shown in line 15

**FSC 1 – FORM 43**

**Returns under the Friendly Societies Prudential Rules**

Long term insurance business: Summarised balance sheet for internal linked funds

**Name of Society**

Period ended 31 December

	Reg No	Units £/£000	OB/IB	No of fund/ Summary	No of part of fund
[ ]	[ ]	[ ]	[ ]	[ ]	[ ]

**Name of fund/summary**

Name of fund  1	Directly held assets  2	Investment in other internal linked funds of the society  3	Total assets (2 + 3)  4	Provision for tax on unrealised capital gains  5	Secured and unsecured loans  6	Other liabilities  7	Net asset value (4 – 5 – 6 – 7)  8
<b>Total</b>							

**NOTE**

The total of the net asset value in column 8 less the total of column 3 must equal line 59 of Form 44.

**FSC 1 – FORM 44****Returns under the Friendly Societies Prudential Rules**

Long term insurance business: Aggregate revenue account for internal linked funds

**Name of Society**

Period ended 31 December

Reg No	Units £/£000	OB/IB	No of fund/ Summary	No of part of fund
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

Name of fund/Summary

Value of total creation of units	11	<input type="text"/>
Investment income attributable to the funds before deduction of tax	12	<input type="text"/>
Increase (decrease) in the value of investments in financial year	13	<input type="text"/>
Other income (Note 1)	14	<input type="text"/>
Total income (11 to 14)	19	<input type="text"/>
Value of total cancellation of units	21	<input type="text"/>
Charges for management	22	<input type="text"/>
Charges in respect of tax on investment income	23	<input type="text"/>
Taxation on realised capital gains	24	<input type="text"/>
Increase (decrease) in amount set aside for tax on capital gains not yet realised	25	<input type="text"/>
Other expenditure (Note 1)	26	<input type="text"/>
Total expenditure (21 to 26)	29	<input type="text"/>
Increase (decrease) in funds in the year (19 – 29)	39	<input type="text"/>
Internal linked funds brought forward	49	<input type="text"/>
Internal linked funds carried forward	59	<input type="text"/>

**NOTES**

1. Particulars to be specified by way of note.

**FSC 1 – FORM 45**

**Returns under the Friendly Societies Prudential Rules**

Long term insurance business: Supplementary information for internal linked funds

**Name of Society**

Period ended 31 December

<input type="text"/>	Reg No <input type="text"/>	Units £/£000 <input type="text"/>	OB/IB <input type="text"/>	No of fund <input type="text"/>	No of part of fund <input type="text"/>
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**Name of fund**

Name of fund 1	Amount of taxable unrealised capital gain or loss 2	Percentage provision for tax on unrealised capital gains 3	Percentage provision for tax on realised capital gains 4	Liquidity percentage 5	Valuation price per unit 6
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

# FSC 1 – FORM 46

## Returns under the Friendly Societies Prudential Rules

Long term insurance business: Summary of changes in long term insurance business

Name of Society

Period ended 31 December

	Reg No	OB/IB	UK/ Overseas	Taxable/ Non Taxable	Linked Non-Linked

		Life Assurance and General Annuity		Pensions Business		Permanent Health		Other Business (Note 1)	
		1. No. of Contracts	2. Annual Premiums £	3. No. of Contracts	4. Annual Premiums £	5. No. of Contracts	6. Annual Premiums £	7. No. of Contracts	8. Annual Premiums £
In force at beginning of year	11								
New business and increases	12								
Net transfers and other alterations "on"	13								
Total "on" (12 + 13)	19								
Deaths	21								
Other insured events	22								
Maturities	23								
Surrenders	24								
Forfeitures	25								
Conversions to paid-up policies for reduced benefits	26								
Net transfers, expiries and other alterations "off"	27								
Total "off" (21 to 27)	29								
In force at end of year (11 + 19 – 29)	39								

**NOTE**

1. Specify particulars of other business contracts included in columns 7 and 8.

# FSC 1 – FORM 47

## Returns under the Friendly Societies Prudential Rules

Long term insurance business: Analysis of new long term insurance business

Name of Society

Period ended 31 December

	Reg No	Units £/£000	OB/IB	UK/Overseas	Taxable/Non Taxable
<input type="text"/>					

TYPE OF INSURANCE	Single Premium Contracts			Regular Premium Contracts		
	No of Contracts	Premiums	Sum assured, annuities per annum or other measure of benefits	No of Contracts	Annual Premiums	Sums assured, annuities per annum or other measure of benefits
1	2	3	4	5	6	7
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

**FSC 1 – FORM 48****Returns under the Friendly Societies Prudential Rules**

Long term insurance business: Expected income from admissible assets not held to match liabilities in respect of linked benefits

Name of Society

Period ended 31 December

	Reg No	Units £/£000
	<input type="text"/>	<input type="text"/>

Category of assets/Total

**1** Value of admissible assets as shown in Form 13

**2** Expected income from admissible assets

**3** Yield %

**TYPE OF ASSETS**

Land and Buildings		11	<input type="text"/>	<input type="text"/>	<input type="text"/>
<i>Fixed interest Securities</i>	Approved securities	12	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Other	13	<input type="text"/>	<input type="text"/>	<input type="text"/>
<i>Variable interest and variable yield securities (excluding items shown in line 16)</i>	Approved securities	14	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Other	15	<input type="text"/>	<input type="text"/>	<input type="text"/>
Equity shares and holdings in collective investment schemes		16	<input type="text"/>	<input type="text"/>	<input type="text"/>
Loans secured by mortgages		17	<input type="text"/>	<input type="text"/>	<input type="text"/>
All other assets	Producing income	18	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Not producing income	19	<input type="text"/>	<input type="text"/>	<input type="text"/>
Total (11 to 19)		29	<input type="text"/>	<input type="text"/>	<input type="text"/>

## FSC 1 – Notes to Forms 48 and 49

1. Where Form 13 is for the same fund or group of funds:-

- the entry at 48.11.1 must be equal to 13.11.1.
- the entry at 48.12.1 must be equal to 13.45.1 and the appropriate part of 13.84.1.
- the entry 48.13.1 must be equal to 13.46.1 and the appropriate part of 13.84.1.
- the entry 48.14.1 must be equal to 13.47.1 and the appropriate part of 13.84.1.
- the entry at 48.15.1 must be equal to 13.42.1 + 13.48.1 and the appropriate part of 13.84.1.
- the entry at 48.16.1 must be equal to 13.41.1 + 13.43.1.
- the entry at 48.17.1 must be equal to 13.50.1 and the appropriate part of 13.84.1.
- the entry at 48.29.1 must be equal to 13.87.1 + 13.89.1 – 13.58.1 – 13.59.1.

The appropriate part of the entry at 13.84.1 to be included in lines 12 to 15 is that part which represents accrued interest on assets included in the relevant line of Form 48. The amounts so included shall be stated in a supplementary note to Form 48.

- 2.
- The entries at 48.12.3, 48.13.3, 48.14.3 and 48.15.3 must be equal to 49.19.2, 49.29.2, 49.19.5 and 49.29.5 respectively. Subject to paragraphs 19(5A) and (5B) of Appendix 9, the yields to be inserted in column 3 of form 48 for other categories of asset must be the running yields determined in accordance with paragraphs 10(3) to (6A) in Appendix 5.
  - The entry at 48.29.3 must be the weighted average of the yields in column 3 of Form 48, where the weight given to each asset is the value of that asset applicable for entry into column 1; assets not producing income must be included in the calculation.
  - The entries at 49.19.1, 49.19.2, 49.19.4, 49.19.5, 49.29.1, 49.29.2, 49.29.4 and 49.29.5 must be equal to the values at 48.12.1, 48.12.3, 48.14.1, 48.14.3, 48.13.1, 48.13.3, 48.15.1 and 48.15.3 respectively.
  - The entries at 49.19.2, 49.19.5, 49.29.2 and 49.29.5 must be the weighted average of the yields in columns 2 and 5 as appropriate for lines 11 to 18 and 21 to 28 respectively, where the weight given to each yield is the value shown in columns 1 and 4 respectively.



# FSC 1 – FORM 51

## Returns under the Friendly Societies Prudential Rules

Long term insurance business: Valuation summary of non-linked contracts (other than accumulating with-profit policies)

Name of Society

Period ended 31 December

<input type="text"/>	Reg No <input type="text"/>	Units £/£000 <input type="text"/>	UK/Overseas <input type="text"/>	Taxable/Non Taxable <input type="text"/>
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Name of Fund

Type of business:

Type of insurance or name of contract <b>1</b>	VALUATION BASIS		Number of contracts <b>4</b>	Amount of sums assured or annuities per annum, including vested reversionary bonuses <b>5</b>	AMOUNT OF ANNUAL PREMIUMS		Proportion of office premiums reserved for expenses and profits <b>8</b>	Value of sums assured or annuities per annum, including vested reversionary bonuses <b>9</b>	VALUE OF ANNUAL PREMIUMS		Amount of Mathematical Reserves <b>12</b>
	Rate of interest <b>2</b>	Mortality or morbidity table <b>3</b>			Office Premiums <b>6</b>	Net premiums <b>7</b>			Office premiums <b>10</b>	Net premiums <b>11</b>	
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
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# FSC 1 – FORM 52

## Returns under the Friendly Societies Prudential Rules

Long term insurance business: Valuation summary of accumulating with-profit policies

Name of Society

Period ended 31 December

Reg No	Units £/£000	UK/Overseas	Taxable/Non Taxable
<input style="width: 40px; height: 30px;" type="text"/>			

Name of Fund  Type of business:

Type of insurance or name of contract	VALUATION BASIS		Number of contracts	Amount of sums assured or annuities per annum including vested reversionary bonuses			AMOUNT OF ANNUAL PREMIUMS		Proportion of office premiums reserved for expenses and profits	Liability in respect of current benefits including vested bonuses		OTHER LIABILITIES		Amount of Mathematical Reserves
	Rate of interest	Mortality or morbidity table		Guaranteed on death	Current on death	Guaranteed on maturity	Office premiums	Net premiums		Current benefit value	Discounted value	Mortality and expenses	Options & guarantees other than investment performance guarantees	
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>8</b>	<b>9</b>	<b>10</b>	<b>11</b>	<b>12</b>	<b>13</b>	<b>14</b>	<b>15</b>
<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>				
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**FSC 1 – FORM 53**

**Returns under the Friendly Societies Prudential Rules**  
 Long term insurance business: Valuation summary of property linked contracts

**Name of Society**

Period ended 31 December

Reg No	Units £/£000	UK/Overseas	Taxable/Non Taxable
<input style="width: 40px; height: 20px;" type="text"/>			

Name of Fund  Type of business:

Name of Contract	VALUATION BASIS		Number of contracts	Amount of sums assured or annuities per annum including vested reversionary bonuses			AMOUNT OF ANNUAL PREMIUMS		Category of unit link	UNIT LIABILITY		OTHER LIABILITIES		Amount of Mathematical Reserves
	Rate of interest	Mortality or morbidity table		Guaranteed on death	Current on death/ current payable per annum	Guaranteed on maturity	Office premiums	Net premiums		Current benefit value	Discounted value	Mortality and expenses	Options & guarantees other than investment performance guarantees	
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>8</b>	<b>9</b>	<b>10</b>	<b>11</b>	<b>12</b>	<b>13</b>	<b>14</b>	<b>15</b>
<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>				
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# FSC 1 – FORM 54

## Returns under the Friendly Societies Prudential Rules

Long term insurance business: Valuation summary of index linked contracts

Name of Society

Period ended 31 December

	Reg No	Units £/£000	UK/Overseas	Taxable/Non Taxable
<input style="width: 50px; height: 30px;" type="text"/>				

Name of Fund

Type of business:

Name of Contract	VALUATION BASIS		Number of contracts	Amount of sums assured or annuities per annum including vested reversionary bonuses			AMOUNT OF ANNUAL PREMIUMS		Name of index link	INVESTMENT LIABILITY		OTHER LIABILITIES		Amount of Mathematical Reserves
	Rate of interest	Mortality or morbidity table		Guaranteed on death	Current on death/current payable per annum	Guaranteed on maturity	Office premiums	Net premiums		Current benefit value	Discounted value	Mortality and expenses	Options & guarantees other than investment performance guarantees	
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 50%; height: 25px;" type="text"/>	<input style="width: 50%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 50%; height: 25px;" type="text"/>	<input style="width: 50%; height: 25px;" type="text"/>	<input style="width: 50%; height: 25px;" type="text"/>	<input style="width: 50%; height: 25px;" type="text"/>	<input style="width: 50%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 50%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>			
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# FSC 1 – FORM 55

## Returns under the Friendly Societies Prudential Rules

Long term insurance business: Analysis of units in internal linked funds and direct holdings of assets matching liabilities in respect of property linked benefits

**Name of Society**

Period ended 31 December

Reg No	Units £/£000	UK/ Overseas	Internal Fund/Direct Assets
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

**Name of Fund**

Name of fund link or directly held asset	Name of unit type	Valuation price per unit or asset	Total actual number of units in force or directly held assets	Value of total actual units in force or directly held assets	Value of actual units held by other internal linked funds	Value of directly held assets and actual units in force excluding those held by other internal linked funds (5-6)	Value of units or directly held assets deemed allocated to contracts		Value of surplus units or directly held assets (7 – 8 + 9)
							Gross	Reinsurance ceded	
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>8</b>	<b>9</b>	<b>10</b>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

# FSC 1 – FORM 56

## Returns under the Friendly Societies Prudential Rules

Long term insurance business: Analysis of assets and liabilities matching investment liabilities in respect of index linked benefits

Name of Society

Period ended 31 December

	Reg No	Units £/£000	UK/Overseas
	<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>

Name of fund

	Name of index link	Value of assets or liabilities	Gross derivative value
TYPE OF ASSETS AND LIABILITIES	1	2	3
<input style="width: 100%; height: 25px;" type="text"/>			
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**FSC 1 – FORM 57**

**Returns under the Friendly Societies Prudential Rules**

Long term insurance business: Matching rectangle

**Name of Society**

Period ended 31  
December

	Reg No	Units £/£000	UK/ Overseas	With-profits/ Non profit	Sterling/Non sterling	Rate of interest

Category of assets/Total

Type of business

Type of asset notionally allocated
------------------------------------

	The valuation		The resilience scenario		
	Value of asset notionally allocated 1	Risk adjusted yield % 2	Value of assets notionally allocated		Risk adjusted yield % 6
			On original allocation 3	Increase or decrease 4	

Land and Buildings
--------------------

11						
----	--	--	--	--	--	--

Fixed interest securities	Approved securities
	Other

12						
13						

Variable interest and variable yield securities (excluding items shown at line 16)	Approved securities
	Other

14						
15						

Equity shares and holdings in collective investment schemes
---

16						
----	--	--	--	--	--	--

Loans secured by mortgages
----------------------------

17						
----	--	--	--	--	--	--

All other assets	Producing income
	Not producing income

18						
19						

Total (11 to 19)
------------------

29						
----	--	--	--	--	--	--

Gross valuation interest rate %
---------------------------------

31						
----	--	--	--	--	--	--

Net valuation interest rate %
-------------------------------

32						
----	--	--	--	--	--	--

Mathematical reserve or other liability, net of reinsurance
---

33						
----	--	--	--	--	--	--

## FSC 1 – FORM 58

## Returns under the Friendly Societies Prudential Rules

Long term insurance business: Valuation result and distribution of surplus

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input type="text"/>	<input type="text"/>	<input type="text"/>

Name of Fund/Summary

Valuation result	Fund carried forward (Note 1)		11	<input type="text"/>
	Bonus payments made to policyholders in anticipation of a surplus		12	<input type="text"/>
	Net transfer to other funds (Note 2)		15	<input type="text"/>
	Total (11 + 12 + 15)		16	<input type="text"/>
	Mathematical reserves for accumulating with profit contracts		17	<input type="text"/>
	Mathematical reserves for non-linked contracts (Note 4)		18	<input type="text"/>
	Mathematical reserves for property linked contracts		19	<input type="text"/>
	Mathematical reserves for index linked contracts		20	<input type="text"/>
	Total (17 to 20)		21	<input type="text"/>
	Surplus including contingency and other reserves towards the solvency margin (Deficiency) (16 – 21)		29	<input type="text"/>
	Composition of surplus	Balance of surplus brought forward unappropriated from last valuation		31
Net transfer from other funds (Note 2)		34	<input type="text"/>	
Surplus arising since the last valuation		35	<input type="text"/>	
Total (31 + 34 + 35) (= 29)		39	<input type="text"/>	
Distribution of surplus	Bonus payments made to policyholders in anticipation of a surplus		41	<input type="text"/>
	Allocated to policyholders by way of	Cash bonuses	42	<input type="text"/>
		Reversionary bonuses	43	<input type="text"/>
		Other bonuses	44	<input type="text"/>
		Premium reductions	45	<input type="text"/>
	Total allocated to policyholders (41 to 45)		46	<input type="text"/>
	Transfer to other funds (Note 2 + 5)		47	<input type="text"/>
	Total distributed surplus (46 + 47)		48	<input type="text"/>
	Balance of surplus including contingency and other reserves held towards the solvency margin carried forward unappropriated (Note 3)		49	<input type="text"/>
	Total (48 + 49) (= 29)		59	<input type="text"/>

## NOTES

- The entry at line 11 must be equal to the entry at line 59 in the revenue account for the relevant fund (Form 40).
- Particulars to be specified by way of note.
- Where the entry at line 21 exceeds the entry at line 16, the difference must be included at line 13 of Form 14.
- For each fund, the entry at line 18 must be equal the total liabilities in column 12 of Form 51 and the entries at lines 17, 19 and 20 must equal the total liabilities in column 15 of Forms 52, 53 and 54 respectively.
- The figure at line 47 must equal the figure at line 15.

**FSC 1 – FORM 60 (Sheet 1)**

**Returns under the Friendly Societies Prudential Rules**

Long term insurance business: Required minimum margin

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>

Class	Classes I & II	Class III business with relevant factor of				Class IV	Class VI	Class VII business with relevant factor of				Unallocated additional mathematical reserves with relevant factor of		Total for all classes	
Relevant factor (Note 1)	4% 1	4% 2	1% 3	Expense related 4	Total 5	4% 6	4% 6A	4% 7	1% 8	Expense related 9	Total 10	4% 11	1% 12	This year 13	Previous year 14
Mathematical reserves before deduction for reinsurance: (Note 5)	Reserves before distribution of surplus	11	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>									
	Reserves for bonus allocated to policyholders	12	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>									
	Reserves after distribution of surplus	13	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>									
Mathematical reserves after deduction for reinsurance: (Note 5)	Reserves before distribution of surplus	14	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>									
	Reserves for bonus allocated to policyholders	15	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>									
	Reserves after distribution of surplus	16	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>									
Ratio of 16 to 13, or 0.85 if greater		17	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>									
Required margin of solvency – first result – (Note 2)		19	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>									
Required margin of solvency based on administrative expenses (note 7)		20	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>									
Non negative capital at risk before reinsurance: (Note 3)	Temporary assurances with required margin of solvency of .001	21	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>									
	Temporary assurances with required margin of solvency of .0015	22	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>									
	All other contracts with required margin of solvency of .003	23	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>									
Total for (21 to 23)		29	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>	<input style="width: 40px; height: 20px;" type="text"/>									

**FSC 1 – FORM 60 (Sheet 2)**

**Returns under the Friendly Societies Prudential Rules**

Long term insurance business: Required minimum margin

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>

Class	Classes I & II	Class III business with relevant factor of				Class IV	Class VI	Class VII business with relevant factor of				Unallocated additional mathematical reserves with relevant factor of	Total for all classes		
Relevant factor (Note 1)	4% 1	4% 2	1% 3	Expense related 4	Total 5	4% 6	4% 6A	4% 7	1% 8	Expense related 9	Total 10	4% 11	1% 12	This year 13	Previous year 14
Non negative capital at risk after reinsurance (all contracts) (Note 3)	31	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>										
Ratio of line 31 to line 29, or 0.50 if greater	32	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>										
Required margin of solvency second result (Note 4)	39	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>										
Sum of first and second results = (19 + 20 + 39)	49	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>										
Required margin of solvency for subsidiary provisions and the additional margin for class IV business (Notes 6 and 8)	51	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>										
Total required margin of solvency for long term business = 49 + 51	59	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>										
Minimum guarantee fund	61	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>										
Required minimum margin (greater of 59 and 61)	69	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>										

**NOTES**

1. The appropriate factor specified in rule 1(2)(a) and 2(3) and (4) of Appendix 1.
2. Line 19 equals line 13 x Line 17 x relevant factor.
3. Capital at risk must be shown after distribution of surplus.
4. Line 39 equals line 32 x [line 21 x .001 + line 22 x .0015 + line 23 x .003] for Classes I and II or line 32 x line 29 x 0.003 for classes III and VII.
5. Any additional mathematical reserves shown at line 63 to Form 14 must be included in this Form (applied to all relevant classes)
6. For Class V business, the amount of the required margin of solvency must be stated in a note to the form and must be included in line 51
7. For class III and VII business, the entry at line 20 is 25% of the financial year's net administrative expenses pertaining to business for which the friendly society bears no investment risk and the allocation to cover management expenses is not fixed for a period exceeding five years. (Appendix 1 para 2(4)).
8. For class IV business and subsidiary provisions taken together, Forms 11 and 12 in Appendix 10 must be completed and appended to Form 60 (unless the Forms would be blank or paragraph 24(2) of Appendix 9 permits the friendly society not to complete the Forms). Lines 44 and 49 of Form 12 should be left blank. For the purposes of these Forms "health insurance" is health insurance based on actuarial principles that meets the conditions set out in paragraph 7 of Appendix 2. The entry at line 51 of Form 60 must equal the entry at 51.43 of Form 12 plus the amount to be included for class V business (see note 6).

**FSC 1 – FORM 61A**

**Returns under the Friendly Societies Prudential Rules**

Descriptive section of actuarial investigation

Name of Society:

Reg No	.....
<input type="text"/>	

1. The date to which the investigation relates is

2. The date to which the latest previous investigation relates is

## Returns under the Friendly Societies Prudential Rules

Long term insurance business: Annual Investigation Certificate and Signatures

Name of Society

Period ended 31 December

Reg No	
<input type="text"/>	<input type="text"/>

We certify that:

- (a) (i) the information in this Return complies with the rules in IPRU(FSOC) and proper records have been kept by the society adequate for the purpose of the valuation of the liabilities of its long term insurance business;
- (ii) the sum of the mathematical reserves and the deposits received from reinsurers as shown in Form 14 together, if the case so requires, with £..... (being part of the excess of the value of the admissible assets representing the long term insurance business funds over the amount of those funds shown in Form 14) constitute proper provision at the end of the financial year for the long term insurance liabilities (including all liabilities arising from deposit back arrangements, but excluding liabilities which have fallen due before the end of the financial year) including any increase in those liabilities arising from a distribution of surplus as a result of any investigation as at that date into the financial condition of the long term insurance business; and
- (iii) for the purpose of sub-paragraph (ii) above the liabilities have been assessed in accordance with Appendix 5 in the context of assets valued in accordance with Appendix 4, as shown in Form 13;
- (iv) premiums for contracts entered into during the financial year and income earned thereon are sufficient, on reasonable actuarial assumptions, and taking into account the other financial resources of the society that are available for the purpose, to enable the society to meet its commitments in respect of those contracts, and, in particular, to establish adequate mathematical reserves; and
- (v) In preparing this Return, we have taken and paid due regard to advice from every *actuary* appointed by the society to perform the *actuarial function* in accordance with SUP 4.3.13R

- (b) The amount of the required minimum margin of solvency applicable to the society's long term insurance business immediately following the end of the financial year (including any amounts resulting from any increase in liabilities arising from a distribution of surplus as a result of the investigation into the financial condition of the long term insurance business) is £.....
- (c) We have the following additional comments (use extra pages).

We confirm also that the society consents to a copy of this Return being placed on the public file of the society.

**Chief Executive**

Name (Block Capitals)

**Secretary**

Name (Block Capitals)

**Member of Committee**

Name (Block Capitals)

Additional Committee member if the offices of the Chief Executive and Secretary are held by the same person.

Name (Block Capitals)

# FSC 1 – FORM 61C

## Returns under the Friendly Societies Prudential Rules

Long term insurance business: Annual Investigation – Auditor’s Report

Name of Society

Period ended 31 December

	Reg No
<input type="text"/>	<input type="text"/>

Auditor’s Report

Signature ..... Dat .....

Name: \_\_\_\_\_

Address: \_\_\_\_\_

Qualification: \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_

**FSC 1 – FORM 61D**

[deleted]

## FSC 2 - RETURN

<b>FSC2 Return</b> Periodic Investigation: Long Term and General Insurance Business
<b>FORM FSC 2</b>

Register Number

Period ended 31  
December

Name of  
Society (as  
registered)

Registered  
Office

Post Code:
------------

The information provided in this FSC2 Return (Periodic Investigation: Long Term and General Insurance Business), and the Actuary's certificate included herein are the form and contents of an abstract under rule 5.2(2) for use by a non-directive unincorporated friendly society (other than a flat rate benefits business friendly society) in respect of its insurance business.

One copy of the Return must be signed by the chief executive, the secretary and one committee member of the society (or two members of the committee if the offices of chief executive and secretary are held by the same person).

Three copies of this Return (including the original signed copy) must be submitted as soon as possible after 31 December and not later than 30 June:-

Regulatory Data Group,  
Statistics and Regulatory  
Data Division (HO5 A-B),  
Bank of England,  
Threadneedle Street,  
London, EC2R 8AH

## Returns under the Friendly Societies Prudential Rules

## Statement of solvency

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input type="text"/>	<input type="text"/>	<input type="text"/>

		1 As at the end of the period	2 As at the end of the previous period
Total available assets	10	<input type="text"/>	<input type="text"/>
<b>GENERAL INSURANCE BUSINESS</b>			
Other than long term insurance business assets allocated towards general insurance business required minimum margin	11	<input type="text"/>	<input type="text"/>
Implicit items valued in accordance with a waiver under section 148 of the Act	11a	<input type="text"/>	<input type="text"/>
Required minimum margin for general insurance business	12	<input type="text"/>	<input type="text"/>
Excess (deficiency) of available assets over the required minimum margin (11+11a – 12)	13	<input type="text"/>	<input type="text"/>
<b>LONG TERM INSURANCE BUSINESS</b>			
Long term insurance business admissible assets	21	<input type="text"/>	<input type="text"/>
Other than long term insurance business assets allocated towards long term insurance business required minimum margin	22	<input type="text"/>	<input type="text"/>
Total mathematical reserves (after distribution of surplus)	23	<input type="text"/>	<input type="text"/>
Other insurance and non-insurance liabilities	24	<input type="text"/>	<input type="text"/>
Available assets for long term insurance business required minimum margin (21 + 22 – 23 – 24)	25	<input type="text"/>	<input type="text"/>
<b>Implicit items valued in accordance with a waiver under section 148 of the Act</b>			
Future profits	31	<input type="text"/>	<input type="text"/>
Zillmerising	32	<input type="text"/>	<input type="text"/>
Hidden reserves	33	<input type="text"/>	<input type="text"/>
Total of available assets and implicit items (25 + 31 + 32 + 33)	34	<input type="text"/>	<input type="text"/>
<b>Required minimum margin</b>			
Required minimum margin for long term insurance business	41	<input type="text"/>	<input type="text"/>
Explicit required minimum margin (1/6 x Line 41, or minimum guarantee fund if greater)	42	<input type="text"/>	<input type="text"/>
Excess (deficiency) of available assets over explicit required minimum margin (25 – 42)	43	<input type="text"/>	<input type="text"/>
Excess (deficiency) of available assets and implicit items over the required minimum margin (34 – 41)	44	<input type="text"/>	<input type="text"/>
<b>CONTINGENT LIABILITIES</b>			
Quantifiable contingent liabilities in respect of other than long term insurance business	51	<input type="text"/>	<input type="text"/>
Quantifiable contingent liabilities in respect of long term insurance business	52	<input type="text"/>	<input type="text"/>

# FSC 2 – FORM 9A

## Returns under the Friendly Societies Prudential Rules Descriptive Section

Name of Society:

Reg No	''''
	''''
	''''
	''''
	''''
	''''
<input type="text"/>	

1. The date to which the investigation relates is

2. The date to which the latest previous investigation relates is

3. A synopsis of the report by the appropriate actuary on his investigation into the financial condition of the society in respect of its insurance business, including
- a statement of the assets and liabilities of the society;
  - information and comments on the
    - changes in membership of the society,
    - benefit entitlements that have been valued,
    - mortality, sickness and claims experience of the society,
    - investment returns achieved by the society,
    - suitability of the assets held by the society,
    - provisions made for future expenses,
    - reserves set aside for activities of the society not covered by the valuation,
    - scope for enhancement of benefits; and
  - the actuary's assessment of the financial viability of the society and, where the assessment indicates that changes are necessary or desirable, the options open to the *committee* along with the advantages and disadvantages of each course of action and the likely consequences of taking no action.

**FSC 2 – FORM 9B****Returns under the Friendly Societies Prudential Rules**

Actuary's Certificate

**Name of Society**


Period ended 31 December

Reg No	
<input type="text"/>	<input type="text"/>

I certify that:

- (a) (i) in my opinion, proper records have been kept by the society adequate for the purpose of the valuation of the liabilities of its insurance business;
- (ii) the contents of the synopsis in Form 9A correctly reflect the results of my investigation into the financial condition of the society in respect of its insurance business;
- (iii) no matters, except as described in Form 9A, have come to my attention during the course of my investigation which in my opinion prejudice the financial viability of the society or the reasonable expectations of its members;
- (iv) I have had regard to the following standards and guidance adopted or issued by the Board of Actuarial Standards and, in so far as they are relevant to my investigation for the purposes of this certificate, I have complied with them

- (b) The amount of the required minimum margin of solvency applicable to the society's insurance business immediately following the end of the period of investigation (including any amounts resulting from any increase in liabilities arising from a distribution of surplus as a result of the investigation into the financial condition of the insurance business) is £.....
- (c) I have the following additional comments (use extra pages).

Signature

Date

Name:

Address:

Qualification:

**FSC 2 – FORM 9C****Return under the Friendly Societies Prudential Rules**

Signatures

**Name of Society**


Period ended 31 December

Reg No	
<input type="text"/>	<input type="text"/>

**Signatures to the FSC2 Return**

We certify that the information in this Return complies with the rules in chapter 5 of IPRU(FSOC).

We confirm also that the society consents to a copy of this Return being placed on the public file of the society.

**Chief Executive**


Date

Name (Block Capitals)


**Secretary**


Date

Name (Block Capitals)


**Member of Committee**


Date

Name (Block Capitals)



Additional Committee member if the offices of the Chief Executive and Secretary are held by the same person.

Date

Name (Block Capitals)

### FSC 3 - RETURN

FSC3 Return  General Insurance Business: Periodic Investigation
<b>FORM FSC 3</b>

Register Number

Period ended 31 December

Name of Society (as registered)

Registered Office

Post Code:

The information provided in this FSC3 Return (General Insurance Business: Periodic Investigation), and the Actuary's certificate and Auditor's report included herein are the form and contents of an abstract under rule 5.2(2) for use by a friendly society which is a directive friendly society or non-directive incorporated friendly society (other than a flat rate benefits business friendly society) which is carrying on general insurance business.

One copy of the Return must be signed by the chief executive, the secretary and one committee member of the society (or two members of the committee if the offices of chief executive and secretary are held by the same person).

Three copies of this Return (including the original signed copy) must be submitted as soon as possible after 31 December and not later than 30 June:-

Regulatory Data Group,  
Statistics and Regulatory  
Data Division (HO5 A-B),  
Bank of England,  
Threadneedle Street,  
London, EC2R 8AH

**FSC 3 – CONTENTS****Returns under the Friendly Societies Prudential Rules**

General insurance business: Periodic Investigation

Summary sheet of completed forms submitted

**Name of Society**

Period ended 31 December

	Reg No
<input type="text"/>	<input type="text"/>

Where appropriate, certain Forms need to be copied in order to furnish separate details of business in the same format (e.g. the same Form completed separately for different classes of business). Where a Form is completed, please enter the total number of such forms in the corresponding box in the third column below. Where no Form is completed, please enter NIL. Where an additional summary form has been completed, please indicate YES in the fourth column.

<b>Form Number</b>	<b>Details on Form</b>	<b>Number completed</b>	<b>Summary form used</b>
<b>Form 9</b>	Statement of solvency	<input type="text"/>	<input type="text"/>
<b>Form 11</b>	Margins of solvency – first method	<input type="text"/>	<input type="text"/>
<b>Form 12</b>	Margins of solvency – second method – and Required minimum margin	<input type="text"/>	<input type="text"/>
<b>Form 13</b>	Analysis of admissible assets	<input type="text"/>	<input type="text"/>
<b>Form 14</b>	Liabilities and margins: (long term insurance business)	<input type="text"/>	<input type="text"/>
<b>Form 15</b>	Liabilities (other than long term insurance business)	<input type="text"/>	<input type="text"/>
<b>Form 17</b>	Analysis of derivative contracts	<input type="text"/>	<input type="text"/>
<b>Form 20</b>	Technical account	<input type="text"/>	<input type="text"/>
<b>Form 21</b>	Analysis of premiums	<input type="text"/>	<input type="text"/>
<b>Form 22</b>	Analysis of claims, expenses and technical provisions	<input type="text"/>	<input type="text"/>
<b>Form 23</b>	Analysis of net claims and premiums	<input type="text"/>	<input type="text"/>
<b>Form 23A</b>	Descriptive section	<input type="text"/>	<input type="text"/>
<b>Form 23B</b>	Actuary's certificate	<input type="text"/>	<input type="text"/>
<b>Form 23C</b>	Auditor's report	<input type="text"/>	<input type="text"/>
<b>Form 23D</b>	Signatures of officers	<input type="text"/>	<input type="text"/>

**Returns under the Friendly Societies Prudential Rules**  
 Statement of Solvency

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input type="text"/>	<input type="text"/>	<input type="text"/>

		1 As at the end of the period	2 As at the end of the previous period
Total available assets	10	<input type="text"/>	<input type="text"/>
<b>GENERAL INSURANCE BUSINESS</b>			
Other than long term insurance business assets allocated towards general insurance business required minimum margin	11	<input type="text"/>	<input type="text"/>
Implicit items valued in accordance with a waiver under section 148 of the Act	11a	<input type="text"/>	<input type="text"/>
Required minimum margin for general insurance business (Note 1)	12	<input type="text"/>	<input type="text"/>
Excess (deficiency) of available assets over the required minimum margin (11+11a – 12)	13	<input type="text"/>	<input type="text"/>
<b>LONG TERM INSURANCE BUSINESS</b>			
Long term insurance business admissible assets	21	<input type="text"/>	<input type="text"/>
Other than long term insurance business assets allocated towards long term insurance business required minimum margin	22	<input type="text"/>	<input type="text"/>
Total mathematical reserves (after distribution of surplus)	23	<input type="text"/>	<input type="text"/>
Other insurance and non-insurance liabilities (Note 2)	24	<input type="text"/>	<input type="text"/>
Available assets for long term insurance business required minimum margin (21 + 22 – 23 – 24)	25	<input type="text"/>	<input type="text"/>
<b>Implicit items valued in accordance with a waiver under section 148 of the Act</b>			
Future profits	31	<input type="text"/>	<input type="text"/>
Zillmerising	32	<input type="text"/>	<input type="text"/>
Hidden reserves	33	<input type="text"/>	<input type="text"/>
Total of available assets and implicit items (25 + 31 + 32 + 33)	34	<input type="text"/>	<input type="text"/>
<b>Required minimum margin</b>			
Required minimum margin for long term insurance business	41	<input type="text"/>	<input type="text"/>
Explicit required minimum margin (1/6 x Line 41, or minimum guarantee fund if greater)	42	<input type="text"/>	<input type="text"/>
Excess (deficiency) of available assets over explicit required minimum margin (25 – 42)	43	<input type="text"/>	<input type="text"/>
Excess (deficiency) of available assets and implicit items over the required minimum margin (34 – 41)	44	<input type="text"/>	<input type="text"/>
<b>CONTINGENT LIABILITIES</b>			
Quantifiable contingent liabilities in respect of other than long term insurance business (Note 3)	51	<input type="text"/>	<input type="text"/>
Quantifiable contingent liabilities in respect of long term insurance business (Note 3)	52	<input type="text"/>	<input type="text"/>

## FSC 3 – Notes to Form 9

**1** The entry at line 12 must be equal to the entry at line 49 in Form 12.

**2** The entry at line 24 must be equal to the sum of lines 12 and 49 in Form 14, less line 19b in Form 14.

**3** Particulars to be specified by way of supplementary note.

Name of Society

--

Reg No

Units £/£000

Period ended 31 December

--

--

--

2 Last 12 months of previous period

Name of Fund/Summary

--

1 Last 12 months of this period

--

Gross premiums receivable	11			
Premium taxes and levies (included in line 11)	12			
Sub-total A (11 – 12)	15			
Division of Sub-total A	Other than health insurance	Up to and including sterling equivalent of 6 1 . 3 M Euro x 18/100	17	
		Excess (if any) over 6 1 . 3 M Euro x 16/100	18	
	Health insurance	Up to and including sterling equivalent of 6 1 . 3 M Euro x 6/100 100	19	
		Excess (if any) over 6 1 . 3 M Euro x 16/300	20	
Sub-total B (17 + 18 + 19 + 20)	21			
Gross premiums earned	22			
Premium taxes and levies (included in line 22)	23			
Sub-total H (22 – 23)	26			
Division of Sub-total H	Other than health insurance	Up to and including sterling equivalent of 6 1 . 3 M Euro x 18/100	28	
		Excess (if any) over 6 1 . 3 M Euro x 16/100	29	
	Health insurance	Up to and including sterling equivalent of 6 1 . 3 M Euro x 6/100	30	
		Excess (if any) over 6 1 . 3 M Euro x 16/300	31	
Sub-total I (28 + 29 + 30 + 31)	32			

**FSC3 - FORM 11 (Sheet 2)**

**Returns under the Friendly Societies Prudential Rules**

General insurance business: Calculation of required margin of solvency – first method

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>	<input style="width: 100%; height: 20px;" type="text"/>

Name of Fund/Summary

**1** Last 12 months of this period

**2** Last 12 months of this period

Sub-total J (greater of sub-total B and sub-total I)	40		
Claims paid in 3 year period	41		
Claims outstanding carried forward at the end of the period	43		
Claims outstanding brought forward at the beginning of the period	45		
Sub-total C (41 + 43 – 45)	46		
Amounts recoverable from reinsurers in respect of claims included in Sub-total C	47		
Sub-total D (46 – 47)	48		
First result Sub-total J x $\frac{\text{Sub-total D}}{\text{Sub-total C}}$ (or, if 0.5 is greater, x 0.5)	49		
Provisions for claims outstanding (before discounting and net of reinsurance)	50		
Brought forward amount (12.43.2 x 50.1 / 50.2 or, if less, 12.43.2)	51		
Greater of lines 49 and 51	52		

**NOTES**

1. Entries in column 2, lines 17-20 and 28-31 must be the corresponding entries in column 1 of the Form for the previous year, even if the amount of Euro in the description of the line has changed.
2. 51.2 must be 11.51.2 from the previous year's return.

**FSC 3 – FORM 12**

**Returns under the Friendly Societies Prudential Rules**  
 General insurance business: Calculation of required margin of solvency – second method, and statement of required minimum margin

**Name of Society**

Period ended 31 December

	<b>RegNo</b>	<b>Units£/£000</b>

Name of Fund/Summary		1 Last 12 months of this period	2 Last 12 months of the previous period		
Reference period (means the three last preceding financial years) (Note 1)	11				
Claims paid in reference period	21				
Claims outstanding carried forward at the end of the period	23				
Claims outstanding brought forward at the beginning of the period	25				
Sub-total E (21 + 23 – 25)	29				
Sub-total F: Conversion of Sub-total E to annual figure (multiply by 12 and divide by the number of months in the reference period)	31				
Division of Sub-total F	Other than health insurance	Up to and including sterling equivalent of 42.9 M Euro x 26/100 (note 3)	32		
		Excess (if any) over 42.9 M Euro x 23/100 (note 3)	33		
	Health insurance	Up to and including sterling equivalent of 42.9 M Euro x 26/300 (note 3)	34		
		Excess (if any) over 42.9 M Euro x 23/300 (note 3)	35		
Sub-total G (32 to 35)	39				
Second result Sub-total G x Sub-total D / Sub-total C (or, if 0.5 is greater, x 0.5)	41				
Higher of first result and brought forward amount (Note 2)	42				
Required margin of solvency (the higher of lines 41 and 42)	43				
Minimum guarantee fund	44				
Required minimum margin (the higher of lines 43 and 44)	49				

**NOTES**

1. If the society has not been in existence long enough to acquire a reference period, this must be stated and lines 11 to 41 ignored.
2. The entry at line 42 must be equal to the entry at line 52 on Form 11.
3. Entries in column 2, lines 32-35 must be the corresponding entries in column 1 of the Form for the previous year, even if the amount of Euro in the description of the line has changed.

## FSC 3 – FORM 13 (Sheet 1)

## Returns under the Friendly Societies Prudential Rules

## Analysis of admissible assets

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input type="text"/>	<input type="text"/>	<input type="text"/>

Category of assets/Total			1 As at the end of the period	2 As at the end of the previous period	
<b>INVESTMENTS:</b>					
Land and Buildings		11	<input type="text"/>	<input type="text"/>	
Investments in associated bodies	UK insurance dependants	Shares	21	<input type="text"/>	
		Debts securities issued by, and loans to, dependants	22	<input type="text"/>	
	Other insurance dependants	Shares	23	<input type="text"/>	
		Debts securities issued by, and loans to, dependants	24	<input type="text"/>	
	Non insurance dependants	Shares	25	<input type="text"/>	
		Debts securities issued by, and loans to, dependants	26	<input type="text"/>	
	Other associated bodies	Shares	27	<input type="text"/>	
		Debts securities issued by, and loans to, associated bodies	28	<input type="text"/>	
	<b>TOTAL (11 to 28)</b>		39	<input type="text"/>	<input type="text"/>
	Other financial investments	Equity shares		41	<input type="text"/>
Others shares and other variable yield securities		42	<input type="text"/>		
Holdings in collective investment schemes		43	<input type="text"/>		
Rights under derivative contracts		44	<input type="text"/>		
Debt securities and other fixed income securities		Fixed interest	Approved Securities	45	<input type="text"/>
			Other	46	<input type="text"/>
		Variable interest	Approved securities	47	<input type="text"/>
			Other	48	<input type="text"/>
Participation in investment pools		49	<input type="text"/>		
Loans secured by mortgages		50	<input type="text"/>		
Other loans		Loans to public or local authorities and nationalised industries or undertakings		51	<input type="text"/>
		Loans secured by policies of insurance issued by the society		52	<input type="text"/>
		Other		53	<input type="text"/>
Deposits with approved credit institutions and approved financial institutions		Withdrawal subject to a time restriction of one month or less		54	<input type="text"/>
		Withdrawal subject to a time restriction of more than one month		55	<input type="text"/>
Other		56	<input type="text"/>	<input type="text"/>	

**FSC 3 – FORM 13 (Sheet 2)**

**Returns under the Friendly Societies Prudential Rules**

Analysis of admissible assets

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 60%; height: 25px;" type="text"/>	<input style="width: 60%; height: 25px;" type="text"/>	<input style="width: 60%; height: 25px;" type="text"/>

Category of assets / Total

**1** As at the end of the period

**2** As at the end of the previous period

**INVESTMENTS AND OTHER ASSETS:**

Deposits with ceding undertakings		57	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
Assets held to match linked liabilities	Index linked	58	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
	Property linked	59	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
Reinsurer's share of technical provisions	Provision for unearned premiums	60	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
	Claims outstanding	61	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
	Provision for unexpired risks	62	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
	Other	63	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
<b>TOTAL (41 to 63)</b>		<b>69</b>	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
Debtors arising out of direct insurance operations	Policyholders	71	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
	Intermediaries	72	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
Debtors arising out of reinsurance operations	Due from ceding insurers and intermediaries under reinsurance business accepted	74	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
	Due from reinsurers and intermediaries under reinsurance contracts ceded	75	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
Other debtors	Due from dependants	Due in 12 months or less after the end of the financial year	76	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
		Due more than 12 months after the financial year	77	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
	Other	Due in 12 months or less after the end of the financial year	78	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
		Due more than 12 months after the end of the financial year	79	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>
Tangible assets		80	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
Cash at bank and in hand	Deposits not subject to time restriction on withdrawal, with approved credit institutions and approved financial institutions and local authorities	81	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
	Cash in hand	82	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
Other assets (particulars to be specified by way of supplementary note)		83	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
Prepayments and accrued income	Accrued interest and rent	84	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
	Deferred acquisition costs	85	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	
	Other prepayments and accrued income	86	<input style="width: 100%; height: 25px;" type="text"/>	<input style="width: 100%; height: 25px;" type="text"/>	

**FSC 3 – FORM 13 (Sheet 3)**

**Returns under the Friendly Societies Prudential Rules**

Analysis of admissible assets

Name of Society

Period ended 31 December

Reg No	Units £/£000
<input style="width: 80%; height: 25px;" type="text"/>	<input style="width: 80%; height: 25px;" type="text"/>

Category of assets/Total

**1** As at the end  
of the period

**2** As at the end  
of the previous  
period

Deductions (under paragraphs 15(2)(b) and 15(3) of Appendix 4) from the aggregate value of assets

87



Total (71 to 86 less 87)

88



Grand total of admissible assets (39 + 69 + 88)

89



RECONCILIATION TO ASSET VALUES  
DETERMINED IN ACCORDANCE WITH  
ACCOUNTS REGULATIONS (Note 1):

Total admissible assets (as per line 89 above)

91



Total assets in excess of the admissibility limits of Appendix 4 (as valued in accordance with those rules before applying admissibility limits) (Note 2)

92



[deleted]

93



Other differences in the valuation of assets (other than for assets not valued above)

94



Assets of a type not valued above (as valued in accordance with the Accounts Regulations) (Note 3)

95



Total assets determined in accordance with the Accounts Regulations (91 to 95)

99



Amounts included in line 89 attributable to debts due from associated bodies, other than those under contracts of insurance or reinsurance

100

## FSC 3 – Notes to Form 13

1

The Accounts Regulations refer to the Friendly Societies (Accounts and Related Provisions) Regulations 1994.

2

The admissibility limits are those applied under Annex B to Appendix 4.

3

‘Assets of a type not valued above’ refers to assets left out of account under 2(3) of Appendix 4.

4

If the amount shown at line 12 of Form 15 has had to be increased because of restrictions on discounting (see note 2 to Form 15), the reinsurers' share shown at line 61 must be adjusted to be consistent with the amount shown in Form 15.

## Returns under the Friendly Societies Prudential Rules

Long term insurance business liabilities and margins

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input type="text"/>	<input type="text"/>	<input type="text"/>

Category of assets/Total			1 As at the end of the period	2 As at the end of the previous period	
Mathematical reserves after distribution of surplus		11	<input type="text"/>	<input type="text"/>	
Cash bonuses which had not been paid to policyholders prior to end of the financial year		12	<input type="text"/>	<input type="text"/>	
Balance of surplus/valuation deficit		13	<input type="text"/>	<input type="text"/>	
Long term insurance business fund carried forward (11 to 13)		14	<input type="text"/>	<input type="text"/>	
Claims outstanding which had fallen due for payment before the end of the financial year	Gross amount	15	<input type="text"/>	<input type="text"/>	
	Reinsurers share	16	<input type="text"/>	<input type="text"/>	
	Net (15 – 16)	17	<input type="text"/>	<input type="text"/>	
Management Fund – Balance – surplus/(deficit)		19a	<input type="text"/>	<input type="text"/>	
Members' surplus and savings accounts	Long term insurance business after distribution of surplus	19b	<input type="text"/>	<input type="text"/>	
	Other	19c	<input type="text"/>	<input type="text"/>	
Other Revenue Account funds		19d	<input type="text"/>	<input type="text"/>	
Provisions for other risks and charges	Taxation	21	<input type="text"/>	<input type="text"/>	
	Other	22	<input type="text"/>	<input type="text"/>	
Deposits received from reinsurers		23	<input type="text"/>	<input type="text"/>	
Creditors and other liabilities	Arising out of insurance operations	Direct business	31	<input type="text"/>	<input type="text"/>
		Reinsurance accepted	32	<input type="text"/>	<input type="text"/>
		Reinsurance ceded	33	<input type="text"/>	<input type="text"/>
	Debenture loans	Secured	34	<input type="text"/>	<input type="text"/>
		Unsecured	35	<input type="text"/>	<input type="text"/>
	Amounts owed to credit institutions		36	<input type="text"/>	<input type="text"/>
	Taxation		37	<input type="text"/>	<input type="text"/>
	Other			<input type="text"/>	<input type="text"/>
Accruals and deferred income		39	<input type="text"/>	<input type="text"/>	
Provision for adverse changes		41	<input type="text"/>	<input type="text"/>	
Total other insurance and non-insurance liabilities (17 to 41)		49	<input type="text"/>	<input type="text"/>	

# FSC 3 – FORM 14 (Sheet 2)

## Returns under the Friendly Societies Prudential Rules

Long term insurance business liabilities and margins

**Name of Society**

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 60px; height: 20px;" type="text"/>	<input style="width: 60px; height: 20px;" type="text"/>	<input style="width: 60px; height: 20px;" type="text"/>

Category of assets/Total

**1** As at the end of the period

**2** As at the end of the previous period

Excess of the value of net admissible assets (Note 1)	51		
Total liabilities and margins	59		
Amount included in line 59 attributable to liabilities to associated bodies, other than those under contracts of insurance or re-insurance	61		
Amount included in line 59 attributable to liabilities in respect of property linked benefits	62		
Amount of any additional mathematical reserves included in line 51 which have been taken into account in the appointed actuary's certificate	63		

NOTE

1. The entry at line 51 must be:
  - (a) the value of the admissible assets (as included in line 89 of the appropriate Form 13) representing the long-term insurance business funds, fund or group of funds to which the Form relates, less
  - (b) the amount of those funds, fund or group of funds, being the sum of the amounts shown at lines 14 and 49.

## Returns under the Friendly Societies Prudential Rules

Liabilities (Other than long term insurance business)

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input type="text"/>	<input type="text"/>	<input type="text"/>

Class of Business (as in Part III of Chapter 7)

			1 As at the end of the period	2 As at the end of the previous period	
Technical provisions (gross amount)	Provision for unearned premiums (Note 1)	11	<input type="text"/>	<input type="text"/>	
	Claims outstanding	12	<input type="text"/>	<input type="text"/>	
	Provision for unexpired risks	13	<input type="text"/>	<input type="text"/>	
	Other	16	<input type="text"/>	<input type="text"/>	
	Total (11 to 16)	19	<input type="text"/>	<input type="text"/>	
	Provisions for other risks and charges	Taxation	21	<input type="text"/>	<input type="text"/>
Other		22	<input type="text"/>	<input type="text"/>	
Deposits received from reinsurers		31	<input type="text"/>	<input type="text"/>	
Creditors	Arising out of insurance operations	Direct business	41	<input type="text"/>	<input type="text"/>
		Reinsurance accepted	42	<input type="text"/>	<input type="text"/>
		Reinsurance ceded	43	<input type="text"/>	<input type="text"/>
	Debenture loans	Secured	44	<input type="text"/>	<input type="text"/>
		Unsecured	45	<input type="text"/>	<input type="text"/>
	Amounts owed to credit institutions		46	<input type="text"/>	<input type="text"/>
	Other creditors	Taxation	47	<input type="text"/>	<input type="text"/>
		Other	49	<input type="text"/>	<input type="text"/>
Accruals and deferred income		51	<input type="text"/>	<input type="text"/>	
Total (19 to 51)		59	<input type="text"/>	<input type="text"/>	
Provision for adverse changes		61	<input type="text"/>	<input type="text"/>	
Total (59 + 61)		69	<input type="text"/>	<input type="text"/>	
Amounts included in line 69 attributable to liabilities to associated bodies other than those under contracts of insurance or reinsurance		71	<input type="text"/>	<input type="text"/>	

NOTE

- The amounts shown in lines 11 to 13 and 16 must be stated gross of the reinsurer's share.
- The amount shown in line 12 may only be discounted or reduced to take account of investment income:
  - for class 1 or 2 business; or
  - in respect of annuities.
 So, if the technical provisions for claims outstanding for other business are discounted or reduced to take account of investment income, then they must be increased by the difference between the undiscounted and discounted provisions. In this case, the amount of the increase must be shown in a supplementary note to this form, together with the corresponding increase in the reinsurers' share shown in line 9-61 of Form 13.

## Returns under the Friendly Societies Prudential Rules

Analysis of derivative contracts (other than those relating to property linked contracts or index linked benefits)

Name of Society

Period ended 31 December 19

	Reg No	Units £/£000
<input type="text"/>	<input type="text"/>	<input type="text"/>

Business: Long Term/Other than long term

As at the end of the period

As at the end of the previous period

Category of assets/Total

Assets

Liabilities

Assets

Liabilities

1

2

3

4

### Derivative Contracts

Futures Contracts	Fixed-interest securities	11	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Equity shares	12	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Land	13	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Currencies	14	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Other	15	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Options	Fixed-interest securities	21	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Equity shares	22	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Land	23	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Currencies	24	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Other	25	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Contracts for Differences	Fixed-interest securities	31	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Equity shares	32	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Land	33	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Currencies	34	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Other	35	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Adjustments for variation margin		41	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Total (11 to 41) (Note 1)		49	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

NOTE

1. The entry at line 49.1 must be included at Form 13.44.1 and the entry at line 49.2 must be included at Form 14.38.1 or 15.49.1 as appropriate.

## Returns under the Friendly Societies Prudential Rules

General insurance business: Technical account

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input type="text"/>	<input type="text"/>	<input type="text"/>

Class of business (as in Part III of Chapter 7)

Items to be shown net of reinsurance			1 This period	2 Previous period
This period's underwriting	Earned premium (Note 2)	11	<input type="text"/>	<input type="text"/>
	Claims incurred (Note 3)	12	<input type="text"/>	<input type="text"/>
	Claims management costs (Note 4)	13	<input type="text"/>	<input type="text"/>
	Increase in provision for unexpired risks (Note 5)	15	<input type="text"/>	<input type="text"/>
	Other technical income or charges (Note 1)	16	<input type="text"/>	<input type="text"/>
	Net operating expenses (Note 6)	17	<input type="text"/>	<input type="text"/>
	Balance of period's underwriting (11 – 12 – 13 – 15 + 16 – 17)	19	<input type="text"/>	<input type="text"/>
Previous period's underwriting	Earned premium (Note 7)	21	<input type="text"/>	<input type="text"/>
	Claims incurred (Note 8)	22	<input type="text"/>	<input type="text"/>
	Claims management costs (Note 9)	23	<input type="text"/>	<input type="text"/>
	Other technical income or charges (Note 1)	25	<input type="text"/>	<input type="text"/>
	Net operating expenses	26	<input type="text"/>	<input type="text"/>
	Balance (21 – 22 – 23 + 25 – 26)	29	<input type="text"/>	<input type="text"/>
Balance of all periods underwriting (19 + 29)		49	<input type="text"/>	<input type="text"/>

### NOTES

- Particulars to be specified by way of supplementary note.
- The entry at line 11 must be equal to Form 21.19.5
- The entry at line 12 must be equal to Form 22.17.4
- The entry at line 13 must be equal to Form 22.18.4
- The entry at line 15 must be equal to Form 22.19.4
- The entry at line 17 must be equal to Form 22.29.4
- The entry at line 21 must be equal to Form 21.11.5
- The entry at line 22 must be equal to Form 22.13.4
- The entry at line 23 must be equal to Form 22.14.4

**Returns under the Friendly Societies Prudential Rules**

General insurance business: Analysis of premiums

Name of Society

Period ended 31 December

	Reg No	Units £/£000
<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>	<input style="width: 60%; height: 20px;" type="text"/>

Class of business (as in Part III of Chapter 7)

Premiums receivable during the period		GROSS PREMIUMS WRITTEN		REINSURERS' SHARE		NET OF REINSURANCE		
		Earned in previous period <b>1</b>		Earned in previous period <b>3</b>		Earned in previous period <b>5</b>		
11	In respect of risks incepted in previous periods							
		Earned in the period <b>1</b>	Unearned at the end of the period <b>2</b>	Earned in the period <b>3</b>	Unearned at the end of the period <b>4</b>	Earned in the period <b>5</b>	Unearned at the end of the period <b>6</b>	
12	In respect of risks incepted in previous periods							
13	Current financial year of period 31/12/...	For periods of less than 12 months						
		For periods of 12 months						
		For periods of more than 12 months						
	13a	Previous financial year of period 31/12/...	For periods of less than 12 months					
			For periods of 12 months					
			For periods of more than 12 months					
	13b	Opening financial year of period 31/12/...	For periods of less than 12 months					
			For periods of 12 months					
			For periods of more than 12 months					
16	Premiums receivable (less rebate and refunds) in previous periods not earned in the periods and brought forward to this period							
19	Total (12 to 16)							

**FSC 3 – FORM 22****Returns under Friendly Societies Prudential Rules**

General insurance business: Analysis of claims, expenses and technical provisions

Name of Society

Period ended 31 December

	Reg No	Units £/£000
	<input type="text"/>	<input type="text"/>

Class of business (as in Part III of Chapter 7)

			<b>1</b> Amount brought forward from previous period	<b>2</b> Amount payable/receivable in this period	<b>3</b> Amount carried forward to next period	<b>4</b> Amount attributable to this period (Note 2)
Claims incurred in respect of incidents occurring prior to this period	Gross amount (Note 1)	11	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Reinsurers's share	12	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Net (11 – 12) (Note 3)	13	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Claims management costs	14	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Claims incurred in respect of incidents occurring in this period	Gross amount	15	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Reinsurers' share	16	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Net (15 – 16)	17	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Claims management costs	18	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Provision for unexpired risks		19	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Net operating expenses	Commissions	21	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Other acquisition expenses	22	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Administrative expenses	23	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Reinsurance commissions and profit participations	24	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
	Total (21 + 22 + 23 – 24)	29	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

**NOTES**

- Amounts included at lines 11 to 18 must be shown undiscounted.
- The values in column 4 must be calculated as follows: for lines 11 to 18 values in columns 2 + 3 – 1; for line 19 values in columns 3 – 1; and for lines 21 to 29 values in columns 1 + 2 – 3.
- The amounts shown at lines 11 to 13 must exclude amounts in respect of claims management costs.

# FSC 3 - FORM 23

## Returns under the Friendly Societies Prudential Rules

General insurance business: Analysis of net claims and premiums

Name of Society:

Reg No  Units £/£000

Period ended 31 December

Class of Business (as in Part III of Chapter 7)

Financial year of origin		Claims paid (net) during the period	Claims out-standing (net) as at the end of the period	Total claims paid (net) since the end of the period, but prior to this financial year	Claims paid (net) during this period	Claims outstanding carried forward		Claims outstanding brought forward		Balance on each period <small>(4 + 5 + 6 - 7 - 8)</small>	Earned premiums (net)	Deterioration (surplus) of original reserve %	Claims ratio %
Month	Year					Reported (net)	Incurred but not reported (net)	Reported (net)	Incurred but not reported (net)				
		<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>8</b>	<b>9</b>	<b>11</b>	<b>12</b>	<b>13</b>
<input type="text"/>	<input type="text"/>	11				<input type="text"/>	<input type="text"/>			<input type="text"/>	<input type="text"/>		<input type="text"/>
<input type="text"/>	<input type="text"/>	12	<input type="text"/>		<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	13	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	14	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	15	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	16	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	17	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	18	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	19	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	20	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Previous years		21				<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>			
Reconciliation		22				<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>			
Total (11 to 22)		29				<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>			

## FSC 3 – Notes to Form 23

**1** All figures must be shown net of the reinsurers' share.

**2** Columns 1 to 9 must be shown undiscounted.

**3** All amounts shown must exclude claims management costs.

**4** The percentage shown at column 12 must be the ratio of the columns 3 + 4 + 5 + 6 – 2 to column 2.

**5** The percentage shown at column 13 must be the ratio of the columns 1 + 3 + 4 + 5 + 6 to column 11.

**6**  $23.29.5 + 23.29.6 = 22.13.3 + 22.17.3$ ;  
 $23.29.7 + 23.29.8 = 22.13.1$ ; and  
 $23.29.4 = 22.13.2 + 22.17.2$

**7** The percentages shown at columns 12 and 13 must be expressed as percentages to one place of decimals.

**FSC 3 – FORM 23A**

**Returns under the Friendly Societies Prudential Rules**

Descriptive Section

Name of Society:

	<i>R</i>
Reg No	<i>e</i>
	<i>g</i>
	<i>N</i>
	<i>o</i>
<input type="text"/>	

1. The date to which the investigation relates is

2. The date to which the latest previous investigation relates is

3. A synopsis of the report by the appropriate actuary on the investigation into the financial condition of the society in respect of its general insurance business, including the actuary's assessment of the financial viability of the society and his or her interpretation of the reasonable expectations of policyholders.

**FSC 3 – FORM 23B**

**Returns under the Friendly Societies Prudential Rules**

General insurance business: Periodic Investigation – Actuary’s Certificate

**Name of Society**

Period ended 31 December

Reg No	

I certify that:

- (a) (i) in my opinion, proper records have been kept by the society adequate for the purpose of determining the technical provisions in Form 15;
- (ii) in my opinion, the technical provisions shown in Form 15 are appropriate having regard to the nature of general insurance business undertakings of the society including my interpretation of the reasonable expectations of its members as described in Form 23A; and
- (iii) for the purpose of sub-paragraph (ii) above the liabilities have been assessed in accordance with Appendix 5 in the context of assets valued by the *committee* of the society in accordance with Appendix 4, as show in Form 13;
- (iv) the contents of the synopsis in Form 23A correctly reflect the results of my investigation into the financial condition of the society in respect of its insurance business in so far as that investigation relates to general insurance business;
- (v) I have had regard to the following standards and guidance adopted or issued by the Board of Actuarial Standards and, in so far as they are relevant to my investigation for the purposes of this certificate, I have complied with them

(b) I have the following additional comments (use extra pages).

Signature

*Date*

Name:

Address:

Qualification:

**FSC 3 – FORM 23C**

**Returns under the Friendly Societies Prudential Rules**

General insurance business: Periodic Investigation – Auditor’s Report

**Name of Society**

Period ended 31 December

Reg No	
<input type="text"/>	<input type="text"/>

Auditor’s Report

Signature .....

Date .....

Name \_\_\_\_\_

Address: \_\_\_\_\_

Qualification: \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_

**FSC 3 – FORM 23D****Return under the Friendly Societies Prudential Rules**

General insurance business: Periodic Investigation - Signatures

Name of Society

Period ended 31 December

Reg No	
<input type="text"/>	<input type="text"/>

**Signatures to the FSC3 Return**

We certify that the information in this Return complies with the rules in chapter 5 of IPRU(FSOC).

We confirm also that the society consents to a copy of this Return being placed on the public file of the society.

**Chief Executive**

Date



Name (Block Capitals)


**Secretary**

Date



Name (Block Capitals)


**Member of Committee**

Date



Name (Block Capitals)



Additional Committee member if the offices of the Chief Executive and Secretary are held by the same person.

Date



Name (Block Capitals)





## Annex 1:

### Guidance on Corporate Governance of Friendly Societies

This Annex sets out the *PRA*'s view of best practice in the corporate governance of *friendly societies*.

#### *The committee of management*

1. 

FCA	PRA
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- (1) The *committee* should meet regularly, retain full and effective control over the *friendly society* and monitor the executive management, subject always to the authority vested in members either directly or through delegate bodies, either annually or at other properly constituted meetings.
  - (2) The effectiveness of a *committee's* arrangements for monitoring the performance of executive management and for the overall control and direction of the *friendly society* are important tests of its compliance with the *PRA* principles for business in particular principles 2 (“Skill, care and diligence”) and 3 (“Management and control”).
  - (3) There should be appropriate arrangements such as a clearly accepted division of responsibilities at the head of a *friendly society*, which will ensure a balance of power and authority, such that no one individual can exert undue influence.
  - (4) The *1992 Act* envisages that the offices of Chairman and Chief Executive would be separately held.
  - (5) In relation to the size of the *friendly society*, the *committee* should include nonexecutive members of sufficient number for their views to carry significant weight in the *committee's* decisions.
  - (6) A *committee* should have non-executive members of sufficient quality, breadth of experience and calibre for their views to carry weight in the *committee's* decisions and who, individually, can devote the necessary time and attention to the *friendly society's* business.
  - (7) There should be an agreed procedure for any member of the *committee* to seek additional information from the executives and to take independent professional advice at the *friendly society's* expense; as may be necessary in the furtherance of his/her duties.

#### *Non-Executive members of the committee of management*

2. 

FCA	PRA
-----	-----
- (1) Non-executive members of the *committee* should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct.
  - (2) In assessing whether a candidate for election has an appropriate level of competence, consideration should be given to his or her previous experience of similar responsibilities, the record in

performing them and, where appropriate, whether the candidate has relevant qualifications and training. Also important is the individual's ability to bring informed, independent judgement to bear on the issues considered by the *committee*.

- (3) They should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement.
- (4) If fees are paid they should reflect the time which non-executives commit to the *friendly society* and the particular responsibilities related to the size, complexity and diversity of the *friendly society's* business.
- (5) Non-executive members should be elected for specified terms subject to the ceiling imposed by paragraph 6(1)(a) of Schedule 11 to the *1992 Act*; and re-election should not be automatic. Candidates for election as non-executive members should be selected from as wide a constituency as possible.

*Executive members of the committee of management*

3. 

FCA	PRA
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- (1) Where appointments of senior executives are subject to a formal service contract for a fixed term, the term should not exceed 3 years.
  - (2) In the case of any other service contract the period of notice which the *friendly society* has to give to terminate the contract should not exceed 1 year.
  - (3) There should be full and clear disclosure of the total emoluments and terms of appointment (including notice) of all of the members of the *committee*.
  - (4) Such disclosure would normally be given in the accounts issued by the *friendly society* to its members.

## Annex 2:

### Guidance on Officers' Liability Insurance

#### *Introduction*

1. **PRA** This Annex draws attention to the need for a *committee of a friendly society* to consider whether to purchase and maintain liability insurance for *officers* and to make sure that the terms of any such policy are fully understood and meet the *friendly society's* needs. A *committee* should disclose the fact that the *friendly society* has purchased or maintained such insurance in the *committee's* annual report.

#### *Section 106*

2. **PRA** Section 106 of the 1992 Act provides that a *friendly society* cannot exempt its *officers* (including the *appropriate actuary*) or auditors from liability for negligence, default, breach of duty or breach of trust, or indemnify them against such liability. A *friendly society* may, however, indemnify its *officers* or auditors against liability for defence against proceedings where judgement is favourable or the person is acquitted. Section 106 also provides that a *friendly society* can purchase and maintain insurance against any such liability.

3. **FCA PRA** A *friendly society* which attempts either directly or indirectly (eg, via a year end bonus) to compensate its *officers* for any liabilities arising as a result of error or omission would contravene the provisions of section 106. Such contravention would also clearly risk breaching principle 2 of the *PRA* Principles for Businesses (conduct of business with due skill, care and diligence).

#### *Duty of care*

4. **PRA** Annex 3 (Guidance on Systems of Accounting, Control of Business and Inspection and Report) draws attention to the increasing risks faced by *friendly societies* in the light of the increasing complexity of operations and the increasing pace of change and risks in the financial markets. These factors have led to an increase in the risk that errors and omissions will occur which may give rise to substantial liabilities for *officers*.

5. **FCA PRA** Annex 3 also draws attention to the special duty of care that the *officers* of a *friendly society* have in respect of protecting the interests of *policyholders*. This duty is recognised in the *PRA* and *FCA's* Principles for Business, including principle 6 of the *FCA's* Principles for Businesses (paying due regard to *policyholders* interests and treating them fairly). In the *PRA's* view, because of the increasing risk of error and omission, and the possibility that any liabilities which may arise as a result could be substantially greater than an *officer's* or *officers'* financial resources to cover them, that duty of care places a responsibility on a *committee* to consider whether the *friendly society* should obtain indemnity insurance cover for appropriate *officers* in the interests of members (see 6).

### *Liability insurance*

6. **The PRA will expect any committee that has not already done so to give formal consideration to whether to obtain indemnity insurance cover against error and omission for appropriate officers (eg. committee and senior executives). The committee may wish to take into account a number of factors including: the implications of the risks inherent in the nature and scale of the friendly society's business; the cost of the indemnity insurance premiums; and officers' concerns about the risk of liability that they face because of their duties and responsibilities for the friendly society. The minutes of the meeting at which the issue was formally discussed by the committee should record the decision reached and underlying reasoning.**

PRA

7. **A committee which decides to obtain and maintain indemnity insurance cover for its officers will need to ensure that the implications of the policy terms and conditions, and particularly of the list of exclusions, are fully understood. The best starting point may be for the committee to decide the key elements it thinks are essential for such a policy before considering, in conjunction with its professional advisers, whether the terms and conditions of specific policies adequately meet those requirements.**

PRA

8. **The committee of a friendly society which has obtained suitable indemnity cover should not relax its approach to minimising the risks of liability arising from error and omission. It is very important that a committee takes every step it can to ensure its friendly society's systems are adequate to minimise the risks: systems of control should be sufficient to minimise the risk of errors or omissions occurring; systems of inspection and report need to be capable of identifying any such problems at an early stage, so that matters can be rectified quickly before substantial damage has occurred.**

PRA

### *Reporting requirements*

9. **For companies subject to the requirements of the Companies Acts the fact of the purchase and/or maintenance of indemnity insurance against officers' and auditors' liabilities should be disclosed in the directors' report to the annual accounts. The PRA considers that the committee of a friendly society which obtains and/or maintains such an insurance policy should similarly disclose the fact to members in the committee's annual report.**

PRA

## Annex 3

### Part I:

## Guidance on Systems of Accounting, Control of Business and Inspection and Report

1. FCA PRA This Part of the Annex sets out the key issues that the *PRA* considers the *committee* and the management of a *friendly society* need to address if the *friendly society's* systems are to satisfy the principle 3 of the *PRA* Principles for Business. That principle requires a *friendly society* to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. The *PRA* expects that these issues will have been considered by a *non-directive friendly society's committee* in preparing its reports under rule 3.1.

### A. INTRODUCTION

#### *Background*

2. PRA Rule 3.1 requires the *committee* of a *friendly society* to send a statement of opinion (also referred to in this note as the rule 3.1 report) to the *PRA* each year on the compliance of the *friendly society* with that section.

3. PRA This Annex provides practical guidance to *friendly societies* about the key issues in the *PRA's* view that:

- (a) need to be addressed if the requirements of rule 3.1 are to be satisfied; and
- (b) need to be considered by the *friendly society's committee* in preparing its reports to the *PRA*,

and also provides guidance on the format of reports.

#### *Application of rule 3.1*

4. PRA Experience among financial institutions generally continues to demonstrate the importance for the protection of investors of adequate systems of control. As far as *friendly societies* are concerned the powers under the 1992 Act, the increasing complexity of *friendly societies' operations* (including activities carried on by the controlled bodies of *incorporated friendly societies*) combined with the increased pace of change in financial markets emphasises the need for such systems. Rule 3.1 requires *friendly societies* to:

- (a) cause adequate accounting records to be kept; and
- (b) establish and maintain systems of control of business and records and of inspection and report.

**These requirements are intended to form a sound basis for the control of *friendly societies' businesses* and the protection of *policyholders' funds*. The**

requirements of rule 3.1 apply to *friendly societies* and *registered branches*.

5. Chapter 3 covers the roles of *committees*, and the *PRA* with regard to systems and reporting. As with other prudential provisions, it is the responsibility of the *committee* of a *friendly society* to ensure the requirements of rule 3.1 are met and to be able to demonstrate that to the *PRA*. The *PRA* sees the main elements of the *committee's* responsibilities to be:

FCA PRA

- (a) establishing and maintaining arrangements for the continuous review of systems, including those for new business;
- (b) [deleted]
- (c) assessing whether the *friendly society* (including any *registered branches*), or the *friendly society* and any controlled bodies (“the group”), has complied with the relevant requirements of the Act, *PRA* rules made under the Act and the 1992 Act for the period under review and, as necessary, identifying any shortcomings in compliance with the requirements, together with the corrective actions taken or proposed, including timetable;
- (d) preparing and submitting the rule 3.1 reports required by the *PRA* from the *committee* by the due date; and
- (e) discussing with the *PRA* any issues arising from these reports and, where appropriate, corrective actions taken or planned.

*Satisfying the requirements of rules 3.1*

6. It would not be practical to document all the possible considerations the *committee* and management of a *friendly society* will have to take into account in considering whether their *friendly society* satisfies the requirements of rule 3.1. This note therefore focuses on the main issues which, in the opinion of the *PRA*, need to be addressed by the *committee* and by the management of a *friendly society* if the *friendly society* is to satisfy the requirements of rule 3.1. Where the chief executive of a *friendly society* is not also a member of the *committee*, it is nevertheless still important that he or she gives full consideration to these issues - not least because the chief executive is required to be a signatory to the *committee's* reports to the *PRA* under rule 3.1. This note includes a framework which the *PRA* believes can be applied to all *friendly societies* but also recognises the considerable diversity in nature, scale and scope of *friendly societies' operations*.

PRA

7. The *PRA* expects that the issues set out in this Annex will have been addressed prior to the preparation of the rule 3.1 report.

PRA

*Friendly societies with registered branches*

9. Rules 2.2 and 2.3 require a *friendly society* with *registered branches* to supervise the activities of the branches, notwithstanding the duties of the *committees* and managements of those branches. This includes supervision of compliance with the requirements of rule 3.1. The management information provided to the *committee* and management of a *friendly society* which has

PRA

*registered branches* will need to include information about the activities of the *friendly society* as a whole (see 18).

*Business standards*

10. Principle 3 of the *PRA* Principles for Businesses requires a *friendly society* to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. The high standards needed for the management of a *friendly society* apply not only to accounting records and controls, but more broadly to business controls over all aspects – including key management information – of the business carried on by a *friendly society*.

FCA PRA

**B. ACCOUNTING RECORDS AND SYSTEMS**

11. The principal reasons why a *friendly society* (including any *registered branch*) or a group is required by rule 3.1 to maintain adequate accounting and other records are:

FCA PRA

- (a) to provide the *committee* and management of a *friendly society* (or a branch) with adequate financial and other information to enable them to conduct its business in a prudent manner on a day to day basis;
- (b) to enable members of the *committee* to fulfil their statutory duties in relation to the preparation of annual accounts in accordance with sections 69 and 70 and the regulations made under section 70 of the *1992 Act* (currently the *Accounts Regulations*);
- (c) to safeguard the assets of the *friendly society* (or branch) and to protect the interests of *policyholders*;
- (d) to enable the *friendly society* (or branch) properly to discharge the duties imposed on it by or under the *Act*, *PRA* rules made under the *Act* and the *1974 Act* and/or the *1992 Act*; and
- (e) to provide the *committee* and the management of the *friendly society* (or branch) with sufficiently timely and accurate information to enable them to submit the information required or requested by the *PRA*.

12. When forming their opinion on whether the accounting and other records are adequate, the *committee* and chief executive of a *friendly society* should assess the scope and nature of the records in the context of the *friendly society's* needs and particular circumstances. They should have regard to the manner in which the business is structured, organised and managed, as well as the size and nature of the *friendly society* and the volume and complexity of its transactions and commitments. In particular, they will need to satisfy themselves that the records:

FCA PRA

- (a) are kept in legible form and/or are capable of reproduction in a legible form to be inspected or made available for inspection;
- (b) are such that adequate precautions are taken for guarding against the possibility of falsification and for facilitating the discovery of

falsification should that occur;

- (c) are such that sufficient information is available to enable the rights and reasonable expectations of the *policyholders* to be determined;
- (d) capture and record on a timely basis, and in an orderly fashion every transaction and commitment which a *friendly society* or any *registered branch* enters into with sufficient information about each to explain:
  - (i) its nature and purpose;
  - (ii) the assets and/or liabilities, actual and contingent, which arise or may arise from it;
  - (iii) the income and/or expenditure, current and deferred, which arise from it;
- (e) disclose in an orderly and integrated manner, and with reasonable accuracy and promptness, the state of the business at any time.

The *committee* and management of a *registered branch* will also need to have regard to the matters in (a) to (e).

13. The records should be maintained so as to enable the financial and business information to be extracted promptly so that the *committee* and management can monitor and control the performance of the business, the state of its affairs and the risks to which it is exposed.

PRA

## C. SYSTEMS OF BUSINESS CONTROL

### *General*

14. It is important for a *friendly society* to identify the risks associated with each area of the business it undertakes and the manner in which it carries out that business. Risks associated with the activities of any *registered branches* or controlled bodies should be similarly identified. Control objectives may then be set for each area of the business, and controls established and maintained which address appropriately the identified risks with the aim of ensuring:

PRA

- (a) the conduct of the business in a prudent manner and in accordance with the *friendly society's* statements of policy and business practice and any applicable registered rules;
- (b) that the *committee* and management have sufficient, and sufficiently reliable, financial information to enable them to effectively direct, control and monitor the business and manage the risks identified; and
- (c) compliance with all relevant statutory and regulatory requirements.

15. It is not practical for this section of the Annex to set out a comprehensive list of the risks that arise or the controls that might be established to address the risks. This section therefore focuses on general areas of concern to *friendly societies* and, in particular on the “high level” controls (see 16 to 24) that

PRA

need to be established in these areas. “High level” controls would, in this context, be the overall supervisory controls available to and exercised by the *committee* and other senior *officers* (eg chief executive) - see also B4 in Attachment B of this Annex and C2(e) and C5(b) in Attachment C of this Annex.

*Organisational control systems*

16. *A friendly society needs:*

PRA

- (a) clearly defined organisational arrangements together with a defined structure of authorities and responsibilities - including reporting lines – distinguishing between decisions to be reserved for the *committee* and those to be delegated to managers and other employees; and
- (b) arrangements for reviewing compliance with, and effectiveness of, organisational controls.

17. In forming their opinion on systems of business control the *committee* and chief executive of a *friendly society* need to establish whether:

FCA PRA

- (a) the *friendly society's* overall organisational arrangements are adequately defined and documented, for example in an organisational manual;
- (b) the *friendly society's* decision-making processes together with authority limits and responsibilities are adequately defined and documented, for example in operating manuals; and
- (c) compliance with approved authority limits and stipulated segregation of duties is effectively monitored and controlled.

*Management information systems*

18. Rule 3.1(5) requires the *committee* of a *friendly society* (including a *friendly society* with *registered branches*, see 9) or the *committee* of a *registered branch* to maintain information systems which, amongst other matters:

FCA PRA

- (a) enable the respective *committee* to direct and control the *friendly society's* business or the *registered branch's* business; and
- (b) provide information required by the *PRA* in its role of prudential supervisor.

19. In evaluating whether a *friendly society* has complied with the requirements, the *committee* and management of the *friendly society* need to satisfy themselves that:

FCA PRA

- (a) the information is sufficient to enable the *committee* to determine whether the *friendly society* is meeting the requirement to maintain adequate financial resources (see the rules in chapter 4 and also the guidance in 21);

- (b) the information available for the different areas of a *friendly society's* activities, including those of controlled bodies, is sufficient for the proper assessment of the risks (including those arising from current relevant market conditions and trends) and the proper determination of the need for capital and liquidity;
- (c) the information about the relative assets and liabilities attributable to different classes of members is sufficient to enable the *friendly society* to determine whether the reasonable expectations of each class of *policyholders* are likely to be met;
- (d) the information available is sufficiently comprehensive to provide the *committee* with a clear statement of the performance and financial position of the *friendly society* (including any *registered branches*) and, if appropriate, the group;
- (e) management information reports are prepared as regularly as necessary to ensure that the *committee* is given timely information about all aspects of the business;
- (f) actual performance is compared with planned or budgeted performance on a regular basis and significant variations are highlighted and explained (see also A6 of Attachment A of this Annex);
- (g) sufficient attention is focused on key factors affecting income and expenditure, including capital expenditure, and that appropriate performance indicators are employed; and
- (h) management information is accurately prepared from the underlying accounting and other records and is presented in a form which is clear, consistent and understandable to those persons for whom it is provided.

The *committee* and management of a *registered branch* will also need to have regard to the matters in (a) to (h) in so far as they are relevant to a branch.

20. It is important that the form and content of management information is regularly reviewed to ensure that it remains appropriate and relevant to the current pattern of a *friendly society's* business and to market conditions.

FCA PRA

21. In forming a view on whether the management information system is sufficiently comprehensive, the *committee* and management of a *friendly society* need to consider whether the information made available to them provides, where relevant, a clear statement of:

PRA

- (a) the solvency position;
- (b) the liquidity position;
- (c) surpluses and shortfalls, assets and liabilities, profits and losses in respect of controlled bodies;
- (d) the performance of investments;

- (e) for a *friendly society* which makes use of *derivative contracts* the *exposures* and uncovered transactions arising from off-balance sheet transactions; and
- (f) the financial viability of products and controlled bodies.

The *committee* and management of a *registered branch* will also need to have regard to the matters in (a) to (f) in so far as they are relevant to a branch.

22. Where the *friendly society* has controlled bodies it is particularly important that information covers all the component activities and also the overall group position.

PRA

*Information for the PRA*

23. Rule 3.1(5)(b) requires the systems of control and of inspection and report to be maintained to ensure that the information reported to the *PRA* is sufficiently accurate for the purpose for which it is obtained and is regularly provided. In the case of items requiring estimates or judgement by management there will inevitably be a degree of approximation involved. In these cases, the approximations should be capable of being clearly explained, and should be based on stated assumptions. Financial information should be reviewed prior to submission to the *PRA* at sufficiently senior levels in the *friendly society* to ensure, amongst other matters, consistency with any applicable guidance notes and consistency of information provided in different returns but drawn from the same data source.

PRA

*Planning systems*

24. The *committee* and management of a *friendly society* have to satisfy the *PRA* Principles for Businesses in respect of the *friendly society's* current and its future business. For this reason the *committee* and management need to satisfy the *PRA* that the *friendly society* currently meets the requirements of the *PRA* Principles for Businesses and in addition that there is the capacity and intention to continue to do so. A satisfactory planning system is essential for this latter purpose. Further details are set out in Attachment A of this Annex.

PRA

*Documentation of systems*

27. Rule 3.1(4)(b) provides that systems of control should not be treated as if they have been established or maintained unless a detailed statement in writing of the systems as in operation for the time being is kept available for the *committee*. Further details are set out in Attachment B of this Annex.

PRA

**D. SYSTEM OF INSPECTION AND REPORT**

28. The requirement for a *friendly society* or a *registered branch* to establish and maintain a system of inspection and report is distinct from the requirement to establish and maintain systems of control. The *PRA* expects that the system of inspection will be undertaken by one or more independent inspectors ("the inspection function"). In this context independent means independent of the functions inspected, see C3(a) at Attachment C of this Annex. The precise arrangements will depend upon the size and nature of the *friendly society* and

PRA

could therefore vary considerably. Suitable arrangements would include a department (eg an internal audit department) of one or more members of staff appointed on a full or part-time basis or inspection services provided from outside the *friendly society*, for example from an auditing firm other than the *friendly society's* auditors (who would not normally be expected to provide inspection services - see C6(a) of Attachment C of this Annex). The inspection function should report direct to the *committee* or the audit sub-committee (see 29). The needs of the smallest *friendly societies* with respect to a system of inspection and report may be very simple and it is for the *committee* of such a *friendly society* to consider how best to fulfil the requirements. Further details are set out in Attachment C of this Annex.

## E. COMMITTEE REVIEW AND OVERSIGHT

29. The ultimate responsibility for ensuring a *friendly society* complies with the requirements of rule 3.1 rests with the *committee* (see 5). The *committee* will therefore need effective oversight and review procedures to be able to discharge its responsibilities, including those under rule 3.1. An audit sub-committee can assist a *committee* in this respect - although such a sub-committee cannot have delegated to it the responsibilities of the full *committee* for the systems of control and of inspection and report. The *committee* of a *friendly society* may wish to consider whether to establish an audit sub-committee, which would normally be expected to consist of nonexecutive *committee* members, to advise it on at least some of the issues it will need to consider. As with any sub-committee of the *committee*, the audit sub-committee will need to have documented terms of reference which make clear its role, responsibilities and reporting lines. It would not be appropriate for an audit sub-committee, or any of its members, to carry out inspections themselves, since this would put the members of the sub-committee in the position of being responsible for reviewing the effectiveness of their own work. The matters on which an audit sub-committee might advise include:

PRA

- (a) the review of the adequacy of the *friendly society's* system of business control;
- (b) the preparation and supervision of the *friendly society's* inspection programme;
- (c) the receiving of reports from the inspection function and reporting to the *committee* on the inspection programme together with recommendations for improvements;
- (d) the review of the effectiveness of the *friendly society's* system of inspection and report, including an assessment of the scope of work performed by the inspection function, the nature and timing of inspection reports and the adequacy of resources available to the inspection function;
- (e) the review of the adequacy of management information and other reports made available to the *committee*;

- (f) the review of the annual accounts prior to their approval by the *committee*;
- (g) any major problems arising which might have a detrimental impact upon the *friendly society's* solvency position or reputation; and
- (h) liaison with the *friendly society's* auditors, including discussion on the scope of and matters arising from the audit.

If a *friendly society* has not established an audit sub-committee the matters in (a) to (h) will need to be dealt with directly by the full *committee*.

## F. ANNUAL REPORTS BY THE COMMITTEE

### *Statement of opinion of committee of management and chief executive*

30. PRA As explained in 2 the *committee* of a *friendly society* is required to send a statement of opinion to the *appropriate regulator* every year stating whether the *friendly society* has complied with the requirements of rule 3.1 and in the case of a *friendly society* with *registered branches*, stating whether its branches have complied with the requirements.

31. The purposes of requiring an annual statement of opinion by the *committee* and chief executive are:

PRA

- (a) to focus the attention of the *committee* on the need to review and develop systems in line with the changing business environment and risks associated with it, in order to provide adequate protection to members' funds; and
- (b) to take the first step in satisfying the *appropriate regulator* that the *committee* has done so.

In forming their opinion, the *committee* and chief executive will need to consider the matters which are set out in rule 3.1 and in this Annex.

### *Criteria for determining compliance and non-compliance*

32. PRA The *PRA* considers that rule 3.1(6) requires matters to be reported which individually or collectively are significant and which result in there not being reasonable assurance that the requirements of rule 3.1 have been complied with in some significant respect at any time during the year. The matters reported should be confined to significant shortcomings and exceptions only (see 34). It is not necessary for the reports to detail how the *friendly society* has achieved compliance with the provisions of rule 3.1. Where significant deficiencies have been identified and reported, the *PRA* expects the report to include: explanations of the shortcomings or exceptions which are sufficiently detailed to enable the *PRA* to understand the matters being reported and their seriousness without the necessity to refer to other sources of information; a statement of the corrective measures taken and/or to be taken; and date of full rectification or target timetable for completion of the corrective action. A shortcoming that has been rectified before the year end will still need to be reported, with details provided of the corrective action that

was taken and the date rectification was achieved.

34. **PRA** The *PRA* does not consider that minor deficiencies identified in the accounting records, or systems of control and of inspection and report, need to be reported provided that the *committee* and the chief executive have satisfied themselves that those deficiencies were not symptomatic of more serious problems. If a *committee* is undecided as to whether a particular marginal matter is of sufficient significance to require inclusion in its rule 3.1 report, it should seek the advice of the *friendly society's* auditors.

*Matters to be reported to the PRA*

35. **PRA** Circumstances in which the *PRA* would normally expect exceptions to be included in the rule 3.1 report include:

- (a) the absence of accounting records, or of systems of control, or of the system of inspection and report, or of the documentation of the systems of control necessary to enable *committee* members and other *officers* to discharge their duties;
- (b) a significant weakness or failure in any of the records or systems or documentation of those systems which occurred during the year; and
- (c) other matters which resulted, individually or collectively, in there not being reasonable assurance that the requirements of rule 3.1 have been complied with.

36. **PRA** A format for rule 3.1 reports is provided in Attachment D of this Annex.

37. **PRA** The *PRA* intends the rule 3.1 reporting process to be beneficial for the *committee* of a *friendly society*, as well as fulfilling the purposes of prudential supervision. In the normal course of events the *PRA* would not expect a qualified report to trigger the exercise of any of its powers provided there was evidence that the *committee* was carrying out its duties conscientiously and taking appropriate corrective action. Conversely, in the context of maintaining a frank and open supervisory relationship between the *PRA* and a *friendly society*, the *PRA* would view seriously any failure to disclose known significant shortcomings.

*The PRA's response to reports received*

39. **PRA** The reports received from *friendly societies* will, together with other information available to it, be used by the *PRA* as part of its evaluation of the position of each *friendly society* in relation to:

- (a) the requirements of rule 3.1; and
- (b) the *PRA* Principles for Businesses.

40. **PRA** When a qualified report is received the *PRA* will consider whether the corrective action appears sufficient, and whether it calls in question the adequacy of the protection of the interests of *policyholders* of the *friendly*

**society. A qualification of the rule 3.1 report may not call such protection into question, provided that the report also indicates timely and effective corrective action. Before reaching any conclusions, however, a meeting with a *friendly society's committee* and/or management may be arranged, which the *friendly society's* auditors may also be asked to attend. The purposes of such a meeting would be to:**

- (a) establish whether or not the matters reported are prudentially significant;**
- (b) understand fully any proposals in the report for corrective action; and**
- (c) where appropriate, agree a basis for monitoring the implementation and effectiveness of the proposals.**

**Whether or not a report is qualified, the *PRA* may wish to explore the basis of the assessment by the *committee* in its report. In so doing, the *committee* may be asked to satisfy the *PRA* on how it has dealt with the various issues in this Annex.**

## Annex 3

### Part II:

## Guidance on Systems of Control Over Investments

1. **This Part of the Annex provides guidance on the main elements of systems of control over investments in conjunction with Part I of this Annex which provides guidance on Systems of Accounting, Control of Business and Inspection and Report. A and B of this Part of the Annex include guidance of general application to *friendly societies*. C provides guidance to *friendly societies* which make use of *derivative contracts*.**

PRA

### A. BACKGROUND

2. **Chapter 3 includes a number of provisions with implications for the establishment and maintenance of systems of control over a society's investments - the main provisions are listed below. For ease of reference the provisions listed are split into two elements, those with general implications for the accounting records of, systems of control over, and inspection and report on a society's investments (see 3 to 5) and those which have specific implications for a society's investment policy (see 6 to 13). These lists are not intended to be exhaustive.**

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3. **Principle 3 of the *PRA Principles for Businesses* requires a *friendly society* to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems.**

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4. **Rule 3.1(1) requires every society and branch to "establish and maintain adequate systems of control of its business and records and of inspection and report".**

PRA

5. **Rule 3.1(4) requires the systems of control and inspection and report to be such as to enable the *committee* properly to discharge the duties imposed on them under the *Act*, the *1992 Act* or the *1974 Act*, and for the *committee*, the functions of direction of the affairs of the society or branch.**

PRA

#### *Requirements with implications for investment policy*

##### *General*

6. **Section 46 of the *1974 Act* (as amended by the *1992 Act*): this section provides information about the investments into which societies registered under the *1974 Act* may place funds, and includes any investment in which trustees are authorised by law to invest funds.**

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7. **Section 14 of the *1992 Act*: this section provides information about the investments into which incorporated societies may place funds.**

PRA

*Applicable to non-directive incorporated friendly societies*

9. Rule 4.12(1) requires the assets backing insurance liabilities (other than in respect of *linked benefits*) for a *non-directive incorporated friendly society* to satisfy the following conditions:

PRA

- (a) “.....of appropriate safety, yield and marketability having regard to the *classes* of business carried on”; and
- (b) “..... investments are appropriately diversified and adequately spread and that excessive reliance is not placed on investments of any particular category or description”.

10. Rule 4.12(2) applies to the *linked long-term contracts* of a *non-directive incorporated friendly society* for which liabilities are covered by the value of assets in an internal fund, or units in a collective investment in transferable *securities*, or by reference to a share index, or by assets of appropriate safety, yield and marketability which correspond, as nearly as may be, to the assets on which the reference value is based.

PRA

11. Rule 4.12(3) also applies in respect of the *linked long-term contracts* of a *non-directive incorporated friendly society* and requires the society to secure that its liabilities under the contract in respect of *linked benefits* are covered by assets of a description specified in Appendix 3.

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12. 15 of, and Annex B to, Appendix 4 specify the reductions that should be applied to the aggregate value of a *non-directive incorporated friendly society's* assets for the purposes of the determination of the society's *required margin of solvency* taking account, amongst other matters, of *permitted asset* and *counterparty exposure limits* and *excess concentration with a number of counterparties* (see 20 to 22).

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## B. SYSTEMS OF CONTROL

*Importance of adequate controls*

14. The investments a *friendly society* makes on behalf of its *policyholders* are an important area of its operations: the transactions may be large in relation to other areas of the society's business; and the effects on the society arising from negligence, error or irregularity could be significant. It is therefore important for a society to have preventative controls in place. The nature of those controls will vary with the size and nature of the society and whether or not it makes use of complex investment instruments such as *derivative contracts*. The following guidance on the systems of control over investments should be considered within the overall context of the guidance in Annex 3.

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15. The systems of control over investments of societies will generally include the following features:

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- (a) documentation: this is usually in the form of the investment policy (see 17 to 23);

- (b) a comprehensive management information system (see 24); and
- (c) adequate operational controls over investments (see 25 to 27).

16. Additional considerations for *friendly societies* which make use of *derivative contracts* are included in C (see 31 and 32).

PRA

*Investment policy - general*

17. It is important that the *committee* gives consideration to documenting the investment policy and takes the necessary steps to ensure that the current investment policy is being applied, and that there are systems of control which would result in the *committee* being consulted before any decision is made which may not be in accordance with the current policy. In establishing the policy a *committee* will need to take account of these rules, any requirements in the society's registered rules and advice from the *appropriate actuary* or from the person or persons appointed to perform the *actuarial function*.

PRA

18. The *committee* should ensure that the society's investment policy is one which is appropriate for the society's type of business and its business plans. The policy needs to be appropriate to the size and nature of the society, and recognise changing market circumstances and be reviewed and revised as necessary from time to time. Where a *friendly society* instructs an investment adviser to make investments for it, the society's investment policy should be reflected in any contracts or agreements made with the organisation engaged to invest the funds of the society.

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*Investment policy of a society doing linked long-term business*

19. The *committee* of a society which has been authorised to write *class III* business (linked longterm), will need to ensure that the investment policy with respect to the assets of its linked long-term funds takes into account fully the requirements of the rules in chapter 4.

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*Investment policy of a non-directive incorporated society - exposure limits*

20. The *committee* of a *non-directive incorporated friendly society* should consider whether to include limits in its investment policy on the following matters:

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- (a) the society's *exposure* to particular assets, taking the provisions and limits in Annex B to Appendix 4 (see 12) into account; and
- (b) the society's *exposure* to particular *counterparties* taking the limits in B2 of Annex B to Appendix 4 into account (see also 22).

21. The *committee* of a society which has, or is likely to have, significant aggregate exposures to one or more *counterparties* will need to ensure the society has appropriate procedures in place for assessing the creditworthiness of those *counterparties*. The *committee* may, as a result of the assessments, consider it prudent to set lower internal limits than those in Annex B to Appendix 4. The *committee* of a society which uses a third party to manage some of its investments should ensure that for monitoring purposes (see 24) the exposure to a particular *counterparty* in the funds under third party management is aggregated with the *exposure* to that *counterparty* in the funds

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managed by society staff.

22. PRA In considering counterparty exposure limits, and for the purposes of monitoring aggregate *exposures* to particular *counterparties* (see 24), the *committee* will need to take into account the requirements in B13 to B15A of Annex B to Appendix 4. These provide for the aggregation of *exposures* arising from all types of investment in or with a *counterparty*, together with the value of all rights against that *counterparty* (subject to the exceptions in B14 and B15 of Annex B to Appendix 4) in each case up to the permitted asset exposure limits. The *committee* should also take into account the provisions of B16 of Annex B to Appendix 4 with respect to *excess concentration with a number of counterparties*. The *committee* will need to remember that the permitted *exposure* limits set out in Annex B to Appendix 4 represent the maximum amounts which can be valued for solvency purposes.

*Exposure limits - additional considerations*

23. PRA The *committee* of a *non-directive incorporated friendly society*, particularly if it makes use of the powers under section 14 of the 1992 Act, should consider whether, in addition to any policy limits arising from the *exposure* and concentration provisions in Annex B to Appendix 4 (see 20 to 22), internal policy limits for aggregate exposures to certain categories of assets should be included in the investment policy. The limits for certain categories of assets will need to take account, where applicable, of rule 4.12(1) (see 9). In addition the level of the society's free assets should be taken into account, bearing in mind the possibility that such assets might in future be needed to cover *insurance liabilities* or minimum margin of solvency.

*Management information*

24. PRA It is important for a society to have adequate monitoring and reporting arrangements commensurate with the size and nature of the investment activities. The management information needs to be designed to: enable monitoring against policy limits (and statutory limits where applicable); help assess, in conjunction with the inspection function, the effectiveness of existing operations and controls over the management of investments; and provide a basis on which to determine future investment policy. In this context a *committee* will need to ensure a record of investment decisions, and who made them, is kept for reference purposes. Reports should be provided at regular intervals to the society's *committee* and senior management; frequent reporting being essential where material investment transactions are regularly made and/or where complex investment instruments such as *derivative contracts* are being used.

*Operational controls*

25. PRA The operational controls necessary for a satisfactory control system will vary with the size and nature of the society, the investment strategy and whether third parties are used to manage the investments (see 26). The control system will need to be sufficient to match the complexity of the investment instruments being used. Controls need to be designed to ensure:

- (a) the safeguarding of the assets of the society;

- (b) compliance with the documented investment policy;
- (c) investment deals are performed in an orderly and efficient manner; and
- (d) the risk of loss from negligence, error or irregularity is minimised.

*Third party investment managers*

26. **Where a third party has been appointed to manage part or all of a society's investments, the *committee* should be satisfied that the third party is able to comply with, and adhere to, the society's investment policy criteria and policy limits. In addition the *committee* will need to be satisfied that there are appropriate and effective controls in place. This is particularly important for an *incorporated friendly society* if the investment manager holds funds on its behalf. Before appointing such a third party, or in reviewing the appointment of the existing investment manager, the *committee* will need to be satisfied as to the following:**

PRA

- (a) the standing of the third party, including whether it is subject to a regulatory regime;
- (b) compliance by the third party with the parameters the *committee* considers essential for the society's investment manager. Such parameters might include: performance requirements, minimum staff size (e.g. so that there are sufficient staff to allow for adequate segregation of duties, particularly if complex investment instruments such as derivatives are to be used) and capitalisation requirements;
- (c) the terms of the agreement with the third party:
  - (i) that the agreement sets out clearly the parameters within which the third party may operate, in particular:
    - does it take account of the relevant legislative constraints?
    - does it take account of the society's investment policy criteria and policy limits?
  - (ii) that the agreement provides adequate safeguard for the society in the event of negligence, error or irregularity by the third party;
- (d) the management information (see 24) to be provided by the third party, in particular is the information sufficient for the *committee* to be able to assess performance and monitor compliance with legislative constraints, investment policy criteria and policy limits.

27. **The service provided by the investment manager should not only be monitored throughout the year but should also be subject to more fundamental review on a regular basis.**

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*Audit*

28. **Internal audit will have a role in the operation of the systems of control over**

**PRA**

investments. Internal audit may:

- (a) advise on design of systems of control or improvements to existing systems
- (b) assess the effectiveness of systems from time to time
- (c) test compliance with existing procedures.

*Committee responsibilities*

30. The *committee* of a *friendly society* will need to assess the effectiveness of the arrangements for the systems of control over the society's investments (including where transactions are carried out by a third party on a society's behalf) drawing on the auditors' advice as appropriate, in order to satisfy the requirements of rule 3.1 on this aspect of their responsibilities.

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**C. ADDITIONAL CONSIDERATIONS FOR CONTROLS OVER DERIVATIVE CONTRACTS**

31. 13 to 15 of, and Annex B to, Appendix 4 includes specific provisions with respect to *derivative contracts* and contracts or assets having the effect of *derivative contracts*. This includes provisions restricting those contracts which may be counted as assets for the purposes of determining a *friendly society's required margin of solvency*. Annex 7 refers to *INSPRU 3.2* which discusses the valuation issues surrounding the use of *derivative contracts*. That Annex also draws attention to the need for the *committee* and management of a society which uses *derivative contracts* to have sufficient understanding of the nature and risks of the contracts it uses to ensure there are effective systems in place to monitor the use of derivatives.

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32. The *committee* of a society which uses *derivative contracts* will need to take all steps which are reasonable, taking into account the nature and scale of the use of derivatives, to ensure that:

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- (a) the nature of the derivatives being used and the related risks (including interest rate risk, foreign exchange risk and operational risk) are fully understood by management even where a third party manages derivative transactions as part of the investment management service supplied to the society;
- (b) the investment policy document sets out the objectives and policies for the use of derivatives; there are documented exposure limits for: total exposure to, and/or volume of, derivative transactions; maximum exposures to, and/or volumes of, permitted types of derivative transactions; exposure to counterparties; and exposure to uncovered transactions; where a society's staff manage derivative transactions dealer limits for individual dealers will need to be documented;
- (c) the society has control and/or monitoring procedures which:

- (i) ensure that transactions are in line with the *committee's* policies and new types of instrument are not dealt with without prior consideration at *committee* level;
  - (ii) ensure the *committee* and senior management are provided regularly with statistics and information (appropriately summarised) on the trading volumes of derivatives by type of product including regular reports of all off-balance sheet transactions, mark-to-market position, contingencies and commitments; and
  - (iii) focus particular attention on uncovered transactions (which may only be undertaken in relation to assets which do not match technical provisions) so that in no circumstances is the minimum margin of solvency endangered nor are members' reasonable expectations adversely affected. Systems are needed which are adequate to prevent exposure to unacceptable volatile risks, and to monitor transactions with a frequency commensurate with volatility and risk. The systems in place need to be designed to trigger the society's strategy to hedge or close out a transaction whenever adverse movements or events threaten a significant worsening of the solvency position;
- (d) where derivative transactions are managed by society staff:
- (i) staff authorised to carry out derivative transactions are suitably qualified and competent to transact the range and type of transactions being undertaken and understand the nature of the exposures (including both *counterparty* and market risk) which the use of *derivative contracts* will create;
  - (ii) the resources (including staff resources) and systems are sufficient to cope with the volume and volatility of transactions undertaken. This applies to back office (e.g. accounting staff, record keepers), as well as front office (e.g. fund managers, dealers) systems;
  - (iii) control procedures include independent agreement and reconciliation of positions, independent checking of prices, agreement of profits to accounting profit, appropriate authorisation where dealing limits have been exceeded;
  - (iv) to ensure effective control, those with responsibility for the control systems in respect of derivative transactions are independent of the dealers; and
  - (v) senior managers have the capacity and resources to be able to analyse and monitor the risk of all derivative transactions undertaken both by individual transaction and in aggregate (including interest rate risk, foreign exchange risk, fraud, error, unauthorised access to confidential information and other operational risks). Basic monitoring information may be needed in a daily report to managers. Monitoring information (including that supplied by third party managers) will need to include mark-

**to-market information in respect of all outstanding derivative transactions, valuing derivatives and underlying assets hedged at their current market price to check whether instruments are fulfilling expectations; and**

- (e) there are adequately tested and approved valuation models which are used to value open positions and derivative instruments and that amendment to their programmes are controlled. Such models should include an appropriate test of the robustness of the portfolio to stress in changing investment conditions.**

## Attachment A To Annex 3:

### Business Planning

#### *Introduction*

**A1.** **PRA** The *committee* of a *friendly society* should be aware of the importance of having an integrated system for planning, budgeting, financial accounting, monitoring of actual against budget and feedback of results into management decisions and back into the planning process. However, just how sophisticated a *friendly society's* planning systems need to be will depend upon the size and nature of the *friendly society's* operations. The information in this Annex is neither intended to be prescriptive of what elements of a *friendly society* should be included in its system of business planning, nor can it be comprehensive of all matters that might be appropriate to the business planning of a *friendly society* - there are other publications available on such matters. The information in this Annex is intended to be helpful to *committees* and management, in particular, in providing information on key elements of a full planning system which the *committee* and management of a *friendly society* need to consider before determining on or revising the *friendly society's* system of business planning and documented plans. The *committee* and management will need to decide on the appropriate planning horizon for their *friendly society*, consistent with the *friendly society's* circumstances and appropriate to the effective management of the risks the *friendly society* faces, including any risks that may arise from its own initiatives as well as those arising from the changing business environment.

**A2.** The key features of an integrated planning system include:

- PRA**
- (a) clearly defined and documented short, medium and long-term planning, with clear allocation of responsibilities within the *friendly society* for the development, review and approval of plans, and the subsequent monitoring of performance against them;
  - (b) the conclusions, recommendations, financial projections and assumptions set out in any plan need to be based on adequate data obtained from internal and external sources, and by appropriate critical analysis;
  - (c) a range of possible outcomes need to be considered, relating to varying levels of risk and/or uncertainty, and the financial impact on a *friendly society's* solvency margin should be considered by the *friendly society's* actuary; and
  - (d) key indicators should be identified against which actual performance can be tracked. Actual data should be prepared on a basis consistent with the plan, to enable proper comparison to be made.

#### *Strategic planning*

**A3.** A corporate plan focusing on longer term strategic issues may be developed. Such a plan should be reviewed regularly in the light of experience and

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changing circumstances and could include elements of the *friendly society's* medium term planning, see A5. The key elements for a strategic plan include:

- (a) views on the markets in which the *friendly society* competes or proposes to compete in;
- (b) identification of the *friendly society's* strengths and weaknesses, market and other opportunities open to it, and threats to the *friendly society's* market and financial strength;
- (c) the *friendly society's* strategic aims and the action which needs to be taken to achieve those aims;
- (d) any major resource implications of the strategic aims – including for information technology, senior management and staff as well as financial implications; and
- (e) financial projections – including cash flow forecasting and projections based on different assumptions (eg. on optimistic, pessimistic and expected bases).

A4. A corporate plan including a *friendly society's* strategic aims should not simply consist of a number of desirable aims, but should set out the processes whereby these will be achieved. It will then be important to monitor the extent of achievement of the specified action steps, so that, if necessary, appropriate corrective action may be taken.

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*Medium term planning*

A5. The medium term planning of a *friendly society*:

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- (a) may provide for the setting, review and revision of medium term financial and other objectives, as appropriate, consistent with the *friendly society's* longer term strategic aims and targets; and
- (b) as appropriate, may include new business activities, which need to be adequately researched, analysed and appraised in terms of feasibility, financial returns and requirements for capital.

*Short term planning*

A6. Adequate short term financial and operating plans are necessary as a basis for measuring performance and taking tactical decisions. In general terms this means that a *friendly society's* short term planning will need to include the setting of an annual budget (which may include cash flow forecasting), against which actual performance can be monitored (see also 19(f) of Part I of this Annex).

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*Business continuity planning*

A7. A *friendly society* will need to consider its arrangements to ensure continuity of business in the event of some unforeseen disaster such as a fire or bomb damage. A business continuity plan should, as appropriate, deal with the possibility of major computer hardware or software failure as well as other wider aspects such as premises, personnel and external communications.

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These arrangements should be regularly reviewed and tested to ensure that they work in practice.

*Information technology*

A8. Information technology (IT) will be a major feature of the business of a number of *friendly societies*. IT brings significant benefits to such *friendly societies*, but also brings considerable risks. The issues which the *committee* and management of a *friendly society* will need to address, as appropriate, include:

PRA

- (a) the extent to which a *friendly society's* IT strategy is consistent with its longer term strategic aims;
- (b) whether the procedures for evaluating significant IT investments are sufficiently comprehensive to ensure that the technical and business cases for the investments are clearly demonstrated;
- (c) within the *friendly society*, at *committee* as well as operational level, there should be an appropriate allocation of responsibility for IT issues;
- (d) the security of data and systems is of paramount importance, controls will therefore need to be in place to minimise the risk of unauthorised access or the loss of data. Such controls should cover not only centralised mainframe processing but also remote terminals and stand-alone or linked PCs;
- (e) the exercise of strong control by the *committee* over the development of new or significantly modified IT systems. Appropriate technical and project management skills are likely to be required and a *committee* will need to determine whether it is appropriate to seek expert assistance from outside the *friendly society* in order to facilitate the process; and
- (f) appropriate skills and experience are needed to enable the inspection function to assess the effectiveness of IT controls. The involvement of the inspection function in an advisory capacity during the development of significant new IT systems, will be needed to help ensure that appropriate controls are in place.

*Human resources planning*

A9. The *committee* and management of a *friendly society*, in particular one which has taken, or proposes to take, advantage of the opportunities afforded by the 1992 Act, may need to consider the overall current and future human resources requirements. Such considerations include the planning for, and development of, human resources where a *friendly society* is proposing to enter a field of business activity with which it is not familiar. The matters on which the *committee* and management may need to be satisfied include that:

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- (a) the *friendly society* has identified its present and future staffing and skill requirements relative to its business activities and has defined recruitment, training and development plans to achieve them; and
- (b) there are arrangements for securing the supply of appropriately skilled members of the *committee*, directors of controlled bodies, managers

**and staff.**

## Attachment B to Annex 3:

### Documentation of Systems

#### *Introduction*

**B1.** The need for the documentation of systems is primarily twofold:

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- (a) whilst control systems might be operated satisfactorily for a time without documentation, the absence of documentation makes it impossible to ensure that the systems of control are maintained over time; and
- (b) the *committee* and others (e.g. external auditors and those carrying out the inspection function) have specific responsibilities in respect of the control systems. The absence of documentation makes it impossible for those reviewing the systems to satisfy themselves that the controls being operated are those that have been authorised, that they are complete and that they are adequate for their purpose.

**B2.** Whilst the overall content of such documentation should be comprehensive (see B3(a)), it will of course vary from *friendly society* to *friendly society*,

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according to the nature and scale of business and may only need to be relatively simple for a small *friendly society* with few staff. The specific content of documents may also need to vary within a *friendly society* appropriate to the levels of staff for whose use it has been prepared. Documentation prepared for the *committee* and/or management (see also B4) may need to be wider in scope and to include a greater emphasis on controls, but less detail about operational procedures, than documentation for more junior staff. Documentation prepared for more junior staff will need to include detailed information about the procedures to be followed but may only need to cover the control procedures applicable to the work of the staff concerned.

#### *Form of documentation*

**B3.** The *committee* and management of a *friendly society* will determine the form of control system documentation to be adopted. They should, however, take into account a number of considerations about the documentation, including that:

**PRA**

- (a) it should be comprehensive: and should cover all material aspects of the operations and business of the *friendly society*;
- (b) it should be integrated: separate elements of the system should be interrelated and cross-referred in such a way that the system can be viewed as an integrated whole;
- (c) it should identify risks, and the controls established to guard against those risks: the controls need to be identified and their purpose defined so that their effectiveness can be evaluated and so that the relationship and interdependency with other controls can be established;

- (d) it should attribute responsibility for operating the controls: there need to be named persons or posts for each control operation, alternatives in case of absence and continuity of standards of control during absence;
- (e) it should state how the operation of the control is to be evidenced: methods of evidencing include - signatures or initials; records and registers; retention of control documents; staff attendance records;
- (f) it should establish a comprehensive and unambiguous control discipline: the instructions should be clear and precise, avoiding expressions in relation to control functions such as “normally” and “if possible”;
- (g) it should be suitable for practical day to day use: the separate specifications of controls should have a practical role in the review and improvement of systems, for example, through the inspection function;
- (h) it should be up to date: there should be an accurate description of the system that has been established and is operating. When changes or modifications are made, the appropriate systems of control will need to be established and documented by the time the changes become operative; and
- (i) it should require confirmation of compliance: managers of different areas of a *friendly society's* business are key control points within the overall control system. They should periodically be required to confirm to the *committee*, to the best of their knowledge and belief, compliance of controls within the system which has been established.

**B4.** Documentation should not be restricted to “lower level” clerical and authorisation controls applied in transaction processing, but should also cover “high level” controls (see 15 of Part I of this Annex), including:

**PRA**

- (a) powers to be exercised only by the *committee*, and powers delegated to others;
- (b) the purpose, composition and reporting lines of *committee* member subcommittees and senior management to whom powers and responsibilities have been delegated;
- (c) the role, responsibilities and reporting lines of *committee* members; and
- (d) the timing, form and purpose of *committee* meetings and the mechanism whereby agreed *committee* strategies, policies and decisions are recorded and their implementation monitored.

*Computer controls*

**B5.** The documentation of computer controls need to be integrated within the overall documentation of a *friendly society's* system of business control. Where operating manuals are provided by a computer supplier these can often form a useful part of a *friendly society's* procedures documentation but it is unlikely that such manuals will be in a form which enables them to form part of

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the control documentation. The matters set out in B3 apply equally to the controls surrounding computer systems.

**B6.** There will be a number of key controls performed within the computer programs and a *friendly society* will need to ensure that it documents all such controls if reliance is being placed on them.

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## Attachment C to Annex 3:

### System of Inspection and Report

#### *Purpose of the system*

C1. The purpose of a system of inspection is:

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- (a) to provide a continuous appraisal for management and the *committee* as to the overall effectiveness of the control systems, including all proposed changes, and to recommend improvements where considered desirable or necessary;
- (b) to determine whether the systems and controls established by the management and the *committee* have operated as laid down in the control documentation of the *friendly society* or *registered branch* and comply with policies, procedures, laws, regulations and any other requirements; and
- (c) to assess whether financial and operating information supplied to management and the *committee* is accurate, appropriate, timely and complete.

C2. A *friendly society* should ensure that, in addition to coverage of operational activities, its system of inspection adequately covers the following areas – as appropriate to the scale and nature of the business:

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- (a) controls to verify the accuracy and completeness of returns and other information provided to the *PRA*;
- (b) controls to ensure compliance with relevant statutory and regulatory requirements;
- (c) broader management controls, such as controls over business planning, systems for monitoring and reporting on financial performance and other key business indicators;
- (d) controls over new areas of business and other initiatives, whether carried out within the *friendly society* or through controlled bodies; and
- (e) the “high level” controls referred to Part I of this Annex.

C3. The *committee* and management of a *friendly society* will need to satisfy themselves that the following considerations have been properly addressed within the context of the scale, range, complexity and pace of development of the *friendly society*'s business:

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- (a) the inspection function is independent of the functions it inspects in order to maintain its objectivity;
- (b) sufficient resources are available to achieve the agreed objectives of

the inspection function;

- (c) qualifications, experience and training of individuals performing the inspection function are adequate in relation to the objectives; and
- (d) the status and reporting relationship of the head of the inspection function is sufficient to maintain the independence and objectivity of the function. It is important to ensure that, in addition to regular reporting to management and the *committee* (see C5(f)), the head of the inspection function has the right of direct access to the highest level of management and the *committee*.

C4. An audit sub-committee can have a key role to play in controlling the work of the inspection function and receiving its reports. The role of the audit sub-committee is covered in more detail in paragraph 29 of Part I of this Annex.

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*Key elements of a system*

C5. The key elements of a satisfactory system of inspection include:

PRA

- (a) **Terms of reference:** these should be specified with precision and should include, amongst other matters, scope and objectives of the inspection function, access to records, powers to obtain information/explanations from staff, and reporting requirements. The terms of reference should be approved by management and the *committee*. The *friendly society's* inspectors (or internal auditors) will require a wide-ranging access to records and documents, including material prepared for and by the *committee*. They will also need to be empowered to obtain information and explanations from staff at all levels, and *committee* members.
- (b) **Risk analysis:** risks identified and the controls put in place by management to address those risks should be considered in each area or cycle of the *friendly society's* business. The adequacy of the controls should be assessed. Weaknesses in control should be drawn to the attention of the *committee* or audit sub-committee and other senior *officers* of the *friendly society* as specified in the terms of reference. In this context risk factors may include more than just the risk of pecuniary loss, or error or mis-statement in the accounting records. As appropriate, reputational risk, and wider business and operational risk, may also need to be considered. Full consideration should be given to the high level controls in place within the *friendly society*. These include the controls referred to in 15 of Part I of this Annex and C2(e) – see also B4 in Attachment B of this Annex.
- (c) **Inspection plan:** an inspection plan should be developed covering all aspects of the *friendly society's* business and which, in the opinion of the *committee*, satisfies the requirements of rule 3.1. The inspection function should focus in particular on those areas identified in the risk analysis as higher risk, taking into account the related inherent risk factors and controls in place. However, all areas of the *friendly society's* business should be covered over a set time frame and the inspection plan should identify the scope and frequency of the work to be carried out in each area. The plan should be reviewed and approved at

*committee* level, or by the audit sub-committee on behalf of the *committee*, before work commences.

- (d) **Detailed programmes:** these will set out the specific tests to be performed in each area of the inspection plan.
- (e) **Working papers:** adequate working papers should be maintained to record audit planning and execution, principal findings and follow-up action. Amongst other matters, the papers should provide: evidence of the individual who performed the programmed work; how it was controlled and supervised; and record the conclusions reached - with cross-referencing to the reports made and action taken.
- (f) **System of reporting:** the results of the work performed should be reported to senior management and any audit sub-committee and the *committee* in accordance with the terms of reference. Such reporting should be carried out on a regular and timely basis. Obviously serious matters should be raised immediately. The reports should briefly describe the area(s) covered, significant matters arising, recommendations and overall conclusions. Procedures should be established to make sure the recommendations have been implemented or non-implementation validly justified.

*Reporting and review*

C6. **The *committee* and management of a *friendly society* need to satisfy themselves that the system of inspection is being properly carried out. In order to review the overall effectiveness of the inspection function, the *committee* needs to consider the following aspects:**

PRA

- (a) **adequacy of resources, including number, experience and skills of those providing inspection services. There may be areas (eg computer audit) for which specific skills may need to be obtained from an external source. A *friendly society's* auditors would not normally be expected to provide such inspection services, as there is potential for a conflict of interest to arise;**
- (b) **adequacy and scope of planning and work performed, including the allocation of inspection effort to each area of the *friendly society's* business;**
- (c) **frequency, quality and timeliness of reporting on matters arising from the inspections;**
- (d) **consideration and resolution of points and recommendations raised, and reasons for any rejection of major points; and**
- (e) **review of overall effectiveness of the inspection function.**

## Attachment D to Annex 3:

**PRA**

*Report by the Committee of Management of [NAME OF FRIENDLY SOCIETY] under rule 3.1 of IPRU(FSOC)*

In our opinion during the year ended \_\_\_\_\_, the requirements of rule 3.1 were\* (complied with)/ (complied with except in the respects set out in the attached Schedule [A]).

**Signed by:**

\_\_\_\_\_ **Chairman**

\_\_\_\_\_ **Chief Executive**

**Date** \_\_\_\_\_

**\* Delete as appropriate**

**1. Exceptions arising in previous years:**

**(a) Remedied during 20\_\_ [current report year]**

**Under each appropriate heading provide a clear description of the exception, remedial action(s) taken and date of full rectification.**

**(b) Exceptions not fully rectified during 20\_\_ [current report year]**

**Under each appropriate heading provide a clear description of the exception, the action(s) taken and/or remaining to be taken and timetable for completion.**

**2. Exceptions arising in 20\_\_ [current report year]**

**(a) Remedied during 20\_\_ [current report year]**

**Under each appropriate heading provide a clear description of the exception, remedial action(s) taken and date of full rectification.**

**(b) Exceptions not rectified during 20\_\_ [current report year]**

**Under each appropriate heading provide a clear description of the exception, action(s) taken and/or to be taken and timetable for completion.**



## Annex 4:

### Guidance on Margins of Solvency and the Guarantee Fund

#### *Introduction*

1. **PRA** This Annex gives guidance to *friendly societies* on the application of rules 4.1 to 4.7 which set out the requirements for maintenance of a *required margin of solvency* and a *guarantee fund*. It explains how different categories of *friendly societies* are affected. This Annex does not apply to *flat rate benefits business friendly societies*.

#### *The required margin of solvency*

2. **PRA** Rule 4.1 provides that a *friendly society* which has permission to carry on *general insurance business* and/or *long-term insurance business* is required to maintain a margin of solvency of an amount prescribed in rules 4.2 to 4.10.
3. **PRA** Rules 4.2 to 4.10 do not apply to any *friendly society* which does not have permission to effect new contracts of insurance and is only carrying out contracts of *long-term or general insurance business* which were effected before 13 September 1993. Such societies must maintain an excess of the value of the *friendly society's* assets over the amount of its liabilities.
4. A *friendly society's* failure to maintain a *required margin of solvency* would be an early warning sign of difficulty. The *PRA* would under *SUP* require the *friendly society* to submit a suitable restoration plan within a specified reasonable time and give effect to the plan. The *required margin of solvency* might be restored by, for example, tighter budgetary control, restriction of new business, reassurance arrangements or changes in investment mix.
- 4A **PRA** Guidance in *GENPRU 2 Annex 8G* (Guidance on applications for waivers relating to implicit items) is relevant to *friendly societies* applying for a waiver of rule 4.7(3) of *IPRU(FSOC)* under section 138A of the *Act* (Modification or waiver of rules).<sup>10</sup>

4B. [deleted]

4C. [deleted]

#### *Guarantee fund*

5. **PRA** Rules 4.3 to 4.7 provide for the maintenance of the *guarantee fund*. The *guarantee fund* is generally one-third of the calculated *required margin of solvency*. For *non-directive incorporated friendly societies*, the *guarantee fund* should be not less than the amount set out in rules 4.5 and 4.6 and this is known as the *minimum guarantee fund*.

<sup>10</sup> This paragraph comes into effect on 1 June 2002.

6. **PRA** Failure to meet the *guarantee fund* requirement would be regarded as very serious. The *PRA* would require the *friendly society* to submit and effect a short-term financial scheme if a *friendly society's guarantee fund* or *minimum guarantee fund* falls below requirement. Reasonable time would be granted to have discussions and to convene a meeting, and this would be expected

normally to be followed by immediate action, for example, increased contributions or reduced benefits.

#### *Minimum Requirements*

7. Chapters 4 and 5 which are based on the *insurance Directives*, set out the current solvency and valuation requirements for *friendly societies* carrying on *insurance business*. Rules of this type cannot take into account the individual needs of a particular *friendly society*, but should be regarded as an absolute minimum requirement which will be supplemented by explicit or implicit margins on the advice of the actuary.

PRA

8. There are some important modifications contained in Chapter 4 by way of relaxation of the requirements for *friendly societies* which are *non-directive registered friendly societies* in recognition of their different status or much smaller size. These modifications are:

PRA

- (a) a *non-directive friendly society* which does not have permission to effect new contracts of insurance and is only carrying out contracts of *long-term or general insurance business*, which were effected before 13 September 1993, will not be subject to the specific margin of solvency requirements, as rules 4.2 to 4.10 are not applied to such *friendly societies* (rule 4.1);
- (b) the requirement to have a *minimum guarantee fund* does not apply to a *nondirective friendly society* which is not incorporated (rule 4.4); and
- (c) [deleted]
- (d) the limits placed on the extent to which certain assets may be taken into account in determining their value in the insurance fund apply only to *non-directive incorporated friendly societies* (15(1) of Appendix 4).

9. In addition to these modifications, the *PRA* has power under section 138A of the *Act* to direct that certain requirements do not apply to any particular *friendly society*, and there may be circumstances where the *minimum guarantee fund* may be varied in the case of certain *friendly societies*.

PRA

10. These waivers or modifications do not lessen the requirement for prudent management, and may be accompanied by conditions.

PRA

11.1 *The requirements for the various categories are summarised below.*

PRA

#### *Non-Directive Incorporated Friendly Societies*

11.4 *Long-term business*

PRA

- (1) These may fall outside the EC requirements but fall within the scope of rule 5.1 and are required to be valued annually. The *required margin of solvency* is set out in rules 4.1 to 4.7. New *friendly societies* should have *margins of solvency* at least equal to the appropriate *minimum guarantee fund*. Rule 4.5 specifies a *minimum guarantee fund* with a threshold of 100,000 Euro increasing in steps. This may be varied by

the exercise of the *PRA*'s power under section 138A of the *Act*.

- (2) Accordingly, a *non-directive incorporated friendly society* carrying on *long-term insurance business* will be expected to meet the solvency margin requirement immediately following incorporation. However, a valuation at that date is not necessarily required unless that date would otherwise be a normal *valuation date*.

*General insurance business*

11.5 Similar considerations will apply in the case of *non-directive incorporated friendly societies* carrying on *general insurance business*. The minimum guarantee fund is 225,000 Euro. These societies are required to be valued triennially.

PRA

*Other non-directive Friendly Societies*

11.6 (1) *Non-directive registered friendly societies* which have permission to carry on *long-term or general insurance business* are within the scope of rule 4.1 and are required to be valued triennially.

PRA

(2) The margin of solvency requirements for these societies are set out in Chapter 4. However the specific requirements in respect of the maintenance of a *minimum guarantee fund* (rules 4.5 and 4.6) and 4.11 to 4.19 (including those in respect of matching and localisation) do not apply to them. These societies are also not subject to the admissibility limit rules in paragraph 15(1) of Appendix 4.

(3) Societies which do not have permission to effect new *contracts of insurance* and are only carrying out contracts of *long-term or general insurance business*, which were effected before 13 September 1993 are not required to maintain a specified margin of solvency. Such societies should maintain an excess of the value of the *friendly society's* assets over the amount of its liabilities. They will be required to carry out triennial valuations unless exempted under the *Act*. If any valuation nevertheless discloses a level of concern then the *PRA* may take appropriate remedial action.

12.1 *Resilience Test*

PRA

12.2 The resilience test is a requirement for prudent provision to be made against the effects of possible future changes in the value of assets on the adequacy of these assets to meet liabilities. This requirement is in paragraph 16 of Appendix 5 of *IPRU(FSOC)* and applies to the determination of the amount of *long-term liabilities*. A *friendly society* should for this purpose treat *INSPRU 3.1.16G* to *INSPRU 3.1.26R* as providing guidance on the scenarios that may be appropriate for this purpose. (Any additional reserve required by the resilience test is part of *mathematical reserves* and not a capital requirement).

PRA

12.3 [deleted]

12.4 [deleted]

12.5 [deleted]

12.6 The *friendly society* should also take account of the nature of the assets and liabilities. For example, a *friendly society* which has only unit linked business, some of which carries a guaranteed annuity rate, should not necessarily assume that equity values fall in applying tests for lower fixed interest rates. Indeed *friendly societies* should consider their resilience to a rise in equity values combined with falling interest rates.

PRA

12.7 The *PRA* also expects that *friendly societies* will continue to investigate a wide range of possible future investment scenarios for the purpose of their own stress testing and risk management.

PRA

13. [deleted]

## Annex 5:

### Guidance on Exemption from Triennial Valuation

1. This Annex gives guidance to *friendly societies* who may wish to seek exemption from the requirement in rule 5.2 to cause an actuarial investigation to be carried out.  
**PRA**
2. Rule 5.1 requires any *friendly society* with permission to carry on *long-term insurance business* which is an *incorporated friendly society*, to cause the *actuary* appointed to perform the *actuarial function* under the rules in *SUP* to carry out an annual investigation into the *friendly society's* financial condition in respect of its *long-term insurance business*.  
**PRA**
3. Rule 5.2 provides that any *friendly society* which carries on any *insurance business* which is not subject to the annual valuation requirement under rule 5.1 should cause the *appropriate actuary* to carry out an investigation into the financial condition of that *insurance business* at least once every 3 years. Generally this would be as at the 3<sup>rd</sup> anniversary of the 31 December when the previous valuation was due. The requirements in relation to this triennial valuation are set out in rule 5.2(1) to (6).  
**PRA**
4. The *PRA* has power under section 138A of the *Act* to waive or modify the application of rule 5.2 to a particular *friendly society* (see *SUP*). This may include dispensing with the valuation requirement entirely or modifying it, e.g. to substitute a quinquennial valuation or to restrict the scope of the valuation to only part of the *insurance business*.  
**PRA**
5. Notwithstanding the fact that a *friendly society* may have been exempted from the requirement to carry out an actuarial investigation under rule 5.2, there may be circumstances when the *committee* may, in order to comply with the *PRA* Principles for Businesses, nonetheless need to cause an actuarial valuation to be carried out.  
**PRA**
6. Applications for exemption should be made as soon as possible after the *financial year* end for which valuation is due. Initial enquiries may be made before the end of the *financial year*.  
**PRA**
7. An application form for a waiver or modification of rule 5.2 is set out below.  
**PRA**

## Attachment to Annex 5:

PRA

### Proforma Application

**Insurance Firms Division  
The Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London  
E14 5HS**

Dear Sir or Madam,

**Request for dispensation from actuarial investigation**

The \_\_\_\_\_(insert name of friendly society)\_\_\_\_\_ hereby requests dispensation from the requirement to cause an actuarial investigation to be carried out as at under rule 5.2 of the Interim Prudential Sourcebook for Friendly Societies for one or more of the following reasons –

(a) the purposes of the friendly society are such that (1)

---

(b) the nature of the friendly society's business is such that (1)

---

(c) the manner in which the friendly society's business is carried on is such that (1)

---

(d) the scale of the business is such that the contribution income for each year since the previous valuation date has been as follows, \_\_\_\_\_ the assets as at the valuation date are £\_\_\_\_\_ and no changes in rates of benefits or contributions have been made since the previous valuation date.

[I am also attaching a certificate signed by the friendly society's appropriate actuary supporting the friendly society's request for a dispensation (2)].

(Signed) Chief Executive

Notes

---

(1) Please provide details of why the friendly society is seeking dispensation;

(2) The actuary's certificate is optional - please delete this sentence if the certificate is not provided. If an actuary's certificate is to be attached it should be in the form set out overleaf.

[where supporting actuary's certificate is to be attached it should read as follows]

I have performed an initial investigation as follows:-

I am of the opinion that the friendly society's margin of solvency as at [ ] was/is likely to be in excess of the required margin of solvency and is expected to remain so for the foreseeable future and for so long as there is no significant change in the nature or volume of business transacted or in the nature or distribution of the assets held by the friendly society and I support the application on the ground(s) that

(Signed) Fellow of the

of Actuaries



## **Annex 6:**

[deleted]



## Annex 7:

### Guidance on the Use of Derivative Contracts by Friendly Societies

#### *Introduction*

1. The main purpose of this Annex is to draw attention to the rules which cover whether a *derivative contract* has an admissible value which can count towards a *friendly society's* solvency margin.

PRA

#### *Approved derivatives contracts*

2. An *approved derivative contract*, if held by a *friendly society* which maintains the *required margin of solvency*, in accordance with Part I of Chapter 4, may have an admissible value which can count towards a *friendly society's required solvency margin*. However, any *derivative contract* which is a liability to a *friendly society* (whether or not it falls within the definition of an *approved derivative contract* and is held for the purposes specified in 13 of Appendix 4) will count as a liability for solvency purposes.

PRA

3. [deleted]

#### *Information for the FCA and PRA*

4. A *friendly society* which proposes to make use of *derivative contracts* for the first time is asked to inform *FCA and PRA* staff of its proposals. Societies should note that they are likely to be strongly discouraged from using *derivative contracts* unless they can demonstrate robust systems and controls and a full understanding of the implications of the arrangement.

PRA

#### *Note of caution*

5. You will no doubt be aware, from the publicity given to a number of cases, that the use of *derivative contracts* can, if not properly controlled, adversely affect the financial viability of an institution. It is important that any institution which decides to use such contracts has sufficient understanding at board/*committee* and senior executive level of the nature and risks of the *derivative contracts* it is proposed to use, to ensure there are effective systems in place to monitor and control the use of derivatives – including where derivative transactions are carried out by investment managers on behalf of the institution. The *committee* of a *friendly society* which is considering using *derivative contracts* will need to be satisfied that there is sufficient understanding at appropriate levels, and that effective control systems are in place, before the *friendly society* commences to use *derivative contracts*.

PRA



## **Annex 8:**

[deleted]



# **Interim Prudential Sourcebook**

## **Insurers**

### **Volume One Rules**

# THE INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS INSTRUMENT 2001

## INTRODUCTION

- 1 The FSA makes the rules and guidance in this instrument on 21 June 2001.
- 2 [deleted]
- 3 This instrument will come into force at the beginning of the day on which section 19 of the *Act* (the general prohibition) comes into force.
- 4 This instrument is to be interpreted in accordance with, and applies subject to, the general provisions contained in the General Provisions Instrument 2001.
- 5 This instrument may be cited as the Interim Prudential Sourcebook for Insurers Instrument 2001.
- 6 This instrument, excluding the provisions in this Introduction, may be cited as the Interim Prudential Sourcebook for Insurers.

**By Order of the Board**

**21 June 2001**

**INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS  
GUIDANCE**

**THE PURPOSE OF THE PRUDENTIAL RULES FOR INSURERS AND  
AN OVERALL DESCRIPTION**

[deleted text]

# INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS

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**Chapter 3** Long-term insurance business

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**Chapter 5** [deleted]

**Chapter 6** [deleted]

**Chapter 7** [deleted]

**Chapter 8** Non-UK insurers

Part I [deleted]

Part II [deleted]

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**Chapter 9** Financial reporting

Part I Accounts and statements

Part II Accounts and statements for a marine mutual

Part III Statistical rules

Part IV Material connected-party transactions

Part V Group Capital Adequacy

Part VII Lloyd's of London

<b>Chapter 9</b>	<b>Financial reporting</b>
Part I	Accounts and statements
Part II	Accounts and statements for a marine mutual
Part III	Statistical rules
Part IV	Material connected-party transactions
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<b>Appendix 4.1</b>	<b>[deleted]</b>
<b>Appendix 4.2</b>	<b>[deleted]</b>
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<b>Appendix 9.4</b>	<b>Abstract of valuation report (rules 9.4 and 9.31)</b>
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# 1 Chapter 1: Application Rule

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# 1 Chapter 1: Application Rule

## APPLICATION

### *Insurers*

1.1 An insurer must comply with *IPRU (INS)* unless it is –

**FCA** **PRA**

(a) a *friendly society*<sup>1</sup>; or

(b) an *EEA insurer* or an *EEA pure reinsurer* qualifying for authorisation under Schedules 3 or 4 to the Act.

### *The Society of Lloyd's*

1.2 No provisions of *IPRU (INS)* apply to the *Society of Lloyd's*, or *members of the Society of Lloyd's* except rules 9.37 and 9.38, and Part VII of Chapter 9.

**FCA** **PRA**

1.3 [deleted]

1. A *non-directive friendly society* must comply with *IPRU(FSOC)*; a *directive friendly society* must comply with *GENPRU* and *INSPRU*; with Chapters 1, 2 and 3, 4 (rules 4.20 to 4.23 only), 5 (rule 5.1A only) 7, 8 and Appendix 3 of *IPRU(FSOC)*. Rule 5.1A of *IPRU(FSOC)* effectively applies most of Chapter 9 of *IPRU(INS)* to *directive friendly societies*, notwithstanding *IPRU(INS)* 1.1(a)

**2 Chapter 2**  
**[deleted]**



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- 3.6 [deleted]**
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### 3 Chapter 3: Long-Term Insurance Business

#### PART I: IDENTIFICATION AND APPLICATION OF ASSETS AND LIABILITIES

3.1 (1) [deleted]

(2) [deleted]

##### *Application of assets of insurer with long-term insurance business*

*Limitation on use of assets in long-term insurance fund*

3.2 [(1) to (5) deleted]

**PRA** *Restriction in relation to dividends*

(6) **A long-term insurer must not declare a dividend at any time when the value of the long-term insurance assets, as determined in accordance with GENPRU 1.3 and INSPRU 2.1 is less than the amount of the long-term insurance business technical provisions and any other liabilities connected with the long-term insurance business.<sup>1</sup>**

##### *Allocations to policy holders*

*Allocation of established surplus*

3.3 (1) **Where –**

**FCA** (a) **there is an ‘established surplus’ in which long-term policy holders of any category are eligible to participate; and**

(b) **an amount has been allocated to policy holders of that category in respect of a previously ‘established surplus’ in which policy holders of that category were eligible to participate,**

**an insurer must not by virtue of INSPRU 1.5.27R transfer or otherwise apply assets representing any part of the surplus mentioned in (a) unless the insurer has –**

(i) **allocated to policy holders of that category in respect of that surplus an amount not less than the ‘relevant minimum’, or**

(ii) **complied with the requirements of (3) and made to those policy holders any allocation of which notice is given under (3)(a).**

(2) **Subject to (6) and (7), the relevant minimum is the amount represented by the formula –**

$$\frac{b \times c}{a} - \frac{c}{200}$$

**where –**

- a** is the last previously 'established surplus' in respect of which an amount was allocated to *policy holders* of the category in question;
- b** is the amount so allocated; and
- c** is the surplus referred to in (1)(a).

*Requirements where less than the relevant minimum is to be allocated*

- (3) The requirements referred to in (1)(ii) are that the *insurer* –
  - (a) at least 14 days before publication has given the *FCA* written notice stating that it proposes to make no allocation or an allocation of an amount (specifying it) which is smaller than the 'relevant minimum', and a copy of the statement that it proposes to publish in accordance with (b); and
  - (b) has published a statement in the London, Edinburgh and Belfast Gazettes and in two national newspapers explaining the allocation it proposes to make to *policy holders* and the reasons for it,and that a period of not less than 56 days has elapsed since the date, or the last date, on which the *insurer* has published the statement mentioned in (b) as required by that paragraph.
- (4) In this rule, established surplus means an excess of assets representing the whole or a particular part of the *long-term insurance fund or funds* over the liabilities, or a particular part of the liabilities, of the *insurer* attributable to that business as shown by an *actuarial investigation*.

*Amounts to be treated as allocated to policy holders*

- (5) For the purposes of this rule, an amount is allocated to *policy holders* if, and only if –
  - (a) bonus payments are made to them; or
  - (b) reversionary bonuses are declared in their favour or a reduction is made in the premiums payable by them,

and the amount of the allocation is, in a case within (a), the amount of the payments and, in a case within (b), the amount of the liabilities assumed by the insurer in consequence of the declaration or reduction.

*Bonus payments in anticipation of established surplus*

- (6) For the purposes of this rule, the amount of any bonus payments made in anticipation of an 'established surplus' is treated as an amount allocated in respect of the next 'established surplus' in respect of which an amount is allocated to eligible *policy holders* generally; and for the purposes of (2) the amount of any surplus in respect of which such an allocation is made is treated as increased by the amount of any such payments.

*Unappropriated surplus carried forward*

- (7) (1) does not authorise the application for purposes other than those mentioned in *INSPRU* 1.5.30R of assets representing any part of the surplus mentioned in (1)(a) which the *insurer* has decided to carry forward unappropriated; and for the purposes of (2) the amount of any surplus is treated as reduced by any part of it which the *insurer* has decided to carry forward unappropriated.

*Eligibility to participate in an established surplus*

- (8) For the purposes of (1), *policy holders* are taken to be eligible to participate in an 'established surplus' in any case where they would be eligible to participate in a later 'established surplus' representing it if it were carried forward unappropriated.

*Restriction on transactions with connected persons*

3.4 [deleted]

*Arrangements to avoid unfairness between separate insurance funds*

3.5 (1) An *insurer* which carries on *long-term insurance business* in the UK must have adequate arrangements for securing that transactions affecting assets of the *insurer* (other than transactions outside its control) do not operate unfairly between the *long-term insurance fund or funds* and the other assets of the *insurer* or, in a case where the *insurer* has more than one 'identified fund', between those funds.

FCA

(2) In this rule, identified fund means assets representing the *insurer's* receipts from a particular part of its *long-term insurance business* which can be identified as such by virtue of accounting or other records maintained by the *insurer*.

(3) [deleted]

3.5a [deleted]

3.6 [deleted]

3.7 [deleted]

**4 Chapter 4**  
**[deleted]**



**5 Chapter 5**  
**[deleted]**



**6 Chapter 6**  
**[deleted]**



**7 Chapter 7**  
**[deleted]**



## **8 Chapter 8: Non-UK Insurers**

### **CONTENTS**

#### *Part I – Deposits*

**[deleted]**

#### *Part II – Location of accounts and records*

**[deleted]**

#### *Part III – Rules applicable to branches*

**8.3**

## 8 Chapter 8: Non-UK Insurers

### PART I: DEPOSITS

8.1 [deleted]

### PART II: LOCATION OF ACCOUNTS AND RECORDS

8.2 [deleted]

### PART III: RULES APPLICABLE TO BRANCHES

8.3 **An *insurer* which has its head office outside the United Kingdom (other than a *pure reinsurer* which has a Treaty right under Schedule 4 to the *Act*, or a *Swiss general insurer*) must appoint and maintain the appointment of a chief executive (who alone or jointly with one or more others, is responsible for the conduct of its business through an establishment in the United Kingdom).**

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8.4 [deleted]

8.5 [deleted]

## 9 Chapter 9: Financial Reporting

### PART I: ACCOUNTS AND STATEMENTS

#### *Application*

9.1 These *Accounts and Statements Rules* apply to every *insurer* other than –

- PRA**
- (a) an *EEA-deposit insurer*, in relation to *insurance business* carried on by it outside the United Kingdom; or
  - (b) a *Swiss general insurer*, in relation to *general insurance business* carried on by it outside the United Kingdom.

#### *Interpretation*

9.2 (1) In rules 9.25 to 9.27, 9.29, 9.30 and 9.32, and in the Appendices relevant to the *Accounts and Statements Rules*, unless the context otherwise requires, words and expressions not defined in *IPRU (INS)* or the *Glossary* which are used in the *insurance accounts rules* have the same meanings as in those rules.

**PRA**

(2) In the *Accounts and Statements Rules* –

- (a) any reference to *long-term insurance business* or *general insurance business* is, in relation to an *EEA-deposit insurer*, to *long-term insurance business* or *general insurance business* carried on by it through a branch in the United Kingdom; and
- (b) any reference to *general insurance business* is, in relation to a *Swiss general insurer*, to *general insurance business* carried on by it through a branch in the United Kingdom,

and accordingly any reference to, or requirement imposed in respect of, the accounts and balance sheet (including any notes, statements, reports and certificates annexed to them) is to, or imposes a requirement in respect of, *insurance business* carried on through that branch.

(3) In the *Accounts and Statements Rules*, any reference to *long-term insurance business* or to *general insurance business* is -

- (a) in relation to an *external insurer*, to its entire *long-term insurance business* or to its entire *general insurance business* and (except in the case of a *non-EEA insurer* whose *insurance business* in the United Kingdom is restricted to *reinsurance* or an *insurer* whose head office is in any *EEA State* except the United Kingdom whose *insurance business* in the *EEA* is restricted to *reinsurance*), to any *long-term insurance business* or *general insurance business* carried on by it through a branch in the United Kingdom; and
- (b) in relation to a *UK-deposit insurer*, to its entire *long-term insurance business* or to its entire *general insurance business*

and to any *long-term insurance business* or *general insurance business* carried on by it through a branch in any *EEA State*,

and accordingly any reference to, or requirement imposed in respect of, the accounts and balance sheet (including any notes, statements, reports and certificates annexed to them) relevant to *long-term insurance business* or to *general insurance business* is to, or imposes a requirement in respect of –

- (i) accounts prepared in respect of its entire *long-term insurance business* or entire *general insurance business*; and
- (ii) accounts prepared in respect of the *long-term insurance business* or the *general insurance business* carried on, in the case of an *external insurer*, by the branch in the United Kingdom and, in the case of a *UK-deposit insurer* (other than a *non-EEA insurer* whose *insurance business* in the United Kingdom is restricted to *reinsurance* or an *insurer* whose head office is in any *EEA State* except the United Kingdom whose *insurance business* in the *EEA* is restricted to *reinsurance*), by the branches in question in the *EEA States* taken together.

(4) In the *Accounts and Statements Rules* and in Chapter 12 –

- (a) any reference to a numbered Form is a reference to the Form so numbered in Appendices 9.1 to 9.3;
- (b) references to a numbered *class of insurance business* are references to the *class* so numbered in either Annex 11.1 or 11.2; and
- (c) references to a numbered PRA *general insurance business reporting category* are references to the PRA *general insurance business reporting category* so numbered in Annex 11.3.

(5) To the extent there is a contradiction between *SUP 16.3* and the *Accounts and Statements Rules*, the *Accounts and Statements Rules* apply.

#### *Annual accounts and balance sheets*

9.3

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- (1) Subject to (2) and (3), an *insurer* which does not fall within (5) must, with respect to each of its *financial years*, prepare –
  - (a) a revenue account for the year;
  - (b) a balance sheet as at the end of the year; and
  - (c) a *profit and loss account* for the year.
- (2) An *insurer* not trading for profit must, with respect to each of its *financial years*, prepare an income and expenditure account for the year.
- (3) If a form is required for –

- an account
- a balance sheet
- a note
- a statement
- a report, or
- a certificate attached to any of the above,

the account etc. must be in that form.

- (4) *An insurer's financial year* must be a 12 month period.
- (5) *A long-term insurer* which:
- (a) has transferred all of its *long-term insurance business* to another insurer;
  - (b) has no intention to carry on further *long-term insurance business*; and
  - (c) is not carrying on *general insurance* business,

must provide to the PRA within three months of the date of transfer Forms 40, 41, 42, 43, 45, 46 and 47 in respect of the period from the end of the *financial year* most recently ended to the date of transfer together with a certificate in accordance with Appendix 9.6 paragraphs 1(1)(a) and 1(1)(b)(i) and a statement that no *long-term insurance business* has been carried on by the insurer since then, there is no intention to carry on further any such business and the insurer is not carrying on *general insurance business*.

- (6) The Forms 40, 41, 42, 43, and 45 provided under (5) must be audited by a person qualified to do so, in accordance with the rules in SUP, who must make and annex to those documents a report in accordance with Appendix 9.6 paragraph 4(a)(i) in respect of those documents.

*Half-yearly balance sheet and report for realistic valuation*

- 9.3A
- PRA
- (1) Every *long-term insurer* which is a *realistic basis life firm* must in respect of each *financial year* prepare Forms 2, 18 and 19 of Appendix 9.1, as at the end of the first six months of that *financial year*.
  - (2) The Forms in (1) must be prepared in accordance with Appendix 9.1, and Form 2 must be completed in respect of the *long-term insurance business* of the firm and Forms 18 and 19 must be completed in respect of each of the firm's *with-profit funds*.
  - (3) The Forms in (1) must be accompanied by a report (instead of the reports required under rule 9.4(1)(b)) identifying any changes to the methods and assumptions used from those set out in the report for the realistic

valuation as at the end of the *preceding financial year*.

- (4) Rules 9.4, 9.6, 9.10, 9.11, 9.12, 9.33 and 9.34, Appendices 9.1 and 9.4A and Part I of Appendix 9.6 apply to this rule and to any documents required under this rule as if –
- (a) an additional balance sheet were required under rule 9.3;
  - (b) the documents required by (1), and only those documents, were required by rule 9.12 for the purposes of the balance sheet in (a) above;
  - (c) an additional investigation were required under rule 9.4(1)(a) in respect of the six-month period covered by this rule;
  - (d) any document required by (3) were a document required by rule 9.31(b) for the purposes of the investigation in (c) above;
  - (e) any reference to the *financial year in question* (however expressed) were a reference to the six-month period referred to in (1);
  - (f) any reference to the preceding year were a reference to the end of the *preceding financial year*;
  - (g) the required signatory in each case were any director of the *insurer*;
  - (h) any reference to a particular amount shown in a document not required under (1) or (3) were a reference to the amount which would be shown in that document (subject to any modifications in (a) to (f) above) in accordance with the *Accounts and Statements Rules* if that document were required to be produced;
  - (i) any requirement (other than in this rule) to refer in the *return* or any certificate annexed to it by virtue of rule 9.34 to a document not required under (1) or (3) were omitted; and
  - (j) in 9.6(2)(a) a single printed copy is required and for both 9.6(2)(a) and 9.6(2)(b) the printed copy must be sent to the *insurer's* normal supervisory contact.
- (5) Instead of a valuation report under rule 9.31(a), the report referred to in (3) must include, in an additional numbered answer following the answers to the 5 31 December 2009 paragraphs in Appendix 9.4A –
- (a) a full description of each of the changes in the methods and assumptions used in the investigation for the purposes of rule 9.4(2)(a) and (b) since the previous investigation at the end of the *preceding financial year*; or
  - (b) if there has been no such change, a statement to that effect.

Rules 9.3, 9.5, 9.7, 9.13 to 9.30, 9.31, 9.32 and 9.35 to 9.39 do not apply in respect of the documents required under this rule.

*Periodic actuarial investigation of long-term insurer*

9.4 (1) Every *long-term insurer* –

PRA

- (a) must, once in every period of 12 months, cause an investigation to be made into its financial condition in respect of its *long-term insurance business*, in accordance with the methods and assumptions determined by the *insurer*, by the person or persons who for the time being are appointed to perform the *actuarial function* under the rules in *SUP*; and
- (b) when such an investigation has been made, or when at any other time an investigation into the financial condition of the *insurer* in respect of its *long-term insurance business* has been made with a view to the distribution of profits, or the results of which are made public, must cause an abstract of the report or reports of the investigation to be made.
- (2) An investigation to which (1) relates must include –
- (a) a determination of the liabilities of the *insurer* attributable to its *long-term insurance business*;
- (b) a valuation of any excess over those liabilities of the assets representing the *long-term insurance fund* or *funds* and, where any rights of any long-term *policy holders* to participate in profits relate to particular parts of such a fund, a valuation of any excess of assets over liabilities in respect of those parts; and
- (c) for the investigation in (1)(a), for every *long-term insurer* which is a *realistic basis life firm*, a calculation of the *with-profits insurance capital component*.
- (3) For the purposes of any investigation to which this rule applies, the value of any assets and the amount of any liabilities must be determined in accordance with *GENPRU 1.3*, *INSPRU 2.1* and *INSPRU 1*.
- (4) The form and contents of any abstract under this rule must be in accordance with rule 9.31.

*Audit of accounts*

9.5 (1) The ‘accounts and balance sheets’ of every *insurer* must be audited in accordance with rule 9.35 by a person qualified in accordance with the rules in *SUP*.

PRA

- (2) In (1), the reference to *accounts and balance sheets* includes a reference to any notes or statement or report annexed to them, save for –
- (a) the *directors’ certificate* annexed pursuant to rule 9.34, and

(b) **Forms 46 to 47A, 50 to 55, 57 and 59.**

**Deposit of accounts etc. with the PRA**

9.6

PRA

- (1) Every 'account', 'balance sheet', abstract or statement required by rules 9.3, 9.3A, 9.4 and 9.36A and any report of the auditor of the *insurer* made in pursuance of rules 9.5 or 9.36E must be printed, and the 'required copies' must be deposited with the PRA within the periods set out in the table below.

deposit period following the <i>financial year</i> end or, for documents required by rule 9.3A, the end of the first six months of the <i>financial year</i>			
3	where the deposit is made electronically or under rule 9.36A	4	otherwise
5	3 months		2 months and 15 days

- (1A) If the due date for deposit of documents required by (1) falls on a day which is not a *business day*, the documents must be submitted no later than the first *business day* after the due date.
- (1B) [deleted]
- (2) In (1), the reference to the *required copies* is to –
- (a) five printed copies of the document; or
- (b) one printed copy of the document and one copy of it in an electronic form which may be readily used or translated by the PRA sent by email to InsuranceData@bankofengland.co.uk. The title of the email must be: <firm name> PRA returns <dd/mm/yyyy>.
- The printed copies must be sent to Regulatory Data Group, Statistics and Regulatory Division (HO5 A-B), Bank of England, Threadneedle Street, London EC2R 8AH (and must not be addressed to the *insurer's* normal supervisory contact).
- (3) In the case of any document deposited under (1), except an auditor's report, one of the printed copies, or, as the case may be, the printed copy, of the document must be signed in accordance with rule 9.33.
- (4) In the case of any auditor's report deposited under (1), one of the printed copies, or, as the case may be, the printed copy, of the document must be signed by the auditor.
- (5) If within 24 months of the date of deposit, the PRA notifies the *insurer* that a document deposited under (1) appears to it to be inaccurate or incomplete, the *insurer* must consider the matter and within one month of the date of notification it must correct any inaccuracies and make good

any omissions and deposit the relevant parts of the documents again.

- (6) There must be deposited with every revenue 'account' and 'balance sheet' of an *insurer* any statement or report on the affairs of the *insurer* made or submitted:
- (a) to the *insurer's* shareholders or *policyholders*; or
  - (b) to the *insurer's with-profits policyholders* under COBS 20.4.7R or SUP 4.3.16AR(4) of the FCA Handbook,

in respect of the *financial year* to which the 'account' and 'balance sheet' relate.

The *insurer* may either send a printed copy or an electronic copy of these reports. The requirements in (2) above as to postal address, email address and email title apply.

- (6A) Where a statement or report has not been made or submitted at the time the revenue 'account' and 'balance sheet' are deposited (see (6)), it must be deposited as soon as possible thereafter.
- (7) In this rule, any reference to an account or balance sheet includes a reference to any note, or statement or report annexed to it by virtue of rule 9.3 and any certificate annexed to it by virtue of rule 9.34.

*Right to receive copies of deposited documents*

9.7 An *insurer* must provide to any person (or the person who has already been provided with a copy under (a)) within 30 days of the date of request (or, in the case of (b), the date of deposit under rule 9.6(5)):

PRA

- (a) a copy of any of the documents last deposited by the *insurer* under rule 9.6(1) in respect of the *financial year in question*, and the two *financial years* preceding the financial year in question;
- (b) a copy of any document deposited under rule 9.6(5) which corrects or makes good any document provided under (a); and
- (c) a copy of any report deposited with any such document under rule 9.6(6),

where the deposit is made electronically, in the form (whether printed or electronic) requested or, if the deposit is not made electronically, in printed form, but (except in the case of (b)) the *insurer* may make a charge to cover its reasonable costs, including those of printing and postage.

*Documents deposited with the PRA*

9.8 [deleted]

*Documents deposited in Northern Ireland*

9.9 [deleted]

*Value of assets and amount of liabilities*

9.10 Unless otherwise provided in the *Accounts and Statements Rules*, in the documents which an *insurer* is required to prepare in accordance with the *Accounts and Statements Rules* –

PRA

- (a) the value or amount given for an asset or a liability of the *insurer* is the value or amount of that asset or liability as determined in accordance with *GENPRU 1.3* and *INSPRU 1* at the end of the *financial year in question*;
- (b) no value shall be given to exposures in excess of the limits set out in *INSPRU 2.1.22R (3)*;
- (c) notwithstanding (a) and (b) (but subject to the conditions set out in (d)), an *insurer* may, for the purposes of an *actuarial investigation*, elect to assign to any of its assets the value given to the asset in question in the books or other records of the *insurer*; and
- (d) the conditions referred to in (c) are that –
  - (i) the election does not enable the *insurer* to bring into account any asset that is not an *admissible asset*; and
  - (ii) the value assigned to the aggregate of the *insurer's* assets is not higher than the aggregate of the value of those assets as determined in accordance with (a) and (b), without taking 9 31 December 2009 advantage of (c).

*Content and form of accounts*

9.11 Every account, balance sheet, note, statement, report and certificate required to be prepared by an *insurer* pursuant to rule 9.3(1), (2) and (3) (annual accounts and balance sheets) or 9.3(5) must be prepared in the manner set out in the *Accounts and Statements Rules* and must fairly state the information provided on the basis required by the *Accounts and Statements Rules*. Where the *rules* in *IPRU(INS)* require a Form to be submitted, but all entries (including comparatives) would be blank, that Form may be omitted provided that a note coded FF00 (where F is the Form number) is included stating that this why the Form has been omitted. Where a Form is omitted because of the operation of a de minimis limit, a note coded FF00 must be included stating that this is why the Form has been omitted. This note is not needed where a Form is omitted because the *rules* do not require it for a reason other than the operation of a de minimis limit.

PRA

*Balance sheet*

- 9.12
- (1) The balance sheet required to be prepared by an *insurer* under rule 9.3(1) must comply with the requirements of Appendix 9.1 and must be in Forms 1 to 3, 10 to 15 and 17 to 19 of that Appendix completed (as may be appropriate) as specified in (2) to (9).
  - (2) Form 1 must be completed by every *insurer* that carries on *general insurance business*, other than a *Swiss general insurer* or an *EEA-deposit insurer*.

PRA

- (2A) **Form 2** must be completed by every *long-term insurer*, other than an *EEA-deposit insurer*.
- (3) **Form 3** must be completed by every *insurer* other than a *Swiss general insurer* or an *EEA-deposit insurer*.
- (3A) **Form 10** must be completed by an *external insurer* (other than a *non-EEA insurer* whose *insurance business* in the United Kingdom is restricted to *reinsurance* or an *insurer* whose head office is in any *EEA State* except the United Kingdom whose *insurance business* in the *EEA* is restricted to *reinsurance*), an *EEA-deposit insurer* or a *Swiss general insurer*.
- (4) **Forms 11 and 12** must be completed by every *insurer* which carries on *general insurance business*, other than a *Swiss general insurer* or an *EEA deposit insurer* and, except when the instructions for completion of *Forms 11 and 12* specify otherwise, by every *insurer* which carries on *long-term insurance business*.
- (5) **Form 13** must be completed (as appropriate) –
- (a) by every *insurer* which carries on *long-term insurance business* in respect of –
    - (i) its total *long-term insurance assets*; and
    - (ii) the *long-term insurance assets* appropriated by it in respect of each *long-term insurance fund* or, where such assets have been appropriated for a group of funds, those assets;
  - (b) by every *insurer* in respect of its total assets other than *long-term insurance assets*;
  - (c) by every *external insurer* (other than a *non-EEA insurer* whose *insurance business* in the United Kingdom is restricted to *reinsurance* or an *insurer* whose head office is in any *EEA State* except the United Kingdom whose *insurance business* in the *EEA* is restricted to *reinsurance*) in respect of *long-term insurance business* or *general insurance business* carried on by it through a branch in the United Kingdom in respect of those assets which are –
    - (i) deposited under *INSPRU 1.5.54R*,
    - (ii) maintained in the United Kingdom, and
    - (iii) maintained in the United Kingdom and the other *EEA States*; and
  - (d) by every *UK-deposit insurer* in respect of *long-term insurance business* or *general insurance business* carried on by it through branches in the *EEA States* in respect of those assets which are –

- (i) deposited under *INSPRU 1.5.54R*,
  - (ii) maintained in the United Kingdom and such other *EEA States* where *insurance business* is carried on, and
  - (iii) maintained in the United Kingdom and the other *EEA States*.
- (6) **Form 14** must be completed by every *long-term insurer* in respect of –
- (a) its total *long-term insurance liabilities* and margins;
  - (b) the *long-term insurance liabilities* and margins for each *long-term insurance fund* or where *long-term insurance assets* have been appropriated in respect of a group of funds, for the group; and
  - (c) subject to (6A), except where the information is provided by virtue of (a) or (b), each *with-profits fund*, with a supplementary note (code 1406) stating the amount, if any, of the increase or decrease, as the case may be, in the value of *non-linked assets*.
- (6A) Where the amount (or part of the amount) of any increase or decrease in the value of *non-linked assets* has yet to be allocated between *with-profits funds* or between one or more *with-profits funds* and other purposes, the note required by (6) must state the total amount which has yet to be aggregated:
- (a) identifying the *with-profits funds* to which the information relates; and
  - (b) describing the basis upon which increases or decreases in the value of *non-linked assets* are, or will be, allocated between the *with-profits funds* or between the *with-profits funds* and other purposes.
- (7) **Form 15** must be completed by every *insurer* except an *insurer* not trading for profit which carries on only *long-term insurance business*.
- (8) For each **Form 13** which an *insurer* is required to complete under (5)(a) or (b), the *insurer* must complete **Form 17** in respect of the same *insurance business*, subject to the de minimis requirement set out in instruction 1 to **Form 17**.
- (9) **Forms 18 and 19** must be completed by every *long-term insurer* which is a *realistic basis life firm*, in respect of each of its *with-profits funds*.

***Profit and loss account***

9.13 The ***profit and loss account*** required to be prepared by every *insurer* under rule 9.3 must comply with the requirements of **Appendix 9.1** and must be in **Form 16**.

PRA

*Revenue account*

9.14 The revenue account to be prepared by every *insurer* under rule 9.3 –

PRA

- (a) in the case of an *insurer* carrying on *general insurance business*, must comply with the requirements of Appendix 9.2 and must be in Form 20 in respect of the whole of the *general insurance business* carried on by it; and
- (b) in the case of an *insurer* carrying on *long-term insurance business*, must comply with the requirements of Appendix 9.3 and must be in Form 40 and –
  - (i) separate accounts must be prepared in Form 40 in respect of:
    - (A) each *long-term insurance fund* maintained by it, and
    - (B) except where the information is provided by virtue of (A), each *with-profits fund*, with a supplementary note [code 4010] stating the amount, if any, of investment income relating to *linked assets* included at line 12; and
  - (ii) where there is more than one Form 40 under (i) above, the *insurer* must also prepare a summary Form 40 for the total *long-term insurance business*.

*Allocation of general insurance business to risk categories*

9.14A Every *insurer* preparing the Forms required under rules 9.15, 9.17, 9.19, 9.20 and 9.20A must allocate its *general insurance business* to one or more *risk categories*.

PRA

*Allocation of contracts of insurance covering more than one risk category*

9.14B (1) This rule applies in any case where a *contract of insurance* falls within the description of more than one *risk category*.

PRA

- (2) If the *contract of insurance* falls, to any extent, within the description of *risk category* 274, 590 or 690, an *insurer* must allocate all the *general insurance business* represented by that *contract of insurance* to that *risk category*.
- (3) In any other case, an *insurer* must, unless (4) applies, allocate all the *general insurance business* represented by the *contract of insurance* to the single *risk category* that, in the reasonable opinion of the *insurer's governing body*, best describes the risk covered by the *contract of insurance*.
- (4) If:
  - (a) the premium payable under the *contract of insurance* is separable into the components relating to different *risk categories*; or

- (b) in the reasonable opinion of the *insurer's governing body*, allocation under (3) would be misleading;

then the *insurer* must apply a reasonable method to allocate the *general insurance business* represented by the *contract of insurance* amongst the appropriate *risk categories* and must apportion the amounts it reports in the Forms accordingly.

*General insurance business (content of revenue account and additional information as to balance sheet)*

- 9.15 (1) Every *insurer* which carries on *general insurance business* must, in accordance with the requirements of Appendix 9.2, prepare –

PRA

- (a) Form 20A in respect on the whole of the *general insurance business* carried on by it;
- (b) Form 20 in respect of each *required category*;
- (c) Forms 21, 22 and 23 for *insurance business* accounted for on an 'accident year basis' in respect of each *required category*; and
- (d) Forms 24 and 25 for *insurance business* accounted for on an 'underwriting year basis' in respect of each *required category*.

- (2) For the purposes of this rule and rules 9.17(1), 9.19(1) and 9.22(2), business must be taken to be *accounted for* on an underwriting year basis where it relates to risks –

- (a) which have been reported previously under the *Accounts and Statements Rules* on Forms 24 and 25;
- (b) in respect of which the *claims* outstanding for such *insurance business* are calculated using the method described in paragraph 52 of *the insurance accounts rules*; or
- (c) which have not previously been reported on any Form under the *Accounts and Statements Rules* and which the *insurer* accounts for on an 'underwriting year basis',

and business not *accounted for* on an 'underwriting year basis' is taken to be *accounted for* on an accident year basis.

- (3) Every *insurer* which, in respect of any *financial year*, includes in Form 22 or 25 amounts relating to adjustments for *discounting* must prepare Form 30 in accordance with the requirements of Appendix 9.2.

- 9.16 [deleted]

*Additional information on general insurance business (treaty reinsurance business)*

- 9.17 (1) Every *insurer* which carries on *general insurance business* must, in accordance with the requirements of Appendix 9.2 prepare –

PRA

- (a) **Forms 26 and 27** for *treaty reinsurance business* accounted for on an 'accident year basis' in respect of each *required category*; and
- (b) **Forms 28 and 29** for *treaty reinsurance business* accounted for on an 'underwriting year basis' in respect of each *required category*.

(2) [deleted]

(3) [deleted]

9.18 [deleted]

*Additional information on general insurance business (direct and facultative business)*

9.19 (1) Every *insurer* which carries on *general insurance business* must, in accordance with the requirements of **Appendix 9.2**, prepare –

PRA

- (a) **Form 31 or 32** for *direct and facultative insurance business* accounted for on an 'accident year basis' in respect of each *required category*; and
- (b) **Form 34** for *direct and facultative insurance business* accounted for on an 'underwriting year basis' in respect of each *required category*.

(2) [deleted]

(3) Where any of **Forms 31, 32 or 34** has been prepared in respect of the entire *insurance business* of an *insurer*, no separate forms need be prepared –

- (a) in the case of an *external insurer*, in respect of *insurance business* carried on by it through a branch in the United Kingdom; and
- (b) in the case of a *UK deposit insurer*, in respect of *insurance business* carried on by it through a branch in any *EEA State*.

*PRA general insurance business reporting categories falling below de minimis criteria*

9.20 (1) This rule applies to any *financial year* after the first *financial year* ended on or after 31 December 2005 in any case where –

PRA

- (a) for the previous *financial year*, an *insurer* was required to prepare a **Form 20 to 34** for a category of business (as set out in column 2 of paragraph 2B of **Appendix 9.2**) that was not *category number* 001 to 003, 409 or 709; and
- (b) for the *financial year in question*, the 'reporting criteria' for that Form and category of business are not met.

- (2) In this rule, any references to 'reporting criteria', in relation to a Form, are the reporting criteria specified for that Form in column 3 in the Table in paragraph 2B of Appendix 9.2.
- (3) Unless paragraph (4) applies, any such business that satisfies (1) must be reported in the same category of business (as set out in column 2 of paragraph 2B of Appendix 9.2) in the same Form for the *financial year in question*.
- (4) An *insurer* may cease to report such business on that Form in that category of business if –
- (a) the *gross written premiums* in the *financial year in question* and the 'gross undiscounted provisions' at the end of that *financial year* for that category of business are each less than £0.5m; or
  - (b) the following conditions are met –
    - (i) the *financial year in question* ended on or after 31 December 2008;
    - (ii) the business in 1(a) has been reported on that Form for that category of business in each of the three previous *financial years*; and
    - (iii) the *gross written premiums* in the *financial year in question* and the 'gross undiscounted provisions' at the end of that *financial year* for that category of business are each less than 50% of the amounts respectively specified in the 'reporting criteria' for that Form in respect of that category of business.
- (5) For the purpose of this rule, rule 9.20A and paragraph 2B of Appendix 9.2, *gross undiscounted provisions* are gross undiscounted reported claims outstanding plus gross undiscounted incurred but not reported claims plus gross provision for unearned premiums plus provision for unexpired risks.

*Further information on general insurance business to ensure adequate coverage in the return*

- 9.20A (1) Subject to (2) and (3), if the total of all 'gross undiscounted provisions' in all the Forms 26 to 29, 31, 32 and 34 required under rules 9.17, 9.19 and 9.20, or included despite rule 9.20(4), is less than 80% of the *insurer's* total 'gross undiscounted provisions', the *insurer* must prepare Forms 26 to 29, 31, 32 and 34, as appropriate, for further categories of business (as set out in column 2 of paragraph 2B of Appendix 9.2) in decreasing order of size (measured in 'gross undiscounted provisions'), until the 80% criterion is met.
- (2) An *insurer* need not prepare a Form 26, 27, 28, 29, 31, 32, or 34 for a category of business (as set out in column 2 of paragraph 2B of Appendix 9.2) if

PRA

- (a) the *insurer's gross written premiums* in the *financial year in question* for that category of business are less than £1m; and
  - (b) the *insurer's 'gross undiscounted provisions'* at the end of the *financial year in question* for that category of business are less than £1m.
- (3) An *insurer* need only prepare a *Form 26, 27, 28, 29, 31, 32 or 34* for a category of business (as set out in column 2 of paragraph 2B of Appendix 9.2) if it is required to prepare a *Form 20* for category number 110, 120, 160, 180, 220, 260, 270, 280, 330, 340, 350, 400, 500, 600, or 700 which includes that category of business.

*Currencies other than sterling*

- 9.21 (1) Every *insurer* which, in respect of a *financial year*, prepares a Form under rules 9.17 or 9.19 containing figures in a currency other than sterling must prepare *Form 36* in accordance with the requirements of Appendix 9.2.

PRA

*Additional information on general insurance business (claims equalisation provisions)*

- 9.22 (1) This rule applies to non-credit *insurance business* as defined in *INSPRU 1.4.11R (1)* and credit *insurance business* as defined in *INSPRU 1.4.38R*.

PRA

- (2) An *insurer* to which *INSPRU 1.4.11R* to *INSPRU 1.4.37G* apply (unless *INSPRU 1.4.18R* applies) and an *insurer* to which *INSPRU 1.4.43R* applies (unless *INSPRU 1.4.44R* applies) must, in accordance with the requirements of Appendix 9.2, prepare –

- (a) *Form 37*;
- (b) *Form 38* for *general insurance business* accounted for on an 'accident year basis'; and
- (c) *Form 39* for *general insurance business* accounted for on an 'underwriting year basis'.

*Additional information on long-term insurance business*

- 9.23 Every *insurer* which carries on *long-term insurance business* must, in respect of the *financial year in question* and in accordance with the requirements of Appendix 9.3, prepare –

PRA

- (a) *Forms 41 to 43* in respect of each revenue account prepared separately under rule 9.14(b)(i);
- (b) summary *Forms 41 to 43* if a summary *Form 40* is required under rule 9.14(b)(ii); and
- (c) *Forms 44 to 59B* and, except in the case of an *EEA-deposit insurer*, *Form 60*.

as appropriate, together with the information specified in relation to those Forms.

*Forms to be annexed*

9.24 The forms prepared pursuant to rules 9.15, 9.17 and 9.19 to 9.23 must be annexed to the documents referred to in rules 9.12, 9.13 and 9.14.

PRA

*Additional information on general insurance business: major treaty reinsurers*

9.25 (1) Subject to the provisions of rule 9.28, an *insurer* which carries on *general insurance business* must annex to the documents referred to in rules 9.12, 9.13 and 9.14, and relating to the *financial year in question*, a statement of –

PRA

- (a) the ‘full name’<sup>1</sup> of each of its ‘major treaty reinsurers’ and the address of the registered office or of the principal office in the country where it is incorporated (or, in the case of an unincorporated body, of the principal office) of each such *reinsurer*;
- (b) whether (and, if so, how) the *insurer* was at any time in the *financial year* ‘connected’<sup>2</sup> with any such *reinsurer*;
- (c) the amount of the *reinsurance* premiums payable in the *financial year* to each such *reinsurer* in respect of –
  - (i) *general insurance business ceded* under proportional *reinsurance* treaties; and
  - (ii) *general insurance business ceded* under non-proportional *reinsurance* treaties;
- (d) the amount of any *debt* of each such *reinsurer* to the *insurer* in respect of *general insurance business ceded* under *reinsurance* treaties, included at line 75 of Form 13;
- (e) the amount of any deposit received from each such *reinsurer* under *reinsurance* treaties as included at line 31 of Form 15; and
- (f) the amount of any anticipated recoveries from each such *reinsurer* under *reinsurance* treaties to the extent that such recoveries have been taken into account by the *insurer* in determining the *reinsurers’* share of *technical provisions* in respect of *claims* outstanding as shown at line 61 of Form 13; except that, in respect of *claims* incurred but not reported, such recoveries need only be included to the extent that they are in respect of any specific occurrences for which provisions have been allocated by the *insurer*,

or a statement that it has no ‘major treaty *reinsurer*’.

(2) For the purposes of this rule, a *major treaty reinsurer* of an *insurer* is another *company* –

- (a) to which (whether alone or with any *company* which is ‘connected’<sup>3</sup> with the other *company*) the *insurer* has *ceded*

**general insurance business under one or more reinsurance treaties –**

- (i) in the case of proportional *reinsurance*, for which the total amount of the *reinsurance* premiums payable is equal to not less than 2% of the *gross premiums receivable* by the *insurer* in respect of *general insurance business*, or
- (ii) in the case of non-proportional *reinsurance*, for which the total amount of the *reinsurance* premiums payable is equal to not less than 5% of the total premiums payable by the *insurer* in respect of all such non-proportional *reinsurance*,

in the *financial year in question* or in any of the five *preceding financial years* of the *insurer*; or

- (b) in relation to which (whether alone or with any *company* which is 'connected' with the other *company*) the aggregate of the amounts referred to in (1)(d) and (f) exceeds the sum of 20,000 Euro and 5% of the *insurer's* liabilities arising from its *general insurance business*, net of *reinsurance ceded*.

<sup>1</sup>. for the meaning of 'full name' in this rule, see rule 9.28(4)

<sup>2</sup>. for the meaning of 'connected', in this rule, see rule 9.28(1)

**Additional information on general insurance business: major facultative reinsurers**

9.26

PRA

- (1) Subject to rule 9.28, an *insurer* which carries on *general insurance business* must annex to the documents referred to in rules 9.12, 9.13 and 9.14, and relating to *the financial year in question*, for each 'major facultative reinsurance contract', a statement in respect of each 'major facultative reinsurer' of –
  - (a) its 'full name'<sup>4</sup> and the address of the registered office or of the principal office in the country where it is incorporated (or, in the case of an unincorporated body, of the principal office);
  - (b) whether (and, if so, how) the *insurer* was at any time in the *financial year* 'connected' with such *reinsurer*;
  - (c) the amount of the *reinsurance* premiums payable in the *financial year*;
  - (d) the amount of any *debt* to the *insurer* included at line 75 of Form 13;
  - (e) the amount of any deposit received as included at line 31 of Form 15; and
  - (f) the amount of any anticipated recoveries to the extent that such recoveries have been taken into account by the *insurer* in determining the *reinsurers' share of technical provisions* in respect of *claims* outstanding as shown at line 61 of Form 13;

except that, in respect of *claims* incurred but not reported, such recoveries need only be included to the extent that they are in respect of any specific occurrences for which provisions have been allocated by the *insurer*,

or a statement that it has no 'major facultative reinsurer'.

- (2) For the purposes of this rule, a ***major facultative reinsurance contract*** is a contract under which *general insurance business* has been *ceded* by the *insurer* on a facultative basis –
- (a) under which the total amount of premiums payable to any *reinsurer* (a ***major facultative reinsurer***) is equal to not less than 0.5% of *gross premiums receivable* by the *insurer* in respect of *general insurance business*; or
  - (b) in relation to which, in respect of any *reinsurer* (a ***major facultative reinsurer***) the aggregate of amounts in (1)(d) and (f) exceeds the sum of 4,000 Euro and 1% of the *insurer's* liabilities arising from its *general insurance business*, net of *reinsurance ceded*.

<sup>3</sup>For the meaning of 'connected', in this rule, see rule 9.28(1)

<sup>4</sup>For the meaning of 'full name' in this rule, see rule 9.28(4)

***Information on major general insurance business: reinsurance cedants***

- 9.27 (1) Subject to rule 9.28, an *insurer* which carries on *general insurance business* must annex to the documents referred to in rules 9.12, 9.13 and 9.14, and relating to the *financial year in question*, a statement of –

PRA

- (a) the 'full name' of each of its 'major cedants' and the address of the registered office or of the principal office in the country where it is incorporated (or, in the case of an unincorporated body, of the principal office) of each such cedant;
- (b) whether (and, if so, how) the *insurer* was at any time in the *financial year* 'connected' with any such cedant;
- (c) the amount of the total of the *gross premiums receivable* in the *financial year* from each such cedant in respect of *general insurance business* accepted under *reinsurance treaties*;
- (d) the amount of any deposit made with any such cedant as included at line 57 of *Form 13*; and
- (e) the amount of any *debt* of each such cedant in respect of *general insurance business* accepted under *reinsurance treaties*, included at line 74 of *Form 13*,

or a statement that it has no 'major cedant'.

- (2) For the purposes of this rule, a ***major cedant*** of an *insurer* is another *company* from which (whether alone or with any *company* which is

**'connected' with the other company) the insurer has accepted general insurance business under one or more reinsurance treaties for which the gross premiums receivable exceed the greater of –**

- (a) **5% of the gross premiums receivable by the insurer in respect of general insurance business accepted under reinsurance treaties; and**
- (b) **2% of the gross premiums receivable by the insurer in respect of general insurance business,**

**in the financial year in question or in any of the three preceding financial years of the insurer.**

*Provisions supplemental to rules 9.25 to 9.27*

9.28

PRA

- (1) For the purposes of rules 9.25(1)(b) and (2), 9.26(1)(b) and 9.27(1)(b) and (2), a company and another person are connected with each other if –

- (a) the other person is –
  - (i) a subsidiary undertaking of the company,
  - (ii) a parent undertaking of the company, or
  - (iii) a subsidiary undertaking of the parent undertaking of the company; or
- (b) one of them is 'controlled' by the other or both are 'controlled' by the same person,

but a company is not to be taken to be 'connected' with another person if the insurer furnishing the statement does not know and could not upon reasonable enquiry be expected to discover that it is so 'connected' with the other person.

- (2) Except as provided in (3), for the purposes of (1)(b), a person is taken to control a company if he is a person –
- (a) in accordance with whose directions or instructions the directors of the company or of a company of which it is a subsidiary are accustomed to act; or
  - (b) who, either alone or with an associate is entitled to exercise, or 'control' the exercise of, 15% or more of the voting power at any general meeting of the company or of a company of which it is a subsidiary.
- (3) In relation to an insurer –
- (a) making a statement pursuant to rules 9.25 or 9.26, a reinsurer is not to be taken by virtue of (2) to be 'connected' with another

*reinsurer*, or

- (b) making a statement pursuant to rule 9.27, a cedant is not to be taken by virtue of (2) to be 'connected' with another cedant,

for the purposes of paragraph (2) of rules 9.25, 9.26 or 9.27, as the case may be, unless it is also 'connected' by virtue of (1) with the *insurer* making the statement.

- (4) In rules 9.25, 9.26 and 9.27 and in this rule, ***full name*** means -
- (a) in the case of a company, its corporate name; and
- (b) in the case of an individual or any unincorporated body, the name under which the individual or body lawfully carries on business.
- (5) The following provisions of ***Appendix 9.1*** apply for the purposes of rules 9.25, 9.26, and 9.27 -
- (a) paragraphs 4 and 5 (which relate to currencies other than sterling);
- (b) paragraphs 8(1) and 8(2) (which, among other things, relate to amounts due to the *insurer*); and
- (c) paragraph 9 (which provides for amounts to be shown to the nearer £1,000).
- (6) Rules 9.25(2), 9.26(1)(a) to (c) and 9.27 apply in relation to the members of the *Society* taken together as they apply in relation to an *insurer* and in relation to the members of the *Society* (1) to (4) of this rule do not apply.

***Additional information on derivative contracts***

9.29

PRA

- (1) Every *insurer* must, in respect of the *financial year in question*, annex to the documents referred to in rules 9.12, 9.13 and 9.14 a statement comprising a brief description of -
- (a) any investment guidelines operated by the *insurer* for the use of *derivative contracts*;
- (b) any provision made by such guidelines for the use of contracts under which the *insurer* had a right or obligation to acquire or dispose of assets which was not, at the time when the contract was entered into, reasonably likely to be exercised and, if so, the circumstances in which, pursuant to that provision, such contracts would be used;
- (c) the extent to which the *insurer* was during the *financial year* a party to any contracts of the kind described in (b);
- (d) [deleted];

- (e) [deleted];
- (f) [deleted];
- (g) [deleted];
- (h) the circumstances surrounding the use of any *derivative* or *quasi-derivative* held at any time during the *financial year* which required a 'significant' provision to be made for it under *INSPRU 3.2.17R*, or (where appropriate) did not fall within the definition of a *permitted derivatives contract*; and
- (i) the total value of any fixed consideration received by the *insurer* (whether in cash or otherwise) during the *financial year* in return for granting rights under *derivatives* and *quasi-derivatives* and a summary of contracts under which such rights have been granted.

(1A) For the purposes of determining in accordance with (1)(h) whether a required provision is 'significant', the *insurer* must have regard to its obligations under the contract and the volatility of the assets identified by the *insurer* as being suitable to cover such obligations; and the required provision in respect of any one *derivative contract* must be treated as significant if –

- (a) the aggregate provision required in respect of all contracts having a similar effect is significant; or
- (b) the aggregate provision required in respect of all contracts with which it is connected is significant.

(2) [deleted]

(2A) [deleted]

(2B) [deleted]

(2C) [deleted]

(2D) [deleted]

*Additional information on controllers*

9.30 Every *insurer* with its head office in the United Kingdom must, in respect of the *financial year in question*, annex to the documents referred to in rules 9.12, 9.13 and 9.14 –

PRA

- (a) a statement naming each person who, to the knowledge of the *insurer*, has been, at any time during the *financial year*, a *controller* of that *insurer*; and
- (b) in the case of each person so named, a statement of –

- (i) the percentage of *shares* which, to the knowledge of the *insurer*, he held at the end of the *financial year in question* in the *insurer*, or in another company of which the *insurer* is a *subsidiary undertaking*; and
- (ii) the percentage of the voting power which, to the knowledge of the *insurer*, he was entitled at the end of the *financial year in question* to exercise, or control the exercise of, at any general meeting of the *insurer*, or another company of which it is a *subsidiary undertaking*,

in each case, either alone or with any *associate* or *associates*.

*Valuation reports on long-term insurance business*

**9.31** Every *insurer* which carries on *long-term insurance business* must prepare and annex to the documents referred to in rules 9.12, 9.13 and 9.14 –

**PRA**

- (a) for the purposes of rule 9.4 other than in relation to the calculation required by rule 9.4(2)(c):
  - (i) where an investigation into the financial condition of the *insurer* has been made in accordance with rule 9.4(1)(a), a valuation report which, complies with the requirements of Appendix 9.4 and contains the information specified in that Appendix; and
  - (ii) where an investigation into the financial condition of the *insurer* has been made at some other time with a view to the distribution of profits or the results of which are made public, Form 58 and a valuation report which, instead of complying with the requirements of Appendix 9.4, includes a full description of each of the changes in the methods and assumptions used in the investigation for the purposes of rule 9.4(2)(a) and (b) since the previous investigation at the end of the *preceding financial year* or if there has been no such change, a statement to that effect; and
- (b) for the purposes of rule 9.4 in relation to the calculation required by rule 9.4(2)(c) (if applicable), a valuation report for the realistic valuation which complies with the requirements of Appendix 9.4A and contains the information specified in that Appendix.

*Additional information on general insurance business ceded*

**9.32** An *insurer* which carries on *general insurance business* must annex to the documents referred to in rules 9.12, 9.13 and 9.14, and relating to the *financial year in question*, a statement of the information required by Appendix 9.5.

**PRA**

*Additional information on financial reinsurance and financing arrangements: general insurers*

**9.32A** (1) An *insurer* which carries on *general insurance business* must annex to the documents referred to in rules 9.12, 9.13 and 9.14, and relating to the *financial year in question*, a statement of the information required by this

rule.

- (2) This rule applies to any *contract of insurance* under which *general insurance business* has been *ceded* by the *insurer*, where –
- (a) the value placed on future payments in respect of the contract in the *return* for the *financial year in question* is not commensurate with the economic value provided by that contract, after taking account of the level of risk transferred; or
  - (b) there are terms or foreseeable contingencies (other than the insured event) that have the potential to affect materially the value placed on the contract in the *insurer's* balance sheet at, or any time after, the end of the *financial year in question*.
- (3) In determining whether a *contract of insurance* meets one or both of the conditions in (2), the *insurer* must –
- (a) treat as part of a contract any agreements, correspondence (including or understandings that amend or modify, or purport to amend or modify, the contract or its operation; and
  - (b) consider whether the contract meets the condition in (2)(a) when considered together with one or more other *contracts of insurance* entered into between:
    - (i) the *insurer* and the reinsurer under the first contract; or
    - (ii) the *insurer* and any other *person*, where it could reasonably be predicted, at the time the most recent contract was entered into, that the contracts when considered together would meet the condition in (2)(a).
- (4) Subject to (9), for each *contract of insurance* to which this rule applies the statement must contain the following information –
- (a) the *financial year* of the *return* in which the contract was first reported in the *return*;
  - (b) the financial effect of the contract on the *insurer's capital resources* as shown in line 13 of *Form 1* of the *return* for the *financial year in question*;
  - (c) the amount of any undischarged obligation of the *insurer* under the contract and a brief description of the conditions for the discharge of such obligation; and
  - (d) how any undischarged obligations, including any contingent obligations, have been taken into account in determining the *insurer's capital resources*.
- (5) The statement must include a general description of how the *insurer* makes the financial assessment that enables it to determine whether a contract satisfies the condition in (2)(a), even if there are no contracts in

respect of which information is required by (4).

- (6) This rule applies to any ***financing arrangement***, which for the purpose of this rule means any contract, other than a ***contract of insurance***, that has been entered into by the ***insurer***, in respect of ***contracts of insurance*** written by the ***insurer***, which has the effect of increasing the ***capital resources*** of the ***insurer*** in line 13 of ***Form 1***, and which includes terms for –
- (a) the transfer of assets to the ***insurer***, the creation of a ***debt*** to the ***insurer*** or the transfer from the ***insurer*** to another party of liabilities to ***policyholders*** (or any combination of these); and
  - (b) either an obligation for the ***insurer*** to return (with or without interest) some or all of such assets, a provision for the diminution of such ***debt*** or a provision for the recapture of such liabilities, in each case, in specified circumstances.
- (7) In determining whether a contract falls within the definition of 'financing arrangement' in (6), the ***insurer*** must –
- (a) treat as part of a contract any agreements, correspondence (including side-letters) or understandings that amend or modify, or purport to amend or modify, the contract or its operation; and
  - (b) consider whether the contract meets the conditions in (6) when considered together with one or more other contracts entered into between:
    - (i) the ***insurer*** and the ***counterparty*** under the first contract; or
    - (ii) the ***insurer*** and any other ***person***, where it could reasonably be predicted, at the time the most recent contract was entered into, that the contracts when considered together would meet the conditions in (6).
- (8) Subject to (9), for each 'financing arrangement' entered into by the ***insurer*** the statement must contain the following information –
- (a) the ***financial year*** of the ***return*** in which the 'financing arrangement' was first reported in the ***return***;
  - (b) the financial effect of the 'financing arrangement' on the ***insurer's capital resources*** as shown in line 13 of ***Form 1*** of the ***return*** for the ***financial year in question***;
  - (c) the amount of any undischarged obligation of the ***insurer*** under the 'financing arrangement' and a brief description of the conditions for the discharge of such obligation; and
  - (d) how any undischarged obligations, including any contingent obligations, have been taken into account in determining the

*insurer's capital resources.*

- (9) No information need be supplied pursuant to (4) or (8) in respect of a *contract of insurance* or 'financing arrangement' if, when it is considered in aggregate with all such contracts with the same *reinsurer* or *counterparty* or any other *person* with whom the *insurer* has entered into a contract in the circumstances described in (3)(b)(ii) or, as the case may be, (7)(b)(ii) –
- (a) A is less than 1% of B in the *return* for the *financial year in question*; and
- (b) the *insurer* expects A to remain less than 1% of B for the foreseeable future;
- where:
- (i) A is the financial effect on the *insurer's capital resources* as a result of the existence of the contract(s); and
- (ii) B is the *insurer's* total gross amount of *technical provisions*.
- (10) Where the statement required by (1) includes information about a *contract of insurance* in respect of which information has been included in the statement required by rule 9.32 relating to the *financial year in question*, the *insurer* must include in the statement under (1) a cross-reference to that other information.

*Additional information on financial reinsurance and financing arrangements: guidance*

9.32B

PRA

- (1) In line with normal practice, an *insurer* may take account of an appropriate risk margin to reflect the nature and level of risk transferred, including any uncertainty in the amount and timing of future payments, when assessing the economic value of the transaction at the end of the *financial year in question* in order to see whether the condition in rule 9.32A(2)(a) is met. In addition, an *insurer* would be expected to take account of any credit or legal risk associated with the transaction when assessing its economic value.
- (2) For most *proportional reinsurance treaties* and most standard *non-proportional reinsurance treaties*, such as contracts providing excess-of-loss cover, which include a significant transfer of risk to the *reinsurer* and do not contain any of the features described in (5) below, it is likely that the *insurer* will be able to determine that the contracts do not meet the condition in rule 9.32A(2)(a) without making a detailed calculation. The approach taken to the assessment made for the purpose of rule 9.32A(2)(a) should, however, still be described in the statement provided as required by rule 9.32A(5).
- (3) When considering whether these are foreseeable contingencies, other than the insured event, that may affect the contract's given value, the *insurer* should consider the normal commercial uncertainties about the

size of the *claim* that may ultimately be payable (for example, the outcome of any possible court action) to be part of the insured event. These normal commercial uncertainties would not then trigger any disclosure requirement under rule 9.32A.

- (4) It is likely that one or both of the conditions in rule 9.32A(2) will be satisfied if the *contract of insurance* contains features that have the effect of materially limiting the size of the difference between –
- (a) the extent of the indemnity cover provided by the contract and by any related or potentially related contracts, and
  - (b) the *premiums* payable under those contracts,
- relative to the size of the *premiums* payable under those contracts.
- (5) Some characteristic features which the *insurer* should consider carefully in relation to a *contract of insurance* before deciding whether one or both of the conditions in rule 9.32A(2) are satisfied with respect to a particular contract include (but are not limited to) the following –
- (a) sliding scale fees, retrospectively rated *premiums* and profit-sharing formulae which adjust cash flows between the *insurer* and the *reinsurer* based on loss experience (for example, increasing payments from the *insurer* as losses increase and decreasing payments as losses decrease, subject to maximum and minimum limits);
  - (b) provision for an *experience account* or arrangements having similar effect, including arrangements which recognise an assumed rate of investment return;
  - (c) provision for, or a contingent obligation on, the *insurer* to make payments to the *reinsurer* or to any other *person*, where the payments –
    - (i) depend upon the loss experience of *general insurance business* that has been or may be carried on by the *insurer*; and
    - (ii) are not simply reinstatement *premiums*;
  - (d) provision for termination or commutation of the contract at the sole discretion of the *reinsurer*, when there is a positive balance of money due from the *reinsurer*;
  - (e) a provision for, or a contingent obligation on, the *insurer* to make payments to the *reinsurer* or to any other *person*, where the payments are in respect of business carried on in a period outside of the term of the contract;
  - (f) the contract includes a term requiring the *insurer* to enter into a further contract if the loss experience of the business subject to

the contract attains a specific level;

- (g) the term of the contract exceeds, or may exceed, 12 months, and the *premium* or amount of indemnity payable under the contract in subsequent years may be affected by the loss experience of earlier years;
- (h) dual triggers which require the occurrence of both –
  - (i) an insurable event; and
  - (ii) a change in a separate variable specified in the contract;

in order to trigger payment of a benefit/*claim*;

- (i) amounts payable under the contract could affect, or depend on, other contracts or agreements entered into by the *insurer*, or a *person connected* with the *insurer*, except where –
    - (i) that effect or dependence is clear from the description of that other contract or agreement given by the *insurer*; or
    - (ii) that effect or dependence arises solely as part of the normal market mechanism for the pricing of a risk; and
  - (j) terms that defer payment of *claims* –
    - (i) for a period of more than 12 months after the amount payable under the contract has been agreed; or
    - (ii) until some specified date that is more than 12 months after the end of the term of the contract.
- (6) For purpose of rule 9.32A(4), (8) and (9), the 'financial effect' of the transaction (that is, the contract or 'financing agreement') on the *insurer's capital resources* should normally be regarded as the sum of (a) the value placed on the transaction in the *return* for the *financial year in question* plus (b) the net sum of all receipts less payments made in respect of the transaction since the transaction was first reported in the *return*.

*Signature of documents*

- 9.33
- PRA**
- (1) In respect of any document relating to the *insurance business* of an *insurer*, wherever it may be carried on, the signatories for the purposes of rule 9.6 are –
    - (a) where there are more than two *directors* of the *insurer*, at least two of those *directors* and, where there are not more than two *directors*, all the *directors*, and
    - (b) a chief executive, if any, of the *insurer* or (if there is no chief

executive) the secretary, if any.

- (2) In respect of any document relating to *insurance business* carried on through a branch in the United Kingdom by a *Swiss general insurer*, an *EEA-deposit insurer* or an *external insurer* or through branches in any *EEA State* (taken together) by a *UK-deposit insurer*, the signatories for the purposes of rule 9.6(3) are –
- (a) the authorised UK representative referred to in article 3(1)(a) of The Financial Services and Markets Act 2000 (Variation of Threshold Conditions) Order 2001 (2001/2507), and
  - (b) the chief executive appointed under rule 8.3 or, in the case of a *Swiss general insurer*, a person who alone or jointly with one of more others, is responsible for the conduct of its *insurance business* through the branch.

#### *Certificates by Directors*

- 9.34 (1) Except for reporting under rule 9.3A, there must be annexed to the documents referred to in rules 9.12, 9.13 and 9.14 a certificate in accordance with the requirements of Part I of Appendix 9.6 which must be signed by the persons required by rule 9.33 to sign the documents to which the certificate relates.
- PRA
- (2) In respect of reporting under rule 9.3A, there must be annexed to the documents referred to in that rule a certificate in accordance with the requirements of Part IA of Appendix 9.6 which must be signed by a *director of the insurer*.

#### *Audit and auditor's report*

- 9.35 (1) The documents referred to in rules 9.12, 9.13 and 9.14, together with Forms 40 to 45, 48, 49, 56, 58 (including a Form 58 completed under rule 9.31(a)(ii)) and 60, and every statement, analysis or report annexed pursuant to rules 9.24 to 9.27, 9.29 and 9.31 must be audited by a person, in accordance with the rules in *SUP*, who must make and annex to those documents a report in accordance with the requirements of Part II of Appendix 9.6.
- PRA
- (1A) For the purposes of rule 9.5 and (1) and Appendix 9.6, to the extent that any document, form, statement, analysis or report to be audited under (1) contains amounts or information abstracted from the *actuarial investigation* performed pursuant to rule 9.4, the *insurer* must ensure that the auditor obtains and pays due regard to advice from a suitably qualified *actuary* who is independent of the *insurer*.
- (2) For the purposes of the *Accounts and Statements Rules* –
- (a) section 237(1), (2) and (3) and section 389A(1) of the Companies Act 1985 and article 245(1), (2) and (3) and article 397A(1) of the 1986 Order where applicable, otherwise sections 498(1), (2) and (3) and 499(1) of the Companies Act 2006 apply as if –

- (i) the references to the *profit and loss account* in ‘individual accounts’ in section 226(1) of the Companies Act 1985 and article 234(1) of that Order, and section 394 of the Companies Act 2006 respectively, included references to the revenue account; and
  - (ii) the auditors of the *insurer* were not under a duty for the purposes of preparing their report to carry out any investigation into information given in Forms 31, 32 and 34 relating wholly or partly to the number of *claims* notified or the amount of payments made prior to the *financial year* of the *insurer* in which the Insurance Companies (Accounts and Statements) Regulations 1980 first applied; and
- (b) section 389A(3) and (4) of the Companies Act 1985 and article 397A(3) and (4) of the 1986 Order, where they are applicable, otherwise section 500(1) of the Companies Act 2006 apply as if the references in them to a ‘parent company’ were references to the *insurer*.

*Information on the actuary who has been appointed to perform the with-profits actuary function*

9.36

PRA

- (1) Subject to the provisions of this rule, there must be annexed to the documents referred to in rules 9.12, 9.13 and 9.14, with respect to every person who, at any time during the *financial year in question*, was the *actuary* who has been appointed to perform the *with-profits actuary function* for the *insurer*, a statement of the following information –
- (a) particulars of any *shares* in, or debentures of, ‘the *insurer*’ in which the ‘actuary’ was ‘interested’ at any time during that year;
  - (b) particulars of any pecuniary interest of ‘the actuary’ in any transaction between ‘the actuary’ and ‘the *insurer*’ and subsisting at any time during that year or, in the case of transactions of a minor character, a general description of such interests;
  - (c) the aggregate amount of –
    - (i) any remuneration and the value of any other benefits (other than a pension or other future or contingent benefit) under any contract of service of ‘the actuary’ with, or contract for services by ‘the actuary’ to, ‘the *insurer*’, and
    - (ii) any emoluments, pensions or compensation as *director* of the *insurer* which are required by regulation 8 of and schedule 5 to the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) to be included in a note to the accounts of ‘the *insurer*’, receivable by ‘the actuary’ in respect of

any period in that year; and

- (d) a general description of any other pecuniary benefit (including any pension and other future or contingent benefit) received by 'the actuary' from 'the insurer' in that year or receivable by him from 'the insurer',

together with the statement specified in (2).

- (2) The statement referred to in (1) is a statement that 'the insurer' has made a request to 'the actuary' to furnish to it the particulars specified in that paragraph and identifying any particulars furnished pursuant to that request.

- (3) For the purposes of (1)(a) to (d) –

- (a) references to the actuary include reference to –

- (i) the spouse, civil partner and any minor child (including stepchild) of 'the actuary',
- (ii) any person who is a business partner of 'the actuary',
- (iii) any person (other than 'the insurer') of which 'the actuary' is an employee, and
- (iv) any person (other than 'the insurer') of which 'the actuary' is a *director* or which is 'controlled' by him;

- (b) a person is deemed to be *interested* in *shares* or debentures if he is interested in them according to the rules set out in Schedule 1 to the Companies Act 2006 with the addition, in paragraph 6(4) of that Schedule, of a reference to a scheme under section 25 of the Charities Act (Northern Ireland) 1964; and

- (c) a person is deemed to have an *interest* or benefit if he has a beneficial interest.

- (4) For the purposes of (1)(a) to (d) and of (3)(a), references to *the insurer* include references to any *body corporate* which is 'the insurer's' *subsidiary undertaking* or *parent undertaking* and to any other *subsidiary undertaking* of its *parent undertaking*.

- (5) For the purposes of (3), a person is taken to *control* a *body corporate* if he is a person –

- (a) in accordance with whose directions or instructions the *directors* of that *body corporate* or of a *body corporate* of which it is a *subsidiary* are accustomed to act; or
- (b) who, either alone or with any other person falling within (3)(a), is entitled to exercise, or control the exercise of, 15% or more of the voting power at any general meeting of the *body corporate* or of

a body corporate of which it is a subsidiary.

## Part II

### ACCOUNTS AND STATEMENTS FOR A MARINE MUTUAL

#### Returns

9.36A Subject to rules 9.36B, 9.36C, 9.36D and 9.36E and Appendix 9.8, a *marine mutual* may complete an abbreviated *return* which comprises –

PRA

- (1) Forms 1, 3, 11 and 12; and
- (2) Forms M1 to M5 in Appendix 9.8,

and, if so, rules 9.3 to 9.4, 9.12 to 9.28, 9.31 and 9.32 and 9.34 to 9.36 do not apply.

#### Information to be annexed to the forms

9.36B A *marine mutual* must annex to the *return* provided under rule 9.36A –

PRA

- (1) a description of the significant *reinsurance* arrangements which will be in operation in the *financial year* following the *financial year in question*;
- (2) in respect of *insurance business* ceded by way of non-facultative *reinsurance* in respect of the *financial year in question* or any *previous financial year* ended on or after 20 February 1998, a statement of –
  - (a) in the case of contracts which are subject to no or a limited number of reinstatements, any contract not previously reported to the *PRA* under which it is anticipated that any such limit will be exhausted by such *claims* (including *claims* incurred, but not reported, in respect of any specific occurrence for which provisions have been allocated);
  - (b) the percentage of cover, if in excess of 10%, and if such information was not included in the *return* of the *marine mutual* for the *previous financial year*, which has been ceded to *reinsurers* which have ceased to pay *claims* to their reinsureds in full, whether because of insolvency or for any other reason; and
  - (c) if the percentage specified in (b) has increased by more than 10% since the *previous financial year* in which it was included in the *marine mutual's return*, that percentage unless, in the opinion of the *directors*, the likelihood of any *claim* being incurred under that *policy* is minimal;
- (3) a statement concerning:
  - (a) the default rates of members (or adjusted default rates, as the case may be) on the supplementary calls collectable during the

*financial year in question* and the two *previous financial years*, respectively; and

- (b) the total amount of each such call, the *financial year* to which it relates, the amount paid and the amount remaining outstanding; and
- (4) a copy of the rules of association of the marine mutual in force on the date of deposit of the return, unless there has been no change in a copy of the rules deposited with the return for a previous financial year.

*Information to PRA*

**9.36C** **A marine mutual** which provides a *return* under rule 9.36A must, with effect from the date of its deposit with the *PRA* until the date of deposit of the *return* for the following *financial year*, provide the *PRA* with written notice of:

**PRA**

- (1) any change which is proposed in the rules of association of the *marine mutual*, not less than 14 days before the change is put to a meeting;
- (2) any change which has been made in the rules of association, within 7 days of the change;
- (3) any significant change in the *reinsurance* arrangements, a description of which has been annexed to the *return* in accordance with rule 9.36B(1), within 7 days of the change;
- (4) a fall in tonnage entered by its members of 10% net or more since the end of the *financial year in question*, within 7 days of the *marine mutual* becoming aware of this; and
- (5) whether tonnage entered by its members who have withdrawn from membership or who have defaulted on their obligations has increased so as to exceed 10% or more of total tonnage entered, whether before, on or after the date of deposit of the *return*, within 7 days of the date of deposit or of the *marine mutual* becoming aware of this, whichever is earlier.

*Directors' certificate*

**9.36D** **A marine mutual** must annex to the *return* provided under rule 9.36A a *directors' certificate* in accordance with Part II of [Appendix 9.8](#).

**PRA**

*Auditors' report*

**9.36E** **A marine mutual** must annex to the *return* provided under rule 9.36A an *auditors' report* in accordance with Part III of [Appendix 9.8](#).

**PRA**

## Part III

### STATISTICAL RULES

#### *Insurance statistics: EEA States*

- 9.37 (1) Every *UK insurer* which in any calendar year –
- PRA** (a) carries on *general insurance business* in an *EEA State* other than the United Kingdom through a branch in that State; or
- (b) provides general insurance in such a State through an establishment in the United Kingdom or another *EEA State*,
- must prepare in respect of the *direct general insurance business* so carried on by it a statement in *Form 91* (analysis of financial particulars – branches), or the direct general insurance so provided by it a statement in *Form 92* (analysis of financial particulars – provision of insurance), in accordance with the requirements of *Appendix 9.7*.
- (2) Every *UK insurer* which in any calendar year –
- (a) carries on *long-term insurance business* in an *EEA State* other than the United Kingdom through a branch in that State; or
- (b) provides long-term insurance in such a State through an establishment in the United Kingdom or another *EEA State*,
- must prepare in respect of the *direct long-term insurance business* so carried on by it a statement in *Form 93* (analysis of financial particulars – branches), or the direct long-term insurance so provided by it a statement in *Form 94* (analysis of financial particulars – provision of insurance), in accordance with the requirements of *Appendix 9.7*.
- (3) The forms mentioned in (1) and (2) must be prepared separately in respect of each *EEA State* in which the *insurer* carries on the *insurance business* or provides the insurance.
- (4) The statements required by this rule must be printed, and three copies must be deposited with the *PRA* within four months after the end of the calendar year to which they relate; but if in any case it appears to the *PRA* that the circumstances are such that a longer period than four months should be allowed, the *PRA* may extend that period by such period not exceeding three months as it thinks fit. If the due date for deposit of documents required by this rule falls on a day which is not a *business day*, the documents must be submitted no later than the first *business day* after the due date.
- (5) One of the copies of the statement deposited under (4) must be signed by a *director*, a chief executive or the secretary of the *insurer*.

- (6) Subject to (7), where a *UK insurer* which has notified the *PRA* –
- (a) in accordance with the rules in *SUP*, of its intention to establish a branch in a *EEA State* other than the United Kingdom; or
  - (b) in accordance with those rules, of its intention to provide insurance in such a State,
- does not in any calendar year carry on *insurance business* or, as the case may be, provide insurance in that State, it must send to the *PRA* a notification of that fact within four months after the end of the calendar year to which the notification relates, signed by a *director*, a chief executive or the secretary of the *insurer*.
- (7) (6) does not apply if the *insurer* has, before the beginning of the calendar year, informed the *PRA*, in accordance with the rules in *SUP*, that it has ceased to carry on *insurance business* or, as the case may be, to provide insurance in the State in question.
- (8) If within 24 months of the date of deposit under (4), the *PRA* notifies the *insurer* that a document deposited appears to it to be inaccurate or incomplete, the *insurer* must consider the matter and within one month of the date of notification it must correct any inaccuracies and make good any omissions and deposit the relevant parts of the documents again.

*Application of rule 9.37 to the Society of Lloyd's*

- 9.38 (1) Subject to (2) and (3), rule 9.37 applies in relation to the *Society* as it applies in relation to a *UK insurer*.
- PRA (2) The information required in the case of the *Society* to be included in the statements referred to in rule 9.37(4), or the notification referred to in rule 9.37(6), is that relating to the members of the *Society* taken together.
- (3) Any such statements, forms or notification must be signed by the Chairman or a Deputy Chairman, for and on behalf of the Council of Lloyd's.

## PART IV

### MATERIAL CONNECTED-PARTY TRANSACTIONS

- 9.39 (1) If, during the *financial year in question*, an *insurer* has agreed to, or carried out, a *material connected-party transaction*, it must provide a brief description of that transaction by way of a supplementary note to *Form 20* (note 2007) or *Form 40* (note 4009).
- PRA (2) The description to be provided in accordance with (1) must state –
- (a) the names of the transacting parties;

- (b) a description of the relationship between the parties;
  - (c) a description of the transaction;
  - (d) the amounts involved;
  - (e) any other elements of the transaction necessary for an understanding of its effect upon the financial position or performance of the *insurer*; and
  - (f) amounts written off in the period in respect of *debts* due to or from *connected* parties.
- (3) Transactions with the same *connected* party may be disclosed on an aggregated basis unless separate disclosure is needed for a proper understanding of the effect of the transactions upon the financial position or performance of the *insurer*.

## PART V

### GROUP CAPITAL ADEQUACY

- 9.40 (1) Subject to (2), an *insurer* to which *INSPRU* 6.1 applies must, in respect of its *ultimate insurance parent undertaking* and its *ultimate EEA insurance parent undertaking* (if different), report:
- PRA**
- (a) the name, location of the head office and principal activity of that *undertaking*;
  - (b) the *group capital resources* of that *undertaking* (calculated in accordance with *INSPRU* 6.1.36R);
  - (c) the group capital resources requirement of that undertaking (calculated in accordance with *INSPRU* 6.1.33R); and
  - (d) the difference between (b) and (c).
- (1A) Subject to (2), an *insurer* to which *INSPRU* 6.1 applies must, in respect of its *ultimate EEA insurance parent undertaking*, report:
- (a) where its *ultimate EEA insurance parent undertaking* has published annual consolidated accounts prepared in accordance with accounting standards, policies and legislation applicable to it, a reconciliation between:
    - (i) the *group capital resources* of the *ultimate EEA insurance parent undertaking*; and
    - (ii) the shareholders' funds, subordinated liabilities and other relevant amounts included in the published annual consolidated accounts, of the ultimate EEA

- insurance parent undertaking; and
- (b) where its *ultimate EEA insurance parent undertaking* includes a capital statement in the form prescribed by the Accounting Standards Board's Financial Reporting Standard 27, an explanation of any differences between:
- (i) the amounts included in that capital statement; and
- (ii) the amounts in (1)(b).
- (2) No report is required if:
- (a) the *insurer* is an *undertaking* listed in *INSPRU 6.1.17R(2)*; or
- (b) under Article 4(2) of the *Insurance Groups Directive*, a *competent authority* of an *EEA State* other than the *United Kingdom* has agreed to be the *competent authority* responsible for exercising supplementary supervision in accordance with *INSPRU 6.1.23R*.
- (3) The report in (1) must:
- (a) comply with the requirements of *SUP 16.3*;
- (b) subject to (4), be signed by the persons described in *IPRU(INS) 9.33(1)*; and
- (c) include a statement from the auditors of the *insurer* (or of an *insurer* under (4)) that, in their opinion, the report in (1) has been properly compiled in accordance with *INSPRU 6.1* from information provided by members of the *insurance group* and from the *insurer's* own records.
- (4) The reports in (1) and (1A) must be provided by either the *insurer* or on behalf of the *insurer* (the first *insurer*) by any other *insurer* to which *INSPRU 6.1* applies and which is a member of the *insurance group* (the second *insurer*) where:
- (a) it is signed by two *directors* of the second *insurer*, and
- (b) it contains a statement that it has been copied to the board of *directors* of the first *insurer*.
- 9.41 (1) Subject to (2), an *insurer* must include, in the report in rule 9.40(1), the details of any *regulated related undertaking* in the *insurance group* where the *individual capital resources requirement* of that *undertaking* exceeds its *solo capital resources*, stating in each case:
- (a) where the *undertaking* in rule 9.41(1)(a) is a *subsidiary undertaking* of the *ultimate insurance parent undertaking* or *ultimate EEA insurance parent undertaking* (if different), the full amount of the calculation items set out in *INSPRU 6.1.28R* of that *undertaking* in accordance with *INSPRU 6.1.30R* and *INSPRU*

PRA

6.1.31R; or

- (b) where the *undertaking* in rule 9.41(1)(a) is not a *subsidiary undertaking*, the *ultimate insurance parent undertaking's* or *ultimate EEA insurance parent undertaking's* relevant proportion, as set out in *INSPRU 6.1.29R*, of the calculation items set out in *INSPRU 6.1.28R* of that *undertaking*.
- (2) Subject to paragraph (4) an *insurer* can exclude a *regulated related undertaking* where the *individual capital resources requirement* of that *undertaking* exceeds its *solo capital resources* if:
- (a) the *group capital resources* of the *ultimate insurance parent undertaking* or the *ultimate EEA insurance parent undertaking* (as the case may be) exceed its *group capital resources requirement*;
  - (b) paragraph 3 applies to the *regulated related undertaking*.
- (3) This paragraph applies to a *regulated related undertaking* if:
- (a) in respect of the *insurance group*, it is not;
    - (i) the *insurer*; or
    - (ii) a *parent undertaking* of the *insurer*; or
    - (iii) a *participating undertaking* in the *insurer*; or
    - (iv) a *related undertaking* of the *insurer*; and
  - (b) the amount by which its *individual capital resources requirement* exceeds its *solo capital resources* does not exceed 5% of the amount that the *group capital resources* exceed the *group capital resources requirement* referred to in rule (2)(a).
- (4) An *insurer* must include *regulated related undertakings* to which paragraph (2) would apply if the amount of D less E exceeds 10% of the amount that the *group capital resources* exceed the *group capital resources requirement* referred to in rule (2)(a), where:
- (a) D is the sum of the *individual capital resources requirements* of the *regulated related undertakings*; and
  - (b) E is the sum of the *solo capital resources* of the *regulated related undertakings*.

9.42 (1) The reports in rule 9.40(1) and rule 9.40(1A) must include information and calculations required by rule 9.40 and rule 9.41:

PRA

- (a) as at the end of the *financial year* of:

- (i) the *insurer*, or
  - (ii) the *ultimate EEA insurance parent undertaking*; or
  - (iii) the *ultimate insurance parent undertaking*;
- (b) subject to (2), as at the same date for every member of the *insurance group* to which the report relates. Where the *financial year end* of a member of the *insurance group* differs from the date chosen for the purposes of 1(a), interim calculations must be prepared for that member as at the date chosen for the purposes of 1(a); and
- (c) as at a date no later than 12 months from the day after the end of the *financial year* by reference to which the information and calculations required in the report were last provided under this chapter or Chapter 10 of *IPRU(INS)*.
- (2) If it is not practical to prepare interim calculations for a member of the *insurance group* whose *financial year end* differs from the date chosen for the purposes of 1(a), calculations as at the member's last *financial year end* may be used, provided that:
- (a) the member's *financial year end* is not more than three months before the date chosen for the purposes of 1(a); and
  - (b) the calculations are adjusted to take account of any changes between the *financial year end* and the date chosen for the purposes of 1(a) that materially affect the information and calculations required by rules 9.40 and 9.41.
- (3) If for any reason the end of the *financial year* chosen for the purposes of (1)(a) is changed so as to end on a date later than that specified in 1(c):
- (a) the report after the change takes effect must be as at the later date; but
  - (b) unless the report contains information and calculations that do not materially differ from what they would be as at the date specified in 1(c), the *insurer* must also provide the *PRA* with an interim statement.

The insurer must send one printed copy and one electronic copy to the appropriate addresses set out in rule 9.6(2) above. The electronic copy must be sent by email and the title of the email must be:

<firm name> group capital adequacy <dd/mm/yyyy>.

- (4) Subject to (4A) and (4B), an *insurer* must submit the reports in rule 9.40(1) and in rule 9.40(1A) to the *PRA* no later than 4 months from the end of:
- (a) the *financial year in question*; or

- (b) the *financial year* of the relevant parent, where the report is provided as at the end of its *financial year* under (1)(a).

The *insurer* must send one printed copy and one electronic copy to the appropriate addresses set out in rule 9.6(2) above. The electronic copy must be sent by email and the title of the email must be:

<firm name> group capital adequacy <dd/mm/yyyy>.

- (5) If within 24 months of receipt, the *PRA* notifies the *insurer* that a report appears to be inaccurate or incomplete, the *insurer* must, within one month of notification, provide a revised report correcting any inaccuracies and making good any omissions.
- (4A) Where an *insurer's ultimate EEA insurance parent undertaking* publishes annual consolidated accounts in accordance with accounting standards, policies and legislation applicable to it, the report required by rule 9.40(1A) must be submitted to the *PRA* by no later than the date which is 30 days after publication of those consolidated accounts or the final date of submission required by (4), whichever is the later.
- (4B) If the due date for submission of reports under (4) or (4A) falls on a day which is not a *business day*, the reports must be submitted no later than the first *business day* after that date.

9.42A (1) An *insurer* that reports under rule 9.40(1) must, subject to rule 9.42B, provide to any person, within 30 days, of the date of request (or the date of submission to the *PRA* if later):

**PRA**

- (a) the following information from the report in respect of the *financial year in question*:
- (i) the name, location of the head office and principal activity of the *ultimate EEA insurance parent undertaking*;
  - (ii) the amount of the *group capital resources* of the *ultimate EEA insurance parent undertaking*;
  - (iii) the amount of the *group capital resources requirement* of the *ultimate EEA insurance parent undertaking*;
  - (iv) the difference between (ii) and (iii); and
- (b) a copy of the report in rule 9.40(1A) in respect of the *financial year in question*; and
- (c) a copy of any information provided under rule 9.42(5) that revises any information provided in (a) and (b),

where the information is available in an electronic form, in the form requested or, if the information is not available electronically, in printed form, but (except in the case of (c)) the *insurer* may make a change to

cover its reasonable costs, including those of printing and postage.

- (2) (1) does not apply to a *pure reinsurer* which became a *firm in run-off* before 10 December 2007 and whose *Part 4A permission* has not subsequently been varied to add back the *regulated activity of effecting contracts of insurance*.

9.42B (1) An *insurer* identified at stage F of the decision tree in rule 9.42C must provide to any person within 30 days of the request the information in rule 9.42D.

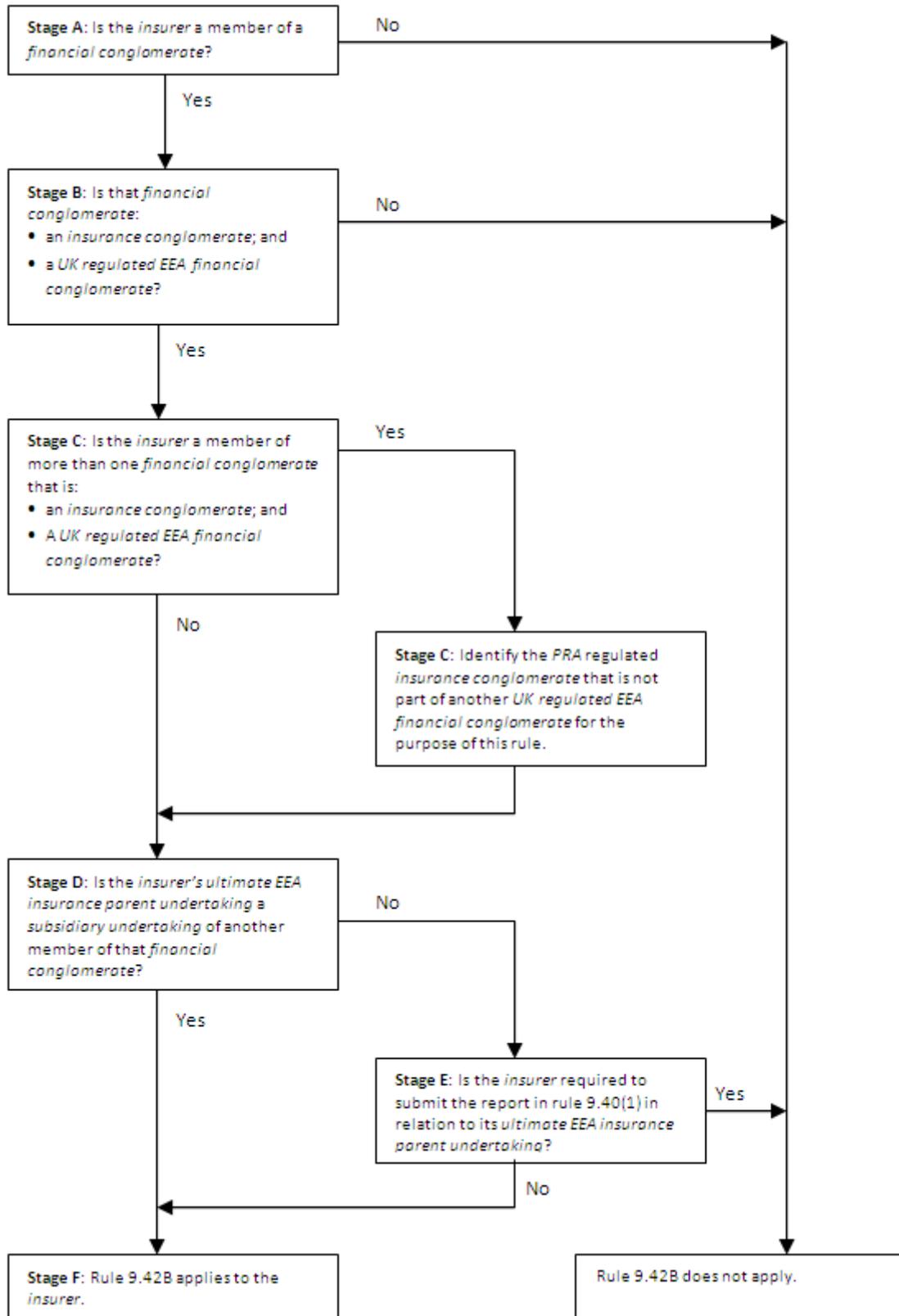
PRA

- (2) The information referred to in (1) must be provided, where the information is available to an electronic form, in the form requested or, if the information is not available electronically, in printed form, but the *insurer* may make a charge to cover its reasonable costs, including those of printing and postage.

9.42C

The decision tree determining application of 9.42B.

PRA



9.42D

PRA

- (1) An *insurer* must provide the following information from the report prepared in accordance with SUP 16.12.33R in respect of the *financial year in question* of the *financial conglomerate* identified at Stage C of the decision tree in rule 9.42C:
- (a) the capital resources and capital resources requirement identified in (2) of the *financial conglomerate*;
  - (b) the difference between the capital resources and capital resources requirement of the *financial conglomerate* referred to in (a);
  - (c) where the *parent undertaking* in the *financial conglomerate* that is not a *subsidiary* of another member of the *financial conglomerate* has published annual consolidated accounts prepared in accordance with accounting standards, policies and legislation applicable to it, a reconciliation between:
    - (i) the amount of capital resources of the *financial conglomerate* in (2); and
    - (ii) the shareholders' funds, subordinated liabilities and other relevant amounts included in the published annual consolidated accounts of that *parent undertaking*; and
  - (d) where the *parent undertaking* in the *financial conglomerate* that is not a *subsidiary undertaking* of another member of the *financial conglomerate* includes a capital statement in the form prescribed by the Accounting Standards Board's Financial Reporting Standard 27, an explanation of any differences between:
    - (i) the capital resources of the *financial conglomerate* in (2); and
    - (ii) the amounts included in that capital statement.
- (2) The capital resources and capital resources requirement of the *financial conglomerate* identified at Stage C of the decision tree in rule 9.42C are:
- (a) where GENPRU 3.1.26R applies to the *financial conglomerate*, the capital resources of the *financial conglomerate* and the minimum amount of capital resources that the *financial conglomerate* must have to meet the requirement in GENPRU 3.1.26R; or
  - (b) where GENPRU 3.1.29R applies to the *financial conglomerate*, its *conglomerate capital resources* and its *conglomerate capital resources requirement*.

### Guidance

- 9.43
- PRA**
- (1) An *insurer* may use Appendix 9.9 Form 95 for the purposes of the report required by rule 9.40(1).
  - (2) The reports required by rule 9.40 do not form part of the *insurer's* return.
  - (3) Where several *insurers* to which rule 9.40 applies have the same *ultimate insurance parent undertaking* or *ultimate EEA insurance parent undertaking* or both, rule 9.40 applies to all of them. In these circumstances one *insurer* may submit the reports in rule 9.40 on behalf of the other *insurers* in the *insurance group* as set out in rule 9.40(4). This should consist of one package of the relevant information with confirmation that the *insurer* submitting the information has made it available to the boards of directors of the other *insurers* in the *insurance group*. The purpose of this requirement is to ensure that all the *insurers* in the *insurance group* are aware of the relevance of the group information to themselves.
  - (4) Where an *insurance group* consists of an *ultimate insurance parent undertaking* or *ultimate EEA insurance parent undertaking* which is itself an *insurer* whose head office is in the *United Kingdom* and which has a *United Kingdom insurance subsidiary* or *subsidiaries* which is or are themselves *insurers*, the reports in 9.40(1) and 9.40(1A) will cover the same *group undertakings*. The subsidiary *insurer* need not in these circumstances deposit the reports in 9.40(1) and 9.40(1A). However, this does not affect the requirement to provide information under rule 9.41.

## PART VI

### ENHANCED CAPITAL REQUIREMENT

- 9.44
- PRA**
- (1) An *insurer* to which *INSPRU* 1.1.72BR applies must, in respect of each *financial year*, report its *enhanced capital requirement* (calculated in accordance with *INSPRU* 1.1.72CR) as at the end of that *financial year*.
  - (2) The report must be in the form of ECR1 set out in Appendix 9.10.
  - (3) An *insurer* must deposit a printed copy of the report with the *PRA* within 2 months and 15 days of the *financial year* end unless, in addition to depositing a printed copy, an *insurer* also deposits an electronic copy, then the period for deposit is within 3 months of the *financial year* end. The copies must be sent to the appropriate addresses set out in rule 9.6(2) above.

If the due date for deposit of documents required by (1) falls on a day which is not a *business day*, the documents must be submitted no later than the first *business day* after the due date.

- (4) The printed copy of the report must be signed by the persons described in *IPRU(INS)* 9.33(1).
- (5) The electronic copy deposited under (3) above must be in an electronic form which may be readily used or translated by the *PRA* and must be sent by email to the appropriate address set out in rule 9.6(2) above. The title of the email must be:

<firm name> Form ECR1 <dd/mm/yyyy>.

*Guidance*

9.45 The report required by rule 9.44(1) does not form part of the *insurer's return*.

PRA

9.46 An electronic copy that is not completed Form ECR1 spreadsheet file template from the *PRA* website that can be accessed by Microsoft Excel is unlikely to be readily used or translated by the *PRA*.

PRA

## Part VII

### LLOYD'S OF LONDON

*Application*

9.47 PART VII of *IPRU(INS)* chapter 9 applies to the *Society* and to *managing agents*.

FCA PRA

*Requirement to report to the PRA*

9.48 (1) The *Society* must report to the *PRA* within 6 months of the end of each *financial year* on its financial situation and solvency and on the whole of the *insurance business* carried on by *members*.

PRA

(2) The report in *IPRU(INS)* 9.48 (1) must be prepared in accordance with GENPRU 1.3.4 R and this chapter.

(3) The report in *IPRU(INS)* 9.48 (1) must include:

- (a) the *Lloyd's Return* which comprises a completed set of the forms set out in *IPRU(INS)* Appendix 9.11, together with any statements, notes, reports or certificates required by this chapter; and
- (b) a copy of the *syndicate* accounts for each *syndicate* that is required by *byelaw* to prepare accounts for the *financial year*.

(4) With the exception of the statements required to be annexed to the *Lloyd's Return* by *IPRU(INS)* 9.49 (6), the *Lloyd's Return* must be examined and reported on by the auditors appointed to audit the

affairs of the *Society*.

- (5) The *Society* must provide a printed copy of the *Lloyd's Return* to the *PRA*, with Form 1 signed by three signatories who are senior officers of the *Society* each duly authorised by the *Council* to sign the *Lloyd's Return* on behalf of the *Society*.
- (6) If the *PRA* notifies the *Society* that any part of the *Lloyd's Return* is not in conformity with this chapter, the *Society* must promptly make any appropriate corrections or adjustments and if necessary re-submit the *Lloyd's Return* (or relevant part of it).

*Content and form of the Lloyd's Return*

9.49

(1) In preparing the *Lloyd's Return*, the *Society* must:

**PRA**

- (a) complete the forms in *IPRU(INS)* Appendix 9.11, following the requirements of and making the disclosures required under Appendices 9.1, 9.2, 9.3 and 9.4 of *IPRU(INS)* as if in the documents referred to in those Appendices references to an *insurer* were references to the *Society* and *members*, and adapting the requirements in those Appendices where necessary;
  - (b) complete the forms in *IPRU(INS)* Appendix 9.11 using standard accounting *classes* as set out in *IPRU(INS)* Appendix 9.16 where the forms require reporting by accounting class;
  - (c) report treaty reinsurance general business falling in accounting *classes* 9 to 10 as set out in *IPRU(INS)* Appendix 9.16 in Forms 28 and 29 in *IPRU (INS)* Appendix 9.11 by reference to the categories in the underlying accounting classes; and
  - (d) complete forms 13, 14, 40-60 in *IPRU(INS)* Appendix 9.11 for each *long-term insurance business syndicate*.
- (2)
- (a) Where a reinsurance contract in *IPRU(INS)* 9.49 (1)(c) covers more than one underlying accounting class as set out in *IPRU(INS)* Appendix 9.16 it must be apportioned between accounting classes in the way that best reflects its underlying composition.
  - (b) However, where the apportionment in (a) cannot be made with reasonable accuracy or without disproportionate effort, then the contract must be allocated to the accounting class as set out in *IPRU (INS)* Appendix 9.16 that most closely reflects its underlying composition.
  - (c) Whether apportioned under (a) or allocated under (b), a consistent approach must be taken to reporting:
    - (i) the progress of a treaty in subsequent years; and

- (ii) substantially similar *insurance business* in subsequent years.
- (d) Where a different policy is subsequently followed a suitable explanatory note must be provided.
- (3) If, during the financial year in question, the *Society* has agreed to, or carried out, a material connected party transaction, it must provide a brief description of that transaction by way of a supplementary note to the *Lloyd's Return*.
- (4) The description to be provided under *IPRU(INS) 9.49 (3)* must state:
  - (a) the names of the transacting parties;
  - (b) a description of the connection between the parties;
  - (c) a description of the transaction;
  - (d) the amounts involved;
  - (e) any other elements of the transaction needed for an understanding of its effect or potential effect upon the financial position of the *Society*; and
  - (f) amounts written off in the period in respect of debts due to or from transacting parties which are connected parties.
- (5) Transactions with the same connected party may be disclosed on an aggregated basis unless separate disclosure is needed for a proper understanding of the effect of the transactions upon the financial position of the *Society*.
- (6) The *Society* must annex to the *Lloyd's Return* a copy of each statement completed by a *managing agent* under *IPRU(INS) 9.60 (7)*.
- (7) For the purposes of the *Lloyd's Return* and *IPRU(INS) 9.49 (6)*, the *Society* must, for each statement annexed, identify the *syndicate* to which the *contract of insurance* or 'financing arrangement' relates.

*Risk groups for general insurance business*

9.50

PRA

- (1) The *Society* must for the purposes of reporting under this chapter:
  - (a) classify the direct and facultative *general insurance business* of *members* according to appropriate risk groups; and
  - (b) where the risks are material, complete a separate Form 34 in *IPRU(INS) Appendix 9.11* for each group.
- (2) The *Society* must not include:
  - (a) policies falling within *classes 14, 15, 16, 17 or 18* within the same risk group as policies falling within any other *class*,

except that policies falling within *class 14* may be included in the same risk group as policies falling within *class 15*; or

- (b) policies in respect of private motor car risks, within the same risk group as policies in respect of other risks falling within accounting class 2 as set out in *IPRU(INS) Appendix 9.16*; or
  - (c) policies in respect of comprehensive private motor car risks, within the same risk group as policies in respect of non-comprehensive private motor car risks; or
  - (d) policies transferred to *members* by way of a transfer under section 111 of the Act (Sanction of the court for business transfer schemes), within the same risk group as other policies.
- (3) The *Society* must give the *PRA* notice of proposed changes to the definition or classification of the risk groups in *IPRU(INS) 9.50 (1)*, sufficient to allow the *PRA* properly to assess the implications of the proposals.

*Major treaty reinsurers*

9.51

PRA

- (1) The *Society* must, in connection with the *general insurance business* carried on by *members*, include in the *Lloyd's Return* a statement of major treaty reinsurers.
- (2) A major treaty reinsurer is any insurance company to which in the *financial year* in question or any of the five preceding *financial years*:
- (a) in the case of proportional reinsurance, 2% or more of the gross premiums receivable in respect of *general insurance business* of the *members* in aggregate has been ceded; or
  - (b) in the case of non-proportional reinsurance, 5% or more of the gross premiums receivable in respect of *general insurance business* has been ceded.
- (3) The statement required under *IPRU(INS) 9.51 (1)* must include:
- (a) the full name of each major treaty reinsurer;
  - (b) the amount of the reinsurance premiums payable in the *financial year* to each such reinsurer;
  - (c) whether and if so how the reinsurer was connected to any *member* or any *managing agent*;
  - (d) the amount of any debt of each such reinsurer included at line 75 of Form 13 in *IPRU(INS) Appendix 9.11*;
  - (e) the amount of any deposit received from each such reinsurer under reinsurance treaties included at line 31 of Form 15 in *IPRU(INS) Appendix 9.11*; and

- (f) the reinsurers' share of *technical provisions* shown on Form 13 in *IPRU(INS)* Appendix 9.11 except that in respect of claims incurred but not reported, such recoveries need only be included to the extent that they are in respect of specific occurrences for which provisions have been allocated;

or, as the case may be, a statement that having aggregated the reinsurance ceded by *members* no reinsurer is a major treaty reinsurer.

- (4) The requirements of *IPRU(INS)* 9.51 (1), *IPRU(INS)* 9.52 (1) and *IPRU(INS)* 9.53 (1) may be satisfied by giving a fair view and making use of an appropriate degree of approximation. The *Society* may employ any reasonable methods to establish the information required.

*Major facultative reinsurers*

9.52

PRA

- (1) The *Society* must, in connection with the *general insurance business* carried on by *members*, include in the *Lloyd's Return* a statement of major facultative reinsurers.
- (2) A major facultative reinsurer is an insurance company to which or with respect to which:
- (a) 0.5% or more of the gross premiums *receivable* in respect of *general insurance business* of the *members* in aggregate has been ceded; or
- (b) the addition of the amounts in items (d) and (e) of *IPRU(INS)* 9.51 (3) produces an amount exceeding 1% of the aggregate gross assets of *members*.
- (3) The statement required under *IPRU(INS)* 9.52 (1) must include the matters listed in *IPRU(INS)* 9.51 (3), with appropriate amendments.

*Major reinsurance cedants*

9.53

PRA

- (1) The *Society* must, in connection with the *general insurance business* carried on by *members*, include in the *Lloyd's Return* a statement of major reinsurance cedants.
- (2) A major reinsurance cedant is an insurance company which in the *financial year* in question or any of the three preceding *financial years*:
- (a) cedes an amount which exceeds 5% of the gross premiums *receivable* by *members* in respect of *general insurance business* accepted under reinsurance treaties; and
- (b) cedes an amount which exceeds 2% of the gross premiums *receivable* by *members* in respect of *general insurance business*.
- (3) The statement required under *IPRU(INS)* 9.53 (1) must include the matters listed in *IPRU(INS)* 9.51 (3), with appropriate amendments.

*Derivative contracts*

9.54

PRA

- (1) The *Society* must annex a statement to the *Lloyd's Return* comprising a brief description of:
- (a) any *byelaws* and guidelines issued by the *Society* governing the use of *derivative* contracts;
  - (b) any provision in those guidelines governing the use of contracts under which *members* have a right or obligation to acquire or dispose of assets which was not, at the time when the contract was entered into, reasonably likely to be exercised and the circumstances in which, pursuant to that provision, such contracts may be used;
  - (c) the extent to which *members* were during the *financial year* a party to any contracts of the kind described in (b);
  - (d) the extent to which any of the amounts recorded in Form 13 would be changed if assets which *members* had a right or obligation to acquire or dispose of under *derivative* contracts outstanding at the end of the *financial year* (being, in the case of *options*, only those *options* which it would have been prudent to assume would be exercised) had been acquired or disposed of;
  - (e) the difference between (d) and the amount which would result under (d) if such *options* had been exercised and this were reflected in Form 13 to the maximum extent;
  - (f) how different the information provided pursuant to (d) and (e) would have been if, instead of applying to contracts outstanding at the end of the *financial year*, (d) and (e) had applied to *derivative* contracts outstanding at such other time during the *financial year* as would have changed the amounts in Form 13 to the maximum extent;
  - (g) the maximum loss which would be incurred by *members* on the failure by any one other person to fulfil its obligations under *derivative* contracts outstanding at the end of the *financial year*, both under existing market conditions and in the event of other foreseeable market conditions, together with an assessment of whether such maximum loss would have been materially different at any other time during the *financial year*;
  - (h) the circumstances surrounding the use of any *derivative* contract held at any time during the *financial year* which did not fulfil the criteria in *INSPRU 4.2.5 R*; and
  - (i) the total value of any fixed consideration received by *members* (whether in cash or otherwise) during the *financial year* in return for granting rights under *derivative* contracts and a summary of contracts under which such rights have been

granted.

- (2) For the purposes of *IPRU(INS) 9.54 (1)*, if *members* are a party to:
- (a) a *contract for differences*; or
  - (b) any other contract which is to be, or may be, settled in cash they must be treated as having a right or obligation to acquire or dispose of the assets underlying the contract.

*General insurance business ceded*

- 9.55 (1) The *Society* must annex to the *Lloyd's Return* a statement:
- PRA
- (a) of each major treaty reinsurer and major facultative reinsurer; and
  - (b) for each of the realistic disaster scenarios set by the *Society* when fulfilling its obligations under *INSPRU* and *GENPRU* to monitor aggregation of risk within the *Lloyd's* market of the contribution it is assumed each such reinsurer would provide in the event of that disaster occurring.

*The Society*

- 9.56 (1) The *Society* must annex to the *Lloyd's Return* a statement naming each individual who has served:
- PRA
- (a) on the *Council*;
  - (b) as Chairman of the *Council*; and
  - (c) as Chief Executive Officer of the *Society*;
- at any time during the *financial year*, including in each case the dates of commencement or end of service (as the case may be) of any individual who has not served for the entire year.

*Capacity controlled*

- 9.57 (1) The *Society* must annex to the *Lloyd's Return* a statement identifying any *members*, *members' agents* or *managing agents* that control a significant share of the underwriting capacity of the *Society*.
- PRA
- (2) To control a significant share means:
- (a) in relation to a *managing agent*, managing, directing through one or more *Members' Agent Pooling Arrangements* or owning, whether directly or in conjunction with *connected persons*, capacity which in aggregate is greater than 5% of the total underwriting capacity of the *Society*;
  - (b) in relation to a *members' agent*, directing through one or more *Members' Agent Pooling Arrangements* or owing, whether directly or in conjunction with *connected persons*, underwriting

capacity which in aggregate is greater than 2.5% of the total underwriting capacity of the *Society*; and

- (c) in relation to a member, owning, whether directly or in conjunction with *connected persons*, underwriting capacity which, in aggregate, is greater than 2.5% of the total underwriting capacity of the *Society*.

*Certificates and audit report*

9.58 (1) Certificates

PRA

The *Society* must annex to the *Lloyd's Return*:

- (a) a certificate from the *Council*, including the statements required by *IPRU (INS)* Appendix 9.12;
- (b) a statement from the *Lloyd's actuary*, including the statements required by *IPRU (INS)* Appendix 9.13;
- (c) a certificate from the *syndicate actuary* of each *syndicate* which carries on *long-term insurance business*, including the statements required by *IPRU (INS)* Appendix 9.14, and;
- (d) an abstract from the *syndicate actuary* of each *syndicate* which carries on *long-term insurance business* of the *actuary's* report made under *SUP 4.6.14G*.

(2) Audit report

The *Society* must ensure that the *Lloyd's Return* and every document annexed to or provided with it has been examined by the *Society's* auditors and must provide with the *Lloyd's Return* an audit certificate in respect of that examination.

- (3) The certificate in *IPRU(INS)* 9.58 (2) must be in the form set out in *IPRU(INS)* Appendix 9.15.

*Public disclosure*

9.59 (1) The *Society* must provide within a period not exceeding 30 days:

PRA

- (a) on demand to any *member* or policyholder a copy of the *Lloyd's Return* and the *global account* most recently submitted to the *PRA*; and
- (b) if specifically requested by a *member* or policyholder, a copy of any *syndicate* account submitted to the *PRA*.

*Syndicate-level reporting*

9.60 (1) Each *managing agent* must:

PRA

- (a) prepare a return for each *financial year* in respect of the *insurance business* carried on through each *syndicate*

- managed by it; and
- (b) provide the return in (a) to the *Society* as soon as practicable after the end of the financial year but in any event in time to enable the *Society* to report to the *PRA* in accordance with *IPRU(INS) 9.48 (1)*.
- (2) The *Society* must:
- (a) issue instructions to *managing agents* setting out the form and content of the return under *IPRU(INS) 9.60 (1)*; and
  - (b) issue the instructions in (a) as soon as practicable but in any event in time to enable *managing agents* to comply with *IPRU(INS) 9.60 (1)*.
- (3) A *managing agent* must annex to each return which it prepares under *IPRU(INS) 9.60 (1)*, a certificate signed by the persons referred to in *IPRU(INS) 9.60 (4)*, including the statements required by *IPRU(INS) Appendix 9.17*.
- (4) The certificate in *IPRU(INS) 9.60 (3)* must be signed by:
- (a) where there are more than two *directors* of the *managing agent*, at least two of those *directors* and, where there are not more than two *directors*, all the *directors*; and
  - (b) a *chief executive*, if any, of the *managing agent* or (if there is no *chief executive*) the secretary.
- (5) A *managing agent* must ensure for each *syndicate* managed by it that the return required under *IPRU(INS) 9.60 (1)* is examined and reported on by the *syndicate* auditor.
- (6) A *managing agent* must annex to each return required under *IPRU(INS) 9.60 (1)* an audit certificate provided by the *syndicate* auditor including the statements required by *IPRU(INS) Appendix 9.18*.
- (7) A *managing agent* must annex to each return which it prepares under *IPRU(INS) 9.60 (1)* a statement of the information required by *IPRU(INS) rule 9.32A*, as if in that *rule* references to:
- (a) '*insurer*' were to the *members* carrying on *insurance business* through the relevant *syndicate*;
  - (b) the '*return*' were to the return required to be prepared by it in respect of the business carried on through the relevant *syndicate* under *IPRU(INS) 9.60 (1)*
  - (c) the '*insurer's* balance sheet' were to the *syndicate* balance sheet;
  - (d) the '*insurer's capital resources*' were to the *capital resources* managed by or at the direction of the *managing agent* in
-

respect of the *insurance business* carried on through the relevant *syndicate*; and

- (e) the 'insurer's total technical provisions' were to the technical provisions in respect of the insurance business carried on through the relevant *syndicate*.

#### *The Central Fund*

9.61

PRA

- (1) The *Society* must give the *PRA* a report on the *Central Fund* as at the end of each calendar quarter.
- (2) The report referred to in *IPRU(INS)* 9.61 (1) must reach the *PRA* within two weeks of the end of each calendar quarter and must include information on:
  - (a) the net market value of the *Central Fund*;
  - (b) payments made from the *Central Fund* in that quarter;
  - (c) the types of investment in which the *Central Fund* is held;
  - (d) the commencement or cessation of, or any changes in the terms of, any insurance policy taken out to protect the *Central Fund*; and
  - (e) any claim made, or circumstances notified that are likely to lead to a claim, under any insurance policy taken out to protect the *Central Fund*.

#### *Information about the capacity transfer market*

9.62

FCA

- (1) The *Society* must give the *FCA* a report as at the end of each calendar quarter in which any capacity is transferred.
- (2) The report referred to in (1) must reach the *FCA* within one month of the end of the relevant calendar quarter and must include information on:
  - (a) the total capacity in *syndicates* transferred during the quarter, analysed by *syndicate* and method of transfer;
  - (b) the number, and nature, of all investigations by the *Society* into conduct in the *capacity transfer market* undertaken or continued during the quarter; and
  - (c) the number, and nature, of all complaints received during the quarter about the operation of the *capacity transfer market*.

#### *Guidance*

9.63

PRA

- (1) *IPRU(INS)* Chapter 9 Part VII requires the *Society* to report on the *insurance business* carried on by *members* and on the assets and liabilities of *members* and the *Society*, and requires reports from the *Society* on the *Central Fund* and the *capacity transfer market*. It also

requires *managing agents* to report on the *insurance business* carried on through each *syndicate* they manage. Reporting at *syndicate level* is required to enable the *Society* to prepare the *Lloyd's Return*. The statements required to be annexed to the return by *IPRU(INS) 9.60 (7)* should not be included in the audit under *IPRU(INS) 9.49 (6)*.

- (2) The *Lloyd's Return* is made annually and contains the statement required from the *Society* that *capital resources* at least equal to the *capital resources requirements* for *general insurance business* and *long-term insurance business* under *GENPRU 2* have been maintained at all times throughout the *financial year*.
- (3) For *general insurance business*, the *capital resources requirement* for the *Society* is the higher of the aggregate of the *members' capital resources requirements* for *general insurance business*, calculated in accordance with *GENPRU 2.3.5 R*, and the *Society GICR*. For *long-term business*, the *capital resources requirement* for the *Society* is the aggregate of the *members' capital resources requirements*, calculated in accordance with *GENPRU 2.3.7 R*. The *Society* is required to ensure that each *member's capital resources requirement* is covered by that *member's capital resources*, or, where there is a shortfall in the *member's capital resources*, by the *Society's own capital resources*. For *general insurance business*, the *Society* must ensure that the *Society GICR* is covered by the aggregate *capital resources* supporting the *insurance business* of all the *members*.
- (4) Where appropriate, the *Society* is also required to modify prudential reporting to make it more like that of an *insurer*. This is to aid comparisons between *Lloyd's* and *insurers*.

9.64 The *Society* should make the report referred to in *IPRU(INS) 9.48 (1)*, including amendments and corrections, and amalgamated *syndicate* accounts available at its head office for inspection by policyholders and potential policyholders and *members*.

PRA

9.65 (1) In assessing what are appropriate risk groups for reporting purposes the *Society* should ensure where possible that:

PRA

- (a) each risk group should include only risks from within a single accounting class and in relation to a single country;
- (b) policies are not included in the same risk group where, having regard to the patterns of risk, *claims* incurrence and settlement patterns, it is necessary to group them separately for the purposes of applying statistical methods in calculating the provision for *claims* outstanding in accordance with generally accepted accounting practice; and
- (c) claims-made policies are not included in the same risk group as policies which are not claims-made policies, except:
  - (i) where this is not possible without disproportionate

expense; and

- (ii) where the policies within the risk group do not exhibit materially different characteristics.

- (2) Subject to *IPRU(INS) 9.50 (2)(a)* and *IPRU(INS) 9.50 (2)(b)* and *IPRU(INS) 9.65 (1)(c)*, the *Society* may in respect of any accounting class include all *insurance business* carried on by *members* in any country in any *financial year* as a single risk group.
- (3) Notwithstanding the provisions of *IPRU(INS) 9.50 (2)(a)* and *IPRU(INS) 9.50 (2)(b)* and *IPRU(INS) 9.65 (1)(c)*, the *Society* may classify all *insurance business* carried on by *members* in any country in respect of any accounting class in any financial year as a single risk group, as long as gross premiums written for that year in respect of that *insurance business* are less than 5% of the world-wide gross premiums written for all accounting classes for that year.
- (4) The requirements to report a separate risk group in *IPRU(INS) 9.50 (2)(a)* do not apply where, in the case of any *financial year*, the gross premiums receivable for that year in respect of that risk group would be less than £1million.

9.66 The *Society* should be treated as if it were a major treaty reinsurer when *intersyndicate reinsurance* in aggregate exceeds the amounts set out in *IPRU(INS) 9.51 (2)*

PRA

9.67 The *Society* should be treated as if it were a major facultative reinsurer when *inter-syndicate reinsurance* in aggregate exceeds the amounts set out in *IPRU(INS) 9.52 (2)*.

PRA

9.68 The *Society* should be treated as if it were a major reinsurance cedant when inter-syndicate cessions in aggregate exceed the amounts set out in *IPRU(INS) 9.53 (2)*.

PRA

9.69 In relation to required disclosures of *derivative* contracts in *IPRU(INS) 9.54 (1)*, references to a *derivative* contract and related expressions should be taken to include:

PRA

- (1) any *derivative* contract entered into by a *managing agent* on behalf of a *member* as part of that *member's insurance business*; and
- (2) any *derivative* contract entered into by the *Society*.

9.70 Contracts that are *quasi-derivative contracts* should be treated as *derivative* contracts.

PRA

9.71 The requirements of *IPRU(INS) 9.55(1)* may be satisfied by giving a fair view and may make use of an appropriate degree of approximation. The *Society* may employ any reasonable methods to establish the information required. The *Society* may also include such explanation as it considers to be necessary to allow a reasonable interpretation to be put on this statement.

PRA

9.72

PRA

- (1) Because of the significance of the *Central Fund* in the protection of policyholders, the *Society* should notify the *appropriate regulator* under *IPRU(INS) 9.61 (2)(e)* of all matters relevant to any actual or potential claim. These include but are not limited to the facts on which that claim is based, the circumstances under which those facts arose and any relevant response to the claim from any *insurer* or reinsurer concerned.
- (2) The report referred to in *IPRU(INS) 9.61 (1)* must be submitted in writing in accordance with *SUP 16.3.7* to *SUP 16.3.10* (see *SUP 16.3.6*).

# 10 Chapter 10

[deleted]



# 11 Chapter 11: Definitions

## PART I: DEFINITIONS

11.1 For the purposes of *IPRU (INS)*, the term or phrase in the first column has the meaning given to it in the second column unless the context otherwise requires.

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Term or phrase	Definition
<i>1981 Regulations</i>	Insurance Companies Regulations 1981 (S.I. 1981 No. 1654)
<i>1982 Act</i>	Insurance Companies Act 1982
<i>1983 Regulations</i>	Insurance Companies Regulations 1983 (S.I. 1983 No. 1811)
<i>1986 Order</i>	Companies (Northern Ireland) Order 1986
<i>1994 Regulations</i>	Insurance Companies Regulations 1994 (S.I. 1994 No.1516)
<i>1996 Regulations</i>	Insurance Companies (Accounts and Statements) Regulations (S.I. 1996 No. 943)

<i>accounted for</i>	reported pursuant to the <i>Accounts and Statements Rules</i>
<i>Accounts and Statements Rules</i>	rules 9.1 to 9.36E and rule 9.39 of Chapter 9
<i>actuarial investigation</i>	an investigation to which rule 9.4 applies
<i>admissible asset</i>	an asset that falls into one or more categories in <i>GENPRU 2 Annex 7R</i>
<i>annuities on human life</i>	does not include superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of persons engaged, or who have been engaged, in any particular profession, trade or employment, or of the dependants of such persons
<i>approved investment firm</i>	an investment firm as defined in the <i>Investment Services Directive</i>
<i>associate</i>	has the meaning given in rule 11.2
<i>available assets</i>	the excess of an <i>insurer's</i> assets (other than <i>implicit items</i> ) over its liabilities, in each case valued in accordance with <i>GENPRU 1.3, INSPRU 2.1 and INSPRU 1</i>

<i>balancing category</i>	a <i>PRA general insurance business reporting category</i> to
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	which any of the <i>category numbers</i> 409 or 709 has been allocated in column 1 of <b>Annex 11.3</b>
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<i>category number</i>	the category number for the <i>PRA general insurance business reporting category</i> listed in column 1 of <b>Annex 11.3</b>
<i>cede and cession</i>	in relation to <i>reinsurance</i> , include retrocede and retrocession
<i>claim</i>	a <i>claim</i> against an <i>insurer</i> under a <i>contract of insurance</i>
<i>claims-made policy</i>	a contract of liability insurance which provides that no liability is incurred by the <i>insurer</i> in respect of an incident unless –  (a) the incident is notified to the <i>insurer</i> (or its agent or representative); and  (b) such notification is received by the <i>insurer</i> (or its agent or representative) before the end of a specified period which is no longer than three years following the final date for which cover is provided under the contract
<i>claims management costs</i>	refers to those claims management costs required by the <i>insurance accounts rules</i> (note (4) to the profit and loss account format) to be included in <i>claims</i> incurred other than those which, whether or not incurred through the employment of the <i>insurer's</i> own staff, are directly attributable to particular <i>claims</i>
<i>class</i>	a class of <i>long-term insurance business</i> , listed in <b>Annex 11.1</b> or a class of <i>general insurance business</i> listed in <b>Annex 11.2</b>
<i>collecting book</i>	includes any book or document held by a <i>collector</i> in which payments of premiums are recorded
<i>collector</i>	includes every person, howsoever remunerated, who, by himself or by any deputy or substitute, makes house to house visits for the purpose of receiving premiums payable on <i>policies</i> of insurance on human life, or holds any interest in a <i>collecting book</i> , and includes such a deputy or substitute
<i>combined category</i>	a <i>PRA general insurance business reporting category</i> to which any of the <i>category numbers</i> 001, 002, 003, 110, 120, 180, 220, 260, 270, 280, 330, 340, 500 or 600 has been allocated in column 1 of <b>Annex 11.3</b>
<i>commitment</i>	a commitment represented by <i>insurance business</i> of any of the <i>classes</i> of <i>long-term insurance business</i>
<i>company</i>	(a) for the purposes of the <i>Accounts and Statements Rules</i> means an <i>insurance undertaking</i> ; and

	(b) otherwise, includes any <i>body corporate</i>
<i>connected</i>	<p>a <i>body corporate</i> “A” and another <i>body corporate</i> “B” are connected with each other if:</p> <p>(a) B is a <i>related undertaking</i> of A;</p> <p>(b) B is a <i>participating undertaking</i> in A; or</p> <p>(c) B is a <i>related undertaking</i> of a <i>participating undertaking</i> in A</p> <p>a <i>body corporate</i> “C” and a natural person “D” are connected if D holds a <i>participation</i> in:</p> <p>(d) C or any of its <i>related undertakings</i>;</p> <p>(e) a <i>participating undertaking</i> in C; or</p> <p>(f) a <i>related undertaking</i> of a <i>participating undertaking</i> in A</p>
<i>connected company</i>	<p>of any <i>company</i> means –</p> <p>(a) that <i>company’s holding company</i>;</p> <p>(b) a <i>subsidiary</i> of that <i>company</i>; or</p> <p>(c) a <i>subsidiary</i> of the <i>holding company</i> of that <i>company</i></p>
<i>connected-party transaction</i>	the transfer of assets or liabilities or the performance of services by, to or for a <i>connected</i> person irrespective of whether or not a price is charged
<i>consequential loss risk</i>	risk falling within <i>general insurance business class 16</i> comprising risks of the persons insured sustaining loss attributable to interruptions of the carrying on of business carried on by them or to reduction of the scope of business so carried on
<i>controller</i>	has the meaning given in rule 11.2
<i>counterparty</i>	<p>in relation to an <i>insurer</i> –</p> <p>(a) any one individual;</p> <p>(b) any one unincorporated body of persons;</p> <p>(c) any one <i>company</i> not being a member of a <i>group</i>;</p> <p>(d) any <i>group</i> of <i>companies</i> excluding any <i>companies</i> within the <i>group</i> which are <i>subsidiary undertakings</i> of the <i>insurer</i>; or</p> <p>(e) any government of a State together with all the public bodies, local authorities or nationalised industries of that State,</p> <p>in which the <i>insurer</i> has made investments or against whom it has rights whether in pursuance of a contract</p>

	entered into by the <i>insurer</i> or otherwise
<i>credit default swap</i>	a <i>swap</i> contract in which a buyer makes a series of payments to a seller and, in exchange, receives the right to a payment if a credit instrument issued by a named borrower (the reference entity) goes into default or on the occurrence of a specified credit event, for example bankruptcy or restructuring of the reference entity, during the currency of the contract

<i>debt</i>	includes an obligation to pay a sum of money under a negotiable instrument
<i>dependant</i>	a dependant for a <i>firm</i> is any <i>subsidiary undertaking</i> of the <i>firm</i> that is valued in accordance with GENPRU 1.3.47R
<i>derivative contract</i>	has the meaning given to <i>derivative</i> in the <i>Glossary</i>
<i>direct and facultative</i>	<i>direct insurance business</i> and inwards facultative <i>reinsurance business</i>
<i>direct insurance business</i>	<i>insurance business</i> other than <i>reinsurance business</i>
<i>discounting</i>	refers to discounting or deductions to take account of investment income within the meaning of paragraph 48 of the <i>insurance accounts rules</i>

<i>equivalent securities</i>	<i>securities</i> issued by the same <i>issuer</i> being of an identical type and having the same nominal value, description and amount
<i>established surplus</i>	has the same meaning as in rule 3.3(4)
<i>exemption category</i>	a <i>PRA general insurance business reporting category</i> to which the <i>category numbers</i> 114(p) or 710(p) have been allocated in column 1 of <b>Annex 11.3</b>
<i>experience account</i>	<p>an account (whether real or notional) established under a <i>contract of insurance</i> where:</p> <p>(a) <i>premiums</i> payable or paid, or amounts related to <i>premiums</i> payable or paid, under the contract are credited to the account;</p> <p>(b) <i>claims</i> payable or paid or incurred, or amounts related to <i>claims</i> payable or paid or incurred, under the contract are deducted from the account; and</p> <p>(c) either:</p> <p>(i) some part of the amount held in the account is paid out on expiry or termination of the contract in accordance with rights specified in the contract; or</p>

	(ii) the amount held in the account affects the amount payable under the contract.
<i>external insurer</i>	an <i>insurer</i> whose head office is outside the United Kingdom, other than an <i>EEA-insurer</i> , a <i>Swiss general insurer</i> or an <i>UK- or EEA-deposit insurer</i> .

<i>facultative business</i>	facultative <i>reinsurance</i> business
<i>financial year</i>	each period at the end of which the balance of the accounts of the <i>insurer</i> is struck or, if no such balance is struck, the calendar year
<i>financial year in question</i>	the <i>financial year</i> which last ended before the date on which accounts and statements (as specified in the <i>Accounts and Statements Rules</i> ) of the <i>insurer</i> relating to that <i>financial year</i> are required to be deposited with the <i>PRA</i> pursuant to rule 9.6, and the preceding financial year and previous financial years are construed accordingly

<i>group</i>	has the meaning given in section 262 of the Companies Act 1985 where applicable, otherwise section 474(1) of the Companies Act 2006
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<i>home foreign business</i>	<i>general insurance business</i> carried on in the United Kingdom primarily relating to risks situated outside the United Kingdom, but excluding <i>insurance business</i> in category numbers 330, 340, 350, 500, 600 and 700 and <i>insurance business</i> where the risk commences in the United Kingdom
<i>hybrid security</i>	a <i>debt security</i> , other than an <i>approved security</i> , the terms of which provide or have the effect that the holder does not or would not have an unconditional entitlement to payment of interest and repayment of capital in full within 75 years of the <i>relevant date</i>

<i>incepted</i>	refers to the time when the liability to risk of an <i>insurer</i> under a <i>contract of insurance</i> commenced and, for this purpose, a contract providing continuous cover is deemed to commence on each anniversary date of the contract, and incepting and inception are construed accordingly
<i>index linked contract</i>	a <i>linked long-term contract of insurance</i> conferring <i>index linked benefits</i>
<i>industrial assurance</i>	the business of effecting <i>contracts of insurance</i> on human

<i>business</i>	<p>life, premiums in respect of which are received by means of <i>collectors</i>;</p> <p>But such <i>insurance business</i> does not include –</p> <p>(a) <i>contracts of insurance</i>, the premiums in respect of which are payable at intervals of two months or more;</p> <p>(b) <i>contracts of insurance</i>, effected whether before or after the passing of the Industrial Assurance Act 1923 by a society or company established before the date of the passing of that Act which at that date had no <i>contracts of insurance</i> outstanding the premiums on which were payable at intervals of less than one month so long as the society or company continues not to effect any such contracts;</p> <p>(c) <i>contracts of insurance</i> effected before the passing of the Industrial Assurance Act 1923, premiums in respect of which are payable at intervals of one month or more, and which have up to the passing of that Act been treated as part of the business transacted by a branch other than the industrial branch of the society or company; or</p> <p>(d) <i>contracts of insurance</i> for £25 or more effected after the passing of the Industrial Assurance Act 1923, premiums in respect of which are payable at intervals of one month or more, and which are treated as part of the business transacted by a branch other than the industrial branch of the society or company, in cases where the relevant authority certified prior to 1 December 2001 under section 1(2)(d) of that Act that the terms and conditions of such contracts are on the whole not less favourable to the <i>policy holders</i> than those imposed by that Act</p>
<i>initial margin</i>	<p>in respect of a <i>derivative</i> or <i>quasi-derivative</i>, means assets which, before or at the time the contract is entered into, are transferred by the <i>insurer</i> subject to a condition that such assets (or where the assets transferred are <i>securities, equivalent securities</i>) will be returned to the <i>insurer</i> on completion of that contract</p>
<i>insurance liabilities</i>	<p>amounts calculated in accordance with GENPRU 1.3 (Valuation) in respect of those items shown at C and D under the heading 'Liabilities' set out in paragraph 9 of the <i>insurance accounts rules</i></p>
<i>internal linked fund</i>	<p>an account to which an <i>insurer</i> appropriates certain <i>linked assets</i> and which may be sub-divided into units the value of each of which is determined by the <i>insurer</i> by reference to the value of those <i>linked assets</i></p>

<i>linked assets</i>	in relation to an <i>insurer</i> , <i>long-term insurance business assets</i> of the <i>insurer</i> which are, for the time being, identified in the records of the <i>insurer</i> as being assets by reference to the value of which <i>property linked benefits</i> are to be determined, and non-linked assets is construed accordingly
<i>long-term policy holder</i>	a <i>policy holder</i> in respect of a <i>policy</i> the effecting of which by the <i>insurer</i> constituted the carrying on of <i>long-term insurance business</i>

<i>management expenses</i>	in relation to <i>long-term insurance business</i> , means all expenses, other than commission, incurred in the administration of an <i>insurer</i> or its business
<i>marine mutual</i>	an <i>insurer</i> - <p>(a) whose <i>insurance business</i> is restricted to the insurance of its members or their <i>associates</i> against loss, damage or liability arising out of marine adventures (including losses on inland waters or any risk incidental to any sea voyage); and</p> <p>(b) whose articles of association, rules or bye laws provide for the calling of additional contributions from, or the reduction of benefits to, the majority of its members, in either case without limit, in order to ensure that the <i>insurer</i> has sufficient financial resources to meet any valid <i>claims</i> as they fall due</p>
<i>material connected-party transaction</i>	a <i>connected-party transaction</i> for which (together with any similar transactions): <p>(a) the price actually paid or received for the transfer of assets or liabilities or the performance of services; or</p> <p>(b) the price which would have been paid or received had that transaction been negotiated at arm's length between unconnected parties, exceeds:  <p>(c) in the case of an <i>insurer</i> that carries on <i>long-term insurance business</i> but not <i>general insurance business</i>, 5% of the <i>insurer's</i> liabilities arising from its <i>long-term insurance business</i>, excluding <i>property-linked liabilities</i> and net of <i>reinsurance ceded</i>; or</p> <p>(d) in the case of an <i>insurer</i> that carries on <i>general insurance business</i>, but not <i>long-term insurance business</i>, the sum of Euro 20,000 and 5% of the <i>insurer's</i> liabilities arising from its <i>general insurance business</i>, net of <i>reinsurance ceded</i>; or</p> </p>

	<p>(e) in the case of an <i>insurer</i> that carries on both types of business either –</p> <p>(i) 5% of the <i>insurer's</i> liabilities arising from its <i>long-term insurance business</i>, excluding <i>property-linked liabilities</i>, net of <i>reinsurance ceded</i> where the transaction is in connection with the <i>insurer's long-term insurance business</i>, or</p> <p>(ii) in other cases, the sum of Euro 20,000 and 5% of the <i>insurer's</i> liabilities arising from <i>general insurance business</i> net of <i>reinsurance ceded</i></p>
<i>miscellaneous category</i>	a <i>PRA general insurance business reporting category</i> to which the <i>category numbers</i> 400 or 700 have been allocated in column 1 of <b>Annex 11.3</b>
<i>mortgage</i>	in relation to Scotland, means a heritable security within the meaning of section 9(8) of the Conveyancing and Feudal Reform (Scotland) Act 1970

<i>non-linked assets</i>	see <i>linked assets</i>
<i>non-profit policy</i>	see <i>with-profits policy</i>
<i>non-proportional reinsurance treaty</i>	see <i>proportional reinsurance treaty</i>

<i>ordinary long-term insurance business</i>	<i>long-term insurance business</i> which is not <i>industrial assurance business</i>
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<i>PRA general insurance business reporting category</i>	a category of <i>general insurance business</i> that consists of the effecting or carrying out of <i>contracts of general insurance</i> falling within the description in column 2 of <b>Annex 11.3</b>
<i>preceding financial year</i>	see <i>financial year in question</i>
<i>previous financial years</i>	see <i>financial year in question</i>
<i>preceding financial year</i>	see <i>financial year in question</i>
<i>previous financial years</i>	see <i>financial year in question</i>
<i>Product code</i>	has the meaning given in paragraph 3 of the Instructions for completion of <b>Form 47</b> in <b>Appendix 9.3</b>
<i>profit and loss account</i>	in relation to an <i>insurer</i> not trading for profit, an income and expenditure account

<i>property linked benefits</i>	benefits other than <i>index linked benefits</i> provided for under a <i>linked long-term contract of insurance</i>
<i>property linked liabilities</i>	<i>insurance liabilities</i> in respect of <i>property linked benefits</i>
<i>proportional reinsurance treaty</i>	<p>(a) a <i>reinsurance</i> treaty under which a predetermined proportion of each <i>claim</i> payment by the <i>cedant</i> under <i>policies</i> subject to the treaty is recoverable from the <i>reinsurer</i>, and</p> <p>(b) for the purposes of the <i>Accounts and Statements Rules</i>, a <i>reinsurance</i> treaty under which in return for a proportion of the premium a pre-determined proportion of each <i>claim</i> payment by the <i>cedant</i> under <i>policies</i> subject to the treaty is recoverable from the <i>reinsurer</i>, and</p> <p>non-proportional reinsurance treaty is construed accordingly</p>

<i>readily realisable</i>	<p>in relation to an investment:</p> <p>(a) an investment which, had negotiations for the assignment or transfer of the investment commenced not more than seven working days before the <i>relevant date</i>, it is reasonable to assume could have been assigned or transferred on the <i>relevant date</i> for an amount not less than 97.5% of the <i>market value</i> to a person other than the <i>issuer</i> or an <i>associate</i> or <i>associated company</i> of the <i>issuer</i> or of the <i>insurer</i>, or</p> <p>(b) a <i>listed</i> investment with respect to which (a) does not apply by reason only that –</p> <p>(i) the listing of the investment has been temporarily suspended following receipt of price sensitive information received by the stock exchange on which the investment is <i>listed</i> or the <i>regulated market</i> on which facilities for dealing have been granted, or</p> <p>(ii) the extent of the holding would prevent an orderly disposal of the investment for an amount equal to or greater than 97.5% of <i>market value</i></p>
<i>receivable</i>	in relation to an <i>insurer</i> , a <i>financial year</i> and a premium, means due to the <i>insurer</i> whether or not the premium is received during that <i>financial year</i>
<i>reinsurance recoveries</i>	amounts in respect of <i>claims</i> receivable by an <i>insurer</i> from a <i>reinsurer</i> under a contract of <i>reinsurance</i>
<i>related company</i>	in relation to an <i>insurer</i> –

	<p>(a) a <i>subsidiary undertaking</i> of the <i>insurer</i>;</p> <p>(b) a company of which the <i>insurer</i> is a <i>subsidiary undertaking</i>; or</p> <p>(c) a <i>subsidiary undertaking</i> of a company of which the <i>insurer</i> is a <i>subsidiary undertaking</i></p>
<i>relevant company</i>	an <i>insurer</i> whose <i>insurance business</i> is restricted to <i>reinsurance</i> of the <i>marine mutual</i> on terms that provide that the <i>marine mutual</i> can cancel the <i>reinsurance</i> arrangements at any time and can require the <i>insurer</i> immediately to transfer its assets and liabilities to the <i>marine mutual</i>
<i>relevant date</i>	in relation to the valuation of any asset or liability, the date at which the value of the asset or liability falls to be determined for the purposes of reporting under the <i>Accounts and Statements Rules</i>
<i>required category</i>	<p>in relation to a Form in the <i>return</i>, a category of <i>general insurance business</i> set out in column 2 of the Table in Paragraph 2B of <b>Appendix 9.2</b> that –</p> <p>(a) is, or is included in, a <i>PRA general insurance business reporting category</i> for which the Table in Paragraph 2A of <b>Appendix 9.2</b> contains a tick in the row for that <i>PRA general insurance business reporting category</i> and in the column for that Form; and</p> <p>(b) either:</p> <p>(i) meets the reporting criteria specified in the entry in column 3 of that Table that corresponds to the entry in column 2 for that the category of <i>general insurance business</i> and the entry in column 1 for that Form, or</p> <p>(ii) is required for that Form under rule 9.20.</p>
<i>return</i>	the documents required (taken together) to be deposited under rule 9.6(1)
<i>risk category</i>	any <i>PRA general insurance business reporting category</i> that is not a <i>combined category</i> , or <i>balancing category</i> or <i>exemption category</i>

<i>secured debt</i>	<p>a debt fully secured on:</p> <p>(a) assets whose value at least equals the amount of debt; or</p> <p>(b) a letter of credit or guarantee from an <i>approved counterparty</i>.</p>
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<i>securities</i>	includes <i>shares</i> , <i>debt securities</i> , <i>Treasury Bills</i> , Tax Reserve Certificates and Certificates of Tax Deposit
<i>share</i>	has the meaning given in section 1161(2) of the Companies Act 2006
<i>Statistical Rules</i>	rules 9.37 to 9.38
<i>Stock Exchange</i>	London Stock Exchange plc
<i>subsidiary undertaking</i>	has the meaning given in section 1162 of the Companies Act 2006
<i>swaption</i>	an <i>option</i> granting its owner the right but not the obligation to enter into an underlying <i>swap</i>

<i>technical provisions</i>	the items required by the <i>insurance accounts rules</i> to be shown in the balance sheet of an <i>insurer</i> at liabilities items C.1 to 6
<i>total capital resources</i>	the sum calculated at stage O of the calculation in GENPRU 2 Annex 1R
<i>total return swap</i>	a financial contract which transfers both the credit risk and market risk of an underlying asset
<i>Treasury Bills</i>	includes bills issued by Her Majesty's Government in the United Kingdom and Northern Ireland Treasury Bills

<i>unlisted</i>	see <i>listed</i>
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<i>variable interest securities</i>	<i>securities</i> which under their terms of issue provide for variable amounts of interest
<i>variation margin</i>	<p>(a) in respect of a <i>derivative contract</i>, or a <i>quasi-derivative contract</i>, assets (other than assets transferred by way of <i>initial margin</i>) which, at the <i>relevant date</i>, have been transferred by, to, or for the benefit of the <i>insurer</i> in pursuance of a condition in that contract or a related contract; and</p> <p>(b) in respect of an asset having the effect of a <i>derivative contract</i>, assets which, at the relevant date, have been transferred by, to, or for the benefit of, the <i>insurer</i> in pursuance of a contractual right conferred, or obligation imposed, by the holding of the asset having the effect of a <i>derivative contract</i></p>

<i>with-profits fund</i>	for the purposes of the <i>Accounts and Statements Rules</i> – (a) a <i>long-term insurance fund</i> (or that part of such a fund) in which <i>policy holders</i> are eligible to participate in any <i>established surplus</i> ; and (b) where it is an <i>insurer's</i> usual practice to restrict <i>policy holders'</i> participation in any <i>established surplus</i> to that arising from only a part of the fund (or part fund) falling within (a), that part (or that part of the part fund)
<i>with-profits policy</i>	a contract falling within a <i>class of long-term insurance business</i> which is eligible to participate in any part of any <i>established surplus</i> , and non-profit policy is construed accordingly

**Controller**

11.2

PRA

- (1) For the purpose of *IPRU (INS)*, **controller**, in relation to an undertaking ("A"), means a person who falls within any of the cases in (2).
- (2) The cases are where the 'person' –
- (a) holds 10% or more of the 'shares' in A;
  - (b) is able to exercise significant influence over the management of A by virtue of his shareholding in A;
  - (c) holds 10% or more of the 'shares' in a parent undertaking ("P") of A;
  - (d) is able to exercise significant influence over the management of P by virtue of his shareholding in P;
  - (e) is entitled to exercise, or control the exercise of, 10% or more of the 'voting power' in A;
  - (f) is able to exercise significant influence over the management of A by virtue of his 'voting power' in A;
  - (g) is entitled to exercise, or control the exercise of, 10% or more of the 'voting power' in P; or
  - (h) is able to exercise significant influence over the management of P by virtue of his 'voting power' in P.
- (3) In (2) the *person* means –
- (a) the person;
  - (b) any of the person's *associates*; or

- (c) the person and any of his *associates*.
- (4) **Associate**, in relation to a 'person' ("H") holding '*shares*' in an undertaking ("C") or entitled to exercise or control the exercise of 'voting power' in relation to another undertaking ("D"), means –
- (a) the spouse or civil partner of H;
  - (b) a child or stepchild of H (if under 18);
  - (c) the trustee of any 'settlement' under which H has a life interest in possession (or in Scotland a life interest);
  - (d) an undertaking of which H is a *director*;
  - (e) a person who is an employee or partner of H;
  - (f) if H is an undertaking –
    - (i) a *director* of H,
    - (ii) a *subsidiary undertaking* of H,
    - (iii) a *director* or employee of such a *subsidiary undertaking*; and
  - (g) if H has with any other person an agreement or arrangement with respect to the acquisition, holding or disposal of '*shares*' or other interests in C or D or under which they undertake to act together in exercising their 'voting power' in relation to C or D, that other person.
- (5) **Settlement**, in (4)(c), includes any disposition or arrangement under which property is held on trust (or subject to a comparable obligation).
- (6) **Shares** –
- (a) in relation to an undertaking with *share* capital, means allotted shares;
  - (b) in relation to an undertaking with capital but no *share* capital, means rights to share in the capital of the undertaking; and
  - (c) in relation to an undertaking without capital, means interests –
    - (i) conferring any right to share in the profits, or liability to contribute to the losses, of the undertaking, or
    - (ii) giving rise to an obligation to contribute to the debts or expenses of the undertaking in the event of a winding up.
- (7) **Voting power**, in relation to an undertaking which does not have general meetings at which matters are decided by the exercise of

voting rights, means the right under the constitution of the undertaking to direct the overall policy of the undertaking or alter the terms of its constitution.

## PART 2: GENERAL PROVISIONS

### *Powers under which the rules are made*

11.3 [deleted]

FCA PRA

### *Actions for damages*

11.4 Section 138D(2) of the Act does not apply to a contravention of the rules in the IPRU (INS).

FCA PRA

### *Use of definitions*

11.5 A word or phrase which is printed in italics is used in the defined sense. If a defined term does not appear in the IPRU(INS) glossary listed in part 1 of Chapter 11, the definition appearing in the main Handbook *Glossary* applies.

FCA PRA

11.6 Unless the context otherwise requires, a word or phrase which is defined in a related enactment bears the same meaning as in that enactment.

FCA PRA

11.7 Unless the context otherwise requires, a word which is related to a defined word is construed by reference to the defined word.

FCA PRA

### *Supplementary and ancillary provisions*

11.8 For the purposes of this IPRU (INS):

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- (a) a *contract of insurance* is to be treated as falling within *Annex 11.1*, notwithstanding the fact that that it contains supplementary provisions falling within *class 1* or *class 2* of *Annex 11.2* if:
  - (i) its principal object is that of a contract falling within *Annex 11.1*, and
  - (ii) it is effected or carried out by an *insurer* who has permission to effect or carry out contracts falling within *class 1* of *Annex 11.1*; and
- (b) a *contract of insurance* whose principal risk falls within any of *classes 1* to *18* of *Annex 11.2* is to be treated as falling within that *class* and no other, notwithstanding the fact that it also covers *ancillary risks*.

## Annex 11.1: Classes of Long-Term Insurance Business

FCA PRA

Number	Description	Nature of business
I	Life and annuity	Effecting or carrying out <i>contracts of insurance</i> on human life or contracts to pay <i>annuities on human life</i> , but excluding (in each case) contracts within class III.
II	Marriage and birth	Marriage or the formation of a civil partnership and birth: Effecting or carrying out <i>contracts of insurance</i> to provide a sum on marriage or the formation of a civil partnership or on the birth of a child, being contracts expressed to be in effect for a period of more than one year.
III	Linked long term	Effecting or carrying out <i>contracts of insurance</i> on human life or contracts to pay <i>annuities on human life</i> where the benefits are wholly or partly to be determined by reference to the value of, or the income from, property of any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified).
IV	Permanent health	Effecting or carrying out <i>contracts of insurance</i> providing specified benefits against risks of persons becoming incapacitated in consequence of sustaining injury as a result of an accident or of an accident of a specified class or of sickness or infirmity, being contracts that –  (a) are expressed to be in effect for a period of not less than five years, or until the normal retirement age for the persons concerned, or without limit of time; and  (b) either are not expressed to be terminable by the insurer, or are expressed to be so terminable only in special circumstances mentioned in the contract.
V	Tontines	Effecting or carrying out tontines.
VI	Capital redemption	Effecting or carrying out capital redemption contracts.
VII	Pension fund management	Effecting or carrying out –  (a) <i>pension fund management contracts</i> ; or  (b) contracts of the kind mentioned in (a) that are combined with <i>contracts of insurance</i> covering either conservation of capital or payment of a minimum interest.
VIII	Collective insurance etc	Effecting or carrying out contracts of a kind referred to in Article 2(2)(e) of the <i>Consolidated Life Directive</i> .
IX	Social insurance	Effecting or carrying out contracts of a kind referred to in Article 2(3) of the <i>Consolidated Life Directive</i> .

## Annex 11.2: Classes, and Groups of Classes, of General Insurance Business

### PART I: CLASSES OF GENERAL INSURANCE BUSINESS

FCA	PRA
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Number	Description	Nature of business
1	Accident	<p>Effecting or carrying out <i>contracts of insurance</i> providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of the person insured or, in the case of a contract made by virtue of section 140, 140A or 140B of the Local Government Act 1972, a person for whose benefit the contract is made –</p> <p>(a) sustaining injury as the result of an accident or of an accident of a specified class, or</p> <p>(b) dying as the result of an accident or of an accident of a specified class, or</p> <p>(c) becoming incapacitated in consequence of disease or of disease of a specified class,</p> <p>inclusive of contracts relating to industrial injury and occupational disease but exclusive of contracts falling within <i>class 2</i> or within <i>class IV</i> in <b>Annex 11.1</b>.</p>
2	Sickness	<p>Effecting or carrying out <i>contracts of insurance</i> providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of the two) against risks of loss to the persons insured attributable to sickness or infirmity, but exclusive of contracts falling within <i>class IV</i> in <b>Annex 11.1</b>.</p>
3	Land vehicles	<p>Effecting or carrying out <i>contracts of insurance</i> against loss of or damage to vehicles used on land, including motor vehicles but excluding railway rolling stock.</p>
4	Railway rolling stock	<p>Effecting or carrying out <i>contracts of insurance</i> against loss of or damage to railway rolling stock.</p>
5	Aircraft	<p>Effecting or carrying out <i>contracts of insurance</i> upon aircraft or upon the machinery, tackle, furniture or equipment of aircraft.</p>
6	Ships	<p>Effecting or carrying out <i>contracts of insurance</i> upon vessels used on the sea or on inland water, or upon the machinery, tackle, furniture or equipment of such vessels.</p>
7	Goods in transit	<p>Effecting or carrying out <i>contracts of insurance</i> against loss of or damage to merchandise, baggage and all other goods in transit, irrespective of the form of transport.</p>
8	Fire and natural forces	<p>Effecting or carrying out <i>contracts of insurance</i> against loss of or damage to property (other than property to which <i>classes 3</i> to <i>7</i></p>

		above relate) due to fire, explosion, storm, natural forces other than storm, nuclear energy or land subsidence.
9	Damage to property	Effecting or carrying out <i>contracts of insurance</i> against loss of or damage to property (other than property to which <i>classes 3 to 7</i> above relate) due to hail or frost or to any event (such as theft) other than those mentioned in <i>class 8</i> above.
10	Motor vehicle liability	Effecting or carrying out <i>contracts of insurance</i> against damage arising out of or in connection with the use of motor vehicles on land including third-party risks and carrier's liability.
11	Aircraft liability	Effecting or carrying out <i>contracts of insurance</i> against damage arising out of or in connection with the use of aircraft, including third-party risks and carrier's liability.
12	Liability for ships	Effecting or carrying out <i>contracts of insurance</i> against damage arising out of or in connection with the use of vessels on the sea or on inland water, including third-party risks and carrier's liability.
13	General liability	Effecting or carrying out <i>contracts of insurance</i> against risks of the persons insured incurring liabilities to third parties, the risks in question not being risks to which <i>class 10, 11 or 12</i> above relates.
14	Credit	Effecting or carrying out <i>contracts of insurance</i> against risks of loss to the persons insured arising from the insolvency of debtors of theirs or from the failure (otherwise than through insolvency) of debtors of theirs to pay their debts when due.
15	Suretyship	Effecting or carrying out— (a) <i>contracts of insurance</i> against risks of loss to the persons insured arising from their having to perform contracts of guarantee entered into by them; (b) contracts for fidelity bonds, performance bonds, administration bonds, bail bonds or customs bonds or similar contracts of guarantee.
16	Miscellaneous financial loss	Effecting or carrying out <i>contracts of insurance</i> against any of the following risks, namely – (a) risks of loss to the persons insured attributable to interruptions of the carrying on of business carried on by them or to reduction of the scope of business so carried on; (b) risks of loss to the persons insured attributable to their incurring unforeseen expense (other than loss such as is covered by contracts falling within <i>class 18</i> ); (c) risks neither falling within (a) or (b) nor being of a kind such that the carrying on of the business of effecting or carrying out <i>contracts of insurance</i> against them constitutes the carrying on of <i>insurance business</i> of some other class.
17	Legal expenses	Effecting or carrying out <i>contracts of insurance</i> against risks of loss to the persons insured attributable to their incurring legal expenses (including costs of litigation).

18	Assistance	Effecting or carrying out <i>contracts of insurance</i> providing either or both of the following benefits, namely –  (a) assistance (whether in cash or in kind) for persons who get into difficulties while travelling, while away from home or while away from their permanent residence, or  (b) assistance (whether in cash or in kind) for persons who get into difficulties otherwise than as mentioned in paragraph (a) above.
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## PART II: GROUPS OF CLASSES OF GENERAL INSURANCE BUSINESS

FCA | PRA

Number	Description	Nature of business
1	Accident and health	<i>Classes 1 and 2.</i>
2	Motor	<i>Class 1 (to the extent that the relevant risks are risks of the person insured sustaining injury, or dying, as the result of travelling as a passenger) and classes 3, 7 and 10.</i>
3	Marine and transport	<i>Class 1 (to the said extent) and classes 4, 6, 7 and 12.</i>
4	Aviation	<i>Class 1 (to the said extent) and classes 5, 7 and 11.</i>
5	Fire and other damage to property	<i>Classes 8 and 9.</i>
6	Liability	<i>Classes 10, 11, 12 and 13.</i>
7	Credit and suretyship	<i>Classes 14 and 15.</i>
8	General	<i>All classes.</i>

## Annex 11.3: Descriptions of *PRA* General Insurance Business Reporting Categories

### PART I: CATEGORIES TO WHICH CONTRACTS OF GENERAL INSURANCE BUSINESS ARE TO BE ALLOCATED FOR THE PURPOSE OF REPORTING IN THE RETURN

PRA

Category Number	<i>PRA</i> general insurance business reporting category	Map to classes of business in Annex A of 73/239/EEC
001	<b>Total Business</b> ( <i>category numbers</i> 002 and 003 combined).	N/A
002	<b>Total Primary (Direct) and Facultative Business</b> ( <i>category numbers</i> 110, 120, 160, 180, 220, 260, 270, 280, 330, 340, 350 and 400 combined).	N/A
003	<b>Total Treaty Reinsurance Accepted Business</b> ( <i>category numbers</i> 500, 600 and 700 combined).	N/A
<b>Primary (Direct) and Facultative Personal Lines Business</b>		
110	<b>Total primary (direct) and facultative accident &amp; health</b> ( <i>category numbers</i> 111 to 114 combined).	
111	<b>Medical expenses</b> <i>Contracts of insurance</i> (other than treaty reinsurance contracts) providing benefits in the nature of indemnity, with or without limit, against risks of loss to the persons insured attributable to their incurring the cost of medical treatment for sickness or infirmity or injuries sustained.	1, 2
112	<b>HealthCare cash plan</b> <i>Contracts of insurance</i> (other than treaty reinsurance contracts) providing fixed pecuniary benefits against risks of the persons insured requiring health care for sickness, infirmity or injuries sustained.	2
113	<b>Travel</b> <i>Contracts of insurance</i> (other than treaty reinsurance contracts) against a combination of risks of loss to the persons insured attributable to their travelling, or to their making of travel arrangements, and which fall within <i>classes</i> 1, 2, 8, 9, 17 or 18 and do not fall within <i>category number</i> 160 (Household and domestic all risks).	1, 2, 8, 9, 17, 18
114	<b>Personal accident or sickness</b> <i>Contracts of insurance</i> (other than treaty reinsurance contracts) which fall within <i>classes</i> 1 or 2 and which do not fall within <i>category numbers</i> 111 (Medical expenses), 112 (HealthCare cash plans), 113 (Travel), 114(p), 182 (Creditor).	1, 2

114(p)	<p><b>Personal accident as a result of insured travelling as a passenger</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against risks of death of, or injury to, passengers which the insurer elects to allocate to <i>category numbers</i> 121 to 123, 221 to 223, 331 to 333 or 341 to 347, notwithstanding that they would also fall within the definition of <i>category number</i> 114.</p>	1
120	<p><b>Total primary (direct) and facultative personal motor business</b></p> <p>(<i>category numbers</i> 121 to 123 combined).</p>	3, 10
121	<p><b>Private motor comprehensive</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against loss of, or damage to, motor vehicles used on land and against the risks of the persons insured incurring liabilities to third parties arising out of or in connection with the use of motor vehicles on land, where the motor vehicle has more than two wheels and is not a motorcycle with side-car and:</p> <p>(a) the primary purpose of each vehicle insured on the contract is to transport nine or fewer non-fare paying persons and each motor vehicle insured on the contract is individually rated;</p> <p>(b) the primary purpose of each vehicle insured on the contract is to transport nine or fewer non-fare paying persons, the persons insured are not a body corporate or partnership, and the number of vehicles insured on the contract is three or less; or</p> <p>(c) the primary purpose of each vehicle insured on the contract is to transport ten or more non-fare paying persons, the persons insured are not a body corporate or partnership and each motor vehicle insured on the contract is individually rated.</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number</i> 114(p) which the insurer elects to allocate to this category.</p>	3, 10
122	<p><b>Private motor non-comprehensive</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against the risks of the persons insured incurring liabilities to third parties arising out of or in connection with the use of motor vehicles on land or against loss of or damage to motor vehicles used on land arising only from fire or theft, where the motor vehicle has more than two wheels and is not a motorcycle with side-car and:</p> <p>(a) the primary purpose of each vehicle insured on the contract is to transport nine or fewer non-fare paying persons and each motor vehicle insured in the contract is individually rated;</p> <p>(b) the primary purpose of each vehicle insured on the contract is to transport nine or fewer non-fare paying persons, the persons insured are not a body corporate or partnership, and the number of vehicles insured on the contract is three or less; or</p> <p>(c) the primary purpose of each vehicle insured on the contract is to transport ten or more non-fare paying persons and the persons insured are not a body corporate or partnership and each motor</p>	3, 10

	<p>vehicle insured on the contract is individually rated.</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number 114(p)</i> which the insurer elects to allocate to this category.</p>	
123	<p><b>Motor cycle</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against loss of or damage to two-wheeled motor vehicles or motor cycles with a side car used on land and or against the risks of the persons insured incurring liabilities to third parties arising out of or in connection with the use of such vehicles on land.</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number 114(p)</i> which the insurer elects to allocate to this category</p>	3, 10
160	<p><b>Primary (direct) and facultative household and domestic all risks.</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against loss of or damage to any of:</p> <p>(a) structure of domestic properties,</p> <p>(b) contents of domestic properties, or</p> <p>(c) contents of domestic properties and personal items.</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against loss of or damage to structure of domestic properties and against risks to the persons insured incurring liabilities to third parties arising out of injuries sustained within the boundary of a domestic property.</p>	8, 9
180	<p><b>Total primary (direct) and facultative personal lines financial loss business</b></p> <p>(<i>category numbers 181 to 187</i> combined).</p>	
181	<p><b>Assistance</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) which:</p> <p>(a) fall within <i>class 18</i> (such as contracts relating to vehicle assistance, household assistance and legal expense helpline); and</p> <p>(b) do not fall within <i>category number 113</i> (Travel).</p>	18
182	<p><b>Creditor</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against the risk that the persons insured sustain injury, suffer sickness or infirmity, suffer loss of income due to causes that may or may not be specified in the contract, where the benefits payable under the contract relate to loans, credit card balances or other debts and the contract does not fall within <i>category number 185</i> (Mortgage indemnity).</p>	1, 2, 16
183	<p><b>Extended warranty</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against the</p>	16

	risks of loss to the persons insured attributable to failure of a product, where the purpose of the contract is to put the persons insured in the position as if the manufacturer's or vendor's warranty on the product is extended for a period of time or is extended in scope.	
184	<p><b>Legal expenses</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against the risks of loss to the persons insured attributable to their incurring legal expenses including cost of litigation that do not fall within <i>category number</i> 120.</p>	17
185	<p><b>Mortgage indemnity</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against risks of loss to the persons insured arising from the failure of debtors of theirs to pay debts relating to the purchase of a property when due and the persons insured being unable to recover the full amount of any outstanding debt by selling the property concerned.</p>	14
186	<p><b>Pet insurance</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance) against risk of loss to the person insured attributable to sickness of or accidents to domestic pets.</p>	16
187	<p><b>Other personal financial loss</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance) against risk of loss to the person insured attributable to:</p> <p>(a) loss, breakdown or reduction in value of a personal item that attach to the purchase of that item, or</p> <p>(b) to an event not taking place as intended</p> <p>where the persons insured are not a body corporate or partnership and the <i>contracts of insurance</i> do not fall within <i>category numbers</i> 113, 160 or 181 to 186.</p>	
<b>Primary (Direct) and Facultative Commercial Lines Business</b>		
220	<p><b>Total primary (direct) and facultative commercial motor business</b></p> <p>(<i>category numbers</i> 221 to 223 combined).</p>	3, 10
221	<p><b>Fleets</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against loss of, or damage to, motor vehicles used on land and / or against the risks of the persons insured incurring liabilities to third parties arising out of or in connection with the use of motor vehicles on land, where the motor vehicle has more than two wheels and is not a motorcycle with side-car and:</p> <p>(a) the primary purpose of the vehicle insured on the contract is to transport non-fare paying persons;</p> <p>(b) the motor vehicles insured on the contract are not individually rated (that is, the premium charged is for the contract as a whole and either the firm does not disclose or record for internal management purposes a separate premium for each vehicle insured on the contract, or the premium for the contract is not necessarily the same as the sum of the premiums that would have been charged had the</p>	3, 10

	<p>firm insured the vehicles under a private motor policy); and</p> <p>(c) the contract does not fall within <i>category numbers</i> 121 (private motor comprehensive) or 122 (private motor non-comprehensive).</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number</i> 114(p) which the insurer elects to allocate to this category.</p>	
222	<p><b>Commercial vehicles (non-fleet)</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against loss of, or damage to, motor vehicles used on land and / or against the risks of the persons insured incurring liabilities to third parties arising out of or in connection with the use of motor vehicles on land, where:</p> <p>(a) the persons insured are a body corporate or partnership; and</p> <p>(b) the primary purpose of the vehicles insured on the contract is to transport ten or more persons, to transport goods or for construction.</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number</i> 114(p) which the insurer elects to allocate to this category.</p>	3, 10
223	<p><b>Motor other</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) which:</p> <p>(a) fall within <i>classes</i> 3 or 10; and</p> <p>(b) do not fall within <i>category numbers</i> 120, 221 or 222.</p> <p>This category includes <i>contracts of insurance</i> relating to motor trade and taxis.</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number</i> 114(p) which the insurer elects to allocate to this category.</p>	3, 10
260	<p><b>Total primary (direct) and facultative commercial lines property business</b> (<i>category numbers</i> 261 to 263 combined).</p>	N/A
261	<p><b>Commercial property (including livestock and crops but excluding energy)</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against:</p> <p>(a) loss of or damage to commercial property; or</p> <p>(b) loss of or damage to commercial property and risks that fall within the definition of <i>category number</i> 262 (consequential loss), where the premium for the contract is rated on a single package basis and no separately identifiable premium for either the property loss or the consequential loss is charged or recorded for internal management purposes.</p> <p>This category does not include <i>contracts of insurance</i> that fall within <i>category number</i> 160 (Household), 263 (Contractors or engineering all risks), 274 (Mixed commercial package) or 343 (Energy).</p>	4, 8, 9

262	<p><b>Consequential loss (i.e. business interruption)</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against risks of loss to the persons insured attributable to interruptions of the business carried on by them, or to the reduction of the scope of the business so carried out, which result from perils insured against or other events (whether or not specified in the contract).</p> <p>This category does not include <i>contracts of insurance</i> that fall within <i>category numbers</i> 261 (Commercial property) or 343 (Energy).</p>	16
263	<p><b>Contractors or engineering all risks</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against loss of or damage to property or equipment, or against the risks of the persons insured incurring liabilities to third parties, which arise from, or are attributable to:</p> <ul style="list-style-type: none"> <li>(a) materials and works in progress during construction,</li> <li>(b) extension or renovation work,</li> <li>(c) temporary sites,</li> <li>(d) breakdown or malfunction of or damage to plant and machinery,</li> <li>(e) use of equipment hired or owned by the persons insured, or</li> <li>(f) similar types of activities.</li> </ul> <p>This category excludes <i>contracts of insurance</i> that fall within <i>category number</i> 274 (Mixed commercial package).</p>	8, 9 13
270	<p><b>Total primary (direct) and facultative commercial lines liability business</b></p> <p>(<i>category numbers</i> 271 to 274 combined).</p>	N/A
271	<p><b>Employers liability (including the employers liability part of mixed liability packages but excluding mixed commercial packages)</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against the risks of the persons insured incurring liabilities to their employees for injury, illness or death arising out of their employment during the course of business.</p> <p>This category excludes <i>contracts of insurance</i> that fall within <i>category number</i> 274 (Mixed commercial package).</p>	13
272	<p><b>Professional indemnity (including directors' and officers' liability and errors and omissions liability)</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against the risks of the persons insured incurring liabilities to third parties arising from wrongful acts (such as breach of duty, breach of trust, negligence, error or omissions) by professionals, named individuals or businesses occurring in the course of the insured's professional activities.</p>	13
273	<p><b>Public and products liability</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against the risks of the persons insured incurring liabilities to third parties for damage to property, injury, illness or death, arising in the course of the insured's business, that do not fall within <i>category numbers</i> 120 (Personal motor), 160</p>	13

	(Household and domestic all risks), 271 (Employers liability), 272 (Professional indemnity) or 274 (Mixed commercial package).	
274	<p><b>Mixed commercial package</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against more than one of:</p> <ul style="list-style-type: none"> <li>(a) loss or damage to property;</li> <li>(b) risks to the persons insured incurring liabilities to third parties;</li> <li>(c) risks of loss to the persons insured arising from the failure of debtors of theirs to pay their debts when due;</li> <li>(d) risks of loss to the persons insured attributable to interruptions of business carried on by them;</li> <li>(e) risks of loss to the persons insured attributable to their incurring unforeseen expenses; or</li> <li>(f) any other risk of loss to a commercial operation;</li> </ul> <p>where the risks and losses covered in the contract are rated on a single package basis and no separately identifiable premium is charged or recorded for internal management purposes for any one group of risks or losses specified in the contract.</p> <p>This category excludes <i>contracts of insurance</i> that fall within <i>category numbers</i> 261 (Commercial property) or 343 (Energy).</p>	8, 9, 13,14, 16, 17
280	<b>Total primary (direct) and facultative commercial lines financial loss business</b> ( <i>category numbers</i> 281 to 284 combined).	
281	<p><b>Fidelity and contract guarantee</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against risks of loss to the persons insured arising from the theft or misappropriations of money or goods by employees, or attributable to failure to complete a contract on time.</p>	16
282	<p><b>Credit</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against risks of loss to the persons insured arising from the insolvency of debtors of theirs or from the failure (otherwise than through insolvency) of debtors of theirs to pay their debts when due, and which do not fall within <i>category number</i> 185 (Mortgage indemnity).</p>	14
283	<p><b>Suretyship</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) which fall within <i>class</i> 15.</p>	15
284	<p><b>Commercial contingency</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance) against risk of loss to the person insured attributable to an event not taking place as intended where the persons insured are a body corporate or partnership.</p>	16

<b>Primary (Direct) and Facultative Aviation, Marine and Transport</b>		
330	<b>Total primary (direct) and facultative aviation business</b> ( <i>category number</i> 331 to 333 combined).	N/A
331	<p><b>Aviation liability (including liability part of airline packages)</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against:</p> <p>(a) damage arising out of, or in connection with, the use of aircraft; or</p> <p>(b) the risks of the persons insured incurring liabilities to third parties, or carrier's liabilities, arising out of, or in connection with, the use of aircraft.</p> <p>This category excludes contracts that fall within <i>category numbers</i> 332 (Aviation hull) or 333 (Space and satellite) and risks relating to use of hovercraft.</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number</i> 114(p) which the insurer elects to allocate to this category.</p>	11
332	<p><b>Aviation hull (including hull part of airline packages)</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) loss of or damage to aircraft, or the machinery, tackle, furniture or equipment of aircraft.</p> <p>This category excludes contracts that fall within <i>category number</i> 333 (Space and satellite) and risks relating to use of hovercraft.</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number</i> 114(p) which the insurer elects to allocate to this category.</p>	5
333	<p><b>Space and satellite</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) upon satellites, aircraft or the machinery, tackle, furniture or equipment of satellites or aircraft.</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against:</p> <p>(a) damage arising out of or in connection with the use of satellites or aircraft; or</p> <p>(b) the risks of the persons insured incurring liabilities to third parties arising out of or in connection with the use of satellites or aircraft;</p> <p>where any aircraft insured in the contract is intended to transport satellites or to travel to, or be transported to, beyond the earth's atmosphere.</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number</i> 114(p) which the insurer elects to allocate to this category.</p>	5, 11
340	<b>Total primary (direct) and facultative marine business</b> ( <i>category numbers</i> 341 to 347 combined).	N/A
341	<b>Marine liability</b>	12

	<p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against damage or against the risks of the persons insured incurring liabilities to third parties or carrier's liabilities, arising out of or in connection with the use of vessels on the sea or on inland water (including hovercraft), and which do not fall within <i>category numbers</i> 342 (Marine hull) or 347 (Yacht).</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number</i> 114(p) which the insurer elects to allocate to this category.</p>	
342	<p><b>Marine hull</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against loss of or damage to vessels on the sea or on inland water (including hovercraft), or upon the machinery, tackle, furniture or equipment of such vessels, which do not fall within <i>category numbers</i> 346 (War risks) or 347 (Yacht).</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number</i> 114(p) which the insurer elects to allocate to this category.</p>	6
343	<p><b>Energy (on and off-shore)</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against loss of or damage to property, or against the risks of the persons insured incurring liabilities to third parties, or against risks of loss to the persons insured attributable to interruptions of business carried on by them, arising from the undertaking of energy operations on both land and sea.</p> <p><i>Contracts of insurance</i> other than treaty reinsurance that fall within the definition of <i>category number</i> 114(p) which the insurer elects to allocate to this category.</p>	6, 8, 9, 12, 13, 16
344	<p><b>Protection and indemnity</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against the risks of the persons insured incurring liabilities to third parties for damage to property, injury, illness or death on board vessels on the sea or inland water or at locations associated with the operation of such vessels such as docks, arising from the negligence of the owner of or individuals responsible for the vessels.</p> <p><i>Contracts of insurance</i> other than treaty reinsurance that fall within the definition of <i>category number</i> 114(p) which the insurer elects to allocate to this category.</p>	12
345	<p><b>Freight demurrage and defence</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against the risks of loss to the persons insured attributable to their incurring legal expenses (including costs of litigation) arising from loss of or damage to goods during a period of transit that included, or was due to include, transport of the goods via sea or inland water.</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number</i> 114(p) which the insurer elects to allocate to this category.</p>	17
346	<p><b>War risks</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against loss of or damage to property or mass transportation vehicles arising from war, civil war, revolution, rebellion, insurrection or hostile act by a belligerent power.</p>	6

	<i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number 114(p)</i> which the insurer elects to allocate to this category.	
347	<p><b>Yacht</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) upon vessels on the sea or on inland water.</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against:</p> <p>(a) damage arising out of or in connection with the use of vessels on the sea or on inland water, or upon the machinery, tackle, furniture or equipment of such vessels; or</p> <p>(b) the risks of the persons insured incurring liabilities to third parties, arising out of or in connection with the use of vessels on the sea or on inland water;</p> <p>where the vessels insured in the contract are not used for transporting goods or fare-paying passengers.</p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that fall within the definition of <i>category number 114(p)</i> which the insurer elects to allocate to this category.</p>	6, 12
350	<p><b>Primary (direct) and facultative goods in transit</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) against loss of, or damage to, merchandise, baggage and all other goods in transit, irrespective of the form of transport.</p>	7
400	<p><b>Miscellaneous primary (direct) and facultative business</b></p> <p><i>Contracts of insurance</i> (other than treaty reinsurance contracts) that, in the reasonable opinion of the <i>insurer's governing body</i>, do not fall within <i>category numbers 110 to 350</i> or may mislead users of the return if allocated to one of <i>category numbers 110 to 350</i>.</p>	N/A
<b>Non-Proportional Reinsurance Treaty Business</b>		
500	<b>Total Non-Proportional Reinsurance Treaty Business accepted</b> ( <i>category numbers 510 to 590 combined</i> ).	N/A
510	<b>Non-proportional accident &amp; health</b> <i>Contracts of insurance</i> , effected or carried out under <i>non-proportional reinsurance treaties</i> or proportional retrocession of <i>non-proportional treaty reinsurance</i> business, which fall within <i>classes 1 or 2</i> , and do not fall within <i>category numbers 590 or 710(p)</i> .	1, 2
520	<b>Non-proportional motor</b> <i>Contracts of insurance</i> , effected or carried out under <i>non-proportional reinsurance treaties</i> or proportional retrocession of <i>non-proportional treaty reinsurance</i> business, which fall within <i>classes 3 or 10</i> , or <i>category number 710(p)</i> , and do not fall within <i>category number 590</i> .	3, 10

530	<p><b>Non-proportional aviation</b></p> <p><i>Contracts of insurance, effected or carried out under non-proportional reinsurance treaties or proportional retrocession of non-proportional treaty reinsurance business, which fall within classes 5 or 11, or category number 710(p), and do not fall within category number 590.</i></p>	5, 11
540	<p><b>Non-proportional marine</b></p> <p><i>Contracts of insurance, effected or carried out under non-proportional reinsurance treaties or proportional retrocession of non-proportional treaty reinsurance business, which fall within classes 6 or 12, or category number 710 (p), and do not fall within category number 590.</i></p>	6, 12
550	<p><b>Non-proportional transport</b></p> <p><i>Contracts of insurance, effected or carried out under non-proportional reinsurance treaties or proportional retrocession of non-proportional treaty reinsurance business, which fall within class 7, and do not fall within category number 590.</i></p>	7
560	<p><b>Non-proportional property</b></p> <p><i>Contracts of insurance, effected or carried out under non-proportional reinsurance treaties or proportional retrocession of non-proportional treaty reinsurance business, which fall within classes 8 or 9, and do not fall within category number 590.</i></p>	4, 8, 9
570	<p><b>Non-proportional liability (non-motor)</b></p> <p><i>Contracts of insurance, effected or carried out under non-proportional reinsurance treaties or proportional retrocession of non-proportional treaty reinsurance business, which fall within class 13, and do not fall within category numbers 520, 530, 540 or 590.</i></p>	13
580	<p><b>Non-proportional financial lines</b></p> <p><i>Contracts of insurance, effected or carried out under non-proportional reinsurance treaties or proportional retrocession of non-proportional treaty reinsurance business, which fall within classes 14, 15, 16, 17 or 18, and do not fall within category number 590.</i></p>	14, 15, 16, 17, 18
590	<p><b>Non-proportional aggregate cover</b></p> <p><i>Contracts of insurance, effected or carried out under non-proportional reinsurance Treaties or proportional retrocession of non-proportional treaty reinsurance business, which will fall within more than one of category numbers 510 to 580, where no one of these categories accounts for more than 90% of the exposure on the contract.</i></p>	1 to 18
<b>Proportional Reinsurance Treaty Business</b>		
600	<p><b>Total Proportional Reinsurance Treaty Business accepted</b> (<i>category numbers 610 to 690 combined</i>).</p>	N/A
610	<p><b>Proportional accident &amp; health</b></p> <p><i>Contracts of insurance, effected or carried out under proportional reinsurance treaties other than proportional retrocession of non-proportional treaty reinsurance business, which fall within classes 1 or 2 and do not fall within category numbers 690 or 710 (p).</i></p>	1, 2

620	<p><b>Proportional motor</b></p> <p><i>Contracts of insurance effected or carried out under proportional reinsurance treaties other than proportional retrocession of non-proportional treaty reinsurance business, which fall within classes 3 or 10, or category number 710(p) and do not fall within category number 690.</i></p>	3, 10
630	<p><b>Proportional aviation</b></p> <p><i>Contracts of insurance, effected or carried out under proportional reinsurance treaties other than proportional retrocession of non-proportional treaty reinsurance business, which fall within classes 5 or 11, or category number 710(p) and do not fall within category number 690.</i></p>	5, 11
640	<p><b>Proportional marine</b></p> <p><i>Contracts of insurance, effected or carried out under proportional reinsurance treaties other than proportional retrocession of non-proportional treaty reinsurance business, which fall within classes 6 or 12, or category number 710(p) and do not fall within category number 690.</i></p>	6, 12
650	<p><b>Proportional transport</b></p> <p><i>Contracts of insurance, effected or carried out under proportional reinsurance treaties other than proportional retrocession of non-proportional treaty reinsurance business, which fall within class 7 and do not fall within category number 690.</i></p>	7
660	<p><b>Proportional property</b></p> <p><i>Contracts of insurance, effected or carried out under proportional reinsurance treaties other than proportional retrocession of non-proportional treaty reinsurance business, which fall within classes 8 or 9 and do not fall within category number 690.</i></p>	4, 8, 9
670	<p><b>Proportional liability (excluding motor)</b></p> <p><i>Contracts of insurance, effected or carried out under proportional reinsurance treaties other than proportional retrocession of non-proportional treaty reinsurance business, which fall within class 13 and do not fall within category numbers 620, 630, 640 or 690.</i></p>	13
680	<p><b>Proportional financial lines</b></p> <p><i>Contracts of insurance, effected or carried out under proportional reinsurance treaties other than proportional retrocession of non-proportional treaty reinsurance business, which fall within classes 14, 15, 16, 17, or 18 and do not fall within category number 690.</i></p>	14, 15, 16, 17, 18
690	<p><b>Proportional aggregate cover (i.e. more than one of the above)</b></p> <p><i>Contracts of insurance, effected or carried out under proportional reinsurance treaties other than proportional retrocession of non-proportional treaty reinsurance business, which fall within more than one of the category numbers 610 to 680, where no one of these categories accounts for more than 90% of the exposure on the contract.</i></p>	1 to 18
700	<p><b>Miscellaneous treaty reinsurance accepted business</b></p> <p><i>Contracts of insurance effected or carried out under reinsurance treaties that, in the reasonable opinion of the insurer's governing body, do not fall within category numbers 500 or 600 or may mislead users of the return if allocated</i></p>	N/A

	to one of these categories.	
710(p)	<p><b>Treaty reinsurance passenger accident</b></p> <p><i>Contracts of insurance effected or carried out under reinsurance treaties against risks of death of, or injury to, passengers which the insurer elects to allocate to category numbers 520, 530, 540, 590, 620, 630, 640 or 690 notwithstanding that they would also fall within the definition of category numbers 510 or 610.</i></p>	

**PART II: GROUPS OF CATEGORIES OF *GENERAL INSURANCE BUSINESS* TO WHICH CATEGORIES IN PART I ARE TO BE ALLOCATED FOR THE PURPOSE OF REPORTING IN THE RETURN**

**PRA**

Category Number	<i>PRA</i> general insurance business reporting category	Map to classifications in Annex A of 73/239/EEC
409	<p><b>Balance of all primary (direct) and facultative business</b></p> <p>All <i>direct and facultative insurance business</i> reported in a <i>Form 20 to 25</i> under <i>category number 002</i> that is not also reported in the same Form under <i>category numbers 110, 120, 160, 180, 220, 260, 270, 280, 330, 340, 350, and 400.</i></p>	N/A
709	<p><b>Balance of all treaty reinsurance accepted business</b></p> <p>All <i>treaty reinsurance business</i> reported in a <i>Form 20 to 25</i> under <i>category number 003</i> that is not also reported in the same Form under <i>category numbers 500, 600 and 700.</i></p>	N/A



## 12 Chapter 12: Transitional Arrangements

*Reporting of information relating to financial years prior to the financial year ending on or after 31 December 2005*

12.1

PRA

- (1) An *insurer* that is required to report the information in (2) in respect of any *financial year* ending on or after 31 December 2005, may report that information as set out in (3).
- (2) The information in (1) is information that is required to be inserted in –
  - (a) column 1 to 3 or 11 and rows relating to accident years prior to 1995 of Forms 23, 26 or 27;
  - (b) column 1,3 or 10 and rows relating to accident years prior to 1995 of Forms 31 and 32; or
  - (c) column 1 or 8 and rows relating to underwriting years prior to 1995 of Form 34.
- (3) Information relating to –
  - (a) aggregate treaty business falling within the definition of *category number 590 or 690*, may be reported in *category numbers 510 to 580 or 610 to 680*;
  - (b) commercial package business falling within the definition of *category number 274* business, may be reported in *category numbers 261, 271 or 273*;
  - (c) business that was reported under a single risk group or business category in the *return* for the *financial year* immediately preceding the first *financial year* that ended on or after 31 December 2005, may be reported in a single *risk category* if and 90% or more of the claim liabilities reported under the risk group or business category fall into that single *risk category*;
  - (d) any business covering risks relating to hovercraft which was classified under the heading 'Aviation' in the *return* for the *financial year* immediately preceding the first *financial year* that ended on or after 31 December 2005, may be reported in any of *category numbers 331 to 333* (aviation);
  - (e) any business covering liability for loss of, or damage to, goods in transit which was classified under the heading 'Transport' in the *return* for the *financial year* immediately preceding the first *financial year* that ended on or after 31 December 2005, may be reported in *category number 350* (transport);
  - (f) any business which was classified under the heading 'Accident and Health' in the *return* for the *financial year* immediately preceding the first *financial year* that ended on or after 31 December 2005, and which would otherwise be allocated to

*category number 114(p)*, may be reported in *category number 114*;

- (g) any business which was classified under the heading 'Marine, Aviation or Transport Treaty' in the *return* for the *financial year* immediately preceding the first *financial year* that ended on or after 31 December 2005, and which would otherwise be allocated to *category number 550* or *650*, may be reported in *category numbers 530, 540, 630* or *640*; and
- (h) any business which was classified under the heading '*accounting class 11*' in the *return* for the *financial year* immediately preceding the first *financial year* that ended on or after 31 December 2005, may be reported in *category number 510* to *590* (non-proportional treaty reinsurance).

*Reporting of historical information relating to Forms 26, 27, 28, 29, 31, 32 and 34*

- 12.2
- (1) An *insurer* that is required by rule 9.17 or 9.19 to prepare any of Forms 26, 27, 28, 29, 31, 32 or 34 in respect of the first *financial year* ending on or after 31 December 2005 must send to the *PRA* the additional information in (2).
  - (2) The additional information in (1) –
    - (a) is historical development data in respect of business reported on each relevant Form;
    - (b) must be prepared as set out in (3) to (8);
    - (c) must be submitted in the format of the 2005 Return Transitional Tables A, B, C and D in the form laid out in rule 12.4;
    - (d) must be submitted as a computer spreadsheet file that can be accessed by Microsoft Excel; and
    - (e) must be submitted to *PRA* by electronic email or a CDROM disk, in either case at the same time as the *return* to which it relates.
  - (3) An *insurer* must prepare –
    - (a) 2005 Return Transitional Tables A and B in respect of each required category for which it is required to prepare Form 26, 27, 28, 29, 31, 32 or 34 except where the *required category* is *category number 400* or *700*; and
    - (b) 2005 Transitional Table C and D in respect of each *required category* for which it is required to prepare Form 31 or 32 except where the *required category* is *category number 400*.
  - (4) An *insurer* must show years of origin in the first two columns of each Table where –

- (a) a year of origin is a *financial year* and the columns contain the month and year, on the Gregorian calendar, in which that *financial year* ends;
  - (b) the month and year are to be in MM and YYYY date format, where MM is a two digit month of the year (between 01 and 12) and YYYY is a calendar year;
  - (c) years of origin are entered in sequence with the latest year of origin (i.e. the first *financial year* ended on or after 31 December 2005) in row 33;
  - (d) not report more than the 30 latest years of origin are reported;
  - (e) the years of origin reported on a Table are consistent with how the *insurer* has allocated claims to accident or underwriting years on the *Forms 27, 29, 31, 32 or 34*, as the case may be, on which the same business is reported.
- (5) If an *insurer* is reporting business on a Table that is reported on a *Form 27, 31 or 32*, the year of origin must be an accident year and the entries along the rows of the Table must relate to claims that occurred in that origin year. If an *insurer* is reporting business on a Table that is reported on a *Form 29 or 34*, the year of origin must be an underwriting year and the entries along the rows of the Table must relate to claims arising from business written in that origin year.
- (6) Historical development data must be prepared in the same currency as the Form that gave rise to the requirement to prepare the Table.
- (7) In preparing any of the 2005 Return Transitional Tables A, B C and D, an *insurer* must, subject to (9), complete
- (a) all entries relating to years of origin ending between 31/12/1996 and 30/12/2006 inclusive and all entries for the "prior years" row; and
  - (b) subject to the total number of years of origin reported on a Table being no more than 30, all entries relating to:
    - (i) years of origin ending between 23/12/1993 and 30/12/1996 inclusive for business in *category numbers* 610, 620, 650, 660 and 680.
    - (ii) years of origin ending between 31/12/1983 and 30/12/1996 inclusive for business in *category numbers* 510 to 580, 630, 640 and 670, and
    - (iii) years of origin ending prior to 31/12/1996 for business in *category numbers* 271 to 273;
- (8) an *insurer* that does not maintain records of historical development data by a *required category* for which it is required to prepare any of 2005 Return Transitional Tables A, B, C and D, may make a reasonable

estimate of an entry required under (7) in the Table for that *required category*;

- (9) an *insurer* may omit an entry required under (7) in a Table for a *required category* if –
- (a) in the opinion of its *governing body*, the *insurer* does not have the information needed to complete, or make a reasonable estimate of, the entry;
  - (b) it does not use any data required for that entry when setting its provisions for claim liabilities for business in the *required category*; and
  - (c) it states in a supplementary note to the Table an explanation for the entry omitted.
- (10) If for any year of origin the duration of any development year is not 12 months, an *insurer* must identify each such development year and state its duration in a supplementary note to the Tables (code TA02).

*Reconciliation of information reported in the return for the first financial year ended on or after 31 December 2005 to equivalent information reported in the previous return*

### 12.3

An *insurer* must carry out and send to the appropriate regulator, at the same time as it submits its *return* in respect of the first *financial year* ending on or after 31 December 2005, the following reconciliations –

- (a) the sum of the amounts reported in column 1 plus column 3 on each Form 27 in the *return* for the first *financial year* ended on or after 31 December 2005 to the sum of the amounts reported in the column 1 plus column 3 plus column 4 on each Form 27 in the previous *return*;
- (b) the amounts reported in the column headed 'Gross claims paid / In previous financial years' on each of Forms 31, 32 and 34 in the *return* for the first *financial year* ended on or after 31 December 2005 to the sum of the amounts reported in the column headed 'Gross claims paid / In previous financial years' plus the amounts reported in the column headed 'Gross claims paid / In this financial year' on each Forms 31, 32, and 34 in the previous *return*;
- (c) the amounts reported in the column headed 'Gross claims outstanding brought forward / Reported' on each of Forms 27, 31, 32 and 34 in the *return* for the first *financial year* ended on or after 31 December 2005 to the amounts reported in the column headed 'Gross claims outstanding carried forward / Reported' on each of Forms 27, 31, 32 and 34 in the previous *return*;
- (d) the amounts reported in the line titled 'Technical provisions / Brought forward / Undiscounted' (line 51) on Form 28 in the

*return* for the first *financial year* ended on or after 31 December 2005 to the amounts reported in the line titled 'Technical provisions / Carried forward / Undiscounted' (line 53) on Form 28 in the previous *return*;

- (e) the amounts in the column headed 'Total number of claims settled at non-zero cost at end of the 2004 financial year' on each Table D to the amounts reported in the column headed 'Number of claims / Closed at some cost during this or previous financial years' (column 1) on each Form 31 and 32 in the previous *return*.

*2005 return Transitional Tables A, B, C and D*

12.4 These tables belong to rule 12.2.



## **Instructions to Table A**

In these instructions "the 2005 *financial year*" means the first *financial year* ending on or after 31 December 2005.

### Table A instruction 1

In the columns 1 and 2 year of origin is the *financial year* ending in the month and year shown.

### Table A instruction 2

In the columns 1 and 2 the years of origin may be accident years or underwriting years.

In row 1 columns 1 and 2 replace "[year of origin]" with "accident year" if the business reported on the Table is reported on **Forms 26, 27, 31 or 32** or "underwriting year" if the business reported on the Table is reported on **Forms 28, 29 or 34**.

If the years of origin in columns 1 and 2 are accident years, the gross paid claims in each of the years of development 0 to 29 must be in respect of all claims in the *required category* that occurred in the year of origin.

If the years of origin in columns 1 and 2 are underwriting years, the gross paid claims in each of the years of development 0 to 29 must be in respect of all policies in the *required category* written in the year of origin.

### Table A instruction 3

In row 3 column 33 the gross claims paid after the last reported year of development are gross claims paid in the 2005 *financial year* in respect of all the years of origin prior to the earliest year of origin for which historic data must be reported in the Table under rule 12.2(7).

### Table A instruction 4

In column 34 the total gross claims paid to end of the 2005 *financial year* for a year of origin is the sum of all incremental payments for that year of origin and should equal:

**Form 27** columns 1+3+4 for the row that matches that year of origin

**Form 31 or 32** columns 3+4 for the row that matches that year of origin

**Form 34** columns 1+2 for the row that matches that year of origin

for treaty, accident year;

for direct & facultative, accident year; or

for direct & facultative, underwriting year.

### Table A instruction 5

In column 35 the total gross claims paid in the 2005 *financial year* for a year of origin is equal to the final entry on each diagonal for that year of origin and should equal:

**Form 27** column 4 for the row that matches that year of origin  
**Form 28** line 21 for the row that matches that year of origin  
**Form 31** or **32** column 4 for the row that matches that year of origin  
**Form 34** column 2 for the row that matches that year of origin

for treaty, accident year;  
for treaty, underwriting year;  
for direct & facultative, accident year; or  
for direct & facultative, underwriting year.

Table A instruction 6

The box marked "category number" must be completed by inserting the 3 digit *category number* to which the *risk category* relates.

The box marked "currency" must be completed by inserting the relevant 3 character currency code from the list in the Table in **Appendix 9.2 Paragraph**

31.

The box marked "reporting territory" must be completed by inserting the relevant 2 character code from the list in the Table in **Appendix 9.2 Paragraph**

32.

Table A instruction 7

The number of *financial years* required may differ from the number of rows against the relevant description where for instance the *insurer* has had *financial years* that are not 12 months.



## Instructions to Table B

In these instructions "the 2005 *financial year*" means the first *financial year* ending on or after 31 December 2005.

### Table B instruction 1

The year of origin is the *financial year* ending in the month and year shown.

### Table B instruction 2

In columns 1 and 2 the years of origin may be accident years or underwriting years.

In row 1 columns 1 and 2 replace "[year of origin]" with "accident year" if the business reported on the Table is reported on **Forms 26, 27, 31 or 32** or "underwriting year" if the business reported on the Table is reported on **Forms 28, 29 or 34**.

If the years of origin in columns 1 and 2 are accident years, the gross incurred claims at the end of each of the years of development 0 to 29 must be in respect of all claims in the *required category* that occurred in the year of origin.

If the years of origin in columns 1 and 2 are underwriting years, the gross incurred claims at the end of each of the years of development 0 to 29 must be in respect of all policies in the *required category* written in the year of origin.

### Table B instruction 3

In row 3 column 34, the gross reported outstanding claims for prior years of origin are the *insurer's* estimate of total gross reported outstanding claims at the end of the 2005 *financial year* in respect of all the years of origin prior to the earliest year of origin for which historic data must be reported in the Table under rule 12.2(7).

### Table B instruction 4

In column 34 gross reported outstanding claims at end of the 2005 *financial year* for a year of origin should equal total gross reported claims at end of the 2005 *financial year* from column 33 of **Table B** less the total gross claims paid to the end of the 2005 *financial year* from column 34 of **Table A** and should also equal:

**Form 27** column 5 for the row that matches that year of origin

**Form 29** line 11 for the row that matches that year of origin

**Form 31** or **Form 32** column 5 for the row that matches that year of origin

**Form 34** column 3 for the row that matches that year of origin

for Treaty, accident year;

for Treaty, underwriting year;

for direct & facultative, accident year; or

for direct & facultative, underwriting year.

Table B instruction 5

The box marked "category number" must be completed by inserting the 3 digit *category number* to which the *risk category* relates.

The box marked "currency" must be completed by inserting the relevant 3 character currency code from the list in the Table in **Appendix 9.2 Paragraph 31**.

The box marked "reporting territory" must be completed by inserting the relevant 2 character code from the list in the Table in **Appendix 9.2 Paragraph 32**.

Table B instruction 6

The number of *financial years* required may differ from the number of rows against the relevant description instance where the *insurer* has had *financial years* that are not 12 months.



## **Instructions to Table C**

In these instructions "the 2005 *financial year*" means the first *financial year* ending on or after 31 December 2005.

### Table C instruction 1

The year of origin is the *financial year* ending in the month and year shown.

### Table C instruction 2

In columns 1 and 2 the years of origin are accident years.

In row 1 columns 1 and 2 replace "[year of origin]" with "accident year".

For each year of origin, the number of claims reported in each of the years of development 0 to 29 must be in respect of all claims in the *required category* that occurred in the year of origin.

### Table C instruction 3

In row 3 column 33, the number of claims reported after the last year of development are all claims reported in the 2005 *financial year* in respect of all the years of origin prior to the earliest year of origin for which historic data must be reported in the Table under rule 12.2(7).

### Table C instruction 4

The box marked "category number" must be completed by inserting the 3 digit *category number* to which the *risk category* relates.

The box marked "currency" must be completed by inserting the relevant 3 character currency code from the list in the Table in **Appendix 9.2 Paragraph 31**.

The box marked "reporting territory" must be completed by inserting the relevant 2 character code from the list in the Table in **Appendix 9.2 Paragraph 32**.

### Table C instruction 5

The number of *financial years* required may differ from the number of rows against the relevant description for instance where the *insurer* has had *financial years* that are not 12 months.



Number of claims settled at non-zero cost excluding any claims re-opened and not yet re-closed at the end of each development year in respect of each year of origin

On this Table "the 2005 financial year" means the first financial year ending on or after 31 December 2005 and the "2004 financial year" means the financial year immediately preceding the 2005 financial year.

1		2		3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35
[year of origin] ended		Year of development																													Total number of claims settled at non-zero cost at end of the 2005 financial year (= final entry of each diagonal)	Total number of reported outstanding claims as at end of the 2005 financial year	Total number of claims settled at non-zero cost at end of the 2004 financial year (= second last entry of each diagonal)			
Month	Year	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28				29		
1		prior years																													see instruction 3					
2		<div style="display: flex; align-items: center; justify-content: center;"> </div> <p style="text-align: center; margin-top: 10px;">Data for years of origin prior to 31/12/1996 is only required for category numbers 271 to 273 (see rule 12.2(7) and instruction 6)</p> <p style="text-align: center; margin-top: 10px;">Data for years of origin prior to 30/12/1996 are only required for category numbers 271 to 273 (see rule 12.2(7) and instruction 6)</p>																													<p>Data for years of origin prior to 30/12/1996 are only required for category numbers 271 to 273 (see rule 12.2(7) and instruction 6)</p>					
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29																																				
30																																				
31																																				
32																																				
33																																				
34																																		All origin years		

## **Instructions to Table D**

In these instructions "the 2005 *financial year*" means the first *financial year* ending on or after 31 December 2005.

### Table D instruction 1

The year of origin is the *financial year* ending in the month and year shown.

### Table D instruction 2

The year of origin is an accident year.

In row 1 columns 1 and 2 replace "[year of origin]" with "accident year".

For each year of origin, the number of claims settled at non-zero cost at the end of each of the development years 0 to 29 must be in respect of all claims in the *required category* that occurred in that year of origin.

### Table D instruction 3

In row 3 column 34, the number of reported outstanding claims for prior years of origin is the number of reported outstanding claims at the end of the 2005 *financial year* in respect of all the years of origin prior to the earliest year of origin for which historic data must be reported in the Table under rule 12.2(7).

### Table D instruction 4

Total number of claims settled at non-zero cost at end of the 2005 *financial year* for each year of origin should equal **Form 31** or **Form 32** column 1.

### Table D instruction 5

The box marked "category number" must be completed by inserting the 3 digit *category number* to which the *risk category* relates.

The box marked "currency" must be completed by inserting the relevant 3 character currency code from the list in the Table in **Appendix 9.2 Paragraph 31**.

The box marked "reporting territory" must be completed by inserting the relevant 2 character code from the list in the Table in **Appendix 9.2 Paragraph 32**.

Table D instruction 6

The number of *financial years* required may differ from the number of rows against the relevant description for instance where the *insurer* has had *financial years* that are not 12 months.

Table D instruction 7

Claims settled at non-zero cost in column 35 are the figures for which the reconciliation is required in rule 12.3(e).

*Financial year ending on or after 31 December 2005*

12.5

PRA

The amendments to *IPRU(INS)* made by the interim Prudential Sourcebook for insurers (Regulatory Reporting) Instrument 2005 first apply to a *firm* with respect to its *financial year* ending on or after 31 December 2005.

- (e) the amounts in the column headed 'Total number of claims settled at non-zero cost at end of the 2004 financial year' on each *Table D* to the amounts reported in the column headed 'Number of claims / Closed at some cost during this or previous financial years' (column 1) on each *Form 31 and 32* in the previous *return*.

*Pure Reinsurance Groups*

12.5A

A *pure reinsurer* whose *ultimate EEA insurance parent undertaking* is the *parent undertaking* of a *group* comprised solely of *reinsurance undertakings* need not comply with rule 9.40 (Group capital adequacy) before 10 December 2007.

*Guidance*

12.6

PRA

- (1) Rule 12.2 requires *insurers* to prepare historical development data in triangular format for each 'required category of business' for which a *Form 26 to 29, 31, 32 or 34* is required in the *return* for the first *financial year* ended on or after 31 December 2005. The purpose of the rule is to enable users of the *return* to carry out independent analysis of the development of paid and incurred claims and claim numbers in the new categories. When preparing data required by this rule an *insurer* should consider the need of the user and provide the data as accurately as reasonable possible.
- (2) Under the reporting requirements of risk groups and *business categories* (i.e. the requirements that applied from 1996 to 2004), it has been common practice for users of the *return* to accumulate data from many returns to create the past claims development, usually in triangular form, for each risk group and business category. With the introduction of a new categorisation of *general insurance business*, users of the *return* will not have past claims development for the new categories without this transitional rule.
- (3) Under rule 12.2(6), an *insurer* that is required to prepare any of Tables A to D for a *required category* may make a reasonable estimate of entries in the Table in the case where the *insurer* maintains its internal records in such a way that there is not a one-one or many-one mapping of its internal classification to the *required category*. For example, if an *insurer* is required to prepare Table A and B for a *category number XXX* carried on in GBP and the insurer's classification of business that it uses for its internal analysis and management reporting is such that business in XXX in GBP is recorded in two of its internal classes both of which also contain business other than XXX in GBP, the insurer may make a reasonable estimate of the data needed in Table A and B for XXX in GBP from the business it has recorded in those two internal classes.

- (4) When an *insurer* does not have all the data required for Tables A to D, it should provide the data that it has available. For example an *insurer* may not hold data for all the years of origin prior to 1996 specified in the Tables, or an *insurer* may not hold data relating to some of the earlier diagonals specified in the Tables. In particular, if an *insurer's* internal classification of its claim development data is such that it would be highly burdensome to extract the data specified in Tables A to D in respect of business that falls into *category numbers* 590 or 690, it need not prepare the Tables for these *category numbers*. An *insurer* need not prepare Tables A to D for *category numbers* 400 and 700 (the *miscellaneous categories*).
- (5) Under rule 12.2(7), an *insurer* that is required to prepare any of Tables A to D for a *required category* may omit an entry for a Table if it does not have the data needed to complete the entry and does not use that data for setting provisions for claim liabilities for business in that *required category*. An *insurer* should not omit data required to be reported on the Tables if it uses that data for its internal claim reserving. For example if an *insurer* is required to prepare Table A for *category number* 570 carried on in GBP and it does not have records of gross claims paid in development years 0 to 5 in respect of year of origin 1986 and it does not use incremental gross claims paid data to set claims provisions in respect of that business and year of origin 1986, it may omit the incremental gross claims paid in development years 0 to 5 in respect of year of origin 1986 in Table A for that *required category*.
- (6) If, for example, an *insurer* has had a 30 September *financial year end* and in, say, 2002 it decided to change to a 31 March *financial year end*, the years of origin it is required to report on a Table under 12.2(4)(a) to (c) could be any of the following unless 12.2(4)(e) requires otherwise:

Actual <i>financial year end</i>	Year of origin shown on Table	Actual <i>financial year end</i>	Year of origin shown on Table	Actual <i>financial year end</i>	Year of origin shown on Table
	A		B	C	
30/09/2000	09-2000	30/09/2000	09-2000		
30/09/2001	09-2001	30/09/2001	09-2001	30/09/2000	09-2000
31/03/2002	03-2002	30/09/2002	09-2002	30/09/2001	09-2001
31/03/2003	03-2003	31/03/2003	03-2003	31/03/2003	03-2003
31/03/2004	03-2004	31/03/2004	03-2004	31/03/2004	03-2004
31/03/2005	03-2005	31/03/2005	03-2005	30/03/2005	03-2005
31/03/2006	03-2006	31/03/2006	03-2006	31/03/2006	03-2006

Under 12.2(4)(e) if, for example the business reported on the Table is reported on a **Form 31** and claims reported on that **Form 31** relating to accident years 2002 and 2003 are claims that occurred in the periods 1

October 2001 to 31 March 2002 and 1 April 2002 to 31 March 2003 respectively, the *insurer* would be required to report the years of origin under option A.

If option C applies, a calendar year (in this case 2002) would be missing from the sequence of years of origin. If the example instead had the *financial year end* changing from 31 March to 30 September in 2002, then a calendar year (in this case 2002) could appear twice in the sequence of years of origin. Thus under 12.2(4)(a) to (c) a calendar year may appear more than once or not at all in the sequence of years of origin in column 1 of a Table.

- (7) If an *insurer* is unable to submit the information required in 12.2(2) to *PRA* in a computer spreadsheet file that can be accessed by Microsoft Excel, it should request guidance from *PRA* as to the format in which to submit the information. The computer spreadsheet file that an *insurer* is required to send to the *PRA*, under 12.2(2)(d), should be the computer spreadsheet file that *PRA* makes available on its website or sends to *insurers* by electronic mail, with the relevant entries completed. An *insurer* should complete a template for each 2005 Return Transitional Tables A, B, C and D it is required to prepare. An *insurer* should submit a single computer spreadsheet file with each tab (or page) of the spreadsheet containing a single 2005 Return Transitional Table. An *insurer* should request guidance from *PRA* as to how to send the computer spreadsheet file if it is unable to send it by electronic mail or on a CD-ROM disk.

12.7

FCA PRA

- (1) GEN (the part of the appropriate regulator Handbook in High Level Standards which has the title General Provisions) contains some technical transitional provisions that apply throughout the Handbook and which are designed to ensure a smooth transition at commencement of the *Act*. These include transitional provisions relevant to record keeping and notification rules.
- (2) *SUP* contains transitional provisions which carry forward written concessions relating to pre-commencement provisions.

*Off-market derivatives in linked funds*

12.8

- (1) This transitional rule has effect from 31 December 2006 to 30 December 2007.
- (2) For the purpose of the definition of *permitted derivative contract* in *IPRU (INS) 11.1*:
- (a) *INSPRU 3.2.5R(3)(b)* has effect as if the words "and is capable of valuation" and "to *INSPRU 3.2.35R*" were omitted;
- (b) *INSPRU 3.2.34R* has effect as if it read "For the purpose of *INSPRU 2.3.5R(3)(b)*, a transaction is on approved terms only if the *firm* reasonably believes that it may be readily closed out"; and

(c) **INSPRU 3.2.35R** does not apply.

**Admissible assets**

- 12.9**
- (1) This transitional *rule* has effect from 31 December 2006 to 30 December 2007.
  - (2) In determining whether its assets are *admissible assets* for the purpose of any *rule* in *IPRU (INS)*, instead of applying *GENPRU 2 Ann 7R*, an *insurer* may elect to treat as an *admissible asset* an asset that would have been an *admissible asset* for the purposes of the Integrated Prudential Sourcebook (PRU) as it was in force on 30 December 2006.
  - (3) (2) does not apply when determining whether a *derivative* or *quasi-derivative* is an *approved derivative* or *approved quasi-derivative*.
  - (4) If an *insurer* applies (2) to any of its assets, it must do so for all of its assets except *derivatives* and *quasi-derivatives*.
- 12.10**
- (1) This transitional *rule* has effect from 31 December 2006 to 30 December 2007.
  - (2) Subject to (3), an *insurer* may use a definition of 343 (Energy) that is as stated in *IPRU (INS) Annex 11.3 Part I* but with the words "or against risks of loss to the persons insured attributable to interruptions of business carried on by them" omitted.
  - (3) If an *insurer* uses a modified definition of 343 (Energy) under (2), it must use a definition of 262 (Consequential loss) that is as stated in *IPRU (INS) Annex 11.3 Part I* but with the words "or 343 (energy)" omitted.



**Appendix 2.1** (rule 2.4(10(b)))

**General Insurance Business Solvency Margin**

**First Method of Calculation (Premium Basis)**

[Deleted]



**Appendix 2.2** (rule 2.4(1)(b))

**General Insurance Business Solvency Margin  
Second Method of Calculation (Claims Basis)**

[Deleted]



## **Appendix 2.3** (rule 2.9)

### **Minimum Guarantee Fund**

[Deleted]



**Appendix 3.1** (rule 3.3(3)(b))

**Form of Allocation Notice to Policy Holders**

[Deleted]



## **Appendix 3.2** (rule 3.7)

### **Permitted Links**

[Deleted]



## **Appendix 4.1** (rule 4.3)

### **Value of Dependants**

[Deleted]



## **Appendix 4.2** (rule 4.14)

### **Assets to be Taken Into Account Only to a Specified Extent**

[Deleted]



**Appendix 5.1** (rule 5.5 and *relevant co-insurance operation*)

**Relevant Co-Insurance Operations**

[Deleted]



## **Appendix 6.1** (rule 6.7)

### **Method of Calculating the Equalisation Reserve**

[Deleted]



## **Appendix 6.2** (rule 6.12)

### **Method of Calculating the Equalisation Reserve for Credit Insurance Business**

[Deleted]



## Appendix 9.1 (rules 9.12 and 9.13)

### Balance Sheet and Profit and Loss Account

#### (Forms 1 to 3 and 10 to 19)

##### *Introduction*

- 1 (1) All the forms included in the part of the *return* to which this Appendix relates (*Forms 1 to 3 and 10 to 19*) are to be laid out as shown in this Appendix, except that the instructions for the completion of the forms need not be reproduced.
- PRA
- (2) All amounts, descriptions or other text required to be shown as supplementary notes to a form must not be presented on the face of that form, but must be presented as a separate statement. The title of that statement must identify the form to which it relates.
- 3 (1) An *insurer* making a *return* must complete the 'company registration number box' using the full registration number given by the Registrar of Companies. If the insurer does not have such a number, it must agree a suitable number with the *PRA*. An *overseas insurer* must use its F-series number issued by the Registrar of Companies.
- PRA
- (2) Boxes marked 'GL/UK/CM' must be completed by inserting –
- (a) 'UK' in the case of a form which is –
- (i) prepared by *EEA-deposit insurer* in respect of *long-term or general insurance business* carried on through a branch in the United Kingdom;
- (ii) prepared by an *external insurer* (other than a *non-EEA insurer* whose *insurance business* in the United Kingdom is restricted to *reinsurance* or an *insurer* whose head office is in any *EEA State* except the United Kingdom whose *insurance business* in the *EEA* is restricted to *reinsurance*) in respect of *long-term or general insurance business* carried on through a branch in the United Kingdom; or
- (iii) prepared by a *Swiss general insurer* in respect of *general insurance business* carried on through a branch in the United Kingdom;
- (b) 'CM' in the case of a form which is prepared by a *UK-deposit insurer* in respect of *long-term or general insurance business* carried on through branches in the *EEA States* concerned; or
- (c) 'GL' in any other case.
- (3) Boxes marked 'Period ended' must be completed so as to show, in

numerals, the date of the last day of the *financial year in question*.

(4) No entry should be made in a box which is shaded or is not labelled.

(5) In the forms 'this financial year' means the *financial year in question*.

#### *Currency*

4 **PRA** The value of any asset or the amount of any liability denominated in a currency other than sterling must be expressed in sterling as if conversion had taken place at the closing middle rate on the last day for which the appropriate rate is available in the financial year to which the asset or liability relates.

5 **PRA** (1) The amount of any income or expenditure must be expressed in sterling using such bases of conversion as are in accordance with generally accepted accounting practice.

(2) The bases of conversion adopted must be stated by way of supplementary note (code 1601) to *Form 16* or, if there is no *Form 16*, by way of supplementary note (code 4005) to *Form 40*.

#### *Presentation of amounts*

6 Negative amounts must be shown between round brackets.

**PRA**

7 **PRA** Firms should not normally restate comparatives unless restatement is necessary in order to allow the appropriate comparison to be made. Where in any Form an amount which is a comparative (i.e. shown in a "previous year" column) or shown brought forward from a previous year differs from the corresponding amount shown in a "this financial year" column in a return for a previous year or as carried forward from that year, as the case may be, and the difference is not due solely to the use of a different rate to express other currencies in sterling, an explanation of the reason for the difference must be given by way of a supplementary note to that form. (For *Forms 1, 2, 3, 10, 11, 12, 13, 14, 15, 16, 18* and *19* the code for the supplementary note is 0111, 0211, 0311, 1011, 1111, 1211, 1311, 1411, 1511, 1611, 1811 and 1911 respectively.)

8 **PRA** (1) Except to the extent permitted by (2), amounts due to or from the *insurer* must be shown gross.

(2) In calculating amounts due to or from the *insurer* –

(a) amounts due from any person may, unless expressly provided otherwise, be included net of amounts which are due to that person, provided that such amounts may be set off against each other under generally accepted accounting practice; and

(b) amounts due to any person may, unless expressly provided otherwise, be included net of amounts which are due from that person, provided that such amounts may be set off against each other under generally accepted accounting practice.

(3) If amounts shown include amounts calculated on the basis set out in (2), a supplementary note to *Form 13* (code 1304 for other than *long-term insurance business* and code 1310 for *long-term insurance business*) to that effect must be provided.

(4) This paragraph does not apply to *Form 17*.

9 All amounts are to be shown to the nearer £1,000. Calculations must be performed using unrounded figures. Figures which are determined from other figures (whether or not on the same form) must be rounded after performing calculations on the unrounded component figures.

PRA

#### *Premiums*

10 (1) Notwithstanding the requirements of the *insurance accounts rules*, amounts included in *Forms 11* and *12* in respect of –

PRA

- (a) *gross written premiums*;
- (b) *gross earned premiums*;
- (c) *claims paid*;
- (d) *claims outstanding*; and
- (e) *reinsurance recoveries*,

must be determined in accordance with *INSPRU 1.1.66R* and *INSPRU 1.1.71R*.

(2) Where any amount included in *Form 11* or *12* pursuant to (1) differs from the aggregate of the corresponding amounts included in *Forms 21, 22, 24* and *25*, there must be stated by way of supplementary note to *Form 11* or *12* (code 1105 or 1205), as the case may be –

- (a) the amount of such difference; and
- (b) an explanation for such difference.

#### *Counterparty exposure*

11 (1) There must be given by way of a supplementary note to *Form 13* (code 1305 for other than *long-term insurance business* and code 1319 for *long-term insurance business*) –

PRA

- (a) the maximum extent to which, in accordance with any investment guidelines operated by the *insurer*, it was permitted to be exposed to any one *counterparty* during the *financial year in question*;
- (b) the maximum extent to which, in accordance with such guidelines, it was permitted to be exposed to any one *counterparty*, other than by way of exposure to an *approved*

*counterparty*, during the *financial year in question*; and

(c) an account of any occasions during the *financial year* on which either of those amounts was exceeded.

(2) In each case where a *counterparty exposure* of the *insurer* which is subject to any of the limits in *INSPRU 2.1.22R(3)* exceeds at the end of the *financial year in question*:

(a) 5% of the sum of its *base capital resources requirement* and its *long-term insurance liabilities*, excluding *property linked liabilities* and net of *reinsurance ceded*, or

(b) the sum of 20,000 Euro and 5% of its liabilities arising from its *general insurance business*, net of *reinsurance ceded*,

as appropriate –

(a) the amount of that *exposure*; and

(b) the nature of the assets held which give rise to that *exposure*,

must be stated by way of a supplementary note to *Form 13* (code 1306 for other than *long-term insurance business* and code 1312 for *long-term insurance business*).

(3) There must be stated by way of supplementary note to *Form 13* (code 1307 for other than *long-term insurance business* and code 1313 for *long-term insurance business*) the aggregate value of any rights to which *INSPRU 2.1.35R* or *INSPRU 2.1.36R* and *INSPRU 2.1.37R* relates.

*Provision for reasonably foreseeable adverse variations*

12 There must be stated by way of supplementary note to *Form 14* (code 1401) or *Form 15* (code 1501) the methods and assumptions used to determine the amount of any adjustment or provision made pursuant to *GENPRU 1.3.30R* to *GENPRU 1.3.33R* or *INSPRU 3.2.17R* to *INSPRU 3.2.18R* or, if there is no such adjustment or provision, the methods and assumptions used to determine that no adjustment or provision is required.

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*Liabilities*

13 (1) Subject to (3), the following information must be given by way of a supplementary note to *Form 14* (code 1402) or *Form 15* (code 1502) –

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(a) in the case of any ‘charge’ over assets of the *insurer*, the particulars specified in (2) or a statement that there are no such ‘charges’;

(b) the total potential liability, and the amount provided for that liability, to taxation on capital gains which might arise if the *insurer* disposed of its assets, or a statement that there is no such potential liability;

- (c) a brief description of any other liabilities being contingent liabilities not included in *Form 14* or *15* (other than liabilities arising under an inwards *contract of insurance* or *reinsurance*) including, where practicable, the amounts or estimated amounts of those liabilities, or a statement that there are no such contingent liabilities;
  - (d) a brief description of any guarantee, indemnity or other contractual commitment, effected by the *insurer* other than in the ordinary course of its *insurance business*, in respect of the existing or future liabilities of any *related companies*, including –
    - (i) the maximum liability of the *company* specified in such guarantee, indemnity or contractual commitment or, where no such amount is specified, a statement to that effect,
    - (ii) the amount of any provision made in respect of such liability, and
    - (iii) the amount reported under (c) in respect of such liability, or a statement that there are no such guarantees, indemnities or contractual commitments; and
  - (e) a description of any other uncertainty where such a description is, in the opinion of the directors, necessary for a proper understanding of the financial position of the *insurer*.
- (2) The particulars referred to in (1)(a) are –
- (a) the nature of the ‘charge’, including a brief description of the terms which are relevant to securing the prior claim of any person to assets which are subject to the ‘charge’;
  - (b) for each line in *Form 13*, the amount included in respect of assets which are subject to the ‘charge’; and
  - (c) for each line in *Form 14* or *15*, the amount included in respect of liabilities which are secured by the ‘charge’.
- (3) (1)(a) and (c) may be disregarded by an *insurer* in the case of –
- (a) one or more ‘charges’ over assets which are attributable to either the *long-term insurance assets* or the ‘other assets’ and whose aggregate value (as shown on *Form 13*) does not exceed 2.5% of the *long-term insurance assets* (other than reinsurance recoveries and assets required to match *property linked liabilities*) or the ‘other assets’ (other than *reinsurance recoveries*), as the case may be; or
  - (b) one or more contingent liabilities whose aggregate value does not exceed 2.5% of the *long-term insurance assets* (other than *reinsurance recoveries* and assets required to match *property*

*linked liabilities*) or the 'other assets' (other than *reinsurance recoveries*), as the case may be.

- (4) (1)(d) may be disregarded by an *insurer* in respect of one or more guarantees, indemnities or contractual commitments where the aggregate of the maximum liabilities specified in such guarantees, indemnities or contractual commitments does not exceed 2.5% of the *long-term insurance assets* (other than *reinsurance recoveries* and assets required to match *property linked liabilities*) or the 'other assets' (other than *reinsurance recoveries*), as the case may be.
- (5) For the purposes of this paragraph, *charge* includes any arrangement whatsoever, whether contractual or otherwise, which operates to secure the prior claim of any person over general creditors to any assets on a winding up of the *insurer*, and other assets means assets that are not *long-term insurance assets*.

*Derivative contracts*

15 Any *derivative contract* entered into by an *insurer* –

- PRA (a) the value of which is taken into account for the purposes of calculating benefits payable to *policy holders* under *property linked contracts*; or
- (b) in order to match its liabilities in respect of the payment of *index linked benefits*,

must be excluded from *Form 17*.

16 Where, in respect of any *derivative contract* included in *Form 17*, assets have been transferred to or for the benefit of the *insurer* by way of *variation margin* there must be stated by way of supplementary note (code 1701) to *Form 17* –

- PRA (a) the aggregate amount of any liability to repay such assets or equivalent assets;
- (b) for each line in *Form 13*, the amount included in respect of such assets; and
- (c) to what extent any amounts included in *Form 13* have taken account of any requirement to repay such assets or equivalent assets.

17 If –

- PRA (a) the aggregate value of rights under contracts or in respect of assets, either of which have the effect of derivative contracts, exceeds 2.5% of the aggregate value of assets shown at line 89 of *Form 13*; or
- (b) the aggregate amount of liabilities under contracts or in respect of assets, either of which have the effect of derivative contracts, exceeds 2.5% of the aggregate of the amounts shown in lines 17 to 39 of *Form 14* or lines 31 to 51 of *Form 15*, as appropriate,

the corresponding value, if not zero, must be stated (by way of supplementary note (code 1702) to Form 17) for each line in *Form 13, 14 or 15* and paragraph 16 applies to the insurer as if such contracts or assets had been included in *Form 17*.

## FORMS

**[Forms 1-3 and 10-19 to follow]**

**Statement of solvency – general insurance business**

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Solo solvency calculation / Adjusted solo solvency calculation

	Company registration number	GL/UK/CM	day	month	year	units
	R1					£000
					<b>As at end of this financial year 1</b>	<b>As at end of the previous year 2</b>

**Capital resources**

Capital resources arising outside the long-term insurance fund	11		
Capital resources allocated towards long-term insurance business arising outside the long-term insurance fund	12		
Capital resources available to cover general insurance business capital resources requirement (11-12)	13		

**Guarantee fund**

Guarantee fund requirement	21		
Excess (deficiency) of available capital resources to cover guarantee fund requirement	22		

**Minimum capital requirement (MCR)**

General insurance capital requirement	31		
Base capital resources requirement	33		
Individual minimum capital requirement	34		
Capital requirements of regulated related undertakings	35		
Minimum capital requirement (34 + 35)	36		
Excess (deficiency) of available capital resources to cover 50% of MCR	37		
Excess (deficiency) of available capital resources to cover 75% of MCR	38		

**Capital resources requirement (CRR)**

Capital resources requirement	41		
Excess (deficiency) of available capital resources to cover general insurance business CRR (13-41)	42		

**Contingent liabilities**

Quantifiable contingent liabilities in respect of other than long-term insurance business as shown in a supplementary note to Form 15	51		
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Instructions for completion of Form 1

PRA

- 1 An insurer (other than a Swiss general insurer or an EEA-deposit insurer) carrying on general insurance business must complete Form 1 in respect of its entire general insurance business. An external insurer (other than a non-EEA insurer whose insurance business in the United Kingdom is restricted to reinsurance or an insurer whose head office is in any EEA State except the United Kingdom whose insurance business in the EEA is restricted to reinsurance) that is carrying on general insurance business must complete Form 1 in respect of business carried on through a branch in the United Kingdom. An UK-deposit insurer that is carrying on general insurance business must complete Form 1 in respect of business carried on through its branches in EEA States taken together. Form 1 is not required for Swiss general insurers or EEA-deposit insurers.
- 2 In the case of a *marine mutual* completing an abbreviated *return* under rule 9.36A, units must be the same as those used in Form M1.
- 3 For *financial years* commencing on or before 31 December 2004 lines 11 to 42, column 2 must be blank.
- 4 The entry at line 13 must be equal to the *total capital resources* after deductions at line 79, column 1 on Form 3. The entry at line 11 includes also *capital resources* allocated towards the *long-term insurance business* (and included in column 2 on Form 3) that arise outside the *long-term insurance fund*. For a *branch* the entry at line 11 is equal to Form 10 line 23.
- 5 For a *firm* carrying on *long-term insurance business* the entry at line 12 on Form 1 must equal the entry at line 12 on Form 2. For a *firm* not carrying on *long-term insurance business* the entry at line 12 on Form 1 is nil.

*Instructions 6-12 only apply to firms that do not meet the conditions specified in GENPRU 2.1.13R(2), i.e. that are not required to perform an adjusted solo calculation under INSPRU 6.1.*

- 6 For an *insurer* other than a *pure reinsurer* writing both non-life and life business, the *guarantee fund* requirement at line 21 is calculated by reference to *GENPRU 2.2.34R* as the higher of line 33 and 1/3 of line 31. For a *pure reinsurer* writing both non-life and life business, the *guarantee fund* calculated by reference to *GENPRU 2.2.34AR* must be allocated between F1.21 and F2.21 in the ratio of the *general insurance capital requirement* to the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*.
- 7 The excess (deficiency) of available *capital resources* to cover the *guarantee fund* requirement at line 22 is equal to line 81 on Form 3 less line 21, except for a *branch*. For a *branch* this is equal to line 13 less line 21 less an adjustment because assets held to cover the *guarantee fund* must be held in the *United Kingdom* (or for *UK-deposit insurers*, in the *EEA States* where the *firm* carries on *insurance business*); the adjustment is the difference between Form 13 line 89 for categories 1 and 3 (or 5), except for *branches* carrying on both *long-term insurance business* and *general insurance business* (composite branches); composite *branches* will need to state

how the difference is allocated between *general insurance business* and *long-term insurance business* in a note to the Form (Note 0102).

- 8 The *general insurance capital requirement* at line 31 must be equal to the amount shown at line 43 of Form 12, which is calculated in accordance with *GENPRU 2.1.34R*.
- 9 The *base capital resources requirement* at line 33 must be taken from *GENPRU 2.1.30R*. For a branch, this figure should be halved. For a *pure reinsurer* writing both non-life and life business, the *base capital resources requirement* must be allocated between F1.33 and F2.33 in the ratio of the *general insurance capital requirement* to the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*.
- 9A The individual *minimum capital requirement* at line 34 is calculated in accordance with *GENPRU 2.1.24R* and is the higher of lines 31 and 33.
- 9B The capital requirements of *regulated related undertakings* at line 35 must be nil.
- 9C The *minimum capital requirement* at line 36 is equal to the sum of lines 34 and 35.
- 10 The excess (deficiency) of available *capital resources* to cover 50% of the *minimum capital requirement* at line 37 is equal to line 82, column 1 on Form 3 less 50% of line 36. For a *branch*, line 37 is to be left blank.
- 11 The excess (deficiency) of available *capital resources* to cover 75% of the *minimum capital requirement* at line 38 is equal to line 83, column 1 on Form 3 less 75% of line 36. For a *branch*, line 38 is to be left blank.
- 12 The *capital resources requirement* at line 41 is calculated in accordance with *GENPRU 2.1.17R* and is equal to line 36.

*Instructions 13-20 only apply to firms that meet the conditions specified in GENPRU 2.1.9 R(2), i.e. that perform the adjusted solo solvency calculation in accordance with INSPRU 6.1.*

- 13 The *guarantee fund requirement* at line 21 is calculated as the share of the *general insurance business* of  
 $\frac{1}{3}X + (R - S - U - X)$  by reference to *INSPRU 6.1.45R*.
- 14 The excess (deficiency) of available *capital resources* to cover the *guarantee fund requirement* at line 22 is equal to line 81, column 1 on Form 3 less line 21.
- 15 The *general insurance capital requirement* at line 31 is taken from the amount shown at line 43 of Form 12, which is calculated in accordance with *GENPRU 2.1.34R*.
- 16 The *base capital resources requirement* at line 33 must be taken from *GENPRU 2.1.30R*. For a *branch* this figure should be halved. For a *pure reinsurer* writing both non-life and life business, the *base capital resources requirement* must be allocated between F1.33 and F2.33 in the ratio of the *general insurance capital requirement* to the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*.

- 16A The *individual minimum capital requirement* at line 34 is calculated in accordance with *GENPRU 2.1.24R* and is the higher of lines 31 and 33.
- 16B The capital requirements of *regulated related undertakings* at line 35 is line 36 less line 34.
- 17 The *minimum capital requirement* at line 36 must equal the amount represented by (R-S) with reference to *INSPRU 6.1.45R*.
- 18 The excess (deficiency) of available *capital resources* to cover 50% of the *minimum capital requirement* at line 37 is equal to line 82, column 1 on Form 3 less 50% of line 36.
- 19 The excess (deficiency) of available *capital resources* to cover 75% of the *minimum capital requirement* at line 38 is equal to line 83, column 1 on Form 3 less 75% of line 36.
- 20 The entry at line 41 must equal the amount represented by R with reference to *INSPRU 6.1.45R*.

*Instructions 21 onwards apply to all firms*

- 21 The entry at line 51 must not include provision for any liability to tax on capital gains referred to in paragraph 13(1)(b) of Appendix 9.1. Amounts in *related undertakings* must not be included.
- 22 Where a direction under section 148 of the Act has been issued disapplying or modifying any of the provisions of the *Accounts and Statements Rules*, a note to *Form 1* explaining the effect of the order is usually required. The requirement for such a note would be specified in the direction itself. [Code 0101].

**Statement of solvency – long-term insurance business**

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Solo solvency calculation / Adjusted solo solvency calculation

	Company registration number	GL/ UK/ CM	day	month	year	units
R2						£000
					<b>As at end of this financial year 1</b>	<b>As at end of the previous year 2</b>

**Capital resources**

Capital resources arising within the long-term insurance fund	11		
Capital resources allocated towards long-term insurance business arising outside the long-term insurance fund	12		
Capital resources available to cover long-term insurance business capital resources requirement (11+12)	13		

**Guarantee fund**

Guarantee fund requirement	21		
Excess (deficiency) of available capital resources to cover guarantee fund requirement	22		

**Minimum capital requirement (MCR)**

Long-term insurance capital requirement	31		
Resilience capital requirement	32		
Base capital resources requirement	33		
Individual minimum capital requirement	34		
Capital requirements of regulated related undertakings	35		
Minimum capital requirement (34+35)	36		
Excess (deficiency) of available capital resources to cover 50% of MCR	37		
Excess (deficiency) of available capital resources to cover 75% of MCR	38		

**Enhanced capital requirement**

With-profits insurance capital component	39		
Enhanced capital requirement	40		

**Capital resources requirement (CRR)**

Capital resources requirement (greater of 36 and 40)	41		
Excess (deficiency) of available capital resources to cover long-term insurance business CRR (13-41)	42		

**Contingent liabilities**

Quantifiable contingent liabilities in respect of long-term insurance business as shown in a supplementary note to Form 14	51		
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Instructions for completion of Form 2

PRA

- 1 An insurer (other than an EEA-deposit insurer) carrying on long-term insurance business must complete Form 2 in respect of its entire long-term insurance business. An external insurer (other than a non-EEA insurer whose insurance business in the United Kingdom is restricted to reinsurance or an insurer whose head office is in any EEA State except the United Kingdom whose insurance business in the EEA is restricted to reinsurance) or EEA-deposit insurer that is carrying on long-term insurance business must complete Form 2 in respect of business carried on through a branch in the United Kingdom. An UK-deposit insurer that is carrying on long-term insurance business must complete Form 2 in respect of business carried on through its branches in EEA States taken together.
- 2 The entry at line 13 must be equal to the *total capital resources* after deductions at line 79, column 2 on Form 3. The entry at line 11 represents items relating to the *long-term insurance fund*, and that at line 12 represents amounts arising outside the *long-term insurance fund*. For a *branch*, line 11 is equal to the sum of any *implicit items* plus Form 10 line 11 less the sum of lines 11, 12 and 49 in Form 14: when there are implicit items an analysis of line 11 must be given in a supplementary note (code 0202); if the *insurer* is not carrying on *general insurance business* through the *branch*, line 12 will be equal to Form 10 line 23.
- 3 For *financial years* commencing on or before 31 December 2004 lines 11 to 42, column 2 must be blank.
- 4 For *EEA-deposit insurers*, lines 21 to 42 must be blank.

*Instructions 5-14 only apply to firms that do not meet the conditions specified in GENPRU 2.1.13 R(2), i.e. that are not required to perform an adjusted solo calculation under INSPRU 6.1.*

- 5 For an *insurer* other than a *pure reinsurer* writing both non-life and life business, the *guarantee fund* requirement at line 21 is calculated by reference to *GENPRU 2.2.33R* as the higher of line 33 and 1/3 of line 31. For a *pure reinsurer* writing both non-life and life business, the *guarantee fund* calculated by reference to *GENPRU 2.2.34AR* must be allocated between F1.21 and F2.21 in the ratio of the *general insurance capital requirement* to the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*.
- 6 The excess (deficiency) of available *capital resources* to cover the *guarantee fund* requirement at line 22 is equal to line 81, column 2 on Form 3 less line 21, except for a *branch*. For a *branch* this is equal to line 13 less line 21 less an adjustment because assets held to cover the *guarantee fund* must be held in the *United Kingdom* (or for *UK-deposit insurers*, in the *EEA States* where the *firm* carries on *insurance business*) and cannot include *implicit items*; an analysis would be appropriate in a note (code 0203) to the Form.
- 7 The *long-term insurance capital requirement* at line 31 must be equal to the amount shown at line 51 of Form 60, which is calculated in accordance with *GENPRU*

2.1.36R.

- 8 The *resilience capital requirement* at line 32 is calculated in accordance with the rules in *INSPRU 3.1*.
- 9 The *base capital resources requirement* at line 33 must be taken from *GENPRU 2.1.30R*. For a branch, this figure should be halved. For a *pure reinsurer* writing both non-life and life business, the *base capital resources requirement* must be allocated between F1.33 and F2.33 in the ratio of the *general insurance capital requirement* to the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*.
- 9A The individual *minimum capital requirement* at line 34 is calculated in accordance with *GENPRU 2.1.24AR* or *GENPRU 2.1.25R* and is the greater of line 33 and the sum of lines 31 and 32.
- 9B The capital requirements of *regulated related undertakings* at line 35 must be nil.
- 9C The *minimum capital requirement* at line 36 is equal to the sum of lines 34 and 35.
- 10 The excess (deficiency) of available *capital resources* to cover 50% of the *minimum capital requirement* at line 37 is equal to line 82, column 1 on Form 3 less 50% of line 36. For a *branch*, line 37 must be blank.
- 11 The excess (deficiency) of available *capital resources* to cover 75% of the *minimum capital requirement* at line 38 is equal to line 83, column 1 on Form 3 less 75% of line 36. For a *branch*, line 38 is to be left blank.
- 12 The *with-profits insurance capital component* at line 39 must be the total of the amounts shown at line 66 on Forms 18, calculated in accordance with the rules in *INSPRU 1.3*.
- 13 The *enhanced capital requirement* at line 40 is calculated as the sum of lines 31, 32 and 39.
- 14 The *capital resources requirement* at line 41 is calculated in accordance with *GENPRU 2.1.18R*.
- Instructions 15-23 only apply to firms that meet the conditions specified in GENPRU 2.1.13R(2), i.e. that perform the adjusted solo solvency calculation in accordance with INSPRU 6.1.*
- 15 The *guarantee fund requirement* at line 21 is calculated as the share of the *general insurance business* of  $\frac{1}{3}X + (R - S - U - X)$  by reference to *INSPRU 6.1.45R*.
- 16 The excess (deficiency) of available *capital resources* to cover the *guarantee fund requirement* at line 22 is equal to line 81, column 2 on Form 3 less line 21.
- 17 The *long-term insurance capital requirement* at line 31 is taken from the amount shown at line 51 of Form 60, which is calculated in accordance with *GENPRU 2.1.36R*.
- 17A The *resilience capital requirement* at line 32 is calculated in accordance with the rules in *INSPRU 3.1*.

- 17B The *base capital resources requirement* at line 33 must be taken from *GENPRU 2.1.30R*. For a *branch* this figure should be halved. For a *pure reinsurer* writing both non-life and life business, the *base capital resources requirement* must be allocated between F1.33 and F2.33 in the ratio of the *general insurance capital requirement* to the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*.
- 17C The individual *minimum capital requirement* at line 34 is the greater of line 33 and the sum of lines 31 and 32.
- 17D The capital requirements of *regulated related undertakings* at line 35 is the amount shown at line 36 less line 34.
- 18 The entry at line 36 must include the amount represented by (R-S) with reference to *INSPRU 6.1.45R*.
- 19 The excess (deficiency) of available *capital resources* to cover 75% of the *minimum capital requirement* at line 37 is equal to line 82, column 2 on Form 3 less 50% of line 36.
- 20 The excess (deficiency) of available *capital resources* to cover 75% of the *minimum capital requirement* at line 38 is equal to line 83, column 2 on Form 3 less 75% of line 36.
- 21 The *with-profits insurance capital component* at line 39 must be the total of 'S' with reference to *INSPRU 6.1.45R*.
- 22 The entry at line 40 must be the sum of lines 36 and 39.
- 23 The entry at line 41 must equal the amount represented by R with reference to *INSPRU 6.1.45R*.

*Instructions 24 onwards apply to all firms*

- 24 The entry at line 51 must not include provision for any liability to tax on capital gains referred to in paragraph 13(1)(b) of Appendix 9.1. Amounts in *related undertakings* must not be included.
- 25 Where a direction under section 148 of the *Act* has been issued disapplying or modifying any of the provisions of the *Accounts and Statements Rules*, a note to Form 2 explaining the effect of the direction is usually required. The requirement for such a note would be specified in the direction itself. (Code 0201).

## Components of capital resources

Name of insurer  
Global business  
Financial year ended

	Company registration number	GL/ UK/ CM	day	month	year	units
	R3					£000
		General insurance business	Long-term insurance business	Total as at the end of this financial year	Total as at the end of the previous year	
		<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	
<b>Core tier one capital</b>						
Permanent share capital	11					
Profit and loss account and other reserves	12					
Share premium account	13					
Positive valuation differences	14					
Fund for future appropriations	15					
Core tier one capital in related undertakings	16					
Core tier one capital (sum of 11 to 16)	19					
<b>Tier one waivers</b>						
Unpaid share capital / unpaid initial funds and calls for supplementary contributions	21					
Implicit items	22					
Tier one waivers in related undertakings	23					
Total tier one waivers as restricted (21+22+23)	24					
<b>Other tier one capital</b>						
Perpetual non-cumulative preference shares as restricted	25					
Perpetual non-cumulative preference shares in related undertakings	26					
Innovative tier one capital as restricted	27					
Innovative tier one capital in related undertakings	28					
<b>Total tier one capital before deductions (19+24+25+26+27+28)</b>						
Investments in own shares	31					
Intangible assets	32					
Amounts deducted from technical provisions for discounting	33					
Other negative valuation differences	34					
Deductions in related undertakings	35					
Deductions from tier one (32 to 36)	36					
Deductions from tier one (32 to 36)	37					
<b>Total tier one capital after deductions (31-37)</b>	<b>39</b>					

Components of capital resources

Name of insurer  
Global business  
Financial year ended

	Company registration number	GL/UK/CM	day	month	year	units
R3						£000
		General insurance business		Long-term insurance business	Total as at the end of this financial year	Total as at the end of the previous year
		<b>1</b>		<b>2</b>	<b>3</b>	<b>4</b>

Tier two capital

Implicit items, (tier two waivers and amounts excluded from line 22)	41				
Perpetual non-cumulative preference shares excluded from line 25	42				
Innovative tier one capital excluded from line 27	43				
Tier two waivers, innovative tier one capital and perpetual non-cumulative preference shares treated as tier two capital (41 to 43)	44				
Perpetual cumulative preference shares	45				
Perpetual subordinated debt and securities	46				
Upper tier two capital in related undertakings	47				
<b>Upper tier two capital (44 to 47)</b>	<b>49</b>				

Fixed term preference shares	51				
Other tier two instruments	52				
Lower tier two capital in related undertakings	53				
<b>Lower tier two capital (51+52+53)</b>	<b>59</b>				

<b>Total tier two capital before restrictions (49+59)</b>	<b>61</b>				
Excess tier two capital	62				
Further excess lower tier two capital	63				
<b>Total tier two capital after restrictions, before deductions (61-62-63)</b>	<b>69</b>				

**Components of capital resources**

Name of insurer  
Global business  
Financial year ended

	Company registration number	GL/UK/CM	day	month	year	units
	R3					£000
		General insurance business	Long-term insurance business	Total as at the end of this financial year	Total as at the end of the previous year	
		<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	

**Total capital resources**

Positive adjustments for regulated non-insurance related undertakings	71				
<b>Total capital resources before deductions (39+69+71)</b>	72				
Inadmissible assets other than intangibles and own shares	73				
Assets in excess of market risk and counterparty limits	74				
Deductions for related ancillary services undertakings	75				
Deductions for regulated non-insurance related undertakings	76				
Deductions of ineligible surplus capital	77				
<b>Total capital resources after deductions (72-73-74-75-76-77)</b>	79				

**Available capital resources for GENPRU/INSPRU tests**

Available capital resources for guarantee fund requirement	81				
Available capital resources for 50% MCR requirement	82				
Available capital resources for 75% MCR requirement	83				

**Financial engineering adjustments**

Implicit items	91				
Financial reinsurance – ceded	92				
Financial reinsurance – accepted	93				
Outstanding contingent loans	94				
Any other charges on future profits	95				
<b>Sum of financial engineering adjustments (91+92-93+94+95)</b>	96				

Instructions for completion of Form 3

PRA

- 1 **An insurer (other than a Swiss general insurer or an EEA-deposit insurer) must complete Form 3 in respect of its entire business. An external insurer (other than a non-EEA insurer whose insurance business in the United Kingdom is restricted to reinsurance or an insurer whose head office is in any EEA State except the United Kingdom whose insurance business in the EEA is restricted to reinsurance), an EEA-deposit insurer or a Swiss general insurer must complete Form 10 in respect of business carried on through a branch in the United Kingdom. An UK-deposit insurer must complete Form 10 in respect of business carried on through its branches in EEA States taken together.**
- 2 **An insurer that is carrying on long-term insurance business, other than a mutual not carrying on general insurance business, that includes within its capital resources any capital instruments issued by its long-term insurance fund, must include a supplementary note (code 0302) analysing those instruments.**
- 3 **In the case of a marine mutual completing an abbreviated return under rule 9.36A, units must be the same as those used in Form M1. If units are in US\$ or US\$000, then the bases of conversion used in determining the base capital resources requirement must be those used in Forms 11 and 12.**
- 4 **Amounts in columns 1 and 2 refer to capital supporting the general insurance business and the long-term insurance business respectively. For a firm carrying on only general insurance business column 2 should be blank. For a firm carrying on only long-term insurance business column 1 should be blank. All items relating to the long-term insurance fund should be included in column 2. For a composite firm capital items arising outside the long-term insurance fund should be allocated between general insurance business and long-term insurance business in a manner consistent with the firm's view of what business that capital supports. Where there is a material change in way capital items are allocated from one year to the next, the firm should explain the change in a supplementary note (code 0303).**
- 5 **Column 3 is the sum of columns 1 and 2.**
- 6 **For financial years commencing on or before 31 December 2004 column 4 must be blank.**
- 7 **Amounts at lines 11-13 should be taken from the firm's stand-alone accounts prepared under the Companies Acts 1985 or 2006, as appropriate, or (for firms not preparing accounts under the Companies Act legislation) equivalent overseas legislation or the applicable UK legislation.**
- 8 **The entry at line 15.2 must be the FFA taken from the firm's stand-alone accounts prepared under the Companies Acts 1985 or 2006, as appropriate, or (for firms not preparing accounts under the Companies Act legislation) equivalent overseas legislation or the applicable United Kingdom legislation. The entry at line 15**

column 1 must be blank.

- 9 **GENPRU 2.2.105R and 2.2.106G explain how to calculate the valuation differences for inclusion at line 14 or 35. Inadmissible assets or assets in excess of *market risk* and *counterparty* limits are not to be included in the valuation differences. Net valuation differences are shown at line 14 if positive or in line 35 if negative. The *firm* must state in a supplementary note (code 0310) to this form –**
- (a) The amount of positive valuation differences included within line 14 or 35 in respect of assets where valuation in *GENPRU* and *INSPRU* exceeds the valuation that the *firm* uses for external financial reporting purposes, together with a brief explanation indicating the nature of those assets;
  - (b) The amount of positive valuation differences included within line 14 or 35 in respect of liabilities where valuation in *GENPRU* and *INSPRU* is lower than the valuation that the *firm* uses for external financial reporting purposes, together with a brief explanation indicating the nature of those liabilities;
  - (c) The amount of negative valuation included within line 14 or 35 in respect of assets where valuation in *GENPRU* and *INSPRU* is lower than the valuation that the *firm* uses for external financial reporting purposes (excluding inadmissible assets and assets in excess of *market risk* and *counterparty* limits), together with a brief explanation indicating the nature of those assets; and
  - (d) The amount of negative valuation included within line 14 or 35 in respect of liabilities where valuation in *GENPRU* and *INSPRU* exceeds the valuation that the *firm* uses for external financial reporting purposes (excluding amounts deducted from *technical provisions* for discounting shown at line 34), together with a brief explanation indicating the nature of those liabilities.

The amount in (a) plus the amount in (b) less the amount in (c) less the amount in (d) should equal the amount shown at line 14 if positive or at line 35 if negative."

*Instructions 10-32 only apply to firms that do not meet the conditions specified in GENPRU 2.1.9R(2), i.e. that are not required to perform an adjusted solo calculation under INSPRU 6.1.*

- 10 The entries at line 16 must be nil.
- 11 Amounts may only appear in lines 21 and 22 if the *PRA* has issued a *waiver* permitting these amounts to count as *tier one capital* (tier one waivers). These amounts are restricted by *GENPRU 2.2.29R (1)*, so that amounts in line 24 may not be greater than the sum of the corresponding amounts in lines 19 and 37. If the *PRA* has issued a *waiver* permitting amounts to count as *tier two capital* (tier two waivers), these are to be included at line 41, together with any amounts that arise from the restriction at *GENPRU 2.2.29R(1)*.
- 12 The entries at line 23 must be nil.
- 13 The entries at lines 25 and 27 must be restricted to comply with *GENPRU 2.2.29R* and *2.2.30R*, so that the total of the amounts in lines 24, 25 and 27 is not greater than the total amount in line 19 plus line 37, and the amount in line 27 is not greater than 15/85 of the total of the amounts in lines 19, 24 and 25 minus line 37. Amounts

- in excess of the limits are entered at lines 42 and 43 respectively.
- 14 The entries at lines 26 and 28 must be nil.
- 15 The entries at line 32 for investments in own *shares* should, in the majority of cases, be zero.
- 16 For the purpose of completing line 33, the *firm* should refer to *GENPRU 2.2.155R* and *GENPRU 2.2.156G*.
- 17 The amounts in line 34 must be calculated in accordance with *GENPRU 2.2.107R(1)* and *GENPRU 2.2.107R(2)*.
- 18 The entries at line 36 must be nil.
- 19 The entries at lines 45 and 46 for perpetual cumulative *preference shares*, subordinated *debt* and *securities* must be the total, unrestricted, amounts that the *firm* can include in *upper tier two capital* in accordance with *GENPRU 2.2.159R* to *2.2.174R*, *GENPRU 2.2.177R* to *2.2.181R* and *GENPRU 2.2.270R* to *2.2.271R*.
- 20 The entries at line 47 must be nil.
- 21 The types of capital instrument that a *firm* can include within its *lower tier two capital* are set out at *GENPRU 2.2.159R* to *2.2.174R*, *GENPRU 2.2.194R* to *2.2.196R* and *GENPRU 2.2.270R* to *2.2.271R*. These should be split between fixed term *preference shares* and other *tier two instruments* and entered at lines 51 and 52 respectively.
- 22 The entries at line 53 must be nil.
- 23 The effect of the restrictions at *GENPRU 2.2.37R* applying to *tier two capital* are shown at lines 62 and 63. Line 62 relates to *tier two capital* as a whole and equals the excess (if any) of line 61 over line 39. Line 63 relates to *lower tier two capital* and equals the excess (if any) of line 59 over the sum of line 62 and 1/2 line 39.
- 24 Line 71 must show positive adjustments for *related undertakings* that are *regulated related undertakings* (other than *insurance undertakings*) required by *GENPRU 2.2.256R*.
- 25 Line 73 must show the deductions for assets that are not *admissible assets* required by *GENPRU 2.2.251R*.
- 26 Line 74 must show the assets in excess of *market risk* and *counterparty limits* in *INSPRU 2.1.22R*.
- 27 Line 75 must show negative adjustments for *related undertakings* that are *ancillary services undertakings* required by *GENPRU 2.2.255R*.
- 28 Line 76 must show negative adjustments for *related undertakings* that are *regulated related undertakings* (other than *insurance undertakings*) required by *GENPRU 2.2.256R*.
- 29 The entries at line 77 must be nil.

- 30 The entry at line 81 is determined as the amount of the *firm's capital resources* available to meet its *guarantee fund* requirement, having regard to *GENPRU 2.2.33R*, *GENPRU 2.2.34R*, *GENPRU 2.2.34AR* and *GENPRU 2.2.35R*. Unless some *innovative tier one capital* does not meet the conditions for it to be treated as *upper tier two capital* (when an adjustment may be needed), line 81 must be either:
- line 79; or
  - (if less) the sum of lines 19, 25, 27, 42, 43, 45, 46 and 59 less the sum of lines 37, 62 and 63 less the greatest of:
    - zero;
    - the sum of lines 27, 37, 43, 45, 46, 59, 73, 74, 75 and 76 less the sum of lines 19, 25, 42, 62, 63 and 71; and
    - line 59 plus one-third of the sum of lines 37, 73, 74, 75 and 76 less the sum of lines 62 and 63 less one-third of the sum of lines 19, 25, 27, 42, 43, 45, 46 and 71
- 31 The entry at line 82 is determined as the amount of the *firm's capital resources* available to meet 50% of its *minimum capital requirement*, having regard to *GENPRU 2.2.32R*. Line 82 must be either:
- line 79; or
  - (if less) the sum of lines 19, 24, 25 and 42 less line 37.
- 32 The entry at line 83 is determined as the amount of the *firm's capital resources* available to meet 75% of its *minimum capital requirement*, having regard to *GENPRU 2.2.38R* and *GENPRU 2.2.39R*. Unless some *innovative tier one capital* does not meet the conditions for it to be treated as *upper tier two capital* (when an adjustment may be needed), line 83 must be either:
- line 79; or
  - (if less) the sum of lines 19, 24, 25, 27, 41, 42, 43, 45 and 46 less the sum of line 37 and any excess of the sum of lines 27, 37, 41, 43, 45 and 46 over the sum of lines 19, 24, 25 and 42.

*Instructions 33-57 only apply to firms that meet the conditions specified in GENPRU 2.1.13R(2), i.e. that perform the adjusted solo solvency calculation in accordance with INSPRU 6.1.*

- 33 *Tier one capital resources* must be calculated in accordance with the *rules* in *INSPRU 6.1.41R* in relation to restricted assets.
- 34 The entries at line 16 must equal the net contribution to core *tier one capital resources* of the *firm's related undertakings* in accordance with the calculation in *INSPRU 6.1.55R (2)*.
- 35 Amounts may only appear in lines 21-23 if the *PRA* has issued a *waiver* permitting these amounts to count as *tier one capital* (tier one waivers). These amounts are restricted by *INSPRU 6.1.45R (1)(c)*, so the amounts in line 24 may not be greater than the sum of the corresponding amounts in lines 19 and 37. If the *PRA* has

issued a *waiver* permitting amounts to count as *tier two capital* (tier two waivers), these are to be included at line 41, together with any amounts that arise from the restriction at *INSPRU 6.1.45R (1)(c)*.

- 36 The entries at line 26 must include the net contribution to the *firm* of perpetual non-cumulative *preference shares* issued by the *firm's related undertakings* – ie. the capital represented by perpetual non-cumulative *preference shares* of each of the *firm's related undertakings* that is a *regulated related undertaking* after deduction of the sum of the book value of the investments by the *firm* in the perpetual non-cumulative *preference shares* of each of its *related undertakings* that is a *regulated related undertaking* and the book value of the investments by *related undertakings* of the *firm* in the perpetual non-cumulative *preference shares* of each of its *related undertakings* that is a *regulated related undertaking* – in a manner consistent with the calculation of GCR in *INSPRU 6.1*.
- 37 The entries at line 28 must equal the net contribution to innovative *tier one capital resources* of the *firm's related undertakings* in accordance with the calculation in *INSPRU 6.1.53R (2)*.
- 38 The entries at lines 25-28 must be restricted to comply with *INSPRU 6.1.45R*, so that the total of the amounts in lines 24-28 is not greater than the total amount in line 19 plus line 37, and the total amount in lines 27 and 28 is not greater than 15/85 of the total of the amounts in lines 19, 24, 25, and 26 minus line 37. Amounts in excess of the limits are entered at lines 42 and 43 as appropriate. If line 42 or 43 includes amounts excluded from line 26 or 28, these amounts must be stated in a supplementary note (code 0304).
- 39 The entries at line 32 for investments in own *shares* should, in the majority of cases, be zero.
- 40 For the purpose of completing line 33, the *firm* should refer to *GENPRU 2.2.155R* and *2.2.156R*.
- 41 The amounts in line 34 must be calculated in accordance with *GENPRU 2.2.107R(1)* and *2.2.107R(2)*.
- 42 The entries at line 36 must equal the total of any of the deductions of the type specified in lines 32-35 that apply to the *firm's related undertakings*.
- 43 The entries at lines 45 and 46 for perpetual cumulative *preference shares*, subordinated *debt* and *securities* must be the total, unrestricted, amounts that the *firm* can include in *upper tier two capital* in accordance with *GENPRU 2.2.159R* to *2.2.174R*, *GENPRU 2.2.177R* to *2.2.181R* and *GENPRU 2.2.270R* to *2.2.271R*.
- 44 The entries at line 47 must equal the net contribution to *upper tier two capital resources* of the *firm's related undertakings* – ie. the sum of the *firm's* share of the *upper tier two capital resources* of each *related undertaking* less the book value of the *firm's* investment in the *upper tier two capital* of its *related undertakings* – in a manner consistent with the calculation of GCR in *INSPRU 6.1*.
- 45 The types of capital instrument that a *firm* can include within its *lower tier two capital* are set out at *GENPRU 2.2.159R* to *2.2.174R*, *GENPRU 2.2.194R* to *2.2.196R* and *GENPRU 2.2.271R*. These should be split between fixed term *preference shares*

and other *tier two instruments* and entered at lines 51 and 52 respectively.

- 46 The entries at line 53 must equal the net contribution to *lower tier two capital resources* of the *insurer's related undertakings* in accordance with the calculation in *INSPRU 6.1.57R(2)*.
- 47 The effect of the restrictions at *INSPRU 6.1.45R* applying to *tier two capital* are shown at lines 62 and 63. Line 62 relates to *tier two capital* as a whole and equals the excess (if any) of line 61 over line 39. Line 63 relates to *lower tier two capital* and equals the excess (if any) of line 59 over the sum of line 62 and 1/2 line 39.
- 48 The entries at line 71 must be nil.
- 49 Line 73 must show the deductions for inadmissible assets required by *INSPRU 6.1.59R*.
- 50 Line 74 must show the assets in excess of *market risk* and *counterparty* limits in *INSPRU 6.1.70R*.
- 51 Line 75 must show negative adjustments for *related undertakings* that are *ancillary services undertakings* required by *INSPRU 6.1.62R*.
- 52 The entries at line 76 must be nil.
- 53 The entries in line 77 must show the total amount calculated in respect of ineligible surplus in accordance with *INSPRU 6.1.65R*.
- 54 The entry at line 81 is determined as the amount of the *firm's capital resources* available to meet its *guarantee fund* requirement, having regard to *INSPRU 6.1.45R(2)*. Unless some innovative tier one capital does not meet the conditions for it to be treated as *upper tier two capital* (when an adjustment may be needed), line 81 must be either:
- line 79; or
  - (if less) the sum of lines 39 and 69 less the sum of lines 24 and 41 less the greatest of:
    - zero;
    - the sum of lines 27, 28, 37, 43, 45, 46, 47, 59 and 72 less the sum of lines 19, 25, 26, 42, 62, 63, 71 and 79.
    - line 59 plus one-third of the sum of lines 24, 41 and 72 less the sum of lines 62 and 63 less one-third of the sum of lines 49, 71 and 79.
- 55 The entry at line 82 is determined as the amount of the *firm's capital resources* available to meet 50% of its *minimum capital requirement*, having regard to *INSPRU 6.1.45R(1)(a)*. Line 82 must be either:
- line 79; or

- (if less) sum of lines 19, 24, 25, 26 and 42 less line 37.

56 The entry at line 83 is determined as the amount of the *firm's capital resources* available to meet 75% of its *minimum capital requirement*, having regard to INSPRU 6.1.45R(1)(b). Line 83 must be either:

- line 79; or
- (if less) the sum of lines 19, 24, 25, 26, 41, 42, 45, 46 and 47 less line 37 and any excess of line 62 over line 59.

57 Amounts relating to financial engineering shown in lines 91-96 must not include amounts in *related undertakings*.

*Instructions 58 onwards apply to all firms*

58 Any arrangement relating to *long-term insurance business* which is not entered in lines 91 to 95, but which falls within the definition of financing arrangement in paragraph 9(3) of Appendix 9.4 (Abstract of valuation report) must be disclosed in a supplementary note (code 0305) to this Form.

59 The entry at line 91 (implicit items) must equal the sum of the entries at lines 22 and 41. Lines 92 to 95 do not apply to *general insurance business* and line 91 is only likely to apply to *long-term insurance business*.

60 The entry at line 92 must equal the gross amount of any contingent liability to repay a *debt* to or recapture a liability from a *reinsurer* not already recognised in Form 14. The *firm* must provide in a supplementary note (code 0306) to this Form the following information on each material *reinsurance* arrangement:

- the amount of any *reinsurance* offset (i.e. the amount of the difference between the *mathematical reserves* at the end of the *financial year in question* were that *reinsurance* to be ignored and the amount of the *mathematical reserves* after deducting the *mathematical reserves* reinsured);
- the amount of the contingent liability for payment to the *reinsurer*; and
- the commutation value at the end of the *financial year in question* of the *reinsurance* arrangement.

61 The entry at line 93 must equal the amount of any contingent asset receivable from a *cedant* not already recognised in Form 13 or 14. The *firm* must provide in a supplementary note (code 0307) to this Form the following information on each material outgoing *reinsurance* arrangement:

- the amount of any *reinsurance* liability (i.e. the amount of the difference between the *mathematical reserves* at the end of the *financial year in question* including the *mathematical reserves* reinsured 'in', and the amount of the *mathematical reserves* were that *reinsurance* to be ignored);
- the amount of the contingent asset for payments from *cedants*; and
- the commutation value at the end of the *financial year in question* of the

*reinsurance* arrangement.

- 62 The amount to be shown for contingent loans at line 94 must be the amount, including any interest accrued, still to be repaid from future profits under the arrangements, as at the end of the *financial year in question*, not already recognised in Form 14.
- 63 Line 95 must include the potential charge against future profits in respect of any other types of financial engineering not included in lines 91 to 94 where the gross amount of any contingent liability is not already recognised in Form 14.
- 64 The *firm* must provide an explanation of the nature of the adjustments in line 94 and 95 in a supplementary note (code 0308) to this Form, together with the amount of the adjustment for each material arrangement. As part of this note, the commutation value of each of the items included at lines 94 and 95, to the extent that value is not already a component of line 79, must be disclosed.
- 65 Details of any promises to *long-term insurance business policyholders* conditional upon future profits (other than bonuses not yet declared), or other charges to future profits not already disclosed, must be provided in a supplementary note (code 0309) to this Form.
- 66 A reconciliation of net *admissible assets* to *total capital resources* after deductions (line 79) must be provided as a supplementary note (code 0301). The reconciliation must contain the following items:
- (i) Net *admissible assets* [Form 13 line 89 (other than long-term business) plus Form 13 line 89 (long-term) less the sum of lines 11, 12 and 49 in Form 14 less Form 15 line 69]
  - (ii) Any components of *capital resources* that are treated as a liability in Form 14 or 15 (each to be specified and identified to the entries on Forms 3 and 14/15). (In particular this would include any subordinated loan capital.) [These items would be added to net *admissible assets* in the reconciliation]
  - (iii) Any components of *capital resources*, not included in (ii), that arise as a result of a *waiver* and are not represented by *admissible assets* included in Form 13 (each to be specified and identified to the entries on Form 3). (In particular this would include any *implicit items* included as a result of a *waiver* within *capital resources*.) [These items would be added to net *admissible assets* in the reconciliation]
  - (iv) Any other items, each such item to be separately specified. An explanation of each such item is to be provided together with, if applicable, the reference to where the item is included elsewhere in the *return* or in the *firm's* stand-alone accounts prepared under the Companies Acts 1985 or 2006, as appropriate, or (for *firms* not preparing accounts under the Companies Act legislation) equivalent overseas legislation or the applicable *United Kingdom* legislation). [These items would be added to or deducted from net *admissible assets* in the reconciliation as appropriate.]

The net *admissible assets* in item (i) plus or minus the additions and deductions in items (ii) to (iv), should equal line 79 (Total capital resources after deductions).

- 67 **Where a direction under section 148 of the *Act* has been issued to an *insurer* permitting it to take into account *implicit items* on *long-term insurance business*, that direction may specify that a note is to be included in the *return* explaining such items. That note must be included as a note to *Form 3* (Code 0312).**
- 68 **A reconciliation of profit and loss account and other reserves (line 12) as at the end of this financial year and the end of the previous financial year (columns 3 and 4) to the profit and loss retained (*Form 16* line 59) must be provided as a supplementary note (code 0313).**



*Instructions for completion of Form 10*

**PRA**

- 1**     **An external insurer (other than a non-EEA insurer whose insurance business in the United Kingdom is restricted to reinsurance or an insurer whose head office is in any EEA State except the United Kingdom whose insurance business in the EEA is restricted to reinsurance), an EEA-deposit insurer or a Swiss general insurer must complete Form 10 in respect of business carried on through a branch in the United Kingdom. An UK-deposit insurer must complete Form 10 in respect of business carried on through its branches in EEA States taken together.**
- 2**     **[deleted]**
- 3**     **[deleted]**
- 4**     **Line 64 must be Form 15.61.2 less 15.61.1.**
- 5**     **Line 65 should include transfers from or to head office (note 1002).**

**Calculation of general insurance capital requirement– premiums amount and brought forward amount**

**Form 11**

Name of insurer  
 Global business / UK branch business / EEA branch business  
 Financial year ended  
 General/long-term insurance business

R11	Company registration number	GL/UK/CM	day	month	year	units
						£000
			This financial year		Previous year	
			<b>1</b>		<b>2</b>	

Gross premiums written	11		
Premium taxes and levies (included in line 11)	12		
Premiums written net of taxes and levies (11-12)	13		
Premiums for classes 11, 12 or 13 (included in line 13)	14		
Premiums for "actuarial health insurance" (included in line 13)	15		
<b>Sub-total A</b> (13 + ½ 14 - ²/₃ 15)	16		
Gross premiums earned	21		
Premium taxes and levies (included in line 21)	22		
Premiums earned net of taxes and levies (21-22)	23		
Premiums for classes 11, 12 or 13 (included in line 23)	24		
Premiums for "actuarial health insurance" (included in line 23)	25		
<b>Sub-total H</b> (23 + ½ 24 - ²/₃ 25)	26		
<b>Sub-total I</b> (higher of sub-total A and sub-total H)	30		
<b>Adjusted sub-total I</b> if financial year is not a 12 month period to produce an annual figure	31		
Division of gross adjusted premiums amount: x 0.18	32		
sub-total I (or adjusted sub-total I if appropriate) Excess (if any) over 57.5M EURO x 0.02	33		
<b>Sub-total J</b> (32-33)	34		
Claims paid in period of 3 financial years	41		
Claims outstanding carried forward at the end of the 3 year period For insurance business accounted for on an underwriting year basis	42		
For insurance business accounted for on an accident year basis	43		
Claims outstanding brought forward at the beginning of the 3 year period For insurance business accounted for on an underwriting year basis	44		
For insurance business accounted for on an accident year basis	45		
<b>Sub-total C</b> (41+42+43-44-45)	46		
Amounts recoverable from reinsurers in respect of claims included in Sub-total C	47		
<b>Sub-total D</b> (46-47)	48		
<b>Reinsurance ratio</b> (Sub-total D / sub-total C or, if more, 0.50 or, if less, 1.00)	49		
<b>Premiums amount</b> (Sub-total J x reinsurance ratio)	50		
Provision for claims outstanding (before discounting and net of reinsurance)	51		
Provision for claims outstanding (before discounting and gross of reinsurance) if both 51.1 and 51.2 are zero, otherwise zero.	52		
Brought forward amount (See instruction 4)	53		
Greater of lines 50 and 53	54		



## Instructions for completion of Forms 11 and 12

PRA

### Long-term insurance business

- 1 For a *composite firm*, Forms 11 and 12 must be completed separately for the total *general insurance business* and for the total *long-term insurance business* which is *class IV* or supplementary accident and sickness insurance business or *life protection reinsurance business* written by a *pure reinsurer* or a *mixed insurer*. For other *firms*, the forms must be completed for the total *general insurance business* or for the total *long-term insurance business* which is *class IV*, or supplementary accident and sickness insurance business or *life protection reinsurance business* written by a *pure reinsurer* or a *mixed insurer*, as appropriate.
- 2 Notwithstanding instruction 1, if the gross annual office premiums for *class IV* business, *life protection reinsurance business* written by a *pure reinsurer* or a *mixed insurer* and supplementary accident and sickness insurance in force on the 'valuation date' do not exceed 1% of the gross annual office premiums in force on that date for all *long-term insurance business*, Forms 11 and 12 need not be completed for *long-term insurance business* as long as it can be stated that the entry in line 21 of Form 60 exceeds the amount that would be obtained if Forms 11 and 12 were to be completed for *long-term insurance business*. In this circumstance, the method of estimating the entry in line 21 of Form 60, together with a statement of the gross annual office premiums in force at the 'valuation date' in respect of *Class IV* business, *life protection reinsurance business* written by a *pure reinsurer* or a *mixed insurer* and supplementary accident and sickness insurance, must be given in a supplementary note (code 6001).
- 3 When completing Forms 11 and 12 for *long-term insurance business* the accounting conventions for *general insurance business* should be followed, but reasonable approximations may be used if they are unlikely to result in an underestimate of the *insurance health risk and life protection reinsurance capital component*.

### Marine mutuals

- 4 In the case of a *marine mutual* completing an abbreviated *return* under rule 9.36A, units must be the same as those used in Form M1. If units are in US\$ or US\$000, then references to the sterling equivalent of Euro in line 33 of Form 11 and lines 33 of Form 12 must be taken to be references to the US\$ equivalent of the specified amount of Euro and the Forms must be amended to reflect the use of US\$. The bases of conversion adopted must be stated by way of a supplementary note to Form 11 (code 1101).

### Pure reinsurers

- 5 Lines 14 and 24 of Form 11 and line 27 of Form 12 must be left blank for a *pure reinsurer* which became a *firm in run-off* before 31 December 2006 and whose *Part 4A permission* has not subsequently been varied to add back the *regulated activity of effecting contracts of insurance*.

#### *Prior year figures*

- 6 ***INSPRU 1.1.71R*** requires recalculation of the ***gross adjusted premiums amount*** and the ***gross adjusted claims amount*** (but not during *financial years* beginning before 31 December 2004, because of the transitional provisions) if there has been a significant change to the business portfolio. This may alter the *claims amount* or the *premiums amount* used in calculating the *general insurance capital requirement* for the *financial year* in question. For this reason, entries in column 2 (but not the *brought forward amount*: this should (errors excepted) equal the *brought forward amount* calculated in the previous year's return) may differ from the corresponding entries from the previous year. Any restatement of the figures should be explained by way of a supplementary note to Form 11 (code 1102) and Form 12 (code 1202).

#### *Prior year figures*

- 7 If the *financial year* ends after 30 December 2006, the amounts to be shown in column 2 must be the amounts shown in column 1 for the previous *financial year*, unless Forms 11 and 12 were not completed for the previous *financial year*. In that event column 2 must be left blank, apart from the amounts in 11.51.2, 11.52.2 and 12.43.2. The amounts in 11.51.2 and 12.43.2 must be calculated in accordance with the rules in force at the date to which they relate, so for a previous *financial year* ending prior to 31 December 2006 they must exclude *life protection re insurance business*.
- 8 Where the *financial year* began between 1 January 2004 and 31 December 2004 (inclusive), the previous *financial year's* figures would normally be those sent under rule 9.6(1B) and may be unaudited.
- 9 If the *financial year* began before 1 January 2005:
- the treatment of "actuarial health insurance" in the calculation will have changed and prior year figures in lines 32 and 33 of Form 11 and lines 32 and 33 of Form 12 may be inappropriate because the form does not represent the calculation at the time. If so, these figures should be left blank and an explanation should be provided by way of a supplementary note to Form 11 (code 1103) and Form 12 (code 1203).
  - the *firm* would not have had a reference period in relation to the *previous financial year* if it had been in existence for less than 3 or 7 *financial years* (as appropriate). If it had no reference period, then lines 11 to 41, column 2, of Form 12 should be left blank.

#### *Premiums and claims*

- 10 ***Premiums*** and ***claims*** are defined by references to *contracts of insurance* and these themselves are defined by the *Regulated Activities Order* so that *premiums* or *claims* may be included for contracts that would not be treated as insurance under normal accounting conventions. All direct and indirect costs related to the *claims* must be included. For *life protection reinsurance business* and *permanent health reinsurance business* the discount to the *premium*, during any initial period, to allow for acquisition expenses of the cedant must be ignored, i.e. an adjustment must be made to *premiums* written and *premiums* earned as if the *premium* is the amount excluding the discount and the discount had been accounted for as an

expense.

#### **Euro**

- 11** The Euro amounts in the calculation of line 33 of Form 11 and line 33 of Form 12 will change from time to time as the result of indexation in accordance with *INSPRU 1.1.49R*. The conversion rate to be used is described in *INSPRU 1.1.50R*. Changes in the Euro amounts or conversion rates will not affect prior year figures.

#### **Actuarial health insurance**

- 12** "Actuarial health insurance" refers to health insurance business that meets the conditions of *INSPRU 1.1.72R* or for *class IV insurance business* those conditions as modified by *INSPRU 1.1.86R*.

#### **Instructions for completion of Form 11**

- 1** Line 30 represents the *gross adjusted premiums amount* calculated in accordance with *INSPRU 1.1.56R*, if the *financial year* has 12 months. Otherwise line 31 represents the *gross adjusted premiums amount*.
- 2** In accordance with *INSPRU 1.1.54R*, the reinsurance ratio calculated at line 49 must be:
- 1.00 if sub-total C is zero
  - 1.00 if sub-total D / sub-total C exceeds 1.00;
  - 0.50 if sub-total D / sub-total C is less than 0.50; and
  - sub-total D / sub-total C, otherwise.

The ratio at line 49 must be shown to two decimal places, but the unrounded ratio must be used for calculating *Form 11* line 50 and *Form 12* line 41.

- 3** The provisions in line 51 must be net of *reinsurance* and must not be discounted or reduced to take account of investment income, except for:
- risks in *classes 1* or *2*;
  - reductions to reflect the discounting of annuities; and
  - a *pure reinsurer* that does not have *permission* under the *Act* to effect *contracts of insurance*.

For these exceptions, the discount must be calculated in accordance with *GENPRU 1.3.4R* and, if any amounts in line 51 are discounted, a supplementary note to the *Form 11* (code 1104) must describe the items that are discounted.

- 4** *Form 11* line 53 column 1 is determined as follows:
- If *Form 11* line 51 columns 1 and 2 and line 52 column 2 are all zero then *Form 11* line 53 column 1 equals *Form 12* line 43 column 2.
  - If *Form 11* line 51 columns 1 and 2 are both zero but line 52 column 2 is non-

zero then *Form 11* line 53 column 1 equals the lesser of *Form 12* line 43 column 2 and (*Form 12* line 43 column 2 multiplied by the ratio of *Form 11* line 52 column 1 to line 52 column 2).

- If *Form 11* line 51 column 2 is zero but line 51 column 1 is non-zero then *Form 11* line 53 column 1 equals *Form 12* line 43 column 2.
- If *Form 11* line 51 column 2 is non-zero then *Form 11* line 53 column 1 equals the lesser of *Form 12* line 43 column 2 and (*Form 12* line 43 column 2 multiplied by the ratio of *Form 11* line 51 column 1 to line 51 column 2)

***Instructions for completion of Form 12***

- 1** The reference period in line 11 is specified in ***INSPRU 1.1.63R***.
- 2** Statistical methods may be used to allocate the ***claims***, provisions and recoveries in respect of ***classes 11, 12 and 13*** in line 27.
- 3** Line 31 represents the ***gross adjusted claims amount*** calculated in accordance with ***INSPRU 1.1.60R***.

**Line 43** represents the ***general insurance capital requirement*** that relates to the following ***financial year***: that is the year commencing on the day after the year end to which the ***returns*** relate.

## Analysis of admissible assets

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Category of assets

	Company registration number	GL/ UK/ CM	day	month	year	units	Category of assets
R13						£000	
						<b>As at end of this financial year 1</b>	<b>As at end of the previous year 2</b>
Land and buildings			11				

**Investments in group undertakings and participating interests**

UK insurance dependants	shares	21		
	debts and loans	22		
Other insurance dependants	shares	23		
	debts and loans	24		
Non- insurance dependants	shares	25		
	debts and loans	26		
Other group undertakings	shares	27		
	debts and loans	28		
Participating interests	shares	29		
	debts and loans	30		

**Other financial investments**

Equity shares	41		
Other shares and other variable yield participations	42		
Holdings in collective investment schemes	43		
Rights under derivative contracts	44		
Fixed interest securities	Approved	45	
	Other	46	
Variable interest securities	Approved	47	
	Other	48	
Participation in investment pools	49		
Loans secured by mortgages	50		
Loans to public or local authorities and nationalised industries or undertakings	51		
Loans secured by policies of insurance issued by the company	52		
Other loans	53		
Bank and approved credit & financial institution deposits	One month or less withdrawal	54	
	More than one month withdrawal	55	
Other financial investments	56		



**Analysis of admissible assets**

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Category of assets

	Company registration number	GL/UK/CM	day	month	year	units	Category of assets
R13						£000	
						<b>As at end of this financial year 1</b>	<b>As at end of the previous year 2</b>

**Reconciliation to asset values determined in accordance with the insurance accounts rules or international accounting standards as applicable to the firm for the purpose of its external financial reporting**

Total admissible assets after deduction of admissible assets in excess of market risk and counterparty limits (as per line 89 above)	91		
Admissible assets in excess of market and counterparty limits	92		
Inadmissible assets directly held	93		
Capital resources requirement deduction of regulated related undertakings	94		
Ineligible surplus capital and restricted assets in regulated related insurance undertakings	95		
Inadmissible assets of regulated related undertakings	96		
Book value of related ancillary services undertakings	97		
Other differences in the valuation of assets (other than for assets not valued above)	98		
Deferred acquisition costs excluded from line 89	99		
Reinsurers' share of technical provisions excluded from line 89	100		
Other asset adjustments (may be negative)	101		
Total assets determined in accordance with the insurance accounts rules or international accounting standards as applicable to the firm for the purpose of its external financial reporting (91 to 101)	102		
Amounts included in line 89 attributable to debts due from related insurers, other than those under contracts of insurance or reinsurance	103		

Instructions for completion of Form 13

PRA

- 1 Form 13 must be completed for the total *long-term insurance business assets* of the *insurer or branch* and for each fund or group of funds for which separate assets are appropriated. The words "*total long-term insurance business assets*" or the name of the fund must be shown against the heading "Category of assets". The corresponding code box must contain "10" for the total assets and, in the case of separate funds, code numbers allocated sequentially beginning with code "11".
- 2 Form 13 must be completed in respect of the total assets of the *insurer or branch* other than any *long-term insurance business assets*. The words "total other than *long-term insurance business assets*" must be shown against the heading "Category of assets", and the corresponding code box must contain "1".
- 3 (a) In the case of the *United Kingdom branch return of an external insurer (other than a non-EEA insurer whose insurance business in the United Kingdom is restricted to reinsurance or an insurer whose head office is in any EEA State except the United Kingdom whose insurance business in the EEA is restricted to reinsurance)* Form 13 must be completed for the following categories of assets –

Category	Code – other than <i>long-term insurance business assets</i>	Code – <i>long-term insurance business assets</i>
In the case of a <i>non-EEA insurer</i> , assets deposited under <i>INSPRU 1.5.54R</i>	2	6
Assets maintained in the <i>United Kingdom</i>	3	7
Assets maintained in the <i>United Kingdom</i> and the other <i>EEA States</i>	4	8

- (b) In the case of an *EEA branch return of a UK-deposit insurer which has made a deposit under INSPRU 1.5.54R*, Form 13 must be completed for the following categories of assets –

Category	Code – other than <i>long-term insurance business assets</i>	Code – <i>long-term insurance business assets</i>
Assets deposited under <i>INSPRU 1.5.54R</i>	2	6
Assets maintained in the <i>United Kingdom</i> and the other <i>EEA States</i>	4	8
Assets maintained in the <i>United Kingdom</i> and the <i>EEA</i>	5	9

States where *insurance business* is carried on

**4** In lines 11 to 86 –

- (a) for the purpose of classifying (but not valuing) assets, headings and descriptions used above, wherever they also occur in the balance sheet format in Schedule 9A to the Companies Act 1985, where applicable, otherwise Schedule 3 to the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410), must have the same meaning as in those Schedules,
- (b) *dependants* of the *firm* must be valued in accordance with *GENPRU 1.3.47R*,
- (c) a *related undertaking* that is not a *dependant* of the *firm* must be valued in accordance with *GENPRU 1.3.47R* unless:
  - It is an *ancillary services undertaking* which must be valued at zero;
  - It is a *related undertaking* that is not a *regulated related undertaking* which must be valued in accordance with *GENPRU 1.3.41R*; or
  - [deleted]
- (d) other assets must be valued in accordance with rule 9.10,
- (e) assets of any particular description must be shown after deduction of assets of that description which (for any reason) fall to be left out of account under *INSPRU 2.1.22R(3)(a), (b), (c), (g) and (h)*. Negative amounts should not be shown at lines 11 to 86. If a deduction is more than the value of the assets to which it relates, the excess element of the deduction should be shown at line 87; and
- (f) deductions in respect of *market risk* and *counterparty risk* are to be shown in line 87, to the extent that (e) does not require them to be recognised in other lines.

**5** The aggregate value of those investments which are:

- (a) *unlisted* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with the *rules* in *GENPRU 1.3*;
- (b) *listed* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with the *rules* in *GENPRU 1.3* and which are not *readily realisable*;
- (c) units or other beneficial interests in *collective investment schemes* that:
  - (i) are not schemes falling within the *UCITS Directive*;
  - (ii) are not authorised unit trust schemes or recognised schemes within the meaning of Part XVII of the *Act*;
  - (iii) do not employ *derivative contracts* unless they meet the criteria in

**INSPRU 3.2.5R;**

- (iv) do not employ contracts or assets having the effect of *derivative contracts* unless they have the effect of *derivative contracts* that meet the criteria in *INSPRU 3.2.5R*; and
- (v) do not include assets other than *admissible assets* among their property; or
- (d) reversionary interests or remainders in property other than land or buildings,

must be stated by way of a supplementary note (code 1301 for other than *long-term insurance business* and code 1308 for *long-term insurance business*) to this Form, together with a description of such investments.

- 6 The aggregate value of those investments falling within lines 46 or 48 which are *hybrid securities* are to be stated by way of a supplementary note (code 1302 for other than *long-term insurance business* and code 1309 for *long-term insurance business*) to this Form.
- 7 Amounts in respect of salvage or subrogation included above other than at line 73 are to be stated by way of a supplementary note (code 1303) to this Form.
- 8 The entry at line 85 must be gross of any related reinsurance commission.
- 9 The amount to be shown in line 93 must equal the total of the relevant proportions in accordance with *GENPRU 1.3.49R* and *GENPRU 1.3.50R* of the *individual capital resources requirements* of the *regulated related undertakings*.
- 10 The amount to be shown in line 94 must equal the ineligible surplus capital and any restricted assets of any *regulated related undertaking* that is an *insurance undertaking* that are deducted in accordance with *GENPRU 1.3.47R (3)(b)*.
- 11 Lines 60 to 63 and 85 relate only to *general insurance business*. The amount in lines 60-62 recoverable from *Insurance Special Purpose Vehicles* must be disclosed in a supplementary note (code 1320).
- 12 Lines 60 to 63 and 85 must be left blank for “Category of assets” code “2”.
- 13 Since the *technical provisions* for *claims* outstanding shown in *Form 15* may only be discounted or reduced to take account of investment income in limited circumstances, the amount shown at line 12 of *Form 15* may need to be increased (see instruction 4 to *Form 15*). In such cases, the reinsurers' share shown at line 61 must be adjusted to be consistent with the amount shown in line 12.
- 14 The amount of any tangible leased asset included at line 80 must be disclosed by way of a supplementary note (code 1314 for other than *long-term insurance business* and code 1316 for *long-term insurance business*) to this Form.
- 15 Particulars of any other assets included at line 83 must be stated by way of a supplementary note (code 1315 for other than *long-term insurance business* and code 1317 for *long-term insurance business*) to this Form.

- 16** Lines 99-102 must be completed in accordance with the *insurance account rules* or *international accounting standards* as applicable to the *firm* for the purpose of its external financial reporting if the *firm* is required to produce such accounts. Otherwise these lines must be left blank. Line 100 includes the discounting adjustment for the *reinsurers'* share of claims outstanding – see instruction 4 of *Form 15*. Details of amounts in line 101 must be disclosed in a supplementary note (code 1318). For years ending on or before 30 December 2008, the previous year figure for line 93 must be left blank and that for line 101 must equal line 100 from the previous *return*.

**Long term insurance business liabilities and margins**

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Total business / subfund

Units

		As at end of this financial year 1	As at end of the previous year 2
Mathematical reserves, after distribution of surplus	11		
Cash bonuses which had not been paid to policyholders prior to end of the financial year	12		
Balance of surplus / (valuation deficit)	13		
Long term insurance business fund carried forward (11 to 13)	14		
Claims outstanding	Gross	15	
	Reinsurers' share	16	
	Net (15-16)	17	
Provisions	Taxation	21	
	Other risks and charges	22	
Deposits received from reinsurers	23		
Creditors	Direct insurance business	31	
	Reinsurance accepted	32	
	Reinsurance ceded	33	
Debenture loans	Secured	34	
	Unsecured	35	
Amounts owed to credit institutions	36		
Creditors	Taxation	37	
	Other	38	
Accruals and deferred income	39		
Provision for "reasonably foreseeable adverse variations"	41		
Total other insurance and non-insurance liabilities (17 to 41)	49		
Excess of the value of net admissible assets	51		
Total liabilities and margins	59		
Amounts included in line 59 attributable to liabilities to related companies, other than those under contracts of insurance or reinsurance	61		
Amounts included in line 59 attributable to liabilities in respect of property linked benefits	62		
Total liabilities (11+12+49)	71		
Increase to liabilities – DAC related	72		
Reinsurers' share of technical provisions	73		
Other adjustments to liabilities (may be negative)	74		
Capital and reserves and fund for future appropriations	75		
Total liabilities under insurance accounts rules or international accounting standards as applicable to the firm for the purpose of its external financial reporting (71 to 75)	76		

**Instructions for completion of Form 14**

**PRA**

- 1** The Form must be completed for the total *long-term insurance business liabilities* and margins of the *insurer* or *branch* and for each fund or group of funds for which separate assets are appropriated and each *with-profits fund*.
- 2** The entry at line 11 must equal the sum of lines 21, 43, 44 and 45 of the appropriate Form or Forms 58.
- 3** The entry at line 12 must equal line 42 of the appropriate Form or Forms 58.
- 4** The entry at line 13 must equal line 49 of the appropriate Form or Forms 58.
- 5** The entry at line 14 must equal line 59 of the appropriate Form or Forms 40.
- 6** Where the provision required by *INSPRU 3.2.17R(3)* is implicit (i.e. the obligation to pay the monetary amount is recognised under the *rules* in *GENPRU 1.3*), *insurers* must state the amount of the provision, in a supplementary note (code 1404).
- 7** The entry at line 51 must be:
  - (a)** the value of the *admissible assets* (as included in line 89 of the appropriate Form 13) representing the *long-term insurance funds*, fund or group of funds to which the Form relates, less
  - (b)** the amount of those funds, fund or group of funds, being the sum of the amounts shown at lines 14 and 49.
- 8** Lines 72-76 must be completed in accordance with the *insurance accounts rules* or *international accounting standards* as applicable to the *insurer* for the purpose of its external financial reporting if the *insurer* is required to produce such accounts. Otherwise, and for *Forms 14* at subfund level, these lines must be left blank. The amount of DAC in line 72 must be adjusted for any associated deferred tax. Details of amounts in line 74 must be disclosed in a supplementary note (code 1405). The previous year figures must be left blank for financial years ending on or before 30 December 2006.
- 9** The amount of each provision, included in line 22, in respect of a deficit in a *regulated related undertaking* and the identity of the *undertaking* must be disclosed in a supplementary note (code 1403) to this Form.

**Liabilities (other than long term insurance business)**

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

	Company registration number	GL/ UK/ CM	day	month	year	units
	R15					£000
			<b>As at end of this financial year 1</b>		<b>As at end of the previous year 2</b>	

**Technical provisions (gross amount)**

Provisions for unearned premiums	11		
Claims outstanding	12		
Provision for unexpired risks	13		
Equalisation provisions	Credit business	14	
	Other than credit business	15	
Other technical provisions	16		
Total gross technical provisions (11 to 16)	19		

**Provisions and creditors**

Provisions	Taxation	21	
	Other risks and charges	22	
Deposits received from reinsurers	31		
Creditors	Direct insurance business	41	
	Reinsurance accepted	42	
	Reinsurance ceded	43	
Debenture loans	Secured	44	
	Unsecured	45	
Amounts owed to credit institutions	46		
Creditors	Taxation	47	
	Foreseeable dividend	48	
	Other	49	
Accruals and deferred income	51		
Total (19 to 51)	59		
Provision for "reasonably foreseeable adverse variations"	61		
Cumulative preference share capital	62		
Subordinated loan capital	63		
Total (59 to 63)	69		

Amounts included in line 69 attributable to liabilities to related insurers, other than those under contracts of insurance or reinsurance	71		
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Amounts deducted from technical provisions for discounting	82		
Other adjustments (may be negative)	83		
Capital and reserves	84		
Total liabilities under insurance accounts rules or international accounting standards as applicable to the firm for the purpose of its external financial reporting (69-82+83+84)	85		

Instructions for completion of Form 15

PRA

- 1 Amounts in lines 11 to 13 and 16 must be stated gross of *reinsurers' share*.
- 2 The aggregate amount of any accrued dividend in respect of cumulative *preference shares* issued by the *insurer* must be shown by way of a supplementary note (code 1503) to this Form.
- 3 Only equalisation provisions that are created as a result of a regulatory requirement are to be included at lines 14 and 15
- 4 The amount shown in line 12 may only be discounted or reduced to take account of investment income:
  - (a) for *Class 1 or 2 business*; or
  - (b) in respect of annuities; or
  - (c) if the *insurer* is a *pure reinsurer* which became a *firm in run-off* before 31 December 2006 and whose *Part 4A permission* has not subsequently been varied to add back the *regulated activity of effecting contracts of insurance*.

So, if the *technical provisions for claims* outstanding for other business are discounted or reduced to take account of investment income, then they must be increased by the difference between the undiscounted and the discounted provisions. If the *technical provisions* are increased the amount of the increase must be shown in line 82 and the corresponding increase in the *reinsurers' share* must be included as a negative item in line 99 of *Form 13*.

- 5 The amount of each provision, included in line 22, in respect of a deficit in a *regulated related undertaking* and the identity of the *undertaking* must be disclosed in a supplementary note (code 1504).
- 6 Where the provision required by *INSPRU 3.2.17R(3)* is implicit (i.e. the obligation to pay the monetary amount is recognised under the *rules in GENPRU 1.3*), the amount of the provision must be stated in a supplementary note (code 1506).
- 7 The amount shown in line 51 must include reinsurance commissions related to *deferred acquisition costs* corresponding to the allowance included in *Form 13* line 85.
- 8 Lines 82-85 must be completed in accordance with the *insurance accounts rules or international accounting standards* as applicable to the *insurer* for the purpose of its external financial reporting if the *insurer* is required to produce such accounts. Otherwise these lines must be left blank. Details of amounts in line 83 must be disclosed in a supplementary note (code 1507).
- 9 The amount at line 48 column 1 is dividends which are foreseeable in accordance with *GENPRU 2.2.87AG*. Where the previous financial year ends before 31 December 2007 the amount shown in column 2 must be the amount shown in the previous annual return (where a different definition for this item may have been

used).

**Profit and loss account (non-technical account)**

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

		Company registration number	GL/ UK/ CM	day	month	year	units
R16							£000
			This financial year 1	Previous year 2			
Transfer (to) / from the general insurance business technical account	From Form 20	11					
	Equalisation provisions	12					
Transfer from the long term insurance business revenue account		13					
Investment income	Income	14					
	Value re-adjustments on investments	15					
	Gains on the realisation of investments	16					
Investment charges	Investment management charges, including interest	17					
	Value re-adjustments on investments	18					
	Loss on the realisation of investments	19					
Allocated investment return transferred to the general insurance business technical account		20					
Other income and charges (particulars to be specified by way of supplementary note)		21					
Profit or loss on ordinary activities before tax (11+12+13+14+15+16-17-18-19-20+21)		29					
Tax on profit or loss on ordinary activities		31					
Profit or loss on ordinary activities after tax (29-31)		39					
Extraordinary profit or loss (particulars to be specified by way of supplementary note)		41					
Tax on extraordinary profit or loss		42					
Other taxes not shown under the preceding items		43					
Profit or loss for the financial year (39+41-(42+43))		49					
Dividends (paid or foreseeable)		51					
Profit or loss retained for the financial year (49-51)		59					

*Instructions for completion of Form 16*

**PRA**

- 1** In addition to the supplementary note (code 1601) required under *Appendix 9.1* paragraph 5(2), where any brought forward amounts on any Form are restated due to currency reversion it would be appropriate to briefly state this fact in a supplementary note (code 1602) to this Form in order to facilitate the *PRA*'s computerised validation of the *return*. This fact may be stated by a simple statement, e.g. 'Some of the brought forward amounts shown in the forms xx to xx have been restated from the corresponding carried forward amounts included in the previous year's *return* due to the reversion of foreign currency amounts at a different rate of exchange'. No further details need be given.
- 1a** Unrealised gains and losses on investments (other than for investments in the long term fund) must be included in their entirety at lines 15 and 18, even if a different accounting treatment is adopted in the Companies Act accounts. Unrealised gains and losses must be measured by reference to the value included for the investment at line 102 on Form 13, i.e. the Companies Act accounts value.
- 2** Particulars of any amounts included at lines 21 must be stated by way of a supplementary note (code 1603) to this Form.
- 3** Particulars of any amounts included at lines 41 must be stated by way of a supplementary note (code 1604) to this Form.
- 4** The amount at line 51 column 1 includes dividends which are foreseeable in accordance with *GENPRU 2.2.87AG*. Where the previous financial year ends before 31 December 2007 the amount shown in column 2 must be the amount shown in the previous annual return (where a different definition for this item may have been used).

**Analysis of derivative contracts**

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Category of assets

		Company registration number	GL/ UK/ CM	day	month	year	units	Category of assets
		R17					£000	
Derivative contracts			Value as at the end of this financial year		Notional amount as at the end of this financial year			
			Assets 1	Liabilities 2	Bought / Long 3	Sold / Short 4		
Futures and contracts for differences	Fixed-interest securities	11						
	Interest rates	12						
	Inflation	13						
	Credit index / basket	14						
	Credit single name	15						
	Equity index	16						
	Equity stock	17						
	Land	18						
	Currencies	19						
	Mortality	20						
	Other	21						
In the money options	Swaptions	31						
	Equity index calls	32						
	Equity stock calls	33						
	Equity index puts	34						
	Equity stock puts	35						
	Other	36						
Out of the money options	Swaptions	41						
	Equity index calls	42						
	Equity stock calls	43						
	Equity index puts	44						
	Equity stock puts	45						
	Other	46						
Total (11 to 46)		51						
Adjustment for variation margin		52						
Total (51 + 52)		53						

Instructions for completion of Form 17

PRA

- 1 Where the year end total notional amount (line 51.3 + line 51.4) exceeds the lesser of £100m and 5% of assets not held to match linked liabilities (Form 13 line 89.1 – Form 13 line 58.1 – Form 13 line 59.1) for the total *long-term insurance business* assets or the total assets other than *long-term insurance business* assets, Form 17 must be completed in respect of that total category of assets of the *insurer* or branch. Form 17 must also be completed for each fund or group of funds referred to in instruction 1 to Form 13 if Form 17 must be completed in respect of the total *long-term insurance business* assets.
- 2 The codes specified in instructions 1 to 3 to Form 13 must be used as appropriate.
- 3 *Derivative contracts* must be analysed according to the description of assets shown in the second column of Form 17 which represents the principal subject of the contract. Credit derivatives include credit default swaps and total return swaps. An option is in the money (and conversely out of the money) if it could be exercised based on market conditions as at the end of the financial year.
- 4 *Derivative contracts* must be reported as assets in column 1 of Form 17 if their value to the *insurer* (gross of *variation margin*) is positive and as liabilities in column 2 of Form 17 if their value (gross of *variation margin*) to the *insurer* is negative.
- 5 All amounts included at lines 11 to 51 columns 1 and 2 of Form 17 in respect of *derivative contracts* must be determined without making any allowance for *variation margin*.
- 6 Amounts in respect of a derivative contract may only be included net of amounts in respect of any other derivative contract if -
  - (a) obligations of the *insurer* under the contracts may be set off against each other under generally accepted accounting practice; and
  - (b) such other contract has the effect (in whole or in part) of closing out the obligations of the *insurer* under the first mentioned contract.
- 7 The effect of any *variation margin* upon amounts included at lines 11 to 51 of Form 17 and columns 1 and 2 must be shown at line 52 columns 1 and 2.
- 8 The entry at 17.53.1 must be included at 13.44.1.
- 9 The entry at 17.53.2 must be included at 14.38.1 or 15.49.1. as appropriate.
- 10 Rights to recover assets transferred by way of *initial margin* must not be shown on Form 17.
- 11 In columns 3 and 4, the notional amount is:

- (a) For interest rate and inflation *swaps*, the cash amount on which the *swap* is based.
- (b) For *credit default swaps*, the nominal value of the bonds on which the *swap* is based.
- (c) For mortality *swaps*, the market value of the fixed future payments.
- (d) For *swaptions*, the nominal amount on which conversion to a fixed interest rate will be applied.
- (e) For *options* other than *swaptions*, the market value of the assets subject to the *option*.
- (f) For *futures*, the market value of the asset that is contracted to be bought / sold.
- (g) For other *contracts for differences*, the nominal value of the property, index or other value referenced by the contract.

12 For the purposes of columns 3 and 4, a contract is bought / long (and conversely sold / short) if it is:

- (a) For currency *futures* and *contracts for differences*, a contract where the *insurer* pays sterling. Currency contracts not involving sterling must be replicated as a contract into sterling and a contract out of sterling. For example, a *future* to buy a currency other than sterling at a price expressed in another non-sterling currency must be replicated by a long *future* to buy the first currency with sterling and a short *future* to sell the second currency for sterling.
- (b) For interest rate and inflation *swaps*, a contract where the *insurer* receives a fixed rate in exchange for paying a variable (short term deposit) rate. A *swap* between a short term deposit rate and inflation must be replicated as a deposit / fixed and a fixed / inflation *swap*.
- (c) For *credit default swaps*, a contract where the *insurer* receives a fixed payment in exchange for taking on credit risk.
- (d) For mortality *swaps*, a contract where the *insurer* receives a fixed payment in exchange for taking on mortality risk.
- (e) For *options*, a contract where the *insurer* has the option to buy the underlying or has provided the option to a counterparty to sell the underlying.

**With-profits insurance capital component for the fund**

Name of insurer  
 With-profits fund  
 Financial year ended  
 Units

	<b>As at end of this financial year 1</b>	<b>As at end of the previous year 2</b>
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**Regulatory excess capital**

Regulatory value of assets	Long-term admissible assets of the fund	11		
	Implicit items allocated to the fund	12		
	Mathematical reserves in respect of the fund's non-profit insurance contracts	13		
	Long-term admissible assets of the fund covering the LTICR of the fund's non-profit insurance contracts	14		
	Long-term admissible assets of the fund covering the RCR of the fund's non-profit insurance contracts	15		
	Total (11+12-(13+14+15))	19		
Regulatory value of liabilities	Mathematical reserves (after distribution of surplus) in respect of the fund's with-profit insurance contracts	21		
	Regulatory current liabilities of the fund	22		
	Total (21+22)	29		
Long-term insurance capital requirement in respect of the fund's with-profits insurance contracts		31		
Resilience capital requirement in respect of the fund's with-profits insurance contracts		32		
Sum of regulatory value of liabilities, LTICR and RCR (29+31+32)		39		
Regulatory excess capital (19-39)		49		

**Realistic excess capital**

Realistic excess capital	51		
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**Excess assets allocated to with-profits insurance business**

Excess (deficiency) of assets allocated to with-profits insurance business in fund (49-51)	61		
Face amount of capital instruments attributed to the fund and included in capital resources (unstressed)	62		
Realistic amount of capital instruments attributed to the fund and included in capital resources (stressed)	63		
Present value of future shareholder transfers arising from distribution of surplus	64		
Present value of other future internal transfers not already taken into account	65		
With-profits insurance capital component for fund (if 62 exceeds 63, greater of 61+62-63-64-65 and zero; else greater of 61-64-65 and zero)	66		

*Instructions for completion of Form 18*

**PRA**

- 1** The entries at lines 11, 12, 13 and 14 must equal the values determined in accordance with *INSPRU* 1.3.24R. The entry at line 15 must be left blank for financial years ending on or after 31 December 2006.
- 2** The entry at line 19 must equal the value determined in accordance with *INSPRU* 1.3.23R(1).
- 3** The entries at lines 21 and 22 must equal the values determined in accordance with *INSPRU* 1.3.29R.
- 4** The entries at lines 29 and 31 must equal the values determined in accordance with *INSPRU* 71.3.23R(2)(a) and (b) respectively. The entry at line 32 must be left blank for financial years ending on or after 31 December 2006.
- 5** The entry at line 39 must equal the value determined in accordance with *INSPRU* 1.3.23R(2).
- 6** The entry at line 49 must equal the value determined in accordance with *INSPRU* 1.3.23R.
- 7** The entry at line 51 must equal the value at Form 19, Line 66.
- 8** The entry at line 62 must equal C, determined in accordance with *INSPRU* 1.3.7R(3)(a).
- 9** The entry at line 63 must equal D, determined in accordance with *INSPRU* 1.3.7R(3)(b).
- 10** The entry at line 64 must equal the value determined in accordance with *INSPRU* 1.3.7R(2)(b)(ii). The previous year figure must be left blank for financial years ending on or before 30 December 2007.
- 11** The entry at line 65 must equal the amount determined in accordance with *INSPRU* 1.3.7R(2)(b)(iii). The previous year figure must be left blank for financial years ending on or before 30 December 2007.
- 12** The entry at line 66 must equal the contribution in respect of the fund to the aggregate value determined in accordance with *INSPRU* 1.3.7R(1).

## Realistic balance sheet

Name of insurer  
With-profits fund  
Financial year ended  
Units

		As at end of this financial year 1	As at end of the previous year 2
<b>Realistic value of assets available to the fund</b>			
Regulatory value of assets		11	
Implicit items allocated to the fund		12	
Value of shares in subsidiaries held in fund (regulatory)		13	
Excess admissible assets		21	
Present value of future profits (or losses) on non-profit insurance contracts written in the fund		22	
Value of derivatives and quasi-derivatives not already reflected in lines 11 to 22		23	
Value of shares in subsidiaries held in fund (realistic)		24	
Prepayments made from the fund		25	
Realistic value of assets of fund (11+21+22+23+24+25-(12+13))		26	
Support arrangement assets		27	
Assets available to the fund (26+27)		29	
<b>Realistic value of liabilities of fund</b>			
With-profits benefit reserve		31	
Future policy related liabilities	Past miscellaneous surplus attributed to with-profits benefits reserve	32	
	Past miscellaneous deficit attributed to with-profits benefits reserve	33	
	Planned enhancements to with-profits benefits reserve	34	
	Planned deductions for the costs of guarantees, options and smoothing from with-profits benefits reserve	35	
	Planned deductions for other costs deemed chargeable to with-profits benefits reserve	36	
	Future costs of contractual guarantees (other than financial options)	41	
	Future costs of non-contractual commitments	42	
	Future costs of financial options	43	
	Future costs of smoothing (possibly negative)	44	
	Financing costs	45	
	Any other liabilities related to regulatory duty to treat customers fairly	46	
	Other long-term insurance liabilities	47	
	Total (32+34+41+42+43+44+45+46+47-(33+35+36))	49	
Realistic current liabilities of the fund		51	
Realistic value of liabilities of fund (31+49+51)		59	

**Realistic balance sheet**

**Form 19  
(Sheet 2)**

Name of insurer  
With-profits fund  
Financial year ended  
Units

	<b>As at end of this financial year 1</b>	<b>As at end of the previous year 2</b>
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**Realistic excess capital and additional capital available**

Value of relevant assets before applying the most adverse scenario other than present value of future profits arising from business outside with-profits funds	62		
Amount of present value of future profits (or losses) on long-term insurance contracts written outside the fund included in the value of relevant assets before applying most adverse scenario	63		
Value of relevant assets before applying the most adverse scenario (62+63)	64		
Risk capital margin for fund (62-59)	65		
Realistic excess capital for fund (26-(59+65))	66		
Realistic excess available capital for fund (29-(59+65))	67		
Working capital for fund (29-59)	68		
Working capital ratio for fund (68/29)	69		

**Other assets potentially available if required to cover the fund's risk capital margin**

Additional amount potentially available for inclusion in line 62	81		
Additional amount potentially available for inclusion in line 63	82		

*Instructions for completion of Form 19*

**PRA**

- 1 The entry at line 11 must equal the value at Form 18, Line 19.
- 2 The entry at line 12 must equal the value at Form 18, Line 12.
- 3 The entry at line 13 must be the amount determined in accordance with *GENPRU* 1.3 and excluded from the amount calculated in accordance with *INSPRU* 1.3.33R(1)(a).
- 4 The entry at line 21 must be the amount of the fund's excess *admissible assets*, determined in accordance with *INSPRU* 1.3.33R(1)(b).
- 5 The entry at line 22 must be the present value of future profits (or losses) on any *non-profit insurance contracts* written in the *with-profits fund*, determined in accordance with *INSPRU* 1.3.33R(1)(c).
- 6 The entry at line 23 must be the market value of any *derivative* or *quasi-derivative* determined in accordance with *INSPRU* 1.3.33R(1)(d).
- 7 The entry at line 24 must be the amount determined in accordance with *INSPRU* 1.3.33R(1)(e).
- 8 The entry at line 25 must be the amount determined in accordance with *INSPRU* 1.3.33R(1)(f).
- 9 The entry at line 26 must be the amount determined in accordance with *INSPRU* 1.3.32R(1).
- 10 The entry at line 27 must be any other amount providing capital support to the fund under a support arrangement, included with the prior agreement of the *PRA*.
- 11 The entry at line 31 must be the amount determined in accordance with *INSPRU* 1.3.40R(1).
- 12 The entries at lines 32, 33, 34, 35, 36, 41, 42, 43, 44, 45, 46 and 47 must be the amounts determined in accordance with *INSPRU* 1.3.137R(1) to (11).
- 13 The entry at line 32 is the (positive) amount determined in accordance with *INSPRU* 1.3.137R(1) if this represents a surplus.
- 14 The entry at line 33 is the (positive) amount determined in accordance with *INSPRU* 1.3.137R(1) if this represents a deficit.
- 15 The entries at lines 34, 35, 36, 41, 42, 43, 44 and 45 are the amounts determined in accordance with *INSPRU* 1.3.137R(2) to (9) respectively.
- 16 The entries at lines 46 and 47 are the values determined in accordance with

**INSPRU 1.3.137R(10) and (11).**

- 17** The entry at line 49 must be the amount determined in accordance with *INSPRU 1.3.40R(2)*.
- 18** The entry at line 51 must be the amount determined in accordance with *INSPRU 1.3.40R(3)*.
- 19** The entry at line 59 must be the amount determined in accordance with *INSPRU 1.3.32R(2)(a)*.
- 20** The entry at line 62 must be the amount described as **A** and determined in accordance with *INSPRU 1.3.43R(3)(a)* adjusted to exclude any amount taken into consideration under *INSPRU 1.3.45R(2)(c)*.
- 21** The entry at line 63 must be any amount taken into consideration under *INSPRU 1.3.45R(2)(c)* in determining the amount described as **A** in accordance with *INSPRU 1.3.43R(3)(a)*.
- 22** The entry at line 64 must be the amount described as **A** and determined in accordance with *INSPRU 1.3.43R(3)(a)*.
- 23** The entry at line 65 must be the amount determined in accordance with *INSPRU 1.3.32R(2)(b)*.
- 24** The entry at line 66 must be the amount determined in accordance with *INSPRU 1.3.32R*.
- 24A** The entry at line 69 must be shown as a percentage to two decimal places.
- 25** The entry at line 81 must be an amount not exceeding the sum of the value of the net shareholders assets of the *firm* and the surplus assets of the *firm's non-profit funds*, to the extent not included at any Form 19 line 27 or at any Form 19 line 62 and to the extent not required to meet regulatory capital requirements in respect of any business written outside the fund.
- 26** The entry at line 82 must be an amount not exceeding 50% of the present value of future profits arising from insurance contracts written by the firm outside its *with-profits funds* reduced by the sum of any amounts included at any Form 19 line 63.



## Appendix 9.2 (rules 9.14 to 9.22)

### General Insurance Business: Revenue Account and Additional Information

#### (Forms 20A and 20 to 39)

##### *Introduction*

**1** All the Forms included in the part of the *return* to which this Appendix relates (*Forms 20A and 20 to 39*) are to be laid out as shown in this Appendix, except that the instructions to Forms need not be reproduced.

PRA

**2** The provisions of paragraph 1(2) and paragraphs 2 to 7 of *Appendix 9.1*, unless otherwise provided, also apply for the purposes of this Appendix.

PRA

##### *Cases where forms are required*

**2A** Table: Forms required for the *PRA general insurance business reporting categories*:

PRA

PRA general insurance business reporting category	Form			
	F20, F21, F22, F23, F24, F25	F26, F27 F28 F29	F31 F34	F32 F34
<i>Combined categories</i>	✓			
<i>Category numbers 160 and 350</i>	✓		✓	
<i>Risk categories with category numbers 121, 122, 123, 221, 222, 223 (i.e. direct and facultative motor)</i>				✓
<i>Risk categories with category numbers below 400 other than category numbers 121, 122, 123, 221, 222, 223, 160 and 350 (i.e. all direct and facultative that is not motor, household or goods in transit and has not been allocated to a miscellaneous category)</i>			✓	
<i>Risk categories with category numbers 510 to 590 and 610 to 690 (i.e. treaty reinsurance)</i>		✓		
<i>Miscellaneous primary (direct) and facultative business (category number 400)</i>	✓		✓	
<i>Miscellaneous treaty reinsurance accepted business (category number 700)</i>	✓	✓		
<i>Balancing categories (category numbers 409, 709)</i>	✓			

**2B** (1) In the Table in (2) a Form, specified in the first column, is required for a category of business, specified in the second column, if the criteria, specified in the third column, are met for that category of business.

PRA

(2) **Table: Criteria (if any) for whether a Form is required for a category of general insurance business. Paragraph 2C belongs to this Table.**

Form	Category of business	Reporting criteria (if any)
<b>F20 to F25</b> Technical provisions and profit & loss account	Category number 001	Forms always required
	Category numbers 002,003	Either -  (a) the <i>insurer's</i> 'gross undiscounted provisions' in the category of business at the end of the <i>financial year</i> exceed zero; or  (b) the <i>insurer's gross written premiums</i> in the category of business in the <i>financial year</i> exceed zero.
	Category numbers 110, 120, 160, 180, 220, 260, 270, 280, 330, 340, 350, 400, 500, 600, 700	Either -  (a) the <i>insurer's</i> 'gross undiscounted provisions' in the category of business at the end of the <i>financial year</i> exceed:  (i) £100m; or  (ii) the higher of 5% of the <i>insurer's</i> total 'gross undiscounted provisions' and £1 million  or  (b) the <i>insurer's gross written premiums</i> in the category of business in the <i>financial year</i> exceed:  (i) £100m; or  (ii) the higher of 5% of the <i>insurer's</i> total <i>gross written premiums</i> and £1 million.
	Category number 409	Some business in <i>category number</i> 002 is not reported on <b>Forms 20 to 25</b> for <i>category numbers</i> 110 to 400.
	Category number 709	Some business in <i>category number</i> 003 is not reported on <b>Forms 20 to 25</b> for <i>category numbers</i> 500, 600 and 700.
<b>F26 to F29</b> Results by year of origin for treaties accepted	Category numbers 510 to 590 and 610 to 690 denominated in any one currency.  Category number 700	Either -  (a) the <i>insurer's</i> 'gross undiscounted provisions' in the category of business at the end of the <i>financial year</i> exceed:  (i) £100m; or  (ii) the higher of 5% of the <i>insurer's</i> total 'gross undiscounted provisions' and £1 million  or  (b) the <i>insurer's gross written premiums</i> in the category of business in the <i>financial year</i> exceed:  (i) £100m; or

		(ii) the higher of 5% of the <i>insurer's</i> total <i>gross written premiums</i> and £1 million.
<b>F31, F32, F34</b> Gross results by year of origin for direct and facultative business	<p><i>Category numbers</i> 331 to 333 and 341 to 350 denominated in any one currency.</p> <p><i>Category numbers</i> 111 to 114, 121 to 160, 181 to 187, 221 to 223, 261 to 263, 271 to 274 and 281 to 284 denominated in any one currency carried on in any 'reporting territory'</p> <p><i>Category number</i> 400</p>	<p>Either -</p> <p>(a) the <i>insurer's</i> 'gross undiscounted provisions' in the category of business at the end of the <i>financial year</i> exceed:</p> <p>(i) £100m; or</p> <p>(ii) the higher of 5% of the <i>insurer's</i> total 'gross undiscounted provisions' and £1 million</p> <p>or</p> <p>(b) the <i>insurer's gross written premiums</i> in the category of business in the <i>financial year</i> exceed:</p> <p>(i) £100m; or</p> <p>(ii) the higher of 5% of the <i>insurer's</i> total <i>gross written premiums</i> and £1 million.</p>

**2C For the purpose of column 2 of the Table in Paragraphs 2B and Paragraphs 3(1) and 3(3) –**

**PRA**

- (a) a currency in which a *contract of insurance* is denominated is –
- (i) the currency in which the contract requires settlement of claims or the successor to that currency if it has been superseded,
  - (ii) the currency in which the *insurer* records claim payments under the contract, if the contract permits settlement of claims in more than one currency or if it is the *insurer's* internal practice to convert claim payments to that currency, or
  - (iii) the currency in which the *insurer* maintains records of the development of *premiums* or *claims* under the contract in order to determine *technical provisions*;
- (b) business denominated in British pound, converted to British pound, or British pound and converted to British pound combined are to be treated as though they were denominated in different currencies from each other; and
- (c) a *reporting territory* is one of –

- (i) 'United Kingdom' if the business is carried on in the United Kingdom and is not *home foreign business*,
- (ii) 'Home Foreign' if the business is *home foreign business*, or
- (iii) 'Non-United Kingdom' if the business is carried on outside the United Kingdom.

*Currency*

3

PRA

- (1) Notwithstanding the provisions of 2, amounts on *Forms 26 to 29, 31, 32, and 34* submitted in accordance with rules 9.17, 9.19 or 9.20A must be shown in the currency in which the business on the Form is denominated except that figures must be shown in sterling in those columns and lines which the forms indicate are always to contain figures expressed in sterling –
  - (a) in those columns and lines which the forms indicate are always to contain figures expressed in sterling; and
  - (b) if business on the form is *category number 400 or 700*.
- (2) For every currency other than sterling in which amounts are shown on the Forms referred to in (1), an entry must be made on *Form 36* to show the rate used to convert those amounts to sterling for inclusion elsewhere in the *returns*.
- (3) Notwithstanding the provisions of 2, all amounts included in
  - (a) columns 1, 2, 3 and 11 of *Form 23*;
  - (b) columns 1, 2, 3, and 11 of any *Form 26 or 27* for *category number 700*;
  - (c) columns 3 and 10 of any *Form 31* for *category number 400*; and
  - (d) columns 1 and 8 of any *Form 34* for *category number 400*,
 must be expressed in sterling, and these amounts that are in respect of business denominated in a non-sterling currency must be expressed in sterling as if conversion of every currency had taken place at the closing middle rate on the last day for which the appropriate rate is available in the *financial year in question*.
- (4) For the purpose of (3), the currencies 'Converted to British pound' and 'British pound and converted to British pound combined' are not non-sterling currencies.
- (5) A *insurer* need not apply (3) to amounts shown in any line of any of the forms mentioned in that subparagraph representing an accident year or underwriting year ending before 23 December 1996.

4

PRA

All amounts shown in sterling must be shown to the nearer £1,000. Amounts in any other currency on *Forms 26 to 29, 31, 32 and 34* must be shown to the nearer 1,000 principal monetary units of that currency except that, where the rate of exchange of the currency in relation to £1 sterling on the last day of the *financial year in question* exceeded 1,000

principal monetary units of that currency, the amounts must be shown to the nearer 1,000,000 principal monetary units and '000,000' must be inserted in the box labelled 'Monetary units'. In other cases, this box must be completed by inserting '000'.

7

(1) The following information must be stated by way of supplementary notes (codes 20Aa to 20Af) to *Form 20A* –

PRA

- (a) (code 20Aa) in respect of each *risk category* (other than *risk categories* with *category numbers* 274, 590 or 690) to which an *insurer* has allocated *general insurance business* under rule 9.14B –
  - (i) the name of the *risk category*,
  - (ii) a description of the *general insurance business* allocated to the relevant *risk category*,
  - (iii) the rationale for the allocation decision made,
  - (iv) the amounts included in *Form 20A* under the *risk category* in respect of *general insurance business* allocated to the *risk category* under rule 9.14B, and
  - (v) in the case of an allocation made under rule 9.14B(4), a description of the method used to make that allocation;
- (b) (code 20Ab) the *risk categories* to which any *contracts of insurance* against risks of death of, or injury to, passengers has been allocated;
- (c) (code 20Ac) a detailed explanation of business allocated to each of *category numbers* 187, 223, 400 and 700 ('Other personal financial loss', 'motor other', 'miscellaneous direct' and 'miscellaneous reinsurance' categories);
- (d) (code 20Ad) in respect of each *risk category* (other than *risk categories* 510 to 590, 610 to 690 and 700) for which the amounts reported in *Form 20A* contain both *claims-made policies* and policies which are not *claims-made*:
  - (i) the name of the *risk category*,
  - (ii) the amounts reported in *Form 20A* under the *risk category* that have arisen from *claims-made policies*, and
  - (iii) the amounts reported in *Form 20A* under the *risk category* that have arisen from policies which are not *claims-made*;
- (e) (code 20Ae) the amounts reported in *Form 20A* under *category number* 002 ("Total primary (direct) and facultative business") that is *facultative business*;
- (f) (code 20Af) the amounts reported in *Form 20A* under each of *category numbers* 113 (Travel), 274 (Mixed commercial package)

and 343 (Energy) that has arisen from business falling within

- (i) each group of classes in *Annex 11.2 Part II*, and
- (ii) *classes 16, 17 and 18 combined (miscellaneous financial loss, legal expenses and assistance)*.

(2) The insurer may make reasonable estimates of the amounts required under (1)(d) to (f).

*Presentation of amounts*

8A Where in any Form an amount which is a comparative (i.e. shown in a "previous year" column) or shown brought forward from a previous year differs from the corresponding amount shown in a "this financial year" column or as carried forward from that year, as the case may be, and the difference is not due solely to the use of a different rate to express other currencies in sterling, an explanation of the reason for the difference must be given by way of a supplementary note to that Form. For *Forms 20, 21, 22, 23, 24, 26, 27, 28, 31, 32 or 34*, the code for the supplementary note is 2011, 2101, 2201, 2301, 2401, 2601, 2701, 2801, 3101, 3201 or 3401 respectively.

PRA

8B Calculations must be performed using unrounded figures. Figures which are determined from other figures (whether or not on the same form) must be rounded after performing calculations on the unrounded component figures. Ratios must be reported to two decimal places.

PRA

*Premiums*

9 In *Forms 23, 26, 27, 31 and 32* –

PRA

- (a) *gross premiums earned* in respect of an accident year must be such proportion of *gross premiums written* as is attributable to risks borne by the *insurer* during that accident year; and
- (b) the *reinsurers'* share of premiums earned must be attributed to the same accident years as the corresponding *gross premiums earned*, so as to calculate the *net earned premiums* for each accident year.

10 In *Forms 24, 25, 28, 29 and 34* –

PRA

- (a) *gross premiums written* in an underwriting year must be the amount of such premiums arising in respect of *contracts of insurance incepted* during that year, whether or not they are received during that year; and
- (b) the *reinsurers'* share of premiums written must be attributed to the same underwriting years as the corresponding *gross premiums written*.

11 For the purposes of 10 and 14, where an *insurer* has acquired *policies* under a transfer approved under Part VII of the *Act* or its predecessor legislation or approved by the competent authority of another *EEA State* under Article 12 of the *Third Non-Life Directive*, the *policies* transferred to the *insurer* must be taken to have *incepted* on the date of such transfer.

PRA

12 In all Forms to which this Appendix relates, amounts required to be shown in respect of premiums must be shown before deduction for commissions.

PRA

### Claims

- 13
- PRA
- (1) In *Forms 23, 26, 27, 31 and 32*, where an amount or number is required to be shown for *claims* in respect of an accident year, that amount or number must be determined on the basis of *claims* arising from incidents occurring during that accident year.
- (2) For the purposes of (1), an incident giving rise to a claim under a *claims-made policy* is deemed to occur on the earlier of –
- (a) the date on which it is notified in accordance with the terms of that *policy*; or
- (b) the date on which the period for which cover is provided under that *policy* expires.
- (3) For the purposes of (1), where an *insurer* has assumed, pursuant to a contract, responsibility (whether wholly or in part) for the payment or reimbursement of *claims* made under *policies* effected by another *insurer*, all incidents occurring prior to the date of such contract and giving rise to *claims* under those *policies* are deemed to have occurred on the date of such contract.
- (4) In the application of (3), the reference to responsibility assumed by an *insurer* includes responsibility assumed as a *reinsurer* or under a transfer under Part VII of the Act or its predecessor legislation or approved by the competent authority of another *EEA State* under Article 12 of the *Third Non-Life Directive*; and in the case of such a transfer the date of the contract is taken to be the date of the transfer.
- 14
- PRA
- In *Forms 24, 25, 28, 29 and 34*, where an amount is required to be shown for *claims* in respect of a *financial year*, that amount must be determined on the basis of *claims* arising under *contracts of insurance incepted* during that year.
- 15
- PRA
- In all *Forms* to which this Appendix relates, amounts required to be shown for *claims* must not include amounts in respect of *claims management costs*.
- UK and overseas business
- 16
- PRA
- (1) For each *risk category* there must be stated by way of supplementary note (code 20Ag) to *Form 20A* –
- (a) if any of the *gross written premiums* reported in *Form 20A* under the *risk category* is attributable to *home foreign business* or overseas business, the amount of the *gross written premiums* in the *risk category* attributable to overseas business, *home foreign business*, and other UK business;
- (b) If the *risk category* is not 510 to 590, 610 to 690 or 700, and any of the business reported in *Form 20A* under the *risk category* is attributable to overseas business, the countries in which the business in the *risk category* is carried on; and
- (c) the name of the *risk category*.
- (2) For the purposes of this Appendix, and (1)(a) in particular, *gross written premiums* must be shown or included as UK premiums if, in the case of

*direct and facultative insurance business* the *contract of insurance* was effected in the United Kingdom or if, in the case of a *reinsurance* treaty, the cedant was an *insurer* having its head office in the United Kingdom or was a member of the *Society*; and overseas premiums must be construed accordingly.

- (3) In a *Form 31, 32 or 34*, an *insurer* must enter in the space alongside 'reporting territory' –
- (a) 'World wide' if the business on the Form is a subset of *category numbers 330 or 340 or category number 350 or 400*; or
  - (b) one of the following if the business on the Form is otherwise
    - (i) 'United Kingdom other than home foreign' for business carried on in the *United Kingdom* that is not *home foreign business*,
    - (ii) 'Home Foreign' for home foreign business, or
    - (iii) 'Overseas' for business carried on outside the United Kingdom.

*Transfers of general insurance business*

17

PRA

- (1) If, during the *financial year*, *policies* already effected by another *insurer* have been transferred to the *insurer*, an *insurer* must state, in respect of each *risk category*, the following by way of supplementary note to *Form 20A* (code 20Ah) –
- (a) the date of the transfer;
  - (b) whether the transfer was approved under Part VII of the *Act* or its predecessor legislation or approved by the competent authority of another *EEA State* under Article 12 of the *Third Non-Life Directive* or was effected by novation;
  - (c) any amounts included in columns 1, 2, 3 and 4 on *Form 20A* in respect of consideration for the transfer;
  - (d) [deleted]
  - (e) the earliest and latest dates upon which the relevant *policies* *incept*; and
  - (f) whether or not any of the *policies* has a duration of longer than 12 months and, if so, the date by which all those *policies* will have expired.
- (2) (1) does not apply in respect of any transfer by way of novation unless the amounts mentioned in (1)(c) exceed in aggregate 2.5% of the insurer's gross premium income for the financial year in question.
- (3) (a) For each *risk category* that contains *general insurance business* for which an *insurer* is required, by rules 9.17 and 9.19, to prepare a *Form 26 to 29, 31, 32 or 34* in the *return* for the *financial year in question*, the *insurer* must, subject to (b), state

the amount included in columns 2 plus 3 and the amount included in column 4 on *Form 20A* that arise from *policies* already effected by another *insurer* that have been transferred to the *insurer*, by way of supplementary note to *Form 20A* (code 20Ai).

- (b) For each *risk category* (a) only applies if the amount included in columns 2 plus 3 plus 4 on *Form 20A* that arises from transferred *policies* exceeds £10m or the higher of £1m and 10% of the amount shown in columns 2 plus 3 plus 4 on *Form 20A* for that *risk category*.

#### *Unearned premiums*

- 18 In *Forms 21* and *25*, the basis on which unearned premiums are calculated and the reason for adopting this basis must be stated by way of supplementary note (code 2102 in the case of *Form 21* and code 2501 in the case of *Form 25*).

PRA

#### *Provision for unexpired risks*

- 19 (1) The amount included for the provision for unexpired risks in *Form 22* or *25* prepared in respect of a *PRA general insurance business reporting category* must be determined without taking into account any surplus expected to arise on the unexpired risks falling within other *PRA general insurance business reporting categories*.

PRA

- (2) Where in determining the amount of the overall provision for unexpired risks (line 13 in *Form 15* less line 62 in *Form 13*) credit has been taken for any aggregate surplus expected to arise on the unexpired risks falling in any *PRA general insurance business reporting category*, the amount of that credit must be included as a negative amount at line 19 of *Form 22* or line 23 of *Form 25*, as appropriate, for that category.

- 20 (1) Where the amount included at column 3 line 19 (provision for unexpired risks) in any *Form 22* or at column 9999 of line 23 (provision for unexpired risks) in any *Form 25* has been determined after taking into account expected investment return, the following must be stated by way of supplementary note (code 2205 in the case of *Form 22* and code 2502 in the case of *Form 25*) –

PRA

- (a) the provision for unexpired risks before taking such investment return into account;
- (b) the rates of investment return assumed; and
- (c) the average interval between the end of the *financial year in question* and the date at which *claims* are expected to be settled in cash.

#### *Cessation of business*

- 21 (1) If the *insurer* has effected no ‘new contracts of insurance’ of any one or more *classes of general insurance business* during the *financial year*, the date on which the last ‘new contract’ of each such *class* was effected must be stated by way of supplementary note (code 20Aj) to *Form 20A*.

PRA

- (2) For the purposes of this paragraph and 22, a *new contract of insurance* is any contract of insurance effected by the insurer other than in fulfilment of its obligations under subsisting *contracts of insurance*.

*Claims management costs*

22

PRA

- (1) In *Forms 22 and 24*, the basis used for the determination of amounts for *claims management costs* payable in the *financial year in question* and carried forward to the following *financial year* must be stated by way of supplementary note (code 2202 in the case of *Form 22* and code 2404 in the case of *Form 24*).

- (2) If, in respect of any *PRA general insurance business reporting category* –

- (a) no amount for *claims management costs* is shown as being carried forward to the following *financial year*; and
- (b) an amount for net claims is shown as being carried forward to that year,

the reason for anticipating that there will be no *claims management costs* incurred during the following *financial years* must be included in the note required by (1).

- (3) If, within a *PRA general insurance business reporting category*, an insurer has ceased to effect ‘*new contracts of insurance*’ during the *financial year in question*, the basis upon which any additional costs arising as a result of such cessation have been determined or the reason for anticipating that no such additional costs will be incurred must be included in the note required by (1).
- (4) Where the amount in respect of *claims management costs* carried forward and included in any *Form 22* or *24* has been determined after taking into account expected investment return, there must be stated by way of supplementary note to *Form 22* (code 2203) or *Form 24* (code 2405) –
- (a) the rates of investment return assumed; and
- (b) the average interval between the end of the *financial year in question* and the date by which the *claims management costs* are expected to be expended.

*Acquisition costs*

23

PRA

The basis used for the determination of amounts for acquisition costs (other than commission) payable in the *financial year in question* and carried forward to the next *financial year*, as shown at line 22 of *Form 22* and line 42 of *Form 24*, must be stated by way of a supplementary note to *Form 22* (code 2204) and *Form 24* (code 2406).

*Underwriting year accounting*

24

PRA

- (1) With reference to the *financial year in question* and in respect of each *PRA general insurance business reporting category*, the following information must be stated by way of supplementary note (code 2402)

to Form 24 –

- (a) the reason for accounting for such business on an underwriting year basis;
  - (b) the basis for distinguishing between such business and any other business falling within the same *PRA general insurance business reporting category* accounted for on an accident year basis;
  - (c) the accounting policy adopted for determining the provision for *claims* outstanding; and
  - (d) if the information provided in (a) to (c) differs in respect of risks *incepted* in the *financial year in question* from risks of a similar description *incepted* in *previous financial years*, the reason for that difference.
- (2) Where the provision for *claims* outstanding is set in respect of any business using the ‘non-annual method’, the note required by (1)(a) must include the following information –
- (a) the reason for using the ‘non-annual method’;
  - (b) the basis for distinguishing between such business and other business accounted for on an underwriting year basis falling within the same *PRA general insurance business reporting category*;
  - (c) the normal period for which an underwriting year is left ‘open’ or, if that period differs for different types of business within a *PRA general insurance business reporting category* –
    - (i) the basis for distinguishing between the types of business,
    - (ii) the normal period for each type, and
  - (d) where an underwriting year is left ‘open’ for longer than the normal period, the reason for not ‘closing the year’.
- (3) For the purposes of this Appendix –
- (a) *Non-annual method* refers to the method described by paragraph 52 of the *insurance accounts rules*; and
  - (b) a year is open with respect to any business *incepted* during that year if the provision for outstanding *claims* in respect of that business is set using the ‘non-annual method’ and if so set previously has not now been replaced in accordance with the requirements of paragraph 52(4) of the *insurance accounts rules*, and *closed year and closing a year* is construed accordingly.

***Business managed together***

25

PRA

- (1) For the purposes of *Forms 25 and 29*, risks may be regarded as managed together if –
- (a) they *incept* in the same *financial year* and are accounted for using the ‘non-annual method’; and
  - (b) they may be treated as managed together under generally accepted accounting practice.
- (2) Where any amount is shown on *Form 25 or 29* for the transfer of anticipated surplus, the following must be stated by way of supplementary note to *Form 25* (code 2504) or *Form 29* (code 2901) –
- (a) a description of the business in respect of which the anticipated surplus arises and of the business in respect of which the deficit to be offset arises (including in the case of *Form 25* the *risk categories* into which such business falls); and
  - (b) the reason for treating the business as managed together.

***Application of accounting practice***

26

PRA

- (1) Amounts in respect of inward and outward *contracts of insurance* must be classified for inclusion in *Forms 20A, 20 to 39* according to their economic substance and in accordance with generally accepted accounting practice.
- (2) Where amounts in respect of an inwards or outwards *contract of insurance* have been excluded from the revenue account, the following must be shown by way of supplementary note (code 20Ak) to *Form 20A*
- (a) a description of the terms of that contract;
  - (b) a description of the accounting treatment adopted and an explanation for adopting that treatment;
  - (c) a statement of the amounts paid and received during the *financial year* under that contract; and
  - (d) a statement of the amounts in respect of that contract included in each Form prepared under this Appendix or *Appendix 9.1*.
- (3) A *insurer* may elect to show the information required by (1) in respect of groups of contracts which were effected in the same *financial year* with substantially the same contract terms and in respect of which the same accounting treatment has been adopted.

***Discounting***

27

PRA

- (1) Sheet 2 of *Form 30* need only be completed if the provision for *claims* outstanding being discounted (before deduction for discounting) exceeds 25% of the total provision for *claims* outstanding (before deduction for discounting).
- (2) Where in accordance with (1) no Sheet 2 is prepared –

- (a) lines 21 and 29 of Sheet 1 need not be completed; and
  - (b) lines 11 to 20 need only be completed in respect of those currencies for which the provision for *claims* outstanding being discounted (before deduction for discounting) exceeds 25% of the total provision for that currency for *claims* outstanding (before deduction for discounting).
- (3) For the purposes of *Form 30*, a *major currency* is a currency in respect of which the provision for *claims* outstanding (before deduction for discounting) is not less than 10% of the total provision for *claims* outstanding (before deduction for discounting).
- (4) In *Form 30*, the value of an asset or liability which would be treated as an asset or liability in a particular currency for the purposes of *INSPRU* 3.1.53R (notwithstanding *INSPRU* 3.1.54R) must be shown in that currency.
- (5) The following must be stated by way of supplementary note (code 3003) to *Form 30* –
- (a) the *risk categories* where adjustments for discounting have been made; and
  - (b) in respect of each such *risk category* –
    - (i) the methods used in calculating the deduction for discounting,
    - (ii) the rate of interest used for the calculation of present values,
    - (iii) the expected average interval between the date for settlement of *claims* being discounted and the end of the *financial year in question*, and
    - (iv) the criteria adopted for estimating the period that will elapse before *claims* are settled.

#### *Reinsurance*

28 **Where the *reinsurers'* share of *claims* incurred (as stated in any *Form 22* or *25*) includes amounts expected to be recovered from *reinsurers* more than 12 months after the payment of the underlying gross *claims* by the *insurer*, the following must be stated by way of supplementary note to *Form 22* (code 2206) or *25* (code 2503) as appropriate –**

PRA

- (a) the amount of such recoveries; and
- (b) the accounting treatment which has been adopted in respect of discounting such recoveries.

#### *Continuation sheets*

30 **Continuation sheets to *Forms 31* and *34* need only be prepared in respect of *PRA general insurance business reporting categories 271* to *274*.**

PRA

**Country codes**

**31** The currency codes required for *Forms 26 to 29, 31, 32 and 34* and country codes must be in accordance with the following Table:

**PRA**

<b>COUNTRY</b>	<b>CODE</b>	<b>CURRENCY</b>	<b>CODE</b>
Afghanistan	QS	Afghani	AFA
Albania	CE	Albanian Lek	ALL
Algeria	KA	Algerian dinar	DZD
Andorra	CG	Euro	EUR
Angola	MT	Kwanza	AOA
Anguilla	GY	East Caribbean Dollar	XCD
Antigua And Barbuda	GP	East Caribbean Dollar	XCD
Argentina	JA	Argentine Peso	ARP
Armenia	RB	Armenian dram	AMD
Aruba	GM	Aruban guilder	AWG
Australia	EA	Australian dollar	AUD
Austria	BL	Euro	EUR
Azerbaijan	RC	Azerbaijani menat	AZM
Bahamas	GD	Bahamian dollar	BSD
Bahrain	PN	Bahraini dinar	BHD
Bangladesh	QA	taka	BDT
Barbados	GA	Barbadian dollar	BBD
Belarus	RD	Belarusian ruble	BYR
Belgium	BD	Euro	EUR
Belize	HH	Belizean dollar	BBD
Benin	LK	CFA franc (BCEAO)	XOF
Bermuda	GE	Bermudan dollar	BMD
Bhutan	QX	ngultrum/Indian rupee	BTN/IN R
Bolivia	JL	boliviano	BOB
Bosnia and Herzegovina	CH	marka	BAM
Botswana	MG	pula	BWP
Brazil	JC	real	BRL
Brunei	QY	Bruneian Dollar	BND

Bulgaria	CD	lev	BGN
Burkina Faso	LL	CFA franc (BCEAO)	XOF
Burundi	MW	Burundi franc	BIF
Cambodia	QU	riel	KHR
Cameroon	MV	CFA Franc (BEAC)	XAF
Canada	FA	Canadian dollar	CAD
Cape Verde	LM	Cape Verdean escudo	CVE
Central African Republic	MY	CFA franc (BCEAO)	XOF
Chad	NA	CFA franc (BCEAO)	XOF
Channel Islands	BA	British pound	GBP
Chile	JB	Chilean peso	CLP
China (Taiwan)	QQ	new Taiwan dollar	TWD
China, Peoples Rep. Of	QJ	Renminbi yuan	CNY
Christmas Island	ET	Australian dollar	AUD
Cocos Island	EU	Australian dollar	AUD
Colombia	JD	Colombian peso	COP
Comoros	MX	Comoran franc	EMF
Congo, Democratic Republic of	MM	Congolese franc	CDF
Congo (Republic of)	MU	CFA franc	XOF
Cook Islands	EV	New Zealand dollar	NZD
Costa Rica	HF	Costa Rican colon	CRC
Croatia	CJ	kuna	HRK
Cuba	GJ	Cuban peso	CUP
Curacao (Netherlands Antillies)	GL	Netherlands Antillean guilder	ANG
Cyprus	DA	Cypriot pound	CYP
Czech Republic	CP	Czech koruna	CZK
Denmark	BE	Danish krone	DKK
Djibouti	NB	Djiboutian franc	DJF
Dominica	GR	East Caribbean Dollar	XCD
Dominican Republic	GF	Dominican peso	DOP
Ecuador	JF	U.S. Dollar	USD
Egypt	KE	Egyptian pound	EGP
El Salvador	HB	Salvadoran colon,	SVC,
England	AC	British pound	GBP

Equatorial Guinea	NC	CFA franc (BCEAO)	XOF
Eritrea	NK	nakfa	ERN
Estonia	RE	kroon	EEK
Ethiopia	MP	birr	ETB
European Currencies, Weighted Average Of	CZ	European Currencies, Weighted Average Of	XBA
European Currency Unit	CY	European Currency Unit	XEU
Falkland Islands	AZ	British pound	GBP
Faro Islands	CT	Danish krone	DKK
Fiji	EC	Fijian dollar	FJD
Finland	BR	Euro	EUR
France	BF	Euro	EUR
French Guiana	JK	Euro	EUR
French Polynesia	EY	CFP Franc	XPF
Gabon	ND	CFA franc (BCEAO)	XOF
Gambia, The	LA	Dalasi	GMD
Georgia	RF	lari	GEL
Germany	BK	Euro	EUR
Ghana	LB	cedi	GHC
Gibraltar	DB	British pound	GBP
Grand Cayman Islands	GW	Caymanian Dollar	KYD
Greece	BN	Euro	EUR
Greenland	CS	Danish krone	DKK
Grenada	GQ	East Caribbean Dollar	XCD
Guam	RW	US dollar	USD
Guatemala	HD	Quetzal	GTQ
Guinea	LN	Guinean franc	GNF
Guinea-Bissau	LP	CFA franc (BCEAO)	XOF
Guyana	JH	Guyanese dollar	GYD
Haiti	GK	gourde	HTG
Home Foreign <i>United Kingdom</i>	AB		
Honduras	HC	Lempira	HNL
Hong Kong	QE	Hong Kong dollar	HKD
Hungary	CC	Hungarian forint	HUF

Iceland	BU	Icelandic krona	ISK
India	QB	Indian rupee	INR
Indonesia	QM	Indonesian rupiah	IDR
Iran	PB	Iranian rial	IRR
Iraq	PJ	Iraqi dinar	IQD
Irish Republic	BC	Euro	EUR
Isle Of Man	BB	British pound	GBP
Israel	PC	New Israeli shekel	ILS
Italy	BG	Euro	EUR
Ivory Coast	LH	CFA franc	XOF
Jamaica	GB	Jamaican dollar	JMD
Japan	QK	yen	JPY
Jordan	PL	Jordanian dinar	JOD
Kazakhstan	RG	Tenge	KZT
Kenya	MA	Kenyan shilling	KES
Kiribati	ED	Australian dollar	AUD
Korea, South	QR	South Korean won	KRW
Korea,North	QP	North Korean won	KPW
Kuwait	PD	Kuwaiti dinar	KWD
Kyrgyz, republic of (Kyrgyzstan)	RV	Kyrgyzstani som	KGS
Laos	RT	kip	LAK
Latvia	RJ	Latvian lat	LVL
Lebanon	PE	Lebanese pound	LBP
Lesotho	MH	South African Rand	ZAR
Liberia	LG	Liberian dollar	LRD
Libya	KD	Libyan dinar	LYD
Liechtenstein	CK	Swiss Franc	CHF
Lithuania	RK	litas	LTL
Luxembourg	BH	Euro	EUR
Macau	QD	pataca	MOP
Macedonia	BZ	denars	MKD
Madagascar	MS	Malagasy franc	MGF
Malawi	MD	Malawian kwacha	MWK
Malaysia	QF	ringgit	MYR

Maldives	RU	rufiyaa	MVR
Mali	LE	CFA franc (BCEAO)	XOF
Malta	DC	Maltese lira	MTL
Marshall Islands	EM	US dollar	USD
Mauritania	LS	Ouguiya	MRO
Mauritius	ML	Mauritian rupee	MUR
Mexico	HA	Mexican peso	MXN
Micronesia	EN	US Dollar	USD
Moldova	RL	Moldovan leu	MDL
Monaco	CF	Euro	EUR
Mongolia	RM	todrog/tugrik	MNT
Monserrat	GS	East Caribbean Dollar	XCD
Morocco	KB	Moroccan dirham	MAD
Mozambique	MR	metical	MZM
Myanmar	QH	Myanmar kyat	MMK
Namibia	NE	Namibian dollar	NAD
Nauru	EE	Australian dollar	AUD
Nepal	QT	Nepalese rupee	NPR
Netherlands	BJ	Euro	EUR
Netherlands Antilles	GX	Netherlands Antillean guilder	ANG
New Caledonia	EZ	CFP Franc	XPF
New Zealand	EB	New Zealand dollar	NZD
Nicaragua	HE	gold cordoba	NIO
Niger	NF	CFA franc (BCEAO)	XOF
Nigeria	LC	naira	NGN
Niue	ER	New Zealand dollar	NZD
Norfolk Island	ES	Australian dollar	AUD
Northern Ireland	AF	British pound	GBP
Norway	BS	Norwegian krone	NOK
Oman	PP	Omani rial	OMR
Pakistan	QC	Pakistani rupee	PKR
Palau	EP	US dollar	USD
Panama	HG	Panama dollar	PAD
Papua New Guinea	EF	kina	PGK

Paraguay	JM	guarani	PYG
Peru	JG	nuevo sol	PEN
Philippines	QL	Philippine peso	PHP
Pitcairn Islands	EX	New Zealand dollar	NZD
Poland	BV	zloty	PLN
Portugal	BP	Euro	EUR
Puerto Rico	GG	US dollar	USD
Qatar	PG	Qatari riyal	QAR
Romania	BW	leu	ROL
Russia	RN	rouble	RUB
Rwanda	NG	Rwandan franc	RWF
San Marino	CL	Euro	EUR
Sao Tome And Principe	LQ	dobra	STD
Saudi Arabia	PF	Saudi riyal	SAR
Scotland	AE	British pound	GBP
Senegal	LJ	CFA franc (BCEAO)	XOF
Serbia and Montenegro	CR	Serbian dinar	CSD
Seychelles	NH	Seychelles rupee	SCR
Sierra Leone	LD	leone	SLL
Singapore	QG	Singapore dollar	SGD
Slovakia	CQ	Slovak koruna	SKK
Slovenia	CM	tolar	SIT
Solomon Islands	EG	Solomon Islands dollar	SBD
Somalia	MQ	Somali shilling	SOS
South Africa	MK	South African Rand	ZAR
Spain	BQ	Euro	EUR
Sri Lanka	QZ	Sri Lankan rupee	LKR
St Helena And Dependencies	NJ	British pound	GBP
St KittsNevis	GT	East Caribbean Dollar	XCD
St Lucia	GV	East Caribbean Dollar	XCD
St Martin	GN	Netherlands Antillean guilder / Euro	ANG / EUR
St Vincent and The Grenadines	GU	East Caribbean Dollar	XCD
Sudan	MN	Sudanese dinar	SDD

Surinam	JJ	Surinamese guilder	SRG
Svalbard	BX	Norwegian krone	NOK
Swaziland	MJ	Swaziland lilangeni	SZL
Sweden	BT	Swedish krona	SEK
Switzerland	BM	Swiss franc	CHF
Syria	PK	Syrian pound	SYP
Tahiti	QV	CFP Franc	XPF
Tajikistan	RP	somoni	TJS
Tanzania	MC	Tanzanian shilling	TZS
Thailand	QN	baht	THB
Togo	LR	CFA franc (BCEAO)	XOF
Tolelau	EQ	New Zealand dollar	NZD
Tonga	EH	pa'anga	TOP
Trinidad And Tobago	GC	Trinidad and Tobago dollar	TTD
Tunisia	KC	Tunisian dinar	TND
Turkey	PA	Turkish lira	TRL
Turkmenistan	RQ	Turkmen manat	TMM
Turks & Caicos Islands	GZ	US dollar	USD
Tuvalu	EJ	Australian dollar	AUD
Uganda	MB	Ugandan shilling	UGX
Ukraine	RR	hryvnia	UAH
United Arab Emirates	PH	Emirati dirham	AED
<i>United Kingdom</i>	AA	British pound	GBP
		Converted to British pound	XBP
		British pound and converted to British pound combined	YBP
Uruguay	JN	Uruguayan peso	UYU
USA	FB	US dollar	USD
Uzbekistan	RS	Uzbekistani sum	UZS
Vanuatu	EK	vatu	VUV
Vatican City	CN	Euro	EUR
Venezuela	JE	bolivar	VEB
Vietnam	QW	dong	VND
Virgin Islands	GH	US dollar	USD

Wales	AD	British pound	GBP
Wallis and Futuna	EW	CFP Franc	XPF
Western Sahara	KF	Moroccan dirham	MAD
Samoa	EL	Samoa tala	WST
Yemen	PM	Yemeni rial	YER
Zambia	ME	Zambian kwacha	ZMK
Zimbabwe	MF	Zimbabwean dollar	ZWD

**32. The reporting territory codes required for *Forms 30, 31, 32 and 34* must be in accordance with the following Table:**

**PRA**

<b>Reporting territory</b>	<b>Code</b>
<i>General insurance business carried on in the United Kingdom that is not home foreign business</i>	AA
<i>home foreign business</i>	AB
<i>General insurance business carried on outside the United Kingdom</i>	XX
World wide	WW

## **FORMS**

**[Forms 20A and 20–39 to follow]**

## General insurance business - summary of business carried on

Name of insurer

Global business/UK branch business/EEA branch

Financial year ended

		Company registration number	GL/ UK/ CM	day	month	year	units
R20A							£000
Category number	PRA return general insurance business reporting category			Gross premium written in this financial year	Provision for undiscounted gross claims outstanding at the end of this financial year		Provision for gross unearned premium at the end of this financial year
					Reported	Incurred but not reported	
				1	2	3	4
001	Total business			1			
002	Total primary (direct) and facultative business			2			
003	Total treaty reinsurance accepted business			3			
110	Total primary (direct) and facultative accident and health (category numbers 111 to 114)			4			
120	Total primary (direct) and facultative personal lines motor business (category numbers 121 to 123)			5			
160	Primary (direct) and facultative household and domestic all risks			6			
180	Total primary (direct) and facultative personal lines financial loss (category numbers 181 to 187)			7			
220	Total primary (direct) and facultative commercial motor business (category numbers 221 to 223)			8			
260	Total primary (direct) and facultative commercial lines property (category numbers 261 to 263)			9			
270	Total primary (direct) and facultative commercial lines liability business (category numbers 271 to 274)			10			
280	Total primary (direct) and facultative commercial lines financial loss (category numbers 281 to 284)			11			
330	Total primary (direct) and facultative aviation (category numbers 331 to 333)			12			
340	Total primary (direct) and facultative marine (category numbers 341 to 347)			13			
350	Total primary (direct) and facultative goods in transit			14			
400	Miscellaneous primary (direct) and facultative business			15			
500	Total non-proportional treaty reinsurance business accepted (category numbers 510 to 590)			16			
600	Total proportional treaty reinsurance business accepted (category numbers 610 to 690)			17			
700	Miscellaneous treaty reinsurance accepted business			18			
	TOTAL (lines 4 to 18)			20			

General insurance business – summary of business carried on

Name of insurer  
Global business/UK branch business/EEA branch  
Financial year ended

		Company registration number	GL/UK/CM	day	month	year	units
		R20A					£000
Category number	PRA return general insurance business reporting category			Gross premium written in this financial year	Provision for undiscounted gross claims outstanding at the end of this financial year		Provision for gross unearned premium at the end of this financial year
					Reported	Incurred but not reported	
				1	2	3	4

PRIMARY (DIRECT) and FACULTATIVE PERSONAL LINES BUSINESS

111	Medical insurance	21				
112	HealthCare cash plans	22				
113	Travel	23				
114	Personal accident or sickness	24				
121	Private motor – comprehensive	25				
122	Private motor – non-comprehensive	26				
123	Motor cycle	27				
160	Household and domestic all risks (equals line 6)	28				
181	Assistance	29				
182	Creditor	30				
183	Extended warranty	31				
184	Legal expenses	32				
185	Mortgage indemnity	33				
186	Pet insurance	34				
187	Other personal financial loss	35				

PRIMARY (DIRECT) and FACULTATIVE COMMERCIAL LINES BUSINESS

221	Fleets	41				
222	Commercial vehicles (non-fleet)	42				
223	Motor other	43				
261	Commercial property	44				
262	Consequential loss	45				
263	Contractors or engineering all risks	46				
271	Employers liability	47				
272	Professional indemnity	48				
273	Public and products liability	49				
274	Mixed commercial package	50				
281	Fidelity and contract guarantee	51				
282	Credit	52				
283	Suretyship	53				
284	Commercial contingency	54				

**General insurance business – summary of business carried on**

Name of insurer  
Global business/UK branch business/EEA branch  
business  
Financial year ended

Category number	PRA return general insurance business reporting category	Company registration number	GL/UK/CM	day	month	year	units	£000	
								1	2

PRIMARY (DIRECT) and FACULTATIVE: AVIATION, MARINE and TRANSPORT

331	Aviation liability	61				
332	Aviation hull	62				
333	Space and satellite	63				
341	Marine liability	64				
342	Marine hull	65				
343	Energy (on and off-shore)	66				
344	Protection and indemnity	67				
345	Freight demurrage and defence	68				
346	War risks	69				
347	Yacht	70				
350	Total primary (direct) and facultative goods in transit (equals line 14)	71				

PRIMARY (DIRECT) and FACULTATIVE: MISCELLANEOUS

400	Miscellaneous primary (direct) and facultative business (equals line 15)	72				
-----	--	----	--	--	--	--

NON-PROPORTIONAL TREATY

510	Non-proportional accident & health	81				
520	Non-proportional motor	82				
530	Non-proportional aviation	83				
540	Non-proportional marine	84				
550	Non-proportional transport	85				
560	Non-proportional property	86				
570	Non-proportional liability (non-motor)	87				
580	Non-proportional financial lines	88				
590	Non-proportional aggregate cover	89				

PROPORTIONAL TREATY

610	Proportional accident & health	91				
620	Proportional motor	92				
630	Proportional aviation	93				
640	Proportional marine	94				
650	Proportional transport	95				
660	Proportional property	96				
670	Proportional liability (non-motor)	97				
680	Proportional financial lines	98				
690	Proportional aggregate cover	99				

TREATY REINSURANCE: MISCELLANEOUS

700	Miscellaneous treaty reinsurance accepted business (equals line 18)	101				
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TOTAL (lines 21 to 101)	111				
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Instructions for completion of Form 20A

PRA

- 1 The amount to be shown under *gross written premiums* for a *PRA general insurance business reporting category* must equate to F21. (11+12+13+14+15). (1+2) plus F24.11.12 as if Forms 21 or 24 were required for that *PRA general insurance business reporting category*.
- 2 The amount to be shown under provision for gross unearned premium for a *PRA general insurance business reporting category* must equate to F21.19.2 + F25.22.12 as if *Forms 21 or 25* were required for that *PRA general insurance business reporting category*, plus the *reinsurers'* share of provision for gross unearned premiums for business in the *PRA general insurance business reporting category* accounted for on an underwriting year basis.
- 3 The amounts to be shown under provisions for gross claims outstanding/ reported for a *PRA general insurance business reporting category* must equate to the sum of (F27.29.5 + F29.11.12, converted to sterling if appropriate) over all currencies or the sum of (F31 or F32.30.5 + F34.30.3) over all the currencies and territories, for that *PRA general insurance business reporting category* as if *Forms 27, 29, 31, 32 or 34* were required for all business in that *PRA general insurance business reporting category*.
- 4 The amounts to be shown under provisions for gross claims outstanding/incurred but not reported for a *PRA general insurance business reporting category* must equate to the sum of (F27.29.6 + F29.13.12, converted to sterling if appropriate) over all currencies or the sum of (F31 or F32.30.6 + F34.30.4) over all the currencies and territories, for that *PRA general insurance business reporting category* as if *Forms 27, 29, 31, 32 or 34* were required for all business in that *PRA general insurance business reporting category*.
- 5 Where the unrounded value for one of the columns is zero for a particular *PRA general insurance business reporting category*, the relevant cell should be left blank.
- 6 Lines 1, 20 and 111 should all be the same and equal to the total *insurance business*.
- 7 If the entry at line 1 column 1 does not equal the amount shown at line 11 column 1 of Form 11, or the entry at line 1 column 4 does not equal the amount shown at line 11 column 1 of Form 15, the *insurer* must provide an explanation for the difference in a supplementary note (code 20A1).

**General insurance business : Technical account (excluding equalisation provisions)**

Name of insurer  
 Global business/UK branch business/EEA branch business  
 Financial year ended  
 PRA general insurance business reporting category

		Company registration number	GL/UK/CM	day	month	year	units	Category number
		R20					£000	
Items to be shown net of reinsurance				This financial year 1	Previous year 2			
This year's underwriting (accident year accounting)	Earned premium (21. 19. 5)	11						
	Claims incurred (22. 17. 4)	12						
	Claims management costs (22. 18. 4)	13						
	Adjustment for discounting (22. 52. 4)	14						
	Increase in provision for unexpired risks (22. 19. 4)	15						
	Other technical income or charges (particulars to be specified by way of supplementary note)	16						
	Net operating expenses (22. 42. 4)	17						
	Balance of year's underwriting (11-12-13+14-15+16-17)	19						
Adjustment for prior years' underwriting (accident year accounting)	Earned premium (21.11. 5)	21						
	Claims incurred (22. 13. 4)	22						
	Claims management costs (22. 14. 4)	23						
	Adjustment for discounting (22. 51. 4)	24						
	Other technical income or charges (particulars to be specified by way of supplementary note)	25						
	Net operating expenses (22. 41. 4)	26						
	Balance (21-22-23+24+25-26)	29						
Balance from underwriting year accounting	Per Form 24 (24. 69. 99-99)	31						
	Other technical income and charges (particulars to be specified by way of supplementary note)	32						
	Total	39						
Balance of all years' underwriting (19+29+39)		49						
Allocated investment income		51						
Transfer to non-technical account (49+51)		59						

*Instructions for completion of Form 20*

**PRA**

- 1. Particulars of any amounts included at lines 16, 25 or 32 ('other technical income or charges') are required to be stated by way of a supplementary note (code 2005) to the form.**

**General insurance business (accident year accounting): Analysis of premiums**

Name of insurer  
 Global business/UK branch business/EEA branch business  
 Financial year ended  
 PRA general insurance business reporting category

		Company registration number	GL/UK/CM	day	month	year	units	Category number
		R21					£000	
Premiums receivable during the financial year		Gross premiums written		Reinsurers' share		Net of reinsurance		
		Earned in previous financial years 1		Earned in previous financial years 3		Earned in previous financial years 5		
In respect of risk incepted in previous financial years	11							
		Earned in this financial year	Unearned at end of this financial year	Earned in this financial year	Unearned at end of this financial year	Earned in this financial year	Unearned at end of this financial year	
		1	2	3	4	5	6	
In respect of risks incepted in previous financial years	12							
In respect of risks incepted in this financial year	For periods of less than 12 months	13						
	For periods of 12 months	14						
	For periods of more than 12 months	15						
Premiums receivable (less rebates and refunds) in previous financial years not earned in those years and brought forward to the financial year	16							
Total (12 to 16)	19							

*Instructions for completion of Form 21*

PRA

- 1 **Lines 13 to 15 of *Form 21* should include *premiums* actually received prior to the *financial year*, but relating to risks incepted in the *financial year* and exclude *premiums* received during the *financial year*, but relating to risks incepting after the end of the *financial year*. In *Forms 13* and *15* the accounting treatment adopted for *premiums* received in respect of risks incepting in future *financial years* should be the same as that adopted in the shareholder accounts, or, if there are no shareholder accounts, should be in accordance with generally accepted accounting practice. If this results in different amounts for the provision of unearned premium (either gross or the *reinsurers'* share) being shown in *Forms 13* or *15* as compared to *Form 21*, it would be appropriate to identify, and provide an explanation, of the difference in a supplementary note (code 2103) to the form.**

**General insurance business (accident year accounting) : Analysis of claims, expenses and technical provisions**

Name of insurer  
 Global business/UK branch business/EEA branch business  
 Financial year ended  
 PRA general insurance business reporting category

		Company registration number	GL/UK/CM	day	month	year	units	Category number
R22							£000	
		Amount brought forward from previous financial year	Amount payable / receivable in this financial year	Amount carried forward to next financial year	Amount attributable to this financial year			
		1	2	3	4			
Claims incurred in respect of incidents occurring prior to this financial year	Gross amount	11						
	Reinsurers' share	12						
	Net (11-12)	13						
	Claims management costs	14						
Claims incurred in respect of incidents occurring in this financial year	Gross amount	15						
	Reinsurers' share	16						
	Net (15-16)	17						
	Claims management costs	18						
Provision for unexpired risks		19						
Net operating expenses	Commissions	21						
	Other acquisition expenses	22						
	Administrative expenses	23						
	Reinsurance commissions and profit participations	24						
	Total (21+22+23-24)	29						
Adjustments for discounting in respect of the items shown at lines 11 to 18 above	Gross amount	31						
	Reinsurers' share	32						
	Claims management costs	33						
	Total (31-32+33)	39						
Split of line 29	Prior financial years	41						
	This financial year	42						
Split of line 39	Incidents occurring prior to this financial year	51						
	Incidents occurring in this financial year	52						

*Instructions for completion of Form 22*

**PRA**

- 1**        **Amounts included at lines 11 to 18 must be shown undiscounted and related adjustments for discounting must be shown at lines 31 to 39.**
  
- 2**        **The values in column 4 are calculated as follows:**  
  
            **for lines 11 to 18 values in columns 2+31;**  
            **for lines 21 to 29 and lines 41 to 42 values in columns 1+23;**  
            **for line 19, lines 31 to 39 and lines 51 to 52 values in columns 31.**
  
- 3**        **Amounts shown at lines 11 to 13, lines 15 to 17 and lines 31 and 32 must exclude amounts in respect of *claims management costs*.**



**Instructions for completion of Form 23**

**PRA**

- 1** All figures are to be shown net of the *reinsurers'* share.
- 2** The accident years shown at lines 11 to 20 must correspond to the *financial year in question* and the nine *previous financial years* respectively.
- 3** Columns 1 to 9 must be shown before deduction for discounting.
- 4** All amounts shown must exclude *claims management costs*.
- 5** The percentage shown at column 12 must be the ratio of the columns 3+4+5+6 to column 2.
- 6** The percentage shown at column 13 must be the ratio of columns 1+3+4+5+6 to column 11.
- 7** 23.29.5 + 23.29.6 = 22.13.3 + 22.17.3; 23.29.7 + 23.29.8 = 22.13.1; 23.29.10 = 22.31.3 22.32.3; and 23.29.4 = 22.13.2 + 22.17.2.
- 8** [deleted]
- 9** [deleted]
- 10** The percentages shown at columns 12 and 13 must be expressed as percentages to one place of decimals.
- 11** Line 22 is to be left blank.



*Instructions for completion of Form 24*

PRA

**1** The underwriting years shown between the columns headed "29 29" and "99 99" must correspond (in reverse order) to the *financial year in question* and the nine *previous financial years* respectively.

**2** Amounts shown in lines 21 to 29 must exclude *claims management costs*.

**3** [deleted]

**4** The amounts shown at lines 51 to 54 must exclude equalisation provisions.

The amounts shown at lines 11 to 49 must be amounts payable or *receivable* during the *financial year in question*.



**Instructions for the completion of Form 25**

**PRA**

- 1**        The underwriting years shown between the columns headed "29 29" and "99 99" must correspond (in reverse order) to the *financial year in question* and the nine *previous financial years*, respectively.
- 2**        Lines 11 to 15, 19 to 21 and 29 must be completed for open years and lines 11 to 18 and 21 to 29 for closed years.
- 3**        Line 29 must equal line 53 less 54 on Form 24.
- 4**        Lines 11 to 15 must be shown before adjustment for *discounting*.
- 5**        Lines 11 to 14, 16 and 17 must exclude *claims management costs*.
- 6**        [deleted]
- 7**        Amounts may only be included at line 19 in so far as they arise from the offset of anticipated surpluses and deficits on *insurance business* managed together as defined by paragraph 25 of Appendix 9.2.
- 8**        Particulars of any amounts included at line 25 on must be stated in a supplementary note (code 2505) to the form.





*Instructions for completion of Form 26*

PRA

- 1 All figures are to be shown net of the *reinsurers'* share.
- 2 The accident years shown at lines 11 to 20 must correspond to the *financial year in question* and the nine *previous financial years* respectively.
- 3 Columns 1 to 9 must be shown before deduction for *discounting*.
- 4 All amounts shown must exclude *claims management costs*.
- 5 The percentage shown at column 12 must be the ratio of the columns 3+4+5+6 to column 2.
- 6 The percentage shown at column 13 must be the ratio of columns 1+3+4+5+6 to column 11.
- 7 [deleted]
- 8 The percentages shown at columns 12 and 13 must be expressed as percentages to one place of decimals.
- 9 The amounts shown in line 21 must be analysed on continuation sheets by accident year subject to instructions 10, 10A and 10B below.
- 10 On the continuation sheet, for *category numbers* 590 and 690, the amounts in columns 4 to 10 for accident years ending prior to 31 December 1996 may be shown in the aggregate and columns 1 to 3, 11 to 13 need not be completed for accident years ending prior to 31 December 1996.
- 10A On the continuation sheet, for *category numbers* 610, 620, 650, 660 and 680 the amounts in columns 4 to 10 for accident years ending prior to 23 December 1993 may be shown in the aggregate and columns 1 to 3 and 11 to 13 need not be completed for accident years ending prior to 23 December 1993.
- 10B On the continuation sheet, for *category numbers* other than those listed in 10 and 10A above, the amounts in columns 4 to 10 for accident years ending prior to 31 December 1983 may be shown in the aggregate and columns 1 to 3 and 11 to 13 need not be completed for accident years ending prior to 31 December 1983.
- 11 The box marked "category number" must be completed by inserting the 3 digit *category number* to which the *PRA general insurance business reporting category* relates.
- 12 The box marked "currency code" must be completed by inserting the relevant 3 character currency code from the list in the Table in *Appendix 9.2 Paragraph 31*.
- 13 Line 22 is to be left blank.





*Instructions for completion of Form 27*

**PRA**

- 1 All figures must be shown gross of the *reinsurers'* share.
- 2 The accident years shown at lines 11 to 20 must correspond to the *financial year in question* and the nine *previous financial years* respectively.
- 3 Columns 1 to 9 are to be shown before deduction for *discounting*.
- 4 All amounts shown must exclude *claims management costs*.
- 5 The percentage shown at column 12 must be the ratio of the columns 3+4+5+6 to column 2.
- 6 The percentage shown at column 13 must be the ratio of columns 1+3+4+5+6 to column 11.
- 7 [deleted]
- 8 The percentages shown at columns 12 and 13 must be expressed as percentages to one place of decimals.
- 9 The amounts shown in line 21 must be analysed on continuation sheets by accident year subject to instruction 10, 10A and 10B below.
- 10 On the continuation sheet, for *category numbers* 590 and 690, the amounts in columns 4 to 10 for accident years ending prior to 31 December 1996 may be shown in the aggregate and columns 1 to 3 and 11 to 13 need not be completed for accident years ending prior to 31 December 1996.
- 10A On the continuation sheet, for *category numbers* 610, 620, 650, 660 and 680 the amounts in columns 4 to 10 for accident years ending prior to 23 December 1993 may be shown in the aggregate and columns 1 to 3 and 11 to 13 need not be completed for accident years ending prior to 23 December 1993.
- 10B On the continuation sheet, for *category numbers* other than those listed in 10 and 10A above, the amounts in columns 4 to 10 for accident years ending prior to 31 December 1983 may be shown in the aggregate and columns 1 to 3 and 11 to 13 need not be completed for accident years ending prior to 31 December 1983.
- 11 The box marked "category number" must be completed by inserting the 3 digit *category number* to which the *PRA general insurance business reporting category* relates.
- 12 The box marked "currency code" must be completed by inserting the relevant 3 character currency code from the list in the Table in *Appendix 9.2 Paragraph 31*.
- 13 Line 22 is to be left blank.





*Instructions for completion of Form 28*

**PRA**

- 1        **The underwriting years shown between the columns headed "29 29" and "99 99" must correspond (in reverse order) to the *financial year in question* and the nine *previous financial years*.**
- 2        **Amounts shown in lines 21 to 29 must exclude *claims management costs*.**
- 3        **The amounts shown at lines 51 to 54 must exclude equalisation provisions.**
- 4        **[deleted]**
- 5        **The amounts shown in the first column must be analysed on continuation sheets by underwriting year (although for *category numbers* 590 and 690 amounts in respect of underwriting years ended before 31 December 1996 may be shown in aggregate, for *risk categories* 610, 620, 650, 660 and 680 amounts in respect of underwriting years ended before 23 December 1993 may be shown in aggregate and for other business amounts in respect of underwriting years beginning prior to 1 January 1983 may be shown in aggregate).**
- 6        **The box marked "category number" must be completed by inserting the 3 digit *category number* to which the *PRA general insurance business reporting category* relates.**
- 7        **The amounts shown at lines 11 to 49 must be amounts payable or *receivable* during the *financial year in question*.**
- 8        **The box marked "currency code" must be completed by inserting the relevant 3 character currency code from the list in the Table in *Appendix 9.2 Paragraph 31*.**







*Instructions for completion of Form 29*

PRA

- 1 The underwriting years shown between the columns headed "29 29" and "99 99" must correspond (in reverse order) to the *financial year in question* and the nine *previous financial years*, respectively.
- 2 Lines 11 to 15, 19 to 21 and 29 must be completed for open years and lines 11 to 18 and 21 to 29 for closed years.
- 3 Line 29 equals line 53 less 54 on Form 28.
- 4 Lines 11 to 15 must be shown before adjustment for *discounting*.
- 5 Lines 11 to 14, 16 and 17 must exclude *claims management costs*.
- 6 [deleted]
- 7 The amounts shown in the first column must be analysed on continuation sheets by underwriting year (although for *category numbers 590 and 690* amounts in respect of underwriting years ended before 31 December 1996 may be shown in aggregate, for *category numbers 610, 620, 650, 660 and 680* amounts in respect of underwriting years ended before 23 December 1993 may be shown in aggregate, and for other business amounts in respect of underwriting years beginning prior to 1 January 1983 may be shown in aggregate).
- 8 The box marked "category number" must be completed by inserting the 3 digit *category number* to which the *PRA general insurance business reporting category* relates.
- 9 Amounts may only be included at line 19 in so far as they arise from the offset of anticipated surpluses and deficits on business managed together (as defined by paragraph 25 of Appendix 9.2).
- 10 The box marked "currency code" must be completed by inserting the relevant 3 character currency code from the list in the Table in *Appendix 9.2 Paragraph 31*.



**General insurance business : Expected income and yield from admissible assets covering discounted provisions**

Name of insurer  
Global business/UK branch business/EEA branch business  
Financial year ended

	Company registration number	GL/ UK/ CM	day	month	year	units
<b>R30</b>						<b>£000</b>

<b>Type of asset</b>			Value of admissible assets as shown on Form 13	Admissible assets hypothecated to cover the provision for outstanding claims being discounted	Expected income from assets included in column 2	Yield %
			1	2	3	4
Land and buildings		31				
Fixed interest securities	Approved securities	32				
	Other	33				
Variable interest and variable yield securities (excluding items shown at line 36)	Approved securities	34				
	Other	35				
Equity shares and holding in collective investment schemes		36				
Loans secured by mortgages		37				
All other assets	Producing income	38				
	Not producing income	39				
<b>Total</b>		<b>49</b>				

*Instructions for completion of Form 30*

**PRA**

- 1**            **The entry at –**

**30.31.1 must equal 13.11.1**  
**30.32.1 must equal 13.45.1 + the appropriate part of 13.84.1**  
**30.33.1 must equal 13.46.1 + the appropriate part of 13.84.1**  
**30.34.1 must equal 13.47.1 + the appropriate part of 13.84.1**  
**30.35.1 must equal 13.42.1 +13.48.1 + the appropriate part of 13.84.1**  
**30.36.1 must equal 13.41.1 +13.43.1**  
**30.37.1 must equal 13.50.1 + the appropriate part of 13.84.1**  
**30.49.1 must equal 13.87.1 +13.89.1 - 13.60.1 - 13.61.1 - 13.62.1 - 13.63.1 – 13.85.1.**
- 2**            **The hypothecated assets shown in column 2 must not be less than (but need not equal) the provision for outstanding *claims* being discounted (column 6 less column 7 on sheet 1). Where specific assets are not hypothecated to cover the provision for outstanding *claims* being discounted, column 2 equals column 1.**
- 3**            **The income in column 3 must be the amounts before deduction of tax which would be received in the next *financial year* on the assumption that –**

  - (i)        the assets are held throughout that year, and**
  - (ii)      the factors which affect income remain unchanged but account is to be taken of any changes in those factors known to have occurred.**
- 4**            **The yield in column 4 must be –**

  - (i)        for *securities* with a redemption value, the rate of interest which, when used to obtain a present value of expected future income or capital payments, gives the current asset value, and**
  - (ii)      for all other assets the ratio of the income included in column 3 to the value included in column 2,**

**or where appropriate an average of the above weighted by reference to the values included in column 2.**
- 5**            **The methods and assumptions used in determining the yield in accordance with instruction 4 must be stated by way of a supplementary note (code 3001) to this Form.**
- 6**            **Where a particular asset is required to be taken into account only to a specified extent by the application of admissibility limits, the expected income and capital payments from that asset must be included only to the same extent.**
- 7**            **The treatment of expected income payments from any asset where such payment is in default must be stated by way of a supplementary note (code 3002) to this Form.**

- 8 In column 8 "Unwind in discount in the next *financial year*" refers to the expected reduction in the deduction for the discounting between –
- (i) that shown at the end of the *financial year in question*, and
  - (ii) that expected to be shown at the end of the next *financial year* but in respect of *claims* incurred prior to the end of the *financial year in question*.
- 9 Columns 4 and 9 to 11 must be expressed as a percentage to one place of decimals.
- 10 In the above instructions, income excludes capital gains or losses or value adjustments.
- 11 The discount rate in column 11 must be the average rate of interest at which the provisions are being discounted, weighted by the provisions contained in column 6.
- 12 The references in the Form to "outstanding claims" and "technical provisions" are to those amounts net of *reinsurance*.
- 13 The entry under the column headed 'reporting territory code' must be one of the codes listed in *Appendix 9.2 Paragraph 32*. "WW" must be used for treaty reinsurance. Otherwise the code must be as defined in *Appendix 9.2 Paragraph 16(3)*.





*Instructions for completion of Form 31*

PRA

- 1 All figures must be shown gross of the reinsurers' share and before any deduction for *discounting*.
- 2 The accident years at lines 11 to 20 must correspond to the *financial year in question* and the nine *previous financial years* respectively.
- 3 All amounts shown must exclude *claims management costs*.
- 4 The percentage shown at column 11 is the ratio of the sum of columns 3 to 6 to column 10.
- 5 Columns 10 and 11 need not be completed in respect of accident years ended before 23 December 1994.
- 6 The percentages shown at column 11 must be expressed as percentages to one place of decimals.
- 7 For *risk categories 271 to 274* the amounts shown in line 21 must be analysed by accident year on continuation sheets subject to instructions 8 to 9A below.
- 8 On the continuation sheet columns 10 and 11 need not be completed in respect of accident years ended before 23 December 1994.
- 9 On the continuation sheet, for *category number 274*, the amounts in columns 2 and 4 to 8 for accident years ending prior to 31 December 1996 may be shown in the aggregate and columns 1 and 3 need not be completed for accident years ending prior to 31 December 1996.
- 9A On the continuation sheet, for *category numbers 271 to 273*, the amounts in columns 2 and 4 to 8 for accident years ending prior to 31 December 1976 may be shown in the aggregate and columns 1 and 3 need not be completed for accident years ending prior to 31 December 1976.
- 10 Columns 1 and 2 need not be completed in respect of *risk categories 331 to 400*.
- 11 The box marked "category number" must be completed by inserting the 3 digit *category number* to which the *PRA general insurance business reporting category* relates.
- 12 The box marked "currency code" must be completed by inserting the relevant 3 character currency code from the list in the Table in *Appendix 9.2 Paragraph 31*.
- 13 The entry alongside "reporting territory" must be that required by *Appendix 9.2 Paragraph 16(3)* and the entry in the box marked "reporting territory code" must be the relevant 2 character code from the list in the Table in *Appendix 9.2 Paragraph 32*.



*Instructions for completion of Form 32*

**PRA**

- 1** All figures must be shown gross of the *reinsurers'* share and before any deduction for *discounting*.
- 2** The accident years at lines 11 to 20 must correspond to the *financial year in question* and the nine *previous financial years* respectively.
- 3** All amounts shown must exclude *claims management costs*.
- 4** The percentage shown at column 11 must be the ratio of the sum of columns 3 to 6 to column 10.
- 5** Columns 10 to 13 need not be completed in respect of accident years ended before 23 December 1994.
- 6** The number of vehicle years insured in any accident year is the aggregate of the product for each *contract of insurance* of the period (being the period during that accident year when the contract was in force) and the number of vehicles insured under the contract. Figures are to be rounded to the nearest thousand-vehicle years only after aggregating component figures.
- 7** For accident years ended on or after 31 December 2006, the percentage shown at column 13 must be the ratio of the sum of columns 1 and 2 to unrounded number of years underpinning column 12. For accident years ended before 31 December 2006, the percentage shown at column 13 must be the ratio of the sum of columns 1 and 2 to either the unrounded number of years underpinning column 12 or the product of 1000 and column 12.
- 8** The percentages shown at columns 11 and 13 must be expressed as percentages to one place of decimals.
- 9** The box marked "category number" must be completed by inserting the 3 digit *category number* to which the *PRA general insurance business reporting category* relates.
- 10** The entry alongside "currency code" must be the relevant 3 character currency code from the list in the Table in *Appendix 9.2 Paragraph 31*.
- 11** The entry alongside "reporting territory" must be that required by *Appendix 9.2 Paragraph 16(3)* and the entry in the box marked "reporting territory code" must be the relevant 2 character code from the list in the Table in *Appendix 9.2 Paragraph 32*.





*Instructions for completion of Form 34*

PRA

- 1 All figures must be shown gross of the *reinsurers'* share and before any deduction for *discounting*.
- 2 The underwriting years at lines 11 to 20 must correspond to the *financial year in question* and the nine *previous financial years* respectively.
- 3 All amounts shown must exclude *claims management costs*.
- 4 The percentage shown at column 9 must be the ratio of the sum of columns 1 to 4 to column 8.
- 5 Columns 8 and 9 need not be completed in respect of *financial years* ended before 23 December 1994.
- 6 The percentages shown at column 9 must be expressed as percentages to one place of decimals.
- 7 For risk categories 271 to 274, the amounts shown in line 21 must be analysed by underwriting year on continuation sheets subject to instructions 8 to 9A below.
- 8 On the continuation sheet columns 8 and 9 need not be completed in respect of underwriting years ended before 23 December 1994.
- 9 On the continuation sheet, for *category number 274*, the amounts in columns 2 to 6 for underwriting years ending prior to 31 December 1996 may be shown in the aggregate and column 1 need not be completed for underwriting years ending prior to 31 December 1996.
- 9A On the continuation sheet, for *category numbers 271 to 273*, the amounts in columns 2 to 6 for underwriting years ending prior to 31 December 1976 may be shown in the aggregate and column 1 need not be completed for underwriting years ending prior to 31 December 1976.
- 10 The box marked "category number" must be completed by inserting the 3 digit *category number* to which the *PRA general insurance business reporting category* relates.
- 11 The box marked "currency code" must be completed by inserting the relevant 3 character currency code from the list in the Table in *Appendix 9.2 Paragraph 31*.
- 12 The entry alongside "reporting territory" must be that required by *Appendix 9.2 Paragraph 16(3)* and the entry in the box marked "reporting territory code" must be the relevant 2 character code from the list in the Table in *Appendix 9.2 Paragraph 32*.



*Instructions for completion of Form 36*

**PRA**

- 1**        **Where any of Forms 26 to 29 or 31, 32 or 34 contains a figure in a currency other than sterling the rate of conversion of those figures into sterling must be stated in column 1 to this Form.**
  
- 2**        **Where the rate of conversion differs according to whether it applies to income and expenditure items, or asset and liability items, the former rate must be used.**

**Equalisation provisions****Form 37**

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

		Company registration number	GL/ UK/ CM	day	month	year	units	
		R37					£000	
		Business grouping A (property)	Business grouping B (business interruption)	Business grouping C (marine and aviation)	Business grouping D (nuclear)	Business grouping E (non- proportional treaty)	All business groupings	Credit insurance business
		1	2	3	4	5	6	7
<b>Calculation of the maximum provision</b>								
Total net premiums written in the previous 4 years	11							
Net premiums written in the current year	12							
Maximum provision	13							
<b>Calculation of the transfer to/from the provision</b>								
Equalisation provision brought forward	21							
Transfers in	22							
Total abnormal loss	23							
Provisional transfers out	24							
Excess of provision transfer out over fund available	25							
Provisional amount carried forward (21+22-24+25)	26							
Excess, if any, of 26 over 13	27							
Equalisation provision carried forward (26-27)	28							
Transfer in/(out) for financial year (28-21)	29							

*Instructions for completion of Form 37*

PRA

- 1 Lines 11 & 12, columns 1 to 5, must include net written premium from Form 21 (accident year *insurance business*) and/or Form 24 (underwriting year *insurance business*) that in whole or in part covers each *insurance business grouping*.
- 2 Only premium for *financial years* covered by the scheme may be included in lines 11 & 12, columns 1 to 5 (see *INSPRU 1.4.20R*). Adjustments in respect of prior years must be included at line 12.
- 3 Any *insurance business* that has been transferred must be excluded from lines 11 & 12, columns 1 to 5 (see *INSPRU 1.4.32R* to *INSPRU 1.4.37G*).
- 4 Line 13, columns 1 to 5 must show the maximum provision for each *insurance business grouping* calculated in accordance with *INSPRU 1.4.24R*. If *insurance business* in a group has been written for less than 5 years, the average of the qualifying years must be used.
- 5 If all rights and obligations in an *insurance business grouping* have been transferred, line 13 columns 1 to 5 must be left blank at the appropriate column.
- 6 Line 22, columns 1 to 5 must be calculated by multiplying the figure at line 12 for each *insurance business grouping* by the % in *INSPRU 1.4.27R*.
- 7 Line 23 must be, for each *insurance business grouping*, the total of abnormal losses, if any, brought forward from Forms 38 and 39, line 19. These must be entered in the same columns as they were on Forms 38 and 39.
- 8 The transfer out for each *insurance business grouping* at line 24, columns 1 to 5 must not exceed the line 13 maximum provision for that group.
- 9 The sum of columns 1 to 5 of lines 13, 22 and 24 must be entered in column 6 of the relevant line.
- 10 In the first year of the scheme, line 21 column 6 must be left blank. In subsequent years this figure must be brought forward from the previous year's figure (normally the figure at Form 15, line 15). Only equalisation provisions required by the *rules* in *INSPRU 1.4.11R* to *INSPRU 1.4.37G* may be included.
- 11 The calculations for lines 25 to 29, column 6 must be carried out and the net transfer in or out for the year must be entered at Form 16, line 12, and the provision carried forward entered at Form 15, line 15.
- 12 Line 13, column 7 must be 150% of the highest annual amount of net premiums written in the last 5 years.
- 13 Line 21, column 7 must equal the statutory credit equalisation provision, if any, brought forward from the previous year at Form 15, line 14.
- 14 Line 22, column 7 must be 75% of the technical surplus, if any, brought forward

from Forms 38 and/or 39, line 29, subject to a limit of 12% of line 12.

- 15** Line 24, column 7 must equal the technical deficit, if any, brought forward from Forms 38 and/or 39, line 29.
- 16** The calculations for lines 25 to 29, column 7 must be carried out and the net transfer in or out for the year must be entered at Form 16, line 12, and the provision carried forward entered at Form 15, line 14.

**Equalisation provisions technical account: Accident year accounting**

**Form 38**

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Company registration number	GL/UK/CM	day	month	year	units
R38					£000

		Business grouping A (property)	Business grouping B (business interruption)	Business grouping C (marine and aviation)	Business grouping D (nuclear)	Business grouping E (non-proportional treaty)
		1	2	3	4	5
<b>Other than credit business</b>						
Net premiums earned	11					
Claims incurred net of reinsurance	12					
Trigger claims value	13					
Abnormal loss	19					
Trigger claims ratio		72.5%	72.5%	95%	25%	100%

**Credit business**

Net premiums earned	21	
Claims incurred net of reinsurance	22	
Claims management costs	23	
Net operating expenditure	24	
Technical surplus / (deficit) (21-22-23-24)	29	

Instructions for completion of Form 38

PRA

- 1        **Apart from *credit insurance business*, any *insurance business* transferred to an *insurer* by novation or under Part VII of the *Act* (or the *1982 Act*) must be accounted for in accordance with *INSPRU 1.45.34R*.**
- 2        **The entries at line 11 must be the part of the amount that would appear on Form 21 at line 11, column 5 and line 19, column 5, that in whole or in part covers the *insurance business grouping* (whether or not a Form 21 for that business is required).**
- 3        **The entries at line 12 must be the part of the amount that would appear on Form 22 at line 13 and 17 column 4, that in whole or part covers the *insurance business grouping* (whether or not a Form 21 for that business is required).**
- 4        **The entries at line 13 must be line 11 (or nil if line 11 is negative) multiplied by the trigger *claims ratio* for the *insurance business grouping*.**
- 5        **For each *insurance business grouping* the entry at line 19 must be the amount, if any, by which the entry at line 12 for that *insurance business grouping* exceeds the entry at line 13. If the entry at line 12 does not exceed the entry at line 13, line 19 must be left blank.**
- 6        **The entry at line 21 must be the part of the amount that would appear on Form 21 for *combined categories 180 and 280*, at line 11 column 5 and line 19 column 5 (whether or not a Form 21 for *combined categories 180 or 280* is required) that relates only to *credit insurance business*.**
- 7        **The entry at line 22 must be the part of the amount that would appear on Form 22 for *combined categories 180 and 280*, at lines 13 and 17 column 4 (whether or not a Form 22 for *combined categories 180 or 280* is required) that relates only to *credit insurance business*.**
8.       **The entry at line 23 must be the part of the amount that would appear on Form 22 for *combined categories 180 and 280*, at lines 14 and 18 column 4 (whether or not a Form 22 for *combined categories 180 or 280* is required) that relates only to *credit insurance business*.**
9.       **The entry at line 24 must be the part of the amount that would appear on Form 22 for *combined categories 180 and 280*, at lines 19 and 29 column 4 (whether or not a Form 22 for *combined categories 180 or 280* is required) that relates only to *credit insurance business*.**

**Equalisation provisions technical account: Underwriting year accounting****Form 39**

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Company registration number	GL/UK/CM	day	month	year	units
R39					£000

		Business grouping A (property)	Business grouping B (business interruption)	Business grouping C (marine and aviation)	Business grouping D (nuclear)	Business grouping E (non-proportional treaty)
		1	2	3	4	5
<b>Other than credit business</b>						
Net premiums written	11					
Claims net of reinsurance	12					
Trigger claims value	13					
Abnormal loss	19					
Trigger claims ratio		72.5%	72.5%	95%	25%	100%

**Credit business**

Net premiums written	21	
Claims net of reinsurance	22	
Claims management costs	23	
Net operating expenditure	24	
Technical surplus / (deficit) (21-22-23-24)	29	

Instructions for completion of Form 39

PRA

- 1        **Apart from *credit insurance business*, any *insurance business* transferred to an insurer by novation or under Part VII of the *Act* (or the *1982 Act*) must be accounted for in accordance with *INSPRU* 1.4.34R.**
  
- 2        **The entries at line 11 must be that part of the amount that would appear on Form 24 at line 19, column 99-99, that in whole or in part covers the *insurance business grouping* (whether or not a Form 24 for that business is required).**
  
- 3        **The entries at line 12 must be that part of the amount that would appear on Forms 24 and 25 at column 99-99, that in whole or part covers the *insurance business grouping* (whether or not Forms 24 and 25 for that business is required), as follows:**  
  
          **line 29 on Form 24 plus line 29 less line 15 plus line 24 on Form 25 less line 29 plus line 15 less line 24 on Form 25 for the *preceding financial year*.**
  
- 4        **The entries at line 13 must be line 11 (or nil if line 11 is negative) multiplied by the trigger *claims ratio* for the *insurance business grouping*.**
  
- 5        **For each *insurance business grouping* the entry at line 19 must be the amount, if any, by which the entry at line 12 for that *insurance business grouping* exceeds the entry at line 13. If the entry at line 12 does not exceed the entry at line 13, line 19 must be left blank.**
  
- 6        **The entry at line 21 must be that part of the amount that would appear on Form 24 for *combined categories* 180 and 280, at line 19 column 99-99 (whether or not a Form 24 for *combined categories* 180 or 280 is required) that relates only to *credit insurance business*.**
  
- 7        **The entry at line 22 must be that part of the amount that would appear on Form 24 for *combined categories* 180 and 280, at line 29, column 99-99, plus line 53, column 99-99 less line 51 column 99-99 (whether or not a Form 24 for *combined categories* 180 or 280 is required) that relates only to *credit insurance business*.**
  
- 8        **The entry at line 23 must be that part of the amount that would appear on Form 24 for *combined categories* 180 and 280, at line 39, column 99-99 (whether or not a Form 24 for *combined categories* 180 or 280 is required) that relates only to *credit insurance business*.**
  
- 9        **The entry at line 24 must be that part of the amount that would appear on Form 24 for *combined categories* 180 and 280, at line 49 column 99-99 (whether or not a Form 24 for *combined categories* 180 or 280 is required) that relates only to *credit insurance business*.**

## Appendix 9.3 (rule 9.14 and 9.23)

### Long-Term Insurance Business

#### Revenue Account and Additional Information

(FORMS 40 TO 60)

- 1 **PRA** All the Forms included in the part of the *return* to which this Appendix relates (*Forms 40 to 60*) are to be laid out as shown in this Appendix, except that the instructions to Forms need not be reproduced.
- 2 **PRA** The provisions of paragraph 1(2) and paragraphs 3 to 7 of *Appendix 9.1* must, unless otherwise provided, also apply for the purposes of this Appendix. All amounts must be shown in sterling to the nearer £1,000 except valuation unit prices in Form 55 where the currency and rounding must be that used in the valuation. Calculations must be performed using unrounded figures. Figures which are determined from other figures (whether or not on the same form) must be rounded after performing calculations on the unrounded component figures. Percentages must be shown to two decimal places.
- 2A **PRA** *Insurers* should not normally restate comparatives unless restatement is necessary in order to allow the appropriate comparison to be made. Where in any Form an amount which is a comparative (i.e. shown in a "previous year" column) differs from the corresponding amount shown in a "this financial year" column in a return for a previous year and the difference is not due solely to the use of a different rate to express other currencies in sterling, an explanation of the reason for the difference must be given by way of a supplementary note to that Form. (For *Forms 40, 41, 42, 43, 44, 45, 46, 50, 58 and 60* the code for the supplementary note is 4011, 4111, 4211, 4311, 4411, 4511, 4611, 5011, 5811 and 6011 respectively.)
- 3 **PRA** For the purposes of this Appendix:
- (a) "overseas business" means *long-term insurance business* which is Overseas Life Assurance Business or Overseas PHI and Sickness Business as defined by the Income and Corporation Taxes Act 1988 or business written overseas by an *insurer* which does not report its Overseas Life Assurance Business separately for taxation purposes;
  - (b) "regular premiums" means premiums under *contracts of insurance* which are payable at regular intervals during the *policy* year, including repeated or recurring single premiums where the level of premium is defined;
  - (c) "single premiums" means premiums under *contracts of insurance* under which there is no expectation of continuing premiums being paid at regular intervals, additional single premiums paid in respect of existing individual contracts and National Insurance rebates received from the Department of Work and Pensions;

- (d) "UK life business" means *long-term insurance business* which is not overseas business or UK pension business;
- (e) "UK pension business" means *long-term insurance business* which is Pension Business as defined by the Income and Corporation Taxes Act 1988.

4 (1) Where an *insurer* maintains more than one *long-term insurance fund*, there must be stated by way of a supplementary note to *Form 40* the principles and methods applied to apportioning the investment income, increase or decrease in the value of assets brought into account, expenses and taxation between the different funds.

PRA

5 Where arrangements have been made for the provision of management services to an *insurer* by another *company* (whether an *insurer* or not) which are a substantial part of the day-to-day administration of the undertaking receiving the services

PRA

- (a) the *insurer* receiving the services must state, by way of a supplementary note to *Form 40*; and
- (b) the *company* (if an *insurer*) providing the services must state, by way of a supplementary note to *Form 40*,

that the arrangements have been in force in the *financial year* and naming the parties to them.

6 Where neither the *mathematical reserves* nor the *gross premiums* with respect to the total overseas business exceeds £50m or 5% of the total *mathematical reserves*, an *insurer* may treat that business –

PRA

- (a) in the case of business which would fall within 3(e) if it were business effected in the United Kingdom, as UK pension business, or
- (b) otherwise, as UK life business.

7 For *financial years* ending on or before 30 December 2006, an *insurer* is not required to complete entries in the 'previous year' column in *Forms 40 to 46, 50 and 58* if the entry cannot be obtained directly from the previous year's *return*.

PRA

8 The full amount of *premiums* and *claims* under a *contract of insurance* must be reported under heading relating to these items. *Forms 40 to 60* must not be completed on the basis of deposit accounting, regardless of whether the *insurer* or any *group* of which it is part uses this basis in accordance with *international accounting standards*.

PRA

## FORMS

[Forms 40 – 60 follow]

**Long-term insurance business: Revenue account****Form 40**

Name of insurer  
 Total business / subfund  
 Financial year ended  
 Units

		<b>Financial year</b>	<b>Previous year</b>
		<b>1</b>	<b>2</b>
<b>Income</b>			
Earned premiums	11		
Investment income receivable before deduction of tax	12		
Increase (decrease) in the value of non-linked assets brought into account	13		
Increase (decrease) in the value of linked assets	14		
Other income	15		
<b>Total income</b>	19		
<b>Expenditure</b>			
Claims incurred	21		
Expenses payable	22		
Interest payable before deduction of tax	23		
Taxation	24		
Other expenditure	25		
Transfer to (from) non technical account	26		
<b>Total expenditure</b>	29		
Business transfers-in	31		
Business transfers-out	32		
Increase (decrease) in fund in financial year (19 - 29 + 31 - 32)	39		
Fund brought forward	49		
Fund carried forward (39+49)	59		

*Instructions for completion of Form 40*

PRA

- 1 The entry at 40.11.1 must be equal to 41.21.4, the entry at 40.21.1 must be equal to 42.46.4, and the entry at 40.22.1 must be equal to 43.46.4.
- 2 Line 13 is the amount of the increase or decrease (realised or unrealised) in the admissible value of assets (other than linked assets) or, where advantage has been taken by virtue of Rule 9.10 to apply a different value for the purposes of the Actuarial investigation under rule 9.4, the increase or decrease in that value.
- 3 Line 14 must include all gains and losses in respect of *linked assets*.
- 4 Any item of income which cannot properly be allocated to lines 11, 12, 13 or 14 must be entered at line 15, and similarly, any item of expenditure which cannot properly be allocated to lines 21, 22, 23 or 24 must be entered at line 25. Particulars of such items must be specified in a supplementary note [Code 4002]. Lines 15 and 25 must be used for transfers of unit management charges into or out of the fund or subfund. Where there are subfunds, inter-subfund other income and other expenditure must be excluded from the total Form 40.
- 5 Where an *insurer* decides to allocate to the *long-term insurance business* the whole or any part of investment income or net capital gains arising from assets not attributable to its *long-term insurance business*, the amounts in question must first be shown in Form 16 at lines 14 to 16, and then as a transfer at line 26 and particulars must be specified in a supplementary note [Code 4003].
- 6 Interest payable must be included at line 23 and not line 22.
- 7 Taxation at line 24 is that attributable to the *long-term insurance business* including payments received in consideration of surrendering losses as group relief.
- 8 Where a transfer is made to the non-technical account, the entry at line 26 must show amounts which have been included at line 47 of Form 58. However, if there is a net transfer into the fund the entry at line 26 will be negative. The sum of Form 58 lines 32 and 33 will be positive, lines 13, 14 and 47 remaining blank.
- 9 The entry at line 12 must exclude value readjustments on investments and gains on the realisation of investments, which must be shown at lines 13 or 14 as appropriate.
- 10 The entry at line 11 must exclude any change in the provision for unearned premiums, even though it may be included in statutory (e.g. Companies Acts 1985 to 2006) accounts.
- 11 The entry at line 21 must exclude *claims management costs*, which must be

included at line 22, and any change in the provision for *claims*.

- 12 Transfers of contracts from or to other funds or from or to another insurer must be included at line 31 or 32, with details specified in a supplementary note [Code 4004]. Where there are subfunds, inter-subfund transfer must be excluded from the total Form 40.
- 13 If any of the brought forward amounts differs from the corresponding carried forward amounts in the previous *return* and the difference is not due solely to the use of a different rate to express other currencies in sterling then the reason must be stated in a supplementary note [Code 4001].
- 14 If the bases of conversion adopted in respect of foreign currency for income and expenditure have not already been stated in a note to Form 16, the bases must be stated in a supplementary note as specified in paragraph 5(2) of Appendix 9.1 [Code 4005].
- 15 Where an *insurer* maintains more than one *long-term insurance business fund*, the principles and methods applied to apportioning the investment income, the increase or decrease in the value of assets brought into account, expenses and taxation between the different funds must be stated in a supplementary note as specified in paragraph 4(1) of Appendix 9.3 [Code 4006].
- 16 Where arrangements have been in force during the *financial year* for the provision either by or to the *insurer* of management services, this fact must be stated in a supplementary note together with the name of the other party (to whom or from whom such services were provided or received) - see paragraph 5 of *Appendix 9.3*. This statement is only needed where a substantial part of the daytoday administration of an *insurer* is undertaken by another company or vice versa. [Code 4008]
- 17 Details of any *material connected-party transactions* as required under rule 9.39 must be stated in a supplementary note [Code 4009].

## Long-term insurance business: Analysis of premiums

Form 41

Name of insurer  
 Total business / subfund  
 Financial year ended  
 Units

		UK Life	UK Pension	Overseas	Total Financial year	Total Previous year
		1	2	3	4	5
<b>Gross</b>						
Regular premiums	11					
Single premiums	12					
<b>Reinsurance - external</b>						
Regular premiums	13					
Single premiums	14					
<b>Reinsurance - intra-group</b>						
Regular premiums	15					
Single premiums	16					
<b>Net of reinsurance</b>						
Regular premiums	17					
Single premiums	18					
<b>Total</b>						
Gross	19					
Reinsurance	20					
Net	21					

*Instructions for completion of Form 41*

**PRA**

- 1**            **Single and regular premiums must include that part of the premium which was or will be recoverable from H.M. Revenue and Customs.**
  
- 2**            **The entries in line 17 must equal line 11 less the sum of lines 13 and 15.  
The entries in line 18 must equal line 12 less the sum of lines 14 and 16.  
The entries at line 19 must equal the sum of lines 11 and 12.  
The entries at line 20 must equal the sum of lines 13 to 16.  
The entries at line 21 must equal line 19 less line 20.**

## Long-term insurance business: Analysis of claims

Form 42

Name of insurer  
 Total business / subfund  
 Financial year ended  
 Units

		UK Life	UK Pension	Overseas	Total Financial year	Total Previous year
		1	2	3	4	5
<b>Gross</b>						
Death or disability lump sums	11					
Disability periodic payments	12					
Surrender or partial surrender	13					
Annuity payments	14					
Lump sums on maturity	15					
<b>Total</b>	16					
<b>Reinsurance - external</b>						
Death or disability lump sums	21					
Disability periodic payments	22					
Surrender or partial surrender	23					
Annuity payments	24					
Lump sums on maturity	25					
<b>Total</b>	26					
<b>Reinsurance - intra-group</b>						
Death or disability lump sums	31					
Disability periodic payments	32					
Surrender or partial surrender	33					
Annuity payments	34					
Lump sums on maturity	35					
<b>Total</b>	36					
<b>Net of reinsurance</b>						
Death or disability lump sums	41					
Disability periodic payments	42					
Surrender or partial surrender	43					
Annuity payments	44					
Lump sums on maturity	45					
<b>Total</b>	46					

***Instruction for completion of Form 42***

**PRA**

- 1** In the case of *industrial assurance business*, *claims* incurred on survival in respect of periodical endowment benefits must be shown in line 13.
- 2** Maturity payments are lump sums paid to *policy holders*. Amounts paid to another *insurer* must be included in 'surrender or partial surrender'.
- 3** The entries in line 41 must equal line 11 less the sum of lines 21 and 31.  
The entries in line 42 must equal line 12 less the sum of lines 22 and 32.  
The entries at line 43 must equal line 13 less the sum of lines 23 and 33.  
The entries at line 44 must equal line 14 less the sum of lines 24 and 34.  
The entries at line 45 must equal line 15 less the sum of lines 25 and 35.  
The entries at line 46 must equal line 16 less the sum of lines 26 and 36.

## Long-term insurance business: Analysis of expenses

Form 43

Name of insurer  
 Total business / subfund  
 Financial year ended  
 Units

		UK Life	UK Pension	Overseas	Total Financial year	Total Previous year
		1	2	3	4	5
<b>Gross</b>						
Commission - acquisition	11					
Commission - other	12					
Management - acquisition	13					
Management - maintenance	14					
Management - other	15					
<b>Total</b>	16					
<b>Reinsurance - external</b>						
Commission - acquisition	21					
Commission - other	22					
Management - acquisition	23					
Management - maintenance	24					
Management - other	25					
<b>Total</b>	26					
<b>Reinsurance - intra-group</b>						
Commission - acquisition	31					
Commission - other	32					
Management - acquisition	33					
Management - maintenance	34					
Management - other	35					
<b>Total</b>	36					
<b>Net of reinsurance</b>						
Commission - acquisition	41					
Commission - other	42					
Management - acquisition	43					
Management - maintenance	44					
Management - other	45					
<b>Total</b>	46					

*Instructions for completion of Form 43*

PRA

- 1 In allocating *management expenses* to the relevant lines:
  - (a) subject to (b), costs of a nonrecurring nature, such as those incurred in developing new systems or new premises, or the costs of corporate restructuring, must be reported as 'management – other';
  - (b) where they do not exceed 2% of the total *management expenses*, non-recurring costs may be included as 'management – acquisition' or 'management maintenance' ;
  - (c) the costs incurred in writing new business (or in obtaining incremental (but not indexed) premiums on existing business), such as underwriting, *policy* issue, setting up (or amending) records, and the maintenance and development of the sales and marketing organisation must be reported as management – acquisition'; and
  - (d) the balancing item will be expenses related to the ongoing costs throughout the year of maintaining the business in force (including any investment management costs) which must be reported as 'management – maintenance'.
- 2 Commission payable to employees of the *insurer* whose job is to sell *policies* must be included as 'management – acquisition' or 'management – maintenance'. Commission payable to employees who sell *policies* on a casual basis must be treated in the same way as that paid to *intermediaries* and to *cedents* and so must be included as 'commission – acquisition' or 'commission – other', as the case may be.
- 3 Expenses must be those which relate only to the *insurer's long-term insurance business*. Those relating to any other business of the *insurer* cannot, by virtue of *INSPRU* 1.5.30R, be paid out of the *long-term insurance fund* and must therefore be shown in the *general insurance business* technical account (Form 20) or the nontechnical account (Form 16).
- 4 The entries in line 41 must equal line 11 less the sum of lines 21 and 31.  
The entries in line 42 must equal line 12 less the sum of lines 22 and 32.  
The entries at line 43 must equal line 13 less the sum of lines 23 and 33.  
The entries at line 44 must equal line 14 less the sum of lines 24 and 34.  
The entries at line 45 must equal line 15 less the sum of lines 25 and 35.  
The entries at line 46 must equal line 16 less the sum of lines 26 and 36.

## Long-term insurance business: Linked funds balance sheet

Form 44

Name of insurer  
 Total business  
 Financial year ended  
 Units

		<b>Financial year</b>	<b>Previous year</b>
		<b>1</b>	<b>2</b>
<b>Internal linked funds (excluding cross investment)</b>			
Directly held assets (excluding collective investment schemes)	11		
Directly held assets in collective investment schemes of connected companies	12		
Directly held assets in other collective investment schemes	13		
<b>Total assets (excluding cross investment) (11+12+13)</b>	14		
Provision for tax on unrealised capital gains	15		
Secured and unsecured loans	16		
Other liabilities	17		
<b>Total net assets (14-15-16-17)</b>	18		
<b>Directly held linked assets</b>			
Value of directly held linked assets	21		
<b>Total</b>			
Value of directly held linked assets and units held (18+21)	31		
Surplus units	32		
Deficit units	33		
<b>Net unit liability (31-32+33)</b>	34		

*Instructions for completion of Form 44*

**PRA**

- 1 Double counting of items arising from cross investment between *internal linked funds* must be eliminated.
- 2 The basis on which the assets have been valued must be stated in a supplementary note [Code 4401].
- 3 The aggregate value of rights (gross of *variation margin*) and the aggregate amount of liabilities (gross of *variation margin*) under *derivative contracts* (or in respect of contracts or assets which have the effect of a *derivative contract*) must each be stated in a supplementary note. The corresponding figures net of *variation margin* must also be stated [Code 4402]. For this purpose, rights and liabilities must not be set off against one another unless -
  - (a) such rights and liabilities may be set off against each other in accordance with generally accepted accounting practice; and
  - (b) such set off results (in whole or in part) from the closing out of obligations under a *contract of insurance*.
- 4 Where there is a liability to repay *variation margin* and there are no arrangements for netting of amounts outstanding, or the arrangements would not permit the accounting of such amounts on a net basis in accordance with generally accepted accounting practice, it must be so stated in a supplementary note [Code 4403].
- 5 The total of the net asset value at line 18 must equal line 59 of Form 45.
- 6 If the surplus units exceed 1% of the net unit liability, a statement of the purpose of the surplus units must be given in a supplementary note [Code 4404].
- 7 A supplementary note setting out the name of the fund, the net asset value and the liquidity ratio [Code 4405] must be provided for any fund –
  - (a) whose net asset value is greater than £10m, and with respect to which there is negative liquidity ratio exceeding 0.05 in magnitude; and
  - (b) whose net asset value is greater than £500,000, and with respect to which there is a negative liquidity ratio exceeding 0.5 in magnitude.

where the liquidity ratio is the sum of *approved securities*, short term deposits and cash held in the fund less the liabilities of the fund expressed as a ratio of the net asset value of the fund.
- 8 'Connected company' has the meaning given in rule 11.1.

## Long-term insurance business: revenue account for internal linked funds

Form 45

Name of insurer  
 Total business  
 Financial year ended  
 Units

		<b>Financial year</b>	<b>Previous year</b>
		<b>1</b>	<b>2</b>
<b>Income</b>			
Value of total creation of units	11		
Investment income attributable to the funds before deduction of tax	12		
Increase (decrease) in the value of investments in the financial year	13		
Other income	14		
<b>Total income</b>	19		
<b>Expenditure</b>			
Value of total cancellation of units	21		
Charges for management	22		
Charges in respect of tax on investment income	23		
Taxation on realised capital gains	24		
Increase (decrease) in amount set aside for tax on capital gains not yet realised	25		
Other expenditure	26		
<b>Total expenditure</b>	29		
Increase (decrease) in funds in financial year (19-29)	39		
Internal linked fund brought forward	49		
Internal linked funds carried forward (39+49)	59		

*Instructions for completion of Form 45*

PRA

- 1** Double counting of items arising from cross investment between *internal linked funds* must be eliminated.
- 2** If any of the brought forward amounts differs from the corresponding carried forward amounts in the previous *return* and the difference is not due solely to the use of a different rate to express other currencies in sterling then the reason for the difference must be stated in a supplementary note [Code 4501].
- 3** Any item of income which cannot properly be allocated to lines 11, 12, or 13 must be entered at line 14, and similarly, any item of expenditure which cannot properly be allocated to lines 21, 22, 23, 24 or 25 must be entered at line 26. Particulars of such items must be specified in a supplementary note [Code 4502].
- 4** The gross value of units created must be shown at line 11. The gross value of units cancelled must be shown at line 21. Each day's movements must be netted or recorded as two separate entries, one positive and one negative. The total net positive and negative movements must be recorded at lines 11 or 21 as appropriate.

## Long-term insurance business: Summary of new business

Form 46

Name of insurer  
 Total business  
 Financial year ended  
 Units

		UK Life	UK Pension	Overseas	Total Financial year	Total Previous year
		1	2	3	4	5
<b>Number of new policyholders / scheme members for direct insurance business</b>						
Regular premium business	11					
Single premium business	12					
<b>Total</b>	13					
<b>Amount of new regular premiums</b>						
Direct insurance business	21					
External reinsurance	22					
Intra-group reinsurance	23					
<b>Total</b>	24					
<b>Amount of new single premiums</b>						
Direct insurance business	25					
External reinsurance	26					
Intra-group reinsurance	27					
<b>Total</b>	28					

**Instructions for completion of Form 46**

**PRA**

- 1**        **Line 11 is the sum of column 3 of Form 47.  
Line 12 is the sum of column 5 of Form 47.  
Lines 21, 22 and 23 are the sum of column 4 of Form 47 for that business.  
Lines 25, 26 and 27 are the sum of column 6 of Form 47 for that business.**
  
- 2**        **'New' *policy holders* or scheme members are those who have effected a new individual contract or joined the scheme during the *financial year in question*.**
  
- 3**        **'New' regular premiums and 'new' single premiums are premiums from new *policy holders* and scheme members, and must also include new increments on existing *policies* accepted by the *insurer*, in the *financial year in question*.**

**Long-term insurance business: Analysis of new business****Form 47**

Name of insurer

Total business

Financial year ended

Units

UK Life / UK Pension / Overseas (State or Territory) / Direct Insurance Business / Reinsurance accepted

external / Reinsurance accepted intra-group

<b>Product code number</b>	<b>Product description</b>	<b>Regular premium business</b>		<b>Single premium business</b>	
		<b>Number of policyholders / scheme members</b>	<b>Amount of premiums</b>	<b>Number of policyholders / scheme members</b>	<b>Amount of premiums</b>
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>

**Instructions for completion of Form 47**

**PRA**

**1 Information must be shown separately for each type of *insurance business* in the sequence specified below:**

- (a) UK life;**
- (b) UK pension; and**
- (c) overseas.**

**Overseas business may, at the discretion of the insurer, be subdivided by state or territory.**

**2 The information must be shown separately within each type of *insurance business* in the sequence specified below:**

- (a) *direct insurance business*;**
- (b) *reinsurance* accepted which is external to the *insurance group*; and**
- (c) *reinsurance* accepted which is from within the *insurance group*.**

**3 Information must be further divided by product code as follows:**

<b>Code</b>	<b>Product description</b>
100	Conventional whole life with-profits OB
105	Conventional whole life with-profits IB
110	Conventional whole life with-profits (ISA)
115	Conventional whole life with-profits (tax exempt)
120	Conventional endowment with-profits OB savings
125	Conventional endowment with-profits OB target cash
130	Conventional endowment with-profits IB
135	Conventional endowment with-profits (ISA)
140	Conventional endowment with-profits (tax exempt)
145	Income protection with-profits
150	Income protection with-profits (Holloway)
155	Conventional pensions endowment with-profits

160	Conventional pensions endowment with-profits - increments
165	Conventional deferred annuity with-profits
170	Conventional deferred annuity with-profits - Increments
175	Group conventional deferred annuity with-profits
180	Group conventional deferred annuity with-profits - increments
185	Group conventional pensions endowment with-profits
190	Group conventional pensions endowment with-profits - Increments
195	Annuity with profits (PLA)
200	Annuity with profits (CPA)
205	Miscellaneous conventional with-profits
210	Additional reserves with profits OB
215	Additional reserves with profits IB
300	Regular premium non-profit WL/EA OB
305	Single premium non-profit WL/EA OB
310	Non-profit IB
315	Individual deposit administration non-profit
320	Group deposit administration non-profit
325	Level term assurance
330	Decreasing term assurance
335	Decreasing term assurance (rider benefits)
336	Mortality risk premium reinsurance
340	Accelerated critical illness (guaranteed premiums)
345	Accelerated critical illness (reviewable premiums)
350	Standalone critical illness (guaranteed premiums)
355	Standalone critical illness (reviewable premiums)
360	Income protection non-profit (guaranteed premiums)
365	Income protection non-profit (reviewable premiums)
370	Long-term care policy

375	Protection menu policy
380	Miscellaneous protection rider
385	Income protection claims in payment
390	Deferred annuity non-profit
395	Annuity non-profit (PLA)
400	Annuity non-profit (CPA)
401	Annuity non-profit (bulk transfer)
405	Annuity non-profit (CPA impaired life)
410	Group Life
411	Group death in service dependants' annuities
415	Collective Life
420	Group income protection
425	Group income protection claims in payment
430	Group critical illness
435	Miscellaneous non-profit
440	Additional reserves non-profit OB
445	Additional reserves non-profit IB
500	Life UWP single premium
505	Life UWP whole life regular premium
506	Life UWP whole life regular premium (ISA)
510	Life UWP endowment regular premium - savings
515	Life UWP endowment regular premium – target cash
516	Life UWP endowment regular premium (ISA)
520	Holloway member accounts
525	Individual pensions UWP
530	Individual pensions UWP - increments
535	Group money purchase pensions UWP
540	Group money purchase pensions UWP - increments
545	Individual deposit administration with-profits

550	Individual deposit administration with-profits - increments
555	Group deposit administration with-profits
560	Group deposit administration with-profits - increments
565	DWP National Insurance rebates UWP
570	Income drawdown UWP
571	Trustee investment plan UWP
574	UWP investment only reinsurance
575	Miscellaneous UWP
580	Term assurance rider
585	Accelerated critical illness rider
590	Standalone critical illness rider
595	Income protection rider
605	Miscellaneous protection rider
610	Additional reserves UWP
700	Life property linked single premium
705	Life property linked single premium quasi index linked
710	Life property linked whole life regular premium
715	Life property linked endowment regular premium - savings
720	Life property linked endowment regular premium – target cash
725	Individual pensions property linked
730	Individual pensions property linked - increments
735	Group money purchase pensions property linked
740	Group money purchase pensions property linked increments
745	DWP National Insurance rebates property linked
750	Income drawdown property linked
755	Trustee investment plan
760	Small self administered schemes
765	Group managed fund
770	Term assurance rider

775	Accelerated critical illness rider
780	Standalone critical illness rider
785	Income protection rider
790	Miscellaneous protection rider
794	Property linked investment only reinsurance
795	Miscellaneous property linked
800	Additional reserves property linked
900	Life index linked single premium
901	Index linked income protection claims in payment
902	Group index linked income protection claims in payment
905	Index linked annuity (CPA)
906	Index linked annuity (bulk transfer)
907	Index linked deferred annuity
910	Miscellaneous index linked
915	Additional reserves index linked

**Codes 100215 are for with-profits business in Form 51.**  
**Codes 300445 are for non-profits business in Form 51.**  
**Codes 500610 are for Form 52.**  
**Codes 700800 are for Form 53.**  
**Codes 900915 are for Form 54.**

**Life regular *premium product codes* include paid-up policies. Compulsory purchase annuities (CPA) include those arising from group death in service *policies*. "Bulk transfer" annuities referred to in codes 401 and 906 cover all annuities in payment as part of a bulk transfer of liabilities from an occupational pension scheme or a reinsurance contract; these codes are to be used for new business instead of codes 400, 405 and 905. Transfers from insurers under Part VII of the *Act* are recorded in Form 40, there being no premiums passing through the revenue account.**

**For the purposes of allocation to product codes (e.g. code 175), group business is where there is another party in the arrangement, normally an employer. An *insurer* may use an internal definition to allocate between individual and group business for schemes with less than ten members.**

**Group money purchase pensions product codes (535, 540, 735, 740) cover policies where the *insurer* holds details at member level. Trustee investment plan product codes (571, 755) cover policies which are not in the name of or earmarked for an individual member. Group managed fund product code (765)**

covers unit-linked investments for final salary pension schemes.

- 4 There may be more than one line for the same *product code* within a type and source of business to identify specific brands.
- 5 For direct individual *policies*, columns 3 and 5 are the number of new plans, i.e. eliminating the effect of multiple policies being issued as part of the same premium, identifiable increments and rider benefits. A *policy holder* who takes out plans of the same product code during the year will contribute to column 3 or 5 for each such plan. For direct group scheme business, where the *insurer* has records of benefits at member level, columns 3 and 5 are the number of new members. For group scheme business, where the *insurer* has no records of benefits at member level, columns 3 and 5 must be zero. For business without such records, the number of new group schemes, divided by *product code*, must be set out in a supplementary note (code 4701). Details of approximations made in determining columns 3 and 5 must be given in a note (code 4703). For reinsurance accepted columns 3 and 5 are nil.
- 6 To avoid double counting, a new scheme member for a plan offering a choice of funds may be treated as contributing to column 3 or 5 for unitised with-profits business if all the premiums in the plan are invested in the *with-profits fund*. For *policies* with protection rider benefits, the entry in column 3 or 5 must be for the main benefit in the plan.
- 7 Details must be given in a supplementary note (code 4702) of approximations used to apportion between product codes.

## Long-term insurance business: Assets not held to match linked liabilities

Form 48

Name of insurer  
 Category of assets  
 Financial year ended  
 Units

		Unadjusted assets	Economic exposure	Expected income from assets in column 2	Yield before adjustment	Return on assets in financial year
		1	2	3	4	5
<b>Assets backing non-profit liabilities and non-profit capital requirements</b>						
Land and buildings	11					
Approved fixed interest securities	12					
Other fixed interest securities	13					
Variable interest securities	14					
UK listed equity shares	15					
Non-UK listed equity shares	16					
Unlisted equity shares	17					
Other assets	18					
<b>Total</b>	19					
<b>Assets backing with-profits liabilities and with-profits capital requirements</b>						
Land and buildings	21					
Approved fixed interest securities	22					
Other fixed interest securities	23					
Variable interest securities	24					
UK listed equity shares	25					
Non-UK listed equity shares	26					
Unlisted equity shares	27					
Other assets	28					
<b>Total</b>	29					
<b>Overall return on with-profits assets</b>						
Post investment costs but pre-tax	31					
Return allocated to non taxable 'asset shares'	32					
Return allocated to taxable 'asset shares'	33					

Instructions for completion of Form 48

PRA

- 1 Line 11.1 + 21.1 must equal 13.11.1.  
Line 12.1 + 22.1 must equal 13.45.1 + the relevant part of 13.84.1.  
Line 13.1 + 23.1 must equal 13.46.1 + the relevant part of 13.84.1.  
Line 14.1 + 24.1 must equal 13.47.1 + 13.48.1 + the relevant part of 13.84.1.  
Line 15.1 + 25.1 must equal the relevant part of 13.41.1.  
Line 16.1 + 26.1 must equal the relevant part of 13.41.1.  
Line 17.1 + 27.1 must equal the relevant part of 13.41.1 + 13.21.1 + 13.23.1 + 13.25.1 + 13.27.1.  
Line 19.1 must equal line 19.2.  
Line 29.1 must equal line 29.2.  
Line 19.1 + 29.1 must equal Form 13.89.1 – 13.58.1 – 13.59.1.
- 2 **Collective investment schemes** (in line 13.43) and **collective investment pools** (in line 13.49) must be allocated in column 1 to line 18 or 28. In column 2 they must be allocated according to the underlying assets, but holdings of a type of asset within a collective investment scheme or pool of less than 5% of the assets for that collective investment scheme or pool may be grouped with the main type of underlying asset for that collective investment scheme or pool. An amount of *collective investment scheme* and *collective investment pool* assets not exceeding 1% of the total non-linked assets may be reallocated from column 1 to column 2 based on the stated investment objective instead of the actual underlying assets at the valuation date. Any gearing will reduce the amounts shown in “other assets” (which may therefore be negative in column 2).
- 3 **Equity shares** (lines 21, 23, 25 and 27 of Form 13) must be allocated in column 2 to lines 11, 15, 16, 21, 25 or 26 as appropriate if the undertaking is principally a holding company for *equity shares* or property. An amount of unlisted *equity shares* not exceeding 1% of the total non-linked assets may be reallocated from column 1 to column 2 based on the stated investment objective instead of the actual underlying assets at the valuation date.
- 4 Where there is an obligation to purchase any of the underlying assets or they are ‘in the money’ at the *relevant date*, *derivative contracts* must be allocated in column 2 as if the underlying asset had been purchased on the *relevant date*. Any assumed purchase of assets in respect of ‘in the money’ derivatives will reduce the amounts shown as “other assets” (which may therefore be negative in column 2).
- 5 For a *with-profits fund* the assets backing the non-profit business must equal the amount of the non-profit *mathematical reserves* (lines 42, 45 and 47 of Form 50), plus the relevant part of the *long-term insurance capital requirement* and *resilience capital requirement* if these are backed by assets in that fund). The remaining assets must be treated as backing the with-profits business. For a fund without with-profits business all assets are to be included in lines 11-19. Allocation of assets to back *mathematical reserves* in the base scenario between lines 11-19 and 21-29 does not prevent switches between these lines for the purposes of the *market risk scenario* used in calculating the *resilience capital requirement*.

- 6 Where part of the with-profits business is with respect to business which falls within paragraph (1)(b) of the definition of *with-profits fund* and that part represents more than 10% of the total with-profits *mathematical reserves*, the *insurer* must set out in a supplementary note (code 4801):
- (a) where the *insurer's* 'asset share' philosophy for the block of business assumes a variation of asset mix by duration of *policy*, the brand names of the bonus series in the block of business; and
  - (b) where the *insurer's* 'asset share' philosophy for the block of business assumes an asset mix which is 5% more or less for any of the asset categories in lines 21 to 28 than the asset mix derived from lines 21 to 29 of column 2, the brand names of the bonus series in, and the asset mix for, the block of business.
- 7 The expected income in column 3 must be the amounts before deduction of tax which would be received in the next *financial year* on the assumption that the assets will be held throughout the year and that the factors which affect income will remain unchanged, but account must be taken of any changes in those factors known to have occurred by the *relevant date* (in particular changes of the type (1), (2), (3), (4), (5) and (6) in *INSPRU* 3.1.33R). The expected income shown in this Form must be that determined before any adjustments considered necessary because of rule *INSPRU* 3.1.41R and *INSPRU* 3.1.44R
- 8 Where a particular asset is required to be taken into account only to a specified extent by the application of the admissibility limits, the expected income from that asset must be included only to the same extent.
- 9 The treatment of the expected income from any asset where the payment of interest is in default and the amount of interest involved must be stated in a supplementary note (code 4802).
- 10 The gross redemption yield in column 4 for fixed and variable interest securities must be calculated as in *INSPRU* 3.1.34R(2) before any allowance for tax required by *INSPRU* 3.1.29R, leaving out of account any adjustment considered necessary because of *INSPRU* 3.1.41R and *INSPRU* 3.1.46R. Where a number of assets with different gross redemption yields are held, the weighted average gross redemption yield must be calculated using as weights the value of the asset applicable for entry into column 2. Where *securities* may be redeemed over a period at the option of the guarantor or the issuer, the yield must be determined on the assumption that they will be redeemed at the date implied by the market valuation. If these *securities* represent more than 1% of fixed and variable interest assets (Form 49 line 61) a supplementary note (code 4803) must be provided explaining how the assumed redemption date was determined and stating the value of these assets. Subject to paragraphs 13 and 14, the yields to be inserted in column 4 for other categories of asset must be the running yields determined in accordance with *INSPRU* 3.1.33R to *INSPRU* 3.1.34R before any allowance for tax required by *INSPRU* 3.1.29R. The entries at 48.19.4 and 48.29.4 must be the weighted average of the yields in column 4, where the weight given to each asset is the value of that asset applicable for entry into column 2. Assets not producing income must be included in the calculation.
- 11 Where the yield in column 4 for a type of asset shown at line 18 or 28 is significantly different from the weighted average of the yields for each asset of that type determined in accordance with *INSPRU* 3.1.34R(2) before any allowance for tax required by *INSPRU* 3.1.29R, then the latter yield figure must be shown in a
-

supplementary note (code 4804). For this purpose, the weighted average of the yields means an average yield weighted by the value of each asset of that type as entered in column 2.

- 12 Where an entry at 13.87.1 has resulted from excess *exposure to a counterparty or excess concentration with a number of counterparties*, the aggregate value of the assets of the *insurer* giving rise to *exposure to such counterparties* must be stated in a supplementary note (code 4805), together with the expected income from those assets.
- 13 To the extent that *INSPRU 3.1.34R(2)* has not been, or would otherwise not be required to be, applied to calculate the yield on equity *shares* or holdings in *collective investment schemes*, that rule may be ignored (in which case *INSPRU 3.1.33R* and *INSPRU 3.1.34R(1)* will apply, before any allowance for tax required by *INSPRU 3.1.29R*) for an amount up to the higher of £5 million or 5% of the value of equity *shares* and holdings in *collective investment schemes* required to be reported in Form 48.
- 14 To the extent that a yield greater than zero on equity *shares* or holdings in *collective investment schemes* is not needed for the purpose of determining rates of interest under *INSPRU 3.1.28R*, *INSPRU 3.1.33R* and *INSPRU 3.1.34R* may be ignored for an amount of up to 1% of the value of equity *shares* and holdings in *collective investment schemes* required to be reported in Form 48, and the relevant yield will be taken as zero.
- 15 Firms must state in a supplementary note (code 4806) which assets have been used to calculate the investment returns shown in lines 21-29 column 5. If the firm identifies a portfolio of assets to back asset shares the returns must be based on these assets. If there are several asset share portfolios the return must be based on the largest. The assets used to calculate the investment returns in column 5 will not necessarily be the same as those assets in columns 1 and 2. The returns in lines 21-29 are before allowance for tax and investment costs, as is the return disclosed in Appendix 9.4A paragraph 4(7).
- 16 Column 5 must be expressed as a percentage.

## Long-term insurance business: Fixed and variable interest assets

Form 49

Name of insurer  
 Category of assets  
 Financial year ended  
 Units

		<b>Value of assets</b>	<b>Mean term</b>	<b>Yield before adjustment</b>	<b>Yield after adjustment</b>
		<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>
<b>UK government approved fixed interest securities</b>	11				
<b>Other approved fixed interest securities</b>	21				
<b>Other fixed interest securities</b>					
AAA/Aaa	31				
AA/Aa	32				
A/A	33				
BBB/Baa	34				
BB/Ba	35				
B/B	36				
CCC/Caa	37				
Other (including unrated)	38				
<b>Total other fixed interest securities</b>	39				
<b>Approved variable interest securities</b>	41				
<b>Other variable interest securities</b>	51				
<b>Total (11+21+39+41+51)</b>	61				

**Instructions for completion of Form 49**

**PRA**

- 1** Where non-linked *fixed interest securities* (which are not *approved securities*) for the *long-term insurance fund* (48.13.2 + 48.23.2) exceed £100m, fixed and variable interest assets must be reported in Form 49.
- 2** The value of assets in column 1 must correspond to the value of assets in column 2 of Form 48.
- 3** The mean term in column 2 may be calculated by using the expected yearly cashflows discounted by the internal rate of return, or an alternative actuarial method. Undated stocks must be assumed to be redeemed after 40 years.
- 4** The gross redemption yield in column 3 must be calculated in accordance with instruction 10 to Form 48.
- 5** The gross redemption yield after adjustment in column 4 makes allowance for the risk adjustment required by *INSPRU 3.1.41R* and *INSPRU 3.1.44R*.
- 6** A supplementary note (code 4901) must be provided stating which rating agency has been used to provide the split by credit rating.
- 7** Other fixed interest securities held in *collective investment schemes* may be allocated to line 38 provided their value does not exceed 1% of the amount in line 39.

## Long-term insurance business: Summary of mathematical reserves

Form 50

Name of insurer  
 Total business / subfund  
 Financial year ended  
 Units

		UK Life	UK Pension	Overseas	Total Financial year	Total Previous year
		1	2	3	4	5
<b>Gross</b>						
Form 51 - with-profits	11					
Form 51 - non-profit	12					
Form 52	13					
Form 53 - linked	14					
Form 53 - non-linked	15					
Form 54 - linked	16					
Form 54 - non-linked	17					
<b>Total</b>	18					
<b>Reinsurance - external</b>						
Form 51 - with-profits	21					
Form 51 - non-profit	22					
Form 52	23					
Form 53 - linked	24					
Form 53 - non-linked	25					
Form 54 - linked	26					
Form 54 - non-linked	27					
<b>Total</b>	28					
<b>Reinsurance - intra-group</b>						
Form 51 - with-profits	31					
Form 51 - non-profit	32					
Form 52	33					
Form 53 - linked	34					
Form 53 - non-linked	35					
Form 54 - linked	36					
Form 54 - non-linked	37					
<b>Total</b>	38					
<b>Net of reinsurance</b>						
Form 51 - with-profits	41					
Form 51 - non-profit	42					
Form 52	43					
Form 53 - linked	44					
Form 53 - non-linked	45					
Form 54 - linked	46					
Form 54 - non-linked	47					
<b>Total</b>	48					

*Instructions for completion of Form 50*

**PRA**

**1 Lines 11 to 18 are just for gross business.**

Line 11 is the sum of column 9 of Form 51 for *product codes 100-299*.  
Line 12 is the sum of column 9 of Form 51 for *product codes 300-499*.  
Line 13 is the sum of column 9 of Form 52.  
Line 14 is the sum of column 7 of Form 53.  
Line 15 is the sum of column 8 of Form 53.  
Line 16 is the sum of column 7 of Form 54.  
Line 17 is the sum of column 8 of Form 54.

**2 Lines 21 to 28 are just for reinsurance ceded external.**

Line 21 is the sum of column 9 of Form 51 for *product codes 100-299*.  
Line 22 is the sum of column 9 of Form 51 for *product codes 300-499*.  
Line 23 is the sum of column 9 of Form 52.  
Line 24 is the sum of column 7 of Form 53.  
Line 25 is the sum of column 8 of Form 53.  
Line 26 is the sum of column 7 of Form 54.  
Line 27 is the sum of column 8 of Form 54.  
Line 28 is the sum of lines 21 to 27.

**3 Lines 31 to 38 are just for reinsurance ceded intra-group.**

Line 31 is the sum of column 9 of Form 51 for *product codes 100-299*.  
Line 32 is the sum of column 9 of Form 51 for *product codes 300-499*.  
Line 33 is the sum of column 9 of Form 52.  
Line 34 is the sum of column 7 of Form 53.  
Line 35 is the sum of column 8 of Form 53.  
Line 36 is the sum of column 7 of Form 54.  
Line 37 is the sum of column 8 of Form 54.  
Line 38 is the sum of lines 31 to 37.

**4**

Line 41 = line 11 – line 21 – line 31.  
Line 42 = line 12 – line 22 – line 32.  
Line 43 = line 13 – line 23 – line 33.  
Line 44 = line 14 – line 24 – line 34.  
Line 45 = line 15 – line 25 – line 35.  
Line 46 = line 16 – line 26 – line 36.  
Line 47 = line 17 – line 27 – line 37.  
Line 48 = line 18 – line 28 – line 38.

**5 Separate Forms must be completed for the total business and each subfund.**

**Long-term insurance business: Valuation summary of non-linked contracts**(other than accumulating with-profits contracts)

Name of insurer

Total business / subfund

Financial year ended

Units

UK Life / UK Pension / Overseas (State or Territory) / Gross / Reinsurance ceded external / Reinsurance ceded intra-group

<b>Product code number</b>	<b>Product description</b>	<b>Number of policyholders / scheme members</b>	<b>Amount of benefit</b>	<b>Amount of annual office premiums</b>	<b>Nominal value of units</b>	<b>Discounted value of units</b>	<b>Other liabilities</b>	<b>Amount of mathematical reserves</b>
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>8</b>	<b>9</b>
					n/a	n/a	n/a	
					n/a	n/a	n/a	







*Instructions for completion of Forms 51, 52, 53 and 54*

PRA

- 1 Separate valuation summaries must be completed in respect of each separate fund or part of a fund for which a surplus is determined.
- 2 Information must be shown separately for each type of *insurance business* for each of the following:
  - (a) UK life;
  - (b) UK pension; and
  - (c) overseas.

Overseas business may, at the discretion of the insurer, be subdivided by state or territory.
- 3 The information must be shown separately for each source of business for each type of *insurance business* in the sequence specified below:
  - (a) *gross insurance business*;
  - (b) *reinsurance ceded* which is external to the *insurance group*; and
  - (c) *reinsurance ceded* which is to another member of the *insurance group*.
- 4 Subject to 11, information must be further divided by *product code*. 'Product description' in column 2 is the narrative description beside the number of the product code in the table in paragraph 3 of the Instructions for completion of Form 47 but may, at the discretion of the *insurer*, include the brand name. Subdivision of pensions business into increments and DWP National Insurance rebates is not required in Forms 5154. Subdivision of annuities in payment into those arising from bulk transfers is not required in Forms 51-54, i.e. new business reported under codes 401 and 906 is reported under codes 400, 405 and 905 for in force business.
- 5 There may be more than one line for the same *product code* within a type and source of business to identify specific brands or *policies* with special features.
- 6 For direct individual *policies*, column 3 is the number of plans, i.e. eliminating the effect of multiple policies being issued as part of the same premium, identifiable increments and rider benefits. A *policy holder* who holds plans of the same product code taken out at different dates will contribute to column 3 for each such plan. For direct group scheme business, where the *insurer* has records of benefits at member level, column 3 is the number of members. For group scheme business, where the *insurer* has no records of benefits at member level, column 3 must be zero. For business without such records, the number of group schemes, analysed by the *product code*, must be set out in a

supplementary note (codes 5101-5401). Details of approximations made in estimating the number of policyholders from the number of contracts must be given in a supplementary note (codes 5102-5402). For reinsurance accepted and reinsurance ceded column 3 is nil.

- 7 A plan must only contribute once to column 3 in Forms 51-54. The total of *premiums* for the plan shown in Forms 51-54 must equal the total *premiums* for the plan. For plans where the *policyholder* has the option for *premiums* to be invested in both with-profits and internal linked funds, the preferred presentation is as follows. If all the *premiums* are invested in with-profits units and the plan is written in the *with-profits fund* the contribution to column 3 should be shown in Form 52, otherwise the contribution to column 3 should be shown in Form 53. The entry in column 3 is for the investment element of the plan, and the entry in column 3 for protection rider benefits is nil. The annual *premium* in column 5 should be allocated between Form 52 and Form 53 based on the current *premium* allocation percentages. If all the *premiums* are invested in with-profits units and the plan is written in the *with-profits fund* the protection rider benefits should be shown in Form 52, otherwise the protection rider benefits should be shown in Form 53. Where the protection rider benefits are paid for by cancelling units the entry in column 5 for the riders should be shown as nil, and all the *premiums* for the plan should be reported in column 5 under the *product code(s)* for the investment element.
- 8 Columns 6, 7 and 8 must be left blank on Form 51. The purpose of the unused columns in Form 51 is the standardisation of column headings in Forms 51-54.
- 9 For *non-linked contracts* the amount of benefit in column 4 is the current death benefit (excluding any interim and terminal bonus) for assurances, the amount payable on claim for standalone critical illness, the annual amount of annuity for deferred annuities and annuities in payment and the annual amount of benefit for income protection and waiver of premium. For *linked long-term contracts* including life assurance, column 4 must be the current amount payable on death.
- 10 For *property linked long-term contracts*, unitised *with-profits policies* and deposit administration contracts, column 6 must be the current value of the units or fund as presented to the *policy holder*. For *index linked contracts* column 6 must be the index linked liability with no allowance for discounting. The amount in column 7 is the amount in column 6 allowing for any discounting in the valuation. The amount in column 9 is the sum of columns 7 and 8.
- 11 Notwithstanding 4, where neither the *gross mathematical reserves* nor the gross annual premiums with respect to products with the same product code exceed the lesser of £10m and 1% of the total *gross mathematical reserves*, the products may be entered as the appropriate miscellaneous product code in column 1 and 2. The test of whether the appropriate miscellaneous product code may be used must be carried out at firm level combining all subfunds. The product code for reinsurance must correspond to the product code for the related gross business.
12. Where a product does not appear to fit into any other product code, the miscellaneous product code can be used. Details must be disclosed in a supplementary note (codes 5103-5403) if the amount of business for the

**product exceeds the threshold in instruction 11.**

- 13 Details must be given in a supplementary note (codes 5104-5404) of approximations used to apportion between product codes.**
- 14 Reserves for non-attributable expenses must be included with the appropriate additional reserves product code, i.e. they are not allocated back to and included with reserves at product code level.**



*Instructions for completion of Form 55*

PRA

- 1 Where the net assets held by the *insurer* for all the *internal linked funds* sharing the same underlying assets for pricing purposes exceed the lesser of £100m and 10% of the total *internal linked funds* (line 59 of Form 45), with the exception of share index tracker funds, any such *internal linked fund* which is in one of the categories listed in 2 must be reported in Form 55. Where a life fund and a pension fund share the same underlying assets, the fund must be reported for the main life series and the main pension series.
- 2 The fund types for column 2 are as follows:
  - 01 - life - stock market managed fund
  - 02 - life - balanced managed fund
  - 03 - life - defensive managed fund
  - 04 - life - other managed fund
  - 05 - life - UK equity
  - 06 - life - overseas equity
  - 07 - life - property
  - 11 - individual pension - stock market managed fund
  - 12 - individual pension - balanced managed fund
  - 13 - individual pension - defensive managed fund
  - 14 - individual pension - other managed fund
  - 15 - individual pension - UK equity
  - 16 - individual pension - overseas equity
  - 17 - individual pension - property
  - 21 - group managed fund - stock market managed fund
  - 22 - group managed fund - balanced managed fund
  - 23 - group managed fund - defensive managed fund
  - 24 - group managed fund - other managed fund
  - 25 - group managed fund - UK equity
  - 26 - group managed fund - overseas equity
  - 27 - group managed fund - property.
- 3 The amount in column 3 is the total net assets attributable to the fund.
- 4 Column 4 is the name of the largest series (by unit liability).
- 5 Column 5 is the annual unit management charge shown to 2 decimal places for the largest series, e.g. 0.75 for an annual charge of 0.75%.
- 6 Columns 6 and 7 are the prices used to value the unit liabilities. Where there has been a transfer of business during the financial year, the price shown in column 6 is from the previous *insurer*.
- 7 Column 8 is  $100 \times (\text{column 7} - \text{column 6}) / \text{column 6}$  shown to 2 decimal places, e.g. 20.00 for a 20% increase in unit price during the year.

**Long-term insurance business: index linked business**

Form 56

Name of insurer  
 Total business  
 Financial year ended  
 Units

		<b>Value of assets</b>	<b>Mean term</b>
		<b>1</b>	<b>2</b>
<b>Analysis of assets</b>			
Approved variable interest securities	11		
Other variable interest securities	12		
Approved fixed interest securities	13		
Other fixed interest securities	14		
Cash and deposits	15		
Equity index derivatives	16		
Inflation swaps	17		
Other assets	18		
Variation margin	19		
<b>Total (11 to 19)</b>	<b>20</b>		
<b>Credit rating of other fixed interest and other variable interest securities</b>			
AAA/Aaa	31		
AA/Aa	32		
A/A	33		
BBB/Baa	34		
BB/Ba	35		
B/B	36		
CCC/Caa	37		
Other (including unrated)	38		
<b>Total other fixed interest and other variable interest securities</b>	<b>39</b>		

**Instructions for completion of Form 56**

**PRA**

- 1**        **Where index-linked assets (13.58.1) exceed £100m they must be analysed in Form 56. The value of assets in line 20 column 1 must correspond to the value of assets in Form 13.58.1.**
  
- 2**        **The mean term in column 2 may be calculated by using the expected yearly cashflows discounted by the internal rate of return, or an alternative actuarial method. Undated stocks must be assumed to be redeemed after 40 years.**
  
- 3**        **Where the sum of other variable interest securities (line 12) and other fixed interest securities (line 14) exceeds £100m, these must be analysed in lines 31-39. A supplementary note (code 5601) must be provided stating which rating agency has been used to provide the split by credit rating.**
  
- 4**        **Amounts in lines 16 and 17 (column 1) must be shown net of any *variation margin*.**
  
- 5**        **[deleted]**
  
- 6**        **[deleted]**
  
- 7**        **[deleted]**
  
- 8**        **[deleted]**

**Long-term insurance business – analysis of valuation interest rate**

Name of insurer

Total business / subfund

Financial year ended

Units

<b>Product group</b>	<b>Net mathematical reserves</b>	<b>Net valuation interest rate</b>	<b>Gross valuation interest rate</b>	<b>Risk adjusted yield on matching assets</b>
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>Total</b>		n/a	n/a	n/a

**CHAPTER 1 Instructions for completion of Form 57**

**PRA**

- 1** This Form must be completed for each fund or sub-fund where *mathematical reserves* for non-linked business exceed £100m. Form 57 must not be completed for the total business where the firm has subfunds.
- 2** Separate lines are required for UK Life, UK Pension and overseas business and for with-profits and non-profit business.
- 3** Separate lines are required for each separate asset mix determined by the notional allocation of assets to contracts.
- 4** Separate lines are required for each valuation interest rate.
- 5** The product group in column 1 must be a narrative description of the products included in the line sufficient to give a cross reference to Forms 51-54, e.g. 'UK L&GA WP Form 51 assurances'.
- 6** The *mathematical reserves* in column 2 must include any increase in reserves resulting from the bonus declaration for the year and must be net of *reinsurance ceded*.
- 7** Up to 10% of the total relevant liabilities for the fund may be shown in a line labelled 'Misc' in column 1. In this case columns 3 and 4 must be 'n/a'. The relevant liabilities are the total *mathematical reserves* including cost of bonus plus any deposit back, less property linked unit liabilities and index linked investment liabilities.
- 8** The risk adjusted yield in column 5 must allow for the adjustments from *INSPRU 3.1.41R*.
- 9** The *insurer* must include a supplementary note (code 5701) where negative *mathematical reserves* on one group of products have been used to offset positive *mathematical reserves* on another group of products, giving details of the amounts and products involved.

## Long-term insurance business: distribution of surplus

Form 58

Name of insurer  
 Total business / subfund  
 Financial year ended  
 Units

		<b>Financial year</b>	<b>Previous year</b>
		<b>1</b>	<b>2</b>
<b>Valuation result</b>			
Fund carried forward	11		
Bonus payments in anticipation of a surplus	12		
Transfer to non-technical account	13		
Transfer to other funds / parts of funds	14		
Subtotal (11 to 14)	15		
Mathematical reserves	21		
Surplus including contingency and other reserves held towards the capital requirements (deficiency) (15-21)	29		
<b>Composition of surplus</b>			
Balance brought forward	31		
Transfer from non-technical account	32		
Transfer from other funds / parts of fund	33		
Surplus arising since the last valuation	34		
Total	39		
<b>Distribution of surplus</b>			
Bonus paid in anticipation of a surplus	41		
Cash bonuses	42		
Reversionary bonuses	43		
Other bonuses	44		
Premium reductions	45		
Total allocated to policyholders (41 to 45)	46		
Net transfer out of fund / part of fund	47		
Total distributed surplus (46+47)	48		
Surplus carried forward	49		
Total (48+49)	59		
<b>Percentage of distributed surplus allocated to policyholders</b>			
Current year	61		
Current year - 1	62		
Current year - 2	63		
Current year - 3	64		

*Instructions for completion of Form 58*

PRA

- 1 Separate Forms must be completed for the total business and each subfund.
- 2 The entry at line 11 must be equal to the entry at line 59 in Form 40 for the relevant subfund.
- 3 Where interim, mortality or terminal bonuses are determined in advance of a valuation and are paid in anticipation of surplus arising at the valuation, the amounts of such bonus actually paid in the period up to the *relevant date* must be entered at lines 12 and 41. To the extent that it is the practice of the *insurer* to make special provision for the cost of such bonuses payable on future *claims* out of surplus arising at a valuation, such amounts must be treated as amounts allocated to *policy holders* at the valuation in question and included at line 44, and the actual amounts paid must not appear at lines 12 and 41 at future valuations. An appropriate supplementary note (code 5801) must identify the various items where necessary.
- 4 Where *policies* have been transferred from one subfund to another, the associated transfer of reserves must not be included as a “transfer” in this Form. Where any other transfer has been made, only one block of lines must be used (lines 13 and 14 or 32 and 33, depending on the direction of the net transfer) leaving the other block blank.
- 5 When the *insurer* records a transfer to the nontechnical account or to another fund or part fund in a revenue account (Form 40) for a particular period, the amount of which has been derived from a valuation completed at the end of that period, that transfer must be shown at line 13 or 14 as appropriate, so that the true surplus appears in line 29.
- 6 Where the *insurer* decides to allocate to the *long-term insurance business* the whole or any part of the investment income or net capital gains arising from assets not attributable to its *long-term insurance business*, the allocation must be included in Form 58 as a transfer from the non-technical account. This transfer must be included at lines 13 or 32, depending on whether, for the *financial year in question*, there is an overall net transfer out of, or into, the fund (or part fund).
- 7 Where the entry at line 14 or line 33 represents more than one transaction, each transfer must be separately identified in a supplementary note (code 5802).
- 8 Line 61 is line 46 expressed as a percentage of line 48.
- 9 For each fund/subfund, the entry at line 21 must equal the total liabilities shown at line 48 in column 4 of Form 50.
- 10 The figure at lines 39 and 59 must equal the figure at line 29.

- 11**      **The figure at line 47 must equal the sum of lines 13 and 14.**
- 12**      **Lines 61-64 are not applicable for the total business where there is more than one subfund.**

**Long-term insurance business: With-profits payouts on maturity (normal retirement)**

**Form 59A**

Name of insurer

Original insurer

Date of maturity value / open market option

<b>Category of with-profits policy</b>	<b>Original term (years)</b>	<b>Maturity value / open market option</b>	<b>Terminal bonus</b>	<b>MVA</b>	<b>CWP / UWP</b>	<b>MVA permitted?</b>	<b>Death benefit</b>
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>8</b>
Endowment assurance	10						
Endowment assurance	15						
Endowment assurance	20						
Endowment assurance	25						
Regular premium pension	5						
Regular premium pension	10						
Regular premium pension	15						
Regular premium pension	20						
Single premium pension	5						
Single premium pension	10						
Single premium pension	15						
Single premium pension	20						

**Long-term insurance business: With-profits payouts on surrender**

Name of insurer  
Original insurer  
Date of surrender value

<b>Category of with-profits policy</b>	<b>Duration at surrender (years)</b>	<b>Surrender value</b>	<b>Terminal bonus</b>	<b>MVA</b>	<b>CWP / UWP</b>	<b>MVA permitted?</b>	<b>Death benefit</b>
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>8</b>
Endowment assurance	5						
Endowment assurance	10						
Endowment assurance	15						
Endowment assurance	20						
With-profits bond	2						
With-profits bond	3						
With-profits bond	5						
With-profits bond	10						
Single premium pension	2						
Single premium pension	3						
Single premium pension	5						
Single premium pension	10						

**Instructions for completion of Forms 59A and 59B**

**PRA**

- 1 **‘Original insurer’ means the insurance undertaking which effected the *policy* (which may be same entity as the *insurer*).**
- 2 **Where the with-profits *mathematical reserves* relating to the business of the original insurer exceed £100m, Forms 59A and 59B must be completed for the original insurer.**
- 3 **The date of the maturity value, open market option or surrender value is two months and one day after the valuation date, for example 1<sup>st</sup> March for a 31<sup>st</sup> December valuation.**
- 4 **In Form 59A, column 3 is the maturity value for endowment assurances or the open market option for regular and single premium pension business.**
- 5 **Maturity values for endowment assurances must be based on a £50 monthly premium paid by a male non-smoker aged 30 next birthday at the date the *policy* commenced.**
- 6 **Open market options for regular premium pension must be based on a personal pension or s226 *policy* with a £200 monthly premium paid by a male aged 65 at retirement, for a selected retirement age of 65 at outset. The *insurer* must assume that the *policy* commenced on the relevant birthday date appropriate to the term of the *policy* with the final premium payable one month before retirement aged 65.**
- 7 **Open market options for single premium pensions must be based on a personal pension or s226 *policy* with a £10,000 single premium paid by a male aged 65 at retirement, for a selected retirement age of 65 at outset. The *insurer* must assume that the *policy* commenced on the relevant birthday date appropriate to the term of the *policy*.**
- 8 **Surrender values for endowment assurances must be based on a £50 monthly premium paid by a male non-smoker aged 30 next birthday with an original term of 25 years at the date the *policy* commenced.**
- 9 **Surrender values for with-profits bonds must be based on a £10,000 single premium paid by a male aged 50 at the date the *policy* commenced. The *insurer* must assume that no prior withdrawals have taken place.**
- 10 **Surrender values for single premium pensions must be based on a personal pension or s226 *policy* with a £10,000 single premium paid by a male aged 40 at the date the *policy* commenced.**
- 11 **Where the *insurer* did not effect *policies* in a particular category or the *policy* category was not open to new business (apart from increments) at the date the *policy* is assumed to have commenced, the entry in columns 3 to 8 must be**

'n/a'.

- 12 **Column 4 is the amount of terminal bonus included in column 3. If a market value (or similar) adjustment has been applied, then that amount must be shown as a negative amount in column 5.**
- 13 **Column 6 is CWP (conventional with-profits) or UWP (unitised with-profits).**
- 14 **Column 7 is Y if an MVA is permitted by the policy conditions at the date of maturity / date of surrender for that policy, otherwise N.**
- 15 **Where there is more than one version or premium rate for one of the data lines, the data shown must be for the version where there is the largest amount of business.**

## Long term insurance capital requirement

Form 60

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

Units

				L60	Global	Financial year ended	Units
		LTICR factor	Gross reserves / capital at risk	Net reserves / capital at risk	Reinsurance factor	LTICR Financial year	LTICR Previous year
		1	2	3	4	5	6
<b>Insurance death risk capital component</b>							
Life protection reinsurance	11	0.0%					
Classes I (other), II and IX	12	0.1%					
Classes I (other), II and IX	13	0.15%					
Classes I (other), II and IX	14	0.3%					
Classes III, VII and VIII	15	0.3%					
<b>Total</b>	<b>16</b>						
<b>Insurance health risk and life protection reinsurance capital component</b>							
Class IV, supplementary classes 1 and 2 and life protection reinsurance	21						
<b>Insurance expense risk capital component</b>							
Life protection and permanent health reinsurance	31	0%					
Classes I (other), II and IX	32	1%					
Classes III, VII and VIII (investment risk)	33	1%					
Classes III, VII and VIII (expenses fixed 5 yrs +)	34	1%					
Classes III, VII and VIII (other)	35	25%					
Class IV (other)	36	1%					
Class V	37	1%					
Class VI	38	1%					
<b>Total</b>	<b>39</b>						
<b>Insurance market risk capital component</b>							
Life protection and permanent health reinsurance	41	0%					
Classes I (other), II and IX	42	3%					
Classes III, VII and VIII (investment risk)	43	3%					
Classes III, VII and VIII (expenses fixed 5 yrs +)	44	0%					
Classes III, VII and VIII (other)	45	0%					
Class IV (other)	46	3%					
Class V	47	0%					
Class VI	48	3%					
<b>Total</b>	<b>49</b>						
<b>Long term insurance capital requirement</b>	<b>51</b>						

Instructions for completion of Form 60

PRA

- 1 The *insurance death risk capital component* in lines 11-15 column 5 is based on capital at risk for those contracts where it is not negative. Capital at risk is the benefit payable as a result of death less the *mathematical reserves* after distribution of surplus. *Life protection reinsurance business* written by a *pure reinsurer* or a *mixed insurer* is reported in line 11. Other business in classes I, II and IX must be split between lines 12, 13 and 14 in accordance with *INSPRU 1.1.82R*. Line 12 is for temporary insurance on death where the original term of the contract is 3 years or less. Line 13 is for temporary insurance where the original term is 5 years or less but more than 3 years. Line 14 is for other *class I, II or IX* business. For a *pure reinsurer* the factor of 0.3% in column 1 of line 15 must be replaced by 0.1%.
- 2 In lines 11-15 columns 2 and 3 are the gross and net capital at risk in accordance with *INSPRU 1.1.83R*. For lines 12-14 the reinsurance factor is calculated in aggregate, so column 4 is the sum of lines 12-14 column 3 divided by the sum of lines 12-14 column 2, subject to a minimum of 0.5 in accordance with *INSPRU 1.1.81R*. For line 15 column 4 is column 3 divided by column 2, subject to a minimum of 0.5 in accordance with *INSPRU 1.1.81R*. Column 5 is column 1 x column 2 x column 4.
- 3 The *insurance health risk and life protection reinsurance capital component* in line 21 column 5 must be equal to the entry at line 43 in Form 12 for *long-term insurance business*, unless an estimate has been made in accordance with instruction 2 to Forms 11 and 12. In this case a supplementary note (code 6001) is required as described in that instruction.
- 4 For the purpose of calculating the *insurance expense risk capital component* and the *insurance market risk capital component* linked contracts must be allocated to:
  - lines 33 and 43 where the *firm* bears an investment risk,
  - lines 34 and 44 where the *firm* does not bear an investment risk but where the allocation to cover *management expenses* is fixed for a period exceeding 5 years from the commencement of the contract, and
  - lines 35 and 45, otherwise.

*Life protection reinsurance business* and *permanent health reinsurance business* written by a *pure reinsurer* or a *mixed insurer* must be allocated to lines 31 and 41.
- 5 The *insurance expense risk capital component* for linked contracts where the *firm* bears no investment risk and the allocation to cover *management expenses* does not have a fixed upper limit for a period exceeding 5 years from the commencement of the contract in line 35 is 25% of net *administrative expenses* in accordance with *INSPRU 1.1.88R(1)*.

- 6 The *insurance expense risk capital component* for class V in line 37 column 5 is 1% of the assets of the tontine in accordance with *INSPRU 1.1.88R(2)*.
- 7 The *insurance expense risk capital component* for other business in lines 32, 33, 34, 36 and 38 column 5 is 1% of adjusted *mathematical reserves* after distribution of surplus in accordance with *INSPRU 1.1.88R(3)*. Column 4 is column 3 divided by column 2, subject to a minimum of 85% (50% for a pure reinsurer) in accordance with *INSPRU 1.1.90R*. Column 5 is column 1 x column 2 x column 4.
- 8 The *insurance market risk capital component* in lines 44 and 45 column 5 for class III, VII and VIII contracts where the *firm* does not bear any investment risk and in line 46 for class V contracts is nil in accordance with *INSPRU 1.1.89R*.
- 9 The *insurance market risk capital component* in line 42, 43, 46 and 48 column 5 is 3% of adjusted *mathematical reserves* after distribution of surplus in accordance with *INSPRU 1.1.89R*. Column 4 is column 3 divided by column 2 subject to a minimum of 85% (50% for a pure reinsurer) in accordance with *INSPRU 1.1.90R*. Column 5 is column 1 x column 2 x column 4. The amount in line 49 column 3 must equal the amount in Form 14 line 11.
- 10 The *long term insurance capital requirement* in line 51 column 5 is the sum of column 5 in lines 16, 21, 39 and 49.
- 11 The ratios in column 4 must be shown to 2 decimal places, but the unrounded ratios must be used for the purposes of calculating column 5.
- 12 Where the previous financial year ends before 31 December 2006, column 6 must be completed using the corresponding figures from the previous return, e.g. line 12 column 6 contains the amount previously shown in line 11 column 5.



## Appendix 9.4 (rule 9.31)

### Abstract of Valuation Report

The following information must be provided in the abstract of the report required under rule 9.31, the answers being numbered to accord with the numbers of the corresponding paragraphs of this Appendix. For the purposes of this Appendix, the “report period” means the period from the date to which the previous investigation under rule 9.4 related to the ‘valuation date’ (as defined in 1).

#### *Introduction*

- 1 (1) The date to which the actuarial investigation relates, namely, the *valuation date*.
- PRA (2) The previous valuation.
- (3) The dates of any interim valuations (for the purposes of rule 9.4) carried out since the previous ‘valuation date’.

#### *Product range*

- 2 (1) Any significant changes in products during the *financial year* (new products, new bonus series, products withdrawn, changes to options or guarantees under existing products), including product brand names and charging methods, but not the amounts of the charges where these form part of the product terms. A statement for each with-profits subfund categorising that subfund into one of the categories (a), (b), (c) or (d) below:
- PRA (a) open to new with-profits business;
- (b) open only to new non-profit business;
- (c) open but was not actively marketing in the previous financial year; or
- (d) closed to new business except by increment.

#### *Discretionary charges and benefits*

- 3 (1) For each accumulating with-profits product where the *insurer* has the option to apply a market value reduction (or equivalent), a statement of the period when this has been applied during the year and a summary of the policy years of entry to which it applied.
- PRA (2) Any changes to premiums on reviewable non-linked protection policies, including for each product affected, the range of the changes (x% to y%), the amount of business affected by a change, and the amount of business where a change was permitted but did not occur at this review date. For yearly renewable term assurance a change means a change in the underlying premium rates.
- (3) For non-profit deposit administration benefits, the interest rate

added during the year.

- (4) For service charges on linked *policies*, the percentage changes to service charges for in force *policies*.
- (5) For benefit charges on linked *policies*, any changes to benefit charges (mortality, morbidity, etc) on linked *policies*, including for each product affected the range of the changes (x% to y%), and the amount of business affected by the change.
- (6) Any changes to unit management charges or notional charges to accumulating with-profits *policies*, and the amount of business affected by the change.
- (7) For unit pricing of *internal linked funds*:
  - (a) a description of the methods, and the types of unit to which each applies, used for:
    - (i) the creation and cancellation of units in *internal linked funds*, and
    - (ii) determining unit prices for the allocation of units to, and the de allocation of units from, *policies*including information on:
    - (iii) the basis of the valuation of assets and how the basis is selected (for example, offer basis for net creations of units and bid basis for net cancellations), and
    - (iv) the timing of the asset valuation used in respect of such operations in relation to the time at which the operation is decided upon and effected;
  - (b) when at any one time different pricing bases apply to different *policies*, details of the circumstances which give rise to the difference; and
  - (c) where assets are units in *collective investment schemes* or similar assets, the price used and the relationship between the last opportunity to deal at that price and the time of the valuation.
- (8) For tax deductions from internal linked funds, the allowance and timing of withdrawal from the fund for tax on realised and unrealised gains and losses, including notional gains on unit trusts, specifying the tax rate used.
- (9) For tax provisions for internal linked funds, a description of the methods and the types of unit to which each applies, used to determine the provision for tax on realised and unrealised capital gains and the percentage of these gains deducted or provided for

during the report period.

- (10) Wherever *units* in *permitted scheme interests* are held in an *internal linked fund*, or where *property linked benefits* are linked to such *units*, the rate of discount, commission or other allowance made to the *insurer* on the purchase, sale or holding of *units* and the extent to which the *policyholder* benefits from such discount, commission or other allowance.

*Valuation basis (other than for special reserves)*

Where either the gross *mathematical reserves* or the gross annual premiums for a group of products using the same valuation method and basis exceed the lesser of £10m and 1% of the total gross *mathematical reserves*, the method and basis of valuation must be given in accordance with 4(1) to 4(9). Where a prospective method has not been used, the basis reported must be the basis used by the *insurer* to test the adequacy of the reserves.

4

PRA

- (1) The valuation methods used and the types of product to which each method applies, including a description of any non-standard method. See 5 to 8 for special reserves.
- (2) A table of the interest rates used, showing the product group, the rate used at the end of the *financial year in question*, and the rate used at the end of the previous *financial year*. Where the valuation with respect to a product involves more than one interest rate (e.g. a rate in deferment and a rate in possession), both interest rates must be shown.
- (3) How the yield was adjusted to allow for risk for equity *shares*, property and other *fixed interest securities* to determine the risk adjusted yield in Form 57.
- (4) A table of mortality bases used, showing the product group and the bases used at the end of the *financial year in question* and at the end of the previous *financial year*. If a mortality basis cannot be expressed as a flat percentage of a standard table or as a standard table subject to a flat age rating, then the mortality basis should be shown as 'modified <name of table>'. For assurance where the 'modified table' description is used, rates must be provided for ages 25, 35, 45 and 55. For all annuitant mortality bases covered by this paragraph, the complete expectation of life at age 65 and 75 for annuities in payment and the complete expectation of life at age 65 for current ages 45 and 55 for deferred annuities must be provided. Allowances made for future changes in mortality where not implicit in the basis, and details of any allowance made and the amount of any reserve held, for any possible detrimental impact of significant changes in the incidence of disease or developments in medical science on the mortality experience of the *insurer* assumed in the valuation of the *contracts of insurance* must be provided.
- (5) A table of morbidity bases used, showing the product group and the bases used at the end of the *financial year in question* and at the end of the previous *financial year*. If a basis cannot be expressed as

a simple modification to a standard table (e.g. flat percentage, age rating), the basis must be shown as 'modified <name of table>'. Where the 'modified table' description is used the morbidity rates and recovery rates must be provided for ages 25, 35, 45 and 55. Inception and recovery rates for income protection business are only required for the most common deferred period in the firm's business and for occupation class 1. The deferred period must be stated. Recovery rates must be provided at durations of 2 and 5 years. Allowances made for future changes in morbidity, and details of any allowance made and the amount of any reserve held, for any possible detrimental impact of significant changes in the incidence of disease or developments in medical science on the morbidity experience of the *insurer* assumed in the valuation of the *contracts of insurance* must be provided.

- (6) A table of expense bases used, showing the product group, the basis for the *financial year in question*, and the basis for the previous *financial year*. The table must show zillmer adjustments, expense assumptions for prospective methods where no further premiums are payable, expense assumptions for gross premium valuations of with-profits and non-profit premium paying business and expense assumptions for non-unit liability calculations for linked business, identifying monetary amounts and the percentages of premiums.

Per policy amounts are only required for the following classes:

CWP savings endowment (product code 120)

CWP target cash endowment (125)

CWP pensions (155 / 165)

Term assurance (325 / 330)

Critical illness (340/ 345 / 350/ 355)

Income protection (360 / 365)

Income protection claims in payment (385)

Annuity (400)

UWP bond (500)

UWP savings endowment (510)

UWP target cash endowment (515)

UWP regular premium pension (525 / 545)

UWP single premium pension (525 / 545)

UWP group regular premium pension (535)

UWP group single premium pension (535)

UL bond (700)

UL savings endowment (715)

UL target cash endowment (720)

UL regular premium pension (725)

UL single premium pension (725)

UL group regular premium pension (735)

UL group single premium pension (735).

Where different expense bases apply to variants within the classes shown above in the same subfund, the basis shown must be that applicable to the largest category by number of policies. Where the expense basis varies by subfund, the table is required at subfund level. Expense bases are not required for other products. Where the *insurer* has treated some expenses as non-attributable, the amount to be shown in the table is the attributable expenses.

Expenses must be shown before adjustment for tax relief and the assumed rate of tax relief must be stated.

- (7) A table showing the unit growth rates for gross and net linked business before management charges and the inflation rates assumed for future expenses and future increases in *policy* charges.
- (8) Future bonus rates for gross premium valuations of with-profits business and for valuations of unitised with-profits business.
- (9) A summary of the lapse, surrender and paid-up assumptions using the format of the table below.

Product		Average lapse / surrender / paid-up rate for the policy years			
		1-5	6-10	11-15	16-20
Level term	lapse				
Decreasing term	lapse				
Accelerated critical illness	lapse				
Income protection	lapse				
CWP savings endowment	surrender				
CWP target cash endowment	surrender				
UWP savings endowment	surrender				
UWP target cash endowment	surrender				
UL savings endowment	surrender				

UL target cash endowment	surrender				
UWP bond	surrender				
UWP bond	automatic withdrawals				
UL bond	surrender				
UL bond	automatic withdrawals				
CWP pension regular premium	PUP				
CWP pension regular premium	surrender				
CWP pension single premium	surrender				
UWP indiv pension regular premium	PUP				
UWP indiv pension regular premium	surrender				
UWP indiv pension single premium	surrender				
UL indiv pension regular premium	PUP				
UL indiv pension regular Premium	surrender				
UL group pension regular premium	PUP				
UL group pension regular premium	surrender				
UL indiv pension single premium	surrender				

**The insurer's lapse, surrender and paid-up rates must be converted into average annual rates over the 5 year period. A simple arithmetic average of the individual annual rates is acceptable. For example, the figure for the period 610 means the average of the lapse rates in policy years 6, 7, 8, 9 and 10. For pension business assume age 40 at entry and retirement at age 65, e.g. 1620 represents surrenders from age 55 to 60. Surrender rates exclude additional surrenders at the end of the period where surrender penalties no longer apply. These additional surrenders must be disclosed in a separate note. For automatic bond withdrawals enter 'x% of current' where the current amount of withdrawal is used at policy level.**

**The distinction between individual and group pension business is the same as in Form 47 instruction 3 to allocate between product**

codes.

Where the *insurer* uses alternative bases for the same product (e.g. a basis which differentiates by source of business or subdivisions of that product), the lapse rates in an individual cell may be calculated from a basis which is used by at least 50% of the business for that product. In other circumstances an estimated weighted average must be calculated. The basis is not required for cells where the assumption will not apply to any business other than increments, or where the business is reported under a miscellaneous product code.

Where the *insurer* uses lapse rates which vary with calendar year, the rates in the table must be the average of the rates which apply to a policy of exact duration 0, 5, 10 or 15 in the five years following the valuation. A note must be provided explaining how lapse rates vary with calendar year.

Where the *insurer* uses lapse rates which vary according to whether the *mathematical reserves* are positive or negative, the table must show both sets of rates. A note must be provided explaining how the *insurer* determines which set of rates is applied.

The lapse basis is not required for products not shown in the table above. Where no allowance is made for lapses in the valuation, this must be stated.

- (10) Any other material basis assumptions not stated elsewhere.
- (11) How the valuation of liabilities allowed for *derivative contracts* (or contracts or assets having the effect of *derivative contracts*). Derivatives held in connection with options or guarantees must be included in 5. If the valuation does not correspond to the *Form 48* presentation, an explanation and reconciliation must be provided. A statement of how any out-of-the-money derivatives have been used to back liabilities must be provided.
- (12) An estimate in £m of the effect on *mathematical reserves* of specified changes in valuation methodology as at the valuation date arising from changes in *INSPRU* valuation rules effective from 31 December 2006. The effect of the changes must be analysed into the categories below.

Allowance for lapses on valuation of protection business  
Allowance for negative reserves on valuation of protection business  
Allowance for lapses on valuation of unit linked business  
Allowance for attributable expenses on valuation of unitlinked business

For protection business, the changes are assumed to be applied in the order shown, e.g. the effect of negative reserves is after the effect of lapses.

### **Options and guarantees**

Where the basic reserve exceeds the lesser of £10m and 1% of the total gross *mathematical reserves*, the methods and bases used for the calculation of the reserves options and guarantees must be given in accordance with 5(1) to 5(4). The bases must include the assumptions for the takeup of the options and guarantees. For the purposes of 5, guarantees do not include those which have already been explicitly valued (e.g. the guaranteed sum assured on endowment contracts).

5

PRA

(1) **Guaranteed annuity rate options (where the ‘asset share’ or amount of benefit may be converted, at the option of the *policy holder* from cash to annuity at a guaranteed rate), including:**

- (a) a description of the method used; and
- (b) a table showing:
  - (i) product name,
  - (ii) basic reserve,
  - (iii) spread of outstanding durations,
  - (iv) guarantee reserve,
  - (v) guaranteed annuity rate (expressed as a percentage of the cash sum for a male age 65). If there are categories of business with guaranteed annuity rates differing by more than one percentage point, these categories must be shown separately,
  - (vi) whether *policy holders* may make increments to the *policy*
  - (vii) form of the annuity (e.g. yearly in arrears, single or joint life, and so on), and
  - (viii) retirement ages.

(2) **Guaranteed surrender values and guaranteed unit linked maturity values, including:**

- (a) a description of the method and basis used; and
- (b) a table showing:
  - (i) product name,
  - (ii) basic reserve,
  - (iii) spread of outstanding durations,

- (iv) guarantee reserve,
- (v) guaranteed amount,
- (vi) MVA free conditions,
- (vii) in force premiums, and
- (viii) whether *policy holders* may make increments to the *policy*.

**(3) Guaranteed insurability options, including:**

- (a) a description of the method and basis used; and
- (b) for conversion and renewal options where the total sum assured exceeds £1b, a table showing:
  - (i) product name,
  - (ii) in force premiums,
  - (iii) sum assured,
  - (iv) description of the option, and
  - (v) guarantee reserve.

**(4) The nature of any other guarantees and options, including a description of the method and basis used, the amount of business (premium, sum assured or reserve), and the amount of additional reserve.**

*Expense reserves*

- (6)**
- PRA
- (1) The aggregate amount of expense loadings, grossed up for taxation where appropriate, expected to arise during the 12 months from the ‘valuation date’ from implicit and explicit reserves made at the ‘valuation date’ to meet expenses in fulfilling contracts in force at the ‘valuation date’. Where all expenses for the *insurer* are attributable, the amounts arising from each of the implicit allowances, explicit allowances for investment expenses and explicit allowances for other maintenance expenses. Where the *insurer* has treated some expenses as nonattributable (*INSPRU* 1.2.54AG), the *insurer* must complete the table below. The name of each risk group must be sufficient to identify the products in the group. The penultimate line is for products where all expenses are attributable.**

Homogeneous risk group	Implicit allowances	Explicit allowances (investment)	Explicit allowances (other)	Non – attributable expenses	Total
<group 1>					
...					
All expenses attributable				n/a	
Total					

- (2) A brief statement of the basis of calculating implicit allowances.
- (3) Where the amount of maintenance expenses is significantly different from the maintenance expenses shown at line 14 of *Form 43*, an explanation of this.
- (4) New business expense overrun reserve, including the method and basis of calculation (whether or not a reserve is required) in respect of the expenses of continuing to transact new business during the 12 months following the ‘valuation date’ and the amount of the reserve so calculated.
- (5) The maintenance expense overrun reserve or, where an explicit reserve has not been made for meeting the expenses likely to be incurred in future in fulfilling the existing contracts on the basis of specific assumptions in regard to the relevant factors, details of the basis used to test the adequacy of the reserves to satisfy *INSPRU 1.2.50R*, in either case stating whether redundancy costs or costs of terminating management agreements have been taken into account (with or without stating the amount of such costs).
- (6) Where the *insurer* has treated some expenses as nonattributable, details of the method used to calculate the reserve for these expenses and a table showing the reserve for each homogeneous risk group.

**Mismatching reserves**

- 7
- (1) Subject to (2), a table of the sum of the *mathematical reserves* (other than liabilities for *property linked benefits*) and the liabilities in respect of the deposits received from *reinsurers* as shown in *Form 14*, analysed by reference to the currencies in which the liabilities are expressed to be payable, together with the value of the assets, analysed by reference to currency, which match the liabilities.

PRA

- (2) Liabilities totalling up to 2% of the total under (1) may be grouped together as 'other currencies', and the assets matching those liabilities are not required to be analysed by reference to currencies as long as the proportion of such liabilities which are matched by assets in the same currency is stated.
- (3) The amount of reserve for currency mismatching and a description of the method used to calculate the reserve.
- (4) A statement of the most onerous scenario under *INSPRU* 3.1.16R for assets invested in the UK and other assets that fall under *INSPRU* 3.1.16R for the purposes of calculating the resilience capital requirement in *INSPRU* 3.1.10R.
- (5) A statement of the most onerous scenario under *INSPRU* 3.1.23R for each significant territory in which assets are invested outside the UK for the purposes of calculating the resilience capital requirement in *INSPRU* 3.1.10R.
- (6) In respect of the scenarios described under (4) and (5) which produce the most onerous requirement (whether or not a resilience capital requirement is required),
  - (a) the amount of the *resilience capital requirement* if such a requirement arises,
  - (b) the change in the aggregate amount of the *longterm insurance liabilities*, and
  - (c) the aggregate amount by which the assets allocated to match such liabilities in the scenario have changed in value from the amount of those assets shown in Form 13.
- (7) A statement of any further reserve made arising from the test on assets in *INSPRU* 1.1.34R together with a brief description of the method used and assumptions made to calculate any such reserve.

*Other special reserves*

- 8 PRA For other special reserves which exceed the lesser of £10m and 0.1% of total *mathematical reserves*, the nature and amount of the reserves, including (where the reserve is greater than the lesser of £10m and 0.5% of total *mathematical reserves*) a description of the method and basis used to calculate each reserve.

*Reinsurance*

- 9 PRA (1) For long-term insurance business ceded on a facultative basis to a reinsurer who is not authorised to carry on insurance business in the United Kingdom at any time during the report period –
- (a) the aggregate of premiums payable by the *insurer* to all such *reinsurers* (subdivided according to financial years, if appropriate) and the aggregate amount deposited at the

**'valuation date' under any *deposit back arrangement*; and**

- (b) the amount of any such premiums payable by the insurer to any reinsurer which is a connected company of the insurer and the aggregate amount deposited at the 'valuation date' under any deposit back arrangement.**

**(2) Where:**

- (a) the treaty is a 'financing arrangement'; or**
- (b) premiums under (f) exceed the lesser of £10m and 1% of *gross premiums*; or**
- (c) reserves under (j) exceed the lesser of £10m and 1% of total *mathematical reserves*,**

**a table showing for each treaty, or group of similar treaties, of *reinsurance* where the *insurer* is the *cedent* and under which business is in force at the 'valuation date':**

- (d) the name of the reinsurer;**
- (e) an indication of the nature and extent of the cover given under the treaty;**
- (f) the premiums payable by the *insurer* under the treaty during the report period;**
- (g) the amount deposited at the 'valuation date' in respect of the treaty under any *deposit back arrangements*;**
- (h) whether the treaty is closed to new business.**
- (i) the amount of any undischarged obligation of the insurer;**
- (j) the amount of mathematical reserves ceded under the treaty; and**
- (k) the retention by the *insurer* (e.g., x% up to £Y) for new *policies* being *reinsured*,**

**with a note setting out:**

- (l) whether the *reinsurer* is authorised to carry on *insurance business* in the United Kingdom;**
- (m) whether the *reinsurer* is a *connected company* of the *insurer*;**
- (n) a description of any material contingencies, such as credit risk or legal risk, to which the treaty is subject;**

- (o) the extent to which provision has been made for any liability of the *insurer* to refund any amounts of *reinsurance* commission in the event of lapses or surrender of the contract; and
- (p) for each 'financing arrangement':
  - (i) a brief description of the conditions for the discharge of any undischarged obligation of the *insurer*, and
  - (ii) a description of how, if at all, all such undischarged obligations have been taken into account in the valuation, including a description of the impact of the arrangement on the reported valuation result and any allowance made for contingencies, such as credit risk or legal risk, associated with the financing arrangement for the purposes of the *return*.

(3) In this paragraph 9:

- (a) *financing arrangement* means any contract entered into by the *insurer*, in respect of *contracts of insurance* of the *insurer*, which has the effect of increasing the long term capital resources in line 11 of *Form 2*, and which includes terms for
  - (i) the transfer of assets to the *insurer*, the creation of a *debt* to the *insurer* or the transfer of liabilities to *policy holders* from the *insurer* (or any combination of these), and
  - (ii) either an obligation for the *insurer* to return (with or without interest) some or all of such assets, a provision for the diminution of such *debt* or a provision for the recapture of such liabilities, in each case, in specified circumstances; and
- (b) paragraphs (1), (2) and (3)(a) of rule 9.28 (which relate to connected persons) have effect for the purposes of this paragraph as they have effect for the purposes of those rules.

*Reversionary (or annual) bonus*

10

PRA

- (1) Where the *mathematical reserves* under (b) exceed the lesser of £10m and 1% of the total *mathematical reserves*, a table showing (by bonus series):
  - (a) name of bonus series;
  - (b) amount of *mathematical reserves*;

- (c) reversionary bonus rate for the *financial year in question*;
  - (d) reversionary bonus rate for the preceding *financial year*,  
and
  - (e) total guaranteed bonus rate for the *financial year in question* (whether in the form of a guaranteed cash benefit, guaranteed investment return or reversionary bonus).
- (2) For unitised with-profits business, the table under (1) must show the percentage increase in unit price during the year or the equivalent in bonus units added.
- (3) For super compound bonuses, the table under (1) must show both rates (e.g., 2%/3% for 2% bonus on the sum assured and 3% bonus on the existing bonus).
- (4) For bonus series where bonus rates vary (e.g., by age or term), the table must show an approximate weighted average reversionary bonus and a note must be included stating the factors by which reversionary bonus rates vary. If they vary according to premium paying status, bonus rates must be shown in separate lines.

## Appendix 9.4A (rule 9.31(b))

### Abstract of Valuation Report for Realistic Valuation

The following information must be provided in the abstract of the report required under rule 9.31(b), the answers being numbered to accord with the numbers of the corresponding paragraphs of this Appendix. For the purposes of this Appendix, the “report period” means the period from the previous calculation of the *with-profits insurance capital component* under rule 9.4(2)(c) related to the ‘valuation date’ (as defined in 1).

#### *Introduction*

- 1
- (1) The date to which the actuarial investigation relates, namely, the *valuation date*.
- PRA
- (2) The date of the previous valuation.
- (3) The dates of any interim valuations carried out since the previous ‘valuation date’.

#### *Assets*

- 2
- (1) For each *with-profits fund* in which any *non-profit insurance contracts* are written, a table of the economic assumptions used to determine the value of future profits (or losses) on those contracts, showing the economic assumptions used at the end of the *financial year in question*, and used at the end of the *preceding financial year*.
- PRA
- (2) For each *with-profits fund* in respect of which the *realistic value of the assets* includes an amount determined under *INSPRU 1.3.33R(2)*, a table of the economic assumptions used to determine any additional amount by reference to the value of future profits (or losses) on *non-profit insurance contracts* according to *INSPRU 1.3.33R(3)(b)(iii)*.
- (3) For each *with-profits fund* in respect of which an asset not exceeding 50% of the present value of future profits arising from insurance contracts written outside the *with-profits funds* is included in the relevant assets for the purpose of *INSPRU 1.3.43R* in accordance with *INSPRU 1.3.45R(2)(c)* and *INSPRU 1.3.45R(5)*, a table of the economic assumptions used to determine that present value.
- (4) Where the valuation of the future profits (or losses) on *non-profit insurance contracts* in (1) or of any additional amount in (2) or of any present value in (3) involves more than one set of economic assumptions, (for example, different sets of economic assumptions are used for different *with-profits funds*), each different set of economic assumptions must be shown.

#### *With-profits benefits reserve liabilities*

- 3
- (1) For each *with-profits fund*, a table of the retrospective methods (see *INSPRU 1.3.119R*) and/or prospective methods (see *INSPRU 1.3.128R*) used to calculate the *with-profits benefits reserve* for that fund,
- PRA

showing:

- (a) the types of product or classes of *with-profits insurance contracts* to which each of the retrospective methods and/or prospective methods applies;
  - (b) for each type of product or class of *with-profits insurance contracts* and method, the corresponding amounts of the *with-profits benefits reserve* and the *future policy related liabilities*; and
  - (c) the aggregate amount of the *with-profits benefits reserve* and the *future policy related liabilities* for those types of product or classes of *with-profits insurance contracts* which are not required to be disclosed separately (in accordance with 3(3)).
- (2) If the total of the amounts of the *with-profits benefits reserve* and *future policy related liabilities* shown in the table under (1) do not correspond to the respective amounts shown at lines 31 and 49 of the appropriate Form 19, an explanation and reconciliation must be provided.
  - (3) The separate disclosure of the retrospective methods and prospective methods used to calculate the *with-profits benefits reserve* of a *with-profits fund* is not required for types of products and/or classes of *with-profits insurance contracts* to the extent the aggregate amount of the *realistic value of liabilities* for all types of products and/or classes of *with-profits insurance contracts* in respect of which the valuation methods are not disclosed is less than the higher of 5% of the *realistic value of liabilities* for that fund and £20 million.
  - (4) References in paragraph 3 of this Appendix to types of product and/or classes should be taken as meaning the constituent elements of a division of the portfolio of *with-profits insurance contracts* by grouping those contracts having regard to materially different guarantees and options such as pension contracts with minimum bonuses and annuity rate options, pension contracts with minimum bonuses, pension contracts with no minimum bonuses, life bonds issued with no Market Value Reduction / Market Value Adjustment type clauses (MVR/MVAs), life bonds with spot MVR/MVA free dates (dates on which the MVR/MVAs do not apply), life bonds with no MVR/MVA free dates, etc.. The extent of disclosure should be sufficient to permit an identification of material groupings of contracts which offer significant variance in terms of the nature of benefits provided to *policyholders*.

*With-profits benefits reserve – Retrospective method*

- 4
- PRA
- (1) For each *with-profits fund*, a table of the retrospective methods used to calculate the *with-profits benefits reserve* showing for each retrospective method:
    - (a) the proportion of the *with-profits benefit reserve* calculated using that retrospective method for which contracts have been valued on an individual basis;

- (b) the proportion of the *with-profits benefit reserve* calculated using that retrospective method for which contracts have been valued on a grouped basis; and
  - (c) in relation to any *with-profits insurance contracts* that have been grouped:
    - (i) a statement of the basis used to group contracts;
    - (ii) the number of individual contracts and the number of model points used to represent them; and
    - (iii) the nature of the validations made to ensure that significant attributes of the contract groupings have not been lost.
- (2) For each *with-profits fund*:
- (a) a description of any significant changes to the valuation method for any types of product or classes of *with-profits insurance contracts* written in that fund compared to the previous valuation; and
  - (b) where the changes in (a) have resulted in any types of product or classes of *with-profits insurance contracts* written in that fund being valued using approaches more approximate than used for the previous valuation, a statement of the types of product or classes of *with-profits insurance contracts* affected.
- (3) For each *with-profits fund*, a description of the basis of allocating expenses to that fund during the *financial year in question* identifying:
- (a) the date of the previous expense investigation;
  - (b) the frequency of expense investigations;
  - (c) a table of the total expenses allocated to the *with-profits benefits reserve* during the *financial year in question* showing:
    - (i) the nature and amount of expenses identified as initial expenses;
    - (ii) the nature and amount of expenses identified as maintenance expenses;
    - (iii) how expenses are charged to the *with-profits benefits reserve* in respect of individual contracts (for example, by way of an average expense charge deducted from all contracts); and
    - (iv) the nature and amount of any expenses charged other than to the *with-profits benefits reserve*.

- (4) For each *with-profits fund*, a description of the nature and amount of any significant charges (for example for the costs of guarantees or the use of capital) deducted from the *with-profits benefits reserve* during the *financial year in question* and a comparison to the charges in the *preceding financial year*.
- (5) For each *with-profits fund*, a description of the nature and amount of any charges deducted from that fund for noninsurance risk (for example, charges deducted from investment only accumulating with-profit business).
- (6) For each *with-profits fund*, a statement (expressed as a percentage) of the ratio of A to B for each of the three *preceding financial years* where:
- A is the total *claims* paid during the financial year on *with-profits insurance contracts* written in that fund; and
- B is the sum of:
- (i) *with-profits benefits reserve* for those *claims*; plus
  - (ii) any past miscellaneous surplus attributed to the *with-profits benefits reserve* in respect of those *claims*; less
  - (iii) any past miscellaneous deficit attributed to the *with-profits benefits reserve* in respect of those *claims*;

Where there has been a change in procedures such that the ratio of A to B would not be directly comparable from year to year, details should be disclosed as to the change in procedures.

- (7) For each *with-profits fund*, the investment return before tax and expenses allocated to the *with-profits benefits reserve* in respect of the *financial year in question*. If the investment return allocated to the *with-profits benefits reserve* in respect of any types of product or classes of *with-profits insurance contracts* differs materially from that allocated to the *with-profits benefits reserve* in respect of other types of product or classes of *with-profits insurance contracts*, other than because of tax, an explanation and reconciliation must be provided.

*With-profits benefits reserve – Prospective method*

5

PRA

- (1) For each *with-profits fund*, a table of the key assumptions used in the prospective method(s) of calculating the *with-profits benefits reserve* showing:
- (a) the discount rate, together with an explanation of any difference between this rate and the risk free rates denoted "r" in the table required by 6(4)(a)(iii) below;
  - (b) the investment returns and risk adjustments made to assets (categorised as in Form 48);

- (c) expense inflation;
  - (d) future assumed *annual* and *final bonus* rates for major types of products and/or classes of *with-profits insurance contracts*;
  - (e) assumptions as to future expenses and future charges for expenses for major types of products and/or classes of *with-profits insurance contracts*; and
  - (f) any significant persistency assumptions at quinquennial durations.
- (2) Where any of the prospective methods in (1) involves more than one set of key assumptions, each different set of key assumptions must be shown.

*Costs of guarantees, options and smoothing*

6

PRA

- (1) For each *with-profits fund*, where the costs of guarantees, options and smoothing do not exceed the lesser of £50m and 0.5% of the total *realistic value of liabilities*, disclosure of the valuation methods in accordance with the following subparagraphs is not required.
- (2) For each *with-profits fund*, a table of the valuation methods used to calculate the costs of guarantees, options and smoothing showing:
- (a) the types of product and/or classes of *with-profits insurance contracts* to which each valuation method applies;
  - (b) for each valuation method and each type of product and/or class of *with-profits insurance contract*:
    - (i) the proportion, measured by reference to the underlying asset shares, of the *with-profits insurance contracts* being valued for which costs have been valued on an individual basis;
    - (ii) the proportion, measured by reference to the underlying asset shares, of the *with-profits insurance contracts* being valued for which costs have been valued on a grouped basis; and
    - (iii) in relation to any *with-profits insurance contracts* that have been grouped,
      - a statement of the basis used to group contracts;
      - the number of individual contracts and the number of model points used to represent them; and
      - the nature of the validations made to ensure that significant attributes of the contract groupings have not been lost;

- (c) if applicable to the disclosures in (a) and (b), a description of any significant approximations in method used for any residual types of product or classes of *with-profits insurance contracts*.
- (3) A description of any significant changes to the valuation methods for valuing the costs of guarantees, options or smoothing since the previous valuation.
- (4) For each of the valuation methods under (2)(b), the following information must be disclosed:
- (a) for each of the costs of guarantees, options and smoothing which have been valued using a full stochastic approach:
- (i) the nature of the guarantee, option or smoothing being valued, including a description of the extent to which the guarantee or option is in or out of the money at the valuation date;
- (ii) a description of the nature of the asset model(s), including the choice of parameters for each model (including the assumed volatility of assets both short term and long term) and any assumed correlations between asset classes and/or between asset classes and economic indicators (such as inflation), and a justification for these assumptions;
- (iii) completion of the following table showing the annualised compound equivalent of the risk free rate(s) assumed for each duration (n) and values derived from the asset model(s) of specified assets/options as shown in the table:

	n	Asset type (all UK assets)	K=0.75				K=1				K=1.5			
			5	15	25	35	5	15	25	35	5	15	25	35
r		Annualised compound equivalent of the risk free rate assumed for the period. (to two decimal places)					x	x	x	x	x	x	x	x
1		Risk-free zero coupon bond					x	x	x	x	x	x	x	x
2		FTSE All Share Index (p=1)												
3		FTSE All Share Index (p=0.8)												



All references to 15 year bonds mean rolling bonds traded to maintain the 15 year duration at all future dates. The corporate bonds should be assumed to be rolling AA rated zero coupon bonds.

Row 16 should be completed showing the value of sterling receiver swaptions with a strike of 5% exercisable n years after the valuation date with swap durations on exercise of L years.

The values should be expressed as a percentage of nominal.

In carrying out the calculations required to complete the table above firms must assume, where appropriate, that the options for which a value is to be included in the table are options which, where appropriate, are based on underlying asset portfolios which are continuously rebalanced to the stated proportions. Swaptions in relation to which a value must be included in the table must be based on swaptions with monthly payments. Firms must include in the table the value that their liability model would produce for such options and values will thus reflect the actual time-intervals underlying their valuation models. The property put options should be assumed to relate to a well diversified portfolio of *United Kingdom* commercial property.

A zero trend growth in property prices should be assumed where this is relevant.

In each case the options should be valued with reinvestment of any dividend income into the FTSE All Share index and reinvestment of any rental or other property income into *United Kingdom* property.

Tax should be ignored in all calculations.

All options should be assumed to be European-style.

A *firm* may consider that its model does not need to be calibrated to produce a reasonable value for a particular entry in the table because that entry is insignificant to the valuation of its assets and liabilities. In such circumstances the *firm* may leave an entry in the table blank, but must give an explanation as a note to the table.

- (iv) **a statement of the initial equity and property rental yields assumed for the *United Kingdom* and each significant territory as applicable;**
- (v) **for each significant territory other than the *United Kingdom* a statement of the entries that would be appropriate (for K=1 only) for the risk free rate and lines 1 and 2;**
- (vi) **a table showing the outstanding durations of significant guarantees within material types of products and/or classes of *with-profits insurance contracts* together with the details of the fit of the asset model(s) to specimen relevant market-traded instruments at these durations;**
- (vii) **a statement of the nature of the validations of the asset model(s) by projecting future income, gains and losses on asset values and comparing the net present value of these amounts to the current asset values;**
- (viii) **a statement of the number of projections of assets and liabilities carried out and the nature of the validations to ensure reasonable convergence of the model results;**
- (b) **for each of the costs of guarantees, options and smoothing which have been valued using the market costs of hedging:**
  - (i) **a description of the method and assumptions used to determine the option points and amounts implied by the**

- underlying guarantee or option or smoothing;
- (ii) a description of the method and assumptions used to value the implied options and hence to determine the costs of the underlying guarantee, option or smoothing (including the assumed volatility of assets both short term and long term and any assumed correlations between asset classes and/or between asset classes and economic indicators (such as inflation) and also including a description as to how those assumptions relate to available market traded instruments and have been assumed to apply in respect of nonavailable instruments);
  - (iii) completion of a table as at 6(4)(a)(iii) above showing the risk free rate(s) assumed and values derived from the asset model(s) of assets/options as shown in the table;
  - (iv) a statement of the equity and property rental yields assumed for the *United Kingdom* and each significant territory as applicable;
  - (v) a table showing the outstanding durations of significant guarantees within material types of products and/or classes of *with-profits insurance contracts*;
- (c) for each of the costs of guarantees, options and smoothing which have been valued using a series of deterministic projections using attributed probabilities:
- (i) a description of the number of projections of assets and liabilities carried out, the attributed probability to each projection and the range of key assumptions underlying the projections of assets and liabilities;
  - (ii) a description of how the range of projections was selected and how the attributed probabilities were determined;
  - (iii) completion of a table as at 6(4)(a)(iii) above showing the risk free rate(s) assumed and values derived from the asset model(s) of assets/options as shown in the table;
  - (iv) a table showing the outstanding durations of significant guarantees within material types of products and/or classes of *with-profits insurance contracts*.
- (5) Where management actions have been assumed in the projection of assets and liabilities used to determine the costs in (4) (a), (b) and (c):
- (a) a description of the nature of the management actions assumed in the projection of assets and liabilities; and

(b) a table of the *firm's* best estimates as to the future proportions of the assets backing the *with-profits benefits reserve* which would consist of equities (whether UK or non-UK) and as to future bonus rates, in each case as at the end of the *financial year in question*, in 5 years time and in 10 years time, making the three sets of assumptions described in this paragraph as to annual investment returns over the periods in question. The table must show, in addition to the specimen equity backing ratios (for the fund), *annual bonus* rates on significant accumulating with-profits business (for each of life and pensions business separately). Calculations should be made assuming that the annual investment return on all assets over the period in question is (i) based on forward rates derived from the risk free interest rate curve as calibrated at the valuation date (ii) based on forward rates derived from the risk free interest rate curve increased across the period by 17.5 % of the long-term gilt yield and (iii) based on forward rates derived from the risk free interest rate curve reduced across the period by 17.5 % of the long-term gilt yield. The effect of any significant assumed equity *derivative contracts* or contracts having the effect of *derivative contracts* on the values disclosed in the table should be described by note. The long-term gilt yield is as defined in *INSPRU 1.3.11R*.

(6) A summary of the surrender and paid-up assumptions used to determine the costs in (4) (a), (b) and (c) using the format of the table below, and where appropriate a statement of the assumed take-up rates of guaranteed annuity options and the rates of annuitant mortality assumed.

Product		Average lapse / surrender / paid-up rate for the policy years			
		1-5	6-10	11-15	16-20
CWP savings endowment	surrender				
CWP target cash endowment	surrender				
UWP savings endowment	surrender				
UWP target cash endowment	surrender				
UWP bond	surrender				
UWP bond	automatic withdrawals				
CWP pension regular premium	PUP				
CWP pension regular premium	surrender				

CWP pension single premium	surrender				
UWP indiv pension regular premium	PUP				
UWP indiv pension regular premium	surrender				
UWP indiv pension single premium	surrender				

The instructions for completing the table are as for Appendix 9.4 paragraph 4(9).

- (7) A statement of the assumptions made, regarding the foreseeable actions that would be taken by *policyholders*, in the projection of assets and liabilities in (4) (a), (b) and (c).

*Financing costs*

- 7  
PRA Where financing arrangements exist in connection with any *with-profits fund(s)*, a statement of the type of financing, the sources available for repayment of capital and interest, the extent to which repayments are subordinated to *policyholders'* interests, the face amount outstanding, the rate of interest payable, the level of fees payable, the expected amount to be repaid and the expected time period for such repayment (or, in the case of reinsurance arrangements, recapture).

*Other long-term insurance liabilities*

- 8  
PRA For each *with-profits fund*, a statement of the nature and amount of *long-term insurance liabilities* which have been included within the amounts of 'any other liabilities related to regulatory duty to treat customers fairly' and 'any other long-term insurance liabilities' shown at lines 46 and 47 of Form 19, including disclosure of any value attributed to future tax relief.

*Realistic current liabilities*

- 9  
PRA A statement of the nature and amount of current liabilities which have been included within the amount of the *realistic current liabilities* shown at line 51 of Form 19 together with a reconciliation to the amount of the *regulatory current liabilities*.

*Risk capital margin*

- 10 For the calculation of the *risk capital margin* for each *with-profits fund*:

- PRA (a) a statement of the amount of the *risk capital margin* and of information relating to the individual scenarios in *INSPRU* 1.3.44R which comprise the most adverse scenario for the purposes of calculating that margin in accordance with *INSPRU* 1.3.43R, including:
- (i) the percentage change assumed in accordance with *INSPRU* 1.3.68R for each of the market values of equities and real estate for the purpose of the *market risk* scenario for *United Kingdom* assets and each significant territory in *INSPRU* 1.3.62R(1)(a), and a statement as to whether a rise or fall was the most onerous in

each case;

- (ii) the nominal change in yields assumed in accordance with *INSPRU 1.3.68R* for fixed interest securities for the purpose of the *market risk* scenario for *United Kingdom* assets and each significant territory in *INSPRU 1.3.62R(1)* together with a statement of the percentage change in and level of the long-term gilt yield or nearest equivalent assumed in each case and a statement as to whether a fall or rise in yields is the more onerous in each case);
  - (iii) the average change in spread for bonds (weighted by value) and the total percentage change in asset value separately for (a) bonds, (b) debts, (c) *reinsurance* (d) analogous non-*reinsurance* financing agreements and (e) other assets (by reference to *INSPRU 1.3.78R*), where the total percentage change is, in each case, calculated as the overall percentage change that results from applying the credit risk scenario to the actual assets of each type held by a firm;
  - (iv) the overall percentage change in the *realistic value of liabilities* that results from applying the persistency risk scenario according to *INSPRU 1.3.100R*, that is, the impact of the persistency risk scenario assuming the market and credit risk stress scenarios have occurred; and
  - (v) to the extent any change in asset value in (iii) is not materially independent of the change in liability values in (iv), a description of the approach to deriving the disclosed changes in asset and liability values;
- (b)
- (i) a statement of the nature of any management actions assumed in the *risk capital margin* calculation that are in addition to those set out in 6(5)(a) above; and any material changes to other assumptions;
  - (ii) a statement of the impact of such actions and assumption changes on the *risk capital margin*; namely the difference between the *risk capital margin* with such actions and assumption changes, and without. An approximate split of the effect of actions and the effect of actions and the effect of assumption changes must be given;
  - (iii) a statement of the approximate change to the table in 6(5)b, that shows future proportions of equity assets and bonus rates, resulting from any such additional actions and assumptions changes being integrated into the projection of assets and liabilities and thus disclosed in 6(5)(a);
  - (iv) a statement as to whether the requirements of *INSPRU 1.3.188R* would be met if any such additional actions and assumptions changes had been integrated into the protection of assets and liabilities and thus disclosed in 6(5)(a);

- (c) (i) a statement of the nature of the assets (categorised as in Form 48) and location of assets held to cover the *risk capital margin*;
- (ii) if any of the assets to cover the *risk capital margin* are located outside of the *with-profits fund*, a statement as to the way the firm would intend to make such assets available to the *with-profits fund* should the need arise.

*Tax*

- 11 A statement of the *firm's* treatment of tax included on assets backing (i) the *with-profits benefits reserve(s)*, (ii) any *future policy related liabilities* and (iii) any *realistic current liabilities*, including any simplifying assumptions.

*Derivatives*

- 12 A full description of any major positions in relation to *derivative contracts* or contracts having the effect of *derivative contracts* held by the *with-profits fund* or located outside the *with-profits fund* to cover the *risk capital margin* in part or in full at the valuation date.

*Analysis of change in working capital*

- 13 For each *with-profits fund*, a reconciliation of the significant movements in the working capital of the *with-profits fund* from that shown at line 68 of Form 19 at the end of the *preceding financial year* and that same entry shown for the *financial year in question*. Such movements may be grouped by the underlying cause of movements such as investment market changes and insurance variation. However, the analysis should at least include, where material:

- (a) the investment return on the opening working capital;
- (b) mismatched profits and losses on assets backing the *future policy related liabilities* (may include associated assumption changes);
- (c) assumption changes split by economic, noneconomic and *policyholder actions* assumptions;
- (d) other variances split at least as to economic and noneconomic variances;
- (e) the impact of new business;
- (f) changes in other liabilities of lines 47 and 51 of Form 19;
- (g) modelling changes and opening adjustments.

Where a closed fund zeroes its working capital (e.g. by assigning any balance to planned enhancements or financial reinsurance), it should analyse the change in working capital prior to such zeroisation showing the opening and closing zeroisation impact.

*Optional disclosure*

- 14 At the option of the *firm*, a statement may be made for each *with-profits fund* of the amount of the *realistic value of liabilities* which relates to contractual

**obligations to *policyholders*, with a description of the approach taken to distinguishing contractual and non-contractual obligations to *policyholders*.**

***Instructions to the report***

**Adhere to numbering above, enter 'not applicable' or 'de minimis' for sections where there is nil or de minimis data.**

## Appendix 9.5 (rule 9.32)

### General Insurance Business

#### Additional Information on Business Ceded

For the purposes of rule 9.32, an *insurer* which carries on *general insurance business* must, in respect of the *financial year in question*, prepare a statement of the following information.

- 1 **PRA** Subject to 2, for each *contract of insurance* entered into or modified during the *financial year in question* under which *general insurance business* has been ceded by the *insurer* on a non-facultative basis, the *insurer* must prepare a statement of –
- (a) the type of business covered by reference to *risk categories* and if only part of a *risk category* is covered, a description of that part;
  - (b) the type of cover, including such details of the terms and conditions of the contract as are necessary for a proper understanding of the nature of the cover;
  - (c) the type of business covered by reference to *risk categories* and if only part of a *risk category* is covered, a description of that part;
  - (d) the period of cover.
- 2 **PRA** Where a contract of *reinsurance* has been modified during the *financial year in question* –
- (a) no information need be supplied pursuant to 1 in respect of a contract of reinsurance which was entered into before the beginning of the *financial year* of the *insurer* to which the Insurance Companies (Accounts and Statements) Regulations 1996 first applied; and
  - (b) in any other case, the information to be supplied pursuant to 1 must be limited to any changes to the information previously supplied pursuant to that paragraph or its predecessor legislation in respect of that contract.
- 3 **PRA** For every contract reported pursuant to 1, whether in the *return* for the *financial year in question* or any previous *return*, the *insurer* must also prepare, if relevant, a statement of –
- (a) in the case of contracts which are subject to no or a limited number of reinstatements, any contract not previously reported pursuant to this provision (or its predecessor) under which it is anticipated that such limit will be exhausted by claims (including claims incurred, but not reported, in respect of any specific occurrence for which provisions have been allocated);

- (b) the percentage of cover, if in excess of 10% and if such information has not already been included in the return of the insurer for any previous financial year, which has been ceded to reinsurers which have ceased to pay claims to their reinsureds in full, whether because of insolvency or for any other reason; and
- (c) if the percentage specified in (b) has increased by more than 10 percentage points since the previous financial year in which it was included in the insurer's return, a statement of that percentage unless, in the opinion of the directors, the likelihood of any claim being incurred under that policy is minimal.

4

PRA

- (1) For each *risk category*, or part thereof, in respect of which separate non-facultative *reinsurance* cover has been obtained, the *insurer* must prepare a statement of the 'maximum net probable loss' to the *insurer* from any one *contract of insurance* effected by it and from all such contracts taken together.
- (2) For the purposes of (1), the *maximum net probable* loss is the maximum loss (net of *reinsurance*) arising from any one incident, or any one series of incidents from the same originating cause, which –
  - (a) the *directors*, at the time they decided upon the *reinsurance* cover in respect of the *financial year in question*, reasonably contemplated to be of a type which might take place during that *financial year*; or
  - (b) has actually occurred during the *financial year in question*.
- (3) The disclosure required by (1) must be given in respect of all *risk categories*, or parts thereof, of the *insurance business* carried on by the *insurer* whether or not the *insurer* has purchased any *reinsurance* cover for that *risk category*, or part thereof, and in (2) deciding upon the *reinsurance* cover includes deciding not to obtain any *reinsurance* cover.

5

PRA

For each *combined category* (other than *category numbers* 500 and 600) and *risk category* with *category numbers* 160, 350, 400, 510 to 590, 610 to 690 and 700 and separately for contracts of facultative and non-facultative *reinsurance* ceded in respect of the *financial year in question* the amount of the *reinsurers'* share of *gross premiums* must be stated.

## Appendix 9.6 (rules 9.34 and 9.35)

### Certificates by Directors and Report of the Auditor

#### *Part I: Certificate by directors*

- 1 (1) Subject to 3, the certificate required by rule 9.34 must state –
- PRA (a) that the *return* has been properly prepared in accordance with the requirements in *IPRU(INS)*, *GENPRU* and *INSPRU*; and
- (b) that the *directors* are satisfied that:
- (i) throughout the *financial year in question*, the *insurer* has complied in all material respects with the requirements in *SYSC* and *PRIN* as well as the provisions of *IPRU(INS)*, *GENPRU* and *INSPRU*; and
- (ii) it is reasonable to believe that the *insurer* has continued so to comply subsequently, and will continue so to comply in future.
- (2) An *insurer* does not comply in all material respects with the requirements specified in (1)(b) if it commits a breach of any of those requirements which is significant, having regard to the potential financial loss to *policyholders* or to the *insurer*, frequency of the breach, implications for the *insurer's* systems and controls and if there were any delays in identifying or rectifying the breach.
- 2 Subject to 3, if the *insurer* carries on *long-term insurance business*, the certificate required by rule 9.34(1) must also state that –
- PRA (a) in the *directors' opinion*, *premiums* for contracts entered into during the *financial year* and the resulting income earned are sufficient, under reasonable actuarial methods and assumptions, and taking into account the other financial resources of the *insurer* that are available for the purpose, to enable the *insurer* to meet its obligations in respect of those contracts and, in particular, to establish adequate *mathematical reserves*;
- (b) the sum of the *mathematical reserves* and the deposits received from *reinsurers* as shown in *Form 14* constitute proper provision at the end of the *financial year in question* for the *long-term insurance liabilities* (including all liabilities arising from *deposit back arrangements*, but excluding other liabilities which had fallen due before the end of the *financial year*) including any increase in those liabilities arising from a distribution of surplus as a result of an *actuarial investigation* as at that date into the financial condition of the *long-term insurance business*;
- (c) the *with-profits fund* has been managed in accordance with the *Principles and Practices of Financial Management*, as established, maintained and recorded under *COBS 20.3* of the *FCA Handbook*; and

- (d) the *directors* have, in preparing the *return*, taken and paid due regard to –
- (i) advice from every *actuary* appointed by the *insurer* to perform the *actuarial function* in accordance with SUP 4.3.13R; and
  - (ii) if applicable, advice from every *actuary* appointed by the *insurer* to perform the *with-profits actuary function* in accordance with SUP 4.3.16AR.

- 3
- (1) Where, in the opinion of those signing the certificate, the circumstances are such that any of the statements required by 1 and 2 cannot truthfully be made, the relevant statements must be omitted.
- (2) Where, by virtue of (1), any statements have been omitted from the certificate, this fact, and the reasons for omission, must be stated in a note to the certificate.

PRA

*Part IA – Certificate by a director on the half-yearly balance sheet and report for realistic valuation*

- 3A Subject to 3C, the certificate required by rule 9.34(2) must state that the *return* has been properly prepared in accordance with the requirements in *IPRU(INS)*, *GENPRU* and *INSPRU*.

PRA

- 3B Subject to 3C, the certificate required by rule 9.34(2) must also state that –

PRA

- (a) the amount provided for *long-term insurance liabilities* for the purpose of determining the *insurer's capital resources* as shown in *Form 2* constitutes proper provision at the end of the six month period referred to in rule 9.3A(1) for those liabilities (including all liabilities arising from *deposit back arrangements*); and
- (b) the *director* has, in preparing the *return*, taken and paid due regard to –
  - (i) advice from every *actuary* appointed by the *insurer* to perform the *actuarial function* in accordance with SUP 4.3.13R; and
  - (ii) advice from every *actuary* appointed by the *insurer* to perform *with-profits actuary function* in accordance with SUP 4.3.16AR of the *FCA Handbook* and SUP 4.3.16R of the *PRA Handbook*.

- 3C
- (1) Where, in the opinion of the *director* signing the certificate, the circumstances are such that any of the statements required by 3A and 3B cannot truthfully be made, the relevant statements must be omitted.
- (2) Where, by virtue of (1), any statements have been omitted from the certificate, this fact, and the reasons for omission, must be stated in a note to the certificate.

PRA

*Part II – Auditor's report*

- 4 The report required by rule 9.35 must, in addition to any statement required under rule 9.35, state:

PRA

- (a) whether, in the auditor's opinion:
- (i) the documents referred to in rules 9.12, 9.13 and 9.14, together with *Forms 40 to 45, 48, 49, 56, 58 and 60* and the statements, analyses and reports annexed pursuant to rules 9.24 to 9.27, 9.29 and 9.31 have been properly prepared in accordance with the *Accounts and Statements Rules, GENPRU and INSPRU*; and
  - (ii) the methods and assumptions determined by the *insurer* and used to perform the *actuarial investigation* (as set out in the valuation reports) appropriately reflect the requirements of *INSPRU 1.2 and INSPRU 1.3*.
- (b) that, in accordance with rule 9.35(1A), to the extent that any document, Form, statement, analysis or report to be audited under rule 9.35(1) contains amounts or information abstracted from the *actuarial investigation* performed pursuant to rule 9.4, the auditor has obtained and paid due regard to advice from a suitably qualified *actuary* who is independent of the *insurer*.

5 [deleted]

6 [deleted]

7 [deleted]

8 [deleted]

9 [deleted]

10 [deleted]

11 [deleted]

12 Where the auditors refer in their report or in any note attached to it to any uncertainty, the report must state whether, in the auditors' opinion, that

PRA

uncertainty is material to determining whether the *insurer* has available assets in excess of its *capital resources requirement*.



**Appendix 9.7** (Rule 9.37)

**Insurance Statistics: Other EEA States**

(FORMS 91 TO 94)

The statements to be provided under rules 9.37 and 9.38 must be given in the form set out in *Forms 91 to 94*.



***Instruction for completion of Form 91***

**PRA**

- 1**      **The box described as "EEA State in which branch is situated" must be completed by inserting the appropriate Code from the *PRA* list of "Country Codes".**

**General insurance business : Analysis of financial particulars - provision of services**

Name of insurer

EEA State in which risk is situated

Company registration number	<u>Calendar year ended</u>			Units	EEA State in which risk is situated
F92	day	month	year	£000	
	31	12			

Groups of Classes							
Accident and sickness  1	Land vehicles, goods in transit and motor vehicle liability (carrier's liability only) 2	Motor vehicle liability (excluding carrier's liability)  3	Fire and other damage to property  4	Aviation, marine and transport  5	General liability  6	Credit and suretyship  7	Other classes  8

Gross premiums written in calendar year	11								
Cost of gross claims paid in calendar year	12								
Cost of gross commission attributable to premiums shown at line 11	13								

***Instructions for completion of Form 92***

**PRA**

- 1**        **The box described as "EEA State in which risk is situated" must be completed by inserting the appropriate Code from the *PRA* list of "Country Codes".**
  
- 2**        **Gross commission attributable equals gross commission paid in the *financial year in question* plus gross commission brought forward less gross commission carried forward.**

**Long term insurance business : Analysis of financial particulars - branches**

Name of insurer

EEA State in which risk is situated

Company registration number	Calendar year ended			Units	EEA State in which branch is situated
	day	month	year		
<b>F93</b>	<b>31</b>	<b>12</b>		<b>£000</b>	

Authorisation classes									Total (1+2+3+4+5+6+7+8+9)
I Life and annuity  1	II Marriage and birth  2	III Linked long term  3	IV Permanent health  4	V Tontines  5	VI Capital redemption  6	VII Pension fund management  7	VIII Collective insurance etc.  8	IX Social insurance  9	

**Income**

Gross premiums written	<b>11</b>									
Net income from investments	<b>12</b>									
Other technical income net of reinsurance	<b>13</b>									
<b>Total (11+12+13)</b>	<b>19</b>									

**Expenditure**

Claims paid, gross amount	<b>21</b>									
Change in provision for claims and mathematical reserves, gross amount	<b>22</b>									
Bonuses	<b>23</b>									
Management expenses	Acquisition costs, change in deferred acquisition costs and administrative expenses	<b>24</b>								
	Commissions	<b>25</b>								
<b>Total (21+22+23+24+25)</b>	<b>29</b>									

***Instructions for completion of Form 93***

**PRA**

- 1**        **The box described as "EEA State in which branch is situated" must be completed by inserting the appropriate Code from the *PRA* list of "Country Codes".**
  
- 2**        **The headings used in this Form are taken from the Companies Act 1985 (Insurance Companies Accounts) Regulations 1993 (S.I. 1993/3246).**

Long term insurance business : Analysis of financial particulars - provision of services

Name of insurer

EEA State of commitment

Company registration number	Calendar year ended			Units	EEA State of commitment
	day	month	year		
F94	31	12		£000	

Authorisation classes								
I	II	III	IV	V	VI	VII	VIII	IX
Life and annuity	Marriage and birth	Linked long term	Permanent health	Tontines	Capital redemption	Pension fund management	Collective insurance etc.	Social insurance
1	2	3	4	5	6	7	8	9

Gross premiums receivable for services business in calendar year	11								
--	----	--	--	--	--	--	--	--	--

***Instruction for completion of Form 94***

**PRA**

- 1        The box described as "*EEA State of commitment*" must be completed by inserting the appropriate Code from the *PRA* list of "Country Codes".**



## Appendix 9.8 (rule 9.36A)

# Marine Mutuels: Items to be Disregarded, Directors' Certificates and Auditors' Reports

### PART I

#### *Items to be disregarded*

- 1 In completing the Forms required under rule 9.36A, a *marine mutual* must disregard *reinsurance* arrangements with any *relevant company* and must treat income and expenditure and assets and liabilities of any *relevant company* as, respectively, income and expenditure and assets and liabilities of the *marine mutual*.

PRA

#### *Completion of Forms*

- 1A Where 'source' appears at the head of a column on a Form, the information to be included in the preceding columns of a particular line is to be taken from those items in the *return* to which reference is made on that line in the column headed 'source'. No entries are to be made in the column headed 'source'.

PRA

### PART II

#### *Directors' certificates*

- 2 Subject to 4, every *return* provided by a *marine mutual* under rule 9.36A must include a certificate signed by the persons required by rule 9.33 to sign the documents to which the certificate relates –

PRA

- (a) confirming that –
- (i) the *return* has been prepared in accordance with the requirements in *IPRU(INS)*, *GENPRU* and *INSPRU*,
  - (ii) the *directors* are satisfied that throughout the *financial year in question*, the *marine mutual* has complied in all material respects with the requirements in *SYSC* and *PRIN* as well as the provisions of *IPRU(INS)*, *GENPRU* and *INSPRU* and that it is reasonable to believe that the *marine mutual* has continued so to comply subsequently, and will continue so to comply in future,
  - (iii) each member of the *marine mutual* which is subject to them has accepted those parts of the *marine mutual's* rules which oblige members to pay their share of any supplementary calls for the year and of calls to meet the *minimum capital requirement* (including any sum needed to make good failure by other members to pay calls made on them), and
  - (iv) the *marine mutual* is empowered to make supplementary calls on its members which, if met, would produce sufficient assets to

meet the *minimum capital requirement*; and

- (b) giving information about the number of –
- (i) members of the *marine mutual* which are not reinsured members,
  - (ii) fixed premium members (on which supplementary calls may not be made),
  - (iii) reinsured members (that is, members whose *contract of insurance* with the *marine mutual* is a contract of *reinsurance*), and
  - (iv) the tonnage of shipping attributable to each of the above classes of members, taken separately, and covered by the *marine mutual* at the end of the *financial year in question*.

3 [deleted]

4 (1) Where, in the opinion of the *directors*, the circumstances are such that any of the matters specified in 2 cannot be confirmed or provided, the relevant statements or information must be omitted.

PRA

(2) Where any statements or information have been omitted from the certificate in accordance with (1), this fact, and the reasons for omission, must be explained in a note to the certificate.

### PART III

#### *Auditor's reports*

5 Every *marine mutual* must procure an auditor's report, pursuant to *SUP*, stating whether, in the auditors' opinion –

PRA

- (a) the Forms, information and statements required (except for the additional information required by rules 9.30, 9.32A and 9.36B and the directors' certificate prepared in accordance with Part II of this Appendix) have been properly prepared in accordance with the *Accounts and Statements Rules*; and
- (b) where the auditors refer in their report or in any note to any uncertainty, that uncertainty is material to determining whether the *marine mutual* has *available assets* in excess of its *capital resources requirement*.

Forms M1 to M5 follow

## Marine mutuals : Revenue account

Name of insurer

Financial year ended

		Company registration number	Period ended			Units	
			day	month	year	(See instruction 1)	
		<b>M1</b>					
			This financial year 1	Previous year 2	Source		
Income	Gross income from contributions etc	<b>11</b>					
	Reinsurance premiums paid	<b>12</b>					
	Net income from contributions and premiums	<b>13</b>					
	Investments	Income before tax	<b>14</b>				
		Value re-adjustments on investments	<b>15</b>				
		Gains on realisation of investments	<b>16</b>				
	Other income	<b>17</b>			See instruction 2		
Total (13 to 17)	<b>19</b>						
Expenditure	Claims paid	<b>21</b>					
	Reinsurance recoveries received	<b>22</b>					
	Net claims paid (21-22)	<b>23</b>					
	Claims outstanding carried forward	<b>24</b>					
	Claims outstanding brought forward	<b>25</b>					
	Increase (decrease) in claims outstanding (24-25)	<b>26</b>					
	Unexpended contributions and unearned premiums (if any) and any amounts set aside for unexpired risks carried forward	<b>27</b>			See instruction 3		
	Unexpended contributions and unearned premiums (if any) and any amounts set aside for unexpired risks brought forward	<b>28</b>			See instruction 3		
	Increase (decrease) in unexpended contributions and unearned premiums (if any) and any additional amounts set aside for unexpired risks (27-28)	<b>29</b>			See instruction 3		
	Administrative expenses	<b>30</b>					
	Acquisition costs including commission	<b>31</b>					
	Taxation	<b>32</b>					
Other expenditure	<b>33</b>			See instruction 4			
Total (23+26+29 to 33)	<b>39</b>						
Surplus/deficit of income over expenditure (19-39)	<b>49</b>						

**Instructions for completion of Form M1**

**PRA**

- 1 Units must be in £, £000, US\$, or US\$000 as appropriate.**
- 2 Particulars of other income shown in line 17 must be stated in a supplementary note.**
- 3 Unexpended contributions, unearned premiums, etc shown in lines 27, 28 or 29 must be recorded net of *reinsurance* and deferred acquisition costs.**
- 4 Particulars of other expenditure shown in line 33 must be stated in a supplementary note.**

**Marine mutuals : Statement of assets and liabilities**

Name of insurer

Financial year ended

	Company registration number	Period ended			Units (See instruction 1)
		day	month	year	
	M2				
	As at the end of the financial year	As at the end of the previous financial year	Source		
	1	2			

Line

Column

**ASSETS**

Admissible assets	11			M3 . 89
Calls approved by the Board but unmade at the end of the financial year	12			
Total (11+12)	19			

**LIABILITIES**

Unexpended contributions and unearned premiums and any additional amounts set aside for unexpired risks, gross of reinsurance and deferred acquisition costs	21			See instruction 2
Gross provision for outstanding claims	22			See instruction 3
Creditors	23			
Taxation	24			
Other liabilities	25			See instruction 4
Total (21 to 25)	29			

**Instructions for completion of Form M2**

**PRA**

- 1**            **Units must be the same as those used in Form M1.**
- 2**            **The amount shown at line 21 must equal the sum of M1.27+M3.60+M3.62+M3.85.**
- 3**            **The amount shown at line 22 must equal the sum of M4.29.8+M4.29.9 for all marine classes.**
- 4**            **Details of the amount shown in line 25 must be stated in a supplementary note.**

## Marine Mutuals: Analysis of admissible assets

Name of insurer  
Financial year ended

		Company registration number	day	month	year	Units (see instruction 1)
		M3				
					<b>As at end of this financial year 1</b>	<b>As at end of the previous year 2</b>
Land and buildings			11			

**Investments in group undertakings and participating interests**

UK insurance dependants	shares	21		
	debts and loans	22		
Other insurance dependants	shares	23		
	debts and loans	24		
Non- insurance dependants	shares	25		
	debts and loans	26		
Other group undertakings	shares	27		
	debts and loans	28		
Participating interests	shares	29		
	debts and loans	30		

**Other financial investments**

Equity shares		41		
Other shares and other variable yield participations		42		
Holdings in collective investment schemes		43		
Rights under derivative contracts		44		
Fixed interest securities	Approved	45		
	Other	46		
Variable interest securities	Approved	47		
	Other	48		
Participation in investment pools		49		
Loans secured by mortgages		50		
Loans to public or local authorities and nationalised industries or undertakings		51		
Loans secured by policies of insurance issued by the company		52		
Other loans		53		
Bank and approved credit & financial institution deposits	One month or less withdrawal	54		
	More than one month withdrawal	55		
Other financial investments		56		

**Marine Mutuals: Analysis of admissible assets**

**Form M3  
(Sheet 2)**

Name of insurer  
Financial year ended

		Company registration number	day	month	year	Units (see instruction 1)
		M3				
					<b>As at end of this financial year 1</b>	<b>As at end of the previous year 2</b>
Deposits with ceding undertakings			57			
Assets held to match linked liabilities	Index linked		58			
	Property linked		59			
<b>Reinsurers' share of technical provisions</b>						
Provision for unearned premiums			60			
Claims outstanding			61			
Provision for unexpired risks			62			
Other			63			
<b>Debtors and salvage</b>						
Direct insurance business	Policyholders		71			
	Intermediaries		72			
Salvage and subrogation recoveries			73			
Reinsurance	Accepted		74			
	Ceded		75			
Dependants	due in 12 months or less		76			
	due in more than 12 months		77			
Other	due in 12 months or less		78			
	due in more than 12 months		79			
<b>Other assets</b>						
Tangible assets			80			
Deposits not subject to time restriction on withdrawal with approved institutions			81			
Cash in hand			82			
Other assets (particulars to be specified by way of supplementary note)			83			
Accrued interest and rent			84			
Deferred acquisition costs (general business only)			85			
Other prepayments and accrued income			86			
Deductions from the aggregate value of assets			87			
Grand total of admissible assets after deduction of admissible assets in excess of market risk and counterparty limits (11 to 86 less 87)			89			

**Marine Mutuels: Analysis of admissible assets**

Name of insurer  
Financial year ended

	Company registration number	day	month	year	Units (see instruction 1)
M3					
				<b>As at end of this financial year 1</b>	<b>As at end of the previous year 2</b>

**Reconciliation to asset values determined in accordance with the insurance accounts rules or international accounting standards as applicable to the firm for the purpose of its external financial reporting**

Total admissible assets after deduction of admissible assets in excess of market risk and counterparty limits (as per line 89 above)	91		
Admissible assets in excess of market and counterparty limits	92		
Inadmissible assets directly held	93		
Capital resources requirement deduction of regulated related undertakings	94		
Ineligible surplus capital and restricted assets in regulated related insurance undertakings	95		
Inadmissible assets of regulated related undertakings	96		
Book value of related ancillary services undertakings	97		
Other differences in the valuation of assets (other than for assets not valued above)	98		
Deferred acquisition costs excluded from line 89	99		
Reinsurers' share of technical provisions excluded from line 89	100		
Other asset adjustments (may be negative)	101		
Total assets determined in accordance with the insurance accounts rules or international accounting standards as applicable to the firm for the purpose of its external financial reporting (91 to 101)	102		

Amounts included in line 89 attributable to debts due from related insurers, other than those under contracts of insurance or reinsurance	103		
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**Instructions for completion of Form M3**

**PRA**

- 1** Units must be the same as those used in Form M1.
- 2** In lines 11 to 85 –
  - (a) for the purpose of classifying (but not valuing) assets, headings and descriptions used above, wherever they also occur in the balance sheet format in the *insurance accounts rules*, have the same meaning as in those rules,
  - (b) assets must be valued in accordance with rule 9.10; and
  - (c) assets of any particular description must be shown after deduction of assets of that description which (for any reason) fall to be left out of account under the rules in *INSPRU 2.1*.
- 3** The aggregate value of those investments which are:
  - (a) *unlisted* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with the rules in *GENPRU 1.3*;
  - (b) *listed* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with the rules in *GENPRU 1.3* and which are not *readily realisable*;
  - (c) units or other beneficial interests in *collective investment schemes* that:
    - (i) are not schemes falling within the *UCITS Directive*;
    - (ii) are not authorised unit trust schemes or recognised schemes within the meaning of Part XVII of the *Act*;
    - (iii) do not employ *derivative contracts* unless they meet the criteria in *INSPRU 3.2.5R*;
    - (iv) do not employ contracts or assets having the effect of *derivative contracts* unless they have the effect of *derivative contracts* that meet the criteria in *INSPRU 3.2.5R*; and
    - (v) do not include assets other than *admissible assets* among their property; or
  - (d) reversionary interests or remainders in property other than land or buildings, must be stated by way of a supplementary note, together with a description of such investments.
- 4** The aggregate value of those investments falling within lines 46 or 48 which are *hybrid securities* must be stated by way of a supplementary note to this

Form.

- 5 Amounts in respect of salvage or subrogation included above other than at line 73 must be stated by way of a supplementary note to this Form.
- 6 The amount to be shown in line 93 must equal the total of the relevant proportions in accordance with *GENPRU 1.3.49R* and *GENPRU 1.3.50R* of the *individual capital resources requirements of the regulated related undertakings*.
- 7 The amount to be shown in line 94 must equal the ineligible surplus capital and any restricted assets of any *regulated related undertaking* that is an *insurance undertaking* that are deducted in accordance with *GENPRU 1.3.47R (3)(b)*.
- 8 Lines 99-102 must be completed in accordance with the *insurance account rules* or *international accounting standards* as applicable to the *insurer* for the purpose of its external financial reporting if the *insurer* is required to produce such accounts. Otherwise these lines must be left blank. Details of amounts in line 101 must be disclosed in a supplementary note. For years ending on or before 30 December 2008, the previous year figure for line 93 must be left blank and that for line 101 must equal line 100 from the previous *return*.



**Instructions for completion of Form M4**

**PRA**

- 1** Separate Forms must be completed for each *class of insurance business*. The relevant description below must be entered against the 'Marine class' heading and the corresponding *class* code entered in the M4 box.

<u>Code</u>	<u>Description</u>
01	Protection and Indemnity
02	Hull and Machinery
03	Freight Demurrage and Defence
04	War risks
05	Strikes
06	Other - nature of business to be detailed in a supplementary note.

- 2** Units must be the same as those used in Form M1.
- 3** The *financial year in question* must be stated at line 11 and *preceding financial years* must be listed in reverse chronological order in lines 12 to 25.

**Marine mutuals : Analysis of derivative contracts**

Name of insurer

Financial year ended

Company registration number      Period ended      Units  
day   month   year      (See instruction 1)

<b>M5</b>					
-----------	--	--	--	--	--

<b>Derivative contracts</b>			As at the end of this financial year		As at the end of the previous year	
			Assets <b>1</b>	Liabilities <b>2</b>	Assets <b>3</b>	Liabilities <b>4</b>
Futures contracts	Fixed-interest securities	<b>11</b>				
	Equity shares	<b>12</b>				
	Land	<b>13</b>				
	Currencies	<b>14</b>				
	Other	<b>15</b>				
Options	Fixed-interest securities	<b>21</b>				
	Equity shares	<b>22</b>				
	Land	<b>23</b>				
	Currencies	<b>24</b>				
	Other	<b>25</b>				
Contracts for differences	Fixed-interest securities	<b>31</b>				
	Equity shares	<b>32</b>				
	Land	<b>33</b>				
	Currencies	<b>34</b>				
	Other	<b>35</b>				
Adjustments for variation margin		<b>41</b>				
<b>Total (11 to 41)</b>		<b>49</b>				

**Instructions for completion of Form M5**

**PRA**

- 1 Units must be the same as those used in Form M1.
- 2 **Derivative contracts** must be analysed according to the description of assets shown in the second column of Form M5 which represents the principal subject of the contract.
- 3 **Derivative contracts** must be reported as assets in column 1 of Form M5 if their value to the *marine mutual* (gross of *variation margin*) is positive and as liabilities in column 2 of Form M5 if their value to the *marine mutual* (gross of *variation margin*) is negative.
- 4 All amounts included at lines 11 to 35 of Form M5 in respect of *derivative contracts* are to be determined without making any allowance for *variation margin*.
- 5 Amounts in respect of a *derivative contract* may only be included net of amounts in respect of any other *derivative contract* if
  - (a) obligations of the *marine mutual* under the contracts may be set off against each other under generally accepted accounting practice; and
  - (b) such other contract has the effect (in whole or in part) of closing out the obligations of the *marine mutual* under the first mentioned contract.
- 6 The effect of any *variation margin* upon amounts included at lines 11 to 35 of Form M5 must be shown at line 41.
- 7 The entry at M5.49.1 must be shown at M3.44.1.
- 8 The entry at M5.49.2 must be included at M2.23.1.
- 9 Rights to recover assets transferred by way of *initial margin* must not be shown on Form M5.



## **Appendix 9.9** (rule 9.40 to guidance 9.43)

### **Group Capital Adequacy**

(Form 95)

**PRA**

**This appendix contains guidance as to how the report to be provided under rule 9.40 may be.**

## FORM 95: INSURANCE GROUP CAPITAL ADEQUACY REPORTING FORM

Form 95

**INSURANCE GROUP CAPITAL ADEQUACY (page 1)**

Name of reporting insurance firm:

Name of insurance parent undertaking:


## Calculation of Consolidated Position:

**Limits on capital  
(see notes)**

		£'000	
1. TIER 1			
Group core tier one	Sum of column G1 (page 4)	<input type="text"/>	H1
Group perpetual non-cumulative preference shares	Sum of column G2 (page 4)	<input type="text"/>	H2
Group innovative tier one	Sum of column G3 (page 4)	<input type="text"/>	H3
Deductions from tier one	Sum of column C (page 2)	<input type="text"/>	H4
2. Total group tier one capital	= H1 + H2 + H3 – H4	<input type="text"/>	Limits 1, 2 & 3 TT1
3. TIER 2			
Group upper tier two	Sum of column G4 (page 4)	<input type="text"/>	H5
Group lower tier two	Sum of column G5 (page 4)	<input type="text"/>	H6
4. Total group tier two capital	= H5 + H6	<input type="text"/>	Limits 4 & 5 TT2
5.			
6. <b>Group capital resources before deductions</b>	= TT2 + TT2	<input type="text"/>	Limit 6 TCR
Total group capital resources deductions	Sum of column D1 & D2 (page 2)	<input type="text"/>	H7
<b>Group capital resources:</b>	= TCR – H7	<input type="text"/>	GCR
<b>Group capital resources requirement:</b>	Sum of column B (page 2)	<input type="text"/>	GCCR
<b>Group surplus/ (deficit)</b>	= GCR – GCCR	<input type="text"/>	I

FORM 95: INSURANCE GROUP CAPITAL ADEQUACY REPORTING FORM

**INSURANCE GROUP CAPITAL ADEQUACY (page 2)**

Name of reporting insurance firm:

Name of insurance parent undertaking:


A	A1	A2	B	C	D1	D2
Name of related undertaking	% interest	Type of firm	CRR	Deductions from Tier 1	Inadmissible assets	Ancillary services undertakings deduction

Related undertaking 1						
Related undertaking 2						
Related undertaking 3						

Parent:						
---------	--	--	--	--	--	--

Totals:						
---------	--	--	--	--	--	--



FORM 95: INSURANCE GROUP CAPITAL ADEQUACY REPORTING FORM

**INSURANCE GROUP CAPITAL ADEQUACY (page 4)**

Name of reporting insurance firm:

Name of insurance parent undertaking:


<b>A</b> Name of related undertaking

G1	G2	G3	G4	G5
<b>Net Contribution to Group Capital Resources</b>				
Core tier 1	Perpetual non-cumulative preference shares	Innovative tier 1	Upper tier 2	Lower tier 2
=F1-E1	=F2-E2	=F3-E3	=F4-E4	=F5-E5

Related undertaking 1
Related undertaking 2
Related undertaking 3


Parent's Capital Resources (by class of capital)
--

--	--	--	--	--

Totals
--------

--	--	--	--	--

FORM 95: INSURANCE GROUP CAPITAL ADEQUACY REPORTING FORM

Insurance Group Capital Adequacy

<i>Ref</i>	<i>Instructions</i>
<p>A (pages 2, 3 &amp; 4)</p>	<p>List the name of each <i>related undertaking</i> of the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> (as applicable) which is a <i>regulated related undertaking</i> or an <i>ancillary services undertaking</i>.</p> <p>Pursuant to <i>INSPRU 6.1.18R</i> to <i>INSPRU 6.1.22R</i>, several entities may be combined where these are not material in relation to the <i>insurance group</i>. The <i>firm</i> should list the relevant entities in a note to the return and should be able to demonstrate the contribution of the individual entities to the group calculation.</p>
<p>AI (page 2)</p>	<p>List the percentage interest in the <i>regulated related undertaking</i> listed in A held by the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> (as applicable).</p> <p>For the purposes of calculating the percentage interest in accordance with <i>INSPRU 6.1.28R</i> and <i>6.1.29R</i>, if the interest is not held directly by the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> but by another member of the <i>insurance group</i>, enter the effective percentage interest of the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> in that <i>undertaking</i> (e.g. where a <i>parent</i> has a 50% holding in a <i>subsidiary</i> which in turn has a 50% holding in another <i>subsidiary</i>, the ultimate <i>parent undertaking's</i> effective percentage interest in the second <i>subsidiary</i> is 25% etc.).</p> <p>Where the entity is a <i>subsidiary</i> of a <i>subsidiary</i> of the <i>parent undertaking</i> (etc.), indicate (S) after the effective percentage interest. Such an entity should be treated as a <i>subsidiary</i> of the <i>parent undertaking</i> and will be included in the calculations in proportion to the <i>parent undertaking's</i> effective percentage interest (or in full if there is a capital resources deficit) (see <i>INSPRU 6.1.30R</i> and <i>6.1.31R</i>).</p>

FORM 95: INSURANCE GROUP CAPITAL ADEQUACY REPORTING FORM ""

<i>Ref</i>	<i>Instructions</i>
A2 (page 2)	<p>State if the <i>related undertaking</i> listed in A is a <i>regulated insurance entity, pure reinsurer, insurance undertaking</i> that is not a <i>regulated insurance entity, insurance holding company, investment firm, credit institution, financial institution</i> which is not either a <i>credit institution or investment firm, financial holding company, asset management company or ancillary services undertaking</i>.</p> <p>For <i>related undertakings</i> which are <i>ancillary services undertakings</i> entries should only be made in this column and column D2 on page 2.</p>
B (page 2)	<p>State the <i>ultimate insurance parent undertaking or ultimate EEA insurance parent undertaking's</i> share (i.e multiplied by the percentage in A1) of the <i>individual capital resources requirement</i> of the <i>regulated related undertaking</i>, or the full amount if there is a capital resources deficit. This is the requirement set out in <i>INSPRU 6.1.34R</i>.</p>
C (page 2)	<p>State the <i>ultimate insurance parent undertaking or ultimate EEA insurance parent undertaking's</i> share (or the full amount if there is a capital resources deficit) of the <i>regulated related undertaking's</i> Tier 1 deductions calculated under the <i>sectoral rules</i> that apply to it.</p>
D1 (page 2)	<p>State the <i>ultimate insurance parent undertaking or ultimate EEA insurance parent undertaking's</i> share (or the full amount if there is a capital resources deficit) of any inadmissible assets held by the <i>regulated related undertaking</i> (see <i>INSPRU 6.1.60R</i>)</p>
D2 (page 2)	<p>This column should be completed only for <i>related undertakings</i> which are <i>ancillary services undertakings</i>. The entry is the higher of: the book value of the direct or indirect investment by the <i>ultimate insurance parent undertaking or ultimate EEA insurance parent undertaking</i> in the <i>ancillary services undertaking</i>; and the <i>ancillary services undertaking's</i> notional capital resources requirement (see <i>INSPRU 6.1.62R to 6.1.64R</i>)</p>

FORM 95: INSURANCE GROUP CAPITAL ADEQUACY REPORTING FORM "

<i>Ref</i>	<i>Instructions</i>
E1 E2 E3 E4 E5 (page 3)	<p>The entries in E1 to E5 should be the book value of the investments of all members of the <i>insurance group</i> in the <i>solo capital resources</i> of each <i>regulated related undertaking</i> listed in A (this represents internal group holdings of the <i>solo capital resources</i> of each <i>regulated related undertaking</i> to be excluded from <i>group capital resources</i> under <i>INSPRU</i> 6.1.49R, 6.1.51R, 6.1.54R, 6.1.56R and 6.1.58R).</p> <p>The book value of the group's investment in <i>core tier one capital resources</i>* should be shown in E1; investments in perpetual non-cumulative <i>preference shares</i>* should be shown in E2; and investments in <i>innovative tier 1 capital resources</i>* should be shown in E3.</p> <p>The book value of the group's investment in <i>tier two capital resources</i> should be shown in E4 (<i>upper tier two capital resources</i>*) and E5 (<i>lower tier two capital resources</i>*).</p> <p>[* these terms should be applied in accordance with <i>INSPRU</i> 6.1.37R to the <i>undertaking</i> in question].</p>
F1 F2 F3 F4 F5 (page 3)	<p>The entries in F1 to F5 should be the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking's</i> share (or the full amount if there is a capital resources deficit) of the components of the <i>solo capital resources</i> of the <i>regulated related undertaking</i> (see <i>INSPRU</i> 6.1.48R(2), 6.1.50R(2), 6.1.53R(2), 6.1.55R(2) and 6.1.57R(2)).</p>

FORM 95: INSURANCE GROUP CAPITAL ADEQUACY REPORTING FORM ""

<i>Ref</i>	<i>Instructions</i>
G1 G2 G3 G4 G5 (page 4)	<p>These entries represent the contribution to <i>group capital resources</i> of the <i>regulated related undertaking</i>. G1 is calculated as the difference between column F1 and E1. (G1 can be positive or negative. A negative figure would principally represent goodwill on acquisition).</p> <p>Similarly G2 is the difference between F2 and E2, G3 is the difference between F3 and E3 etc. (G2, G3, G4 &amp; G5 would normally be positive).</p> <p>The totals of columns G1, G2 and G3 respectively represent the group's <i>core tier one capital</i>, perpetual non-cumulative <i>preference shares</i> and <i>innovative tier one capital resources</i> (see H1 to H3 on page 1).</p> <p>The sum of columns G4 and G5 represent the group's <i>tier two capital resources</i> (see H5 and H6).</p>
Parent's capital resources (page 4)	<p>The entries in this line represent the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking's capital resources</i>, after deduction of the book value of the investments taken together of the individual members of the <i>insurance group</i> in those <i>capital resources</i>. The deduction excludes any holding by the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> (as applicable) of its own <i>shares</i>; such holdings are deducted in calculating the parent's <i>tier one capital resources</i>.</p>
H1 H2 H3 H4 (page 1)	<p>H1 to H3 represent the total contribution of the <i>regulated related undertakings</i> and the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> to <i>total group tier one capital</i>. H4 represents the sum of the Tier 1 deductions for all members of the <i>insurance group</i>.</p>

FORM 95: INSURANCE GROUP CAPITAL ADEQUACY REPORTING FORM "

<i>Ref</i>	<i>Instructions</i>
TT1 (page 1)	<p>This entry is <i>total group tier one capital</i> (see stage A of <i>INSPRU</i> 6.1.43R) after application of limits 1, 2 and 3 below:</p> <p>Limit 1: <i>Total group tier one capital</i>, less <i>innovative tier one capital resources</i> included in <i>total group tier one capital</i>, must account for at least 50% of the <i>group capital resources requirement</i> less any <i>with-profits insurance capital components</i> included in the <i>group capital resources requirement</i> (see <i>INSPRU</i> 6.1.45R(1)(a)).</p> <p>Limit 2: <i>Core tier one capital resources</i> included in <i>total group tier one capital</i> must account for at least 50% of <i>total group tier one capital</i> (see <i>INSPRU</i> 6.1.45R(1)(c)).</p> <p>Limit 3: <i>Innovative tier one capital resources</i> included in <i>total group tier one capital</i> must not exceed 15% of <i>total group tier one capital</i> (see <i>INSPRU</i> 6.1.45R(1)(d)).</p> <p>Any capital item excluded by limit 3 may form part of <i>total group tier two capital</i> (see <i>INSPRU</i> 6.1.46G).</p>
H5 H6 (page 1)	<p>These entries represent the total contribution of the <i>regulated related undertakings</i> and the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> to <i>total group tier two capital</i>.</p>
TT2 (page 1)	<p>This entry is calculated as the sum of H5 and H6 which represents <i>total group tier two capital</i> (stage B in <i>INSPRU</i> 6.1.43R) after application of limits 4 and 5 as follows:</p> <p>Limit 4: <i>Total group tier two capital</i> must not exceed <i>total group tier one capital</i> (see <i>INSPRU</i> 6.1.45R(1)(e)).</p> <p>Limit 5: <i>Lower tier two capital resources</i> calculated in accordance with <i>INSPRU</i> 6.1.57R included in <i>total group tier two capital</i> must not exceed 50% of <i>total group tier one capital</i> (see <i>INSPRU</i> 6.1.45R(1)(f)).</p>

FORM 95: INSURANCE GROUP CAPITAL ADEQUACY REPORTING FORM "

<i>Ref</i>	<i>Instructions</i>
TCR (page 1)	<p>This entry is calculated as the sum of TT1 and TT2 and represents group capital resources before deductions (stage C in <i>INSPRU</i> 6.1.43R) after application of limit 6 as follows:</p> <p>Limit 6: <i>Total group tier one capital less innovative tier one capital resources included in total group tier one capital, plus total group tier two capital less any lower tier two capital resources included in total tier two capital must account for at least 75% of the group capital resources requirement less any with-profits insurance capital components included in the group capital resources requirement (INSPRU 6.1.45R(1)(b)).</i></p>
H7 (page1)	<p>This entry is the sum of columns D1 and D2 on page 2 which represent deductions to be made from total <i>group capital resources</i> in respect of the group's interest in inadmissible assets (see 8.3.59R), and <i>ancillary services undertakings</i> (see <i>INSPRU</i> 6.1.62R).</p>
GCR (page1)	<p>This entry is calculated as TCR less H7. This represents <i>group capital resources</i> (stage H in <i>INSPRU</i> 6.1.43R).</p>
GCCR (page 1)	<p>This entry is calculated as the sum of column B on page 2 which represents the <i>group capital resources requirement (INSPRU</i> 6.1.33R).</p>
I (page 1)	<p>This is calculated as total <i>group capital resources</i> less total <i>group capital resources requirement (GCR – GCRR)</i>. This represents the amount by which <i>group capital resources</i> exceed or fail to exceed the <i>group capital resources requirement</i>.</p>



**Appendix 9.10** (rule 9.44 to guidance 9.45)

**Enhanced Capital Requirement**

**(Form ECR1)**

**ECR Calculation - Summary**Form **ECR1**  
Sheet 1

Name of insurer

Financial year ended

		<b>£000</b>	<b>Source:</b>
Capital Resources	1		<i>Form:1 Line:13 Col:1</i>
Individual Minimum Capital Requirement	2		<i>Form:1 Line:34 Col:1</i>

**ECR Calculation**

Asset Charge	3		<i>Sheet 2: Asset-related Capital Requirement</i>
Premium Charge - Accident Year Business	4		<i>Sheet 3: Insurance-related Capital Requirement Accident Year Business</i>
Technical Provision Charge - Accident Year Business	5		<i>Sheet 3: Insurance-related Capital Requirement Accident Year Business</i>
Premium Charge - Underwriting Year Business	6		<i>Sheet 4: Insurance-related Capital Requirement Underwriting Year Business</i>
Technical Provision Charge - Underwriting Year Business	7		<i>Sheet 4: Insurance-related Capital Requirement Underwriting Year Business</i>
Less Equalisation Provisions	8		<i>Form:15 Line:14+15 Col:1</i>

<b>ECR (3+4+5+6+7+8)</b>	9
<b>ECR gross of Equalisation Provisions (3+4+5+6+7)</b>	10
<b>ICG (if given)</b>	11
<b>Capital Resources / ECR (1 / 9)</b>	12
<b>Capital Resources plus Equalisation Provisions / ICG ( [1+8] / 11, if ICG given)</b>	13
<b>ICG / ECR gross of Equalisation Provisions (11 / 10, if ICG given)</b>	14

**Asset-Related Capital Requirement (Category of assets 1 only)**

**Form ECR1**

**Sheet 2**

Name of insurer

Financial Year ended

Asset item	PRA return source (Form13 Column 1)	Assets (£ 000)	Derivative adjustment (£ 000)	Asset-related capital charge factor	Asset-related capital charge (£ 000)
		(1)	(2)	(3)	Max [ 0, (1)+(2) ] * (3)
					(4)
Land & buildings	L11			7.5%	
Shares in group undertakings excluding participating interests - insurance dependants	L21+23			0.0%	
Shares in group undertakings excluding participating interests - other	L25+27			7.5%	
Debt securities issued by & loans to group undertakings	L22+L24+L26+L28			3.5%	
Participating interests	L29			7.5%	
Debt securities issued by & loans to undertakings in which the insurer has a participating interest	L30			3.5%	
Shares, other variable-yield securities, units in unit trusts and Participation in investment pools	L41+L42+L43+L49			16.0%	
Money market funds				0.0%	
Debt securities and other fixed income securities: approved securities	L45+L47			3.5%	
Debt securities and other fixed income securities: other	L46+L48			3.5%	
Loans secured by mortgages	L50			2.5%	
Other loans	L51+L52+L53			2.5%	
Deposits with approved credit institutions and approved financial institutions	L54+L55			0.0%	
Other financial investments: other	L56+L58+L59			7.5%	
Deposits with ceding undertakings	L57			3.5%	
Reinsurers' share of technical provisions: Provision for unearned premiums	L60			2.5%	
Reinsurers' share of technical provisions: Claims outstanding	L61			2.5%	
Reinsurers' share of technical provisions: Other	L62+63			2.5%	
Debtors arising out of direct insurance operations: policyholders	L71			4.5%	

Debtors arising out of direct insurance operations: intermediaries	L72			3.5%	
Debtors arising out of reinsurance operations	L74+L75			2.5%	
Other debtors	L73+L76+L77+L78+L79			1.5%	
Tangible assets	L80			7.5%	
Cash at bank and in hand	L81+L82			0.0%	
Other Assets	L83			0.0%	
Accrued interest and rent	L84			0.0%	
Deferred acquisition costs	L85			0.0%	
Other prepayments and accrued income	L86			0.0%	
<b>TOTAL</b>	L89+L87-L44				

**Insurance-Related Capital Requirement - Accident Year Business**

Name of insurer  
Financial Year ended

PRA Combined Category or Risk Category	Net Written Premium (£ 000)		Net claims outstanding carried forward (£ 000)		Net unearned premium and unexpired risks less deferred acquisition costs (£ 000)		Net Written Premium capital charge factor	Net technical provision capital charge factor	Net Written Premium capital charge Max (0, 1) * (4)	Net Technical provision capital charge Max[0, (2)+(3) ] * (5)	
	PRA return source	1	PRA return source	2	PRA return source	3					4
<b>Direct and facultative business</b>											
110: Total primary (direct) and facultative accident and health	1						5.0%	7.5%			
120: Total primary (direct) and facultative personal lines motor business	2						10.0%	9.0%			
160: Primary (direct) and facultative household and domestic all risks	3						10.0%	10.0%			
180: Total primary (direct) and facultative personal lines financial loss business	4						25.0%	14.0%			
220: Total primary (direct) and facultative commercial motor business	5	Form 21. Lines(11+12 +13+14+ 15). Columns (5+6)					10.0%	9.0%			
260: Total primary (direct) and facultative commercial lines property business	6						10.0%	10.0%			
270: Total primary (direct) and facultative commercial lines liability business	7						14.0%	14.0%			
280: Total primary (direct) and facultative commercial lines financial loss business	8						25.0%	14.0%			
330: Total primary (direct) and facultative aviation business	9						32.0%	14.0%			
340: Total primary (direct) and facultative marine business	10						22.0%	17.0%			
350: Primary (direct) and facultative goods in transit	11						12.0%	14.0%			
400: Miscellaneous primary (direct) and facultative business	12						25.0%	14.0%			
002: Total Primary (Direct) and Facultative Business (sum of lines 1 to 12)	13										
<b>Treaty reinsurance business</b>											
510: Non-proportional accident and health	14		N/A					35.0%	16.0%		
520: Non-proportional motor	15							10.0%	14.0%		
530: Non-proportional aviation	16							61.0%	16.0%		
540: Non-proportional marine	17						38.0%	17.0%			
550: Non-proportional transport	18						16.0%	15.0%			
560: Non-proportional property	19						53.0%	12.0%			
570: Non-proportional liability (non-motor)	20						14.0%	14.0%			
580: Non-proportional financial lines	21						39.0%	14.0%			
590: Non-proportional aggregate cover	22						53.0%	12.0%			
500: Total Non-Proportional Treaty Reinsurance Business accepted (sum of lines 14 to 22)	23	F21L(11+12+13+14+15)C(5+6)			F22L(13+14+17+18)C3		F21L19C6+F22L(19-29)C3				
610: Proportional accident and health	24	N/A					12.0%	16.0%			
620: Proportional motor	25						10.0%	12.0%			
630: Proportional aviation	26						33.0%	16.0%			
640: Proportional marine	27						22.0%	17.0%			
650: Proportional transport	28						12.0%	15.0%			
660: Proportional property	29						23.0%	12.0%			
670: Proportional liability (non-motor)	30						14.0%	14.0%			
680: Proportional financial lines	31						25.0%	14.0%			
690: Proportional aggregate cover	32						23.0%	12.0%			
600: Total Proportional Treaty Reinsurance Business accepted (sum of lines 24 to 32)	33		F21L(11+12+13+14+15)C(5+6)		F22L(13+14+17+18)C3		F21L19C6+F22L(19-29)C3				
700: Miscellaneous treaty reinsurance business accepted	34	N/A		N/A		N/A	39.0%	14.0%			
003: Total Treaty Reinsurance Business (sum of lines 14 to 22, 24 to 32 and 34)	35	F21L(11+12+13+14+15)C(5+6)		F22L(13+14+17+18)C3		F21L19C6+F22L(19-29)C3					
<b>001: Total Business</b> (sum of lines 1 to 12, 14 to 22, 24 to 32 and 34)	<b>36</b>	F21L(11+12+13+14+15)C(5+6)		F22L(13+14+17+18)C3		F21L19C6+F22L(19-29)C3					

Insurance-Related Capital Requirement - Underwriting Year Business

Name of insurer  
Financial Year ended

PRA Combined Category or Risk Category		Net Written Premium (£ 000)		Net claims outstanding carried forward (£ 000)		Net unearned premium and unexpired risks less deferred acquisition costs (£ 000)		Net Written Premium capital charge factor	Net technical provision capital charge factor	Net Written Premium capital charge	Net Technical provision capital charge
		PRA return source	1	PRA return source	2	PRA return source	3	4	5	Max[0,(1)] * (4)	Max[0,(2)+(3)] * (5)
<b>Direct and facultative business</b>											
110: Total primary (direct) and facultative accident and health	1							5.0%	7.5%		
120: Total primary (direct) and facultative personal lines motor business	2							10.0%	9.0%		
160: Primary (direct) and facultative household and domestic all risks	3							10.0%	10.0%		
180: Total primary (direct) and facultative personal lines financial loss business	4							25.0%	14.0%		
220: Total primary (direct) and facultative commercial motor business	5							10.0%	9.0%		
260: Total primary (direct) and facultative commercial lines property business	6	Form24.		Form25.		Form25.		10.0%	10.0%		
270: Total primary (direct) and facultative commercial lines liability business	7	Line19.		Lines(11-12+13-14+15).		Lines(22+23-24).		14.0%	14.0%		
280: Total primary (direct) and facultative commercial lines financial loss business	8	Column99		Column99		Column99		25.0%	14.0%		
330: Total primary (direct) and facultative aviation business	9							32.0%	14.0%		
340: Total primary (direct) and facultative marine business	10							22.0%	17.0%		
350: Primary (direct) and facultative goods in transit	11							12.0%	14.0%		
400: Miscellaneous primary (direct) and facultative business	12							25.0%	14.0%		
002: Total Primary (Direct) and Facultative Business (sum of lines 1 to 12)	13										
<b>Treaty reinsurance business</b>											
510: Non-proportional accident and health	14							35.0%	16.0%		
520: Non-proportional motor	15							10.0%	14.0%		
530: Non-proportional aviation	16							61.0%	16.0%		
540: Non-proportional marine	17	Form28.		Form29.		Form29.		38.0%	17.0%		
550: Non-proportional transport	18	Line19.		Lines(11-12+13-14+15).		Lines(22+23-24).		16.0%	15.0%		
560: Non-proportional property	19	Column99		Column99		Column99		53.0%	12.0%		
570: Non-proportional liability (non-motor)	20							14.0%	14.0%		
580: Non-proportional financial lines	21							39.0%	14.0%		
590: Non-proportional aggregate cover	22							53.0%	12.0%		
500: Total Non-Proportional Treaty Reinsurance Business accepted (sum of lines 14 to 22)	23	F24L19C99		F25L(11-12+13-14+15)C99		F25L(22+23-24)C99					
610: Proportional accident and health	24							12.0%	16.0%		
620: Proportional motor	25							10.0%	12.0%		
630: Proportional aviation	26							33.0%	16.0%		
640: Proportional marine	27	Form28.		Form29.		Form29.		22.0%	17.0%		
650: Proportional transport	28	Line19.		Line(11-12+13-14+15).		Lines(22+23-24).		12.0%	15.0%		
660: Proportional property	29	Column99		Column99		Column99		23.0%	12.0%		
670: Proportional liability (non-motor)	30							14.0%	14.0%		
680: Proportional financial lines	31							25.0%	14.0%		
690: Proportional aggregate cover	32							23.0%	12.0%		
600: Total Proportional Treaty Reinsurance Business accepted (sum of lines 24 to 32)	33	F24L19C99		F25L(11-12+13-14+15)C99		F25L(22+23-24)C99					
700: Miscellaneous treaty reinsurance business accepted	34	F28L19C99		F29L(11-12+13-14+15)C99		F29L(22+23-24)		39.0%	14.0%		
003: Total Treaty Reinsurance Business (sum of lines 14 to 22, 24 to 32 and 34)	35	F24L19C99		F25L(11-12+13-14+15)C99		F25L(22+23-24)C99					
<b>001: Total Business</b> (sum of lines 1 to 12, 14 to 22, 24 to 32 and 34)	<b>36</b>	F24L19C99		F25L(11-12+13-14+15)C99		F25L(22+23-24)C99					

- 1 The amounts entered in the cells in column 1 of sheet 2 and columns 1, 2 and 3 of sheets 3 and 4 must reconcile to the 'PRA return source' column, shown alongside that cell, except where:
- (a) no PRA return source is shown e.g. sheet 3, lines 14 to 22, columns 1 and 3;
  - (b) in the case of sheets 3 and 4 column 1, the *return* for the *financial year* ended, shown on sheet 1, is for a non 12 month period; or
  - (c) in the case of a cell in sheet 3 or 4, the Form referred to in the 'PRA return source' column, was not prepared for the relevant *combined category* or *risk category* in that *return*.

Where the latter exception applies, the amount entered in that cell must be the amount that would have been reported in that *return* at the 'PRA return source' had the *insurer* prepared that Form for that *combined category* or *risk category*.

*ECR Calculation – Summary (Sheet 1)*

- 2 The amount shown on the ICG line must be the most recent Individual Capital Guidance (ICG) amount given by the PRA. The ICG will usually be based on a percentage of the ECR gross of Equalisation Provisions. In this case the percentage should be applied to the current ECR gross of Equalisation Provisions to obtain the ICG amount. If no ICG has been given, enter "N/A".
- 2A If ICG is based on a percentage of the ECR gross of Equalisation Provisions and that percentage is different to the ratio that appears on line 14, an explanation for the difference must be provided in a supplementary note.
- Asset-related Capital Requirement Sheet (Sheet 2)*
- 3 The amounts shown in column 1 must be the value, in accordance with *GENPRU 1.3*, of the listed asset items as at the *financial year* ended date shown on sheet 1.
- 4 In column 2, derivative adjustments, where a *firm* has entered into a *derivative* then, for the purposes of applying the appropriate capital charge factor as set out in *INSPRU 2.2.16R*, it must treat the value of the *derivative* and the value of the asset associated with the *derivative* as a single asset of a type and value which most closely reflects the economic risk to the *firm* of the combined rights and obligations associated with the *derivative* and the asset associated with the *derivative* (*INSPRU 2.2.11R(4)*).
- 5 Include money market funds as defined in *INSPRU 2.2.14R* in the line for the asset item "Money market funds".
- 6 The amount shown under the columns for "Assets" and "Derivative adjustment" for the asset item "Shares, other variable-yield securities, units in unit trusts and Participation in investment pools" should be after deductions of amounts held in money market funds included in *Form 13* at column 1 lines 41,

42, 43 or 49 of the *return* or the *financial year in question*.

7 The sum of the amounts shown in the "Asset" column for the asset items "Shares, other variable-yield securities, units in unit trusts and Participation in investment pools" and "Money market funds" should be equal to the sum of lines 41, 42, 43 and 49 at column of *Form 13* of the *return* for the *financial year in question*.

7A To give effect to *INSPRU 2.2.11R (2)*, the asset related capital charge shown in column 4 is the asset related capital charge factor in column 3 multiplied by the higher of:

(a) the sum of columns 1 and 2; and

(b) zero.

*Insurance related Capital Requirement - Accident and Underwriting Year Accounted Business (Sheets 34)*

8 Amounts shown in the "Net Written Premium" column must be *net written premiums* before any deduction for commissions in the twelve months preceding the financial year ended date shown on sheet 1.

9 Amounts shown in the "Net claims outstanding carried forward" column must be net of reinsurance and comprise: outstanding claims, provisions for incurred but not reported (IBNR) claims, provisions for incurred but not enough reported (IBNER) claims and related claims management costs as at the financial year ended date shown on sheet 1.

10 Amounts shown in the "Net unearned premium and unexpired risks net of deferred acquisition costs" column must be net of reinsurance and comprise provision for unexpired risk and unearned premium less deferred acquisition costs as at the financial year ended date shown on sheet 1.

10A To give effect to *INSPRU 1.1.77R (2)*, the amount derived in the "Net Written Premium capital charge" column is the net written premium capital charge factor in column 4 multiplied by the higher of:

(a) the net written premium in column 1; and

(b) zero.

11 To give effect to *INSPRU 1.1.77R (2)*, the amount derived in the "Net technical provision capital charge" column is the net technical provision capital charge factor in column 5 multiplied by the higher of:

(a) the sum of the net claims outstanding carried forward and the net unearned premium less deferred acquisition costs; and

(b) zero.

## Appendix 9.11

### Reporting Forms

- 1      **This appendix consists of only one or more forms or templates. Forms and templates are to be found through the 'Forms' link under Useful Links section at [www.fshandbook.info](http://www.fshandbook.info) or on the Handbook CD-ROM.**

**PRA**



## Appendix 9.12 (rules 9.58 (1)(a))

### CERTIFICATE BY THE COUNCIL

1 Subject to 5, the certificate required by *IPRU (INS) 9.58 (1)* must state:

PRA

- (a) in relation to Forms 1 to 3, 13 to 17, 20 to 42, the supplementary notes to the forms and the statements required under rules 9.51 (1), 9.52 (1) and 9.53 (1), 9.54 (1), and 9.57 (1), that:
- (i) the *Lloyd's Return* has been prepared in accordance with *IPRU (INS) Chapter 9 Part VII, INSPRU and GENPRU*;
  - (ii) proper accounting records have been maintained and adequate information has been obtained by the *Society*; and
  - (iii) an appropriate system of control has been established and maintained by the *Society* over its transactions and records;
- (b) that, as applicable, the assets held by *members* throughout the *financial year* in question enabled the *Society* to comply with *INSPRU 1.1.30R (Localisation (UK firms only))* and *INSPRU 1.1.34R (Matching of assets and liabilities)*; and
- (c) in relation to the statement required by rule 9.58 (1)(b) to be made by the *Lloyd's actuary*, that:
- (i) for the purpose of preparing the statement, proper accounts and records have been maintained; and
  - (ii) the information given has been ascertained in conformity with *IPRU (INS) 9.58 (1)*.

2 Subject to 5, the certificate required by rule 9.58 (1) (a) must state that *capital resources* at least equal to the *capital resources requirements* under *GENPRU 2*, have been maintained at all times during the *financial year* in question.

PRA

3 Subject to 5, the certificate required by rule 9.58 (1)(a) must also state in relation to the *long-term insurance business* carried on by *members*:

PRA

- (a) that the requirements of *INSPRU 1.5.18R* to *INSPRU 1.5.33R* have been fully complied with and in particular that, subject to the provisions of *INSPRU 1.5.27R* assets attributable to *long-term insurance business*, the income arising, the proceeds of any realisation of such assets and any other income or proceeds allocated to the *long-term insurance fund* or *funds* have not been applied otherwise than for the purpose of the *long-term insurance business*;
- (b) that all guarantees given by a *member* of the performance by a related *insurer* which would fall to be met by any *long-term insurance fund* have been disclosed in the *Lloyd's Return*, and that the fund or

funds on which each of those guarantees would fall has been identified in it;

- (c) that the return in respect of *long-term insurance business* is not distorted by agreements between the *members* concerned or by any arrangements which could affect the apportionment of expenses and income; and

4 Subject to 5, where the *Council* is satisfied that:

PRA

- (a) the systems of control established and maintained by *managing agents* complied, at the end of the *financial year* in question, with any relevant guidance and it is reasonable to believe that those systems continued so to comply and will continue to so comply; or
- (b) the *Lloyd's Return* has been prepared in accordance with any relevant guidance; this must be so stated, by listing that guidance, in the certificate required by *IPRU (INS) 9.58 (1)(a)*.

5 Where, in the opinion of those signing the certificate, the circumstances are such that any of the statements required by 1 to 4 cannot truthfully be made, the relevant statements must be omitted.

PRA

6 Where, by virtue of 5, any statements have been omitted from the certificate this fact must be stated in a note.

PRA

## Appendix 9.13 (rules IPRU (INS) 9.58 (1)(b))

### STATEMENT BY THE LLOYD'S ACTUARY

1 The statement required by *IPRU (INS) 9.58 (1)(b)* must be prepared and signed by the *Lloyd's actuary*, and must:

PRA

- (a) state whether, for every *syndicate year* in which members carry on *general insurance business* either:
  - (i) the *syndicate actuary* has provided an unqualified opinion, which:
    - (1) is in a form conforming to guidance from the *actuarial bodies*; and
    - (2) confirms that the *technical provisions* set by the *managing agent* are at least equal to the *syndicate actuary's* best estimate; or
  - (ii) the *Lloyd's actuary* has set the *technical provisions* (both gross and net of reinsurance recoveries); and
- (b) describe any source of uncertainty in the liabilities covered by the *technical provisions*, which in his opinion is material to the *Society* as a whole:
  - (i) which any *syndicate actuary* mentions in his opinion; or
  - (ii) which affects any *syndicate year* for which the *Lloyd's actuary* has set the *technical provisions*.

2 If the *Lloyd's actuary* has set the *technical provisions* for any *syndicate year*, the statement must include an opinion covering those *technical provisions*, which:

PRA

- (a) confirms that they are at least equal to his best estimate; and
- (b) is in a form conforming to guidance for *syndicate actuaries* from the *actuarial bodies*, modified to show:
  - (i) that he is retained by the *Society* and not the *managing agent*;
  - (ii) that he, and not the *managing agent*, set the *technical provisions*; and
  - (iii) separately, the *technical provisions* of each *syndicate year* covered.

3

If the *Lloyd's actuary* considers it necessary, such qualification, amplification or explanation as may be appropriate must be added to the statement.

PRA

## Appendix 9.14 (rule IPRU (INS) 9.58 (1))

### CERTIFICATE BY SYNDICATE ACTUARY

1            The certificate required by *IPRU (INS) 9.58 (1)(c)* to be signed by the *syndicate actuary* appointed to a *syndicate* in which *members* carry on *long-term insurance business* must state:

PRA

- (a)            whether in his opinion, proper records have been kept by the *managing agent* adequate for the purpose of the valuation of the liabilities of the *syndicate*;
- (b)            whether the sum of the *mathematical reserves* and the deposits received from reinsurers as shown in Form 14 constitute proper provision at the end of the *financial year* for the *long-term insurance liabilities* where these liabilities:
  - (i)            include any increase in liabilities arising from a distribution of surplus as a result of an investigation as at the end of the *financial year* into the financial condition of the *long-term insurance business*; and
  - (ii)           include all liabilities arising from *deposit back arrangements*;but exclude liabilities which had fallen due before the end of the *financial year*, other than those arising from deposit back arrangements;
- (c)            whether the liabilities have been valued in accordance with *INSPRU* and *GENPRU* in the context of assets valued in accordance with *GENPRU*, as shown in Form 14;
- (d)            by way of a list, the professional guidance that has been complied with;
- (e)            whether in his opinion, premiums for contracts entered into during the *financial year* and the income earned on them are sufficient on reasonable actuarial assumptions, taking into account other financial resources of the *members* and the *Society* that are available for the purpose, to enable the *members* to meet their commitments and, in particular, to establish adequate *mathematical reserves*; and
- (f)            whether the amounts in Form 60 are accurate.

2            If the *syndicate actuary* considers it necessary, such qualification, amplification or explanation as may be appropriate must be added to the certificate.

PRA



## Appendix 9.15 (rule 9.31 IPRU(INS)9.58(3))

### Auditors' Report

- 1 The certificate required by *IPRU (INS) 9.58 (2)* must, in addition to any statement required by section 498 of the Companies Act 2006, state:
- PRA**
- (a) that in the auditors' opinion, Forms 9 to 17, 20 to 42, the supplementary notes to the forms and the statements required under *IPRU (INS) 9.51 (1)*, *IPRU(INS) 9.52 (1)*, *IPRU (INS) 9.53 (1)* and *IPRU (INS) 9.54 (1)* have been properly prepared in accordance with *IPRU (INS) Chapter 9 Part VI, INSPRU* and *GENPRU*;
  - (b) that according to the information and explanations that the auditors have received:
    - (i) in their opinion, the certificate required to be signed in accordance with *IPRU (INS) 9.58 (1)(a)*, otherwise than in relation to statements to which paragraph 1(c) of this table relates, has been properly prepared in accordance with *IPRU (INS) Chapter 9 Part VII, INSPRU* and *GENPRU*; and
    - (ii) subject to paragraph 1(c), it was or was not unreasonable for the persons giving the certificate to have made the statements in it (other than statements to which paragraph 1(c) relates); and
  - (c) the extent to which, in giving their opinion, the auditors have relied:
    - (i) in respect of financial information supplied to the *Society* by *managing agents* on behalf of *syndicates*, on work carried out by *syndicate* auditors; and
    - (ii) in respect of *long-term insurance business* carried on by *members*, on the certificates of the *syndicate actuaries* given in accordance with the requirements of *IPRU (INS) Chapter 9 Part VII, INSPRU* and *GENPRU* with respect to the amounts in Form 60.
- 2 The audit opinion required by 1(b)(i) does not extend to cover the statements required under:
- PRA**
- (a) *IPRU (INS) 9.55 (1)* and ; and *IPRU (INS) 9.57 (1)*
  - (b) *IPRU (INS) Appendix 9.12 1(d)*, but only in so far as it relates to relevant guidance which either states that compliance with the guidance need not be 2 1 October 2009 audited or which relates to controls with respect to money laundering.
- 3 To the extent that the information and explanations they have received do not allow the auditors to express an opinion on whether it was or was not unreasonable for the *Council* to have made the statement required by *IPRU (INS) Appendix 9.12 1(a)(iii)* the auditors must add to their report such
- PRA**

qualification, amplification or explanation as may be appropriate.

4

PRA

Where the auditors refer in their report or in any note attached to their report to any uncertainty, the report must state whether, in the auditors' opinion, that uncertainty is material to determining whether the *Society* is able to meet the solvency requirements of *IPRU (INS)* Chapter 9 Part VII, *INSPRU* and *GENPRU*.

## Appendix 9.16 (Rule IPRU(INS)9.49(1)(b))

### Accounting Classes

1 For the purposes of *IPRU (INS) Chapter 9 Part VII*, the accounting classes for *general insurance business* are those set out in the following table:

PRA

Accounting class	Description	Corresponding classes of <i>general insurance business</i>
1	Accident and health	1 (other than 1(p) and 2)
2	Motor	1(p), 3 and 10
3	Aviation	1(p), 5 and 11
4	Marine	1(p), 6 and 2
5	Transport	7
6	Property	4, 8, and 9
7	Third-party liability	13
8	Miscellaneous and pecuniary loss	14, 15, 16, 17 and 18
9	Non-proportional treaty	
10	Proportional treaty	
11	Marine, aviation and transport treaty	



## Appendix 9.17 (rule 9.31 IPRU(INS)9.60(3))

### Accounting Records

1 The certificate in *IPRU(INS) 9.60 (3)* must state that:

**PRA**

- (a) the return has been properly prepared in accordance with the instructions referred to in *IPRU(INS) 9.60 (2)*;
- (b) proper accounting records have been maintained and adequate information has been obtained by the *managing agent*;
- (c) an appropriate system of control has been established and maintained by the *managing agent* over the *syndicate's* transactions and records;
- (d) in relation to the statement by the *syndicate actuary of a syndicate* carrying on *long-term insurance business* required by *IPRU(INS) 9.58 (1)(c)*:
  - (i) proper accounts and records have been maintained for the purpose of preparing the statement; and
  - (ii) the information given has been ascertained in conformity with *IPRU (INS) Appendix 9.14*.



## Appendix 9.18 (rule 9.31 IPRU(INS)9.60(7))

### Auditors' Report

1 The certificate in *IPRU(INS) 9.60 (7)* must state:

PRA

- (a) that in the auditors' opinion, the return has been properly prepared in accordance with the instructions referred to in *IPRU(INS) 9.60 (2)*;
- (b) that according to the information and explanations that the auditors have received:
  - (i) in their opinion, the certificate required to be signed in accordance with *IPRU(INS) 9.60 (3)* (other than statements to which paragraph 1(c) relates) has been properly prepared in accordance with the instructions; and
  - (ii) it was or was not unreasonable for the *persons* giving the certificate to have made the statements in it (other than statements to which paragraph 1(c) relates);
- (c) the extent to which, in giving their opinion, the auditors have relied, in respect of *long-term insurance business*, on the work of the *syndicate actuary*.

2 The audit opinion required by paragraph 1 does not extend to cover information on major treaty reinsurers or major facultative reinsurers.

PRA

3 To the extent that the information and explanations they have received do not allow the auditors to express an opinion as to whether it was or was not unreasonable for the persons giving the certificate required to be signed in accordance with *IPRU(INS) 9.60 (3)* to have made the statements therein, the auditors must add to their report such qualification, amplification or explanation as may be appropriate.

PRA



# **Interim Prudential Sourcebook**

## **Insurers**

### **Volume Three Guidance**

## Volume 3: Guidance

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#### *Guidance: FSA Guidance Notes*

Guidance Note P.1 [deleted]

Guidance Note P.2 [deleted]

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Guidance Note 2.1 [deleted]

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Guidance Note 2.3 [deleted]

Guidance Note 4.1 [deleted]

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Guidance Note 4.3 [deleted]

Guidance Note 4.4 [deleted]

Guidance Note 5.1 [deleted]

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Guidance Note 10.1 [deleted]

#### *Guidance: FSA 'Dear Director' Letters*

DD1 [deleted]

#### *Other Material: 'Dear Appointed Actuary' Letters*

DAA8 [deleted]

DAA9 [deleted]

DAA11 [deleted]

DAA13 [deleted]

DAA14 [deleted]

DAA15 [deleted]

## **Guidance Note P.1**

### **Systems and Controls over the Investments (and Counterparty Exposure) of Insurers with Particular Reference to the Use of Derivatives**

[Deleted]

## **Guidance Note P.2**

### **Systems and Controls over General Business Claims Provisions**

[Deleted]

## **Guidance Note P.3**

### **Systems and Controls in Insurers**

[Deleted]

## **Guidance Note 2.1**

### **Hybrid Capital: Admissibility for Solvency**

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## **Guidance Note 2.2**

### **Guidance on Applications for Waivers Relating to Implicit Items**

[Deleted]

## **Guidance Note 2.3**

### **Solvency Margin: Implementation of Solvency 1 Directives**

[Deleted]

## **Guidance Note 4.1**

### **Guidance for Insurers and Auditors on the Valuation of Assets Rules**

[Deleted]

## **Guidance Note 4.2 (rule 4.12)**

### **Use of Derivative Contracts in Insurance Funds**

[Deleted]

## **Guidance Note 4.4**

### **Linked Contracts**

[Deleted]

## **Guidance Note 5.1**

### **Resilience Test**

[Deleted]

## **Guidance Note 9.1**

### **Preparation of Returns**

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## **Guidance Note 9.2 (rule 9.3)**

### **Accounts and Statements for a Marine Mutual Company (Forms M1 to M5)**

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## **Guidance Note 10.1:**

### **The Parent Undertaking Solvency Calculation**

[Deleted]

## **Guidance: FSA ‘Dear Director’ letters**

### **DD1**

## **Use of Derivatives – Linked Products**

[Deleted]

## **Other Material: ‘Dear Appointed Actuary’ letters**

### **DAA8**

## **Recommended Aids Reserving Policy and Resilience Test**

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## **Other Material: ‘Dear Appointed Actuary’ letters**

**DAA9**

### **Pensions Review: Reserving for Guarantees**

[Deleted]

## **Other Material: ‘Dear Appointed Actuary’ letters**

**DAA11**

### **Reserving for Guaranteed Annuity Options**

[Deleted]

## **Other Material: ‘Dear Appointed Actuary’ letters**

**DAA13**

### **Reserving for Guaranteed Annuity Options**

[Deleted]

## **Other Material: ‘Dear Appointed Actuary’ letters**

**DAA14**

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[Deleted]

## **Other Material: ‘Dear Appointed Actuary’ letters**

**DAA15**

### **Resilience Test**

[Deleted]

# The Interim Prudential Sourcebook for Investment Businesses

## Contents

### Chapter

- 1 Application and General Provisions
- 2 Authorised Professional Firms
- 3 Securities and Futures Firms which are not MiFID Investment Firms or which are Exempt BIPRU Commodities Firms
- 4 Lloyd's Firms
- 5 Investment Management Firms
- 6 Service Companies
- 7 [Deleted]
- 8 Requirements on credit unions which are CTF providers
- 9 Exempt CAD firms
- 10 [deleted]
- 11 -
- 12 -
- 13 Personal Investment Firms



# Transitional provisions

FCA

1 Table Transitional provisions applying to IPRU(INV)

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1			[Deleted: material moved to UPRU]	[Deleted: material moved to UPRU]	[Deleted: material moved to UPRU]
2			[Deleted]	[Deleted]	[Deleted]
3	<i>IPRU(INV)</i> 9.2.5R and <i>IPRU(INV)</i> 13.1.4(2)R (b)	R	The new limits of <i>indemnity</i> apply to a <i>professional indemnity policy</i> or a comparable guarantee commenced, renewed or extended with effect from or after 1 March 2009. Any other existing non-annual arrangements must be aligned with the new <i>limits of indemnity</i> before 1 March 2010	1 March 2009 to 28 February 2010	1 March 2009
4	[deleted]				



# INTERIM PRUDENTIAL SOURCEBOOK FOR INVESTMENT BUSINESSES

## 1 Chapter 1: Application and General Provisions

### 1.1 PURPOSE

1.1.1 Before 1 January 2007, the Interim Prudential Sourcebook for Investment Businesses (*IPRU(INV)*) was the part of the *Handbook* that dealt with capital requirements for *investment firms* subject to the position risk requirements of the previous version of the *Capital Adequacy Directive*. Now, however, *investment firms* which are subject to the risk-based capital requirements of the *Capital Adequacy Directive* are subject to the General Prudential sourcebook (*GENPRU*) and the Prudential sourcebook for Banks, Building Societies and Investment Firms (*BIPRU*).

FCA PRA

1.1.2 The *rules* and *guidance* in this sourcebook will assist the *appropriate regulator* to meet the statutory objectives. This sourcebook does so by setting minimal capital and other risk management standards thereby mitigating the possibility that firms will be unable to meet their liabilities and commitments to *consumers* and counterparties.

FCA PRA

1.1.3 The general scheme of this sourcebook is, wherever appropriate, to apply the financial and other prudential standards which applied to a *firm* immediately prior to it becoming authorised by the *appropriate regulator* under the *Act*. For convenience, the chapter numbers adopted in this sourcebook correspond with those of the rulebooks of *previous regulators*.

FCA PRA

1.1.3A This sourcebook does not apply to *BIPRU* investment firms except as follows:

FCA PRA

- (1) it does apply to certain exempt *BIPRU commodities firms*; and
- (2) chapter TP of *BIPRU* applies parts of *IPRU(INV)* to certain *BIPRU investment firms* on a transitional basis.

1.1.4 This sourcebook does not apply to *banks, building societies, insurers, the Society of Lloyd's* (except in relation to underwriting agents), *friendly societies* and certain other categories of *firm* and *members' advisers*.

FCA PRA

1.1.5 On becoming authorised by the *appropriate regulator* a *firm* will have to comply with the particular chapter of this sourcebook appropriate to its business. The *firm* will be able to seek guidance on this during the authorisation procedure. If subsequently, the business for which a *firm* has *permission* changes it may be necessary for it to comply with a different set of financial resources requirements. *Firms* will be able to discuss this aspect with the appropriate regulator during the application process.

FCA PRA

1.1.6 The *Supervision manual* sets out provisions relating to the periodic reporting and notification of financial information to the *appropriate regulator* or to the auditing of accounts. However, this sourcebook contains a few additional notification requirements (*notification rules*).

FCA PRA

## 1.2 APPLICATION

1.2.1 R The *Glossary* applies to the transitional provisions, this chapter (*IPRU(INV) 1*, *IPRU(INV) 2*, *IPRU(INV) 4*, *IPRU(INV) 6* and *IPRU(INV) 13*).

FCA PRA

1.2.2 R (1) *IPRU (INV)* applies to:

FCA PRA

- (a) a *members' adviser*;
  - (b) an *investment management firm*;
  - (c) a *personal investment firm*;
  - (d) an *authorised professional firm*;
  - (e) a *securities and futures firm*;
  - (f) a *service company*;
  - (g) the *Society of Lloyd's* (in relation to *underwriting agents*);
  - (h) [deleted]
  - (i) a *credit union* which is a *CTF provider*; and
  - (j) an *exempt CAD firm*.
- (2) *IPRU (INV)* does not apply to:
- (a) a *lead regulated firm*; or
  - (b) a *media firm*;
  - (c) a *BIPRU investment firm* (unless it is an *exempt BIPRU commodities firm*).
- (3) The definitions in the *Glossary* (which is applicable to the *Handbook* generally) apply to this chapter.

1.2.3 G For the avoidance of doubt, *IPRU (INV)* does not apply to any of the following:

FCA PRA

- (a) a *bank*; or
- (b) a *building society*; or
- (c) a *friendly society*; or
- (d) an *ICVC*; or

- (e) an *incoming EEA firm* or an *incoming Treaty firm* which does not have a *top up permission*; or
- (f) an *insurer*, or
- (g) a *UCITS qualifier*, or
- (h) a *UCITS management company*.

## OBLIGATION TO COMPLY

1.2.4 R A *firm* of a kind listed in the left-hand column of Table 1.2.4R must comply with the provisions of IPRU (INV) shown in the right hand column and, where relevant, the provisions of Chapter 14.

FCA	PRA
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1.2.5 R Table

FCA	PRA
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This table belongs to IPRU (INV) 1.2.4R

<i>Authorised professional firm</i>	Chapters 1 and 2
<i>Securities and futures firm (which is not a MiFID investment firm)</i>	Chapters 1 and 3
<i>Securities and futures firm (which is an exempt BIPRU commodities firm)</i>	Chapters 1 and 3
<i>The Society of Lloyd's (in relation to underwriting agents) and members' advisers</i>	Chapters 1 and 4
<i>Investment management firm</i>	Chapters 1 and 5
<i>An exempt CAD firm or a local firm</i>	Chapters 1 and 9
<i>Service company</i>	Chapters 1 and 6
<i>Personal investment firm</i>	Chapters 1 and 13
<i>Credit union which is a CTF provider</i>	Chapters 1 and 8

## CAPITAL SUBSTITUTES: TRANSITIONAL PROVISION

1.2.6 G The financial resource requirements of the Financial Services Act regulators permitted certain types of borrowings or facilities to be treated as part of a *firm's* capital resources. The most common example is that of a subordinated loan which met the relevant conditions. The following provisions permit *firms* to continue to use these borrowings or facilities in the same way as under the relevant *previous regulator's* rules, provided that certain conditions are met.

FCA	PRA
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1.2.7 R (1) If a *firm* was, immediately before *commencement* permitted to treat "relevant funds" as part of its capital resources under the financial resource rules of a *previous regulator* applicable to the

FCA	PRA
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*firm*, it may treat those funds in an equivalent manner under the corresponding provisions of *IPRU (INV)*, provided that the conditions in (3) are met.

- (2) For the purposes of this *rule* “relevant funds” are funds provided to the *firm* under the terms of
- (a) a subordinated loan agreement; or
  - (b) qualifying undertaking; or
  - (c) any other instrument treated in an equivalent manner under the financial resources *rules* applicable to the *firm*.
- (3) The conditions referred to in (1) are either:
- (a) in the case of a subordinated loan agreement, qualifying undertaking or other relevant instrument to which the *firm’s previous regulator* is not party:
    - (i) the parties to it treat all rights (including, without limitation, rights to notice) which the agreement, undertaking or instrument grants to the *firm’s previous regulator* as having been granted to the *appropriate regulator*; and
    - (ii) if there is a variation of the commercial terms the parties include, in the terms of the instrument executed to effect the variation, provision to substitute reference to the *appropriate regulator* in place of any reference to the *firm’s previous regulator*; or
  - (b) in the case of a subordinated loan agreement, qualifying undertaking or other relevant instrument to which the *firm’s previous regulator* is party, the parties treat the rights accorded to the self regulating organisation under the relevant instrument as having been assigned to the *appropriate regulator* immediately before *commencement*.

1.2.8 G An instrument treated in an equivalent manner would, for example, include (in relation to a *personal investment firm*) a "PASS loan".

FCA	PRA
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## 2 Chapter 2: Authorised professional firms

### 2.1 APPLICATION

- 2.1.1 R (1) This chapter applies to an *authorised professional firm* in accordance with *IPRU (INV) 2.1.2R* and *2.1.3R*.
- FCA
- (2) The definitions in the *Glossary* apply to this Chapter.
- 2.1.2 R (1) An *authorised professional firm* of a kind falling within (2) must comply with such of *IPRU (INV) 3, 5, 9* or *13* which in accordance with *IPRU (INV) 2.1.4R*, most appropriately correlates to the type and scale of the business which it conducts.
- FCA
- (2) The type of *authorised professional firm* to which (1) applies is one:
- (a) which is also an *exempt CAD firm*;
  - (b) which acts as a *market maker*;
  - (c) which acts as a *stabilising manager*;
  - (d) which acts as the trustee or operator of a *regulated collective investment scheme*;
  - (e) which acts as a *broker fund adviser* or otherwise participates in a *broker fund* arrangement;
  - (f) whose main business, having regard to (3), is not the practice of its profession or professions;
  - (g) whose *permission* includes a requirement that it acts in conformity with the financial resources *rules* applicable to another type of *firm*; or
  - (h) whose *permission* includes *establishing, operating or winding up a personal pension scheme*.
- (3) For the purposes of (2)(f), a *firm's* professional business practice is not the “main business” of the *firm* unless the proportion of income it derives from *professional fees* is, during its annual accounting period, at least 50% of the *firm's* total income (a temporary variation of not more than 5% may be disregarded for this purpose).
- (4) An *authorised professional firm* which, in accordance with (1), is required to comply with *IPRU (INV) 3, 5, 9* or *13* must immediately give notification of that fact to the *FCA* in accordance with *SUP 15.7* (Forms and method of notification).
- 2.1.3 R An *authorised professional firm* which does not fall within *IPRU (INV) 2.1.2R* must comply with sections 2.2, 2.3 and 2.4 of this chapter.
- FCA

2.1.4 R This table belongs to *IPRU (INV) 2.1.1R*

FCA

TYPE OF BUSINESS ACTIVITY	CHAPTER OF SOURCEBOOK
<p>(i) <i>managing investments</i> other than for <i>retail clients</i>; or</p> <p>(ii) <i>OPS activity</i>; or</p> <p>(iii) [deleted]</p> <p>(iv) acting as the <i>ACD</i> or <i>depository</i> of an <i>ICVC</i>; or</p> <p>(v) <i>establishing, operating or winding-up</i> other <i>collective investment schemes</i>; or</p> <p>(va) <i>establishing, operating or winding up</i> a <i>personal pension scheme</i>; or</p> <p>(vi) <i>safeguarding and administering investments</i>;</p>	<p><i>Investment management firm - IPRU (INV) 5</i></p> <p><i>Investment management firm</i> (which is an exempt <i>CAD</i> firm) – <i>IPRU(INV) 5</i> and <i>9</i></p>
<p>(i) <i>advising on, or arranging deals in, packaged products</i>; or</p> <p>(ii) <i>managing investments for retail clients</i>;</p>	<p><i>Personal investment firm - IPRU (INV) 13</i></p>
<p>(i) a <i>regulated activity</i> carried on as a member of an <i>exchange</i>; or</p> <p>(ii) acting as a <i>market maker</i> in <i>securities</i> or <i>derivatives</i>; or</p> <p>(iii) <i>corporate finance business</i>; or</p>	<p><i>Securities and futures firm</i> (which is an exempt <i>CAD</i> firm) - <i>IPRU(INV) 9</i></p> <p><i>Securities and futures firm</i> (which is not a <i>MiFID investment firm</i>) - <i>IPRU (INV) 3</i></p>
<p>(iv) <i>dealing or arranging deals in securities</i> or <i>derivatives</i>, other than <i>inter-professional investments</i>; or</p> <p>(v) the provision of clearing services as a <i>clearing firm</i>; or</p> <p>(vi) <i>spread betting</i>;</p>	

2.1.5 G An *authorised professional firm* will be a *MiFID investment firm* if its business activities include the provision of *investment services and/or activities* for a third party. An *authorised professional firm* will not however be a *MiFID investment firm* if it falls within one of the exclusions contained in Article 2 of *MiFID*. Article 2(1)(c) provides an exclusion for an *authorised professional firm* which provides *investment services and/or*

FCA

*activities* in an incidental manner in the course of a professional activity and that activity is regulated by the *firm's designated professional body*.

- 2.1.6 G The *FCA* considers the scope of this exclusion cannot be precisely defined. Ultimately questions of interpretation are for the Court to determine. The *FCA* considers that to satisfy the exclusion the services cannot be the major part of the practice of the *firm*. The *FCA* also considers the following factors to be among those that are relevant:
- FCA**
- (1) the scale of *regulated activity* in proportion to other professional services provided;
  - (2) whether and to what extent activities that are *regulated activities* are held out as separate services;
  - (3) the impression given as to how the *firm* provides *regulated activities*, for example through its advertising or other promotions of its service.

## 2.2 FINANCIAL RESOURCES REQUIREMENTS

- 2.2.1 R (1) **A *firm* must be able to meet its liabilities as they fall due.**

- FCA**
- (2) **In complying with (1) a *firm* may use any assets which are available to meet any of its liabilities.**

- 2.2.2 G *Firms* are reminded that:

- FCA**
- (1) requirements relating to the systems and controls which *firms* must establish and maintain for ensuring compliance with financial resources and other requirements are set out in *SYSC*.
  - (2) the financial reports that a *firm* is required to make to the *FCA* are set out in *SUP 16*.

## 2.3 PROFESSIONAL INDEMNITY INSURANCE

- 2.3.1 R **A *firm* must effect and maintain at all times adequate professional indemnity insurance cover for all the business activities which it carries on, or for which it is responsible.**

- 2.3.2 G In assessing the adequacy of a *firms'* professional indemnity insurance cover for the purposes of *IPRU(INV) 2.3.1R*, the *FCA* may have regard to a *firm's* compliance with the professional indemnity insurance requirements of its *designated professional body* in force at the time.
- FCA**

## 2.4 BONDING REQUIREMENT FOR ACCOUNTANTS

- 2.4.1 R **This section applies to a *firm* of accountants practising as such in the UK.**

**FCA**

2.4.2 R (1) **If the aggregate value of *client money* and *bonded investments* a *firm* holds for a *client* is over £50,000 then the *firm* must ensure that it holds a bond for the excess over £50,000.**

FCA

(2) **A *firm* must:**

(a) **ensure that the bond is in the form prescribed by the *FCA*;**

(b) **ensure that the *person* specified to act as trustee in the bond is a *designated professional body* or a solicitor practising as such in the UK;**

(c) **ensure that the bond is lodged with the trustee; and**

(d) **be able at all times to show that the amount of the bond is sufficient to meet the requirements of (1).**

2.4.3 R **A *firm* must notify the *FCA* immediately:**

FCA

(1) **of any bond taken out specifying the amount and where it is lodged; and**

(2) **of the arrangements it has made to comply with *IPRU (INV) 2.4.2R* if a bond is not renewed or is cancelled.**

2.4.4 G (1) *Firms* which hold *client money* or bonded investments for more than one *client*, may hold one bond to cover all of the *clients* concerned. The bonding requirements may be complied with by taking out a global bond. In firms with numerous offices compliance may be achieved in practice by calculating the requirement based on figures supplied by offices which is likely to be at least quarterly. These figures would need to be supplied and assessed soon after the end of each quarter.

FCA

(2) To ensure the global cover is sufficient, this approach would require an estimated safety margin to be incorporated, to allow for changes in the amounts of *client money*, *investments* or assets held. An additional prudent measure would be to ensure that exceptional amounts of these assets are notified by branch offices so that the *firm* can check whether the safety margin can absorb them and reconsider whether the total global bond cover remains sufficient.

2.4.5 G *Firms* which do not expect to hold *bonded investments* or *client money* in excess of the value limit need not hold a bond. However, *firms* may wish to make contingency arrangements with a surety whereby a bond facility is available and can be executed and delivered at short notice.

FCA

### 3 Chapter 3: Financial resources for Securities and Futures Firms which are not MiFID Investment Firms or which are Exempt BIPRU Commodities Firms

3-A R The definitions in the glossary at Appendix 1 apply to this chapter.

FCA

3-1 R This chapter applies to a *securities and futures firm* which:

FCA

- (a) is not a *MiFID investment firm*;
- (b) is an exempt *CAD firm* that carries on any *regulated activity* other than *MiFID business*; or
- (c) is an exempt *BIPRU commodities firm*.

FCA

G An exempt *BIPRU commodities firm* is subject to the non-capital requirements of *GENPRU* and *BIPRU* as indicated in *BIPRU* TP 15.

3-1A R This chapter does not apply to an *oil market participant* unless it is a member of a *recognised or designated investment exchange* which is, under the rules of that exchange, entitled to trade with other members.

FCA

G An *oil market participant* to which this chapter does not apply is still subject to the requirement of *Principle 4* to have adequate financial resources.

3-1B R The provisions on concentrated risk in this chapter do not apply to an exempt *BIPRU commodities firm* which applies the *large exposure* requirements in *BIPRU 10*.

FCA

G *BIPRU 10* applies to an exempt *BIPRU commodities firm* unless it qualifies for exemption under *BIPRU* TP 16.

3-1C G The table in *IPRU(INV)* 3-1D G sets out the parts of the *Handbook* containing provisions on *large exposure* or concentrated risk which apply to a *securities and futures firm*.

FCA

3-1D G Table

FCA

Applicability of the provisions to securities and futures firms

This table belongs to *IPRU(INV)* 3-1C G

(1)	(2)	(3)
Type of securities and futures firm	Whether conditions in <i>BIPRU</i> TP 16 are satisfied	Part of <i>Handbook</i> applicable for large exposure or concentrated risk requirements
<i>Energy market participant</i> (which is an exempt <i>BIPRU commodities firm</i> )	Yes	Not applicable

with a waiver from <i>IPRU(INV) 3</i>	No	<i>BIPRU 10</i> applies
<i>Energy market participant</i> (which is an exempt <i>BIPRU commodities firm</i> ) to which <i>IPRU(INV) 3</i> applies	Yes	<i>IPRU(INV) 3</i> applies
	No	<i>BIPRU 10</i> applies
<i>Oil market participant</i> (which is an exempt <i>BIPRU commodities firm</i> ) if it is a member of a <i>recognised investment exchange</i> or a <i>designated investment exchange</i> which is, under the rules of that exchange, entitled to trade with other members to which <i>IPRU(INV) 3</i> applies	Yes	<i>IPRU(INV) 3</i> applies
	No	<i>BIPRU 10</i> applies
<i>Other oil market participant</i> (which is an exempt <i>BIPRU commodities firm</i> ) to which <i>IPRU(INV) 3</i> does not apply	Yes	Not applicable
	No	<i>BIPRU 10</i> applies
<i>Exempt BIPRU commodities firm</i> which is not an <i>energy market participant</i> or <i>oil market participant</i>	Yes	<i>IPRU(INV) 3</i> applies
	No	<i>BIPRU 10</i> applies
<i>Securities and futures firm</i> (which is not a <i>MiFID investment firm</i> )	Not applicable	<i>IPRU(INV) 3</i> applies

3-2 R A firm must at all times have available the amount and type of *financial resources* required by the rules of the *FCA*.

FCA

3-5 R A firm must notify the *FCA* immediately it becomes aware that it is in breach of, or that it expects shortly to be in breach of, rule 3-2.

FCA

*Valuation of positions \**

3-41(9) R A firm must value a position on a prudent and consistent basis, as well as having regard to the liquidity of the instrument concerned and any special factors which may adversely affect the closure of the position, and must adopt the following general policies:

FCA

- (a) a position must be valued at its close out price (close out price means that a long position shall be valued at current bid price and a short position at current offer price); where firm two way prices are not available a firm must value its position in accordance with the notes to this rule;\*
- (b) where a firm is entitled to use a risk assessment model in the calculation of its *PRR* on *options* positions, it may value its *options* using the values derived from the model;
- (c) where a firm does not use a model as described in (b) above and prices are not published for its *options* positions, a firm

must determine the *mark to market* value as follows:

- (i) for purchased *options*, the *mark to market* value must be the product of:
  - (aa) the *in the money* amount; and
  - (bb) the quantity underlying the *option*;
- (ii) for written *options* the *mark to market* value must be the initial premium received for the *option* plus the product of:
  - (aa) the amount by which the current *in the money* amount exceeds either the *in the money* amount at the time the contract was written, or zero if the contract was *out of the money* at the time it was written; and
  - (bb) the quantity underlying the *option*;
- (d) a *firm* must calculate the value of a *swap* contract or an *FRA* having regard to the net present value of the *future* cash flows of the contract, using current interest rates relevant to the periods in which the cash flows will arise;
- (e) notwithstanding (d) above, a *firm* may refrain from marking a *swap* or an *FRA* to market where it enters into such transactions on a matched principal basis, provided that it is confident that such positions are fully matched;
- (f) a *firm* that is a partnership which experiences *exceptional* administrative or technical difficulties complying with the valuation procedure outlined above should notify the *FCA* immediately; and
- (g) in the case of interest rate *swaps*, currency *swaps* and *FRAs*, a *firm* may limit the bid/offer valuation required under (a) to its net position.

**FCA**

G The *FCA* does not lay down a precise formula for calculating the value of *swaps* and *FRAs* for the purposes of this rule. However, it will expect a *firm* to employ a valuation formula which accords with generally accepted market practice.

**FCA**

G The *FCA* may permit by modification or waiver of this rule an alternative arrangement if it is satisfied that neither the *firm* nor its *counterparties* will be put at risk by the adoption of that alternative procedure.

\* For notes on the valuation of positions, see **Appendix 21**

### **3-60 FIRMS TO WHICH RULES 3-61 TO 3-182 APPLY**

#### ***Broad scope firms***

3-60(1) R Rules 3-61 to 3-182 apply to a *broad scope firm* except that rules 3-80 to 3-178 do not apply to a *venture capital firm* or in respect of *bidding in emissions auctions* carried on by a *firm* that is exempt from *MiFID* under article 2(1)(i).

FCA

*Arrangers*

3-60(2) R Rules 3-61 to 3-182 apply to an *arranger*, except that:

FCA

- (a) Rule 3-61 and rules 3-63 to 3-182 do not apply to a *corporate finance advisory firm* or a *derivative fund manager*; and
- (b) rules 3-80 to 3-178 do not apply to a *venture capital firm*.

*Corporate finance advisory firms*

3-60(3) R Rule 3-61 and rules 3-63 to 3-182 do not apply to a *corporate finance advisory firm* which must instead comply with the following two capital requirements at all times:

FCA

- (a) *tangible net worth* must exceed £10,000; and
- (b) net current assets must exceed £10,000.

3-60(3A) R (a) Net current assets for the purposes of rule 3-60(13)R(b) shall be as calculated for the purposes of producing a balance sheet in accordance with the following provisions, as applicable:

FCA

- (i) Format 1 of the Balance Sheet Format of Schedule 4 to the Companies Act 1985; or
- (ii) Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409); or
- (iii) Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410); or
- (iv) Schedule 1 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); or
- (v) Schedule 1 to the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913).

*Advisers and locals/traded options market makers*

3-60(4) R Rules 3-61 to 3-182 do not apply to an *adviser* or *local/traded options market maker* which must instead comply with the following capital requirements at all times:

FCA

- (a) *tangible net worth* must be positive;
- (b) in the case of an *adviser*, net current assets must be positive; and
- (c) in the case of a *local traded options market maker*, the *firm* must be able to meet its liabilities as they fall due.

3-60(4A) R (a) Net current assets for the purposes of rule 3-60(4)R(b) shall be as calculated for the purposes of producing a balance sheet in accordance with the following provisions as applicable:

FCA

- (i) Format 1 of the Balance Sheet Format of Schedule 4 to the Companies Act 1985; or
- (ii) Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409); or
- (iii) Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410); or
- (iv) Schedule 1 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); or
- (v) Schedule 1 to the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913).

*Derivative fund managers*

3-60(5) R Rule 3-61 and rules 3-63 to 3-182 do not apply to a *derivative fund manager* which must instead comply with the following two capital requirements at all times:

FCA

- (a) *tangible net worth* must exceed £10,000; and
- (b) net current assets, excluding investment in any pooled fund or *unregulated collective investment scheme* which it manages, must exceed £10,000.

3-60(5A) R (a) Net current assets for the purposes of rule 3-60(5)R(b) shall be as calculated for the purposes of producing a balance sheet in accordance with the following provisions as applicable:

FCA

- (i) Format 1 of the Balance Sheet Format of Schedule 4 to the Companies Act 1985; or
- (ii) Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409); or
- (iii) Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI

2008/410); or

- (iv) Schedule 1 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); or
- (v) Schedule 1 to the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913).

*Dematerialised instruction transmitters*

3-60(6) R Rules 3-61 to 3-182 apply to a *dematerialised instruction transmitter*.

FCA

3-60(7) R Rules 3-61 to 3-182 apply to a *firm* whose *permission* includes *establishing, operating or winding-up a personal pension scheme*.

FCA

*Exempt CAD firms*

3-60(8) R Rules 3-61 to 3-182 do not apply to an *exempt CAD firm*, unless it carries on any *regulated activity* other than *MiFID business*.

FCA

*Exempt BIPRU commodities firms*

3-60(9) G An *exempt BIPRU commodities firm* should determine whether it is a *broad scope firm* or one of the other categories in this *rule*.

FCA

**3-61 THE BASIC COMPUTATION**

3-61(1) R A *firm* must, at all times, maintain *financial resources* in excess of its *financial resources requirement*.

FCA

3-61(2) R A *firm* must calculate its *financial resources* and its *financial resources requirement* in accordance with the table below and rules 3-62 to 3-182.

FCA

FCA

R Table 3-61. The basic financial resources calculation

Financial resources	Financial resources requirement
Capital ("A")	Primary requirement ("E")
the sum of -	the sum of -
- ordinary share capital	- base requirement
- preference share capital	- total liquidity adjustment
- share premium account	- charged assets
- profit and loss account	- <i>contingent liabilities</i>
- other approved reserves, and	- deficiencies in <i>subsidiaries</i>
- partners' current and capital	

accounts, and - eligible LLP members' capital Intangible assets and excess LLP members' drawings ("B") A - B = <i>tangible net worth</i> ("C")	
Eligible capital substitutes ("D") the sum of - - subordinated loans - approved bank bonds - approved undertakings	Total PRR ("F") Total CRR ("G")
C + D = <i>financial resources</i>	E + F + G = <i>financial resources requirement</i>

### 3-62 TANGIBLE NET WORTH

#### *Calculation*

3-62(1) R A firm must calculate its *tangible net worth* in accordance with table 3-61, subject to (2), (3) and (4) below.

FCA

#### *Redeemable shares*

3-62(2) R A firm may include redeemable *share* capital as part of *tangible net worth* only if:

FCA

- (a) the firm's memorandum and articles of association or a shareholders' agreement contain provisions that:
  - (i) redemption may not occur if the firm's *financial resources* after redemption would be less than or equal to 120% of its *financial resources requirement*;
  - (ii) dividends may not be paid if the firm's *financial resources* after payment would be less than or equal to 120% of its *financial resources requirement*; and
  - (iii) in the case of a shareholder's agreement, any assignee of the shares is subject to the provisions of the agreement; and
- (b) the firm, before issuing any preference shares, notifies the FCA of its intention to do so.

#### *Notice of redemption*

3-62(3) R A firm must provide the FCA with six months' written notice of redemption of any of its redeemable shares.

FCA

### Approved reserves

3-62(4) R **A firm may not include reserves other than retained profits as part of tangible net worth.**

FCA

FCA

G A firm that wishes to include other reserves will need to apply for a modification or waiver of this rule.

### Profit and loss account/partners' current and capital accounts

3-62(5) R **For the calculation of tangible net worth, a firm must:**

FCA

- (a) **deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;**
- (b) **in respect of a defined benefit occupational pension scheme, derecognise any defined benefit asset.**

3-62(6) R **A firm may, for the purposes of calculating tangible net worth, substitute for a defined benefit liability the firm's deficit reduction amount. The election must be applied consistently in respect of any one financial year.**

FCA

3-62(7) G A firm should keep a record of and be ready to explain to its supervisory contacts in the FCA the reasons for any difference between the deficit reduction amount and any commitment the firm has made in any public document to provide funding in respect of a defined benefit occupational pension scheme.

FCA

3-62(8) R **Where applicable, a firm must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.**

FCA

## 3-63 ELIGIBLE CAPITAL SUBSTITUTES

### Calculation

3-63(1) R **A firm must calculate its eligible capital substitutes in accordance with table 361, subject to (2) to (9) below.**

FCA

### Approved eligible capital substitutes

3-63(2) R **A firm may treat a subordinated loan, approved bank bond or approved undertaking as an eligible capital substitute only if it is:**

FCA

- (a) **drawn up in accordance with the relevant standard form obtained from the FCA; and**
- (b) **signed by authorised signatories of all the parties.**

**FCA** G If a *firm* wishes to use a form which differs from the standard form it will need to seek a modification to, or modification or waiver of, this rule.

**FCA** G A *firm* may, under the provisions of IPRU(INV) 1.2.5R continue to treat a subordinated loan, bank bond or approved undertaking as an eligible capital substitute if it was entitled to do so immediately prior to the *specified day*, and the other conditions set out in IPRU(INV) 1.2.5R are met.

**Approved lenders**

**3-63(3)** R A *firm* may treat a subordinated loan as an *eligible capital substitute* only if the lender is:

- FCA**
- (a) the *firm's* controller;
  - (b) a *regulated banking institution*;
  - (c) an *approved person*; or
  - (d) a *regulated financial institution*.

**FCA** G If the *firm* wishes to include as an *eligible capital substitute* a subordinated loan from a lender not within the above list, it will need to apply for a modification or modification or waiver of 3-63.

**Notice of repayment and termination**

**3-63(4)** R A *firm* must provide the *FCA* with five *business days* written notice of any repayment, prepayment or termination of a subordinated loan, *approved bank bond* or approved undertaking, except when the *firm's financial resources* after payment of interest or principal etc would be less than or equal to 120% of its *financial resources requirement*, in which case the *firm* must not repay, prepay or terminate any subordinated loan, *approved bank bond* or approved undertaking otherwise than in accordance with the terms of the relevant agreement.

**FCA**

**Amounts repayable within three months**

**3-63(5)** R A *firm* may not treat any amount of a subordinated loan which is repayable within three months as an *eligible capital substitute*.

**FCA**

**Limit on eligible capital substitutes**

**3-63(6)** R The total amount of *eligible capital substitutes* which a *firm* may take into account in its *financial resources* must not exceed four times *tangible net worth*.

**FCA**

**Limit on approved bank bonds**

**3-63(7)** R The total of *approved bank bonds* which a *firm* may treat as an *eligible capital substitute* must not exceed:

**FCA**

- (a) 30% of the base requirement; and

- (b) **CRR on exchange-traded-margined-transactions plus concentrated risk to one counterparty arising from exchange-traded-margined-transactions calculated under rules 3-173A and 3-175.**

*Limit on approved undertakings*

- 3-63(8) R A firm may only treat approved undertakings as an *eligible capital substitute* to the extent that its *approved bank bonds* are less than 30% of its base requirement.

FCA

*Approved undertakings*

- 3-63(9) R A firm may treat an undertaking as an *eligible capital substitute* only if the provider of the undertaking is:

FCA

- (a) a *regulated banking institution*; or  
(b) a *regulated financial institution*;

FCA

- G A firm that wishes to include an undertaking where the provider is neither of the above, it will need to seek a modification or waiver from the FCA.

**PRIMARY REQUIREMENT**

*Definition of primary requirement – General rule*

- 3-70 R A firm's *primary requirement* is the sum of:

FCA

- (a) the base requirement calculated in accordance with rule 3-71;  
(b) the total liquidity adjustment calculated in accordance with rule 3-75;  
(c) charged assets calculated in accordance with rule 3-76;  
(d) *contingent liabilities* calculated in accordance with rule 3-77;  
and  
(e) deficiencies in *subsidiaries* calculated in accordance with rule 3-78;

*Base requirement – General rule*

- 3-71 R A firm's base requirement is the highest of:

FCA

- (a) the absolute minimum requirement, calculated in accordance with rule 3-72;  
(b) the expenditure requirement, calculated in accordance with

rule 3-73; or

- (c) the volume of business requirement, calculated in accordance with rule 3-74.

*Absolute minimum requirement General rule*

3-72 R A firm's absolute minimum requirement is:

FCA

- (a) for an *arranger*: £10,000;
- (b) for a *financial bookmaker*: £50,000;
- (c) for an *agency broker*: £50,000;
- (d) for a *firm* which handles *client money* and assets relating to *marginised transactions* and segregates all *money* received from clients as *client money*: £50,000;
- (e) for a *non clearing floor member*: £50,000;
- (ea) for a *dematerialised instruction transmitter*: £50,000;
- (eb) for a *firm* that is exempt from *MiFID* under article 2(1)(i) and whose *permitted activities* include *bidding in emissions auctions*: £50,000;
- (f) for a *broad scope firm* other than one within (b) to (eb) above: £100,000.

3-73 EXPENDITURE REQUIREMENT

*General rule*

3-73(1) R A firm's expenditure requirement is:

FCA

- (a) for an *investment manager*, an *introducing broker* who is not responsible for its *counterparties'* performance; a *venture capital firm* which is an *arranger*, a *model A clearing firm*; a *dematerialised instruction transmitter*, or a *firm* that does not hold *client money* or assets but whose *permission* includes *establishing, operating or winding-up a personal pension scheme*: 6/52nds of *relevant annual expenditure*; or
- (b) for any other *firm*: 1/4 of *relevant annual expenditure*.

*Calculation of relevant annual expenditure*

3-73(2) R Subject to (3), (4) and (5) below, a *firm* must calculate its *relevant annual expenditure* with reference to the *firm's* most recent *annual financial statements*, as follows:

FCA

- (a) its total revenue; and
  - (b) any loss before taxation;
- less the aggregate of the following items:
- (c) profit before taxation;
  - (d) *bonuses*;
  - (e) *profit shares* and other appropriations of profit, except for fixed or guaranteed remuneration of a partner which is payable even if the *firm* makes a loss for the year;
  - (f) paid *commissions shared*, other than to *employees, directors, half commission men or appointed representatives* of the *firm*;
  - (g) fees, brokerage and other charges paid to *clearing houses, exchanges, approved exchanges* and *intermediate brokers* for the purposes of executing, registering or clearing transactions;
  - (h) interest payable to *counterparties*;
  - (i) interest payable on borrowings to finance the *firm's investment business* and *associated business*; and
  - (j) *exceptional or extraordinary items*, provided that it first notify the *FCA* in writing of the nature and amount of the item(s) concerned.

*Absence of annual financial statements*

3-73(3) R If a *firm* does not have *annual financial statements*, it must:

FCA

- (a) where it has just commenced trading, base its *relevant annual expenditure* on budgeted or other accounts which it submitted to the *FCA* as part of its application; or
- (b) where its accounts do not represent a 12 month period, calculate *relevant annual expenditure* on a proportionate basis agreed by the *FCA*.

*Adjustments to relevant annual expenditure*

3-73(4) R A *firm* must use a *relevant annual expenditure* adjusted to take account of its circumstances where:

FCA

- (a) there has been a significant change in the circumstances or activities of the *firm*; or

- (b) the *firm* has a material proportion of its expenditure incurred on its behalf by third parties and such expenditure is not fully recharged to the *firm*.

**FCA** G *FCA* would for example consider an application to vary a *firm*'s permitted activity as a significant change.

**FCA** G *FCA* would consider 10% of a *firm*'s expenditure incurred on its behalf by third parties to be material.

**FCA** G If a *firm* is in any doubt, it should always seek guidance from the FCA.

#### *Recent Authorisation*

**3-73(5)** R If a *firm* has not been authorised long enough to have prepared *annual financial statements* after authorisation, it must base its *relevant annual expenditure* on budgeted or other accounts which it submitted to the *FCA* as part of its application.

**FCA**

#### *Application*

**3-74(1)** R The volume of business requirement applies only to a *firm* which settles *marginised transactions* for *counterparties*.

**FCA**

#### *Marginised transactions*

**3-74(2)** R A *firm*'s volume of business requirement is 3.5% of the aggregate gross amounts of any initial margin (as calculated in (3) below) of the *firm*'s *counterparties* at the relevant time.

**FCA**

#### *Initial margin*

**3-74(3)** R A *counterparty*'s initial margin for the purposes of (2) above is the sum of the following amounts:

**FCA**

- (a) in respect of *exchange traded* transactions, the *counterparty*'s *initial margin requirement*; and
- (b) in respect of *OTC* transactions, the amount of margin that the *counterparty* is required by the *firm* to deposit.

### **3-75** LIQUIDITY ADJUSTMENT

#### *General rule*

**3-75(1)** R A *firm*'s total liquidity adjustment is the sum of amounts specified as liquidity adjustments below.

**FCA**

#### *Intangible assets*

**3-75(2)** R The liquidity adjustment for intangible assets is nil (these must be deducted from capital to arrive at *tangible net worth* under 3-62).

**FCA**

Intangible assets do not include a deferred acquisition cost asset.

*Tangible fixed assets*

- 3-75(3) R The liquidity adjustment for tangible fixed assets is the total net book value of such assets, with the exception of land and buildings used as *security for non recourse loans* or other loans which a *firm* must treat under (4) and (5) below.

FCA

*Land and buildings used as security for non recourse loans*

- 3-75(4) R The liquidity adjustment for land or buildings used as security for a *non recourse loan* is the difference between the net book value of the land or building and the loan principal outstanding, except where the loan principal outstanding is higher than the net book value in which case there is no liquidity adjustment.

FCA

*Land and buildings used as security for other loans*

- 3-75(5) R The liquidity adjustment for land or buildings used as security for loans other than *non recourse loans* is the difference between the net book value of the land or building and the lower of:

FCA

- (a) 85% of a professional valuation of the land and buildings (which must have been carried out in the last two years); or
- (b) the principal outstanding,

except where both (a) and (b) are higher than the net book value in which case there is no liquidity adjustment.

*Physical stocks*

- 3-75(6) R The liquidity adjustment for physical stocks is the balance sheet value of such stocks, except for stock positions associated with the *firm's investment business* which are:

FCA

- (a) *physical commodities* for which the full contract price has been paid;
- (b) work in progress and finished goods which result from the processing of *physical commodities*; or
- (c) raw materials which will be combined with *physical commodities* to produce a finished processed commodity,

in which case there is no liquidity adjustment (but see *PRR* rules).

*Investments in connected companies*

- 3-75(7) R The liquidity adjustment for an *investment* in a *connected company* is the balance sheet value of the *investment*, except where the *investment* is a *marketable investment* which is not in a *subsidiary*, in which case there is no liquidity adjustment but such *investment* must

FCA

be subject to the *PRR* rules.

*Other investments*

- 3-75(8) R Other *investments* have no liquidity adjustment but instead are subject to the *PRR* rules.

FCA

*Prepayments*

- 3-75(9) R The liquidity adjustment for a prepayment is the balance sheet value of that prepayment, except that there is no liquidity adjustment to the extent that it relates to goods and services to be received or performed in the next three months (or six weeks in the case of an *investment manager*, an *introducing broker* who is not responsible for its *counterparties'* performance; a *venture capital firm* which is an *arranger*, or a *model A clearing firm*).

FCA

*Debtors arising from investment business or dealing activities*

- 3-75(10) R Debtors arising from *investment business* or *dealing activities* have no liquidity adjustment but instead are subject to the *CRR* rules.

FCA

*Other debtors*

- 3-75(11) R The liquidity adjustment for debtors other than debtors arising from *investment business* or *dealing activities* is the balance sheet value of the debtor, except that there is no liquidity adjustment in the following circumstances:
- (a) amounts due from *connected companies* which are *adequately secured* and are repayable within 90 days;
  - (b) unsecured amounts due at the request of the *firm* from a *connected company* which is a *regulated banking institution* within 90 days;
  - (c) unsecured amounts due at the request of the *firm* from a *connected company* which is a *regulated financial institution* within seven days;
  - (d) having given prior written notice to the *FCA*, unsecured amounts receivable at the request of the *firm* from a *connected company* within seven days under an *approved treasury arrangement*, up to a maximum of the *firm's* excess of *financial resources* over its *financial resources requirement* before taking into account the *approved treasury arrangement*;
  - (e) amounts receivable in respect of cash dividends declared by either *exchange traded companies* or *authorised persons* which have been outstanding for 30 days or less from the date the dividends were due to be paid;
  - (f) amounts accrued or receivable in respect of interest on *marketable investments* which have been outstanding for 30

days or less from the date the interest was due to be paid;

- (g) amounts receivable on U.K. value added tax which have been outstanding for 30 days or less from the date that the value added tax return was due to be received by HM Customs & Excise; and
- (h) amounts receivable on taxation other than U.K. value added tax which have been agreed with the appropriate tax authorities and have been outstanding for 30 days or less from the date that the amounts were due to be received.

*Cash deposits*

- 3-75(12) R The liquidity adjustment for a cash deposit is the balance sheet value of the deposit, except for *qualifying deposits* and those other deposits which are subject to rule 3-180.

FCA

*Other assets*

- 3-75(13) R The liquidity adjustment for assets other than those specifically stated above is the balance sheet value of the asset concerned. Other assets do not include a *defined benefit asset* or a deferred acquisition cost asset.

FCA

*Charged assets – General rule*

- 3-76 R A *firm* must calculate the *primary requirement* for charged assets as the aggregate balance sheet value of each asset of the *firm* over which a third party has the right of *sale* or retention on default by the *firm* except:

FCA

- (a) to the extent of any liability of the *firm* plus a reasonable margin in respect of the charged asset; or
- (b) where the asset is collateral for a transaction which is subject to the *CRR* rules.

*Contingent liabilities – General rule*

- 3-77 R A *firm* must calculate a *primary requirement* for each of its *contingent liabilities*.

FCA

*Deficiencies in subsidiaries – General rule*

- 3-78 R A *firm* must calculate the *primary requirement* for deficiencies in *subsidiaries* as an amount equal to any deficiency in shareholders' funds at any time of a *subsidiary* of the *firm* except to the extent that:

FCA

- (a) provision has already been made by the firm; or
- (b) the firm has already calculated a liquidity adjustment or CRR because the deficiency arises or partially arises out of a liability of the subsidiary to the firm.

## SECONDARY REQUIREMENT

### *Risk Profile*

- 3-79(1) R A firm must include in its secondary requirement any amount specified in any *requirement* to cover an unusual risk profile

FCA

### *Operational risks*

- 3-79(2) A firm must include in its secondary requirement any amount specified in any *requirement* to cover the inadequate management of operational risk to which a firm is exposed.

FCA

FCA

- G In assessing whether to impose a *requirement* on a firm to cover an unusual risk profile or operational risks, the FCA will consider various criteria. In addition, the FCA will take into account material group risks to a firm, where these have not been captured in a group financial resources test. Secondary requirements may be applied, for example, where there has been a major failure on the part of a firm to maintain adequate controls, as a means of providing an additional capital buffer whilst these problems are addressed.

## POSITION RISK REQUIREMENT

### 3-80 GENERAL PRINCIPLES OF PRR

#### *Application*

- 3-80(1) R Rules 3-80 to 3-169B apply to any *arranger* or *broad scope firm*, except a *venture capital firm* or a *corporate finance advisory firm*.

FCA

#### *Obligation to calculate PRR\**

- 3-80(2) R A firm must calculate a minimum PRR in respect of any position according to one of the methods available to it under the rules below, as appropriate, but may calculate a higher PRR in any other way at its option.

FCA

FCA

- G Notwithstanding the methods available for calculating the PRR, a firm may, in respect of any individual position, calculate a PRR which is more conservative than that calculated under the appropriate rule. However, in that case, the firm will need to be able to demonstrate that, in all circumstances, the calculation being employed does give rise to a higher PRR for the position.

\* For guidance notes as to which methods to apply, see **Appendix 20**

*Frequency of calculation*

- 3-80(3) R A firm must be able to monitor its *total PRR* on an intra-day basis and must re-calculate it in a full and detailed manner before executing any trade which is likely to increase it to such a level that the *firm's financial resources requirement* might exceed the *firm's financial resources*.
- FCA

*Marking to market*

- 3-80(4) R A firm must *mark to market* its positions, whether or not on the balance sheet, in accordance with the valuation rule 3-41(9) at least once every *business day* and more frequently as appropriate.
- FCA
- 3-80(4A) R A firm must calculate the *PRR* for any position which is a *marketable investment* as 8% of the *mark to market* value of the position, other than in respect of a derivative (whatever the nature of the underlying instrument) or off balance sheet contract, when the *PRR* is 8% of the value of the notional position underlying the contract.
- FCA

*Non marketable investments*

- 3-80(5) R A firm must calculate the *PRR* for any position which is not a *marketable investment* as 100% of the *mark to market* value of the position, other than in respect of a derivative (whatever the nature of the underlying instrument) or off balance sheet contract, when the *PRR* is 100% of the value of the notional position underlying the contract.
- FCA

*Instruments for which no percentage risk addition has been specified*

- 3-80(6) R A firm must calculate the *PRR* for any on or off balance sheet position in a *marketable investment* for which no *percentage risk addition* is specified under the *PRR* rules as an appropriate percentage of the current *mark to market* value of any position or notional position underlying the contract and must notify the *FCA* of the terms of the instrument and the proposed *PRR* treatment.
- FCA
- 3-80(6A) E (1) In 3-80(6) "an appropriate percentage" is:
- FCA
- (a) 100%; or
  - (b) A percentage which takes account of the characteristics of the instrument concerned and of discussions with the *FCA* or a predecessor regulator;
- (2) Compliance with (1) may be relied on as tending to establish compliance with 3-80(6).
- (3) Contravention of (1) may be relied on as tending to establish contravention of 3-80(6).

### Group hedging arrangements

- 3-80(7) R A *firm* may amend its PRR to take account of a group hedging arrangement to which the *firm* is party, provided the group hedging arrangement is recorded by an agreement in writing between all the relevant parties and the *firm* first notifies the FCA in writing of the terms of the arrangement and of the proposed amendment to the PRR.

FCA

### Alternative treatments

- 3-80(8) R Where a *firm* has the alternative of treating a position under two or more different methods or treatments within methods, it must treat the position under one of those methods.

FCA

### Simpler approach to PRR calculation

- 3-80(9) R As a simpler approach to calculating PRR, a *firm* may calculate the total PRR by multiplying all positions in *marketable investments* by the relevant percentage stated in the table below and summing the results.

FCA

TABLE 3-80(9)

#### Position risk requirement – simpler approach

#### C: Stock positions in *physical commodities*

Stock positions in <i>physical commodities</i> associated with a <i>firm's investment business</i>	30% of realisable value
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#### D: Certain *derivatives* and foreign exchange

<i>Exchange traded futures</i> and written <i>options</i>	4 x <i>initial margin requirement</i>
<i>OTC futures</i> and written <i>options</i>	Apply the percentage shown in C above to the <i>mark to market</i> value of the underlying position
Purchased <i>options</i>	Apply the percentage shown in C above to the <i>mark to market</i> value of the underlying position but the result may be limited to the <i>mark to market</i> value of the <i>option</i>
<i>Contracts for differences</i>	20% of the <i>mark to market</i> value of the contract
Foreign exchange exposure	10% of the net open long position

## F: Other investments

Single premium unit linked bonds and units in a <i>regulated collective investment scheme</i>	50% of realisable value
Any other <i>investments</i>	100% of <i>mark to market</i> value of <i>investment</i> or underlying instrument
<b>Notes</b>	
	<b>Percentage</b>
1	A percentage means, unless otherwise indicated, a percentage of the <i>mark to market</i> value of the aggregate of the long and the short positions in the particular category.
	<b>Netting</b>
2	The long or (short position) in a particular instrument is the net of any long or short positions held in that same instrument (i.e. a long position in ICI shares can be offset on a <i>share for share</i> basis against a short position in ICI shares) but positions in similar instruments (e.g. ICI shares against BP shares) cannot be offset in this way.
	<b>Stock positions in physical commodities</b>
3	A stock position in <i>physical commodities</i> is the <i>mark to market</i> value of the sum of –
	(i) commodities where the full contract price has been paid;
	(ii) work in progress and finished goods which result from the processing of commodities; and
	(iii) raw materials which will be combined with commodities to produce a finished processed commodity.
4	A stock position in <i>physical commodities</i> is regarded as being associated with a <i>firm's investment business</i> if the contract associated with the <i>physical commodity</i> was made for <i>investment</i> rather than commercial purposes. Indications of this are –
	(i) the contract is <i>exchange traded</i> or
	(ii) the performance of the contract is guaranteed by an <i>exchange</i> an <i>approved exchange</i> or a <i>clearing house</i> .

### Models approach to PRR calculation

3-80(10)

G A *firm* that wishes to use its internal model to calculate *PRR* in respect of all, or some, of its positions will need to apply for a modification or waiver of the relevant *FCA* rules.

**FCA**

**FCA**

G Further guidance on the criteria which such models must meet, and the review process, can be obtained from the *FCA*.

## FOREIGN CURRENCY EXPOSURES AND FOREIGN CURRENCY DERIVATIVES

## METHODS

### *Summary of foreign currency exposures and derivatives methods*

- 3-150 R A firm must calculate an additional *PRR* under the *foreign currency exposures or foreign currency derivatives method* where it has any asset or liability or any off-balance sheet contract which is denominated in a currency other than the currency of its books of account. For these purposes, gold must be treated as another currency.

FCA

## 3-151 TYPES OF EXPOSURES TO BE TREATED AS FOREIGN CURRENCY EXPOSURES

### *General rule*

- 3-151(1) R A firm must apply the *foreign currency exposures or foreign currency derivatives method* to the following positions, identifying each currency separately including the currency of its books of account:

FCA

- (a) any currency *future* at the nominal value of the contract;
- (b) any currency *option*;
- (c) any forward contract for the purchase or *sale* at the contract value, including any future exchange of principal associated with cross-currency *swaps*, but excluding any purchase or *sale* of known but unaccrued future income or expense;
- (d) any other balance sheet asset or liability; and
- (e) any other off balance sheet commitment to purchase or sell an asset denominated in that currency.

### *Dual currency bonds*

- 3-152(2) R In respect of a *dual currency bond*, a firm must include within the *foreign currency exposures method* a notional *forward contract*:

FCA

- (a) for the purchase of the redemption currency derived from the *dual currency bond*, for an amount determined by reference to the terms of issue of the *dual currency bond*; or
- (b) for the *sale* of the issue currency, for an amount equal to the *mark to market* value of the *dual currency bond*, with a deemed settlement date equal to the maturity of the bond.

### *Determining the currency of investments*

- 3-151(3) R For the purposes of determining the currency in which a position in an *investment* is denominated, a firm must apply the following principles:

FCA

- (a) where the price of an instrument is quoted in only one currency, a position in that instrument must be treated as an asset or liability in that currency;
- (b) where the price of an instrument is quoted in more than one currency, a position in that instrument must be treated as an asset or liability in the currency in which the *firm* accounts for the instrument; and
- (c) notwithstanding (a) and (b) above, a position in an American depository receipt or similar form of instrument must be treated as a position, translated at current spot rate, in the currency of the underlying instrument.

### 3-152 APPLICATION OF FOREIGN CURRENCY EXPOSURES AND DERIVATIVES METHODS TO FOREIGN CURRENCY DERIVATIVES

#### *Risk assessment models*

- 3-152(1) G A *firm* may seek a modification or waiver from the *FCA* to use a risk assessment model in respect of its currency *options* to calculate notional positions which may be included in the *foreign currency exposures method*, provided the model forms part of the day to day management supervision of the *firm's options* business and meets other criteria (further guidance on the criteria for the approval of such models can be obtained from the *FCA*).

FCA

#### *Obligatory use of foreign currency derivatives method*

- 3-152(2) R A *firm* must apply the foreign currency derivatives method to any currency option which is less than 5% “in the money”.

FCA

#### *Optional use of foreign currency derivatives method*

- 3-152(3) R Subject to (2) above, a *firm* may apply the foreign currency derivatives method to any exchange traded currency option or future instead of applying the foreign currency exposures method.

FCA

#### *Obligatory use of foreign currency exposures method*

- 3-152(4) R A *firm* must apply the foreign currency exposures method to any OTC currency future.

FCA

#### *Calculation of “in the money”*

- 3-152(5) R For the purposes of this rule, a *firm* must determine the extent to which the *option* contract is “in the money” by reference to the difference between the exercise price and the current forward rate for the final date on which the *option* may be exercised as a percentage of that forward rate.

FCA

### 3-153 FOREIGN CURRENCY DERIVATIVES METHOD

*Exchange traded futures and options*

- 3-153(1) R (a) **A firm must calculate the PRR of an exchange traded foreign currency future or option as 100% of the initial margin requirement of the exchange or approved exchange or, where the initial margin requirement is zero, under (2) below.**
- FCA
- (b) **Where the exchange or approved exchange calculates the margin requirement on an overall basis, the PRR must equal that margin requirement.**
- (c) **Where the exchange offsets futures and options in the margin calculations, the firm may take into account such offsetting.**

*OTC foreign currency options*

- 3-153(2) R **A firm must calculate the PRR of an OTC foreign currency option as 5% of the nominal value of the contract, adjusted as follows:**
- FCA
- (a) **long position: the PRR may be restricted to the mark to market value of the option; and**
- (b) **short position: the PRR may be reduced (but to no less than zero) by any excess of the exercise value over the mark to market value for a call option or vice versa for a put option.**

**3-154 FOREIGN CURRENCY EXPOSURE METHOD**

*Application*

- 3-154(1) R **A firm must apply the foreign currency exposure method to any foreign currency exposure for which the firm has not calculated a PRR under the foreign currency derivatives method.**
- FCA

*Calculation of PRR*

- 3-154(2) R **A firm must calculate a PRR for its foreign currency exposures as 5% of the aggregate of its net open long positions in each currency, including the currency of the firm's books of account when this is a long open position.**
- FCA

*Calculation of net open position*

- 3-154(3) R (a) **A firm must calculate a net open position for all currencies including the currency of the firm's books of account by netting all foreign currency exposures to which the method applies.**
- FCA

- (b) The net open position for the currency of the *firm's* books of account may be calculated as the difference between the aggregate net open long positions and aggregate net open short positions of all other currencies.

## COMMODITIES METHOD

*Types of positions to be included in the commodities method*

### 3-166 GENERAL RULE

- 3-166(1) R **A firm must calculate PRR on all positions in commodities in accordance with one of the four approaches set out in rules 3-167 to 3-169A. All spot, physical trading, derivative and other off balance sheet items whose price is affected by changes in commodities prices must be included in the calculation.**
- FCA
- FCA G In general, a commodity is a physical product which is or can be traded on the secondary market. Commodities include precious metals (except gold, which is to be treated as a foreign currency), agricultural products, minerals and base metals, oil and other energy products.
- 3-166(2) R **A firm must calculate the PRR for each commodity separately, except that:**
- FCA
- (a) **different subcategories of the same commodity that are deliverable against each other may be treated together; and**
- (b) **commodities which are close substitutes for each other, and whose price movements over a minimum period of one year can be shown by the firm to exhibit a stable and reliable correlation of at least 0.9, may be treated together.**
- FCA G The onus is on the *firm* to show that the correlation referred to in (b) above exists on a continuing basis.
- 3-166(3) R (a) **Positions which are purely stock financing may be omitted from the calculation of PRR on commodities positions under rule 3-166 and a firm may net notional long and short government securities arising from swaps, FRAs, futures and options on interest rates and debt securities, cash borrowings, qualifying deposits, the cash legs of "repurchase or similar agreements", forward foreign exchange and foreign currency futures against each other, provided:**
- FCA
- (i) **they are in the same currency;**
- (ii) **the interest rates are within 15 basis points;**
- (iii) (aa) **if the maturity dates are less than one month, the dates are the same;**

- (bb) if the maturity dates are between one month and one year, the dates are within seven days of each other; or
  - (cc) if the maturity dates are over one year, the dates are within 30 days of each other;
  - (iv) for a cash borrowing, the next interest rate refix date is within two years and repayment is within two years; and
  - (v) for a *qualifying deposit*, the next interest rate refix date is within three months.
- (b) In respect of a cash borrowing or *qualifying deposit*, the maturity date is the earlier of the *repayment date* and the next interest rate refix date.
- (c) “Repurchase or similar agreement” means a *repurchase, reverse repurchase, securities or physical commodities lending, securities or physical commodities borrowing, sale and buy back, buy and sale back, undocumented sale and buy back, or undocumented buy and sale back agreement*.

G Stock financing is defined under the *Capital Adequacy Directive*. Where physical stock has been sold forward, the cost of funding must be locked in until the date of the forward sale.

### 3-167 SIMPLIFIED APPROACH

- 3-167(1) R All positions in commodities or commodity *derivatives* must be expressed in terms of the standard unit of measurement for that commodity (such as tonnes, barrels or kilos).
- FCA
- 3-167(2) R A *firm* must multiply the position in each commodity by the current spot price for the commodity converted to the *firm's* reporting currency at current spot rates, and calculate the *PRR* as the sum of:
- FCA
- (a) the overall net position multiplied by 15%; and
  - (b) the gross position multiplied by 3%.
- 3-167(3) R A *firm* must sum the results for each commodity to arrive at the total *PRR* for positions treated under the simplified approach.
- FCA

### 3-168 MATURITY LADDER APPROACH

- 3-168(1) R All positions in each commodity or commodity *derivatives* must be expressed in terms of the standard unit of measurement for that commodity (such as tonnes, barrels or kilos) or in terms of value. A *firm* must allocate net positions on any given day to the appropriate maturity band in the table below. Physical stock must be assigned to
- FCA

the first band.

Table 3-168

Maturity Bands for Maturity Ladder Approach	
0-1 month	1-2 years
1-3 months	2-3 years
3-6 months	over 3 years
6-12 months	

- 3-168(2) R A *firm* may then offset long and short positions within and between maturity bands in accordance with the following:
- FCA**
- (a) For markets which have daily delivery dates, a *firm* may offset contracts in the same commodity against each other provided that the expiry dates are within 10 *business days* of each other.
  - (b) For each maturity band, the *firm* must sum all the open long positions, and sum all the open short positions. The *firm* may then subtract the shorts from the longs to form the overall net position. The amount subtracted is the “matched amount”. The *firm* must multiply twice the matched amount by the spread rate of 1.5%, and then by the spot price for the commodity to arrive at the spread risk charge.
- FCA** G If the total of all longs in a maturity band is 100, and the total of all shorts is 75, the “matched amount” is 75 and the overall net position 25. Algebraically, if the total of all longs is A, and the total of all shorts is B, the “matched amount” is  $\min\{A,B\}$ , and the overall net position is  $A-B$ .

- (c) The *firm* may then carry backwards or forwards all or part of the overall net position within a band to an adjacent maturity band for further netting allowances. Where this is the case, the *firm* must calculate:
- (i) a carry charge by multiplying the amount carried by the carry rate of 0.6%, and
  - (ii) a spread charge, in accordance with (b) above, where the carried position is matched against a position in an adjacent maturity band.

The *firm* may repeat the procedure for carrying positions through to other maturity bands as appropriate. An additional carry charge and spread charge must be calculated at each stage of the process.

- (d) The *firm* must multiply any positions remaining after the permitted offsetting by the outright rate of 15%, and then by the spot price of the commodity to arrive at the outright charge.
- (e) The total *PRR* for each commodity is the sum of the spread risk charge, the carry charge, and the outright charge converted to the *firm's* reporting currency at current spot rates.

*Extended maturity ladder approach*

3-169

FCA

R A *firm* may adopt the same approach as that outlined under rule 3-168(2), but apply the rates in the table below, if the *firm*:

- (a) undertakes significant commodities business, and
- (b) has a diversified commodities portfolio.

Table 3-169

	Precious metals	Base metals	Soft commodities	Other commodities
Spread rate %	1.0	1.2	1.5	1.5
Carry rate %	0.3	0.5	0.6	0.6
Outright rate %	8.0	10.0	12.0	15.0

*Models approach*

3-169A

FCA

G A *firm* may seek a modification or waiver from the *FCA* to use a VaR model as the basis for calculating the *PRR* on its commodity positions.

FCA

- G The *FCA* will grant a modification or waiver permitting the use of a VaR model only where a number of qualitative and quantitative standards are met. In assessing the VaR model the *FCA* will have regard to the matters set out in *BIPRU* 7.10.

### 3-169B OPTIONS

#### *Proprietary options pricing models*

- 3-169B(1) G A *firm* may seek a modification or waiver from the *FCA* permitting it to use its proprietary *options* pricing model to calculate the *PRR* on *options* positions and their related hedges. The application for a modification or waiver may request that the *firm* be permitted to include an *option* in the maturity ladder approach.

FCA

FCA

- G A *firm* may propose any methodology that it believes will capture spread, carry and outright risks and that reflects its own day-to-day risk management. A *firm* is strongly advised to contact the *FCA* at the earliest point if it is considering introducing a model or adapting an existing one.

#### *No models*

- 3-169B(2) R A *firm* may only include an *option* in the maturity ladder approach, the extended maturity ladder approach or the simplified approach if it is in the money by more than the appropriate outright rate. Such *options* must be included as a position in the underlying commodity, of an amount equal to the “tonnage” underlying the *option* (long or short as appropriate), and with a maturity equal to the expiry date of the spot, *forward* or *futures* contract underlying the *option*.

FCA

- 3-169B(3) R An *option* which does not satisfy the condition in rule 3-169B(2) attracts a *PRR* in accordance with the following:

FCA

- (a) In the case of a purchased *option*, the *PRR* must be the *mark to market* value of the full position underlying the *option* multiplied by the appropriate outright rate, but the result may be limited to the *mark to market* value of the *option*.
- (b) In the case of a written *option*, the *PRR* must be the *mark to market* value of the full position underlying the *option* multiplied by the appropriate outright rate, reduced by the out-of-the-money amount. The *PRR* must be limited to zero if the calculation results in a negative number.

FCA

- G The out-of-the-money amount is any excess of the exercise value over the *mark to market* value of the underlying commodity in the case of a *call option*, or vice versa for a *put option*.

### COUNTERPARTY RISK REQUIREMENT

### 3-170 GENERAL PRINCIPLES OF CRR

*Application*

- 3-170(1) R (a) Rules 3-170 to 3-182 apply to a *broad scope firm*, except a *venture capital firm* which is subject only to rules 3-180 to 3-182.
- FCA
- (b) Rules 3-180 to 3-182 apply to an *arranger*, except a *corporate finance advisory firm*.

*General rule*

- 3-170(2) R A firm must calculate its total *CRR* on exposures to *counterparties* as the sum of all the amounts calculated in accordance with the rules referred to in the table below.

FCA

- FCA R Table 3-170(2) – Counterparty Risk Requirement

**Rules**

3-171	Cash against documents transactions
3-173	Free deliveries of physical securities and commodities
3-173A	Derivatives transactions
3-175	Concentrated risk to one counterparty
3-176	Repurchase and reverse repurchase, securities lending and borrowing and sale and buy back agreements
3-177	Money brokers
3-178	Options purchased for a counterparty
3-180	Qualifying and other deposits
3-181	Loans to counterparties
3-182	Other amounts owed to a firm arising out of investment business or investment dealing activities

*Frequency of calculation*

- 3-170(3) R A firm must calculate its *CRR* at least once each *business day*; for the purposes of the relevant calculations the *firm* may use prices of *investments* and *physical commodities* as at the close of business on the previous day.

FCA

*Negative amounts*

- 3-170(4) R A firm must not include any *CRR* if it is a negative amount.

FCA

*Instruments for which no CRR has been specified*

3-170(5) R Where a *firm* is in doubt as to the classification of an item for the purposes of *CRR*, the *firm* must add to its *CRR* an appropriate part of the exposure on the item concerned and must immediately notify the FCA in writing of details of the transaction, the counterparty and the proposed *CRR* treatment.

FCA

3-170(5A) E (1) In 3-170(5) “an appropriate part” is:

FCA

(a) the whole; or

(b) A proportion which takes account of the characteristics of the transaction and the counterparty concerned, and of discussions with the *FCA* or a predecessor regulator.

(2) Compliance with (1) may be relied on as tending to establish compliance with 3-170(5).

(3) Contravention of (1) may be relied on as tending to establish contravention of 3-170(5).

*Provisions*

3-170(6) R A *firm* may reduce the exposure on which its *CRR* is calculated to the extent that it makes provision for a specific *counterparty* balance.

FCA

*Connected companies*

3-170(7) R For the avoidance of doubt, a *firm* must calculate a *CRR* as appropriate on exposures to or from *connected companies*.

FCA

*Basis of valuation*

3-170(8) R For the purposes of valuing instruments and *physical commodities* at market value in the calculation of *CRR*, a *firm* must be consistent in the basis it chooses and may use either mid market value or bid and offer prices (as appropriate).

FCA

*Acceptable collateral*

3-170(9) R A *firm* may reduce the exposure to a *counterparty* on which its *CRR* is calculated to the extent that it holds *acceptable collateral* from that *counterparty*.

FCA

*Nil weighted counterparty exposures*

3-170(10) R A *firm* may disregard any *counterparty* exposure calculated in accordance with rules 3-171 to 3-182, if the *counterparty* is or the contract is guaranteed by or is subject to the full faith and credit of a sovereign government or province or state thereof (or a corporation over 75% owned by such government, province or state), which is a

FCA

member of the *OECD* and the government, province, state or corporation has not defaulted, or entered into any rescheduling or similar arrangement, or announced the intention of so doing, in respect of itself or its agency's debt within the last five years.

*Netting*

3-170(11) R A *firm* which has offsetting exposures in similar types of transactions with a *counterparty* may offset these in accordance with rules 3-171(2A), 3-173(2A), 3-173A(3), 3-176(3), 3-180(2A), 3-181(1) and 3-182(4A) when calculating *CRR* if it has a contractual netting agreement with that *counterparty*, which:

FCA

- (a) covers the transactions which the *firm* is seeking to net;
- (b) creates a single obligation in each currency or a single overall obligation to pay (or receive) a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;
- (c) does not include a *walkaway clause*;
- (d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the *firm's* exposure to be the single net amount mentioned in (b) above.

FCA

G Legal opinions should relate to:

- (a) the law of the jurisdiction in which the *counterparty* is organised;
- (b) the law of the jurisdiction in which any branch involved is located;
- (c) the law that governs the agreement and, if different, the law that governs individual transactions pursuant to it; and
- (d) the law that governs the legal status of the *counterparty* who is entering into transactions of the type which the *firm* is seeking to net.

FCA

G Where a *firm* uses an industry standard agreement and the *firm's* netting/setoff clauses follow the form of that standard agreement, provided a legal opinion has already been obtained on the standard agreement which addresses the capacity of *counterparties* of the type with which the *firm* wishes to contract, that may be relied upon.

FCA

G Legal opinions on netting agreements should be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable. Where the regulator of the *counterparty* is not satisfied that the netting agreement is enforceable under its laws, the netting agreement cannot be relied upon regardless of the opinions obtained by the *firm*.

### 3-171 CASH AGAINST DOCUMENTS TRANSACTIONS

*General rule*

3-171(1) R A *firm* which enters into a transaction on a cash against documents basis must calculate the *counterparty* exposure for transactions still unsettled 16 calendar days after *settlement day* as set out in (2) below and must then multiply this by the appropriate percentage set out in the table below to calculate a *CRR* for each separate unsettled transaction.

FCA

FCA R Table 3-171(1) - Percentage to be applied to the counterparty exposure

Calendar days after settlement day	Percentage
0-15	Nil
16-30	25%
31-45	50%
46-50	75%
Over 60	100%

*Counterparty exposure calculation*

3-171(2) R (a) Where a *firm* has neither delivered *securities* or *physical commodities* nor received payment when purchasing *securities* or *physical commodities* for, or selling *securities* or *physical commodities* to, a *counterparty*, the positive *counterparty* exposure is the excess of the contract value over the market value of the *securities* or *physical commodities*.

FCA

(b) Where a *firm* has neither received *securities* or *physical commodities* nor made payment when selling *securities* or *physical commodities* for, or purchasing *securities* or *physical commodities* from, a *counterparty*, the positive *counterparty* exposure is the excess of the market value over the contract value of the *securities* or *physical commodities*.

*Netting*

3-171(2A) R A *firm* may offset positive and negative *counterparty* exposures, calculated in accordance with (2) above, before it multiplies the residual exposure by the appropriate percentage in Table 3-171(1) provided that:

FCA

- (a) the exposures arise on transactions with the same *counterparty*; and
- (b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).

*Sub-total*

3-171(3) R The sum of the amounts calculated in accordance with (1) above is the *firm's* total *CRR* for cash against documents transactions.

FCA

### 3-173 FREE DELIVERIES OF PHYSICAL COMMODITIES AND SECURITIES

#### *General rule*

- 3-173(1) R When a *firm* makes delivery to a *counterparty* of *physical commodities* or *securities* without receiving payment or pays for *securities* without receiving the certificates of good title, the *firm* must calculate the *free delivery* value for each transaction.

FCA

#### *Free delivery value calculation*

- 3-173(2) R A *firm* must calculate the *free delivery* value for each transaction as set out below and multiply this value by the appropriate percentage in Table 3-173(2) A for free deliveries of *physical commodities* and Table 3-173(2) B for free deliveries of *securities* as follows:

FCA

- (a) if the *firm* has delivered *physical commodities* or *securities* to a *counterparty* and has not received payment, the *free delivery* amount is the full amount due to the *firm* (i.e. the contract value);
- (b) if the *firm* has made payment to a *counterparty* for *securities* and not received the certificates of good title, the *free delivery* amount is the market value of the *securities*; and
- (c) if a *firm* pays for *physical commodities* without receiving delivery or *documents of title* the exposure is to be treated as an unsecured loan to which rule 3-181 applies.

FCA

- R Table 3-173(2)A - Percentage to be applied to free deliveries relating to physical commodities
-

	Nature of counterparty to whom free delivery is made	Business days since delivery		
		0-3	4-15	earlier of 15 days or agreed contractual payment date
1	<i>Firm does not have an ACMP and delivery of physical commodities is made</i>	15% of contract value	100% of contract value	100% of contract value
2	<i>Firm has an ACMP and delivery of physical commodities is made with a settlement day longer than three days from delivery date</i>	15% of contract value		100% of contract value

FCA

**R Table 3-173 (2)B - Percentage to be applied to free deliveries relating to securities**

	Nature of counterparty to whom free delivery is made	Business days since delivery		
		0-3	4-15	Over 15
1	<i>A counterparty to whom securities have been delivered or to whom payment for securities has been made</i>	Nil	100% of contract or market value	100% of contract or market value
2	<i>A regulated financial institution or regulated banking institution to whom securities have been delivered or payment made with the expectation that market practice will result in a settlement day longer than three days from delivery date</i>	15% of contract or market value		100% of contract or market value
2A	<i>A counterparty to whom securities have been delivered which settle through the Crest system or to whom payment for such securities has been made</i>	15% of contract or market value		100% of contract or market value
3	<i>A manager, underwriter, sub-underwriter or member of a selling syndicate or issuer to whom</i>	nil		100% of contract or market value

	payment for <i>securities</i> has been made; or a manager of a <i>regulated collective investment scheme</i> to whom units of the scheme have been delivered or payment for units of the scheme has been made		or, if the issue is in one of the countries specified in Appendix 46, 15% of contract or market value until the end of the period referred to in that Appendix
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**Netting**

3-173 (2A) R A *firm* may reduce the *free delivery* value for a transaction calculated in accordance with (2) above, before it multiplies the residual exposure by the appropriate percentage in Table 3-173(2)A or B, by:

FCA

- (a) the value of any free payment received from the *counterparty*; or
- (b) the contract value of any *securities* received free from the *counterparty*,

provided that:

- (i) the exposures arise on transactions with the same *counterparty*; and
- (ii) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).

**Partners and connected persons**

3-173 (3) R For the purpose of this rule, a *firm* must treat any amount due from a partner or his connected person in respect of *investment business* as a free delivery to a *counterparty*.

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**Sub-total**

3-173 (4) R The sum of the amounts calculated in accordance with (1), (2) and (3) above is the *firm's* total *CRR* for free deliveries of *physical commodities* and *securities*.

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**3-173A DERIVATIVE TRANSACTIONS**

**General rule**

3-173A (1) R A *firm* must calculate for each *derivative* transaction a *CRR* either:

FCA

- (a) by multiplying the *counterparty* exposure calculated in accordance with (2) and (3) below by the appropriate percentage in Table 3-173A(4)A or B, except for single premium *options* purchased on behalf of a *counterparty* and *traditional options* purchased for the *firm's* own account or on behalf of a *counterparty*, which shall be subject to rule 3-178; or
- (b) after notifying the *FCA* in writing, in accordance with rule 3-173B.

**Counterparty exposure**

3-173A (2) R A *firm* must calculate the *counterparty* exposure on *derivative* transactions in accordance with either (a) or (b) below:

FCA

- (a) where a *counterparty* has not fully paid an *initial margin requirement* or *variation margin requirement* on a transaction in a *derivative* listed on an *exchange* or *approved exchange* or met it through the deposit of *acceptable collateral* not otherwise used, the *firm* must calculate the *counterparty* exposure as the shortfall;
- (b) where the *counterparty* exposure arising from a transaction in a *derivative* is not listed on an *exchange* or *approved exchange*, the *counterparty* exposure is the credit equivalent amount calculated in accordance with Table 3-173A(2A).

FCA

R Table 3-173A(2A) – Method of calculating credit equivalent amount

Type of derivative transaction	Credit equivalent amount	
	If A is positive	If A is negative
<b>Interest rate swaps: single currency</b>		
(a) floating rate swapped against floating rate	A	nil
(b) fixed rate swapped against floating rate:		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
<b>Cross-currency interest rate swaps</b>		
- under one year to maturity	A + 1% of N	1% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
<b>Other interest rate contracts*</b>		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N

<p><b>Foreign exchange and gold contracts*</b></p> <ul style="list-style-type: none"> <li>- exchange rate contracts with an original maturity of 14 days or less</li> <li>- under one year to maturity</li> <li>- over one year to five years</li> <li>- over five years</li> </ul>	<p>nil</p> <p>A + 1% of N</p> <p>A + 5% of N</p> <p>A + 7.5% of N</p>	<p>nil</p> <p>1% if N</p> <p>5% of N</p> <p>7.5% of N</p>
<p><b>Equity contracts*</b></p> <ul style="list-style-type: none"> <li>- under one year to maturity</li> <li>- over one year to five years</li> <li>- over five years</li> </ul>	<p>A  + 6% of N</p> <p>A + 8% of N</p> <p>A + 10% of N</p>	<p>6% of N</p> <p>8% of N</p> <p>10% of N</p>
<p><b>Precious metal (not gold) contracts*</b></p> <ul style="list-style-type: none"> <li>- under one year to maturity</li> <li>- over one year to five years</li> <li>- over five years</li> </ul>	<p>A + 7% of N</p> <p>A + 7% of N</p> <p>A + 8% of N</p>	<p>7% of N</p> <p>7% of N</p> <p>8% of N</p>
<p><b>Commodity contracts*</b></p> <ul style="list-style-type: none"> <li>- under one year to maturity</li> <li>- over one year to five years</li> <li>- over five years</li> </ul>	<p>A + 10% of N</p> <p>A + 12% of N</p> <p>A + 15% of N</p>	<p>10% of N</p> <p>12% of N</p> <p>15% of N</p>
<p><b>Notes</b></p> <p>FRAs, swaps, futures, purchased options, and other contracts for differences</p> <p>A = the replacement cost of the contract</p> <p>N = the notional or actual principal amount underlying the contract</p> <p>For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract.</p> <p>In the case of a derivative referenced on a bond which satisfies the criteria for a qualifying debt security, the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.</p> <p>For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.</p>		

- FCA**      **R**      **If a firm uses the extended maturity ladder approach to calculate PRR under rule 3-169, it may use Table 3-173A (2B).**
- FCA**      **R**      **Table 3-173A (2B) – Method of calculating credit equivalent amount for commodities**

Type of derivative transaction*	Credit equivalent amount	
	If A is positive	If A is negative
<b>Precious metals (except gold)</b> <ul style="list-style-type: none"> <li>- under one year to maturity</li> <li>- over one year to five years</li> <li>- over five years</li> </ul>	<ul style="list-style-type: none"> <li>A + 2% of N</li> <li>A + 5% of N</li> <li>A + 7.5% of N</li> </ul>	<ul style="list-style-type: none"> <li>2% of N</li> <li>5% of N</li> <li>7.5% of N</li> </ul>
<b>Base metals</b> <ul style="list-style-type: none"> <li>- under one year to maturity</li> <li>- over one year to five years</li> <li>- over five years</li> </ul>	<ul style="list-style-type: none"> <li>A + 2.5% of N</li> <li>A + 4% of N</li> <li>A + 8% of N</li> </ul>	<ul style="list-style-type: none"> <li>2.5% of N</li> <li>4% of N</li> <li>8% of N</li> </ul>
<b>Softs (agricultural)</b> <ul style="list-style-type: none"> <li>- under one year to maturity</li> <li>- over one year to five years</li> <li>- over five years</li> </ul>	<ul style="list-style-type: none"> <li>A + 3% of N</li> <li>A + 5% of N</li> <li>A + 9% of N</li> </ul>	<ul style="list-style-type: none"> <li>3% of N</li> <li>5% of N</li> <li>9% of N</li> </ul>
<b>Other commodity</b> <ul style="list-style-type: none"> <li>- under one year to maturity</li> <li>- over one year to five years</li> <li>- over five years</li> </ul>	<ul style="list-style-type: none"> <li>A + 4% of N</li> <li>A + 6% of N</li> <li>A + 10% of N</li> </ul>	<ul style="list-style-type: none"> <li>4% of N</li> <li>6% of N</li> <li>10% of N</li> </ul>
<b>Notes</b> <i>FRAs, swaps, futures, purchased options, and other contracts for differences</i> <p>A = the replacement cost of the contract</p> <p>N = the notional or actual principal amount underlying the contract</p> <p>For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract.</p> <p>In the case of a derivative referenced on a bond which satisfies the criteria for a <i>qualifying debt security</i>, the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.</p> <p>For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.</p>		

### **Netting**

**3-173A R A firm may offset counterparty exposures arising on derivative transactions calculated in accordance with (2) above before it**

(3)

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multiplies the residual exposure by the appropriate *CRR* percentage as follows:

- (a) variation margin payable to a *counterparty* against an *initial margin requirement* or *variation margin requirement* receivable from a *counterparty*;
- (b) variation margin payable to a *counterparty* against a positive “A” as calculated in accordance with Table 3-173A(2A);
- (c) a negative “A” as calculated in accordance with Table 3-173A(2A) against an *initial margin requirement* or *variation margin requirement* receivable from a *counterparty*;
- (d) a negative “A” against a positive “A” in each case as calculated in accordance with Table 3-173A(2A);
- (e) losses on a closed out *derivative* transaction which has not been settled against variation margin payable to a *counterparty*; or
- (f) losses on a closed out *derivative* transaction which has not been settled against negative “A” calculated in accordance with Table 3173A(2A),
- (g) profit on a closed out *derivative* transaction which has not been settled against an *initial margin requirement* or *variation margin requirement* receivable from a *counterparty*;
- (h) profit on a closed out *derivative* transaction which has not been settled against a loss on a closed out *derivative* transaction;
- (i) profit on a closed out *derivative* transaction which has not been settled against a positive “A” as calculated in accordance with Table 3-173A(2A);
- (j) premium receivable in respect of written *options* against variation margin payable, initial margin payable or a closed out profit payable to the *counterparty* or a negative “A” as calculated in accordance with Table 3-173A(2A);
- (k) positive “A” on purchased *options* calculated in accordance with Table 3-173A(2A) against negative “A” on written *options*; or
- (l) in the case of *perfectly matched contracts* these may be treated as a single contract with a notional principal equivalent to the net receipts; or
- (m) where transactions are subject to (3)(c) above, the potential future credit exposures (PFCE) on transactions with the

same *counterparty* (i.e. % on N) may be netted in accordance with Table 3-173A(3) below,

provided that:

- (i) the exposures arise on transactions with the same *counterparty*; and
- (ii) the *firm* has a written agreement, supported by a legal opinion obtained in accordance with rule 3-170(11).

FCA

Table 3-173A(3)

<b>The netted PFCE is the sum of:</b>	
step one	40% of gross PFCE
step two	60% of gross PFCE multiplied by the net-to-gross ratio (NGR)
<b>Notes:</b>	
NGR =	$\frac{\text{(gross replacement cost)}}{\text{(net replacement cost)}}$
The NGR must be calculated on all contracts included in a legally valid bilateral netting agreement with a given <i>counterparty</i> .	

**CRR percentages**

3-173A  
(4)

R (a) Where a *firm* does not offset *counterparty* exposures arising on *derivative* transactions in accordance with (3) above, it must multiply the *counterparty* exposure by the appropriate percentage from:

FCA

- (i) Table 3-173A(4)A if the *counterparty* exposure arises on a transaction in a *derivative* listed on an *exchange* or *approved exchange*; or
- (ii) Table 3-173A(4)B if the *counterparty* exposure arises on a transaction in a *derivative* not listed on an *exchange* or *approved exchange*,

but may opt to calculate *CRR* using the highest available credit percentage in Tables 3-173A(4)A or B below in order to avoid undue complication.

(b) Where a *firm* does offset *counterparty* exposures on *derivative* exposures in accordance with (3) above, it must multiply the residual net *counterparty* exposure by the appropriate percentage from Table 3-173A(4)A or B.

- (c) A firm may opt to calculate the CRR using the highest available CRR percentage in the tables below in order to avoid undue complication.

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Table 3-173A(4)A – CRR percentages for transactions in derivatives listed on an exchange or approved exchange

Counterparty		Business days since exposure occurred	
		0 - 3	over 3
1	Firm has an ACMP and counterparty is not a market counterparty	10%	10%
2	Firm has an ACMP and counterparty is a market counterparty	5%	5%
3	Firm does not have an ACMP	10%	100%

FCA

Table 3-173A(4)B – CRR percentages for transactions in derivatives not listed on an exchange or approved exchange

	Status of the counterparty	%
1	A firm, a supranational organisation, a United Kingdom discount house, a gilt edged market maker, a stock exchange money broker, a regulated banking institution, a building society under the Building Societies Act 1986, a United Kingdom local authority, a regulated financial institution.	2%
2	Any other counterparty	5%

*Exposures to locals*

3-173A  
(5)

R A firm must calculate a 100% CRR for amounts of initial and variation margin not met with *acceptable collateral* or a positive *equity balance* owed to a firm by a local in respect of transactions in derivatives listed on an exchange or approved exchange from the date of any shortfall. However, a firm may use an alternative treatment if it:

FCA

- (a) participates in the profits or losses of the local for 25% or more when the firm may include the local position in its own position which will then be subject to PRR; or
- (b) calculates PRR for locals in which case its requirement will

be the sum of the following:

- (i) 10% of the *PRR* result for each *local*; and
- (ii) the excess over the “net liquidating balance” of the *PRR* applied to the positions of each *local*; and
- (c) for the purposes of (b) above, “net liquidating balance” means the cash amount which would remain in a *local* account if all positions were liquidated and there were added (1) cash balances (2) the value of *marketable investments*, and (3) letters of credit and guarantees issued by a *regulated banking institution* which is not the *counterparty* or an *associate* of the *counterparty* in the control of the *firm*; and there were deducted all loans and overdrafts from, and other liabilities to the *firm*; and to the extent that a *firm* includes an exposure in the net liquidating balance calculation, it does not also need to apply the liquidity adjustment in rule 3-75 or the *CRR* to those exposures.

*Sums due for payment or owed on closed out derivative transactions*

3-173A (6) R When a *counterparty* has not fully met amounts owed to a *firm* arising out of losses on closed out *derivative* transactions by depositing, *acceptable collateral* or, has not fully settled amounts owed in respect of periodic or final settlement of transactions, a *firm* must calculate a *CRR* equal to the amount outstanding after three days, unless:

FCA

- (a) the *firm* has offset the amount owed against variation margin payable in accordance with (3)(e) above; or
- (b) the *firm* has offset the amount owed against a negative “A” in accordance with (3)(f) above,

in which case the *firm* must calculate a *CRR* equal to the residual amount outstanding after three days.

*Equivalent contracts*

3-173A (7) R Rule 3-173A (2)(b) also applies to contracts which, although they are listed on an *exchange* or *approved exchange*, are fully dependent upon the issuer for performance (e.g. covered *warrants*).

FCA

*Regulated connected companies*

3-173A (8) R Where a *firm* carries out significant *swaps* business with a *connected company* which has adequate regulation applied to it, the *firm* need not comply with all or part of rule 3-173A so far as it applies to interest rate or foreign exchange *swaps* with that *connected company*, provided that it has given prior written

FCA

notice of this to the *FCA*.

*Sub-total*

3-173A (9) R The sum of the amounts calculated in accordance with this rule is the *firm's* total *CRR* for *derivative* transactions other than those subject to rule 3-178.

FCA

3-173B CRR for derivative transactions under 3-173A(1)(b)

*General rule*

3-173B (1) R A *firm* must calculate for each *derivative* transaction a *CRR* by multiplying the *counterparty* exposure calculated in accordance with (2) and (3) below, by the appropriate percentage in Table 3-173B(5) below.

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*Collateral*

3-173B (2) R A *firm* may:

FCA

- (a) reduce the *counterparty* exposure on which its *CRR* is calculated to the extent that it holds *acceptable collateral* to cover that exposure; and
- (b) where it does not have an *ACMP*, may continue to multiply the *counterparty* exposure by 8% multiplied by the *counterparty* weight, to the extent that the *firm* holds *adequate collateral* to cover that exposure.

*Counterparty exposure*

3-173B (3) R A *firm* must calculate the *counterparty* exposure on *derivative* transactions in accordance with either (a), (b) or (c) below:

FCA

- (a) where a *counterparty* has not fully paid a *margin requirement* on a *derivative* transaction listed on an *exchange* or cleared through a *clearing house*, or met it through the deposit of *acceptable collateral* not otherwise used, a *firm* must calculate the *counterparty* exposure as the shortfall;
- (b) where a *firm* sells or writes an *option* to a *counterparty* or buys an *option* on behalf of a *counterparty* and the *counterparty* has not paid the full *option* premium, or met it through the deposit of *acceptable collateral* not otherwise used, it must calculate the *counterparty* exposure as the uncovered premium on the transaction; or

- (c) a firm must calculate the *counterparty* exposure arising from a *derivative* transaction other than a written or sold *option* or a *derivative* transaction listed on an *exchange* or cleared through a *clearing house*, as the credit equivalent amount calculated in accordance with Table 3-173B(3A), not covered by the deposit of *acceptable collateral* not otherwise used.

FCA

R Table 3-173B(3A) – Method of calculating credit equivalent amount

Type of derivative transaction	Credit equivalent amount	
	If A is positive	If A is negative
<b>Interest rate swaps: single currency</b>		
(a) floating rate swapped against floating rate A nil	A	nil
(b) fixed rate swapped against floating rate:		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
<b>Cross-currency interest rate swaps</b>		
- under one year to maturity	A + 1% of N	1% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
<b>Other interest rate contracts*</b>		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
<b>Foreign exchange and gold contracts*</b>		
- exchange rate contracts with an original maturity of 14 days or less	nil	nil
	A + 1% of N	1% of N
	A + 5% of N	5% of N

- under one year to maturity - over one year to five years - over five years	A + 7.5% of N	7.5% of N
<b>Equity contracts*</b> - under one year to maturity - over one year to five years - over five years	A + 6% of N A + 8% of N A + 10% of N	6% of N 8% of N 10% of N
<b>Precious metal (not gold) contracts*</b> - under one year to maturity - over one year to five years - over five years	A + 7% of N A + 7% of N A + 8% of N	7% of N 7% of N 8% of N
<b>Commodity contracts*</b> - under one year to maturity - over one year to five years - over five years	A + 10% of N A + 12% of N A + 15% of N	10% of N 12% of N 15% of N
<p><b>Notes</b></p> <p>* <i>FRAs, swaps, futures, purchased options, and other contracts for differences</i></p> <p>A = the replacement cost of the contract</p> <p>N = the notional or actual principal amount or value underlying the contract</p> <p>For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract.</p> <p>In the case of a derivative referenced on a bond which satisfies the criteria for a <i>qualifying debt security</i>, the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.</p> <p>For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.</p>		

If a firm uses the modified maturity ladder approach to calculate PRR, it may use Table 3-173B(3B).

FCA

**R Table 3-173B(3B) – Method of calculating credit equivalent amount for commodities**

Type of derivative transaction*	Credit equivalent amount	
	If A is positive	If A is negative
Precious metals (except gold)		
- under one year to maturity	A + 2% of N	2% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Base metals		
- under one year to maturity	A + 2.5% of N	2.5% of N
- over one year to five years	A + 4% of N	4% of N
- over five years	A + 8% of N	8% of N
Softs (agricultural)		
- under one year to maturity	A + 3% of N	3% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 9% of N	9% of N
Other commodity		
- under one year to maturity	A + 4% of N	4% of N
- over one year to five years	A + 6% of N	6% of N
- over five years	A + 10% of N	10% of N
<p><b>Notes</b></p> <p><i>FRAs, swaps, futures, purchased options, and other contracts for differences</i></p> <p>A = the replacement cost of the contract</p> <p>N = the notional or actual principal amount or value underlying the contract</p> <p>For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract.</p> <p>In the case of a derivative referenced on a bond which satisfies the criteria for a <i>qualifying debt security</i>, the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.</p>		

For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.

**Sums due for payment or owed on closed out derivative transactions**

**3-173B (4)** **R** When a *counterparty* has not fully met amounts owed to a *firm* arising out of losses on closed out *derivative* transactions through the deposit of *acceptable collateral* not otherwise used, or has not fully settled amounts owed in respect of periodic or final settlement of transactions, a *firm* must calculate *CRR* equal to the unpaid loss multiplied by the appropriate percentage from the Table 3-173B(5) below.

FCA

**3-173B (4A)** **R** In the case of a failed FX transaction (whether originally contracted for *forward* settlement, or undertaken in the spot market) where the *firm* has released funds to its *counterparty*, but has not received the funds in the alternative currency, the *CRR* must be calculated as the gross value of the funds not received, multiplied by the appropriate percentage from Table 3-173B(5) below.

FCA

**CRR percentages**

**3-173B (5)** **R** A *firm* must multiply the *counterparty* exposure by the appropriate percentage from the table below, but:

FCA

- (a) may opt to calculate *CRR* using the highest available credit percentage in the table below in order to avoid undue complication; and
- (b) may reduce the *counterparty* weight applicable to *counterparty* exposures calculated in accordance with (3)(c) above to 50%, where the *counterparty* would normally attract a *counterparty* weight of 100% in accordance with Table 1 in Appendix 47.

FCA

**R** TABLE 3-173B(5) – CRR percentages

Type of contract	Nature of <i>counterparty</i> to whom <i>counterparty</i>	Business days after <i>counterparty</i> exposure first	
		0 - 5	6 or more
Failed FX transaction	Any	8% x <i>counterparty</i> weight*	100%

Other	A <i>counterparty</i> granted a credit line under an <i>ACMP</i>	8% x <i>counterparty</i> weight*	
	A <i>counterparty</i> not granted a credit line under an <i>ACMP</i>	8% x <i>counterparty</i> weight*	100%

**Netting**

3-173B  
(6)

FCA

**R** A firm may offset *counterparty* exposures arising on *derivative* transactions calculated in accordance with (2), (3) and (4) above before it multiplies the residual exposure by the appropriate *CRR* percentage as follows:

- (a) variation margin payable to a *counterparty* against an initial *margin requirement* or variation *margin requirement* receivable from a *counterparty*;
- (b) variation margin payable to a *counterparty* against a positive “A” as calculated in accordance with Table 3-173B (3A);
- (c) a negative “A” as calculated in accordance with Table 3-173B(3A) against an initial *margin requirement* or variation *margin requirement* receivable from a *counterparty*;
- (d) a negative “A” against a positive “A” in each case as calculated in accordance with Table 3-173B(3A);
- (e) loss on a closed out *derivative* transaction which has not been settled against variation margin payable to a *counterparty*;
- (f) loss on a closed out *derivative* transaction which has not been settled against negative “A” calculated in accordance with Table 3-173B(3A);
- (g) profit on a closed out *derivative* transaction which has not been settled against an initial *margin requirement* or variation *margin requirement* receivable from a *counterparty*;
- (h) profit on a closed out *derivative* transaction which has not been settled against a loss on a closed out *derivative* transaction;
- (i) profit on a closed out *derivative* transaction which has not been settled against a positive “A” as calculated in accordance with Table 3-173B(3A);
- (j) premium receivable in respect of written *options* against variation margin payable, initial margin payable or a closed out profit payable to the *counterparty* or a negative “A” as

calculated in accordance with Table 3-173B(3A);

- (k) where the *firm* has received the premium due for a written *option*, a negative “A” (the replacement cost) for the written *option* against a positive “A” in each case as calculated in accordance with Table 3-173B(3A); or
- (l) in the case of *perfectly matched contracts* these may be treated as a single contract with a notional principal equivalent to the net receipts; or
- (m) where transactions are subject to (3)(c) above, the potential future credit exposures (PFCE) on transactions with the same *counterparty* (i.e. % o N) may be netted in accordance with Table 3-173B(6) below,

provided that:

- (i) the exposures arise on transactions with the same *counterparty*; and
- (ii) the *firm* has a written agreement, supported by a legal opinion obtained in accordance with rule 3-170(11).

**FCA**

**Table 3-173B(6)**

<b>The netted PFCE is the sum of:</b>	
step one	40% of gross PFCE
step two	60% of gross PFCE multiplied by the net-to-gross ratio (NGR)
<b>Notes:</b>	
NGR =	(net replacement cost)
	(gross replacement cost)
The NGR must be calculated on all contracts included in a legally valid bilateral netting agreement with a given counterparty.	

***Equivalent contracts***

- 3-173B (7)**     **R**     Rule 3-173B(3)(c) also applies to contracts, which, although they are listed on an *exchange* are fully dependent upon the issuer for performance (e.g. covered warrants).

**FCA**

***Sub-total***

- 3-173B (8)**     **R**     The sum of the amounts calculated in accordance with this rule is the *firm's CRR* for *derivative* transactions.

**FCA**

### 3-175 CONCENTRATED RISK TO ONE COUNTERPARTY

#### *General rule*

- 3-175(1) R When the total amount due to a *firm* arising from *exchange traded variation margins* or free deliveries of *physical commodities* from a single *counterparty* (or several *counterparties* grouped together by the *firm* for margin or credit treatment) is outstanding under a credit line granted in accordance with an *ACMP* and exceeds 25% of the *firm's financial resources*, the *firm* must calculate an additional *CRR* according to the table below.

FCA

FCA

Table 3-175(1) – Concentrated risk percentages

% of financial resources exposed to counterparty	Standard CRR for variation margin	Standard CRR for free delivery	Additional CRR
0-25%	10%	15%	nil
25%-50%	10%	15%	lower of (1) the excess or (2) the sum of 15% for variation margin plus 10% for free deliveries
over 50%	10%	15%	lower of (1) the excess or (2) the sum of 40% for variation margin plus 35% for free deliveries

#### *Use of approved bank bonds*

- 3-175(2) R If an *approved bank bond* forms a part of a *firm's financial resources*, a *firm* may include it in *financial resources* for the purposes of (1) above at its face value.

FCA

#### *Sub-total*

- 3-175(3) R The sum of the amounts calculated in accordance with (1) above is the total *CRR* for concentrated risk to one *counterparty*.

FCA

- 3-176 R All *repurchase, reverse repurchase, securities or physical commodities* (10) lending or borrowing *sale and buy back* and *buy and sale back agreements* with a stock exchange, *clearing house*, Clearstream or Euroclear are exempt from this rule.

FCA

#### *Repurchase, securities lending and sale and buy back agreements*

**3-176(1) R** Where a *firm* has entered into any *repurchase, securities or physical commodities lending or sale and buy back agreement* in respect of *securities or physical commodities*, it must calculate, subject to (3) below, a *CRR* for each such agreement in accordance with the table below.

FCA

FCA

**Table 3-176(1) - Repurchase, securities lending and sale and buy back agreements**

Type of security sold or lent	CRR
<i>Qualifying debt securities</i>	The “mark to market value” of the <i>securities</i> less 105% of the <i>acceptable collateral</i> under the agreement, if the net figure is positive.
<i>Other securities or physical commodities</i>	The “mark to market value” of the <i>securities or physical commodities</i> less 110% of the <i>acceptable collateral</i> under the agreement, if the net figure is positive.

**Reverse repurchase, securities borrowing and buy and sale back agreements**

**3-176(2) R** Where a *firm* has entered into any *reverse repurchase, securities or physical commodities borrowing or buy and sale back agreement* in respect of *securities or physical commodities*, it must calculate, subject to (3) below, a *CRR* for each such agreement in accordance with the table below.

FCA

FCA

**Table 3-176(2) – Reverse repurchase, securities borrowing and buy and sale back agreements**

Type of security purchased or borrowed		CRR
1	For all transactions where the <i>firm</i> has in its possession a “written agreement” evidencing the transaction, in accordance with rule 3-176(5)	
	a) <i>qualifying debt securities</i>	The amount paid or collateral given for the <i>securities</i> less 105% of the current “mark to market value” of the <i>securities</i> received (see note), if the net figure is positive
	b) <i>other securities or physical</i>	The amount paid or collateral given for the <i>securities or physical commodities</i> less 110% of the current “mark to market value” of the <i>securities or physical</i>

		<i>commodities</i>	<i>commodities</i> received (see note), if the net figure is positive
2	Where a <i>firm</i> does not have in its possession a “written agreement” evidencing the transaction, in accordance with rule 3-176(5)		The appropriate requirements from 1 <i>plus</i> the market value of the <i>securities</i> or <i>physical commodities</i> multiplied by the appropriate <i>percentage risk addition</i> .
<p><b>Note:</b></p> <p>the <i>securities</i> or <i>physical commodities</i> received can be included only where they are held under the control of the <i>firm</i> or where they were delivered into the control of the <i>firm</i> upon initiation of the agreement.</p>			

### Netting

3-176(3) R A *firm* may reduce the *CRR* by netting where it has more than one exposure to an individual *counterparty* provided that it has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11) as follows:

FCA

- (a) in the case of *sale and buy back, repurchase* or *securities* or *physical commodities* lending agreements (Table 3-176(1)), a *firm* may reduce the *CRR* by the excess of the total value of collateral received, including accrued interest, over the “mark to market” value of any other *sale and buy back, repurchase* or *securities* or *physical commodities* lending agreements with the same *counterparty*;
- (b) in the case of *sale and buy back, reverse repurchase* or *securities* or *physical commodities* borrowing agreements (Table 3-176(2)), a *firm* may reduce the *CRR* by the excess of the “mark to market value” over the total value of collateral given, including accrued interest, of any other of *buy and sale back, reverse repurchase* or *securities* or *physical commodities* borrowing agreements with the same *counterparty*; and
- (c) to the extent that an excess has not been used under (a) or (b) above to reduce the *CRR*, a *firm* may use an excess on a *sale and buy back, repurchase* or *securities* or *physical commodities* lending agreement respectively to reduce the *CRR* on a *buy and sale back, reverse repurchase* or *securities* or *physical commodities* borrowing agreement and vice versa provided the agreements are with the same *counterparty*.

### Margin percentages

3-176(4) R A *firm* may opt to calculate the *CRR* using the lower collateral

FCA

rate (105%) in order to avoid undue complication.

*“Written agreement”*

3-176(5)

R For the purpose of this rule and rule 3-177(2), a “written agreement” must, whether in a general agreement or in respect of specific occasions, include the following elements:

FCA

- (a) the names of the persons involved;
- (b) the type and quantity of *securities* or *physical commodities* subject to the *reverse repurchase, securities or physical commodities* borrowing, or *buy and sale back agreement*;
- (c) the type and quantity of collateral;
- (d) the commencement date of the *reverse repurchase, securities or physical commodities* borrowing or *buy and sale back agreement*;
- (e) the completion date of the *reverse repurchase, securities or physical commodities* borrowing or *buy and sale back agreement*, where appropriate;
- (f) interest or fee arrangements, where appropriate;
- (g) arrangements for adjustments in the amount or type of *securities or physical commodities* to be returned, if appropriate;
- (h) arrangements for the calling of margin, if appropriate; and
- (i) agreements for completion,

except that having given prior written notice to the *FCA*, a *firm* may disregard certain of the “written agreement” requirements where it can show there are adequate *internal controls* to evidence the arrangements.

*“Mark to market value”*

3-176(6)

R For the purposes of this rule, the current “mark to market value” of *securities* and the value of cash lodged must include accrued interest.

FCA

*Daily valuation*

3-176(7)

R A *firm* must value collateral and *securities or physical commodities* lent or sold, or borrowed or purchased, at least daily.

FCA

*Settlement failure and pre deliveries*

3-176(8) R Where:

FCA

- (a) simultaneous delivery of *securities* or *physical commodities* and collateral cannot be confirmed immediately due to settlement failure, or
- (b) a *firm* has delivered collateral or *securities* or *physical commodities* prior to the receipt of *securities* or *physical commodities* or collateral,

the *firm* is not required to calculate a *CRR* for three *business days* from the date of payment or delivery by the *firm*.

*Additional acceptable collateral*

3-176(9) R Where the *firm* has called for additional *acceptable collateral* from the other party to the agreement, a *firm* is not required to calculate a *CRR* if that call has been outstanding for no more than one *business day*.

FCA

*Exclusions*

3-176(10) R All *repurchase*, *reverse repurchase*, *securities* or *physical commodities* lending or borrowing *sale and buy back* and *buy and sale back agreements* with a stock exchange, *clearing house*, Clearstream or Euroclear are exempt from this rule.

FCA

*Sub-total*

3-176(11) R The sum of the amounts calculated in accordance with this rule is the total *CRR* for *repurchase* and *reverse repurchase*, *securities* or *physical commodities* lending and borrowing and *sale and buy back agreements*.

FCA

### 3-177 MONEY BROKERS

*Application*

3-177(1) R This rule applies to *money brokers*.

FCA

*Lending money*

3-177(2) R When a *money broker* is lending money it must calculate a 100% *CRR* except to the extent that it holds *acceptable collateral*; except where the broker does not have a “written agreement” in accordance with rule 3-176(5) between the *firm* and *counterparty* specifying, inter alia, the interest rate on the loan and stating that the loan is repayable on demand or for a term no longer than 30 days, when the *CRR* is 100% of the amount outstanding.

FCA

*Lending and borrowing securities etc*

- 3-177(3) R For all *reverse repurchase* and *repurchase agreements*, *securities borrowing* and *lending agreements* and *buy and sale back* and *sale and buy back agreements* other than where *securities* are lent or sold or borrowed or purchased through an approved payments system, a *money broker* must calculate an additional *CRR* of 0.5% applied to the value of all *securities* transferred.

FCA

*Sub-total*

- 3-177(5) R The sum of the amounts calculated in accordance with (2) and (3) above is the *firm's* total *CRR* for *money brokers*.

FCA

3-178 OPTIONS PURCHASED FOR A COUNTERPARTY

*Single premium options*

- 3-178(1) R Where a *firm* has purchased a single premium *option* on behalf of a *counterparty* and the *counterparty* has not paid the full *option* premium cost by three *business days* after trade date, a *firm* must calculate a *CRR* as the amount by which the *option* premium owed to the *firm* exceeds the market value of the *option* or *acceptable collateral*.

FCA

*Traditional options*

- 3-178(2) R Where a *firm* has purchased a *traditional option* for its own account or a *counterparty* and paid the *option* premium, it must calculate a *CRR* equal to the value of the *option* premium.

FCA

*Sub-total*

- 3-178(3) R The sum of the amounts calculated in accordance with (1) and (2) above is the *firm's* *CRR* in respect of purchased *options*.

FCA

3-180 QUALIFYING AND OTHER DEPOSITS

*General rule*

- 3-180(1) R Subject to (2) below, a *firm* must calculate a *CRR* for a deposit referred to in the table below by multiplying the value of the deposit by the appropriate percentage contained in the table below.

FCA

- FCA R Table 3-180(1) Qualifying and other deposit risk percentages

Type of deposit	%
-----------------	---

<i>Qualifying deposits</i>	nil
Other deposits with an <i>approved bank</i> related to a transaction creating an offsetting liability for the <i>firm</i> or subject to an agreement with the bank allowing its use as collateral for a loan that may be withdrawn within –	
- three months to one year	2.5%
- over one year	4.0%
<b>Note:</b> All other deposits are subject to a liquidity adjustment (see rule 3-75(12))	

#### *Timing*

- 3-180(2) R ***Qualifying deposits* and other deposits outstanding three days after a repayment request has been made or more than three days past maturity date are subject to a full *CRR*.**

FCA

#### *Netting*

- 3-180(2A) R **A *firm* may reduce the value of the deposit by an amount owed by the *firm* to a *counterparty* before it multiplies the residual exposure by the appropriate percentage in Table 3-180(1) provided that:**

FCA

- (a) the exposures arise with the same *counterparty*; and
- (b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rules 3-170(11).

#### *Sub-total*

- 3-180(3) R **The sum of the amounts calculated in accordance with Table 3-180(1) is the *firm's CRR* for *Qualifying deposits* and other deposits.**

FCA

### **3-181 LOANS TO COUNTERPARTIES**

#### *General rule*

- 3-181(1) R **A *firm* must calculate a 100% *CRR* on the amount by which a loan to a *counterparty* is not:**

FCA

- (a) secured by *acceptable collateral*; or

- (b) offset against amounts owed by the *firm* to the *counterparty* where the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).

*Sub-total*

- 3-181(2) R The sum of the amounts calculated in accordance with this rule is the *firm's CRR* for loans to *counterparties*.

FCA

**3-182 OTHER AMOUNTS OWED TO A FIRM ARISING OUT OF INVESTMENT BUSINESS OR INVESTMENT DEALING ACTIVITIES**

*Nil CRR items*

- 3-182(1) R The following receivables arising out of *investment business* or *investment dealing activities* do not require a *CRR* at any time:

FCA

- (a) any debt not covered elsewhere in the *CRR* rules to the extent that it is *adequately secured*;
- (b) amounts in respect of 30 day items specified in (3) below which have been outstanding for less than 30 days from the date on which they were first recorded on the *firm's* balance sheet; and
- (c) accrued income for interest on *marketable investments*, except where it has been outstanding for more than 30 days after the date that the interest was due to be received.

*CRR on amounts owed to a firm in respect of international underwriting and stabilisation activities*

- 3-182(2) R (a) Where management or other fees are owed to a *firm* in respect of international underwriting or stabilisation activities, the *firm* must calculate full *CRR* on any amounts remaining unpaid 30 days after they first appeared on the *firm's* balance sheet.

FCA

- (b) A *firm* acting as stabilising manager must also calculate a *CRR* equal to 100% of any income accrued as a result of net profit on stabilising activities while the stabilising account remains open.

*CRR on 30 day items*

- 3-182(3) R A *firm* must calculate a 100% *CRR* in respect of the following receivables due to the *firm* if they have been outstanding for more than 30 days from the date on which they were first

FCA

recorded on the *firm's* balance sheet:

- (a) commissions and fees earned in connection with the *firm's investment business*;
- (b) commissions and fees earned which are due and payable from *client* bank accounts;
- (c) repayments of *marketable investments* at maturity or call;
- (d) the value of scrip issues and rights issues;
- (e) proceeds arising from takeovers and mergers;
- (f) domestic *underwriting* or stabilisation fees; and
- (g) accrued income and work in progress.

**100% CRR items**

- 3-182(4) R A *firm* must calculate a 100% CRR in respect of other receivables arising from *investment business* and *investment dealing activities* not covered elsewhere in this rule from the time that the receivable is recorded on the balance sheet.

FCA

**Netting**

- 3-182(4A) R A *firm* may reduce the value of the amounts owed to the *firm* by an amount owed by the *firm* to a *counterparty* before it multiplies this by 100% provided that:

FCA

- (a) the exposures arise with the same *counterparty*; and
- (b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).

**Sub-total**

- 3-182(5) R The sum of the amounts calculated in accordance with this rule is the CRR for other amounts owed to the *firm* arising out of *investment business* or *investment dealing activities*

FCA

**Consolidated Supervision**

Under the Financial Conglomerates and Other Financial Groups Instrument 2004, the rules in Chapter 14 shall (with respect to a particular firm, group or financial conglomerate) apply from the first day of its financial year beginning in 2005 in place of rules 3-190(1) to 3-195.

**3-300 ACMPs**

- 3-300(1) R A *firm* may only use an ACMP for the purposes of rules 3-170 to

**FCA**

**3-182 if:**

- (a) **the policies and procedures making up the proposed *ACMP* are at all times adequate and appropriate to the *firm* and its business; and**
- (b) **the *firm* gives to the *FCA* at least three months' notice in writing of its intention to use an *ACMP* for the purposes of these rules.**

**3-300(2) R**

**The notice referred to in (1)(b) above must include all relevant details of the policies and procedures making up the proposed *ACMP*.**

**FCA**

**3-300(3) R**

**The notice referred to in (1)(b) is not required if the *firm* was permitted under the relevant requirements of a predecessor regulator, as they were in force immediately prior to the specified day, to use the proposed *ACMP* for the purposes of those requirements.**

**FCA**

**3-300(4) E**

- (a) *A firm's* policies and procedures should take full account of the principles described in Appendix 56.
- (b) Compliance with 3-300(4)(a) may be relied on as tending to establish compliance with 3-300(1)(a).
- (c) Contravention of 3-300(4)(a) may be relied on as tending to establish contravention of 3-300(1)(a).

**FCA**

**FCA**

**G** On receipt of notice under (1)(b) the *FCA* is likely to review the policies and procedures proposed by the *firm* and the degree to which they take full and appropriate account of the matters described in Appendix 56. The *FCA's* review will take account of the context in which the policies and procedures are to operate and the relevant circumstances of the *firm*. The *FCA* will indicate to the *firm* its views on the adequacy and appropriateness of the proposals in the light of its review and may make recommendations of improvements.

**FCA**

**G** The *FCA* may make a further review of the policies and procedures making up an *ACMP* at any time after their implementation for the purposes of these rules as part of its supervision of the *firm*. Any review after implementation will broadly follow the lines described above.



## APPENDIX 1 – GLOSSARY OF TERMS FOR IPRU(INV) 3

### FCA

If a defined term does not appear in the IPRU(INV) glossary below, the definition appearing in the main Handbook *Glossary* applies.

- acceptable collateral*
- (1) (other than for the purposes of rule 3-173B) means any of the following items of collateral provided to a *firm* by a *counterparty* -
    - (a) cash;
    - (b) letters of credit and guarantees to the extent of their face value, issued by a *regulated banking institution* which is not the *counterparty* nor an *associate* of the *counterparty*;
    - (c) letters of credit and guarantees to the extent of their face value, issued by a bank which is not a *regulated banking institution* (not being the *counterparty*, an *associate* of the *counterparty* nor an *affiliated company*) which has been accepted under the *firm's ACMP*;
    - (d) gold and silver bullion and coinage; and
    - (e) *marketable investments*,to which the following conditions apply -
    - (i) the *firm* must have an unconditional right to apply or realise the *acceptable collateral* for the purpose of repaying the *counterparty's* obligations;
    - (ii) *marketable investments* must -
      - (aa) be *marked to market* daily using the valuation principles in rule 3-41(9);
      - (bb) not be issued by the *counterparty* nor by an *associate* of the *counterparty*; and
      - (cc) be discounted by 8% (before allowances for hedging or diversification); and
    - (iii) each item of *acceptable collateral* must be discounted by 5% if it is denominated in a different currency to the *counterparty's* obligation;
  - (2) (for the purposes of rule 3-173B) means any of the following items of collateral provided to a *firm* by a *counterparty*:
    - (a) cash;
    - (b) gold and silver bullion and coinage;
    - (c) certificates of deposit issued by and lodged with the *firm*;

- (d) securities issued by *Zone A* central governments and *Zone A* central banks; and
- (e) *securities* issued by the *EU* or Euratom (the European Atomic Energy Community),

to which the following conditions apply:

- (i) the *firm* must have an unconditional right to apply or realise the *acceptable collateral* for the purpose of repaying the counterparty's obligations to the *firm*; and
- (ii) *securities* must be *marked to market* daily using the valuation principles in rule 3-41(9);

*ACMP*

means, subject to rule 3-300, a credit management policy and procedures according with the principles discussed in **Appendix 56**;

*adequate collateral*

means any of the following items of collateral provided to a *firm* by a *counterparty*:

- (a) cash;
- (b) standby letters of credit and unconditional, irrevocable first on demand guarantees to the extent of their face value, issued by a *Zone A credit institution* which is not the counterparty nor an *associate* of the *counterparty*, and which is not an *affiliated company*, *associate* or a *controller* of the *firm*;
- (c) standby letters of credit and unconditional, irrevocable first on demand guarantees to the extent of their face value, issued by a bank which is not a *Zone A credit institution* (not being the *counterparty* nor an *associate* of the *counterparty*) which has been accepted under the *firm's ACMP* and which is not an *affiliated company*, *associate* or a *controller* of the *firm*;
- (d) certificates of deposit;
- (e) gold and silver bullion and coinage;
- (f) *securities*;
- (g) *physical commodities*; and
- (h) the performance guarantees issued in support of the securities lending and borrowing programmes of Euroclear and Clearstream, in respect only of exposure arising from participation in such programmes,

to which the following conditions apply -

- (i) the *firm* must have an unconditional right to apply or realise the collateral for the purpose of repaying the *counterparty's* obligations to the *firm*; and
- (ii) *securities* must -
  - (aa) be *marked to market* daily using the valuation principles in rule 3-41(9); and

	(bb) not be issued by the <i>counterparty</i> nor by an associate of the <i>counterparty</i> ;
<i>adequately secured</i>	means secured by cash or by <i>marketable investments</i> - <ul style="list-style-type: none"> <li>(a) in respect of which the firm has an unconditional right to apply or realise for the purpose of repaying the <i>counterparty's</i> obligations to the <i>firm</i>;</li> <li>(b) which, in the case of <i>marketable investments</i>, are marked to market daily by the <i>firm</i> using the valuation principles in rule 3-41(9);</li> <li>(c) with, in the case of <i>marketable investments</i>, a marked to market value not lower than the current value of that obligation after being discounted - <ul style="list-style-type: none"> <li>(i) by 8% (before allowances for hedging or diversification); and</li> <li>(ii) at an additional 5% if it is denominated in a different currency to the obligation; and</li> </ul> </li> <li>(d) which, in the case of <i>marketable investments</i>, must not be issued by the <i>counterparty</i> nor by an associate of the <i>counterparty</i>;</li> </ul>
<i>adviser</i>	means a <i>firm</i> which - <ul style="list-style-type: none"> <li>(a) has <i>counterparties</i> who are investors or potential investors;</li> <li>(b) restricts its <i>investment business</i> to activities within article 53 (advising on investments) of <i>the Regulated Activities Order</i>;</li> <li>(c) does not hold, receive or control money or property belonging to another person, nor has a mandate over a <i>customer's</i> bank account;</li> <li>(d) does not introduce its <i>counterparties</i> to other persons as its main business; and</li> <li>(e) does not deal as principal or <i>agent</i> in <i>investments</i> or <i>physical commodities</i>;</li> </ul>
<i>affiliated company</i>	in relation to a <i>firm</i> , means any <i>body corporate</i> controlled by the <i>firm</i> , any parent company of the <i>firm</i> , and any <i>body corporate</i> controlled by a parent company of the <i>firm</i> ;
<i>agency broker</i>	means a <i>broad scope firm</i> which deals as principal only on an incidental basis;
<i>agent</i>	in relation to a person, means any person (including an <i>employee</i> ) who acts on that person's behalf;
<i>allotment date</i>	means the date on which allotments are first made in respect of the <i>securities</i> being offered;
<i>annual accounting reference date</i>	means the date as at which the <i>annual financial statements</i> are prepared as initially notified by the <i>firm</i> to the <i>FCA</i> or as subsequently notified under rule 3-31 for all other purposes and which may not be more than 55 weeks since the previous <i>annual accounting reference date</i> or, if applicable, the date on which the <i>firm</i> commenced trading;
<i>annual financial</i>	means statements drawn up in accordance with whichever of the following is

<i>statements</i>	<p>applicable at the <i>firm's annual accounting reference date</i>:</p> <ul style="list-style-type: none"> <li>(i) Schedule 4 to the Companies Act 1985;</li> <li>(ii) Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409);</li> <li>(iii) Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410); or</li> <li>(iv) Schedule 1 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); or</li> <li>(v) Schedule 1 to the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI2008/1913); or</li> <li>(vi) <i>international accounting standards</i>.</li> </ul>
<i>appointed representative</i>	<p>(in accordance with section 39 of the <i>Act</i>) means a person (other than an <i>authorised person</i>) who:</p> <ul style="list-style-type: none"> <li>(a) is a party to a contract with an <i>authorised person</i> (his principal) which: <ul style="list-style-type: none"> <li>(i) permits or requires him to carry on business of a description prescribed in the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 (SI 2001/1217); and</li> <li>(ii) complies with the requirements prescribed in those Regulations; and</li> </ul> </li> <li>(b) is someone for whose activities in carrying on the whole or part of that business his principal has accepted responsibility in writing;</li> </ul>
<i>approved bank</i>	<p>(in relation to a bank account opened by a <i>firm</i>) means:</p> <ul style="list-style-type: none"> <li>(a) if the account is opened at a branch in the <i>United Kingdom</i>: <ul style="list-style-type: none"> <li>(i) the Bank of England; or</li> <li>(ii) the central bank of a member state of the <i>OECD</i>; or</li> <li>(iii) a <i>bank</i>; or</li> <li>(iv) a <i>building society</i> which offers, unrestrictedly, banking services; or</li> <li>(v) a bank which is supervised by the central bank or other banking regulator of a member state of the <i>OECD</i>; or</li> </ul> </li> <li>(b) if the account is opened elsewhere: <ul style="list-style-type: none"> <li>(i) a bank in (a); or</li> <li>(ii) a <i>credit institution</i> established in an <i>EEA State</i> other than the United Kingdom and duly authorised by the relevant <i>Home State regulator</i>; or</li> </ul> </li> </ul>

	(iii)	a bank which is regulated in the Isle of Man or the Channel Islands; or
	(c)	a bank supervised by the South African Reserve Bank; or
	(d)	any other bank that:
	(i)	is subject to regulation by a national banking regulator;
	(ii)	is required to provide audited accounts;
	(iii)	has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and
	(iv)	has an annual audit report which is not materially qualified;
<i>approved bank bond</i>		means any instrument, by whatever name called, provided by an <i>approved bank</i> which -
	(a)	provides for the immediate payment of a stated sum to the <i>firm</i> on demand whether by the <i>firm</i> or the <i>FCA</i> ;
	(b)	provides that the bank shall have no recourse to the assets of the <i>firm</i> in respect of the bond and that no other person shall have recourse to the assets of the <i>firm</i> arising in respect of the bond, until payment in full of all other creditors;
	(c)	prohibits the bank from terminating the bond unless -
	(i)	the beneficiary will have <i>financial resources</i> equal to at least 120% of its <i>financial resource requirement</i> after termination; or
	(ii)	receives authority from the <i>FCA</i> to do so;
	(d)	prohibits any automatic early termination of the bond whether arising out of any act or default of the <i>firm</i> or otherwise;
<i>approved exchange</i>		means an investment exchange listed as such in <b>Appendix 33</b> ;
<i>approved person</i>		means a <i>person</i> in relation to whom the <i>FCA</i> has given its approval under section 59 of the <i>Act</i> (Approval for particular arrangements) for the performance of a controlled function;
<i>approved treasury arrangement</i>		means an arrangement notified to the <i>FCA</i> in writing whereby a group of <i>connected companies</i> including the <i>firm</i> transfers all cash surpluses to one specified <i>connected company</i> of the <i>firm</i> for the sole purpose of obtaining preferential interest rates on money market deposits;
<i>arranger</i>		means a <i>firm</i> -
	(a)	whose sole <i>investment business</i> consists of activities within the following articles of the Regulated Activities Order -
	(i)	articles 14 (dealing in investments as principal) or 21 (dealing in investments as agent) if -

	(aa)	the firm is a venture capital firm; or
	(bb)	the activity is own account business which would be excluded from being <i>investment business</i> by the provisions of article 16 of the Regulated Activities Order but for the fact that the <i>firm</i> is an <i>authorised person</i> ; or
	(ii)	article 25 (arranging deals in investments);
	(iii)	article 37 (managing investments); and
	(iv)	article 53 (advising on investments);
	(b)	whose <i>permission</i> is subject to a <i>limitation</i> or <i>requirement</i> preventing it from holding money or property belonging to other persons and does not have a mandate over a <i>customer's</i> bank account;
<i>associate</i>		in relation to a person ("A"), means -
	(a)	an undertaking in the same <i>group</i> as A;
	(b)	an <i>appointed representative</i> or where applicable, a <i>tied agent</i> of A or of any undertaking in the same <i>group</i> as A; and
	(c)	any other person whose business or domestic relationship with A or its <i>associate</i> might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties;
<i>associated business</i>		means business which is carried on in connection with <i>investment business</i> ;
<i>bonus</i>		means that part of the remuneration paid by a firm to its <i>employees</i> (including <i>directors</i> ) which is:
	(a)	not a <i>profit share</i> ; and
	(b)	awarded by management entirely on a discretionary basis,
		to the extent that it does not exceed the profit for the financial year of the <i>firm</i> before accounting for such bonus;
<i>bought deal</i>		means an <i>offering</i> where a <i>firm</i> on its own gives an outright binding commitment to the issuer or seller to purchase or subscribe for the <i>securities</i> to be offered;
<i>broad scope firm</i>		means any <i>firm</i> which is not an <i>adviser</i> , an <i>arranger</i> or a <i>local</i> ;
<i>buy and sale back agreement</i>		see <i>reverse repurchase agreement</i> ;
<i>call option</i>		means an <i>option</i> to buy an <i>investment</i> , other instrument, foreign currency or <i>physical commodity</i> at a given price on or before a given date;
<i>cap</i>		means an agreement in respect of a borrowing under which a <i>counterparty</i> contracts to pay any interest costs arising as a result of an increase in rates above an agreed rate: the effect being to provide protection to the holder

	against a rise above that agreed rate;
<i>certificate of deposit</i>	means a negotiable or non-negotiable certificate issued by a bank;
<i>client</i>	means any <i>person</i> with or for whom a <i>firm</i> conducts or intends to conduct <i>designated investment business</i> or any other <i>regulated activity</i> ; and: <ul style="list-style-type: none"> <li>(a) every client is a customer or an <i>eligible counterparty</i>;</li> <li>(b) "client" includes: <ul style="list-style-type: none"> <li>(i) a potential client;</li> <li>(ii) a client of an <i>appointed representative</i> of a <i>firm</i> with or for whom the <i>appointed representative</i> acts or intends to act in the course of business for which the <i>firm</i> has accepted responsibility under section 39 of the <i>Act</i> (Exemption of appointed representatives);</li> <li>(iii) a <i>collective investment scheme</i> even if it does not have separate legal personality;</li> <li>(iv) if a <i>person</i> ("C1"), with or for whom the <i>firm</i> is conducting or intends to conduct <i>designated investment business</i>, is acting as agent for another <i>person</i> ("C2"), either C1 or C2 in accordance with <i>COBS 2.4.3R</i> (Agent as client);</li> </ul> </li> <li>(c) "client" does not include: <ul style="list-style-type: none"> <li>(i) a trust beneficiary;</li> <li>(ii) a <i>corporate finance contact</i>;</li> <li>(iii) a <i>venture capital contact</i>.</li> </ul> </li> </ul>
<i>client money rules</i>	means CASS 4.1 to 4.3;
<i>commissions shared</i>	means that part of the remuneration paid by a <i>firm</i> which is determined on the basis of the number, size or profitability of individual deals carried out;
<i>connected company</i>	and " <i>connected credit institution</i> " mean, in relation to a <i>firm</i> which: <ul style="list-style-type: none"> <li>(a) is a <i>body corporate</i>, a <i>body corporate</i> or <i>credit institution</i> satisfying any of the following conditions - <ul style="list-style-type: none"> <li>(i) the same person is the controller of each <i>body corporate</i> or <i>credit institution</i>;</li> <li>(ii) if a group of two or more persons are <i>controllers</i> of each <i>body corporate</i> or <i>credit institution</i> and the group either consists of the same persons or could be regarded as consisting of the same persons by treating a member of either group as replaced by - <ul style="list-style-type: none"> <li>(aa) that member's <i>close relative</i>;</li> <li>(bb) a person with whom that member is in partnership;</li> </ul> </li> </ul> </li> </ul>

or

(cc) a *body corporate* of which the member is an officer;  
or

(iii) both *bodies corporate* are members of the same group; or

(b) is not a *body corporate*, a *body corporate* or *credit institution* which is controlled -

(i) by the *firm*;

(ii) by a *partner* in the *firm*;

(iii) by a *close relative* of a *partner* in the *firm* or, if the *firm* is a *sole trader*, by a *close relative* of the *sole trader*; or

(iv) collectively by any of the *partners* in the *firm* or their *close relatives*;

*connected credit institution* see “*connected company*”;

*connected person* has the same meaning as given in sections 252, 253 and 254 of the Companies Act 2006 and a person described therein as being connected with a *director* will similarly be deemed to be connected with a *partner* of a *firm*;

*contingency* means a future event the outcome of which is uncertain;

*contingent liability* means a liability dependent upon the occurrence or non-occurrence of one or more uncertain future events;

*convertible* means a *security* which gives the investor the right to convert the *security* into equity at an agreed price or on an agreed basis;

*corporate finance advisory firm* means a *firm* which is an *arranger* and whose *permission* includes a *requirement* that it must not conduct *investment business* other than *corporate finance business*;

*corporate finance business* means –

(a) *designated investment business* carried on by a *firm* with or for:

(i) any *issuer*, holder or owner of *designated investments*, if that business relates to the *offer*, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, those *investments*, or any related matter;

(ii) any *eligible counterparty* or *professional client*, or other *body corporate*, *partnership* or supranational organisation, if that business relates to the manner in which, or the terms on which, or the *persons* by whom, any business, activities or undertakings relating to it, or any *associate*, are to be financed, structured, managed, controlled, regulated or reported upon;

- (iii) any *person* in connection with:
  - (A) a proposed or actual *takeover* or *related operation* by or on behalf of that *person*, or involving *investments* issued by that *person* (being a *body corporate*), its *holding company*, *subsidiary* or *associate*; or
  - (B) a merger, de-merger, reorganisation or reconstruction involving any *investments* issued by that *person* (being a *body corporate*), its *holding company*, *subsidiary* or *associate*;
- (iv) any shareholder or prospective shareholder of a *body corporate* established or to be established for the purpose of effecting a *takeover* or *related operation*, where that business is in connection with that *takeover* or *related operation*;
- (v) any *person* who, acting as a *principal* for his own account:
  - (A) is involved in negotiations or decisions relating to the commercial, financial or strategic intentions or requirements of a business or prospective business; or
  - (B) (provided he is acting otherwise than solely in his capacity as an investor) assists the interests of another *person* with or for whom the *firm*, or another *authorised person* or *overseas person*, is undertaking business as specified in (a)(i),(ii),(iii) or (iv), by himself undertaking all or part of any transactions involved in such business;
- (vi) any *person* undertaking business with or for a *person* as specified in (a)(i), (ii), (iii), (iv) or (v) in respect of activities described in those sub-paragraphs;
- (b) *designated investment business* carried on by a *firm* as a *principal* for its own account where such business:
  - (i) is in the course of, or arises out of, activities undertaken in accordance with (a); and
  - (ii) does not involve transactions with or for, or *advice on investments* to, any other *person* who is a *retail client* in respect of such business;
- (c) *designated investment business* carried on by a *firm* as *principal* for its own account if such business:
  - (i) is in the course of, or arises out of:
    - (A) the *offer*, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*, or any related matter; or

(B) a proposed or actual *takeover or related operation* by or on behalf of the *firm*, or involving *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*; or

(C) a merger, de-merger, reorganisation or reconstruction involving any *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*; and

(ii) does not involve giving advice on investments to any person who is a private customer;

in this definition, “share warrants” and “debenture warrants” mean any *warrants* which relate to *shares* in the *firm* concerned or, as the case may be, *debentures* issued by the *firm*;

<i>counterparty</i>	means any person with or for whom a <i>firm</i> carries on, or intends to carry on, any <i>regulated business</i> or <i>associated business</i> ;
<i>CRR</i>	means the counterparty risk requirement, as calculated in 3-170 to 3-182;
<i>customer</i>	means a client who is not a <i>eligible counterparty</i> ;
<i>dealing activities</i>	means all <i>dealing activities</i> as principal or <i>agent</i> in <i>investments</i> and <i>physical commodities</i> ;
<i>dematerialised instruction transmitter</i>	means a firm -  (a) which restricts its <i>investment business</i> to activities within article 45 (sending dematerialised instructions) of the Regulated Activities Order; and  (b) which does not hold or receive money or property belonging to another person nor has a mandate over another person’s bank account;
<i>derivative fund manager</i>	means an <i>arranger</i> -  (a) whose <i>investment business</i> consists of discretionary management of funds which are invested predominately in <i>derivatives</i> ; and  (b) whose income is not related to the volume of business transacted on behalf of the funds managed by him;
<i>documents of title</i>	means documents of title and documents evidencing title to <i>investments</i> and <i>commodities</i> ;
<i>domestic offering</i>	means an <i>offering</i> or a tranche of an <i>offering</i> which is directed primarily to investors in the United Kingdom and which uses methods normal in the United Kingdom domestic capital markets;
<i>dual currency bonds</i>	means debt securities, the issue price and coupon of which are fixed in one currency whilst the redemption value is fixed in a different currency;
<i>eligible capital</i>	means a subordinated loan, <i>approved bank bond</i> or approved undertaking

<i>substitute</i>	which a <i>firm</i> may treat as an <i>eligible capital substitute</i> in accordance with rule 3-63;
<i>employee</i>	in relation to any person, means an individual - <ul style="list-style-type: none"> <li>(a) who is employed by that person under a contract of service, a contract for services, or any other contract under which the individual will provide services to the person;</li> <li>(b) who is a <i>director</i> of the person where the person is a <i>body corporate</i>;</li> <li>(c) who is a <i>partner</i> of the person where the person is a partnership;</li> <li>(d) who, where the person is an unincorporated association, is a member of its governing body, the secretary or treasurer; or</li> <li>(e) whose services are, under an arrangement between the person and a third party, placed at the disposal and under the control of the person;</li> </ul>
<i>equity balance</i>	means - <ul style="list-style-type: none"> <li>(a) a <i>counterparty's equity balance</i>; or</li> <li>(b) a <i>firm's equity balance</i>;</li> </ul>
<i>exceptional items</i>	means those items which derive from events or transactions within the ordinary activities of the business of a <i>firm</i> and which are both material and not expected to recur frequently or regularly;
<i>exchange</i>	means a <i>recognised investment exchange</i> or <i>designated investment exchange</i> ;
<i>exchange traded</i>	means an <i>investment</i> which is traded or listed <i>on exchange</i> or on an <i>approved exchange</i> ; or an <i>offering</i> where an investment <i>pari passu</i> to that being offered is traded or listed <i>on exchange</i> or on an <i>approved exchange</i> ;
<i>exchange-traded-margined-transaction</i>	means a <i>margined transaction</i> effected by a <i>firm</i> under the rules of an <i>exchange</i> or an <i>approved exchange</i> or <i>clearing house</i> ;
<i>extraordinary items</i>	means those items which derive from events or transactions outside the ordinary activities of the business of a <i>firm</i> and which are both material and not expected to recur frequently or regularly;
<i>financial bookmaker</i>	means a <i>firm</i> which conducts only spread-betting business;
<i>financial reporting statement</i>	means the periodic financial and other reporting statements required to be provided to the <i>FCA</i> under the provisions of Chapter 16 of the <i>Supervision manual</i> ;
<i>financial resources</i>	means the sum of the <i>firm's tangible net worth</i> and <i>eligible capital substitutes</i> ;
<i>financial resources requirement</i>	means the sum of the <i>firm's primary requirement</i> , <i>PRR</i> and <i>CRR</i> ;
<i>financial rules</i>	means the financial rules in Chapter 3 of the <i>FCA's Interim Prudential Sourcebook for Investment Businesses (IPRU(INV)3)</i> ;

<i>floor</i>	means an agreement in respect of a deposit under which a <i>counterparty</i> contracts to pay any lost income arising as a result of a fall in rates below an agreed rate: the effect being to provide protection to the holder against a fall below that agreed interest rate;
<i>foreign currency derivatives method</i>	means the method of calculating <i>PRR</i> under rule 3-153;
<i>foreign currency exposures method</i>	means the method of calculating <i>PRR</i> under rule 3-154;
<i>forward</i>	means a <i>security</i> which is transacted for a settlement date beyond that which would normally apply in the market concerned, and where that forward settlement date is not yet passed;
<i>FRA</i>	means <i>forward</i> rate agreement, i.e. an agreement in which two parties agree on the payment by one party to another of an amount of interest based on an agreed interest rate for a specified period from a specified settlement date applied to an agreed principal amount; no commitment is made by either party to lend or borrow the principal amount; their exposure is only the interest difference between the agreed and actual rates at settlement;
<i>free delivery</i>	means - <ul style="list-style-type: none"> <li>(a) the delivery of <i>securities</i> or <i>physical commodities</i> which takes place before the seller receives payment; or</li> <li>(b) payment made in settlement of a credit balance arising from a sale on behalf of, or a purchase from a counterparty in respect of which the <i>securities</i> are undelivered;</li> </ul>
<i>FRN</i>	means floating rate note, i.e. all debt <i>securities</i> which pay interest at a rate which varies in response to general interest rates (including floating rate collateralised mortgage obligations);
<i>in the money</i>	means, in relation to <i>call options</i> and <i>warrants</i> , that the exercise price is less than the current <i>mark to market</i> value of the <i>underlying instrument</i> and, in relation to <i>put options</i> , that the current <i>mark to market</i> value is less than the exercise price;
<i>initial margin requirement</i>	means the total amount which under the rules of the relevant <i>exchange</i> or <i>exchanges</i> or <i>clearing house</i> or <i>clearing houses</i> the <i>firm</i> or an <i>intermediate broker</i> would be required to deposit in cash as a fidelity deposit in respect of all the <i>client's</i> open positions in <i>marginised transactions</i> at that time, irrespective of any unrealised profit or loss on such positions, on the assumption that those transactions were the only transactions undertaken under the rules of that <i>exchange</i> or those <i>exchanges</i> or that <i>clearing house</i> or those <i>clearing houses</i> by the <i>firm</i> or the <i>intermediate broker</i> at that time;
<i>intermediate broker</i>	in relation to a <i>marginised transaction</i> , means any person through whom the <i>firm</i> undertakes that transaction;
<i>international offering</i>	means an <i>offering</i> which is not a <i>domestic offering</i> or, where an <i>offering</i> has a tranche which is a <i>domestic offering</i> , those tranches which are not;
<i>introducing broker</i>	means an <i>arranger</i> who introduces all transactions in <i>investment business</i> or <i>dealing activities</i> arranged for <i>counterparties</i> to a <i>clearing firm</i> where the <i>clearing firm</i> accepts primary responsibility (including legal liability) for the

	settlement of those transactions;
<i>investment</i>	means a <i>designated investment</i> ;
<i>investment agreement</i>	means any agreement the making or performance of which by either party constitutes an activity which is <i>investment business</i> ;
<i>investment business</i>	means any of the following regulated activities specified in Part II of the Regulated Activities Order and which is carried on by way of business: <ul style="list-style-type: none"> <li>(a) dealing in investments as principal (article 14), but disregarding the exclusion in article 15 (Absence of holding out etc);</li> <li>(b) dealing in investments as agent (article 21);</li> <li>(b) <i>auction regulation bidding</i> (part of <i>bidding in emissions auctions</i>) (article 24A);</li> <li>(c) arranging deals in investments for another person (article 25(1)) but only in relation to <i>investments</i>;</li> <li>(d) making arrangements for deals in investments (article 25(2)) but only in relation to <i>investments</i>;</li> <li>(e) managing investments (article 37);</li> <li>(f) safeguarding and administration of assets (article 40);</li> <li>(g) sending dematerialised instructions (article 45(1));</li> <li>(h) causing dematerialised instructions to be sent (article 45(2));</li> <li>(i) establishing, operating or winding up a collective investment scheme (article 51(1)(a));</li> <li>(j) acting as trustee of an authorised unit trust scheme (article 51(1)(b));</li> <li>(k) acting as the depository or sole director of an open-ended investment company (article 51(1)(c));</li> <li>(l) advising on investments (article 53);</li> <li>(m) agreeing to carry on the activities in (a) to (h) and (l) (article 64);<sup>i</sup></li> </ul>
<i>investment manager</i>	means a person who, acting only on behalf of a <i>customer</i> , either - <ul style="list-style-type: none"> <li>(a) manages an account or portfolio in the exercise of discretion; or</li> <li>(b) has accepted responsibility on a continuing basis for advising on the composition of the account or portfolio;</li> </ul>
<i>investment services</i>	means - <ul style="list-style-type: none"> <li>(a) activities undertaken in the course of carrying on investment business; and</li> <li>(b) activities undertaken in connection with an ISA where those activities</li> </ul>

do not constitute investment business;

*launch* means the time when any announcement, specifying the issuer or the guarantor of and indicating the final *pricing terms* of the *offering* is made for the first time to the public or the press or any *exchange* or *approved exchange* or information service;

*margin requirement* means, in relation to a *counterparty*, the value of any amounts which the *firm* or *intermediate broker* would be required to pay under the rules of an *exchange* or *clearing house* to -

- (a) meet any *marked to market* losses occurring on contracts undertaken for that *counterparty* at that time; or
- (b) as an initial margin fidelity deposit in respect of all the *counterparty's* open positions at that time,

on the assumption that those transactions were the only transactions undertaken on the *exchange* or *clearing house* by the *firm* or *intermediate broker* at that time;

*margin'd transaction* means a transaction effected by a *firm* with or for a *customer* relating to an *investment* of any description referred to in articles 83, 84 and 85 of the Regulated Activities Order (or any right or any interest in such an *investment*) under the terms of which the *customer* will or may be liable to make a deposit in cash or collateral to secure performance of obligations which he may have to perform when the transaction falls to be completed or upon the earlier closing out of his position;

*mark to market* means to value an *investment* at its current market value in accordance with rule 3-41(9);

*marketable investment* means -

- (a) an *investment* which is traded on or under the rules of an *exchange* or an *approved exchange*;
- (b) a debt instrument which may be transferred without the consent of the issuer or any other person (including a collateralised mortgage obligation);
- (c) a *physical commodity*;
- (d) a *warrant*, *option*, *future* or other instrument which entitles the holder to subscribe for or acquire -
  - (i) an *investment* or *physical commodity* which falls under (a) to (c) above;
  - (ii) any currency; or
  - (iii) any combination of (i) and (ii) above;
- (e) a *contract for differences* (including interest rate and currency *swaps*) relating to fluctuations in -
  - (i) the value or price of an *investment* or *physical commodity* in

	(a) to (d) above;
	(ii) any currency;
	(iii) the rate of interest in any currency or any index of such rates;
	(iv) the level of any index which is derived from the prices of an <i>investment or physical commodity</i> in (a) to (c) above; or
	(v) any combination of (i) to (iv) above;
	(f) <i>warrants, options, futures</i> or other instruments entitling the holder to obtain the rights of those contracts in (d) or (e) above; and
	(g) a unit in a <i>regulated collective investment scheme</i> ;
<i>model A clearing firm</i>	means a <i>regulated clearing firm</i> which uses its own money for settlement but is reimbursed on a daily basis by the non-clearing firms it settles for;
<i>money broker</i>	means a <i>firm</i> for which the total value of <i>repurchase, securities lending and sale and buy back agreements</i> is or has been at any time during the previous year, at least 25% of its total assets; <sup>ii</sup>
<i>new securities</i>	means, in relation to a particular <i>offering, securities</i> which are issued pursuant or with a view to an <i>offering</i> ;
<i>new to the market</i>	means, in relation to an <i>offering, securities</i> which are not already <i>exchange traded</i> ;
<i>non clearing floor member</i>	means a <i>firm</i> which: <ul style="list-style-type: none"> <li>(a) is authorised to trade on the floor of a <i>recognised investment exchange</i> which permits this category;</li> <li>(b) is not prohibited by the rules of that exchange from dealing with <i>customers</i>;</li> <li>(c) has entered in to an agreement with a <i>clearing firm</i> which accepts full responsibility for every deal entered into by the non clearing floor member; and</li> <li>(d) is not authorised to handle <i>client money</i>;</li> </ul>
<i>non recourse loan</i>	means a loan to a <i>firm</i> secured on specific land or buildings, under the terms of which the lender has no claim on the other assets of the <i>firm</i> nor on assets for which the <i>firm</i> is accountable in any circumstances (including a winding up);
<i>note issuance facility</i>	means an arrangement under the terms of which a borrower is able to issue short term notes in its own name with a guarantor, or consortium of guarantors ensuring the availability of funds to the borrower by agreeing to purchase any unsold notes, and which includes for example revolving underwriting facilities, note purchase facilities, euronote facilities and similar arrangements;
<i>offering</i>	means an offering of <i>securities</i> which are -

	(a) issued for the purpose of the offering;
	(b) <i>new to the market</i> , or
	(c) existing <i>securities</i> which are <i>exchange traded</i> subject to the purchase of those <i>securities</i> having the same characteristics as an <i>offering of new securities</i> , or <i>securities</i> which are <i>new to the market</i> ;
<i>open-priced deal</i>	means an <i>international offering</i> which is not a <i>bought deal</i> or pre-priced deal;
<i>option</i>	(for the purposes of rule 3-173B) means a contract which confers the right to buy or sell a security, contractually based investment, currency, gold or commodity at a given price on or before a given date. (NB: the definition of an option used for this purposes deliberately differs from that in the main Handbook Glossary);
<i>out of the money</i>	means those <i>options</i> and <i>warrants</i> which are not <i>in the money</i> ;
<i>pari passu security</i>	means a <i>security</i> which is the same as another <i>security</i> , except only in respect of payment, entitlement to initial dividend and the nature of <i>documents of title</i> ;
<i>passport institution</i>	means an <i>incoming EEA firm</i> ;
<i>percentage risk addition</i>	means a percentage to be applied to the value of positions in investments held by the firm to determine its <i>PRR</i> ;
<i>perfectly matching contracts</i>	mean certain <i>OTC derivatives</i> contracts which are included in a legally binding netting agreement that are equal and exact opposites and perfectly matching in all material respects;
<i>physical commodities method</i>	means the method of calculating <i>PRR</i> under rules 3-166 to 3-169B;
<i>physical commodity</i>	means the actual commodity, <i>documents of title</i> to actual commodities or shipping documents conveying title to actual commodities;
<i>preference security</i>	means a <i>share</i> with rights, in respect of capital or dividends, superior to those of ordinary equity;
<i>pre-priced deal</i>	means an <i>international offering</i> other than a <i>bought deal</i> all the <i>pricing terms</i> of which have been fixed;
<i>pricing terms</i>	means, in relation to an <i>offering</i> , the amount of currency, maturity, <i>offering price</i> , rate of or means of calculating interest and any prices at which <i>securities</i> may be redeemed or converted or exchanged into other <i>securities</i> ;
<i>primary requirement</i>	is the primary requirement calculated in accordance with Table 3-61;
<i>profit share</i>	means an appropriation of profit before tax on a predetermined basis for the benefit of management or <i>employees</i> ;
<i>property fund</i>	means a scheme dedicated to permitted immovables and property related assets, whether with or without other transferable securities;
<i>PRR</i>	means the position risk requirement of a firm as calculated in accordance with rules 3-80 to 3-169B;

*put option* means an *option* to sell an *investment*, other instrument, foreign currency or *physical commodity* at a given price on or before a given date;

*qualifying debt security* means a *debt security* which:

- (1) (other than for the purposes of rule 3-173B):
  - (a) represents or evidences indebtedness;
  - (b) is a *marketable investment*;
  - (c) if it or “equivalent debt” is rated by a “relevant agency” (and there has been no announcement that the rating will be cancelled) -
    - (i) the *security* or the “equivalent debt” is so rated at or higher than the level indicated in the table in **Appendix 34**;
    - (ii) there has been no announcement that the rating will be down-graded below the level so indicated; and
    - (iii) the *firm* has no reasonable cause to believe that another “relevant agency” has rated the security or “equivalent debt” below the level so indicated; and
  - (d) if neither it nor any “equivalent debt” is rated by a “relevant agency” (or there has been an announcement that such a rating will be cancelled), it satisfies one or more of the following -
    - (i) it is issued or guaranteed by or is subject to the full faith and credit of a sovereign government or province or state thereof (or a corporation over 75% owned by such sovereign government, or province or state), which is a member of the *OECD* and the government, province, state or corporation has not defaulted, or entered into any rescheduling or similar arrangement, or announced the intention of so doing, in respect of itself or its agency’s debt within the last five years;
    - (ii) it is issued or guaranteed by a *supranational organisation*;
    - (iii) it is issued or guaranteed by a corporation (not being a bank, for which see (iv) below) the ordinary *shares* of which are included within the following categories -
      - (aa) UK : constituents of the FT All Share Index;
      - (bb) Japan : constituents of the First Section of the Tokyo Stock Exchange;
      - (cc) USA: constituents of the NYSE, AMEX or NASDAQ NMS; or
      - (dd) countries listed below: the constituents of the FT-

Actuaries World Indices in respect thereof;

Australia

Belgium

Canada

Denmark

France

Germany

Hong Kong

Italy

Netherlands

Norway

Singapore

Spain

Sweden

Switzerland

(iv) it is issued or guaranteed by a bank which is supervised by an authority in a state such as is referred to above and has capital and reserves (including subordinated loans which are not repayable within five years) of not less than £100,000,000 or the equivalent as shown by its latest published audited consolidated accounts (or, in the absence of consolidated accounts, unconsolidated accounts); or

(iv) is it issued or guaranteed by a local authority or building society in the United Kingdom;

provided that the issuer or guarantor of the *security* is not in default as to any payment on any other *security* issued or guaranteed by it; and

(2) for the purposes of (1) above -

(a) in respect of any *security* of, or guaranteed by, any issuer or guarantor, “equivalent debt” means any debt which ranks *pari passu* with, or subordinate to, the *security* or (as the case may be) the guarantee; and

(b) in relation to any issuer or guarantor, a “relevant agency” means one of the agencies named in **Appendix 34** by reference to the category of issuer or guarantor;

- (3) (for the purposes of rule 3-173B) meets the following conditions:
- (a) it attracts zero specific risk under Table 2 in **Appendix 47**; or
  - (b) it is issued by, or fully guaranteed by:
    - (i) a *Zone B* central government or central bank and the *security* is denominated in the local currency of the issuer;
    - (ii) a *multilateral development bank*;
    - (iii) a *Zone A* public sector entity;
    - (iv) a company whose *share* is a constituent of one of the indices making up the FTSE All-World Index; or
    - (v) an issue of, or fully guaranteed by an investment firm or recognised third-country investment firm; or
  - (c) it is issued by, fully guaranteed by, endorsed or accepted by:
    - (i) a *credit institution* incorporated in a *Zone A* country; or
    - (ii) a *credit institution* incorporated in a *Zone B* country and the debt *security* has a residual maturity of one year or less; or
  - (d) it is a mortgage backed *security* relating to residential real estate of the type referred to in *BIPRU 3.4.94R(1)(d)(i)* which meets the requirements about legal certainty referred to in *BIPRU 3.4.62R*; or
  - (e) it is rated by at least one of the agencies shown in Table 3 Appendix 47, and every such rating equals or exceeds the corresponding minimum shown in that table;

*qualifying deposit* means a deposit which is one of the following -

- (a) balance on current account with an *approved bank*;
- (b) money on deposit with an *approved bank*, United Kingdom local authority, member of the Finance Houses Association, *stock exchange moneybroker*, *regulated clearing firm*, the National Savings Bank, *exchange*, *approved exchange* or *approved depository* which may be withdrawn within three months;
- (c) money on deposit with an *approved bank* directly related to a transaction creating an offsetting liability for the *firm* or subject to an agreement with the bank allowing its use as collateral for a loan that may be withdrawn within three months, which relates to a liability of the same maturity and arises out of a transaction;
- (d) amount evidenced by a certificate of tax deposit;
- (e) amount evidenced by a *certificate of deposit* issued by a *regulated banking institution* which matures within three months; or

	(f) deposit of cash by way of margin with an <i>exchange</i> , <i>approved exchange</i> , <i>clearing house</i> or <i>intermediate broker</i> ;
<i>regulated banking institution</i>	means any banking institution which has paid up share capital and reserves of over £5,000,000 as shown by its latest published audited accounts, and which is authorised under the <i>Act</i> or supervised by the central bank or other regulatory authority of a member state of the <i>OECD</i> in which the bank is incorporated;
<i>regulated business</i>	means <i>investment business</i> which is <ul style="list-style-type: none"> <li>(a) business carried on from a permanent place of business maintained by a <i>firm</i> (or its <i>appointed representative</i>) in the United Kingdom; and</li> <li>(b) other business carried on with or for <i>customers</i> in the United Kingdom, unless that business is - <ul style="list-style-type: none"> <li>(i) business carried on from an office of a <i>firm</i> outside the United Kingdom which, if that office were a separate person, would fall within the overseas persons exclusions set out in article 72 of the Regulated Activities Order; or</li> <li>(ii) business of an <i>appointed representative</i> of the <i>firm</i> which is not carried on in the United Kingdom;</li> </ul> </li> </ul>
<i>regulated clearing firm</i>	means a clearing firm which is an authorised person;
<i>regulated financial institution</i>	means a <i>firm</i> , or an institution which is authorised to conduct <i>investment business</i> involving the execution of transactions on <i>exchanges</i> or on <i>securities</i> or <i>derivatives exchanges</i> by one or more of the following regulators - <ul style="list-style-type: none"> <li>(a) any regulator of <i>investment business</i> in any member state of the <i>EU</i> (other than the United Kingdom) established by law in that state; or</li> <li>(b) a body referred to in Part 1 of <b>Appendix 35</b>;</li> </ul> <p>provided, in the case of any such institution that the <i>firm</i> has no reason to suppose that the institution is in breach, in any material respect, of the rules enforceable by the relevant regulator;</p>
<i>relevant annual expenditure</i>	means the relevant annual expenditure of a <i>firm</i> calculated in accordance with rule 3-73;
<i>reporting statement</i>	means any one or more of the following types of report as required by the <i>Supervision manual</i> : <ul style="list-style-type: none"> <li>(a) audited <i>annual financial statements</i>;</li> <li>(b) <i>annual reporting statement</i>;</li> <li>(c) [deleted];</li> <li>(d) internal control letter;</li> <li>(e) quarterly reporting statement;</li> <li>(f) position risk reporting statement;</li> </ul>

	(g) counterparty risk reporting statement;
	(h) annual reconciliation;
	(i) monthly reporting statement; and
	(j) the audited accounts of a <i>subsidiary</i> of the <i>firm</i> ;
<i>repurchase agreement</i>	(and <i>sale and buy back agreement</i> ) means an agreement for the sale of <i>securities</i> or <i>physical commodities</i> subject to a commitment to repurchase from the same person the same or similar <i>securities</i> or <i>physical commodities</i> ;
<i>reverse repurchase agreement</i>	(and “ <i>buy and sale back agreement</i> ”) means an agreement for the purchase of <i>securities</i> or <i>physical commodities</i> subject to a commitment to resell to the same person the same or similar <i>securities</i> or <i>physical commodities</i> ;
<i>Sale</i>	includes any disposal for valuable consideration;
<i>sale and buy back agreement</i>	see repurchase agreement;
<i>scheme management activity</i>	means the management by an <i>operator</i> of a <i>collective investment scheme</i> of the property held for or within a <i>collective investment scheme</i> of which it is the <i>operator</i> and includes the management of the property of an <i>open-ended investment company</i> by the company itself as its <i>operator</i> but excludes the management of an <i>open-ended investment company</i> by another person as its <i>operator</i> (and excludes in all cases activities relating to transactions in units, <i>shares</i> or interests in the <i>collective investment scheme</i> );
<i>settlement day</i>	means the day on which under the recognised practice of an <i>exchange</i> or <i>approved exchange</i> , bargains are contracted for settlement; and in the case of bargains not transacted on an <i>exchange</i> or <i>approved exchange</i> , or entered into for forward settlement, 20 days from the date of the transaction, or, if earlier, the contractual due date;
<i>stock exchange moneybroker</i>	is a <i>moneybroker</i> which is an <i>authorised person</i> and acts as an intermediary in the gilt market;
<i>supranational organisation</i>	means any organisation referred to in Part 2 of <b>Appendix 35</b> ;
<i>swap</i>	means a transaction in which two <i>counterparties</i> agree to exchange streams of payments over time according to a predetermined basis;
<i>takeover or related operation</i>	means: <ul style="list-style-type: none"> <li>(a) any offer to which the <i>Takeover Code</i> applies and any transaction or arrangement which is of such a nature that the <i>Takeover Code</i> would have applied to it had it concerned a company whose shares are listed under Part VI of the <i>Act</i> and whose head office and place of central management are in the United Kingdom;</li> <li>(b) any offer, transaction or arrangement relating to the purchase of <i>securities</i> with a view to establishing or increasing a strategic holding of a person, or of a person together with his <i>associates</i> in the <i>securities</i> concerned;</li> </ul>

	(c) any transaction or arrangement entered into in contemplation or furtherance of any offer, transaction or arrangement falling within (a) or (b) above; and
	(d) any transaction or arrangement entered into by way of defence or protection against any offer, transaction or arrangement falling within (a), (b) or (c) above which has taken place or which is contemplated;
<i>tangible net worth</i>	is the tangible net worth of a <i>firm</i> calculated in accordance with rule 3-62;
<i>total PRR</i>	means the sum of all the amounts calculated as a <i>PRR</i> under rules 3-80 to 3-169B;
<i>traditional option</i>	means any <i>option</i> arranged but not traded under the rules of the London Stock Exchange;
<i>trust beneficiary</i>	means a beneficiary under a trust (not being the settlor) who benefits from the performance by a <i>firm</i> as trustee of <i>investment services</i> relating to the management of the trust assets;
<i>underwriting</i>	means a commitment to take up <i>securities</i> where others do not acquire or retain them;
<i>underwriting price</i>	means the price at which the <i>firm</i> is committed to take up the securities or the price at which it is committed to do so if required under the <i>underwriting</i> commitment less any commissions or discounts paid or allowed in connection with the transaction, except to the extent that the <i>firm</i> has taken credit for them in its accounts;
<i>variable rate note</i>	means a debt <i>security</i> with the characteristics of an <i>FRN</i> except that the margin with respect to the index rate of interest is subject to variation depending on periodic negotiations;
<i>variation margin requirement</i>	means in relation to a <i>counterparty</i> the value of any amounts which the <i>firm</i> or <i>intermediate broker</i> would be required to pay under the rules of an <i>exchange</i> , <i>approved exchange</i> or <i>clearing house</i> to meet any <i>marked to market</i> losses occurring on contracts undertaken for that <i>counterparty</i> at that time on the assumption that those transactions were the only transactions undertaken on the <i>exchange</i> , <i>approved exchange</i> or <i>clearing house</i> by the <i>firm</i> or <i>intermediate broker</i> at that time;
<i>venture capital schemes</i>	means a scheme for providing capital to a <i>body corporate</i> whose equity is not traded or listed on an <i>exchange</i> ;
<i>walkaway clause</i>	means a provision which permits a non-defaulting counterparty to make only limited payments, or no payment at all, to the estate of the defaulter, even if the defaulter is a net creditor;
<i>warrant fund</i>	means a scheme which is dedicated to <i>transferable securities</i> except that it is permitted to invest entirely in <i>warrants</i> ;
<i>zone A</i>	see definition of <i>Zone A country</i> in the <i>Glossary</i> ; and
<i>zone B</i>	means any country not in <i>Zone A</i> .

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<sup>i</sup> These are the same activities as are included in the definition of "designated investment business" used in the Main Handbook Glossary.

<sup>ii</sup> For guidance notes on *money brokers*, see **Appendix 37**.



## Appendix 20: Guidance Notes on Reconciliation of Firm's Balances with a Counterparty which is a Member of an Exchange (Rule 3-11(1)(D)) and IPRU(INV) 9.6.1r (For An Exempt CAD Firm))

### INTRODUCTION

- 1 The purpose of this guidance is to state how under rule 3-11(1)(d) and *IPRU(INV)* 9.6.1.R (for an *exempt CAD firm*) the reconciliation process with counterparties which are also members of exchanges should be performed.

FCA

### SCOPE

- 2 The reconciliation to be performed with counterparties should cover all outstanding balances and *securities* positions with such counterparties from all sources except to the extent that the components of such balances and *securities* positions have been agreed by other means. Agreement by other means shall include (but is not to be limited to) those which have been–

FCA

- (a) matched or cleared through an exchange, clearing house or clearing system; or
- (b) verified by dispatch to or receipt from the counterparty of a confirmation or statement. Such verification should have been evidenced in writing or by electronic media.

- 3 The reconciliation should cover all remaining outstanding items including, for example, fee-based items, dividends where these are on the *firm's* balance sheet, coupons, amounts arising under *OTC* contracts, *repurchase* and *reverse repurchase agreements* and *securities* lending and borrowing.

FCA

- 4 The items to be included should be all those past trade date which is consistent with *trade date accounting*.

FCA

- 5 Where necessary a *firm* should initially circularise a list of all relevant open items as set out above rather than a net balance. A *firm* should identify the assumptions made by them in ascertaining which balances (or types of balances) have been included in the reconciliation. A *firm* should also identify where the balances or *securities* positions with a counterparty arise from different accounts operated by them with that counterparty.

FCA

- 6 The scope of the rule is intended to cover nil balances although these may be covered on a sample basis only. They are included because discrepancies in such balances may only come to light as being incorrectly stated on the performance of a circularisation. However, reconciliations of nil balances do not need to be performed where–

FCA

- (a) the counterparty is also a *firm*; or
- (b) there has been no outstanding balance with the counterparty at any point during the year.

### TIMING

- 7 It is considered preferable for a *firm* to be aware in advance at which periods of the year they will receive reconciliations requests. This may be of use to a *firm* in enabling it to plan in advance the allocation of staff for the performance of the reconciliations. Thus, it is suggested that a *firm* submits such circularisations, where possible, at calendar quarter end

FCA

dates. It is considered that, in any case, the majority of *firms* would be likely to circularise such statements at these dates. However, a *firm* will be eligible to circularise at other dates as, for example, when its own *annual* or *quarterly accounting reference dates* do not coincide with the calendar quarter end.

- 8 A *firm* may perform the reconciliation in conjunction with the work undertaken by its auditors for the purposes of the annual audit.

FCA

## THE OBLIGATION ON FIRMS

- 9 It is considered preferable for a *firm* to be aware in advance at which periods of the year they will receive reconciliations requests. This may be of use to a *firm* in enabling it to plan in advance the allocation of staff for the performance of the reconciliations. Thus, it is suggested that a *firm* submits such circularisations, where possible, at calendar quarter end dates. It is considered that, in any case, the majority of *firms* would be likely to circularise such statements at these dates. However, a *firm* will be eligible to circularise at other dates as, for example, when its own *annual* or *quarterly accounting reference dates* do not coincide with the calendar quarter end.

FCA

- 10 A recipient of a circularisation request from another *firm* must use its best endeavours to respond. Notwithstanding paragraphs 7 and 8 above, this obligation will apply even if this request is received more frequently than once a year from the same counterparty or is wider in scope than required by paragraphs 2 to 6 above (for example, by also covering balances which have already been agreed by other means). Rule 3-11 (or *IPRU(INV)* 9.6.1R for an *exempt CAD firm*) only requires that specific balances be covered. This is intended as a minimum requirement and not necessarily as the norm. If a *firm* need not reply to a request more than once a year or which covered balances of a wider scope, *firms* would be discouraged from requesting such reconciliations.

FCA

- 11 Rule 3-11(3) (or *IPRU(INV)* 9.6.1(1)R(4) for an *exempt CAD firm*) requires a *firm* to respond, within one month of receipt, to a circularisation request received from another *firm*. The one month response period should also be observed in relation to circularisation requests received under rule 3-11(1)(d) (or *IPRU(INV)* 9.6.1(1)R for an *exempt CAD firm*).

FCA

- 12 It is not considered necessary to issue detailed guidance for the procedure to be adopted in cases where the recipient does not reply to a circularisation request sent by a *firm*. It is intended that a *firm* need only take reasonable steps to obtain any such reply. However, before a *firm* has taken such steps, it should not assume that the circularisation is agreed merely due to the absence of a reply from the counterparts.

FCA

# Appendix 21: Guidance Notes on the Valuation of Positions

## (rule 3-41(9))

### INTRODUCTION

**1** Rule 3-41(9) states that a position must be valued at its close out price, where close out price means that a long position should be valued at current bid price and a short position at current offer price. In addition, rule 3-41(9) states that a *firm* must value a position on a prudent and consistent basis, and have regard to the liquidity of the instrument concerned and any special factors that may adversely affect the closure of the position.

FCA

**2** The following paragraphs give general indications to *firms* on the appropriate valuation methodology. However, it is emphasised that prudence should be the overriding influence in the valuation exercise and that, where uncertainty exists as to the most appropriate price, the *firm* should use that price which gives the most conservative valuation.

FCA

### GENERAL PRINCIPLES

**3** *Firms* should value positions by reference to market prices, but where necessary should add a prudent and appropriate buffer to the bid or offer price to account for factors which would adversely affect the *firm's* ability to realise the close-out value, such as -

FCA

- (a) the liquidity of the *security* in question;
- (b) the size of the position held in that *security* relative to the sizes at which prices are quoted;
- (c) the direction of the position (long or short) relative to the current direction of the market;
- (d) the exposure of the *firm* to the relevant market as a whole;
- (e) any conversion or foreign exchange costs that would be incurred if the position were closed out;
- (f) any other factors which may affect the close-out price.

**4** Where a mid-market or single price only is available for the *security* in question, *firms* must adjust this price by a prudent and appropriate buffer as outlined in paragraph 3 above.

FCA

**5** With respect to paragraphs 3 and 4 above, *firms* should be able to demonstrate at all times how they determined the final price applied to any position in a *security*.

FCA

## Appendix 26 (rules 3-81 to 3-165):

### Summary Tables of Which Method of PRR to Apply to an Instrument

INSTRUMENT		CIRCUMSTANCES	METHOD	RULES
1 FCA	<i>note issuance facilities</i>	all circumstances	note issuance facilities	3-80
2 FCA	foreign currency asset or capital or liability	all circumstances	foreign currency exposures	3-150 to 3-154
3 FCA	<i>currency option and future</i>	see rule 3-152	foreign currency exposures or foreign currency derivatives	3-150 to 3-154
4 FCA	<i>physical commodity, actual and forward</i>	all circumstances	commodities	3-166 to 3-169B
5 FCA	<i>physical commodity, option and future</i>	all circumstances	commodities	3-166 to 3-169B
6 FCA	concentrated position	all circumstances	method relevant to position + <i>concentrated position</i>	As above
7 FCA	forward	equity foreign currency <i>physical commodities</i>	<i>equity</i> <i>foreign currency exposures</i> <i>commodities</i>	3-80 3-150 to 3-154 3-166 to 3-169B
8 FCA	<i>regulated collective investment scheme</i>	all circumstances	<i>equity derivatives</i>	3-80
9 FCA	<i>non marketable investments and others</i>	all circumstances	100% PRR	3-80

## Appendix 33 (exchanges): List of Approved Exchanges

**FCA**

The following exchanges are approved for the purposes of the definition of “approved exchange” –

Athens Stock Exchange (ASE)

Barcelona Stock Exchange (Bolsa de Valores de Barcelona)

Belgian Futures & Options Exchange (BELFOX)

Berlin Stock Exchange (Berliner Börse)

Bilbao Stock Exchange (Bolsa de Valores de Bilbao)

BVLP (Bolsa de Valori de Lisboa e Porto)

Bolsa de Mercadorios & Futures (BM&F)

Boston Stock Exchange

Bovespa (The São Paulo Stock Exchange)

Bremen Stock Exchange (Bremer Wertpapierbörse)

BVRJ (The Rio de Janeiro Stock Exchange)

Cincinnati Stock Exchange

Copenhagen Stock Exchange (Københavns Fondsbørs)

Düsseldorf Stock Exchange (Rheinisch-Westfälische Börse zu Düsseldorf)

Frankfurt Stock Exchange (Frankfurter Wertpapierbörse)

Hannover (Niedersächsische Börse zu Hannover)

Italian Exchange

Kuala Lumpur Stock Exchange

Luxembourg Stock Exchange (Société de la Bourse de Luxembourg SA)

Madrid Stock Exchange (Bolsa de Valores de Madrid)

Mercato Italiano Futures (MIF)

Munich Stock Exchange (Bayerische Börse in München)

Nagoya Stock Exchange

New Zealand Stock Exchange

Oslo Stock Exchange (Oslo Børs)

Stuttgart Stock Exchange (Baden-Württembergische Wertpapierbörse zu Stuttgart)

Swiss Exchange (SWX)

Taiwan Stock Exchange

Tel Aviv Stock Exchange

The Stock Exchange of Thailand

Valencia Stock Exchange (Bolsa de Valores de Valencia)

## Appendix 34 (“qualifying debt security”): Relevant Agency

The agencies in the table below are “relevant agencies” for the purposes of the definitions of “*qualifying debt security*”.

		Securities minimum category	Money market obligations minimum category
1 FCA	<b>For all issuers</b> Moody’s Investors Service Standard and Poor’s Corporation Fitch Ratings Ltd	Baa3 BBB- BBB-	P3 A3 A3
2 FCA	<b>For all banks, Building Societies and parent companies and subsidiaries of banks</b> Thomson BankWatch	BBB-	TBW-3
3 FCA	<b>For Canadian issuers and issues in Canadian dollars</b> Canadian Bond Rating Service Dominion Bond Rating Service	B++low BBB low	A-3 R-2
4 FCA	<b>For Japanese issuers and issues in Japanese yen</b> Fitch Ratings Ltd Japan Credit Rating Agency, Ltd Japan Rating and Investment Information, Inc Mikuni & Co Ltd	BBB- BBB- BBB- BBB	F-3 J-2 a-2 M-3
5 FCA	<b>For United States issuers and issues in US dollars</b> Fitch Ratings Ltd	BBB-	F-3

# Appendix 35 (“regulated financial institution” and “supranational organisation”): List of Regulated Financial Institutions and Supranational Organisations

## PART 1

**FCA**

### List of Regulators for the Purposes of the Definition of Regulated Financial Institution

Australian Stock Exchange Limited;  
The Hong Kong Monetary Authority;  
The Hong Kong Securities and Futures Commission;  
Investment Dealers Association of Canada;  
Japanese Ministry of Finance;  
Sydney Futures Exchange;  
Toronto Stock Exchange;  
United States Commodity and Futures Trading Commission;  
United States Securities and Exchange Commission;  
Vancouver Stock Exchange.

## PART 2

**FCA**

### List of Supranational Organisations

*a multilateral development bank;*  
The Bank for International Settlements;  
The Council of Europe;  
Euratom (The European Atomic Energy Community);  
Eurofima (The European Company for Financing of Railroad Rolling Stock);  
The *EU*;  
The International Monetary Fund;

# APPENDIX 37 (rule3-177): Guidance Notes for Money Brokers

## Application of the Counterparty Risk Requirement

### INTRODUCTION

- 1 This Appendix offers guidance to *money brokers* on the application of rule 3-177 relating to the counterparty risk requirement.

FCA

### CALCULATION OF 0.5% ADDITIONAL CRR

- 2 A *money broker* should calculate the additional *CRR* requirement as follows -

FCA

- (a) if a *money broker* is satisfied that it has a legal right to net off exposures with an individual *counterparty*, valid and enforceable in the United Kingdom or any other relevant country, it may do so in accordance with the rule 3-176(3). The obligation rests with the broker to demonstrate that the method it uses is reasonable and justifiable. It is stressed that this right to net is at the option of the *firm* and is not mandatory;
- (b) a *money broker* should then aggregate its total level of *securities* subject to a *repurchase* or *reverse repurchase agreement*, *securities* lending or borrowing agreement and *sale and buy back* or *buy and sale back agreement* (either net or gross) to or from individual *counterparties* outside an *approved payments system* and money lent against *Talisman short-term certificates*. A capital requirement of 0.5% of this sum should then be calculated.

### APPROVED PAYMENTS SYSTEMS

- 3 The following are *approved payment systems* when the systems concerned provide for settlement on a delivery versus payment basis -

FCA

- Austraclear New Zealand
- Banca D'Italia's Giornaliera
- Banque Nationale de Belgique
- Bank of Spain Interbank Bond Settlements System
- Banque de France's SATURNE
- BOJ-NET DVP
- Central Gilts Office
- Clearstream
- Depository Trust Company
- Euroclear
- Fedwire - see The Federal Reserve System
- Kassenverein

- Necigef
- SICOVAM (Relit settlement only)
- Sociedad de Compensacion y Liquidacion de Valores
- The Canadian Depository for Securities Ltd
- The Federal Reserve System (Fedwire), and
- Vardepapperscentralen VPC AB

## COLLATERAL

4

FCA

It is recognised that letters of credit may be used as collateral and may have a value in excess of the amount of the *securities* transferred. Provided it is clearly established that claims cannot be made on the letter of credit in excess of the value of the *securities* borrowed, no *CRR* will be imposed on the amount by which the letter of credit exceeds the value of the *securities* borrowed. *Firms* are reminded that the definition of *acceptable collateral* includes *marketable investments* which may take the form of money market instruments.

# Appendix 43: Guidance Notes on the Financial Resources and Accounting Treatment of Soft Commission Agreements

(rules 3-73 and 3-182(3))

## INTRODUCTION

1 This Appendix contains detailed guidance to the following rules–

**FCA**

Rules	
3-73	Expenditure requirement
3-182(3)	<i>CRR</i> requirement on other amounts owed to a <i>firm</i> arising out of <i>investment business</i> or <i>investment dealing activity</i>

2 The *FCA* is of the view that it is not responsible for setting accounting policies in relation to a *firm's audited annual financial statements*. However, the *FCA* considers that it is preferable for all *firms* participating in "soft commission agreements" to have consistent accounting policies. Without such consistency, certain *firms* would have a competitive advantage in terms of their *financial resources*. Therefore, for the purposes of completing *financial reporting statement* submitted to the *FCA*, appropriate accounting policies should be used. The guidance and interpretations made in this Appendix should be considered in this context.

**FCA**

3 The guidance applies to all *firms* which participate in "soft commission agreements" whether or not this is the sole *investment business* of the *firm*.

**FCA**

## DEFINITION

4 A soft commission agreement means–

**FCA**

"any agreement, whether oral or written, under which a *firm* which deals in *securities* on an advisory basis, or in the exercise of discretion, receives goods or services in return for an assurance that not less than a certain amount of such business will be put through or in the way of another person;"

## DESCRIPTION

5 A "soft commission agreement" is understood as being one in which a fund manager agrees, either formally or informally, to provide a broker with a certain amount of commission in any one period in return for the provision of services "free". Those services may be provided in-house or by third parties and may take the form of specific research provided by analysts, portfolio valuation systems, or information packages, plus the associated computer hardware and software.

**FCA**

- 6 Under traditional broking arrangements, the full service broker normally receives commission in return for the total servicing of a fund manager's account, a package which includes execution, perhaps custodianship and, almost certainly, research, also "free". The services provided under traditional broking arrangements are in-house i.e. within a broking group, and mostly are not conditional upon receipt by the broker of a certain level of commission, although there is usually an understanding which may never be articulated, that a certain volume of business will be generated.

FCA

## EXISTING DIFFERENCE IN ACCOUNTING POLICIES

- 7 The accounting policies used can in general be divided into those which are "profit & loss" based and those which are "balance sheet" based. Under the former, the *firm* will write-off such expenditure to its profit & loss account but will usually not accrue a liability in its *financial reporting statements* for commissions received in advance. Consequently, the "normal" profit & loss based accounting systems for expenses incurred and commissions received will be used. It should be noted that such *firms*, as they are fundamentally participating in traditional broking arrangements, may not have legally enforceable "soft commission agreements" with their counterparties, such that there may be no absolute contractual liability on the *firm* or counterparty to provide expenditure or commission.

FCA

- 8 *Firms* using the "balance sheet" approach will accrue for liabilities but will also tend to capitalise their expenditure under "soft commission agreements". This may be the policy used by *firms* which specialise in legally enforceable "soft commission agreements" and reflects the legal status of such agreements. These may contract the counterparty to pay a level of commission related to the level of expenditure incurred by the *firm* (and vice versa if the counterparty has paid advance commission in excess of the expenditure paid by the *firm*).

FCA

## EXPENDITURE AND BALANCES RECEIVABLE

- 9 Once expenditure is incurred for a counterparty, the soft commission broker may claim that contractually the counterparty is bound to pay him a certain multiple of that expenditure in the form of commission within a certain period of time from the date the expenditure was incurred. Consequently, certain *firms* have previously capitalised their expenditure and shown it as an asset for the purposes of calculating their *financial resources*.

FCA

## REQUIRED TREATMENT

- 10 Where a *firm* incurs expenditure on behalf of a counterparty or counterparties in respect of "soft commission agreements" (whether or not it is incurred in relation to a written contract), the *firm* should immediately write off such expenditure to its profit & loss account.

FCA

- 11 Notwithstanding the above, expenditure may be capitalised (as an asset) in the balance sheet of the company which incurred the expenditure, **only where this amount is recoverable under a legally enforceable contract** (see paragraph 18 below). Where such expenditure is capitalised it will be subject to rule 3-182(3).

FCA

## INCOME AND BALANCES PAYABLE

- 12 Once commission income is received from a counterparty, the *firm* may recognise that contractually it is bound to pay the counterparty a certain proportion of that income, in the form of the counterparty's expenses, within a certain period. Although certain *firms* are including this amount as a liability on their balance sheet (and thus reducing their *financial*

FCA

resources), other *firms* are making no such provision.

## REQUIRED TREATMENT

13

FCA

Where a *firm* has a contractual liability to, or on behalf of, a counterparty or counterparties which arises from a legally enforceable "soft commission agreement", the *firm* should accrue in its *financial reporting statements* a liability for the relevant proportion of any advanced commission income received from the counterparty that will have to be subsequently incurred as an expense by the *firm* in the form of a payment on behalf of the counterparty for allowable goods and services.

## EXPENDITURE REQUIREMENT

14

FCA

Once expenditure is incurred for a counterparty, the soft commission broker may claim that contractually the counterparty is bound to pay him a certain multiple of that expenditure in the form of commission within a certain period and thus such expenditure should not be included in the *firm's* expenditure requirement.

## REQUIRED TREATMENT

15

FCA

Expenditure incurred by soft commission brokers should be included in a *firm's* expenditure requirement, unless it is incurred under a legally enforceable "soft commission agreement" when it may be excluded from the expenditure requirement calculation.

16

FCA

The reasoning behind this treatment is that the expenditure of a *firm* participating in soft commission arrangements is similar to shared commissions and can, therefore, be treated as though it were shared commissions under rule 3-73(2)(f), except to the extent that such expenses are irrecoverable, i.e. except where there is no enforceable legal agreement.

17

FCA

It is considered that certain *firms* may have been under the misapprehension that there was a concession for all expenditure related to "soft commission agreements" regardless of whether the agreement was legally enforceable. Where a *firm* undertakes a mixture of business between legally enforceable contracts and informal arrangements (all of which the *firm* would classify as "soft commission agreements"), it must take great care in allocating expenditure between legally enforceable contracts and others. Alternatively, it may decide to include all expenditure in the expenditure requirement regardless of source.

## LEGALLY ENFORCEABLE CONTRACTS

18

FCA

For the purposes of this guidance, for a "soft commission agreement" to be legally enforceable there should be a specific written legal contract governing the arrangements. The contract should be legally enforceable by the *firm* involved, both in the UK and in any other relevant country.

## Appendix 46 (Table 3-173(2)B): Countries/Territories in which CRR on Issuing Market Free Deliveries may be Relaxed

FCA

### INTRODUCTION

This Appendix lists the countries/territories in which *free deliveries* made in the issuing market are subject to a reduced *CRR* of 15% of the *free delivery* value, and the time limit on this reduced *CRR*.

Country/Territory	Business days since delivery
Hong Kong SAR	20
Indonesia	30
Malaysia	30
Philippines	75
Singapore	21
Thailand	45

## Appendix 47: Tables applicable to CRR for derivative transactions under the rule 3-173B

FCA

TABLE 1

Counterparty Weights to be Applied in Calculating Liquidity Adjustment and CRR (rule 3-173B(5)(b))

Type of counterparty	Counterparty weight
claims on, or explicitly guaranteed by, or collateralised with <i>securities</i> issued by: <ul style="list-style-type: none"> <li>- the central government or central bank of a <i>Zone A</i> country;</li> <li>- the <i>EU</i> or Euratom (the European Atomic Energy Community);</li> </ul> or <ul style="list-style-type: none"> <li>- any other government or central bank, provided the <i>exposure</i> is denominated in that country's national currency.</li> </ul>	NIL
claims on discount houses, gilt-edged <i>market makers</i> , institutions with a <i>money</i> market dealing relationship with the Bank of England and those <i>Stock Exchange money brokers</i> which operate in the gilt-edged market, where the claims are secured on gilts, UK Treasury bills, eligible <i>local</i> authority and eligible bank bills, or London CDs	10%
claims on, or explicitly guaranteed by: <ul style="list-style-type: none"> <li>- a <i>multilateral development bank</i>;</li> <li>- the regional government or <i>local</i> authority of a <i>Zone A</i> country;</li> <li>- a <i>Zone A credit institution</i>;</li> <li>- a <i>recognised clearing house</i> or <i>recognised exchange</i>;</li> <li>- a recognised third country or <i>EEA investment firm</i>;</li> <li>- a <i>Zone B credit institution</i>, provided the <i>exposure</i> has a maturity of one year or less.</li> </ul>	20%
any other counterparty	100%

### Guidance

The guarantee should be explicit and be legally enforceable by the *firm* and should prevent a *firm's* capital from becoming deficient as a result of experiencing a loss on such an exposure. The exposure must be retained on the *firm's* balance sheet.

FCA

TABLE 2

Specific risk *percentage risk additions*

<b>Issuer</b>	<b>Residual maturity</b>	<b>Percentage risk addition</b>
An issue of, or fully guaranteed by, or fully collateralised by a <i>Zone A</i> central government or central bank or the <i>EU</i> or Euratom (the European Atomic Energy Community)	Any	0%
An issue of, or fully guaranteed by, a <i>Zone B</i> central government or central bank denominated in the local currency	Zero to 12 months	0%

**FCA**

**TABLE 3**

Minimum ratings for *qualifying debt securities*

<b>Issuer</b>	<b>Rating agency</b>	<b>Minimum rating</b>	
		<b>Securities</b>	<b>Money Market Obligations</b>
Any	Moody's Investors Service Standard & Poor's Corporation FITCH Ratings Ltd	Baa3 BBB- BBB-	P3 A3 F-3
Canadian	Canadian Bond Rating Service Dominion Bond Rating Service	B++low BBB low	A-3 R-2
Japanese	Japan Credit Rating Agency, Ltd Mikuno & Co Japan Rating & Investment Information Inc	BBB- BBB BBB-	J-2 M-3 a-2

# Appendix 56: Guide to Adequate Credit Management Policy (ACMP)

(rules 3-73 to 3-175, 3-300 and “ACMP”)

## INTRODUCTION

- 1 This appendix contains general guidance on the standards which the FCA expects a *firm's* ACMP to meet.

FCA

## OBJECTIVE

- 2 The FCA's objective is to ensure that adequate procedures and controls are in place to manage effectively the granting of credit and the monitoring and controlling of credit risk.

FCA

## SCOPE

- 3 The guidance applies to any *firm* which wishes to take advantage of the lower CRR percentages (by which counterparty exposures must be multiplied).

FCA

- 4 Before a *firm* may use the lower percentages in calculating CRR and in preparing its financial reporting statements, it must meet the requirements set by 3-300. The ACMP and its operation will be reviewed periodically by the FCA and, where it is no longer operating effectively, the *firm* may be in breach of those requirements.

FCA

## BACKGROUND

- 5 The FCA is aware that *firms* grant credit to counterparties in many different ways, including for example, loans to cover actual margin calls as a result of delays between trade date and final settlement or of late settlement etc. This guidance is designed to cover all instances where a *firm* becomes exposed to credit risk although, depending on the way in which credit risk arises, the procedures for managing it may differ.

FCA

- 6 In considering the credit management policies of a *firm*, the FCA will expect the *firm* to operate a robust control structure which is appropriate to the size, scale and nature of its business and the diversity and complexity of its exposures. The FCA recognises that different approaches to and styles of credit management can create an effective operational control environment. Therefore, it is not appropriate for the FCA to lay down prescriptive standards which it would expect a *firm* to meet, but rather to suggest a broad framework which is flexible, allows for individualised solutions and can accommodate and encourage evolutionary developments.

FCA

- 7 The prime components of a sound credit risk management process are:

FCA

- the definition by a *firm* of what constitutes a credit exposure/risk and is therefore covered by the *firm's* ACMP;
- a comprehensive credit risk measurement approach;

- the existence of guidelines and other parameters used to determine credit limits and govern the level and types of risk taken; together with
- a strong management information system for controlling, monitoring and reporting exposures.

Thus, when the *FCA* reviews a *firm's* credit management process, it will seek comfort that credit exposures are managed and controlled in a highly disciplined manner and that the relevant staff are well versed in the *firm's* credit procedures.

- 8** Where a *firm's* credit risk management is controlled or overseen by its parent or an affiliate in the same group, provided that the *firm* can identify reasonable grounds for believing that the level of control is suitable, this should not impede use of the *firm's* *ACMP*.

**FCA**

## GENERAL PRINCIPLES

- 9** In forming its view as to the adequacy of a *firm's* credit risk management process, the general characteristics which the *FCA* may take into account include the following:

**FCA**

### *Role of senior management*

- (a) whether the framework of credit risk management, i.e. a *firm's* policies and procedures, is overseen by the board of directors or an equivalent management body;

### *Procedures*

- (b) whether there are clearly established lines of responsibility and levels of authority for:
- the granting of credit to a counterparty;
  - extending its permitted use to cover risk arising on a product new to the counterparty;
  - increasing existing credit facilities; and
  - the monitoring and controlling of all credit risk;
- (c) the extent to which the functions of granting, measuring, monitoring and controlling credit risk are managed independently of the front office with a direct reporting line to the senior management ultimately responsible for credit risk management;
- (d) whether good channels of communication exist which ensure that the *firm's* credit management procedures are well understood and followed by all relevant personnel;
- (e) whether procedures exist for identifying unintentional credit exposures and dealing with counterparty which has failed to settle its obligations to the *firm*, (whether merely due to a delay or actual default), or which is expected not to settle its obligations on the due date; including arrangements for closing out transactions. In addition, the *FCA* may consider whether a *firm* has the ability to identify and attempt to predict, as well as quantify, any shortfall as it arises and on an aged basis;

- (f) whether mechanisms exist for a daily comparison of exposures with credit limits, including the production of exception reports, and the procedures to be followed to deal with the results of those exception reports;

#### **Documentation**

- (g) whether a *firm's* credit management policies and procedures are properly documented and reviewed by the *firm* on a regular and thorough basis to ensure that they continue to remain appropriate and sound;
- (h) whether records are kept in respect of each counterparty (identified on an individual legal entity basis) indicating in sufficient detail, the level of credit risk to a counterparty to which the *firm* is willing to expose itself. Where a *firm* grants a credit facility similar to a loan to cover, for example, margin calls, such records might give details of the credit facility extended to a counterparty together with any information gathered in support of the decision to grant that credit facility, the types of transaction which the *firm* may enter into with the counterparty and to which the credit facility may be allocated. Credit information relating to counterparties should be regularly updated and reviewed by the *firm* to ensure that any credit facility granted remains appropriate;

#### **Collateral and margin**

- (i) whether the *firm* has written policies relating to the margining and collateral arrangements with its counterparties. Terms of business or customer agreements would normally detail the circumstances when margin might be called, and the type and level of collateral which would be acceptable to the *firm* on the basis of its liquidity, volatility and ability to be realised. In addition, it may be relevant to consider the degree to which a *firm's* collateral records are kept up to date and include detail of the practical procedures for the realisation of such collateral.

#### **Measurement and monitoring of exposures**

- (j) whether a *firm* has mechanisms for identifying the level of concentration of credit risk exposures to each individual counterparty, and each group of connected counterparties, etc on a regular and timely basis;
- (k) where a *firm* uses risk reduction techniques (such as master agreements, netting agreements, collateralisation arrangements or the taking of third party credit enhancements, including letters of credit and guarantees), whether the *firm* has procedures for scrutinising documents and assessing their impact on the credit risk of the *firm* and assessing the quality of any guarantees or letters of credit;
- (l) depending on the nature of the credit exposures to which a *firm* is subject, whether the *firm's* mechanisms for measuring such exposures are appropriate to cover the type or level of risk to which they give rise.

# Additional Guidance on the FCA's Assessment of ACMPs

FCA

## PREAMBLE

This document is intended as a guide to those areas of Credit Management Policies which the FCA will address when considering their adequacy.

## A DEFINITION OF CREDIT AND THE MEASUREMENT OF CREDIT RISK

The FCA expects that firms have a clear definition of what is considered to be “credit risk” (by whatever name it is known) within the firm.

The FCA expects firms to consider in depth the measurement of the extent of Credit Risk which is incurred vis a vis any given counterparty. Firms should be aware that the extent of credit risk incurred will not necessarily be the same as the nominal value of contracts entered into (“value at risk” concept).

The FCA will expect that firms measure and monitor the extent of Credit Risk incurred vis a vis any given counterparty by reference to a system of limits showing the maximum Credit Risk which the firm considers it prudent to incur vis a vis that counterparty having regard for the financial strength of the counterparty.

The FCA expects there to be adequate procedures within the firm for the recognition of where credit risk may be incurred, for the approval of incurring such risk, and, once incurred, for the monitoring of that risk to ensure the satisfactory recovery of all amounts owed to the firm by a counterparty.

## THE DECISION TO GRANT CREDIT

*If there is a formal decision making body (e.g. a “Credit Committee”) which reviews applications for credit:*

- How does it derive its authority?
- What is the extent of any Credit Committee’s authority as regards:
  - amount of credit granted
  - tenor of credit granted
  - products for which credit lines may be approved
  - industry sectors for which credit lines may be approved?
- How is any Credit Committee constituted?
- What are the qualifications of any Credit Committee’s members to make the decisions required of them?
- Independence of Committee from profit centres
- Recording of Approvals

*If there is no formal committee, what procedures exist to ensure adequate collective responsibility for credit decisions giving regard for the duality (“four eyes”) principle and independence of decisions made from profit centres likely to benefit from income? e.g.*

- “round robin” circulation of papers to Directors/Credit Management
- individual sign off on each transaction/deal

Many of the comments noted above concerning a “Credit Committee” will be relevant also where no

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formal Committee meets, as will the following remarks concerning the documentation provided to those making credit decisions.

*What documentation is provided to those charged with reaching decision to grant credit?*

Cover sheet detailing proposed credit.

- Name of proposed counterparty (identify correct legal entity)
- Address of proposed counterparty
- Amount of credit
- Currency of credit
- Tenor of credit
- Collateral/Security proposed (where applicable)
- Remuneration for credit granted
- Products
- Existing exposure to counterparty (in case of increase/review)
- Previous payment performance of counterparty (in case of increase/review)

Financial information on proposed counterparty.

In order to ascertain the financial strengths and weaknesses of a proposed counterparty the *FCA* expects *firms* to revert to financial information, some examples of which are given below.

- Annual report and accounts
- Analysis of annual reports and accounts
- Credit reference agency reports e.g. Dun and Bradstreet
- Rating agency reports e.g. Standard and Poors, Moody's
- Brokers reports
- Bank status reports
- Statements of net worth

"Credit memorandum" or other internally produced paper outlining the reason for proposing the granting of credit to the counterparty.

Some areas which might be covered by such a memorandum are as follows:

- Background information on relationship with proposed counterparty
- Commentary/analysis of financial information
- Future prospects (for profitability, growth etc.)
- Reason for present proposal
- What benefit will it bring to a *firm's* relationship with company?
- Perceived risks in providing the credit proposed
- What measures have been taken to mitigate these risks?
- Provision of management accounts
- imposition of financial covenants
- Taking of security
- Comments on the collateral or security to be taken
- Comments on legal documentation to be employed
- Industry exposure
- Country exposure
- Spread of counterparties - large exposures

## **THE MONITORING OF CREDIT EXPOSURES**

Once a proposal to grant credit has been approved the *FCA* will expect that there are adequate

procedures in place to ensure the proper monitoring of all credit exposures entered into.

The *FCA* expects the monitoring function to be separate from and managed independently of those profit centres which may benefit from the incurring of credit risk.

In order to ensure adequate monitoring of credit exposure it will be necessary for firms to ensure that decisions concerning credit matters are communicated promptly and efficiently to those who are responsible for their utilisation and monitoring. firms may wish to consider how such matters are communicated to:

- Those entitled to commit the *firm*
- Credit Control Officers
- Senior Management
- Documentation Staff

The *FCA* will consider the methods by which this information is communicated e.g. memorandum, manual lists, credit procedures manuals etc.

## COMPUTER SYSTEMS

Where use is made of computer systems the *FCA* will consider the various methods by which the integrity of databases is ensured. These could include

- Password protection/access rights
- Accuracy/key verification
- Duality principle
- Physical security of systems
- Back up

Where information is transferred between computer systems e.g. for reporting purposes or to PC based systems the *FCA* will consider any reconciliations which are performed.

## REPORTING

The *FCA* expects there to be an adequate reporting system for the monitoring of credit exposure. Many *firms* make use of a series of reports, analysing their credit exposure based on a number of different criteria. Examples of the kinds of reports which may be found useful by *firms* are given below.

- Excess reports/Exception reports
- Exposure reports
  - by customer/group/connected customers
  - by industry
  - by country
- Overdue payments reports
- Facilities due for review
- Facilities by collateral/security type
- Collateral/security held
- Large Exposures

The *FCA* will give consideration to the frequency of production of reports used in monitoring credit risk.

## CREDIT RISK MANAGEMENT/CONTROL

The *FCA* will expect to be given details of the action taken where monitoring shows that any aspect of credit exposure is not in line with previously agreed parameters.

For example where exposure is in excess of approved limits the *FCA* will expect to be informed about what action is taken, where payments are not received, how this is followed up. If a counterparty's financial standing deteriorates, what action is taken to attempt to mitigate possible credit loss?

## DOCUMENTATION

The *FCA* expects *firms* to have adequate procedures in place to be certain that all transactions which require documentation are documented and that this occurs within an acceptable time frame, and that any transactions which fail to be documented are identified and reported to Senior Management for appropriate action to be taken.

The *FCA* expects any staff responsible for documentation to be separate from front office/profit centres and have an independent reporting structure. This will ensure that the commercial wish to trade and do business does not cloud the negotiation of effective and binding legal documentation.

- Suitability of documentation to be used
- Preparation of documentation
- Qualification of staff (or choice of solicitors to be instructed)
- Training of documentation staff
- Tenacity of documentation staff

Basic documentation to be obtained from all counterparties might include

- Certificate of incorporation
- Memorandum and articles of association (M&AA)
- Board Resolution

Other documents which a *firm* may wish to call for prior to entering into transactions would include:

- a statement of officers authorised to act for the counterparty and to commit it to transactions
- a list of authorised signatories where one exists
- an audited annual report or interim figures
- credit reference report or bank status report

Other areas for consideration could include:

- Prompt execution of documentation
- Monitoring response to documents sent out
- Chasing where no response
- Reporting missing documentation to senior management
- Proper execution
- Secure storage of documentation
- Regular review of documentation held

## ONGOING REVIEW OF CREDIT RISK

The *FCA* expects firms to have in place adequate procedures for the annual (or more frequent) review of

credit risk.

- Scope of the review
- Financial information
- Action where concern is raised
- Possible need for more frequent review
- Monitoring of counterparties' performance
- Defaults and delinquent and bad debts
- Provisioning policy

The *FCA* will expect a *firm* to be able to explain what action may be taken as the result of review e.g. reduction of credit limit, calling for further collateral etc. Where the review indicates cause for concern.

## **DOCUMENTATION OF CREDIT POLICIES AND PROCEDURES AND CUSTOMER FILES**

The *FCA* will expect *firms* to consider the manner in which their Credit Policies are documented. Areas for comment could include:

- Credit Procedures manuals and the context in which they are used
- Internal Board Minutes showing delegated authority
- Credit Committee Minutes
- Operations manuals
- Training material for staff
- Internal memorandum detailing credit policy
- Customer Credit files, to contain
  - credit analysis information
  - copies of decisions to grant credit
  - copies of relevant documentation
  - press cuttings
  - copies of data input documents

# Appendix 62: Netting

## SIMILAR TYPES OF TRANSACTIONS

The rules set out the requirements to be met by firms before offsetting exposures in 'similar types of transactions' with a counterparty (i.e. being those transactions falling under a particular counterparty risk rule). The netting of exposures within a particular rule is to be applied on a first in first out basis.

## DERIVATIVE TRANSACTIONS

Firms may offset the negative replacement cost on written OTC options against the positive replacement cost of OTC purchased options with the same counterparty.

# Guidance on the Netting of Counterparty Exposures

## INTRODUCTION

1. This appendix contains guidance on the requirements to be attained in order for firms to net counterparty exposures assessed under the following areas.

**FCA**

Subject
Cash against documents transactions
Free deliveries of securities
Repurchase and reverse repurchase, securities lending and borrowing and sale and buy back agreements
Derivative transactions
Other amounts owed to a firm arising out of trading book business

## SCOPE

2. The guidance applies to any firm subject to the CRR rules and which takes advantage of the netting provisions contained therein.

**FCA**

## BACKGROUND

3. Agreements which can effect set-off of counterparty exposures exist in two forms:

**FCA**

- (a) novation agreements (referred as netting by novation) which replace existing contracts with one new contract and therefore can only be used to cover similar

transactions with payments in the same currency for the same value dates;and

- (b) netting agreements which can be used to cover transactions of very different types.

The guidance below applies to both novation agreements and netting agreements.

## PRINCIPLES OF OFFSET

- 4. Before offsetting exposures in similar types of transactions with a counterparty a firm must have a contractual netting agreement with that counterparty which:

**FCA**

- (a) covers the transactions which the firm is seeking to net;
- (b) creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;
- (c) does not include a walkaway clause; and
- (d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the firm's exposure to be the single net amount mentioned in (b) above.

## PRINCIPLES OF OFFSET

- 5. The prerequisite of holding a netting agreement supported by an independent legal opinion in order to offset exposures is not required where the Financial Law Panel's (November 1993) Statement of Law on netting applies. This Statement of Law indicates that under English law rule 4-90 of the Insolvency Rules 1986 imposes a requirement for complete set-off of transactions between parties incorporated in England and Wales, provided the transactions are mutual (i.e. credits, debts or claims arise from dealings between the same parties and that the parties are acting in the same capacity). Furthermore, it indicates that set-off is mandatory, applies whether or not there is any contractual entitlement to set-off and cannot be excluded by agreement between the parties.

**FCA**

- 6. As mentioned above mutuality is required in order for there to be complete set-off of transactions. Accordingly, firms are expected to have procedures in place to identify the counterparty and the capacity in which the counterparty is acting. Firms proposing to rely on the Statement of Law on netting must satisfy themselves of the appropriateness of such reliance and, where in doubt, obtain legal advice. It is important to note that Insolvency Rule 4.90 does not apply to building societies, statutory organisations generally, mutual societies, partnerships and individuals.

**FCA**

## LEGAL REQUIREMENTS

- 7. Legal opinions will be needed for the:

**FCA**

- law of the jurisdiction in which the counterparty is organised;
- law of the jurisdiction in which any branch involved is located;

- law that governs the agreement and, if different, the law that governs individual transactions pursuant to it; and
  - law that governs the legal status of the counterparty who is entering into transactions of the type which the firm is seeking to net.
8. Where a firm uses an industry standard agreement which contains netting/setoff clauses the firm may rely only on a legal opinion relating to the netting/setoff clauses in that standard agreement where no amendment has been made to the agreement which would materially affect these clauses and where the legal opinion addresses the capacity of counterparties of the type with which the firm wishes to contract, the contract type and the relevant jurisdictions.
- FCA**
9. Where a netting agreement provides that one or both parties may enter into transactions with each other under the agreement through any of its (or certain designated) branches, then all such branches included in the agreement will be considered to be located in relevant jurisdictions for the purpose of this guidance.
- FCA**
10. Where a netting agreement involves more than one jurisdiction, a legal opinion is required for each to the effect that the agreement creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances.
- FCA**
11. As mentioned above legal opinions should relate to the law of the jurisdiction in which the counterparty is organised (i.e. incorporated or resident). However, certain circumstances may arise where this requirement could be considered not to be applicable; for example where:
- FCA**
- a firm has no assets or exposure in that jurisdiction;
  - any judgement obtained in that jurisdiction against a firm would not be enforceable under any of the rules in the UK relating to the enforcement of foreign judgements; or
  - there are no other factors relating to that jurisdiction which would affect the ability of a firm to make net payments as contemplated by the netting agreement.
12. Where a firm believes that the law of the jurisdiction in which a counterparty is organised is not relevant, that point must be addressed in the legal opinion supporting the netting agreement. The ability to exclude the law of the jurisdiction in which a counterparty is organised does not extend to the netting of those off balance sheet exposures listed in the Solvency Ratio Directive: the amendment to this directive (to permit netting) specifically requires this matter to be addressed in the legal opinion.
- FCA**
13. It is recognised that, with certain aspects of the agreement, it may not be possible to obtain a definite opinion or that a positive opinion regarding enforceability of the netting agreement can only be obtained subject to certain assumptions and/or qualifications. Where qualifications are made, they should be specific and their effect adequately explained. In the same way, assumptions should be specific, of a factual nature (except in relation to matters subject to the law of a jurisdiction other than that covered by the opinion) and should be explained in the opinion.
- FCA**
14. Legal opinions on netting agreements must be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable. Where the regulator in the jurisdiction of the counterparty is satisfied that the netting agreement is not enforceable under the laws of that jurisdiction, the netting agreement cannot be relied upon regardless of the opinions obtained by a firm.
- FCA**

## COMPLIANCE WITH THE LEGAL REQUIREMENTS

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15. It is the responsibility of firms to ensure that the legal requirements set out above are met (firms are to calculate CRR on the gross value of exposures to counterparties where this is not the case). Firms do not need to apply to the FCA in order to net exposures. Similarly, legal opinions on netting agreements and the agreements themselves are not required to be submitted to the FCA for approval. The FCA will establish the existence of legal opinions and netting agreements when compliance with the above requirements is being monitored by its staff.

**FCA**

16. Firms are expected to put procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in light of possible changes in the relevant law.

**FCA**

17. Firms are expected to maintain records demonstrating that, in relation to the legal requirements, the following considerations have been addressed:

**FCA**

- the applicability of the netting agreement to the counterparties, jurisdictions and transactions involved;
- the applicability of the opinions to the counterparties, jurisdictions and transactions involved;
- where more than one jurisdiction is involved, the potential for conflicts in law;
- all documentation is complete and still valid and that the agreement has been properly executed (i.e. that the acceptance of terms have been evidenced);
- the nature and effect of any qualifications in the legal opinions and assessment that these do not impair the obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances; and
- where an industry standard agreement is used upon which a generic legal opinion has been obtained, identification of those clauses which if altered during the course of negotiating the agreement would affect the right to offset. Internal legal counsel is to evidence review of these agreements to ensure that the effectiveness of the set off clauses has not been altered directly or indirectly by virtue of other clauses being added or deleted.

18. Firms are expected to hold a copy of the legal opinion and the agreement to which it relates.

**FCA**

19. Firms are to net exposures within a particular rule on a FIFO basis. Firms may net only current exposures and cannot net potential future exposures.

**FCA**

## **CROSS-PRODUCT NETTING**

### ***Introduction***

The FCA will consider granting rule waivers in order to permit firms to take account of cross-product netting in the calculation of their Counterparty Risk Requirement (CRR) in instances where the FCA regards it appropriate.

The current drafting of the FCA's Financial Rules for securities and futures firms allows 'similar' types of transactions to be netted (where those transactions are covered by a valid netting agreement, with a supporting legal opinion). In practice, 'similar' has been defined as all transactions which fall within a particular CRR Rule treatment. Thus, currently, for the calculation of CRR in relation to exposures to a counterparty which are covered by valid netting arrangements, a firm would be required to assess, for example, a net exposure for all derivative transactions with that counterparty and a separate net

exposure for all repo type transactions with that counterparty.

The FCA will consider granting waivers in accordance with SUP 8, though in general it will expect the following conditions to be met:

1. For the types of transaction which the firm is seeking to net, the firm must have the capability to monitor, and must in practice manage, the resultant exposures on a net basis.
2. All transactions which the firm is seeking to net must be covered by valid netting agreements and supported by legal opinions, in accordance with the requirements of the FCA's Financial Rules; and
3. Where underlying netting agreements are linked by a master netting agreement, the legal opinion must address the enforceability of the netting arrangements in their entirety;

One factor that the FCA will consider in assessing whether a particular applicant meets these requirements is whether the firm has had the use of its ACMP sanctioned for the purposes of calculating CRR.



## 4 Chapter 4: Lloyd's firms

### 4.1 APPLICATION

4.1.1 R This chapter applies to the *Society* and *members' advisers*.

FCA PRA

4.1.2 R This chapter does not apply to a *members' adviser* which is subject to another chapter of *IPRU(INV)*.

FCA

4.1.3 D The directions in *IPRU(INV)* 4.4.1D to 4.4.5D and 4.5.1D are given to the *Council* and to the *Society* acting through the *Council*.

FCA PRA

### 4.2 PURPOSE

4.2.1 G This chapter identifies the financial resource requirements and requirements as to accounts and statements to be met by certain *firms* conducting business at Lloyd's.

FCA PRA

4.2.2 G The directions in *IPRU(INV)* 4.4.1D to 4.4.5D and 4.5.1D are given under section 318 of the *Act* (Exercise of powers through Council), for the purpose of achieving the objective specified, as required by section 318(2) of the *Act*, in *IPRU(INV)* 4.3.1D.

FCA PRA

4.2.3 G *Underwriting agents* are subject to regulation by the *Society* as well as by the *appropriate regulator*. In particular, they are subject to requirements as to their financial resources and as to making and maintaining accounting records, set by the *Society*. The *appropriate regulator* is satisfied that *underwriting agents* will be subject to adequate financial resource and accounting requirements as long as they remain subject to and comply with requirements at least equivalent to Lloyd's Capital and Solvency Requirements 2001 and the relevant parts of, or requirements made under Lloyd's Underwriting Agents Byelaw (No. 4 of 1984), in each case as amended and in force immediately before *commencement*. Accordingly, instead of imposing an obligation directly on *underwriting agents*, the directions in *IPRU(INV)* 4.4.1D to 4.4.5D and 4.5.1D require the *Society* to require those firms to comply with the relevant requirements.

FCA PRA

4.2.4 G A *members' adviser* is not regulated by the *Society* and accordingly this chapter specifies the financial resource and accounting requirements to be met. *Firms* which fall within the scope of this chapter will be *firms* with *permission* only to advise persons on *syndicate* participation at Lloyd's. The nature of that advisory business is akin to corporate finance advice and so the applicable requirements are those in *IPRU(INV)* 3 relevant to *firms* giving corporate finance advice. *Firms* with other *permissions* will fall within the scope of other chapters of *IPRU(INV)*, *GENPRU*, *BIPRU* or *INSPRU*.

FCA PRA

### 4.3 SPECIFICATION OF OBJECTIVE

4.3.1 D The directions in *IPRU(INV)* 4.4.1D to 4.4.5D and 4.5.1D are given in relation to the exercise of the powers of the *Society* and of the *Council* generally, with a view to achieving the objective that *underwriting agents* have adequate financial resources to

FCA PRA

support, and keep and preserve adequate accounting records in respect of their business at Lloyd's.

#### 4.4 FINANCIAL RESOURCE REQUIREMENTS

- FCA** **PRA** D The *Society* must maintain appropriate and effective arrangements to require *underwriting agents* to meet and continue to meet financial resource requirements at least equivalent to the requirements set out in Lloyd's Capital and Solvency Requirements 2001, as they are in force immediately before *commencement*.
- 4.4.2 **FCA** **PRA** D The *Society* must give the *appropriate regulator* a report on each *underwriting agent's* compliance with the financial resource requirements referred to in *IPRU(INV)* 4.4.1D as at the end of each quarter (determined by reference to each *underwriting agent's accounting reference date*).
- 4.4.3 **FCA** **PRA** D The report referred to in *IPRU(INV)* 4.4.2D must reach the *appropriate regulator* within two months of the end of the relevant quarter and must state:
- (1) whether the *Society* has any information indicating or tending to indicate that, during the quarter to which the report relates, the *underwriting agent* failed to meet the financial resource requirements referred to in *IPRU(INV)* 4.4.1D;
  - (2) whether, at the end of the quarter to which the report relates, the *underwriting agent* failed to meet the financial resource requirements referred to in *IPRU(INV)* 4.4.1D; and
  - (3) the nature and extent of any failure to comply reported under (1) or (2) and the actions taken or to be taken by the *Society* in response to this.
- 4.4.4 **FCA** **PRA** D In addition to the reports required under *IPRU(INV)* 4.4.2D, the *Society* must give the *appropriate regulator* an annual report on each *underwriting agent's* compliance or non-compliance with financial resource requirements as at the end of that *underwriting agent's* financial year.
- 4.4.5 **FCA** **PRA** D The report in *IPRU(INV)* 4.4.4D must reach the *appropriate regulator* within seven months of that *underwriting agent's* accounting reference date and must:
- (1) confirm that:
    - (a) the *Society* has received from that *underwriting agent* in respect of the financial year to which the report relates, all relevant attachments to the Annual Financial Return that the *underwriting agent* is required to make to the *Society* under the

requirements identified in *IPRU(INV)* 4.4.1D;

- (b) that *underwriting agent* met the applicable financial resource requirements at the end of the financial year to which the report relates; and
  - (c) the *Society* is not aware of any matters likely to be of material concern to the *appropriate regulator* relating to that *underwriting agent's* compliance with financial resource requirements during the year to which the report relates, or arising from the attachments referred to in (a); or
- (2) if the *Society* is unable to give any of the confirmations required under *IPRU(INV)* 4.4.5D (1)(a), (b) or (c), set out in each case the reasons why it is unable to give that confirmation.

4.4.5A D The *Society* must submit the reports in *IPRU(INV)* 4.4.2D to *IPRU(INV)* 4.4.5D in accordance with the *rules* in *SUP* 16.3 (General provision on reporting).

FCA PRA

4.4.6 R A *members' adviser* must comply with the requirements of *IPRU(INV)* 3-60(3) and 3-62.

FCA

## 4.5 ACCOUNTING RECORDS

4.5.1 D The *Society* must maintain appropriate and effective arrangements to require *underwriting agents* to meet the obligation to keep and preserve accounting records, set out in Lloyd's Underwriting Agents Byelaw (No 4 of 1984), Section III, paragraph 53B, as it is in force immediately before *commencement*.

FCA PRA

4.5.2 R A *members' adviser* must comply with the requirements of *IPRU(INV)* 3-10 to 3-14.

FCA



## 5 Chapter 5: Financial Resources

### 5.1.1 APPLICATION

#### *Application of Chapter 5*

5.1.1 R (1) (a) This chapter applies to an *investment management firm*, other than an *incoming EEA firm* or *MiFID investment firm* (unless it is an exempt *CAD firm* for the purpose of calculating its *own funds* and if it carries on any *regulated activity* other than *MiFID business*), as set out in Table 5.1.1(1)(a).

FCA

(b) [deleted]

TABLE 5.1.1(1)(a)		APPLICATION OF CHAPTER 5		
	Exempt <i>CAD</i> firms	OPS Firms  (see Note 1 below)	Non-OPS Life Offices and Non-OPS Local Authorities	Individuals admitted to membership collectively
<b>Financial resources rules</b>				
5.2.1(1) to 5.2.7(5)	No (see Note 3 below)	No	No	Yes
<b>Accounting records rules</b>				
5.3.1(1) to 5.3.1(6)	No	Yes	Yes	Yes
	Individuals whose sole <i>investment business</i> is giving investment advice to institutional or corporate investors		<i>Firms</i> subject to “lead regulator arrangements”	All other <i>Firms</i>
<b>Financial resources rules</b>				
5.2.1(1) to 5.2.7(5)	No		No  (see Note 2 below)	Yes

### Accounting records rules

5.3.1(1) No Yes Yes  
to  
5.3.1(6)

Note 1. *Firms* are referred to the specific compliance reports for *OPS firms* required by Chapter 16 of the Supervision Manual.

Note 2. A *firm* subject to "lead regulator arrangements" whereby a body other than *the FCA* is responsible for its financial regulation shall comply with the corresponding financial resources rules and financial returns rules of that body, and a breach of such rules shall be treated as a breach of the rules of *the FCA*.

Note 3. The financial and nonfinancial resources rules for an *exempt CAD firm* are set out in *IPRU(INV)* chapter 9. However, rules 5.2.1(1) to 5.2.7(5) apply to an *exempt CAD firm* for the purpose of calculating its *own funds* (see *IPRU(INV)* 9.2.9R(2)(a)) (although the Category A items of Tier 1 capital as set out in Table 5.2.2(1) are replaced by all the items in *IPRU(INV)* 9.3.1R) and if it carries on any *regulated activity* other than *MiFID business* (see *IPRU(INV)* 9.2.3R).

### INTERPRETATION

**FCA** R (c) The definitions in the glossary at Appendix 1 apply to this chapter.

### 5.2.1 GENERAL REQUIREMENT

#### *Adequacy of financial resources*

5.2.1(1) R A *firm* must at all times have available the amount and type of *financial resources* required by the *rules* in this chapter.

**FCA**

#### *Basic requirement*

5.2.1(2) R A *firm* must ensure that, at all times, its *financial resources* are not less than its *financial resources requirement*.

**FCA**

#### *Financial resources*

5.2.1(3) R A *firm's financial resources* means:

**FCA**

- (a) its *own funds*, if the *firm* is subject to an *own funds requirement* under rule 5.2.3(2); or
- (b) its *liquid capital*, if the *firm* is subject to a *liquid capital requirement* under paragraph (a) of rule 5.2.3(1).

(c) [deleted]

(d) [deleted]

## 5.2.2 FINANCIAL RESOURCES

### *Own funds*

5.2.2(1) R A *firm* must calculate its *own funds* in accordance with Table 5.2.2(1).

FCA

### *Liquid capital*

5.2.2(2) R A *firm* must calculate its *liquid capital* in accordance with Table 5.2.2(1).

FCA

## 5.2.3 FINANCIAL RESOURCES REQUIREMENT

### *Determination of requirement*

5.2.3(1)(a) R The *financial resources requirement* for a *firm* is a *liquid capital requirement*, determined in accordance with paragraph (a) of rule 5.2.3(4), unless the *firm* falls within any of the exceptions in rule 5.2.3(2).

FCA

(b) R [deleted]

(c) R [deleted]

### *Exceptions from the liquid capital requirement*

5.2.3(2) R The *financial resources requirement* is an *own funds requirement* determined in accordance with paragraph (a) of rule 5.2.3(3) for a *firm* if its *permitted business* does not include *establishing, operating or winding up a personal pension scheme* and which:

FCA

(i) is an *exempt CAD firm* which is also an *operator* of a *collective investment scheme* and that scheme only invests in *venture capital investments* for *non-retail clients*; or

(ii) is not an *exempt CAD firm* if:

(a) the *firm's permitted business* does not include the holding of *customers' monies* or assets and it neither executes transactions (or otherwise arranges deals) in *investments* nor has such transactions executed for itself or its *customers*; or

(b) the *firm's permitted business* includes the activities as in (a) above, but only in respect of *venture capital investments* for *non-retail clients*; or

- (c) the *firm* is a *trustee of an authorised unit trust scheme* whose *permitted business* consists only of trustee activities and does not include any other activity constituting *specified trustee business* or the *firm* is a *depository of an ICVC* whose *permitted business* consists only of *depository* activities.
- (d) the *firm's permitted business* limits it to acting as the *operator of a collective investment scheme* whose main purpose is to invest in *permitted immovables* whether in the *UK* or abroad.

*Own funds requirement*

5.2.3(3)(a) R The *own funds requirement* for a *firm* subject to rule 5.2.3(2) is:

FCA

- (i) £4,000,000 for a *firm* which is a trustee of an authorised unit trust scheme or a depository of an ICVC;
- (ii) £5,000 for any other *firm*.

(b) R [deleted]

*Liquid capital requirement*

5.2.3(4)(a) R The *liquid capital requirement* for a *firm* subject to paragraph (a) of rule 5.2.3(1) is the greater of:

FCA

- (i) £5,000; and
- (ii) its *total capital requirement* calculated in accordance with rule 5.2.3(5).

(b) R [deleted]

(c) R [deleted]

*Total capital requirement*

5.2.3(5) R A *firm's* total capital requirement is the sum of its:

FCA

- (a) *expenditure based requirement* calculated in accordance with Table 5.2.3(5)(a);
- (b) *position risk requirement* calculated in accordance with Table 5.2.3(5)(b);
- (c) *counterparty risk requirement* calculated in accordance with Table 5.2.3(5)(c);
- (d) *foreign exchange requirement* calculated in accordance

with Table 5.2.3(5)(d); and

(e) **other assets requirement** calculated in accordance with Table 5.2.3(5)(e).

- 5.2.3(6) G A *firm* which discloses clients' money or assets on its balance sheet need not calculate the requirements under paragraphs (b) to (e) of rule 5.2.3(5) on such items where these do not represent assets or liabilities of the *firm* itself.

FCA

## 5.2.4 ANNUAL EXPENDITURE

### *Determination*

- 5.2.4(1) R **Annual expenditure** is:

FCA

- (a) the sum of the amounts described as total expenditure in the four *quarterly financial returns* up to (and including) that prepared at the *firm's* most recent *accounting reference date*, less the following items (if they are included within such expenditure):
- (i) staff bonuses, except to the extent that they are guaranteed;
  - (ii) *employees'* and *directors'* shares in profits, except to the extent that they are guaranteed;
  - (iii) other appropriations of profits;
  - (iv) shared commission and fees payable which are directly related to commission and fees receivable which are included within total revenue;
  - (v) interest charges in respect of borrowings made to finance the acquisition of the *firm's* *readily realisable investments*;
  - (vi) interest paid to *customers* on *client money*;
  - (vii) interest paid to counterparties;
  - (viii) fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions;
  - (ix) foreign exchange losses; or
- (b) where the previous accounting period does not include twelve months' trading, an amount calculated in accordance with paragraph (a) above prorated to an equivalent annual amount; or

- (c) where a *firm* has not prepared four *quarterly financial returns* since the commencement of its *permitted business*, an amount based on forecast expenditure included in its budget for the first twelve months' trading, as submitted with its application for membership.

5.2.4(2) G A *firm's financial resources requirement* will be recalculated annually when its fourth *quarterly financial return* is prepared. The *firm* must maintain *financial resources* sufficient to meet its new *financial resources requirement* from the date on which the fourth *quarterly financial return* is prepared and no later than 80 business days after the *firms' accounting reference date*. The *expenditure based requirement* applicable at the *accounting reference date* will be based on the four *quarterly financial returns* prepared up to and on that date.

FCA

5.2.4(3) R [deleted]

## 5.2.5 QUALIFYING SUBORDINATED LOANS

### *Characteristics of Long Term Qualifying Subordinated Loans*

5.2.5(1) R A long term *qualifying subordinated loan* (item 11 of Table 5.2.2(1)) must have the following characteristics:

FCA

- (a) the loan is repayable only on maturity or on the expiration of a period of notice in accordance with paragraph (c) below or on the winding up of the *firm*;
- (b) in the event of the winding up of the *firm*, the loan ranks after the claims of all other creditors and is not to be repaid until all other debts outstanding at the time have been settled;
- (c) either:
- (i) the minimum original maturity of the loan is 5 years; or
- (ii) the loan does not have a minimum or fixed maturity but requires 5 years notice of repayment; and
- (d) the loan is fully paid-up.

### *Amount allowable in the calculation of own funds*

5.2.5(2) R A *firm* may only take into account the paid-up amount of a long term *qualifying subordinated loan* in the calculation of its *own funds*. This amount must be amortised on a straight-line basis over the five years prior to the date of repayment.

FCA

### *Requirements applicable to short-term qualifying subordinated loans*

5.2.5(3)(a) R A short term *qualifying subordinated loan* (item 15 of Table 5.2.2(1)) must have the characteristics set out in rule 5.2.5(1) save

**FCA** that the minimum period set out in paragraph (c) of rule 5.2.5(1) shall be two years.

(b) **R** A firm must not make any payment of principal or interest which would result in a breach of rule 5.2.1(2).

*Form of qualifying subordinated loan agreement*

5.2.5(4) **R** A qualifying subordinated loan must be in the form prescribed by the FCA for the purposes of this rule.

**FCA**

5.2.5(5) **G** Firms wishing to initiate a subordinated loan agreement other than in the prescribed form are advised to contact the FCA.

**FCA**

*Conditions applicable to qualifying subordinated loans*

5.2.5(6) **R** A firm wishing to include a qualifying subordinated loan in its calculation of liquid capital must:

**FCA**

- (a) provide the FCA with a copy of the agreement not less than 10 business days before the loan is to be made; and
- (b) certify to the FCA that the loan agreement complies with the FCA's prescribed subordinated loan agreement.

*Requirements on a firm in relation to qualifying subordinated loans*

5.2.5(7) **R** A firm including a qualifying subordinated loan in its calculation of liquid capital must not:

**FCA**

- (a) secure all or any part of the loan;
- (b) redeem, purchase or otherwise acquire any of the liabilities of the borrower in respect of the loan;
- (c) amend or concur in amending the terms of the loan agreement;
- (d) repay all or any part of the loan otherwise than in accordance with the terms of the loan agreement; or
- (e) take or omit to take any action whereby the subordination of the loan or any part thereof might be terminated, impaired or adversely affected.

## 5.2.6 QUALIFYING PROPERTY AND QUALIFYING UNDERTAKINGS

*Qualifying property and qualifying amount defined*

5.2.6(1) **R** Qualifying property is any freehold or leasehold (or the equivalent tenure in Scotland or other territories) land and buildings purchased or secured by way of a mortgage (or other

**FCA**

form of secured long-term arrangement) where the security for the liability is the property (and does not include any other allowable assets). The *qualifying amount* is the lowest of:

- (a) 85 per cent of the current market value of the property (if known);
- (b) 85 per cent of the net book value of the property;
- (c) the amount of the liability outstanding under mortgage or other secured long term arrangement, excluding any part of the liability repayable within one year.

5.2.6(2) G Rule 5.2.6(1) can be illustrated as follows:

**FCA**

Current market value	£200,000
Net book value	£100,000
Mortgage	£70,000, including £5,000 payable within one year

Qualifying amount is the lowest of:

- (a)  $85\% \times £200,000 =$  £170,000
- (b)  $85\% \times £100,000 =$  £85,000
- (c)  $£70,000 - £5,000 =$  £65,000

i.e. £65,000

#### *Qualifying undertakings*

5.2.6(3) R **A *qualifying undertaking* is an arrangement between a *firm* and an *approved bank* which:**

**FCA**

- (a) **is in the form prescribed by *the FCA* for the purposes of this rule; and**
- (b) **complies with the appropriate limitations set out in paragraph (7) of Part II to Table 5.2.2(1).**

5.2.7(1) G [deleted]

5.2.7(2) R [deleted]

5.2.7(3) R [deleted]

5.2.7(4) R [deleted]

5.2.7(5) R [deleted]



## TABLE 5.2.2(1) CALCULATION OF OWN FUNDS AND LIQUID CAPITAL

FCA

### PART I

#### METHOD OF CALCULATION

A firm must calculate its *own funds* and *liquid capital* as shown below, subject to the detailed requirements set out in Part II.

Financial resources	Category	Part II Para
Tier 1		
(1) Paid-up share capital (excluding preference shares)	A	2
(1A) <i>Eligible LLP members' capital</i>		
(2) Share premium account		
(3) Reserves		2A
(4) Non-cumulative preference shares		
Less: (5) Investments in own shares	B	
(6) Intangible assets		3
(7) Material current year losses		4
(8) Material holdings in credit and financial institutions and, for <i>exempt CAD firms</i> only, <i>material insurance holdings</i> .		5 and 5A
(8A) <i>Excess LLP members' drawings</i>		
Tier 1 capital = (A-B)	C	
Plus: TIER 2		1
(9) Revaluation reserves	D	
(10) Fixed term cumulative preference share capital		1(a)
(11) Long-term Qualifying Subordinated Loans		1(a); 6
(12) Other cumulative preference share capital and debt capital but, for <i>exempt CAD firms</i> , only perpetual cumulative preference share capital and <i>qualifying capital instruments</i>		6A
(13) Qualifying arrangements		7
"Own Funds" = (C+D)	E	
Plus: TIER 3		
(14) Net trading book profits	F	1(b)(i); 8
(15) Short-term Qualifying Subordinated Loans and excess Tier 2 capital		1(b)(ii); 1(c); 9
Less:(16) Illiquid assets	G	10
Add:(17) Qualifying Property		11
"Liquid Capital" = (E+F+G)		

### PART II

## DETAILED REQUIREMENTS

### 1 Deductions and Ratios (Items 10, 11 and 15)

- (a) Notwithstanding Table 5.2.2(1) for an *exempt CAD firm*, in calculating *own funds*, all of Item 8 must be deducted after the total of Tier 1 and Tier 2 capital and the following restrictions apply:
- (i) the total of fixed term cumulative preference shares (item 10) and long-term *qualifying subordinated loans* (item 11) that may be included in Tier 2 capital is limited to 50 per cent of Tier 1 capital;
  - (ii) Tier 2 capital must not exceed 100 per cent of Tier 1 capital.
- (b) [deleted]
- (c) A *firm* which is not an *exempt CAD firm* and which is subject to a *liquid capital requirement* under rule 5.2.3(1)(a) may take into account *qualifying subordinated loans* in the calculation of *liquid capital* up to a maximum of 400% of its Tier 1 capital.

### 2 Non corporate entities

- (a) In the case of partnerships or sole traders, the following terms should be substituted, as appropriate, for items 1 to 4 in Tier 1 capital:
- (i) partners' capital accounts (excluding loan capital);
  - (ii) partners' current accounts (excluding unaudited profits and loan capital);
  - (iii) proprietors' account (or other term used to signify the sole trader's capital but excluding unaudited profits).
- (b) Loans other than *qualifying subordinated loans* shown within partners' or proprietors' accounts must be classified as Tier 2 capital under item 12.
- (c) For the calculation of *own funds*, partners' current accounts figures are subject to the following adjustments in respect of a *defined benefit occupational pension scheme*:
- (i) a *firm* must derecognise any *defined benefit asset*;
  - (ii) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

#### Note

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

### 2A Reserves

For the calculation of *own funds* the following adjustments apply to the audited reserves figure:

- (a) a *firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (b) in respect of a defined benefit occupational pension scheme, a firm must derecognise any defined benefit asset;
- (c) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year

**Note 1**

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

- (d) a *firm* must not include any unrealised gains from investment property.

**Note**

Unrealised gains from investment property should be reported as part of revaluation reserves.

- (e) where applicable, a *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.

**Note 2**

Reserves must be audited unless the *firm* is exempt from the provisions of Part VII of the Companies Act 1985 (section 249A (Exemptions from audit)), or where applicable, Part 16 of the Companies Act 2006 (section 477 (Small companies: Conditions for exemption from audit)) relating to the audit of accounts.

**3 Intangible assets (Item 6)**

Intangible assets comprise:

- (a) formation expenses to the extent that these are treated as an asset in the *firm's* accounts;
- (b) goodwill, to the extent that it is treated as an asset in the *firm's* accounts; and
- (c) other assets treated as intangibles in the *firm's* accounts.

Intangible assets do not include a deferred acquisition cost asset.

**4. Material current year losses (Item 7)**

Losses in current year operating figures must be deducted when calculating Tier 1 capital if such losses are material. For this purpose profits and losses must be calculated quarterly or monthly, as appropriate. If this calculation reveals a net loss it shall only be deemed to be material for the purposes of this Table if it exceeds 10 per cent of the *firm's* Tier 1 capital.

**5 Material holdings in credit and financial Institutions (Item 8)**

Material holdings comprise:

- (a) where the *firm* holds more than 10 per cent of the equity share capital of the institution, the value of that holding and the amount of any subordinated loans to the institution and the value of holdings in *qualifying capital items* or *qualifying capital instruments* issued by the institution;
- (b) in the case of holdings other than those mentioned in (a) above, the value of holdings of equity share capital in, and the amount of subordinated loans made to, such institutions and the value of holdings in *qualifying capital items* or *qualifying capital instruments* issued by such institutions to the extent that the total of such holdings and subordinated loans exceeds 10 per cent of the *firm's own funds* calculated before the deduction of item 8.

**5A Material insurance holdings (Item 8)**

- (a) A *material insurance holding* means the holdings of an *exempt CAD firm* of items of the type set out in (b) in any:
  - (i) *insurance undertaking*; or
  - (ii) *insurance holding company*,  
that fulfils one of the following conditions:
    - (iii) it is a *subsidiary undertaking* of that *firm*; or
    - (iv) that *firm* holds a participation in it
- (b) An item falls into this provision for the purpose of (a) if it is:
  - (i) an *ownership share*; or
  - (ii) subordinated debt or another item of capital that falls into Article 16(3) of the *First Non-Life Directive* or, as applicable, Article 27(3) of the *Consolidated Life Directive*.

**6 Long term *qualifying subordinated loans* (Item 11)**

Loans having the characteristics prescribed by rule 5.2.5(1) may be included in item 11, subject to the limits set out in paragraph (1) above.

**6A Perpetual cumulative preference share capital**

Perpetual cumulative preference share capital may not be included in the calculation of *own funds* by an *exempt CAD firm* unless it meets the following requirements:

- (a) it may not be reimbursed on the holder's initiative or without the prior agreement of the *FCA*;
- (b) the instrument must provide for the *firm* to have the option of deferring the dividend payment on the share capital;
- (c) the shareholder's claims on the *firm* must be wholly subordinated to those of all non-subordinated creditors;
- (d) the terms of the instrument must provide for the loss-adsorption capacity of the share capital and unpaid dividends, whilst enabling the *firm* to continue its business; and

## 7 Qualifying arrangements (Item 13)

- (e) it must be fully paid-up.
- (a) An *exempt CAD firm* may only include a *qualifying undertaking* or other arrangement in item 13 if it is a *qualifying capital instrument* or a *qualifying capital item*.
- (b) A *firm* which is not an *exempt CAD firm* may only include *qualifying undertakings* in its calculation of *liquid capital* if:
  - (i) it maintains *liquid capital* equivalent to 6/52 of its *annual expenditure* in a form other than *qualifying undertakings*; and
  - (ii) the total amount of all *qualifying undertakings* plus *qualifying subordinated loans* does not exceed the limits set out in paragraph (1)(c) above.

## 8 Net trading book profits (Item 14)

For *firms* which are not *exempt CAD firms* unaudited profits can be included at item 14.

### Note

*Non-trading book* interim profits may only be included in Tier 1 of the calculation if they have been independently verified by the *firm's* external auditors, unless the *firm* is exempt from the provisions of Part VII of the Companies Act 1985 (section 249A (Exemptions from audit)), or where applicable, Part 16 of the Companies Act 2006 (section 477 (Small companies: Conditions for exemption from audit)) relating to the audit of accounts.

For this purpose, the external auditor should normally undertake at least the following:

- (a) satisfy himself that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records;
- (b) review the accounting policies used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the *firm* in drawing up its annual financial statements;
- (c) perform analytical review procedures on the results to date, including comparisons of actual performance to date with budget and with the results of prior periods;
- (d) discuss with management the overall performance and financial position of the *firm*;
- (e) obtain adequate comfort that the implications of current and prospective litigation, all known claims and commitments, changes in business activities and provisions for bad and doubtful debts have been properly taken into account in arriving at the interim profits; and
- (f) follow up problem areas of which the auditors are already aware in the course of auditing the *firm's* financial statements.

A *firm* wishing to include interim profits in Tier 1 capital in a *financial return* should submit to *the FCA* with the *financial*

return a verification report signed by its external auditor which states whether the interim results are fairly stated, unless the *firm* is exempt from the provisions of Part VII of the Companies Act 198 (section 249A (Exemptions from audit)), or where applicable, Part 16 of the Companies Act 2006 (section 477 (Small companies: Conditions for exemption from audit)) relating to the audit of accounts.

Profits on the sale of capital items or arising from other activities which are not directly related to the *investment business* of the *firm* may also be included within the calculation of *liquid capital*, but (unless the firm is exempt as above) only if they can be separately verified by the *firm's* auditors. In such a case, such profits can form part of the *firm's* Tier 1 capital as profits.

**9 Short term qualifying subordinated loans** (Item 15)

Loans having the characteristics prescribed by rule 5.2.5(3) may be included in item 15 subject to the limits set out in paragraph (1) above. Tier 2 capital which exceeds the ratios prescribed by paragraph (1)(a) and (b) may be included in item 15 subject to paragraph (1) above.

**10 Illiquid assets** (Item 16)

Illiquid assets comprise:

- (a) tangible fixed assets;

**Note**

In respect of tangible fixed assets purchased under finance leases the amount to be deducted as an illiquid asset shall be limited to the excess of the asset over the amount of the related liability shown on the balance sheet.

- (b) holdings in, including subordinated loans to, *credit* or *financial institutions* which may be included in the *own funds* of such *institutions* unless they have been deducted under item 8;
- (c) any *investment* in undertakings other than *credit institutions* and other *financial institutions* where such *investments* are not readily realisable;
- (d) any deficiency in net assets of a *subsidiary*;
- (e) deposits not available for repayment within 90 days or less (except for payments in connection with margined futures or options contracts);

**Note**

Where cash is placed on deposit with a maturity of more than 90 days but is repayable on demand subject to the payment of a penalty, then this is not required to be deducted as an illiquid asset but a deduction is required for the amount of the penalty.

- (f) loans, other debtors and accruals not falling due to be repaid within 90 days or which are more than one month overdue by reference to the contractual payment date;
- (g) physical stocks (except where subject to the *position risk requirement* as set out in Table 5.2.3(5)(b)); and
- (h) prepayments to the extent that the period of prepayment exceeds six weeks in the case of a

*firm* subject to the 6/52 *expenditure based requirement* or thirteen weeks in the case of a *firm* subject to the 13/52 *expenditure based requirement* or where a *firm* is required to meet the requirement in rule 5.2.3(4)(c)(i).

- (i) if not otherwise covered, any holding in eligible capital instruments of an insurance undertaking, insurance holding company, or reinsurance undertaking that is a *subsidiary* or *participation*. Eligible capital instruments include ordinary share capital, cumulative preference shares, perpetual securities and long-term subordinated loans, that are eligible for insurance undertakings under PRU 2.

Illiquid assets do not include a *defined benefit asset* or a deferred acquisition cost asset.

**11 Qualifying property** (Item 17)

This item comprises the qualifying amount calculated in accordance with rule 5.2.6(1).

**Table 5.2.3(3)(b)**

**[deleted]**

**Table 5.2.3(5)(a) EXPENDITURE BASED REQUIREMENT**

FCA

**PART I**

**CALCULATION OF REQUIREMENT**

A *firm's expenditure based requirement* is a fraction of its *annual expenditure* determined in accordance with Part II of this Table.

**PART II**

**FRACTIONS**

1: The fraction is 6/52 where:

- (a) the *firm* is an *authorised unit trust manager*, or  
(b) the *firm* acts only as an *authorised corporate director* of an *ICVC*; or  
(c) the *firm* is an *investment manager* (including the *operator* of an *unregulated collective investment scheme* in relation to which the *firm* carries on the activity of an *investment manager*), unless paragraph 2 applies.

2: The fraction is 13/52 where the *firm* is an *investment manager* as in paragraph 1(c) above, or is a *custodian*, and the *firm* either:

- (a) itself holds *customers' monies* or assets; or  
(b) procures the appointment as *custodian* of its *customers' monies* or assets of an *associate* of the *firm* which is not an *approved bank*.

**Note:** Paragraph 1(a) above includes a *firm* which acts as both an *authorised unit trust manager* and as an *authorised corporate director* of an *ICVC*.

## Table 5.2.3(5)(b) POSITION RISK REQUIREMENT

FCA

### PART I

#### CALCULATION OF REQUIREMENT

A *firm's* position risk requirement is determined by calculating on a daily mark to market basis, the sum of the weighted value of each position held by the *firm*. The weighted value for each position must be calculated by multiplying its current market value by the appropriate factor set out in Part II.

**Note:** This requirement does not attach to items deducted in full as illiquid assets.

### PART II

#### WEIGHTINGS

Instrument	Requirement			
<b>A Debt</b>	<b>Maturity</b>	<i>0-2 years</i>	<i>2-5 years</i>	<i>&gt;5 years</i>
Central Government		2%	5%	13%
Qualifying debt securities				
• fixed rate		8%	8%	15%
• floating rate		10%	10%	15%
Non-qualifying debt securities				
• fixed rate		10%	20%	30%
• floating rate		30%	30%	30%
<b>B Equities</b>				
• Traded on a recognised or designated investment exchange.	25%			
• other	100%			
<b>C Stock position in physical commodities</b>				
• Physical positions associated with <i>firm's investment business</i>	30% of realisable value			
<b>D Derivatives</b>				
• Exchange traded futures and written options	4 x initial margin requirement.			
• otc futures and written options	Apply the appropriate percentage shown in Sections A, B, & C above to the market value of the underlying position.			
• Purchased options	Apply the appropriate percentage shown in Sections A, B & C above to the market value of the underlying position but the result may be limited to the market value of the option.			
• Contracts for differences	20% of the market value of the contract.			
<b>E Other investments</b>				
• units in regulated collective investment schemes	25% of realisable value (see Section F).			

- with profit life policies 20% of surrender value.
- other 100% of the value of investment or underlying instrument.

### **F Determination of disallowed value of units**

The disallowed value of units held in a *UCITS management company's* box is the difference between:

(a) the amount at which stocks of units in the box are valued in the balance sheet; and

(b) the adjusted value of the units, being the value of the units calculated at cancellation prices less the value calculated at cancellation prices of the units multiplied by the following percentages based on the types of *investments* in the individual *UCITS schemes*:

Quoted, fixed or floating rate interest bearing securities: 3%

Equities:

USA, Japan, Canada	5%
Europe	6%
Far East and other	10%

### **Note**

This can be illustrated as follows: 100 units, comprising Far East equities, with unit cancellation price of 100 pence.

	£	£
Balance sheet value		104
Value of cancellation price	100	
Less £100 x 10%	10	90
		14
Disallowed		14

Note

The percentages in the requirement column are applied to the market value (unless otherwise stated) of gross positions i.e. both longs and shorts in each category; netting and offsetting are prohibited. The long or short position in a particular instrument is the net of any long or short positions held in that same instrument.

## Table 5.2.3(5)(c) COUNTERPARTY RISK REQUIREMENT (CRR)

**FCA**

1	<b>Receivables</b>	<p>In the case of receivables due to the <i>firm</i> in the form of fees, commission, interest, dividends and margin in exchange-traded futures or options contracts, which are directly related to items included in the <i>trading book</i>, the CRR is calculated as follows:</p> <p>CRR = A x RF, where</p> <p>A = the amount of the sum due; and</p> <p>RF = the appropriate risk factor derived from Table 5.2.3(5)(c)(ii).</p> <p><b>Note</b></p> <p>This requirement attaches only to balances arising from proprietary activity falling within the definition of the <i>trading book</i>.</p> <p><b>Note</b></p> <p>This requirement does not attach to items deducted in full as illiquid assets.</p>
2	<b>Delivery of cash against documents</b>	<p>Where a <i>firm</i> enters into a <i>trading book</i> transaction and the transaction is to be settled by delivery of cash against documents, the <i>firm's</i> CRR in respect of that transaction is calculated as follows:</p> <p>CRR = (SP – MV) x RF, where</p> <p>SP = agreed settlement price;</p> <p>MV = current market value;</p> <p>RF = the appropriate risk factors derived from Table 5.2.3(5)(c)(i).</p> <p>The CRR should only be calculated where the difference between SP and MV would involve a loss if borne by the <i>firm</i>.</p>
3	<b>Free deliveries</b>	<p>Where a <i>firm</i> enters into a <i>trading book</i> transaction and the <i>firm</i> pays for the securities before it receives documents of title or delivers documents of title before receiving payment, the CRR in respect of that transaction is calculated as follows:</p> <p>CRR = V x RF, where</p> <p>V =</p> <ul style="list-style-type: none"> <li>(i) the full amount due to the <i>firm</i> (i.e. the contract value) where the <i>firm</i> has delivered securities to a counterparty and has not received payment; or</li> <li>(ii) the market value of the securities, where the <i>firm</i> has made payment to a counterparty for securities and has not received documents of title; and</li> </ul> <p>RF = the appropriate risk factor derived from Table 5.2.3(5)(c)(ii).</p>
4	<b>Settlement outstanding 30 days or more</b>	<p>In the case of trading book transactions entered into by a <i>firm</i> where the <i>firm</i> pays for the securities before it receives documents of title or delivers documents of title before receiving payment and settlement has not been effected within 30 days of</p>

**5 Repos/Stock Lending and Reverse Repos/Stock Borrowing**

falling due,  $CRR = V$ .

Where a *firm* enters into a transaction based on securities included in the trading book under the terms of a repurchase agreement or a securities lending agreement the *firm's* CRR in respect of that transaction is calculated as follows:

$CRR = V \times RF$ , where

RF = the appropriate risk factor derived from Table 5.2.3(5)(c)(ii); and

for repos/stock lending:

V = the excess of the market value of the securities over the value of the collateral provided under the agreement, if the net figure is positive; or

for reverse repos/stock borrowing:

V = the excess of the amount paid or the collateral given for the securities received under the agreement, if the net figure is positive.

**6 otc derivatives**

In the case of a transaction entered into by a *firm* as principal in an *otc derivative* the CRR is calculated as follows:

$CRR = A \times RF$ , where

A = the appropriate credit equivalent amount derived from Table 5.2.3(5)(c)(iii); and

RF = the appropriate risk factor derived from Table 5.2.3(5)(c)(ii).

This calculation shall not apply to contracts for interest rate and foreign exchange which are traded on a *recognised investment exchange* or *designated investment exchange* where they are subject to a daily margin requirement and foreign exchange contracts with an original maturity of 14 calendar days or less.

A *firm* may net off contracts with the same counterparty in the same *otc derivative* contract for settlement on the same date in the same currency provided that the *firm* is legally entitled under the terms of the contracts with such a counterparty to net such contracts by novation.

**Table 5.2.3(5)(c)(i) COUNTERPARTY RISK FACTOR – CASH SETTLEMENTS**

Number of working days after due settlement date	FCA	Risk Factor
0-4		0%
5-15		8%
16-30		50%
31-45		75%
46 or more		100%

**Table 5.2.3(5)(c)(ii) COUNTERPARTY RISK REQUIREMENT**

		FCA		
Type of counterparty		Risk Weighting	Solvency Ratio	Risk Factor
1	A counterparty which is, or the contract of which is, explicitly guaranteed by a <i>category a</i> body.	NIL	8%	NIL
2	A counterparty which is, or the contract of which is, explicitly guaranteed by a <i>category b</i> body.	20%	8%	1.6%
3	Any other counterparty.	100%	8%	8%

**Table 5.2.3(5)(c)(iii) OTC DERIVATIVES CALCULATION OF CREDIT EQUIVALENT AMOUNT**

FCA			
<b>A</b>	By attaching current market values to contracts (marking to market), obtain the current replacement cost of all contracts with positive values.		
<b>B</b>	To obtain a figure for potential future credit exposure, the notional principal amounts or values underlying the firm's aggregate positions are multiplied by the following percentages:		
	<b>Residual Maturity</b>	<b>Interest-Rate Contracts</b>	<b>Foreign-Exchange Contracts</b>
	One year or less	nil	1%
<b>C</b>	The credit equivalent amount is the sum of current replacement cost and potential future credit exposure.		

**Note**

Except in the case of single-currency "floating/floating interest rate" swaps in which only the current replacement cost will be calculated, bought OTC equity options and covered warrants shall be subject to the treatment accorded to exchange rate contracts.

**Table 5.2.3(5)(d) FOREIGN EXCHANGE REQUIREMENT**

FCA	
Calculation of Requirement	
(1)	A firm's foreign exchange requirement is determined by calculating the excess of its <i>foreign exchange position</i> (FEP) above 2 per cent of its <i>own funds</i> and multiplying this excess by 8 per cent.
(2)	The FEP is the greater of: <ul style="list-style-type: none"> <li>(a) the total in the <i>reporting currency</i> of the net short positions in each currency other than the <i>reporting currency</i>; and</li> <li>(b) the total in the <i>reporting currency</i> of the net long positions in each currency other than the <i>reporting currency</i>;</li> </ul>

where the conversion to the *reporting currency* is performed using spot rates.

**Note**

For this purpose, long and short positions in the same currency can be netted to produce the net position.

(3) In calculating the FEP, a *firm* must include relevant *foreign exchange items*.

**EXCHANGE POSITION FOR HEDGING PURPOSES**

Any positions which the *firm* has taken in order to hedge against the adverse effect of exchange rates on an item already deducted in the calculation of *liquid capital* may not be excluded from the calculation of net open currency positions

**Table 5.2.3(5)(e) OTHER ASSETS REQUIREMENT**

**FCA**

**PART I**

**CALCULATION OF REQUIREMENT**

The requirement to be met in respect of the assets set out in Part II of this Table, other than those to which *position risk requirements* and *counterparty risk requirements* apply or which have been deducted in full as illiquid assets, and in respect of off-balance sheet items set out in Part II of this Table, must be calculated as follows:

A = AV x RF where

A = the amount of the requirement;

AV = the current asset value; and

RF = the appropriate risk factor derived from Part II of this Table.

**PART II**

**RISK FACTORS**

<b>Assets and Off-Balance Sheet Items</b>	<b>Risk Factor</b>
---	--------------------

**Assets**

Cash at bank and in hand and equivalent items	NIL
---	-----

Assets secured by acceptable collateral including deposits and certificates of deposit with lending institutions

Amount due from trustees of authorised unit trusts	NIL
--	-----

**Note**

This only applies to *firms* who are *authorised unit trust managers* in relation to authorised unit trusts they manage.

Amount due from <i>depositories of ICVCs</i>	NIL
--	-----

**Note**

This only applies to *firms* who are *authorised corporate directors* in relation to *ICVCs* they operate

Other receivables due from or explicitly guaranteed by or deposits with <i>category a bodies</i>	NIL
--	-----

Other receivables due from or explicitly guaranteed by or deposits with <i>category b bodies</i>	1.6%
--	------

Pre-payments and accrued income (See paragraph 10 of Part II of Table 5.2.2(1))	8%
Defined benefit asset	NIL
Deferred acquisition cost asset	NIL
All other assets	8%

### OFF-BALANCE SHEET ITEMS

#### Full Risk Items e.g.

Charges granted against assets	8% x counterparty weight (see Table 5.2.3(5)(c)(ii))
Guarantees given	

#### Medium Risk Items e.g.

Undrawn credit facilities granted by the <i>firm</i> with an original maturity of more than one year	4% x counterparty weight (see Table 5.2.3(5)(c)(ii))
--	--

#### Low Risk Items e.g.

Undrawn credit facilities granted by the <i>firm</i> with an original maturity of one year or less	NIL
--	-----

#### Note

- (1) In determining the appropriate *other assets requirement* (OAR) for guarantees given in a group context, a *firm* should follow the calculation below:
  - (a) Categorise the guarantee agreements into:
    - (i) those with the character of credit substitutes; or
    - (ii) those not having the character of credit substitutes; or
    - (iii) agreements to provide guarantees.
  - (b) Calculate the weighted value.
    - (i) For guarantees falling under (1)(a)(i), the weighted value will be 100% of the estimated current year liability under the guarantee.
    - (ii) For guarantees falling under (1)(a)(ii) the weighted value will be 50% of the estimated current year liability under the guarantee.
    - (iii) For guarantees falling under (1)(a)(iii), the weighted value will be nil.
  - (c) The OAR is calculated as:  
Weighted value x 8% x counterparty weighting (Table 5.2.3(5)(c)(ii))
- (2) For the purpose of this requirement, in assessing whether the guarantee has the characteristics of a credit substitute the following factors should be considered:
  - (a) do the agreements allow for periodic or ad-hoc calling of funds;
  - (b) have the guarantees been drawn upon on a regular basis;
  - (c) do *firms* in the group rely on such guarantees to meet their working capital or regulatory capital requirements.
- (3) Where a *firm* is part of a group including other *FCA* regulated entities which together have entered into cross group guarantee arrangements which give rise to an OAR, the estimate of the potential liability under the guarantee may be apportioned between the regulated entities for the purpose of calculating each *firm's* OAR.



### **5.3.1 [DELETED]**

**5.3.1(1) R [deleted]**

(1) [deleted]

(2) [deleted]

(3) [deleted]

(a) [deleted]

(b) [deleted]

5.3.1(2) G [deleted]

**5.3.1(3) R [deleted]**

**5.3.1(4) R [deleted]**

(1) [deleted]

(2) [deleted]

(3) [deleted]

(4) [deleted]

(5) [deleted]

5.3.1(5) G [deleted]

**5.3.1(6) R [deleted]**

### **5.5.1 FINANCIAL NOTIFICATION**

**5.5.1(1) R [deleted]**

### **5.7 CONSOLIDATED SUPERVISION**

Under the Financial Conglomerates and Other Financial Groups Instrument 2004, the rules in Chapter 14 shall (with respect to a particular firm, group or financial conglomerate) apply from the first day of its financial year beginning in 2005 in place of rules 5.7.1(1) to 5.7.5(4).

5.7.1 [deleted]

**5.7.2 [deleted]**

**5.7.3 [deleted]**

**5.7.4** [deleted]

**5.7.5** [deleted]

## Appendix 1: Interpretation

### FCA

Glossary of terms for Chapter 5 (Former IMRO Firms)

The following words or terms throughout Chapter 5 are to have the meanings given to them below if not inconsistent with the subject or context. If a defined term does not appear in the IPRU(INV) 5 glossary below, the definition appearing in the main Handbook *Glossary* applies.

<b>Term</b>	<b>Meaning</b>
<i>accounting reference date</i>	means: <ul style="list-style-type: none"><li>(a) the date to which a <i>firm's</i> accounts are prepared in order to comply with the relevant Companies Act legislation. In the case of a firm not subject to Companies Act legislation, the equivalent date selected by the <i>firm</i>; and</li><li>(b) in the case of an <i>OPS firm</i> which is not subject to the relevant Companies Act legislation, the date to which the accounts of the <i>OPS</i> in respect of which the <i>firm</i> acts are prepared.</li></ul>
<i>admission procedures</i>	means the procedures set out in the Authorisation Manual together with any other procedures which the <i>Board</i> resolves, either generally or in relation to any specific case, should apply to the admission of <i>firms</i> and the admission of <i>approved persons</i> .
<i>annual accounts</i>	means accounts prepared to comply with relevant Companies Act legislation and their equivalent in Northern Ireland or other statutory obligations.
<i>Annual expenditure</i>	has the meaning given in rule 5.2.4(1) (Determination).
<i>authorised unit trust manager</i>	means the manager of an <i>authorised unit trust scheme</i> .
<i>best execution</i>	in relation to the effecting of a transaction, means the effecting of that transaction in compliance with <i>COBS 11.2</i> .
<i>Board</i>	means the board of <i>directors</i> of the <i>FCA</i> or any duly authorised committee of such board.
<i>category a body</i>	means: <ul style="list-style-type: none"><li>(a) the government or central bank of a <i>zone a country</i>; or</li><li>(b) <i>EU</i> or Euratom (the European Atomic Energy Community); or</li><li>(c) the government or central bank of any other country, provided the receivable in question is denominated in that country's national currency.</li></ul>
<i>category b body</i>	means: <ul style="list-style-type: none"><li>(a) the <i>EIB</i> or a multi-lateral development bank; or</li><li>(b) the regional government or local authority of a <i>zone a country</i>; or</li></ul>

- (c) an *investment firm* or *credit institution* authorised in a zone a country; or
- (d) a *recognised clearing house* or *exchange*; or
- (e) an *investment firm* or *credit institution* authorised in any other country, which applies a financial supervision regime at least equivalent to the *Capital Adequacy Directive*.

*Client Money Rules* CASS 4.1 to 4.3.

*company* means a *body corporate* or an unincorporated association and, where the context permits, includes a partnership.

*compliance officer* means the individual from time to time appointed by a *firm* as responsible for compliance matters.

*connected company and connected credit institution* means, in relation to a *firm* which:

- (a) is a *body corporate*, a *body corporate* or *credit institution* satisfying any of the following conditions:
  - (i) the same person is the *controller* of each *body corporate* or *credit institution*; or
  - (ii) if a *group* of two or more persons are *controllers* of each *body corporate* or *credit institution*, the *group* either consists of the same persons or could be regarded as consisting of the same persons by treating a member of either *group* as replaced by:
    - (A) that member's *close relative*; or
    - (B) a person with whom the member is in partnership; or
    - (C) a *body corporate* of which the member is an officer; or
  - (iii) both *bodies corporate* are members of the same *group*; or
- (b) is not a *body corporate* or *credit institution* which is controlled:
  - (i) by the *firm*; or
  - (ii) by a partner in the *firm*; or
  - (iii) by a *close relative* or partner in the *firm* or, if the *firm* is a sole trader, by a *close relative* of the sole trader; or
  - (iv) collectively by any of the partners in the *firm* or their *close relatives*.

*controller* (as defined in section 422 of the *Act* (Controller))

in relation to a *firm* or other undertaking ("A"), means a person who:

- (a) holds 10% or more of the *shares* in A; or
- (b) is able to exercise significant influence over the management of A by virtue

of his shareholding in A; or

- (c) holds 10% or more of the *shares* in a parent undertaking ("P") of A; or
- (d) is able to exercise significant influence over the management of P by virtue of his shareholding in P; or
- (e) is entitled to exercise, or control the exercise of, 10% or more of the voting power in A; or
- (f) is able to exercise significant influence over the management of A by virtue of his voting power in A; or
- (g) is entitled to exercise, or control the exercise of, 10% or more of the voting power in P; or
- (h) is able to exercise significant influence over the management of by virtue of his voting power in P.

and in this definition

(A) "person" means:

- (a) the person; or
- (b) any of the person's *associates*; or
- (c) the person and any of his *associates*.

(B) "associate", in relation to a person (H) holding shares in an undertaking ("C") or entitled to exercise or control the exercise of voting power in relation to another undertaking ("D") means:

1. the spouse of H
2. a child or stepchild of H (if under 18);
3. the trustee of any settlement under which H has a life interest in possession (or in Scotland a life interest);
4. an undertaking of which H is a *director*;
- (e) a person who is an *employee* or *partner* of H;
- (f) if H is an undertaking:
  - (i) a *director* of H;
  - (ii) a *subsidiary* undertaking of H;
  - (iii) a *director* or *employee* of such a *subsidiary* undertaking; and
- (g) if H has with any other person an agreement or arrangement with respect to the acquisition, holding or disposal of shares or other interests in C or D or under which they undertake to act together in exercising their voting power in relation to C or D, that other person;

- (a) "settlement" includes any disposition or arrangement under which property is held on trust (or subject to a comparable obligation);
- (b) "shares" means:
  - (a) in relation to an undertaking with a share capital, allotted shares;
  - (b) in relation to an undertaking with capital but no share capital, rights to share in the capital of the undertaking;
  - (c) in relation to an undertaking without capital, interests:
    - (i) conferring any right to share in the profits, or liability to contribute to the losses, of the undertaking; or
    - (ii) giving rise to any obligation to contribute to the debts or expenses of the undertaking in the event of a winding up.

*corporate finance business* means:

- (a) *designated investment business* carried on by a *firm* with or for:
  - (i) any issuer, holder or owner of *designated investments*, if that business relates to the offer, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, those *investments*, or any related matter;
  - (ii) any *eligible counterparty* or *professional client*, or other *body corporate*, partnership or supranational organisation, if that business relates to the manner in which, or the terms on which, or the persons by whom, any business, activities or undertakings relating to it, or any *associate*, are to be financed, structured, managed, controlled, regulated or reported upon;
  - (iii) any person in connection with:
    - (A) a proposed or actual *takeover or related operation* by or on behalf of that person, or involving investments issued by that person (being a *body corporate*), its *holding company*, *subsidiary* or *associate*; or
    - (B) a merger, de-merger, reorganisation or reconstruction involving any investments issued by that person (being a *body corporate*), its *holding company*, *subsidiary* or *associate*;
  - (iv) any shareholder or prospective shareholder of a *body corporate* established or to be established for the purpose of effecting a *takeover or related operation*, where that business is in connection with that *takeover or related operation*;
  - (v) any person who, acting as a *principal* for his own account:
    - (A) is involved in negotiations or decisions relating to the commercial, financial or strategic intentions or requirements of a business or prospective business; or

- (B) (provided he is acting otherwise than solely in his capacity as an investor) assists the interests of another person with or for whom the *firm*, or another *authorised person* or *overseas person*, is undertaking business as specified in (a)(i),(ii),(iii) or (iv), by himself undertaking all or part of any transactions involved in such business;
- (vi) any person undertaking business with or for a person as specified in (a)(i), (ii), (iii), (iv) or (v) in respect of activities described in those sub-paragraphs;
- (b) *designated investment business* carried on by a *firm* as a *principal* for its own account where such *business*:
  - (i) is in the course of, or arises out of, activities undertaken in accordance with (a); and
  - (ii) does not involve transactions with or for, or *advice* to, any other person who is a *retail client* in respect of such business;
- (c) *designated investment business* carried on by a *firm* as *principal* for its own account if such *business*:
  - (i) is in the course of, or arises out of
    - (A) the offer, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, shares, share warrants, *debentures* or debenture warrants issued by the *firm*, or any related matter; or
    - (B) a proposed or actual *takeover or related operation* by or on behalf of the *firm*, or involving shares, share warrants, *debentures* or debenture warrants issued by the *firm*; or
    - (C) a merger, de-merger, reorganisation or reconstruction involving any shares, share warrants, *debentures* or debenture warrants issued by the *firm*; and
  - (ii) does not involve giving *advice on investments* to any person who is a *retail client*;

in this definition, “share warrants” and “debenture warrants” means any *warrant* which relates to shares in the *firm* concerned or, as the case may be, *debentures* issued by the *firm*.

<i>counterparty</i>	means any person with or for whom a <i>firm</i> carries on <i>regulated business</i> or an <i>ancillary activity</i> .
<i>counterparty risk requirement</i>	has the meaning given in Table 5.2.3(5)(c) (Counterparty risk requirement).
<i>customer</i>	see the meaning given to the term in the <i>Glossary</i>
<i>customer investment</i>	means an <i>investment</i> , or a document of title or a certificate or other record evidencing title to an <i>investment</i> , (other than an <i>investment</i> falling within articles 83, 84 and 85 of the <i>RAO</i> ) which is legally or beneficially owned by a <i>customer</i> of a <i>firm</i> .

<i>customer transaction</i>	does not include an <i>own account transaction</i> .
<i>EEA parent</i>	means a <i>firm's</i> direct or indirect <i>parent</i> which has its head office in the <i>EEA</i> .
<i>EIB</i>	means the European Investment Bank.
<i>expenditure based requirement</i>	means the requirement calculated in accordance with Table 5.2.3(5)(a) (Expenditure based requirement).
<i>finance officer</i>	means the most senior individual from time to time directly responsible for the <i>firm's</i> finances and for compliance with the requirements of the Supervision Manual.
<i>financial resources</i>	has the meaning given in rule 5.2.1(3) (Financial resources).
<i>financial resources requirement</i>	has the meaning given in rule 5.2.3(1) (a) to (c) (Determination of requirement).
<i>financial resources rules</i>	has the meaning given in rules 5.2.1 to 5.2.7.
<i>financial return</i>	means <i>quarterly financial return</i> or <i>monthly financial return</i> as the case may be.
<i>foreign exchange position</i>	has the meaning given in Table 5.2.3(5)(d) (Foreign exchange requirement).
<i>funds under management</i>	<p>(1) <i>collective investment schemes</i> other than <i>OEICs</i> managed by the <i>firm</i> including <i>schemes</i> where it has delegated the management function but excluding <i>schemes</i> that it is <i>managing as delegate</i>; and</p> <p>(2) <i>OEICs</i> for which the <i>firm</i> is the designated management company.</p>
<i>Group of connected counterparties</i>	<p>means:</p> <p>(a) two or more natural or legal persons who constitute a single risk because one of them, directly or indirectly, has <i>control</i> over the other or others; or</p> <p>(b) two or more natural or legal persons between whom there is no relationship of <i>control</i> as in (a) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to exercise financial problems, the other or all of the others would be likely to encounter difficulties in performing its or their obligations.</p>
<i>IADB</i>	means the Inter-American Development Bank.
<i>IBRD</i>	means the International Bank for Reconstruction and Development.
<i>IFC</i>	means the International Finance Corporation.
<i>investigation</i>	means an investigation authorised pursuant to the Enforcement Guide.
<i>investment</i>	means a <i>designated investment</i> .

<i>investment business</i>	means <i>designated investment business</i> .
<i>investment firm</i>	has the meaning given to <i>investment firm</i> in the main <i>Glossary</i> except that it excludes persons to which the <i>MIFID</i> does not apply as a result of articles 2 or 3 of <i>MIFID</i> .  <b>Note:</b> An <i>investment firm</i> is not necessarily a <i>firm</i> for the purposes of the rules.
<i>investment management firm</i>	see the meaning given to the term in the <i>Glossary</i>
<i>investment manager</i>	means a person who, acting only on behalf of a <i>customer</i> , either: <ul style="list-style-type: none"> <li>(a) manages an account or portfolio in the exercise of discretion; or</li> <li>(b) has accepted responsibility on a continuing basis for advising on the composition of the account or portfolio.</li> </ul>
<i>investment services</i>	means activities undertaken in the course of carrying on <i>designated investment business</i> or undertaken as an <i>ISA manager</i> .
<i>ISA cash deposit</i>	means a cash deposit within Regulation 8 of the Individual Savings Account Regulations 1998 (SI 1998/1870) which is held within a cash component ISA.
<i>liquid capital</i>	has the meaning given in rule 5.2.2(1) (Calculation of own funds and liquid capital).
<i>liquid capital requirement</i>	has the meaning given in rule 5.2.3(4) (a) to (c) (Liquid capital requirement).
<i>marketable investment</i>	means: <ul style="list-style-type: none"> <li>(a) an <i>investment</i> which is traded on or under the rules of an exchange;</li> <li>(b) a debt instrument which may be transferred without the consent of the issuer or any other person (including a collateralised mortgage obligation);</li> <li>(c) a commodity;</li> <li>(d) a <i>warrant</i>, option, future or other instrument which entitles the holder to subscribe for or acquire: <ul style="list-style-type: none"> <li>(i) an <i>investment</i> or commodity in (a) to (c); or</li> <li>(ii) any currency; or</li> <li>(iii) any combination of (i) and (ii);</li> </ul> </li> <li>(e) a contract for differences (including interest rate and currency swaps) relating to fluctuations in: <ul style="list-style-type: none"> <li>(i) the value or price of an <i>investment</i> or commodity in (a) to (d); or</li> <li>(ii) any currency; or</li> <li>(iii) the rate of interest in any currency or any index of such rates; or</li> </ul> </li> </ul>

	(iv) the level of any index which is derived from the prices of an <i>investment</i> or commodity in (a) to (c); or
	(v) any combination of (i) to (iv);
	(f) <i>warrants</i> , options, futures or other instruments entitling the holder to obtain the rights of those contracts in (d) or (e);
	(g) a <i>unit</i> in a <i>regulated collective investment scheme</i> .
<i>marketing group</i>	means a group of persons:
	(a) who are allied together (either formally or informally) for the purposes of marketing <i>packaged products</i> of the group; and
	(b) each of whom, if it holds itself out in the UK as marketing any <i>packaged products to retail clients</i> , does so only as an <i>investment manager</i> or in relation to those of the <i>marketing group</i> .
<i>member state</i>	means a member state of the <i>EEA</i> .
<i>monthly financial return</i>	means the return referred to in the Supervision Manual.
<i>non-retail client</i>	means a <i>professional client</i> or an <i>eligible counterparty</i> .
<i>OPS or occupational pension scheme</i>	means any scheme or arrangement which is comprised in one or more instruments or agreements and which has, or is capable of having, effect in relation to one or more descriptions or categories of employment so as to provide benefits, in the form of pensions or otherwise, payable on termination of service, or on death or retirement, to or respect of earners with qualifying service in an employment of any such description or category.
<i>OPS activity</i>	see the meaning given to the term in the <i>Glossary</i>
<i>OPS firm</i>	means:
	(a) a <i>firm</i> which:
	(i) carries on <i>OPS activity</i> but not with a view to profit; and
	(ii) is one or more of the following:
	(A) a trustee of the <i>occupational pension scheme</i> in question;
	(B) a <i>company</i> owned by the trustees of the <i>occupational pension scheme</i> in question;
	(C) a <i>company</i> which is:
	(I) an employer in relation to the <i>occupational pension scheme</i> in question in respect of its employees or former employees or their dependants; or
	(II) a <i>company</i> within the <i>group</i> which includes an employer within (I); or

(III) an administering authority subject to the Local Government Superannuation Regulations 1986; or

- (b) a *firm* which:
- (i) has satisfied the requirements set out in (a) at any time during the past 12 *months*; but
  - (ii) is no longer able to comply with those requirements because of a change in the control or ownership of the employer referred to in (a)(ii) during that period.

<i>otc derivative</i>	means interest rate and foreign exchange contracts covered by Annex III to the previous version of the <i>Banking Consolidation Directive</i> (i.e. Directive (2000/12/EC) and off balance sheet contracts based on equities which are not traded on a <i>recognised</i> or <i>designated investment exchange</i> or other exchange where they are subject to daily margin requirements, excluding any foreign exchange contract with an original maturity of 14 calendar days or less.
<i>other assets requirement</i>	has the meaning given in Table 5.2.3(5) (e) (Other assets requirement).
<i>overseas person</i>	see the meaning given to the term in the <i>Glossary</i>
<i>own funds</i>	has the meaning given in rule 5.2.2(1) (Calculation of own funds and liquid capital).
<i>own funds requirement</i>	has the meaning given in rule 5.2.3(3) (a) (Own funds requirement).
<i>parent</i>	means any parent undertaking as defined in section 1162 of the Companies Act 2006 and any undertaking which effectively exercises a dominant influence over another undertaking.
<i>participation</i>	has the meaning given to the term in the <i>Glossary</i> .
<i>permitted business</i>	means <i>regulated activity</i> which a <i>firm</i> has <i>permission</i> to carry on.
<i>plan investment</i>	means an <i>investment</i> included in a <i>PEP</i> or in any <i>ISA</i> component.
<i>position risk requirement</i>	has the meaning given in Table 5.2.3(5)(b) (Position risk requirement).
<i>prescribed subordinated loan agreement</i>	means the subordinated loan agreement prescribed by the <i>appropriate regulator</i> for the purposes of rule 5.2.5(4).
<i>qualifying amount</i>	has the meaning given in the Supervision Manual.
<i>qualifying capital instrument</i>	means that part of a <i>firm's</i> capital which is a security of indeterminate duration, or other instrument, that fulfils the following conditions: <ul style="list-style-type: none"><li>(a) it may not be reimbursed on the bearer's initiative or without the prior agreement of the <i>appropriate regulator</i>;</li><li>(b) the debt agreement must provide for the <i>firm</i> to have the option of deferring the payment of interest on the debt;</li></ul>

- (c) the lender's claims on the *firm* must be wholly subordinated to those of all non-subordinated creditors;
- (d) the documents governing the issue of the securities must provide for debt and unpaid interest to be such as to absorb losses, whilst leaving the *firm* in a position to continue trading; and
- (e) only fully paid-up amounts shall be taken into account.

*qualifying capital item*

means that part of a *firm's* capital which has the following characteristics:

- (a) it is freely available to the *firm* to cover normal banking or other risks where revenue or capital losses have not yet been identified;
- (b) its existence is disclosed in internal accounting records; and
- (c) its amount is determined by the management of the *firm* and verified by independent auditors, and is made known to, and is monitored by, the *FCA*.

**Note:** Verification by internal auditors will suffice until such time as EU provisions making external auditing mandatory have been implemented.

*qualifying property*

has the meaning given in rule 5.2.6(1) (Qualifying property and qualifying amount defined).

*qualifying subordinated loan*

has the meaning given in rule 5.2.5 (1) to (7) (Qualifying subordinated loans).

*qualifying undertaking*

has the meaning given in rule 5.2.6(3) (Qualifying undertakings).

*quarterly financial return*

means the return referred to in the Supervision Manual.

*readily realisable investment*

means a unit in a *regulated collective investment scheme*, a *life policy* or any *marketable investment* other than one which is traded on or under the rules of a *recognised* or *designated investment exchange* so irregularly or infrequently:

- (a) that it cannot be certain that a price for that *investment* will be quoted at all times; or
- (b) that it may be difficult to effect transactions at any price which may be quoted.

*recognised overseas clearing house*

means an *overseas clearing house* which is declared by a recognition order made under section 290 or 292 of the *Act* for the time being in force to be a *recognised clearing house*.

*recognised overseas investment exchange*

means an *overseas investment exchange* which is declared by a recognition order made under section 290 or 292 of the *Act* for the time being in force to be a *recognised investment exchange*.

*recognised third country investment firm*

means an *investment firm* which is authorised in a country other than a *member state* and which is subject to and complies with prudential rules equivalent to the requirements of the *Capital Adequacy Directive*.

**Note:** A *recognised third country investment firm* is not necessarily a *firm* for the purposes of the *rules*.

**Note:** A list of the non-EEA regulators which are approved by *the FCA or PRA* for the purposes of recognising *recognised third country investment firms* under the Capital Adequacy Directive is available on request from the *FCA*.

<i>registered individual</i>	means an <i>approved person</i> .
<i>registrable activity</i>	in relation to a <i>firm</i> , means any one of the following: <ul style="list-style-type: none"><li>(a) holding the post of <i>director</i> or <i>chief executive</i>;</li><li>(b) acting as an <i>investment manager</i> in the course of the <i>permitted business</i> of the <i>firm</i>;</li><li>(c) acting in a senior capacity with responsibility either alone or jointly with one or more other individuals for the management, supervision and control of a part of the <i>firm's permitted business</i> (including the <i>compliance officer</i> and the <i>finance officer</i>);</li><li>(d) procuring or endeavoring to procure other persons to enter into <i>investment agreements</i>, or giving advice to persons with whom he deals about entering into <i>investment agreements</i> or exercising rights conferred by <i>investments</i>, in the course of the <i>permitted business</i> of the <i>firm</i>;</li><li>(e) committing the <i>firm</i> or its <i>customers</i> in market dealings or in transactions in <i>securities</i> or in other <i>investments</i> in the course of the <i>firm's permitted business</i>.</li></ul>
<i>regulated activity</i>	see the meaning given to the term in the <i>Glossary</i>
<i>regulated business</i>	means <i>designated investment business</i> .
<i>regulated friendly society</i>	means, as respects <i>investment business</i> carried on for or in connection with any of the purposes mentioned in Schedule 1 to the Friendly Societies Act 1974, or, as the case may be, to the Friendly Societies Act (Northern Ireland) 1970, means a society which is a friendly society within the meaning of section 7(1)(a) of the Friendly Societies Act 1974 and is registered within the meaning of that Act or is a friendly society within the meaning of section 1(1)(a) of the Friendly Societies Act (Northern Ireland) 1970 and is registered or deemed to be registered under that Act; and <ul style="list-style-type: none"><li>(a) under its rules, has its registered office at a place situated in Great Britain or, as the case may be, Northern Ireland; and</li><li>(b) carries on <i>investment business</i> in the UK.</li></ul>
<i>relevant foreign exchange items</i>	means: <ul style="list-style-type: none"><li>(a) all assets less liabilities, including accrued interest, denominated in the currency (all investments at market or realisable value);</li><li>(b) any currency future, at the nominal value of the contract;</li><li>(c) any forward contract for the purchase or sale of the currency, at the contract value, including any future exchange of principal associated with</li></ul>

currency swaps;

- (d) any foreign currency options at the net delta (or delta-based) equivalent of the total book of such options;
- (e) any non-currency option, at market value;
- (f) any irrevocable guarantee;
- (g) any other off-balance sheet commitment to purchase or sell an asset denominated in that currency.

*reporting currency* means the currency in which the *firm's* books of account are maintained.

*specified trustee business* 1. means any *investment business* carried on in the UK by a *trustee firm*, but excluding each of the following activities:

(a) **Dealing or arranging deals in *investments***

- (i) where the deal is transacted or arranged by a *trustee firm* with or through a *PTP*; or
- (ii) where the dealing or arranging is done in the course of, or is incidental to, an activity of management falling within paragraph (b) below; or
- (iii) where the trust is a *unit trust scheme* and the deal is or the arrangements are made with a view to either an issue or sale of units in such a *scheme* to, or a redemption or repurchase or conversion of such units or a dealing in investments for such a *scheme* carried out by with or through, the *operator* or on the instructions of the *operator*; or
- (iv) where the *trustee firm*, being a bare trustee (or, in Scotland, a nominee) holding *investments* for another person, is acting on that person's instructions; or
- (v) where any arrangements do not or would not bring about the transaction in question.

(b) **Managing Investments**

- (i) where the *trustee firm* has no general authority to effect transactions in *investments* at discretion; or
- (ii) if and to the extent that all day-to-day decisions in relation to the management of the *investments* or any discrete part of the *investments* are or are to be taken by a *PTP*; or
- (iii) if and to the extent that investment decisions in relation to the *investments* or any discrete part of the *investments* are or are to be taken substantially in accordance with the advice given by a *PTP*; or
- (iv) where the *trustee firm* is a personal representative or executor and is acting in that capacity; or

- (v) where the trust is a *unit trust scheme* and all day-to-day investment decisions in the carrying on of that activity are or are to be taken by the *operator* of the *scheme*.

(c) **Investment Advice**

- (i) where the relevant advice:
  - (A) does not recommend the entry into any investment transaction or the exercise of any right conferred by any *investment* to acquire, dispose of, underwrite or convert such an *investment*; and
  - (B) is accompanied by a recommendation that independent advice be obtained; or
- (ii) if and to the extent that the relevant advice is in substance the advice of a *PTP*; or
- (iii) where the relevant advice is given by the *trustee firm* acting in the capacity of personal representative or executor.

(d) **Establishing, operating or winding up a *collective investment scheme* including acting as *trustee* of an *authorised unit trust scheme*** but only to the extent that such activities do not otherwise constitute *specified trustee business*.

(e) **Any *trustee activity* undertaken as trustee of an issue of debentures or government or public securities**

- (i) where the issue is made by a company listed on a *recognised investment exchange* or on a *designated investment exchange* (or by a wholly-owned subsidiary of such a company); or
- (ii) where the issue is listed or traded either on a *recognised investment exchange* or on a *designated investment exchange* or on the Société de la Bourse de Luxembourg; or
- (iii) where the issue is made by a government, local authority or international organisation; or
- (iv) where the aggregate amounts issued (pursuant to the trust deed or any deed supplemental thereto and ignoring any amounts redeemed, repurchased or converted) exceed the sum of £10,000,000.

2. For the purpose of this definition of “*specified trustee business*”:

- (a) a transaction is entered into through a person if that person:
  - (i) enters into it as agent; or
  - (ii) arranges for it to be entered into as principal or agent by another person and the arrangements are such that they bring about the transaction in question;
- (b) **investment transaction** means a transaction to purchase, sell, subscribe for or underwrite a particular investment and “investment

decision” means a decision relating to an investment transaction;

- (c) **debentures** means any securities falling within article 77 of the RAO;
- (d) **government or public securities** means any securities falling within article 78) of the RAO;
- (e) *government, local authority or international organisation* means:
  - (i) the government of the *United Kingdom*, of Northern Ireland, or of any country or territory outside the United Kingdom;
  - (ii) a local authority in the *United Kingdom* or Anywhere; or
  - (iii) an international organisation the members of which include the *United Kingdom* or another EEA State.
- (f) in determining the size of an issue of debentures or government or public securities made in a currency other than sterling, the amount of the issue shall be converted into sterling at the exchange rate prevailing in London on the date of issue.

*statutory rules*

means the rules made by the *FCA* under the Act.

*total capital requirement*

has the meaning given in rule 5.2.3(5) (Total capital requirement).

*trading book*

in relation to a *firm's* business or exposures, means:

- (a) its proprietary positions in financial instruments:
  - (i) which are held for resale and/or are taken on by the *firm* with the intention of benefiting in the short term from actual and/or expected differences between their buying and selling prices or from other price or interest-rate variations;
  - (ii) arising from matched principal broking;
  - (iii) taken in order to hedge other elements of the *trading book*;
- (b) exposures due to unsettled securities transactions, free deliveries, *OTC derivative* instruments, repurchase agreements and securities lending transactions based on securities included in (a)(i) to (iii) above, reverse repurchase agreements and securities borrowing transactions based on securities included in (a)(i) to (iii) above; and
- (c) fees, commission, interest and dividends, and margin on exchange-traded derivatives which are directly related to the items included in (a) and (b) above.

*trust beneficiary*

means a beneficiary under a trust (not being the settlor) who benefits from the performance by a *firm* as *trustee of investment services* relating to the management of the trust assets (in accordance with section 2372 of the Act (Other definitions)).

*trustee activity*

means, in relation to a *firm*, any activity undertaken in the course of or incidental to the exercise of any of its powers, or the performance of any of its duties, when

	acting in its capacity as a trustee.
<i>UCITS qualifier</i>	see the meaning given to the term in the <i>Glossary</i>
<i>unit trust manager</i>	means the manager of a <i>unit trust scheme</i> .
<i>zone a country</i>	see definition of <i>Zone A country</i> in the <i>Glossary</i>
<i>zone b country</i>	means a country which is not a <i>zone a country</i> .



## 6 Chapter 6: Service Companies

### 6.1 APPLICATION

6.1.1 R This chapter applies to *service companies*.

FCA

#### FINANCIAL RESOURCES REQUIREMENTS

6.1.2 R (1) *A service company* must be able to meet its liabilities as they fall due.

FCA

(2) In complying with (1) a *firm* may use any assets which are available to meet any of its liabilities.



## **7 Chapter 7: UCITS Management Companies**

*[Deleted: material moved to UPRU]*



## 8 Chapter 8: Requirements on credit unions which are CTF providers

### 8.1 APPLICATION, GENERAL AND PROFESSIONAL INDEMNITY INSURANCE REQUIREMENTS

#### *Application*

8.1.1 R (1) This chapter applies to a *credit union* to the extent that it is a **CTF provider whose permissions relate to accepting deposits and making arrangements with a view to transactions in investments.**

PRA

(2) The definitions in the Glossary at Appendix 13(1) apply to this chapter.

#### *General requirements*

8.1.2 R A *credit union* to which this chapter applies must:

PRA

(1) have and maintain at all times financial resources of the kinds and amounts specified in, and calculated in accordance with, the *rules* of this chapter, in *CREDS* and, where applicable, in *MIPRU 4 (Capital Resources)*; and

(2) be able to meet its liabilities as they fall due.

8.1.3 G The *rules* in this chapter should be read with the *rules* relating to capital in *CREDS* and, where applicable, *MIPRU*.

PRA

#### *Requirement to hold professional indemnity insurance*

8.1.4 G (1) Under *Principles 3 and 4*, a *credit union* is required to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems and to maintain adequate financial resources.

PRA

(2) Although financial resources and appropriate systems and controls can generally mitigate operational risk, professional indemnity insurance has a role in mitigating the risks a *credit union* faces in its day to day operations. The purpose of *IPRU(INV) 8.1.6R* to *IPRU(INV) 8.1.14E* is to ensure that a *credit union* has in place the type, and level, of professional indemnity insurance necessary to mitigate these risks.

8.1.5 R The term "relevant income" in *IPRU(INV) 8.1* refers to all income received or receivable which is commission, brokerage, fees or other related income, whether arising from the *credit union's* activities related to *making arrangements with a view to transactions in investments* or not, for the last accounting year prior to inception or renewal of the professional indemnity insurance policy ("the policy").

PRA

- 8.1.6 R **A *credit union* must take out and maintain at all times professional indemnity insurance that is at least equal to the requirements of IPRU(INV) 8.1.7R to IPRU(INV) 8.1.14E.**

PRA

***Professional indemnity insurance policy terms***

- 8.1.7 R **The professional indemnity insurance policy must incorporate terms which are appropriate and must make provision for:**

PRA

- (1) **cover in respect of any claim for loss or damage, for which the *credit union* may be liable as a result of an act or omission by:**
  - (a) **the *credit union*; or**
  - (b) **any *person* acting on behalf of the *credit union* including *employees*, *appointed representatives* or its other agents;**
- (2) **the minimum *limits of indemnity* in each year if the *credit union* is an *IMD insurance intermediary* are as set out in MIPRU 3.2.7R;**
- (3) **the following *limits of indemnity* if the *credit union* is an investment intermediary other than an *IMD insurance intermediary*:**
  - (a) **if the *credit union* has relevant income of up to £3,000,000, no lower than £500,000 for a single claim against the *credit union* and £500,000 in the aggregate; or**
  - (b) **if the *credit union* has relevant income of more than £3,000,000, no lower than £650,000 for a single claim against the *credit union* and £1,000,000 in the aggregate.**
- (4) **If (2) applies, and the policy is denominated in any currency other than euros, a *credit union* must take reasonable steps to ensure that the *limits of indemnity* are, when the policy is effected (i.e. agreed) and at renewal, at least equivalent to those required in IPRU(INV) 8.1.7R.**

***Readily realisable own funds***

- 8.1.8 G **For the purposes of the following provisions relating to professional indemnity insurance, the *PRA* expects items included in *own funds* to be regarded as “readily realisable” only if they can be realised, at any given time, within 90 days.**

PRA

***Additional requirements***

- 8.1.9 E (1) **In addition to the specific requirements in IPRU(INV) 8.1.7R, to incorporate appropriate terms, the policy should make provision for the following:**

PRA

- (a) for a *credit union* with relevant income of more than £6,000,000, the aggregate limit identified in the table below:

Relevant income is (£)		Minimum aggregate <i>limit of Indemnity</i> (£)
more than	up to	
6,000,000	7,000,000	1,150,000
7,000,000	8,000,000	1,300,000
8,000,000	9,000,000	1,450,000
9,000,000	10,000,000	1,600,000
10,000,000	12,500,000	2,000,000
12,500,000	15,000,000	2,400,000
15,000,000	17,500,000	2,800,000
17,500,000	20,000,000	3,150,000
20,000,000	25,000,000	3,800,000
25,000,000	30,000,000	4,250,000
30,000,000	35,000,000	4,500,000
35,000,000	40,000,000	4,750,000
40,000,000	50,000,000	5,500,000
50,000,000	60,000,000	6,000,000
60,000,000	70,000,000	6,750,000
70,000,000	80,000,000	7,250,000
80,000,000	90,000,000	7,750,000
90,000,000	100,000,000	8,500,000
100,000,000	150,000,000	11,250,000
150,000,000	200,000,000	14,000,000
200,000,000	250,000,000	17,000,000
250,000,000	300,000,000	19,750,000

300,000,000	n/a	22,500,000
-------------	-----	------------

- (b) full retroactive cover in respect of the kinds of liabilities described in *IPRU(INV)* 8.1.7R for claims arising from work carried out by the *credit union*, or on its behalf, in the past; and
- (c) cover in respect of *Ombudsman* awards made against the *credit union*.

- (2) Compliance with (1)(a) may be relied on as tending to establish compliance with the requirement in *IPRU(INV)* 8.1.7R for the professional indemnity insurance terms to be appropriate.
- (3) Contravention of (1)(a) may be relied on as tending to establish contravention of the requirement in *IPRU(INV)* 8.1.7R for the professional indemnity insurance terms to be appropriate.

8.1.10 G A *credit union* should consider whether the overall cover is adequate taking account of *IPRU(INV)* 8.1.13G(2) and whether the *credit union* should seek additional cover or legal expenses insurance. (Legal defence costs are costs of defence against claims that fall under the terms of the policy.)

PRA

8.1.11 G The cover provided by the policy should be wide enough to include the liability of the *credit union*, its *appointed representatives*, *employees* and its agents for breaches of the *credit union's* duty of skill and care, fiduciary duty, duty to look after documents or assets, fraud, and breaches of obligations imposed by or under the *Act*.

PRA

#### **Exclusions**

8.1.12 R **The policy must not be subject to conditions or exclusions which unreasonably limit the cover provided for in *IPRU(INV)* 8.1.7R (whether by exclusion of cover, by policy excesses or otherwise).**

PRA

8.1.13 G (1) The *PRA* considers it reasonable for a *credit union's* policy to exclude cover for:

PRA

(a) specific business lines if that type of business has not been carried out by the *credit union* in the past and will not be carried out by the *credit union* during the life of the policy; or

(b) specific claims that have been previously notified to the *credit union's insurer* and claimed for under another policy.

(2) The *PRA* does not consider it reasonable for a *credit union's* policy to treat legal defence costs cover as part of the *limits of indemnity* if this reduces the cover available for any individual substantive claim.

8.1.14 E (1) The policy should not:

PRA

(a) make provision for payment by the *credit union* of an excess on any claim of more than £5,000. (This does not apply to the extent that the *credit union* holds additional *own funds* in a readily realisable form, in accordance with *IPRU(INV)*)

8.1.16E); or

- (b) exclude any type of business or activity that has been carried out by the *credit union* in the past or will be carried out by the *credit union* during the time for which the policy is in force. (This does not apply to the extent that the *credit union* holds, by way of additional *own funds* in a readily realisable form, an amount equivalent to a reasonable provision against its potential liabilities for that business or activity. *Guidance* on this is given in *IPRU(INV)* 8.1.17G and *IPRU(INV)* 8.1.18G); or
- (c) exclude liability which is identified or crystallised as a result of regulatory action against the *credit union* (either individually or as a member of a class of *authorised person*).

- (2) Contravention of (1)(a) may be relied on as tending to establish contravention of *IPRU(INV)* 8.1.12R.

**Excess level**

- 8.1.15 E The reference to “excess” in *IPRU(INV)* 8.1.14E(1)(a) is to the highest excess level required to be paid under the policy unless that excess relates to a type of business that has not been carried out by the *credit union* in the past. In those circumstances, the reference is to the next highest excess level required by the policy.

**PRA**

**Additional own funds**

- 8.1.16 E The amount of additional *own funds* in *IPRU(INV)* 8.1.14E (1)(a) should be calculated by referring to the *credit union*’s relevant income and excess obtained in the following table:

**PRA**

*All amounts are shown in £000s*

Relevant income		Excess obtained, up to and including											
more than	up to	5	10	15	20	25	30	40	50	75	100	150	200+
0	100	0	4	7	9	12	14	18	21	28	34	45	54
100	200	0	7	11	14	17	20	25	29	38	46	59	70
200	300	0	9	14	18	21	24	30	35	45	54	69	82
300	400	0	11	16	21	24	28	34	39	50	60	77	91
400	500	0	13	18	23	27	30	37	43	55	66	83	98
500	600	0	14	20	25	29	33	40	46	59	70	89	105
600	700	0	16	22	27	31	35	42	49	63	74	94	111

700	800	0	17	23	28	33	37	45	52	66	78	99	117
800	900	0	18	24	30	35	39	47	54	69	82	103	122
900	1,000	0	19	26	31	36	41	49	56	72	85	107	126
1,000	1,500	0	23	31	37	43	48	57	66	83	99	124	146
1,500	2,000	0	26	35	42	48	54	64	73	93	109	138	161
2,000	2,500	0	29	38	46	53	59	71	81	102	121	152	179
2,500	3,000	0	32	42	51	58	65	78	89	112	132	166	195
3,000	3,500	0	35	46	55	63	71	84	96	121	142	179	210
3,500	4,000	0	38	50	59	68	76	90	102	129	152	191	223
4,000	4,500	0	41	53	63	72	80	95	108	137	161	202	236
4,500	5,000	0	43	56	67	76	85	100	114	144	169	212	248
5,000	6,000	0	48	62	73	84	93	110	125	157	185	231	271
6,000	7,000	0	52	67	79	90	101	119	135	169	199	249	291
7,000	8,000	0	56	72	85	97	107	127	144	181	212	265	310
8,000	9,000	0	59	76	90	103	114	134	152	191	224	280	328
9,000	10,000	0	63	80	95	108	120	141	160	201	236	294	344
10,000	100,000	0	63y	80y	95y	108y	120y	141y	160y	201y	236y	294y	344y
100	n/a	0	630	800	950	1080	1200	1410	1600	2010	2360	2940	3440

For *firms* with relevant income more than £10m but up to £100m value y is calculated by relevant income/ £10m

### Exclusion

8.1.17 G A *credit union* should take into account the following when assessing the amount of additional *own funds* to be held as provision as described in IPRU(INV) 8.1.14E(1)(b):

**PRA**

- (1) the type of business line or activity excluded and the types of claim which might arise from it;
- (2) the number of contracts written or volume of activity;
- (3) the number of complaints received by the *credit union* relating to the excluded business or activity;

- (4) generally accepted accounting principles applicable to provisions; and
- (5) any other relevant information.

8.1.18 G If the *credit union* holds additional *own funds* in accordance with *IPRU(INV)* 8.1.17G then the amount should be reviewed regularly. The reviews should take account of changes in the status of the policy exclusion(s) and any relevant changes to the *credit union's* circumstances.

PRA

***Policies providing cover for more than one credit union***

8.1.19 R **If the policy provides cover to more than one *credit union* then in relation to *IPRU(INV)* 8.1.7R:**

PRA

- (1) the relevant income for calculating the *limits of indemnity* is that of all the *credit unions* named in the policy combined;
- (2) each *credit union* named in the policy must have the benefit of the minimum *limits of indemnity* as required in *IPRU(INV)* 8.1.7R;
- (3) each *credit union* named in the policy must notify the *appropriate regulator* if the aggregate cover in the policy falls below the minimum in *IPRU(INV)* 8.1.7R.

***Exemption from holding professional indemnity insurance***

8.1.20 R (1) A credit union is not required to effect or maintain professional indemnity insurance in relation to insurance mediation activity, if another authorised person which has net tangible assets of more than £10 million provides a comparable guarantee.

(2) A 'comparable guarantee' means a written agreement on terms at least equal to those in *MIPRU* 3.2.4R to finance the claims that might arise as a result of a breach by the *credit union* of its duties under the *regulatory system* or civil law.

PRA

8.1.21 R **A *credit union* must take out professional indemnity insurance from:**

PRA

- (1) any *insurance undertaking* which is authorised to transact professional indemnity insurance in the *EEA*; or
- (2) a *person* of equivalent status in:
  - (a) a *Zone A country*;
  - (b) the Channel Islands, Gibraltar, Bermuda or the Isle of Man.

***Notification requirements***

8.1.22 G *Rule IPRU(INV)* 8.1.24R is a *notification rule* and is in addition to any

PRA

notification requirements in the Supervision manual (*SUP 15*).

8.1.23

G *Credit unions* are reminded to comply with *SUP 15.7* (Form and method of notification) when notifying the *PRA* in accordance with *IPRU(INV) 8.1.24R*.

PRA

8.1.24

R **A *credit union* must notify the *PRA* immediately it becomes aware, or has information which reasonably suggests, that any of the matters in Table 8.1(1) has occurred, may have occurred or may occur in the foreseeable future.**

PRA

#### Table 8.1(1)

***This table forms part of IPRU(INV) 8.1.24R***

##### NOTIFIABLE EVENTS

In relation to professional indemnity insurance, required in accordance with *IPRU(INV) 8.1.6R* to *IPRU(INV) 8.1.21R*, if:

- (1) it cannot be obtained within 28 days of the inception or renewal date;
- (2) it is cancelled;
- (3) the amount of aggregate cover is exhausted;
- (4) the *credit union* commences business lines for which it had not obtained cover;
- (5) the *credit union* is relying on *IPRU(INV) 8.1.19R*; or
- (6) the *credit union* is relying on *IPRU(INV) 8.1.20R*.

## 8.2 CAPITAL REQUIREMENTS

8.2.1

R 'Capital' in this chapter has the meaning described in *CREDS 5.2.1R*.

PRA

8.2.2

R **A *version 1 credit union* with total assets of more than £5 million or a total number of members of more than 5,000, or both, or a *version 2 credit union*, which acts as a *CTF provider* and whose *permissions* include *regulated activities* relating to *accepting deposits* and *making arrangements with a view to transactions in investments* other than *contracts of insurance* or *rights to or interests in a life policy* must maintain at all times capital which is equal to the higher of:**

PRA

- (1) £10,000;
- (2) the capital requirements for the *credit union* under *CREDS*; and

8.2.3

R **A *version 1 credit union* with total assets of more than £5 million or a total number of members of more than 5,000, or both, or a *version 2 credit union*, which acts as a *CTF provider* which *makes arrangements with a view to transactions in investments* including *contracts of insurance* or *rights to or interests in a life policy* must**

PRA

**maintain at all times capital which is equal to the highest of:**

- (1) £10,000;**
- (2) the capital requirements for the *credit union* under *CREDS*;  
and**
- (3) the capital requirements for the *credit union* under *MIPRU 4*.**



## 9 Chapter 9: Financial resources requirements for an exempt CAD firm

### 9.1 APPLICATION

9.1.1 R (1) This chapter applies to an *exempt CAD firm* which is:

FCA

- (a) an *investment management firm*; or
- (b) a *securities and futures firm*.

(2) This chapter also applies to a *local firm*.

### 9.2 GENERAL REQUIREMENTS

9.2.1 G For an *exempt CAD firm*, the *rules* contained within this chapter replace the *rules* in respect of financial resources, financial resources requirements and nonfinancial resources related requirements contained within Chapter 3 or 5, as applicable. However, an *exempt CAD firm* must continue to comply with the requirements of Chapter 3 or 5, to the extent it is referred to Chapter 3 or 5 by a *rule* in this chapter.

FCA

9.2.2 R A *firm* must be able to meet its liabilities as they fall due.

FCA

9.2.3 R An *exempt CAD firm* that carries on any *regulated activity* other than *MiFID business* must also have and maintain at all times financial resources calculated in accordance with the chapter of *IPRU(INV)* to which the *firm* is otherwise subject (Chapters 3 or 5) at least equal to the requirements set out in the relevant chapter (except that if the only *designated investment business* an *exempt CAD firm* is carrying on in addition to *investment services and activities* is *making arrangements with a view to transactions in investments* (article 25(2) *Regulated Activities Order*) or agreeing to carry on that *regulated activity* or both, it only needs to comply with requirements set out in this chapter and not chapters 3 or 5).

FCA

*Initial capital and professional indemnity insurance requirements – exempt CAD firms that are not IMD insurance intermediaries*

9.2.4 R (1) An *exempt CAD firm* which is not an *IMD insurance intermediary* must have:

FCA

- (a) *initial capital* of €50,000; or
- (b) professional indemnity insurance covering the whole territory of the *EEA* or some other comparable guarantee against liability arising from professional negligence, representing at least €1,000,000 applying to each claim and in aggregate €1,500,000 per year for all claims; or

- (c) a combination of *initial capital* and professional indemnity insurance in a form resulting in a level of coverage equivalent to (a) or (b).

[Note: Article 67(3) of *MiFID* and Article 7 of *CAD*]

- (2) If a *firm* chooses to meet the requirements of either (b) or (c) above, it must nevertheless have *initial capital* of at least £5,000.

*Initial capital and professional indemnity insurance requirements – exempt CAD firms that are also IMD insurance intermediaries*

9.2.5

FCA

- R (1) A *exempt CAD firm* that is also an *IMD insurance intermediary* must comply with the professional indemnity insurance requirements at least equal to those set out in 9.2.4R(1)(b) (except that the minimum *limits of indemnity* are at least €1,120,200 for a single claim and €1,680,300 in aggregate) and in addition has to have:
  - (a) *initial capital* of €25,000; or
  - (b) professional indemnity insurance covering the whole territory of the *EEA* or some other comparable guarantee against liability arising from professional negligence, representing at least €500,000 applying to each claim and in aggregate €750,000 per year for all claims; or
  - (c) a combination of *initial capital* and professional indemnity insurance in a form resulting in a level of coverage equivalent to (a) or (b).

[Note: Article 67(3) of *MiFID* and Article 8 of *CAD*]

- (2) If a *firm* chooses to meet the requirements of either (b) or (c) above, it must nevertheless have *initial capital* of at least £5,000.

9.2.5A

FCA

- G Article 4(7) of the *Insurance Mediation Directive* requires the *limits of indemnity* to be reviewed every five years to take into account movements in European consumer prices. These *limits* will therefore be subject to further adjustments on the basis of index movements advised by the European Commission.

9.2.6

FCA

- G A trade-off between *initial capital* and professional indemnity insurance is appropriate such that €1 of *initial capital* is the equivalent of professional indemnity insurance cover of €20 for a single claim against the *firm* and €30 in aggregate.

*Comparable guarantee*

9.2.7

FCA

- R (a) If another *authorised person* which has net tangible assets of more than £10 million provides a comparable guarantee, an *exempt CAD firm* can treat it as an alternative to effecting or maintaining professional indemnity insurance pursuant to the rules relating to professional indemnity insurance above.
- (b) If the *exempt CAD firm* is a member of a *group* in which there is an *authorised person* with net tangible assets of more than £10 million, the comparable guarantee must be from that *person*.

- (c) A comparable guarantee means a written agreement on terms at least equal to those required by the *initial capital* and professional indemnity insurance requirements above to finance the claims that might arise as a result of the breach by the *exempt CAD firm* of its duties under the *regulatory system* or civil law.

*Initial capital and ongoing capital requirements for local firms*

9.2.8 R A *local firm* must:

FCA

- (a) have *initial capital* of €50,000; and
- [Note: Article 67(2) of *MiFID* and Article 6 of *CAD*]
- (b) maintain *own funds* calculated in accordance with the *rules* relating to *own funds* in 9.5, at least to the requirement for *initial capital*.

*Ongoing capital requirements*

9.2.9 R (1) An *exempt CAD firm* must, at all times, maintain a combination of professional indemnity insurance and *own funds*, (*own funds* to be calculated in accordance with (2)), at least equal to the requirements in this chapter for professional indemnity insurance and *initial capital*.

FCA

- (2) (a) If the *exempt CAD firm* is an *investment management firm* its *own funds* must be calculated in accordance with the *rules* in *IPRU(INV)* 5.2.1(1) to 5.2.7(5).
- (b) If the *exempt CAD firm* is a *securities and futures firm* its *own funds* must be calculated in accordance with the *rules* relating to *own funds* in 9.5.

### 9.3 CALCULATING INITIAL CAPITAL

*Initial capital*

9.3.1 R A *firm's initial capital* consists of the sum of the following items:

FCA

- (1) ordinary *share* capital which is fully paid;
- (2) perpetual non-cumulative *preference share* capital which is fully paid;
- (3) *share* premium account;
- (4) reserves excluding revaluation reserves;
- (5) audited retained earnings;

- (6) externally *verified* interim net profits;
- (7) partners' capital;
- (8) *eligible LLP members' capital* (in accordance with the provisions of *IPRU(INV)* Annex A); and
- (9) *sole trader* capital.

*Perpetual noncumulative preference share capital*

- 9.3.2 R A *firm* may include *preference share capital* in *initial capital* only where any *coupon* on it is not cumulative, and the *firm* is under no obligation to pay a *coupon* in any circumstances.

FCA

*Audited retained earnings*

- 9.3.3 R When calculating *initial capital*, a *firm* may include its audited retained earnings only after making the following adjustments:

FCA

- (1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;
- (2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;
- (3) a *firm* must not include any unrealised gains from investment property (these should be reported as part of revaluation reserves);
- (4) where applicable, a *firm* must deduct any asset in respect of *deferred acquisition costs* and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

*Externally verified interim net profits or current account*

- 9.3.4 R A *firm* may include interim net profits or current account when calculating *initial capital* to the extent that they have been *verified* by the *firm's* external auditor and are net of any foreseeable tax, dividend and other appropriations.

FCA

- 9.3.5 R When calculating *initial capital*, a *firm* may include its partners' capital only after making the following adjustments:

FCA

- (1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;
- (2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;
- (3) where applicable, a *firm* must deduct any asset in respect of *deferred acquisition costs* and add back in any liability in respect

of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

*Defined benefit pension scheme: defined benefit liability*

9.3.6 R For the calculation of *initial capital*, a firm may substitute for a *defined benefit liability* the firm's *deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

FCA

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

FCA

## 9.4 POLICY TERMS FOR PROFESSIONAL INDEMNITY INSURANCE

*Insurers whose professional indemnity insurance policies can be used by an exempt CAD firm*

9.4.1 R An *exempt CAD firm* that has professional indemnity insurance in accordance with this chapter must take out and maintain professional indemnity insurance that is at least equal to the requirements of the rule below from:

FCA

- (1) an *insurance undertaking* which is authorised to transact professional indemnity insurance in the EEA; or
- (2) a person of equivalent status in:
  - (a) a *Zone A country*;
  - (b) the Channel Islands, Gibraltar, Bermuda or the Isle of Man.

*Terms to be incorporated in the professional indemnity insurance policy*

9.4.2 R The policy of professional indemnity insurance must incorporate terms which make provision for:

FCA

- (1) cover in respect of claims for which an *exempt CAD firm* may be liable as a result of the conduct of itself, its *employees* and its *appointed representatives* or where applicable, its *tied agent* (acting within the scope of their appointment);
- (2) the minimum *levels of indemnity* per year as set out in the rules relating to professional indemnity insurance above;
- (3) appropriate cover in respect of legal defence costs; and
- (4) cover in respect of *Ombudsman* awards made against the *exempt CAD firm*.

*Policies in other currencies*

9.4.3 R If a professional indemnity insurance policy is denominated in any currency other than euros, an *exempt CAD firm* must take reasonable

FCA

steps to ensure that the *limits of indemnity* are, when the policy is effected and at *renewal*, at least equivalent to those required for the purposes of the rules relating to professional indemnity insurance above.

*Conditions and exclusions*

- 9.4.4 R A professional indemnity insurance policy must not be subject to conditions or exclusions which unreasonably limit the cover provided (whether by exclusion of cover, by policy excesses or otherwise).

FCA

9.5 CALCULATION OF OWN FUNDS

- 9.5.1 R A firm's initial capital:

FCA

minus the sum of the items set out against **B**

plus the sum of the items set out against **C**

minus material holdings in credit and financial institutions and material insurance holdings

equals own funds.

- 9.5.2 R Table

FCA

The table forms part of *rule 9.5.1R*

(1)	Investments in own shares at book value	<b>B</b>
(2)	Intangible assets	
(3)	Material current year losses	
(1)	Revaluation reserves	<b>C</b>
(2)	Perpetual cumulative preference share capital	
(3)	Long-term subordinated loans	
(4)	Perpetual long-term subordinated loans	
(5)	Fixed term preference share capital	

*Perpetual long-term subordinated loans and perpetual cumulative preference share capital*

- 9.5.3 R Perpetual long-term subordinated loans and perpetual cumulative preference share capital may not be included in the calculation of own funds unless they meet the following requirements:

FCA

- (1) it may not be reimbursed on the holder's initiative or without the

prior agreement of the *FCA*;

- (2) the instrument must provide for the *firm* to have the option of deferring the dividend payment on the share capital;
- (3) the shareholder's claims on the *firm* must be wholly subordinated to those of all non-subordinated creditors;
- (4) the terms of the instrument must provide for the loss-absorption capacity of the share capital and unpaid dividends, whilst enabling the *firm* to continue its business; and
- (5) it must be fully paid-up.

*Subordinated loans*

9.5.4 R A *firm* may include a subordinated loan in the calculation of its *own funds* only:

FCA

- (a) if it is drawn up in accordance with the standard forms obtained from the *FCA*;
- (b) if it is signed by authorised signatories of all the parties; and
- (c) to the extent that it is fully paid up.

*Long-term subordinated loans*

9.5.5 R A long-term subordinated loan may not be included in the calculation of *own funds* unless it meets the following requirements:

FCA

- (1) it must be fully paid-up;
- (2) it has an original maturity of at least five years;
- (3) the extent to which it may be used in the calculation of *own funds* shall be amortised on a straight line basis during at least the five years before repayment; and
- (4) it must not become repayable before the agreed repayment date other than in the winding-up of the *firm* or unless the *firm* has provided the *FCA* with at least five years' written notice.

9.5.6 R A *firm* must not (except in accordance with the terms of the loan) make any payment of interest if after such action the *firm's own funds* will fall below 120% of its *own funds requirement*.

FCA

*Perpetual noncumulative and cumulative preference share capital*

9.5.7 R A *firm* may include perpetual non-cumulative and cumulative preference share capital in its *initial capital* and its *own funds* only if there is an agreement between the *firm* and the shareholders which provides that redemption of the shares may not take place, if after such redemption the *firm* would be in breach of its *own funds requirement*.

FCA

*Own funds - Restrictions*

9.5.8 R (1) In calculating *own funds*:

FCA

- (i) the total amount of revaluation reserves, perpetual cumulative preference *share* capital, long-term subordinated loans, perpetual long-term subordinated loans and fixed term preference *share* capital must not exceed 100% of *initial capital* minus B; and
- (ii) the total amount of fixed term preference *share* capital and long-term subordinated loans must not exceed 50% of *initial capital* minus B.

## 9.6 NON-FINANCIAL RESOURCE REQUIREMENTS

*Reconciliation of balances*

9.6.1 R (1) A *firm* must reconcile all balances and positions with:

FCA

- (a) *banks* and *building societies* (other than a client bank account subject to the *client money rules*), *exchanges*, *approved exchanges*, *clearing houses* and *intermediate brokers*; and
- (b) *eligible counterparties* which are members of an *exchange* or *approved exchange*

as recorded by the *firm* to the balance or position on a statement or circularisation obtained by the *firm* from those entities and must correct any differences by agreement on a timely basis, unless:

- (i) the balances and positions due to and from the *eligible counterparty* have been agreed by other means; or
  - (ii) it arises solely as a result of identified differences in timing between the records of the *firm* and the *bank* or *building society*.
- (2) A *firm* must perform reconciliations under (1) above as frequently as is appropriate for the volume of transactions on the accounts and in any event not less than once every five weeks or, in relation to positions with *eligible counterparties*, not less than once every year.
- (3) A *firm* must circularise or request statements from *banks*, *building societies*, *exchanges*, *approved exchanges*, *clearing houses*, *intermediate brokers* and *eligible counterparties* which are members of an *exchange* or an *approved exchange* in good time in order to be able to comply with (1) and (2) above.

- (4) **A firm must use its best endeavours to respond within one month of receipt to any circularisation from another firm requesting confirmation of outstanding balances.**

9.6.2 G For guidance notes on the reconciliation of a firm's balance with market counterparties see Appendix 20 to Chapter 3.

**FCA**

***Financial notification***

9.6.3 R **A firm must notify the FCA in writing as soon as it has reason to believe that it is in breach of its own funds requirement.**

**FCA**

## Appendix 9(1): Interpretation

### FCA

#### Glossary of defined terms for Chapter 9

Note: If a defined term does not appear in the glossary below, the definition appearing in the Handbook Glossary applies.

<i>approved exchange</i>	means an investment exchange listed as such in Appendix 33 to <i>IPRU(INV)</i> 3.
<i>exchange</i>	means a <i>recognised investment exchange</i> or <i>designated investment exchange</i> .
<i>initial capital</i>	means the initial capital of a <i>firm</i> calculated in accordance with section 9.3.
<i>intangible assets</i>	the full balance sheet value of a <i>firm's</i> intangible assets including goodwill, capitalised development costs, licences, trademark and similar rights etc.
<i>intermediate broker</i>	in relation to a <i>margined transaction</i> , means any person through whom the <i>firm</i> undertakes that transaction.
<i>material current year losses</i>	means losses of an amount equal to 10% or more of <i>initial capital</i> minus B (with B calculated in accordance with Table 9.5.2R).
<i>material holding</i>	means a <i>firm's</i> holdings of <i>shares</i> and any other interest in the capital of a <i>credit institution</i> or <i>financial institution</i> :  (a) which exceeds 10% of the capital of the issuer, and, where this is the case, any holdings of subordinated debt of the same issuer, the full amount is a <i>material holding</i> ; or  (b) holdings not deducted under (a) if the total amount of such holdings exceeds 10% of that <i>firm's own funds</i> , in which case only the excess amount is a <i>material holding</i> .
<i>material insurance holdings</i>	(a) means the holdings of an <i>exempt CAD firm</i> of items of the type set out in (b) in any:  (i) <i>insurance undertaking</i> ; or  (ii) <i>insurance holding company</i>  that fulfils one of the following conditions:  (iii) it is a <i>subsidiary undertaking</i> of that <i>firm</i> ; or  (iv) that <i>firm</i> holds a participation in it.  (b) An item falls into this provision for the purpose of (a) if it is:  (i) an <i>ownership share</i> ; or  (ii) subordinated debt or another item of capital that falls into Article 16(3) of the First Non-Life Directive or, as applicable, Article 27(3) of the Consolidated Life Directive.
<i>own funds</i>	means the own funds of a <i>firm</i> calculated in accordance with 9.2.9R(2) and

9.2.8R(b).

*own funds  
requirement*

means the requirement set out in 9.2.9R(1) and 9.2.8R(b).

*verified*

means checked by an external auditor who has undertaken at least to:

- (a) satisfy himself that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records;
- (b) review the accounting policies used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the *firm* in drawing up its annual financial statements and are in accordance with the relevant accounting principles;
- (c) perform analytical procedures on the result to date, including comparisons of actual performance to date with budget and with the results of prior period(s);
- (d) discuss with management the overall performance and financial position of the *firm*;
- (e) obtain adequate comfort that the implications of current and prospective litigation, all known claims and commitments, changes in business activities and provisioning for bad and doubtful debts have been properly taken into account in arriving at the interim profits; and
- (f) follow up problem areas of which he is already aware in the course of auditing the *firm's* financial statements.



## 13 Chapter 13: Financial Resource Requirements for Personal Investment Firms

### APPLICATION, GENERAL REQUIREMENTS AND PROFESSIONAL INDEMNITY INSURANCE REQUIREMENTS

- 13.1.1 R (1) This chapter applies to a *firm* which is a *personal investment firm*.
- FCA
- (2) For a *personal investment firm* which is an *exempt CAD firm*, the following apply:
- (a) sections 13.1 and 13.1A; and
  - (b) if it is not an *opted-in exempt CAD firm*, sections 13.2 to 13.8; or
  - (c) if it is an *opted-in exempt CAD firm*, sections 13.9 to 13.12 (but reading references to *category B firm* as references to the *firm*).
- (3) For a *personal investment firm* which is a *category B firm*, section 13.1 and sections 13.9 to 13.12 apply.

### PURPOSE

- 13.1.2 G This chapter amplifies *threshold condition* 2D or 3C as applicable (Adequate resources) by providing that a *firm* must meet, on a continuing basis, a basic solvency requirement and a minimum capital resources requirement. This chapter also amplifies *Principles* 3 and 4 which require a *firm* to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems and to maintain adequate financial resources by setting out capital resources for a *firm* according to the *regulated activity* or activities it carries on.
- FCA
- 13.1.3 G Although financial resources and appropriate systems and controls can generally mitigate operational risk, professional indemnity insurance has a role in mitigating the risks a *firm* faces in its day-to-day operations, including those arising from not meeting the legally required standard of care when *advising on investments*. The purpose of the *rules* in this section is also to ensure that a *firm* has in place the type, and level, of professional indemnity insurance necessary to mitigate these risks. This includes, in the case of a *UK firm* exercising an *EEA right*, cover for breaches of obligations imposed by or under laws, or provisions having the force of law, in each *EEA State* in which the *firm* carries on business.
- FCA

### GENERAL REQUIREMENTS

- 13.1.4 R A *firm* must at all times:
- FCA
- (1) have and maintain capital resources of the kinds and amounts specified in, and calculated in accordance with, the *rules* of this

chapter; and

- (2) be able to meet its liabilities as they fall due.

#### REQUIREMENT TO HOLD PROFESSIONAL INDEMNITY INSURANCE

13.1.5 R A *firm* must take out and maintain at all times professional indemnity insurance that is at least equal to the requirements in this section from:

FCA

- (1) an *insurance undertaking* which is authorised to transact professional indemnity insurance in the *EEA*; or
- (2) a *person* of equivalent status in:
- (a) a Zone A country;
- (b) the Channel Islands, Gibraltar, Bermuda or the Isle of Man.

[Note: Article 4(3) of the *Insurance Mediation Directive*]

13.1.6 R An *exempt CAD firm* is not required to effect and maintain professional indemnity insurance unless it chooses this option (see 13.1A).

FCA

#### COMPARABLE GUARANTEE

13.1.7 R (1) A *firm* is not required to effect or maintain professional indemnity insurance if a *bank*, *building society* or an *insurer* provides the *firm* with a comparable guarantee.

FCA

- (2) If the *firm* is a member of a *group* in which there is a *bank*, *building society* or an *insurer*, the *firm's* comparable guarantee must be from that *bank*, *building society* or *insurer*.
- (3) A comparable guarantee means an enforceable, written agreement on terms at least equal to those required by *IPRU(INV)* 13.1.9R to 13.1.13R, as appropriate.

13.1.8 R The term "relevant income" in this section refers to all income received or receivable which is commission, brokerage, fees or other related income, whether arising from the *firm's permitted activities* or not, for the last accounting year prior to inception or renewal of the professional indemnity insurance policy ("the policy").

FCA

#### POLICY TERMS

13.1.9 R The policy must incorporate terms which are appropriate and must make provision for cover in respect of any claim for loss or damage, for which the *firm* may be liable as a result of an act or omission by:

FCA

- (1) the *firm*; or
- (2) any *person* acting on behalf of the *firm* including *employees*, *appointed representatives* or its other agents;

#### LIMITS OF INDEMNITY

13.1.10 R If the *firm* is an *IMD insurance intermediary*, whether or not it is also an *exempt CAD firm*, the appropriate minimum *limits of indemnity* per year are no lower than:

FCA

- (1) €1,120,200 for a single claim against the *firm*; and
- (2) €1,680,300 in the aggregate

[Note: Article 4(3) of the *Insurance Mediation Directive*]

13.1.11 R If the *firm* is an *exempt CAD firm* that maintains professional indemnity insurance under 13.1A.3(1)(b), the appropriate minimum *limits of indemnity* per year are no lower than:

FCA

- (1) €1,000,000 for a single claim against the *firm*; and
- (2) €1,500,000 in the aggregate;

[Note: Article 67(3) of *MiFID* and Article 7 of *CAD* (see also rule 13.1A.3)]

13.1.12 R If the *firm* is both an *IMD insurance intermediary* and an *exempt CAD firm* that maintains professional indemnity insurance under 13.1A.4(1)(b), the appropriate additional *limits of indemnity* to 13.1.10R per year are no lower than:

FCA

- (1) € 500,000 for a single claim against the *firm*; and
- (2) € 750,000 in the aggregate.

[Note: Article 67(3) of *MiFID* and Article 8 of *CAD* (see also rule 13.1A.4)]

13.1.13 R If the *firm* is not an *IMD insurance intermediary* or an *exempt CAD firm*, then the following *limits of indemnity* apply:

FCA

- (1) if the *firm* has relevant income of up to £3,000,000, no lower than £500,000 for a single claim against the *firm* and £500,000 in the aggregate; or
- (2) if the *firm* has relevant income of more than £3,000,000, no lower than £650,000 for a single claim against the *firm* and £1,000,000 in the aggregate.

13.1.14 G Article 4(7) of the *Insurance Mediation Directive* requires the *limits of indemnity* to be reviewed every five years to take into account movements in European consumer prices. These *limits* will therefore be subject to further adjustments on the basis of index movements advised by the European Commission.

FCA

- 13.1.15 R If a policy is denominated in any currency other than euros, a *firm* must take reasonable steps to ensure that the *limits of indemnity* are, when the policy is effected (i.e. agreed) and at renewal, at least equivalent to those denominated in euros.
- FCA**
- 13.1.16 G A *firm* should consider whether the overall cover is adequate taking account of 13.1.22G(2) and whether the *firm* should seek additional cover or legal expenses insurance. (Legal defence costs are costs of defence against claims that fall under the terms of the policy.)
- FCA**
- 13.1.17 G The cover provided by the policy should be wide enough to include the liability of the *firm*, its *appointed representatives*, its *tied agents*, *employees* and its agents for breaches under the *regulatory systems* or civil law. If the *firm* operates outside the *United Kingdom* then the policy should cover other regulatory requirements imposed under the laws of other countries in which the *firm* operates.
- FCA**

### POLICIES PROVIDING FOR MORE THAN ONE FIRM

- 13.1.18 R If the policy provides cover to more than one *firm* then:
- FCA**
- (1) The relevant income for calculating the *limits of indemnity* is that of all the *firms* named in the policy combined;
  - (2) each *firm* named in the policy must have the benefit of the minimum *limits of indemnity* as required in this section; and
  - (3) each *firm* named in the policy must notify the *appropriate regulator* if the aggregate cover in the policy falls below the minimum *limits of indemnity*.

### LIMITS OF INDEMNITY - ADDITIONAL REQUIREMENTS

- 13.1.19 R In addition to the specific requirements in 13.1.9R to 13.1.13R, the policy must make provision for the following:
- FCA**
- (1) for a *firm* with relevant income of more than £6,000,000, the aggregate limit identified in the table below:

Relevant income is (£)		Minimum aggregate <i>limit of indemnity</i> (£)
more than	up to	
6,000,000	7,000,000	1,150,000
7,000,000	8,000,000	1,300,000
8,000,000	9,000,000	1,450,000
9,000,000	10,000,000	1,600,000
10,000,000	12,500,000	2,000,000
12,500,000	15,000,000	2,400,000

15,000,000	17,500,000	2,800,000
17,500,000	20,000,000	3,150,000
20,000,000	25,000,000	3,800,000
25,000,000	30,000,000	4,250,000
30,000,000	35,000,000	4,500,000
35,000,000	40,000,000	4,750,000
40,000,000	50,000,000	5,500,000
50,000,000	60,000,000	6,000,000
60,000,000	70,000,000	6,750,000
70,000,000	80,000,000	7,250,000
80,000,000	90,000,000	7,750,000
90,000,000	100,000,000	8,500,000
100,000,000	150,000,000	11,250,000
150,000,000	200,000,000	14,000,000
200,000,000	250,000,000	17,000,000
250,000,000	300,000,000	19,750,000
300,000,000	n/a	22,500,000

- (2) **full retroactive cover in respect of the kinds of liabilities described in 13.1.9R for claims arising from work carried out by the *firm*, or on its behalf, in the past; and**
- (3) **cover in respect of *Ombudsman* awards made against the *firm*.**

#### LIMITATIONS

- 13.1.20 R The policy must not be subject to conditions or exclusions which unreasonably limit its cover (whether by exclusion of cover, by policy excesses or otherwise).

FCA

#### EXCLUSIONS

- 13.1.21 R The policy must not:

FCA

- (1) **exclude any type of business or activity that has been carried out by the *firm* in the past or will be carried out by the *firm* during the time for which the policy is in force; or**
- (2) **exclude liabilities which are identified or crystallised as a result of regulatory action against the *firm* (either individually or as a**

**member of a class of *authorised persons*);**

**unless the *firm* holds additional capital resources, in accordance with 13.1.23R.**

13.1.22 G (1) The *FCA* considers it reasonable for a *firm's* policy to exclude cover for:

**FCA**

- (a) specific business lines if that type of business has not been carried out by the *firm* in the past and will not be carried out by the *firm* during the life of the policy; or
  - (b) specific claims that have been previously notified to the *firm's insurer* and claimed for under another policy.
- (2) The *FCA* does not consider it reasonable for a *firm's* policy to treat legal defence costs cover as part of the *limits of indemnity* if this reduces the cover available for any individual substantive claim.

### **ADDITIONAL CAPITAL RESOURCES - EXCLUSIONS**

13.1.23 R **The amount of additional capital resources that a *firm* must hold as a result of an exclusion under 13.1.21R should be calculated by referring to the *firm's* relevant income in the following table:**

**FCA**

Relevant income £000s		Minimum additional capital resources £000s (Notes 1 and 2)
more than	up to	
0	100	5
100	200	12
200	300	18
300	400	21
400	500	23
500	600	25
600	700	27
700	800	28
800	900	30
900	1,000	31
1,000	1,500	37
1,500	2,000	42

2,000	2,500	46
2,500	3,000	51
3,000	3,500	55
3,500	4,000	59
4,000	4,500	63
4,500	5,000	67
5,000	6,000	73
6,000	7,000	79
7,000	8,000	85
8,000	9,000	90
9,000	10,000	95
10,000	100,000	95y
100,000	n/a	950
Note 1 – For <i>firms</i> with relevant income of more than £10m but up to £100m value y is calculated by relevant income/ £10m.		
Note 2 – The calculation of a <i>firm's</i> capital resources is set out in sections 13.1A to 13.12 (see <i>rule</i> 13.1.1 for application of these sections to an <i>exempt CAD firm</i> and a <i>category B firm</i> ).		

- 13.1.24 G The *firm* should hold additional capital resources in excess of those minimum amounts set out in the table in 13.1.23R where the required amounts of additional capital resources provide insufficient cover, taking into account the *firm's* individual circumstances.
- FCA**

#### EXCESS LEVEL

- 13.1.25 R The policy must not make provision for payment by the *firm* of an excess on any claim of more than £5,000, unless the *firm* holds additional capital resources, in accordance with 13.1.27R.
- FCA**

- 13.1.26 R The reference to "excess" is to the highest excess level required to be paid under the policy unless that excess relates to a type of business that has not been carried out by the *firm* in the past. In those circumstances, the reference is to the next highest excess level required by the policy applicable to a type of business that has been carried out by the *firm* in the past.
- FCA**

#### ADDITIONAL CAPITAL RESOURCES - EXCESS

## 13.1.27 R

FCA

The amount of additional capital resources that a *firm* must hold where the policy's excess on any claim is more than £5,000 must be calculated by referring to the *firm's* relevant income and excess obtained in the following table:

All amounts are shown in £000s (Notes 1 and 2)

Relevant income is		Excess obtained, up to and including											
more than	up to	5	10	15	20	25	30	40	50	75	100	150	200 +
0	100	0	4	7	9	12	14	18	21	28	34	45	54
100	200	0	7	11	14	17	20	25	29	38	46	59	70
200	300	0	9	14	18	21	24	30	35	45	54	69	82
300	400	0	11	16	21	24	28	34	39	50	60	77	91
400	500	0	13	18	23	27	30	37	43	55	66	83	98
500	600	0	14	20	25	29	33	40	46	59	70	89	105
600	700	0	16	22	27	31	35	42	49	63	74	94	111
700	800	0	17	23	28	33	37	45	52	66	78	99	117
800	900	0	18	24	30	35	39	47	54	69	82	103	122
900	1,000	0	19	26	31	36	41	49	56	72	85	107	126
1,000	1,500	0	23	31	37	43	48	57	66	83	99	124	146
1,500	2,000	0	26	35	42	48	54	64	73	93	109	138	161
2,000	2,500	0	29	38	46	53	59	71	81	102	121	152	179
2,500	3,000	0	32	42	51	58	65	78	89	112	132	166	195
3,000	3,500	0	35	46	55	63	71	84	96	121	142	179	210
3,500	4,000	0	38	50	59	68	76	90	102	129	152	191	223
4,000	4,500	0	41	53	63	72	80	95	108	137	161	202	236
4,500	5,000	0	43	56	67	76	85	100	114	144	169	212	248
5,000	6,000	0	48	62	73	84	93	110	125	157	185	231	271
6,000	7,000	0	52	67	79	90	101	119	135	169	199	249	291
7,000	8,000	0	56	72	85	97	107	127	144	181	212	265	310
8,000	9,000	0	59	76	90	103	114	134	152	191	224	280	328
9,000	1,0000	0	63	80	95	108	120	141	160	201	236	294	344
10,000	1,0000 0	0	63 y	80 y	95y	108 y	120 y	141 y	160 y	201 y	236 y	294 y	344 y
100,000	n/a	0	63 0	80 0	950	108 0	120 0	141 0	160 0	201 0	236 0	294 0	344 0
Note 1 - For <i>firms</i> with relevant income more of £10m but up to £100m value y is calculated by relevant income/ £10m.													

Note 2 – The calculation of a *firm's* capital resources is set out in sections 13.1A to 13.12 (see *rule* 13.1.1 for application of these sections to an *exempt CAD firm* and a *category B firm*).

## NOTIFICATION REQUIREMENTS

- 13.1.28 R **A *firm* must notify the FCA immediately if it becomes aware, or has information which reasonably suggests, that any of the following matters in relation to its professional indemnity insurance has occurred, may have occurred or may occur in the foreseeable future:**
- FCA**
- (1) professional indemnity insurance cannot be obtained within 28 days of the inception or renewal date;
  - (2) professional indemnity insurance is cancelled;
  - (3) the amount of aggregate cover is exhausted;
  - (4) the *firm* commences business lines for which it had not obtained cover;
  - (5) the *firm* is relying on a policy cover for more than one *firm*; or
  - (6) the *firm* is relying on a comparable guarantee provided in accordance with the *rules* in this chapter.
- 13.1.29 G For the purposes of the provisions relating to professional indemnity insurance, “additional capital resources” means readily realisable *own funds*. The FCA expects items included in *own funds* to be regarded as “readily realisable” only if they can be realised, at any given time, within 90 days.
- FCA**

## 13.1A FINANCIAL RESOURCES REQUIREMENTS FOR AN EXEMPT CAD FIRM

### *Application*

- 13.1A.1 R This section applies to a *personal investment firm* which is an *exempt CAD firm*.

**FCA**

### *Initial capital and professional indemnity insurance requirements*

- 13.1A.2 R The financial resources requirement for a *personal investment firm* which is an *exempt CAD firm* is the higher of:

**FCA**

- (1) the requirement that is applied by section 13.1A; and
- (2) (a) the requirement that is applied by sections 13.2 to 13.8; or  
(b) if it is an *opted-in exempt CAD firm*, the requirement that is applied by sections 13.9 to 13.12 (but reading references to *Category B firm* as references to the *firm*).

- 13.1A.3 R (1) A *firm* which is not an *IMD insurance intermediary* must

FCA

have:

- (a) *initial capital* of €50,000; or
- (b) professional indemnity insurance at least equal to the requirements of 13.1.11R and 13.1.15R to 13.1.27R; or
- (c) a combination of *initial capital* and professional indemnity insurance in a form resulting in a level of coverage equivalent to (a) or (b).

[Note: Article 67(3) of *MiFID* and Article 7 of *CAD* (see also rule 13.1.11R)]

- (2) If a *firm* chooses to comply with either (b) or (c) above, it must nevertheless have *initial capital* of at least £10,000.

13.1A.4

R

- (1) A *firm* that is also an *IMD insurance intermediary* must have professional indemnity insurance at least equal to the limits set out in 13.1.10R and in addition has to have:

FCA

- (a) *initial capital* of €25,000; or
- (b) professional indemnity insurance at least equal to the requirements of 13.1.12R and 13.1.15R to 13.1.27R; or
- (c) a combination of *initial capital* and professional indemnity insurance in a form resulting in a level of coverage equivalent to (a) or (b).

[Note: Article 67(3) of *MiFID* and Article 8 of *CAD* (see also rule 13.1.12R)]

- (2) If a *firm* chooses to comply with either (b) or (c) above, it must nevertheless have *initial capital* of at least £10,000.

13.1A.5

G

A trade-off between *initial capital* and professional indemnity insurance is appropriate such that € 1 of *initial capital* is the equivalent of professional indemnity insurance cover of € 20 for a single claim against the *firm* and € 30 in aggregate.

FCA

*Initial capital*

13.1A.6

R

A *firm's initial capital* consists of the sum of the following items:

FCA

- (1) ordinary *share capital* which is fully paid;
- (2) perpetual non-cumulative *preference share capital* which is fully paid;
- (3) *share premium account*;
- (4) reserves excluding revaluation reserves;

- (5) audited retained earnings;
- (6) externally *verified* interim net profits;
- (7) partners' capital;
- (8) *eligible LLP members' capital* (in accordance with the provisions of IPRU(INV) Annex A); and
- (9) *sole trader* capital.

*Perpetual non-cumulative preference share capital*

13.1A.7 R A firm may include *preference share* capital in *initial capital* only where any *coupon* on it is not cumulative, and the *firm* is under no obligation to pay a *coupon* in any circumstances.

FCA

*Audited retained earnings*

13.1A.8 R When calculating *initial capital*, a *firm* may include its audited retained earnings only after making the following adjustments:

FCA

- (1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;
- (2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;
- (3) a *firm* must not include any unrealised gains from investment property (these should be reported as part of revaluation reserves);
- (4) where applicable, a *firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

*Externally verified interim net profits or current account*

13.1A.9 R A *firm* may include interim net profits or current account when calculating *initial capital* to the extent that they have been *verified* by the *firm's* external auditor and are net of any foreseeable tax, dividend and other appropriations.

FCA

13.1A.10 R When calculating *initial capital*, a *firm* may include its partners' capital only after making the following adjustments:

FCA

- (1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;
- (2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;

- (3) where applicable, a *firm* must deduct any asset in respect of *deferred acquisition costs* and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

*Defined benefit pension scheme: defined benefit liability*

13.1A.11 R For the calculation of *initial capital*, a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

FCA

13.1A.12 R A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FCA* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme*.

FCA

*Ongoing capital requirements*

13.1A.13 R A *firm* must, at all times, maintain a combination of professional indemnity insurance and *own funds*, at least equal to the requirements in this chapter for professional indemnity insurance and *initial capital*.

FCA

13.1A.14 R A *firm's initial capital*:

FCA

minus the sum of the items set out against **B**

plus the sum of the items set out against **C**

minus *material holdings* in *credit* and *financial institutions* and *material insurance holdings*

equals *own funds*.

13.1A.15 R Table 13.1A.15R

FCA

This table forms part of *rule 13.1A.14*

(1)	<i>Investments</i> in <i>own shares</i> at book value	<b>B</b>
(2)	Intangible assets	
(3)	<i>Material current year losses</i>	
(4)	Excess of current year drawings over current year profits	
(1)	Revaluation reserves	<b>C</b>
(2)	Perpetual cumulative preference <i>share capital</i> and <i>debt capital</i>	
(3)	Long-term subordinated loans (in accordance with <i>IPRU (INV) 13.5.5AR</i> )	
(4)	Fixed term preference <i>share capital</i> (if not	

	redeemable by shareholders within 5 years)	
--	--	--

***Perpetual cumulative preference share capital***

**13.1A.16 R** Perpetual cumulative preference *share* capital may not be included in the calculation of *own funds* unless it meets the following requirements:

**FCA**

- (1) it may not be reimbursed on the holder's initiative or without the prior agreement of the *FCA*;
- (2) the instrument must provide for the *firm* to have the option of deferring the dividend payment on the share capital;
- (3) the shareholder's claims on the *firm* must be wholly subordinated to those of all non-subordinated creditors;
- (4) the terms of the instrument must provided for the loss-absorption capacity of the share capital and unpaid dividends, whilst enabling the *firm* to continue its business; and
- (5) it must be fully paid-up.

***Own funds – Restrictions***

**13.1A.17 R** (1) In calculating *own funds*:

**FCA**

- (i) the total amount of revaluation reserves, perpetual cumulative preference *share* capital, long-term subordinated loans and fixed term preference *share* capital must not exceed 100% of *initial capital* minus the sum of the items set out against B; and
- (ii) the total amount of fixed term preference *share* capital and long-term subordinated loans must not exceed 50% of *initial capital* minus the sum of the items set out against B.

**13.2 FINANCIAL RESOURCES TESTS**

**13.2.1 R** An exempt CAD firm must meet:

**FCA**

- (1) [deleted]
- (2) Financial Resources Test 1A (the Adjusted *Net current assets* Test) calculated in accordance with section 13.4; and
- (3) Financial Resources Test 2 (the Expenditure-based Test) calculated in accordance with section 13.5.

13.2.2 G [deleted]

13.2.3 G Table 13A is a summary of the financial resources test for *exempt CAD firm*.

**FCA**

### Table 13.A

*This table forms part of guidance 13.2.3*

<b>SUMMARY OF FINANCIAL RESOURCES FOR EXEMPT CAD FIRMS</b>			
<b>Type of firm</b>	<b>Financial Resources Test 1A Adjusted <i>net current assets</i> Test</b>	<b>Financial Resources Test 2 Expenditure-based Test</b>	<b>Rules/section references</b>
<i>Exempt CAD firm</i>	Adjusted net current assets of £1	Financial resources equal to the highest of 4/52 of Relevant Annual Expenditure or 13/52 of Relevant Annual Expenditure without <i>special adjustments</i> or £400 per <i>adviser</i>	13.1A.14 13.4 13.5.1D and 13.5.2 to 13.5.4
<i>Exempt CAD firm which is a network</i>	Adjusted net current assets of £1	Financial resources equal to the higher of 13/52 of Relevant Annual Expenditure or £400 per <i>adviser</i>	13.1A.14 13.4 13.5.1B and 13.5.2 to 13.5.4

## 13.3 FINANCIAL RESOURCES TEST 1 – OWN FUNDS

13.3.1 R [deleted]

13.3.1A G [deleted]

13.3.2	R	[deleted]
13.3.2A	R	[deleted]
13.3.2B	G	[deleted]

Table 13.3.2(2)  
[deleted]

#### ALTERNATIVE TO FINANCIAL RESOURCES TEST 1

13.3.3	R	[deleted]
13.3.3A	R	[deleted]
13.3.3B	R	[deleted]

#### 13.4 FINANCIAL RESOURCES TEST 1A – ADJUSTED NET CURRENT ASSETS

13.4.1 R An *exempt CAD firm* must adjust its *net current assets* as follows:

FCA

- (1) exclude assets which cannot be realised or recovered within twelve months;
- (2) exclude amounts receivable from *connected persons* to the extent that they are not *properly secured*, except amounts that are *deposits* referred to at item (11) in Part I of table 13.5.4(1) or at item (11) in Part I of table 13.5.4(2);
- (3) value *investments* at current *market value*, using the *bid price* for a *net long position* in an investment and the *offer price* for a *net short position* in an investment;
- (4) where applicable, 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.

13.4.2 R An *exempt CAD firm* must at all times have adjusted *net current assets* of at least £1.

FCA

#### 13.5 FINANCIAL RESOURCES TEST 2 – EXPENDITURE-BASED REQUIREMENT

##### *Requirement*

13.5.1B R An *exempt CAD firm* which is a network must have financial resources calculated in accordance with whichever of (1), or (2) produces the

FCA

higher amount:

- (1) 13/52 of its relevant annual expenditure, calculated in accordance with *rule 13.5.2*; or
- (2) an amount equal to £400 multiplied by the number of its *advisers*.

13.5.1D R

FCA

- (1) [deleted]
- (2) An *exempt CAD firm* which is not permitted to carry on the activity of *managing investments* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3), (4) or (5) produces the highest amount.
- (3) Financial resources which taking into account all the *special adjustments* amount to 4/52 of its relevant annual expenditure calculated in accordance with *rules 13.5.2*; or
- (4) financial resources which disregarding all the *special adjustments* amount to 13/52 of its relevant annual expenditure, calculated in accordance with *rules 13.5.2*; or
- (5) financial resources taking into account all the *special adjustments* of an amount equal to £400 multiplied by the number of its *advisers*.

#### CALCULATION OF RELEVANT ANNUAL EXPENDITURE

13.5.2 R

FCA

- (1) An *exempt CAD firm* must calculate its relevant annual expenditure by reference to the amount described as total expenditure in its most recently prepared set of *annual financial statements*. If those statements were for a period other than 12 months, the amounts in the *firm's* profit and loss account must be adjusted proportionately.
- (2) Where an *exempt CAD firm* has just begun trading or has not been authorised long enough to submit such statements, the *firm* must calculate its relevant annual expenditure on the basis of forecast or other appropriate accounts submitted to the *FCA*.
- (3) An *exempt CAD firm* may, subject to *rule 13.5.3*, deduct from its total expenditure the items set out in table 13.5.2.

Table 13.5.2

This table forms part of *rule 13.5.2*

DEDUCTIONS FROM EXPENDITURE	
(a)	Staff bonuses (except to the extent that they are guaranteed);

- (b) *employees' and directors' shares* in profits (except to the extent that the amount is guaranteed);
- (c) other appropriations of profits;
- (d) shared commissions paid which are directly related to commissions received;
- (e) interest charges in respect of borrowing made to finance the acquisition of its *readily realisable investments*;
- (f) interest paid to *clients* on *client money*;
- (g) interest paid to *counterparties*;
- (h) fees, brokerage and other charges paid to *recognised clearing houses, exchanges and intermediate brokers* for the purposes of executing, registering or clearing transactions;
- (i) foreign exchange losses;
- (j) a *firm* must not deduct any exceptional expenditure.

- 13.5.2A G (1) Salaries of *directors* or partners are not eligible for deduction, except to the extent that they can be demonstrated to be non-fixed costs of the *firm*.
- FCA**
- (2) The deduction in item (c) is intended to cover forms of remuneration, other than those set out in (b), that are not fixed or guaranteed.

#### ADJUSTMENTS TO CALCULATION OF RELEVANT ANNUAL EXPENDITURE

- 13.5.3 R **A *firm* must ensure that the expenditure base properly reflects the ongoing annual operating costs of the *firm* by having proper regard to its circumstances when deciding whether to include or exclude any item of expenditure or to make any other adjustment to the calculation of relevant annual expenditure.**
- FCA**

- 13.5.3A G In *rule* 13.5.3 the *FCA* would expect a *firm* to take proper account of the effect of, for example, the ongoing annual operating costs of the *firm* being met by another party, or of a significant change in the structure of the *firm's* business during the year.
- FCA**

#### CALCULATION OF FINANCIAL RESOURCES TO MEET TESTS 1, 1A OR 2

- 13.5.4 R **An *exempt CAD firm* must be able to calculate its financial resources at any time on the basis of the balance sheet it could draw up at that time. For this purpose:**
- FCA**
- (1) [deleted]
  - (2) **An *exempt CAD firm* must, adjust the assets in the balance sheet as specified in table 13.5.4(2) and include the liabilities after making the adjustments specified in table 13.5.4(2).**

- (3) the assets and liabilities in the balance sheet are also subject to the following adjustments:
- (a) a *firm* must deduct any unrealised gains or, where applicable, back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
  - (b) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined business asset*;
  - (c) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year;
  - (d) where applicable, a *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.

Table 13.5.4(2) Part I

FCA

This table forms part of *rule 13.5.4*

EXEMPT CAD FIRM		
ASSETS	CALCULATION	TYPE OF ADJUSTMENT
(1) Land and Buildings	Exclude in full. (A loan secured by a charge on land and buildings may be deducted from liabilities in accordance with item (14) of Part II of this table.	An Illiquid Adjustment
(2) <i>Investments</i>	Exclude in full the value of <i>shares in connected companies</i> .  Include any <i>net long position</i> in any fixed or current asset investment  (a) valued at its current <i>bid price</i> (or, in the case of a with profits <i>life policy</i> , at its surrender value), and  (b) discounted by the applicable percentage specified in table 13.5.4A.	An Illiquid Adjustment  A Position Risk Adjustment
(3) <i>Investments</i> subject to Repurchase, Reverse	Include <i>investments</i> for which the <i>firm</i> has entered as principal into a repurchase, reverse repurchase, stock borrowing or stock lending transaction.	A Position Risk Adjustment  A Counterparty

Repurchase, Stock Borrowing or Stock Lending transactions	<p>after making (I) a deduction in accordance with item (2), and (II) a deduction calculated by</p> <p>(a) computing the <i>firm's</i> exposure (the difference between the <i>market value</i> of the <i>securities</i> and the loan or collateral (including accrued interest) where that difference is not in the <i>firm's</i> favour, after adjusting for any excess collateral), and</p> <p>(b) multiplying that exposure by the applicable percentage in table 13.5.4C.</p>	Risk Adjustment
(4) Debtors relating to Unsettled Securities Transactions - Cash against Documents	<p>Include debtors where the <i>firm</i> has entered into a transaction in <i>securities or units in collective investment schemes</i> as agent on a cash against documents basis and the transaction remains unsettled, after deducting an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i> where that difference is not in the <i>firm's</i> favour, and</p> <p>(b) multiplying that difference by the applicable percentage specified in table 13.5.4B.</p>	A Counterparty Risk Adjustment
(5) Debtors relating to Unsettled Securities Transactions – Free Deliveries	<p>Where the <i>firm</i> has delivered <i>securities or units in collective investment schemes</i> before receiving payment for them, or paid for such <i>investments</i> before receiving certificates of good title for them, and not more than 3 days have passed since delivery, include debtors after deducting an amount calculated by</p> <p>(a) (i) (where the <i>firm</i> has delivered them) computing the full amount due to a <i>firm</i> under the contract;</p> <p>(ii) (where the <i>firm</i> has paid for them) computing their current <i>market value</i>; and</p> <p>(b) multiplying the amount or value at (a) by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude debtors if more than 3 days have passed since delivery.</p>	A Counterparty Risk Adjustment An Illiquid Adjustment
(6) <i>Regulated collective investment</i>	Include an amount owing in respect of a transaction in <i>units</i> in a <i>regulated</i>	A Counterparty Risk Adjustment

<i>schemes</i>	<p><i>collective investment scheme</i> only</p> <p>(a) if the amount has been due and unpaid for less than 90 days after the settlement date of the transaction to which it relates, and</p> <p>(b) after discounting that amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude amounts that have been due and unpaid for more than 90 days.</p>	An Illiquid Adjustment
(7) Debts of <i>group</i> or <i>connected companies</i>	<p>Include an amount due from <i>group</i> or <i>connected companies</i> (which does not relate to trade debts)</p> <p>(a) where the <i>firm</i> has no reason to doubt that it will be repaid in full on demand, and</p> <p>(b) after discounting the amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude an amount that the <i>firm</i> has reason to doubt will be repaid in full on demand.</p>	A Counterparty Risk Adjustment An Illiquid Adjustment
(8) Debtors	<p>Include amounts due from debtors (including <i>group</i> or <i>connected companies</i>) which have been due and unpaid for less than 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude amounts that have been due and unpaid for more than 90 days.</p>	A Counterparty Risk Adjustment An Illiquid Adjustment
(9) Prepayments	<p>Include the amount of prepayments which relate to goods or services to be received or performed within 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude the amount of prepayments relating to more than 90 days.</p>	A Counterparty Risk Adjustment An Illiquid Adjustment
(10) Accrued income	<p>Include accrued income, including any such income not yet due and receivable in respect of fees earned in the performance of <i>investment management</i> services that is receivable within 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude accrued income receivable</p>	A Counterparty Risk Adjustment An Illiquid Adjustment

	after 90 days.	
(11) <i>Deposits</i>	<p>Include amounts in respect of</p> <p>(a) cash and balances on current accounts and on <i>deposit</i> accounts with an <i>approved bank</i> or National Savings Bank which can be withdrawn within 90 days;</p> <p>(b) money on <i>deposit</i> with a UK local authority which can be withdrawn within 90 days;</p> <p>(c) money <i>deposited</i> and evidenced by a certificate of tax <i>deposit</i>.</p> <p>Exclude amounts which can only be withdrawn after 90 days.</p>	An Illiquid Adjustment
(12) Other amounts due from Government bodies or local authorities	<p>Include other amounts due from UK Government bodies or local authorities if they are agreed and due within 90 days, after discounting the amounts by the applicable percentage specified in table 13.5.4C.</p> <p>Exclude amounts that are not due to be paid within 90 days.</p>	<p>A Counterparty Risk Adjustment</p> <p>An Illiquid Adjustment</p>
(13) All other assets	<p>Exclude in full.</p> <p>If not otherwise excluded in full in this table, this category should include any holding in eligible capital instruments of an insurance undertaking, insurance holding company, or reinsurance undertaking that is a <i>subsidiary</i> or participation.</p> <p>Eligible capital instruments include ordinary share capital, cumulative preference shares, perpetual securities and long-term subordinated loans, that are eligible for insurance undertakings under PRU 2.</p>	An Illiquid Adjustment
Where applicable - <i>Large exposures</i>	Deduct an amount calculated in accordance with <i>rule</i> 13.6.2.	A <i>Large exposure</i> Adjustment

**Table 13.5.4(2) Part II**

FCA

**This table forms part of rule 13.5.4**

<b>EXEMPT CAD FIRM</b>		
<b>LIABILITY</b>	<b>CALCULATION</b>	<b>TYPE OF ADJUSTMENT</b>
(14) Secured Liabilities	<p>Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced by the smallest of the following amounts:</p> <p>(a) the aggregate amount of the <i>firm's</i> secured liabilities which are due more than one year after the balance sheet date;</p> <p>(b) (if the land and buildings have been valued by an independent professional valuer within the past 18 months) 85% of the amount certified by the valuer as their <i>market value</i>; and</p> <p>(c) 85% of the net book value of land and buildings.</p>	An Illiquid Adjustment
(15) Subordinated loans	<p>Include in full except any long term or short term subordinated loan in the standard form prescribed by the <i>FCA</i> which may be treated as capital up to the limits specified in <i>SUP</i> 16.</p>	
(16) Commission on indemnity terms from the sale of <i>life policies</i> or <i>pension contracts</i>	<p>Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the <i>firm</i> has received on indemnity terms during the previous twelve months. This provision must be reasonable having regard to the <i>firm's</i> circumstances and, in particular, its previous lapse ratio.</p>	An Illiquid Adjustment

(17) <i>Investments</i> (Short Positions)	Include a <i>net short position</i> (a) valued at its <i>offer price</i> , and (b) increased by the applicable percentage specified in table 13.5.4A.	A Position Risk Adjustment
(18) Deficiency in <i>subsidiary</i>	Include as a liability the amount by which the liabilities of any <i>subsidiary</i> (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the <i>firm</i> has not already made such a provision elsewhere in its financial statements.	An Illiquid Adjustment
(19) Liability for tax	Include as a liability a provision for taxation on the whole of the profits of its business up to its balance sheet date.	An Illiquid Adjustment
(20) Creditors relating to Unsettled <i>Securities</i> Transactions Cash against Documents	Include creditors where a <i>firm</i> has entered into a transaction in <i>securities</i> or <i>units in collective investment schemes</i> as agent on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by  (a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i> , and  (b) multiplying that exposure by the applicable percentage specified in table 13.5.4B.	A Counterparty Risk Adjustment
(21) Creditors relating to Unsettled <i>Securities</i> Transactions Free Deliveries	Include an amount for creditors where (acting as agent) the <i>firm</i> has delivered certificates of title for <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or where the <i>firm</i> has bought such <i>investments</i> before	A Counterparty Risk Adjustment

	<p>receiving certificates of good title for them, after adding an amount calculated by</p> <p>(a) (i) (where the <i>firm</i> has paid for them but not received certificates of good title for them) computing their current <i>market value</i>;</p> <p>(ii) (where the <i>firm</i> has delivered the certificates without receiving payment for them) computing the full amount due to a <i>firm</i> under the contract for sale; and</p> <p>(b) multiplying that exposure by the applicable percentage specified in table 13.5.4C.</p>	
(22) <i>Over the counter derivatives</i>	<p>Include as a liability an amount for its positions in such <i>derivatives</i> calculated by</p> <p>(a) computing the credit equivalent of those positions in accordance with table 13.5.4D, and</p> <p>(b) increasing that credit equivalent by the applicable percentage specified in table 13.5.4C, (in addition to making an adjustment in accordance with item (17) of this table and (in respect of bought <i>OTC</i> equity <i>options</i> and covered <i>warrants</i>) in accordance with item (25)).</p>	A Counterparty Risk Adjustment
(23) Contingent Liabilities	A <i>firm</i> must include a provision for any contingent liabilities which exist at its balance sheet date that must be made.	An Illiquid Adjustment
(24) Preference <i>Shares</i>	Include as a liability any amounts in excess of the amounts which may be treated as financial resources specified in table 13.3.2(2) and <i>SUP</i> 16.	
(25) <i>Net open foreign</i>	Include as a liability an	A Foreign Exchange Risk

<i>currency position</i>	amount in respect of its foreign exchange risk calculated in accordance with table 13.5.4E.	Adjustment
(26) All other liabilities	Include in full.	

**Table 13.5.4A**

**FCA**

**This table forms part of *rule 13.5.4***

<b>POSITION RISK</b>			
The percentages in the table are applied to the <i>market value</i> (unless otherwise stated) of gross positions, i.e. both longs and shorts in each category; netting and offsetting are prohibited. The long or short position in a particular investment is the net of any long or short positions held in that same investment.			
<b>INVESTMENT</b>	<b>DISCOUNT</b>		
A. Debt Central Government	<b>Maturity</b>		
	<b>0-2 years</b>	<b>2-5 years</b>	<b>&gt;5 years</b>
	2%	5%	13%
<i>Qualifying debt security:</i>			
- fixed rate	8%	8%	15%
- floating rate	10%	10%	15%
<i>Non-qualifying debt security:</i>			
- fixed rate	10%	20%	30%
- floating rate	30%	30%	30%
B. Equities			
- exchange traded	25%		
- other	100%		
C. <i>Derivatives</i>			
- exchange traded futures	4 x initial margin requirement		
- OTC <i>futures</i>	Apply the appropriate percentage shown in A and B to the <i>market value</i> of the underlying position		
- Purchased <i>options</i>	Apply the appropriate percentage shown in A and B to the <i>market value</i> of the underlying position but the <u>result may be limited to the <i>market value</i> of the</u>		

	option
- <i>Contracts for differences</i>	20% of the <i>market value</i> of the contract
<b>D. Other Investments</b>	
- <i>Units in regulated collective investment schemes</i>	25%
- units in higher volatility funds or property funds	50%
- with profit life policies	20% of <i>surrender value</i>
- other	100%

**Table 13.5.4B**

FCA

This table forms part of *rule 13.5.4*

<b>UNSETTLED SECURITIES TRANSACTIONS</b>	
Number of business days after due settlement date	Percentage
0 – 4	0
5 – 15	8
16 – 30	50
31 – 45	75
46 or more	100

**Table 13.5.4C**

FCA

This table forms part of *rule 13.5.4*

<b>COUNTERPARTY RISK</b>	
Type of Counterparty	Deduction
A counterparty which is, or the contract of which is, explicitly guaranteed by: - the government or central bank of the <i>United Kingdom</i> or another <i>Zone A country</i> ; or	NIL

- the <i>European Economic Area</i> ; or - any other government or central bank, provided the exposure is denominated in that country's national currency.	
A counterparty which is, or the contract of which is, explicitly guaranteed by: - a local authority or regional government in the <i>United Kingdom</i> or another <i>Zone A country</i> ; or - a credit institution authorised in the <i>United Kingdom</i> or another <i>Zone A country</i> ; or - a recognised <i>clearing house</i> or recognised investment exchange; or - an <i>investment firm</i> or a comparable undertaking regulated by a <i>recognised third country</i> .	1.6%
Any other counterparty	8%

**Table 13.5.4D**

FCA

This table forms part of *rule 13.5.4*

OVER THE COUNTER DERIVATIVES		
a. By attaching current <i>market values</i> to contracts (marking to market), obtain the current replacement cost of all contracts with positive values.		
b. To obtain a figure for potential future credit exposure (except in the case of single currency "floating/floating interest rate swaps" in which only the current replacement costs will be calculated), multiply the notional principal amounts or values underlying the <i>firm's</i> aggregate positions by the following percentages:		
Residual Maturity	Interest Rate Contracts	Foreign Exchange Contracts
One year or less	Nil	1%
More than 1 year	More than 1 year	5%
c. The credit equivalent is the sum of current replacement cost and potential future credit exposure.		

**Table 13.5.4E**

FCA

This table forms part of *rule 13.5.4*

## FOREIGN EXCHANGE RISK

**(a) A firm must deduct a foreign exchange risk requirement for all the following items which are denominated in a foreign currency:**

- (i) all assets and liabilities, including accrued interest, denominated in the currency (all *investments* at market or realisable value);
- (ii) any currency future, at the nominal value of the contract;
- (iii) any forward contract for the purchase or sale of the currency, at the contract value, including any future exchange of principal associated with currency swaps;
- (iv) any foreign currency *options* at the net delta (or delta-based) equivalent of the total book of such *options*;
- (v) any non-currency option, at *market value*;
- (vi) any irrevocable guarantee;
- (vii) any other off-balance sheet commitment to purchase or sell an asset denominated in that currency.

**(b) The requirement must be calculated as follows:**

- (i) using the spot rate, convert the *net long position* and *net short position* in each foreign currency into the currency in which its *annual financial statements* are reported;
- (ii) total the *net open long positions* and the *net open short positions*;
- (iii) the higher of (i) and (ii) above is the *firm's net open foreign currency position*;
- (iv) multiply the *firm's net open foreign currency position* by 10%.

**(c) A firm may not include any future income or expense not yet accrued but fully hedged (subject to deduction of an appropriate risk requirement).**

## SUBORDINATED LOANS

**13.5.5 R An exempt CAD firm may treat a subordinated loan as a financial resource, as specified in table 13.1A.15R and subject to rule 13.5.5C, if the long term subordinated loan is eligible for such treatment in accordance with rule 13.5.5A.**

FCA

**13.5.5A R A long term subordinated loan is eligible for such treatment if:**

FCA

- (1) it is fully paid up;
- (2) it has an original maturity of at least five years, or where it has no fixed term, it is subject to five years' notice of repayment;
- (3) repayment, prepayment or termination is only permitted under the loan agreement:
  - (a) on maturity, or on expiration of the period of notice, if after such payment or termination a *firm* meets 120% of its financial resource requirement; or
  - (b) on winding up after the claims of all other creditors and all

outstanding debts have been settled;

- (4) the amount used in the calculation of its financial resources is reduced on a straight line basis over the last five years of its term;
- (5) it is in the standard form prescribed by the *appropriate regulator* for long term subordinated loans.

13.5.5C R The total amount of long term subordinated loans that an *exempt CAD firm* may include in the calculation of its financial resources is restricted as stipulated in 13.1A.17R and in *SUP 16*.

FCA

13.7.2B R An *exempt CAD firm* must, where it is *exposed* to undue risk in consequence of its membership of a *group*, provide against, reduce or eliminate that risk.

FCA

### 13.9 FINANCIAL RESOURCES TESTS FOR CATEGORY B FIRMS

13.9.1 R A *Category B firm* must meet:

FCA

- (1) financial Resources Test 1 (the *Own funds Test*) calculated in accordance with section 13.10;
- (2) Financial Resources Test 1A (the *Adjusted Net current assets Test*) calculated in accordance with section 13.11, unless the *firm* is a *low resource firm* which is not permitted to carry on the activity of *managing investments* in respect of portfolios containing only *life policies*; and
- (3) Financial Resources Test 2 (the *Expenditure-based Test*) calculated in accordance with section 13.12 unless the *firm* is a *low resource firm*.

13.9.1A G Table 13B is a summary of the financial resources test for a *Category B firm*.

FCA

Table 13B This table forms part of *rule 13.9.1*

SUMMARY OF FINANCIAL RESOURCES FOR CATEGORY B FIRMS				
Type of <i>firm</i>	Financial Resources Test 1 <i>Own funds Test</i>	Financial Resources Test 1A <i>Adjusted Net current assets Test</i>	Financial Resources Test 2 <i>Expenditure-based Test</i>	<i>Rule/section References</i>
<i>Category B1</i> (including any <i>Network</i> in this category)	£10,000	<i>Adjusted net current assets</i> of £1	Liquid capital equal to the highest of 13/52 of relevant	13.10 13.11 13.12.1C

			annual expenditure or £400 per adviser or £10,000	13.12.2 to 13.12.5A 0
Category B2 which is permitted to carry on the activity of <i>investment management</i> in respect of portfolios containing only <i>life policies</i> or to delegate such activity to an <i>investment firm</i>	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 13/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1D 13.12.2 to 13.12.5A
Category B2 with 26+ advisers	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 8/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1E 13.12.2 to 13.12.5A
Category B2 with 1-25 advisers	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 4/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1F 13.12.2 to 13.12.5A
Category B3 which is permitted to carry on the activity of <i>managing investments</i> in respect of portfolios containing only <i>life policies</i> or to delegate such activity	£10,000	Adjusted <i>net current assets</i> of £1	Adjusted capital equal to the higher of 8/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1E 13.12.2 to 13.12.5A

to an investment firm				
Category B3 with 26+ advisers	£10,000	N/A	N/A	13.10
Network in Category B2 or B3	£10,000	Adjusted net current assets of £1	Adjusted capital equal to the higher of 13/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1D 13.12.2 to 13.12.5A
All Category B firms that do not hold client money or assets, but are permitted to establish, operate or wind up a personal pension scheme.	£10,000	Adjusted net current assets of £1	Adjusted capital equal to the highest of 6/52 of relevant annual expenditure, £400 per adviser, £10,000 and any other expenditure-based requirement set out in 13.12.1 applicable to the firm.	13.10 13.11 13.12.1 13.12.2 to 13.12.5A
All Category B firms that hold client money or assets and are permitted to establish, operate or wind up a personal pension scheme.	£10,000	Adjusted net current assets of £1	Adjusted capital equal to the highest of 13/52 of relevant annual expenditure, £400 per adviser, and £10,000	13.10 13.11 13.12.1G 13.12.2 to 13.12.5A

## 13.10 FINANCIAL RESOURCES TEST 1- OWN FUNDS REQUIREMENT

### Requirement

**13.10.1 R A Category B firm's own funds must at all times be at least £10,000.**

**FCA**

**Calculation**

**13.10.2 R A Category B firm's own funds must be calculated in accordance with table 13.10(2).**

**FCA**

**Table 13.10(2).**

**This table forms part of rule 13.10.2**

<b>OWN FUNDS</b>	
<b>Companies</b>	<b>Sole Traders: Partnerships</b>
Paid-up <i>share</i> capital (excluding preference shares redeemable by shareholders within 2 years) <i>Eligible LLP members' capital</i> Share premium account Retained profits (see 13.10.2AR) and interim net profits (Note 1) Revaluation reserves Short-term subordinated loans <i>Debt capital</i>	Balances on proprietor's or partners' - capital accounts - current accounts (see 13.10.2AR) Revaluation reserves Short-term subordinated loans
less - Intangible assets - Material current year losses - <i>Excess LLP members' drawings</i>	less - Intangible assets - Material current year losses - Excess of current year - drawings over current year profits
<p><b>Note 1</b></p> <p>Retained profits must be audited and interim net profits must be verified by the <i>firm's</i> external auditor, unless the <i>firm</i> is exempt from the provisions of Part VII of the Companies Act 1985 (section 294A (Exemptions from audit)), or where applicable, Part 16 of the Companies Act 2006 (section 477 (Small companies: Conditions for exemption from audit)) relating to the audit of accounts.</p>	

**13.10.2A R For the purpose of calculating a Category B firm's own funds, the following adjustments apply to retained profits or, (for non-corporate entities), current accounts figures.**

**FCA**

- (1) a **Category B firm** must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (2) a **Category B firm** must derecognise any **defined benefit asset**;
- (3) a **Category B firm** may substitute for a **defined benefit liability** its **deficit reduction amount**. The election must be applied

consistently in respect of any one financial year.

- (4) a **Category B firm** must deduct any unrealized gains on investment property and include these within revaluation reserves.
- (5) where applicable, a **Category B 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.

13.10.2B G A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FCA* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme*.

FCA

Where a *Category B firm* is a sole trader or a partnership:

- (1) it can use (to the extent necessary to make up any shortfall in the required resources) any of its personal assets (not being needed to meet liabilities arising from its personal activities and any business activities not regulated by the *FCA*);
- (2) the *firm's* total financial resources, from whatever source, must at all times be sufficient to cover its total liabilities.

13.10.3 R (1) **Where a *Category B3 firm* with 1-25 advisers has a facility under the PASS Loan Agreement Scheme it may make an adjustment in its *own funds* calculation in accordance with (2).**

FCA

- (2) a *firm* in (1) can regard as additional to its *own funds* the lower of either:
  - (a) the amount of the loan facility agreed (less any loan repayments already made and less the amount of the facility withdrawn or lapsed); or
  - (b) the amount of the *firm's* provision for redress (net of any professional indemnity insurance recoverable) at the time of its application for the loan facility.

## 13.11 FINANCIAL RESOURCES TEST 1A - ADJUSTED NET CURRENT ASSETS

### *Application*

13.11.1 R This section does not apply to a *low resource firm*.

FCA

### *Requirement*

13.11.2 R A ***Category B firm*** must adjust its *net current assets* as follows:

FCA

- (1) exclude assets which cannot be realised or recovered within twelve months;
- (2) exclude amounts receivable from *connected persons* to the extent that they are not *properly secured*, except amounts that are *deposits* referred to in item (11) of table 13.12.3(1) or item (11) in table 13.12.3(2);
- (3) value *investments* at current *market value*, using the *bid price* for a *net long position* in an investment and the *offer price* for a *net short position* in an investment;
- (4) where applicable, 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.

13.11.3 R A *Category B firm* must at all times have adjusted *net current assets* of at least £1.

FCA

## 13.12 FINANCIAL RESOURCES TEST 2 - EXPENDITURE-BASED REQUIREMENT

### 13.12.1 Application

13.12.1A R This section does not apply to a *low resource firm*.

FCA

#### Requirement

13.12.1B R A *Category B firm* must have at all times financial resources calculated in accordance with *rules* 13.12.2 to 13.12.5 which equal or exceed the amount specified in *rules* 13.12.1C to F as applicable.

FCA

13.12.1C R A *Category B1 firm*, including a *Network* must have financial resources calculated in accordance with whichever of (1), (2) or (3) produces the higher amount.

FCA

- (1) 13/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or
- (2) an amount equal to £400 multiplied by the number of its *advisers*; or
- (3) £10,000;

13.12.1D R (1) A *Category B2 firm* which is permitted to carry on the activity of *investment management* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.

FCA

- (2) A *Network* in Category B2 or B3 must have financial resources calculated in accordance with whichever of (3) or (4) produces

the higher amount.

- (3) 13/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or
- (4) an amount equal to £400 multiplied by the number of its *advisers*.

13.12.1E R

FCA

- (1) A *Category B2 firm* with more than 25 *advisers* which is not a *Network* and is not permitted to carry on the activity of *managing investments* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.
- (2) A *Category B3 firm* which is permitted to carry on the activity of *investment management* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.
- (3) 8/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or
- (4) an amount equal to £400 multiplied by the number of its *advisers*.

13.12.1F R

FCA

- (1) A *Category B2 firm* with fewer than 26 *advisers* which is not a *Network* and is not permitted to carry on the activity of *managing investments* in respect of portfolios containing only *life policies* or to delegate such activity of *investment management* to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.
- (2) A *Category B3 firm* which is not permitted to carry on the activity of *investment management* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.
- (3) 4/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or
- (4) an amount equal to £400 multiplied by the number of its *advisers*.

13.12.1G R

FCA

A *category B firm* whose permission includes *establishing, operating or winding up a personal pension scheme* must have financial resources calculated in accordance with (1) or (2):

- (1) For a *firm* which holds *client money* or assets, the highest of:
  - (a) 13/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D;
  - (b) an amount equal to £400 multiplied by the number of its

advisers; and

(c) £10,000.

(2) For a *firm* which does not hold client money or assets, the highest of:

(a) 6/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D;

(b) an amount equal to £400 multiplied by the number of its advisers;

(c) £10,000; and

(d) any other expenditure-based requirement set out in 13.12.1 applicable to the *firm*.

*Calculation of Relevant Annual Expenditure*

13.12.2 R A *Category B firm* must calculate its relevant annual expenditure by reference to the amount described as total expenditure in its most recently prepared set of *annual financial statements*. If those statements were for a period other than 12 months, the amounts in its profit and loss account must be adjusted proportionately.

FCA

13.12.2A R Where a *Category B firm* has just begun trading or have not been

FCA

authorised long enough to submit such statements the *firm* must calculate its relevant annual expenditure on the basis of forecast or other appropriate accounts submitted to the *FCA*.

13.12.2B R A *Category B firm* may deduct from its relevant annual expenditure items (a) to (f) set out in table 13.12.2, unless the *firm* is a *Category B1 firm*, in which case it may not deduct item (e).

FCA

Table 13.12.2

This table forms part of *rule 13.12.2*

DEDUCTIONS FROM EXPENDITURE	
(a)	staff bonuses;
(b)	<i>employees' and directors' shares</i> in profits;
(c)	interest charges in respect of borrowing made to finance the acquisition of its <i>readily realisable investments</i> ;
(d)	shared commissions paid which are directly related to commissions received;

(e)	emoluments of <i>directors</i> , partners or a sole trader;
(f)	a <i>firm</i> must not deduct any exceptional expenditure.

**Adjustments to Calculation of Relevant Annual Expenditure**

**13.12.2C R** **A *firm* must ensure that the expenditure base properly reflects the ongoing annual operating costs of the *firm* by having proper regard to its circumstances when deciding whether to include or exclude any item of expenditure or to make any other adjustment to the calculation of relevant annual expenditure.**

**FCA**

**13.12.2D G** In *rule* 13.12.2C the *FCA* would expect a *firm* to take proper account of the effect of, for example, the ongoing annual operating costs of the *firm* being met by another party, or of a significant change in the structure of the *firm's* business during the year.

**FCA**

**Calculation of Financial Resources to meet Tests 1, 1a or 2**

**13.12.3 R (1)** **This *rule* does not apply to a *low resource firm*;**

**FCA**

- (2)** **A *Category B firm* must be able to calculate its financial resources at any time on the basis of the balance sheet the *firm* could draw up at that time. For this purpose:**
- (a)** **a *Category B1 firm* must adjust the assets in the balance sheet as specified in Part I of table 13.12.3(1) and include the liabilities after making the adjustments specified in Part II of table 13.12.3(1);**
  - (b)** **a *Category B2 or B3 firm* to which 13.12 applies must adjust the assets in the balance sheet as specified in Part I of table 13.12.3(2) and include the liabilities after making the adjustments specified in Part II of table 13.12.3(2).**
- (3)** **the assets and liabilities in the balance sheet are also subject to the following adjustments:**
- (a)** **a *Category B firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;**
  - (b)** **in respect of a *defined benefit occupational pension scheme*, a *Category B firm* must derecognise any *defined benefit asset*;**
  - (c)** **a *Category B firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year;**
  - (d)** **where applicable, a *Category B 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.

Table 13.12.3(1) Part I

FCA

This table forms part of *rule 13.12.3*

FIRMS CATEGORY B1	
Calculation of Assets	
ASSETS	ADJUSTMENTS
(1) Land and Buildings	Exclude in full. (A loan secured by a charge on land and buildings may be deducted from liabilities in accordance with item (14) of Part II of this table.)
(2) <i>Investments</i>	<p>Include any <i>net long position</i> in any fixed or current asset investment (including <i>shares</i> in any connected company)</p> <p>(a) valued at its current <i>bid price</i> (or, in the case of a with-profits <i>life policy</i>, at its surrender value), and</p> <p>(b) discounted by the applicable percentage specified in table 13.12.3A.</p> <p>A <i>firm</i> which acts as a market-maker in second-hand <i>life policies</i> must comply with the relevant requirements in respect of second-hand <i>life policies</i> held by the <i>firm</i> and include such a <i>policy</i>.</p> <p>(a) valued at its surrender value at the date on which the <i>firm</i> acquired it, or its latest available surrender value if different.</p> <p>(b) where a life office whose <i>policy</i> is held by the <i>firm</i> has altered adversely the basis on which it calculates surrender values, the <i>firm</i> must revise its valuation of the second-hand <i>policy</i> as soon as practicable after becoming aware of the alteration.</p>
(3) Investments subject to Repurchase, Reverse Repurchase, Stock Borrowing or Stock Lending transactions	Include <i>investments</i> for which the <i>firm</i> has entered as principal into a repurchase, reverse repurchase, stock borrowing or stock lending transaction on its own behalf, after making (I) a deduction in accordance with item (2), and (II) a deduction calculated by computing its exposure (the difference between the <i>market value</i> of the <i>securities</i> and the loan or collateral (including accrued interest) where that difference is not in the <i>firm's</i> favour, after adjusting for any excess collateral).
(4) Debtors relating to Unsettled Securities Transactions Cash against	<p>Include debtors where the <i>firm</i> has entered into a transaction on its own behalf in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis, and the transaction remains unsettled, after deducting an amount calculated by</p> <p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>bid price</i> where that</p>

Documents	<p>difference is not in the <i>firm's</i> favour, and</p> <p>(b) multiplying that difference by the applicable percentage specified in table 13.12.3B.</p>
(5) Debtors relating to Unsettled Securities Transactions Free Deliveries	<p>(a) Include the full amount due to the <i>firm</i> from debtors if a <i>firm</i> has delivered <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or paid for such <i>investments</i> before receiving certificates of good title for them, so long as not more than three days have passed since delivery</p> <p>(b) If more than three days have passed since delivery, exclude in full.</p>
(6) <i>Regulated collective investment schemes</i>	<p>Include an amount owing in respect of a transaction in <i>units</i> in a <i>regulated collective investment scheme</i> only if the amount has been due and unpaid for 30 days or less after the settlement date of the transaction to which it relates.</p>
(7) Loans secured on <i>investments</i>	<p>If the <i>firm</i> holds client title documents as security for</p> <p>(a) the repayment of money it has lent; or</p> <p>(b) money due to the <i>firm</i> in connection with the purchase for or sale to another person of those <i>investments</i>, which the <i>firm</i> has for genuine commercial reasons agreed to postpone, the <i>firm</i> may include as an asset the lower of the following:</p> <p>(i) the total amount due;</p> <p>(ii) the <i>market value</i> of the <i>investments</i> multiplied by the appropriate rates set out in table 13.12.3A.</p>
(8) Trade debtors	<p>Include amounts owing only in respect of</p> <p>(a) (i) commission;</p> <p>(ii) <i>investment management</i> fees;</p> <p>(iii) other fees earned in connection with the <i>firm's investment business</i>, which are due from other authorised or <i>EEA firms</i>, <i>recognised investment exchanges</i> or <i>recognised clearing houses</i> and have been due and unpaid for 30 days or less;</p> <p>(b) (i) <i>investment management</i> fees; or</p> <p>(ii) pensions administration which have been due from its customers and unpaid for 30 days or less.</p> <p>(c) All other trade debtors must be deducted in full.</p>
(9) Prepayments	<p>Include prepayments which relate to goods or services to be received or performed within 90 days.</p>
(10) Accrued income	<p>(a) Accrued income relating to <i>investment management</i> fees not yet due and payable may be included if the fees relate to services provided within the previous six months.</p> <p>(b) Other accrued income may be included if it relates to interest on marketable debt instruments or on <i>deposits</i> included in item (11).</p>
(11) <i>Deposits</i>	<p>The following may be included:</p> <p>(a) cash and balances on current accounts and on <i>deposit</i> accounts with an <i>approved bank</i> or National Savings Bank which can be withdrawn within 90 days;</p>

	(b) money on <i>deposit</i> with a UK local authority which can be withdrawn within 90 days; (c) money <i>deposited</i> and evidenced by a certificate of tax <i>deposit</i> .
(12) Other Debts	(a) Amounts owing in respect of (i) interest on <i>investments</i> ; (ii) repayments of marketable debt instruments at maturity or call; (iii) dividends declared by authorised or not <i>EEA firms</i> or by companies in respect of <i>shares</i> listed on a recognised or designated investment exchange; which have been due and unpaid for 30 days or less may be included. (b) Other amounts due from UK government bodies may be included if they are agreed and due within 30 days.
(13) All other assets	Exclude in full.

**Table 13.12.3(1) Part II**

**FCA**

**This table forms part of *rule 13.12.3***

<b>FIRMS IN CATEGORY B1</b>	
<b>Calculation of Liabilities</b>	
<b>LIABILITIES</b>	<b>ADJUSTMENTS</b>
(14) Secured Liabilities	Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced by the smallest of the following amounts: (a) the aggregate amount of the <i>firm's</i> secured liabilities which are due more than one year after the balance sheet date; (b) (if the land and buildings have been valued by an independent professional valuer within the past 18 months) 85% of the amount certified by the valuer as their <i>market value</i> ; (c) 85% of the net book value of the land and buildings.
(15) Subordinated loans	Include in full, except any short-term subordinated loan in the standard form prescribed by the <i>FCA</i> which may be treated as capital up to the limits specified in <i>rules 13.12.5</i> and <i>13.12.5A</i> .
(16) Commission on indemnity terms from the	Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the <i>firm</i> has received on indemnity terms during the previous twelve

sale of <i>life policies</i> or <i>pension contracts</i>	months. This provision must be reasonable having regard to its circumstances and, in particular, its previous lapse ratio.
(17) Short Positions	Include a <i>net short position</i> (a) valued at its <i>offer price</i> and (b) increased using the applicable percentage rate in table 13.12.3A.
(18) Deficiency in <i>subsidiary</i>	Include as a liability the amount by which the liabilities of any <i>subsidiary</i> (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the <i>firm</i> has not already made such a provision elsewhere in its financial statements.
(19) Liability for tax	Include as a liability a provision for taxation on the whole of the profits of the <i>firm's</i> business up to its balance sheet date.
(20) Creditors relating to Unsettled <i>Securities</i> Transactions – Cash against Documents	Include creditors where the <i>firm</i> has entered into a transaction on its own behalf in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by (a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i> where that difference is not in the <i>firm's</i> favour, and (b) multiplying that difference by the applicable percentage specified in table 13.12.3B.
(21) Creditors relating to Unsettled <i>Securities</i> Transactions – Free Deliveries	Include an amount for creditors where (acting on the <i>firm's</i> own behalf) the <i>firm</i> has delivered certificates of title for <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or where a <i>firm</i> has bought such <i>investments</i> before receiving certificates of good title for them, as follows: (a) (if the <i>firm</i> has paid for them and not more than 3 days have passed since the payment was made) include in full: (b) (if more than 3 days have passed since the payment was made) include the full value of the <i>securities</i> at their current <i>offer price</i> .
(22) <i>Over the counter derivatives</i>	If the <i>firm</i> holds positions in <i>derivatives</i> on its own behalf must (a) make the adjustment in item (17) of this table, and (b) deduct the credit equivalent of those positions computed in accordance with table 13.12.3C. In addition, bought <i>OTC options</i> and covered <i>warrants</i> will be subject to table 13.12.3D.
(23) Contingent Liabilities	A <i>firm</i> must include a provision for any contingent liabilities which exist at its balance sheet date that must be made.
(24) Redeemable	Include as a liability any redeemable preference <i>shares</i> which fall due within two years. If <i>shares</i> are not redeemable by the

Preference Shares	shareholder within 2 years, they must be treated in accordance with <i>rules</i> 13.12.5 and 13.12.5A.
(25) Foreign currency risk	If the <i>firm</i> holds positions on its own behalf in foreign currencies or has assets or liabilities denominated in foreign currencies, the <i>firm</i> must calculate a provision to cover the risk in accordance with table 13.12.3D and include the amount as a liability
(26) All other liabilities	Include in full.

**Table 13.12.3(2) Part I**

**FCA**

This table forms part of *rule* 13.12.3

<b>FIRMS IN CATEGORIES B2 AND B3 (except low resource firms)</b>	
<b>Calculation of Assets</b>	
<b>ASSETS</b>	<b>ADJUSTMENTS</b>
(1) Land and Buildings	Include land and buildings which are not subject to any charge only if they have been valued either (a) at 60% of their net book value, or (b) (if valued by an independent professional valuer within the past three years) at 60% of the amount certified by the valuer to be the <i>market value</i> .
(2) Motor vehicles	(a) Include motor vehicles acquired less than 12 months ago valued at 50% of their cost (b) Include motor vehicles acquired within the past 24 months (but more than 12 months ago) valued at 25% of their cost (c) Exclude in full any other motor vehicles.
(3) <i>Investments</i>	Include any <i>net long position</i> in any fixed or current asset investment (including <i>shares</i> in any connected company) (a) valued at its current <i>bid price</i> (or, in the case of a with-profits <i>life policy</i> , at its surrender value), and (b) discounted by the applicable percentage specified in table 13.12.3A.
(4) Debtors relating to Unsettled <i>Securities</i> Transactions Cash against	Include debtors where the <i>firm</i> has entered into a transaction on its own behalf in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis, and the transaction remains unsettled, after deducting an amount calculated by (a) computing the difference between the agreed settlement price

Documents	for those <i>investments</i> and their current <i>bid price</i> where that difference is not in the <i>firm's</i> favour, and  (b) multiplying that difference by the applicable percentage specified in table 13.12.3B.
(5) Debtors relating to Unsettled Securities Transactions Free Deliveries	(a) Where the firm has delivered securities or units in collective investment schemes before receiving payment for them or paid for such investments before receiving certificates of good title for them include the full amount due to a firm from debtors so long as not more than 3 days have passed since delivery.  (b) Exclude in full if more than 3 days have passed since delivery.
(6) <i>Regulated collective investment schemes</i>	Include an amount owing in respect of a transaction in <i>units</i> in a <i>regulated collective investment scheme</i> only if the amount has been due and unpaid for 30 days or less after the settlement date of the transaction to which it relates.
(7) Debts of group or connected companies	Include amounts due from group or connected companies (which do not relate to trade debts) where a firm has no reason to doubt that repayment will be made in full on demand.
(8) Trade debtors	Include amounts due from trade debtors (including <i>group or connected companies</i> ) which have been due and unpaid for less than 90 days.
(9) Prepayments	Include prepayments which relate to goods or services to be received or performed within 90 days.
(10) Accrued income	(a) Include accrued income not yet due and payable in respect of fees earned in the performance of <i>investment management</i> services that is receivable within six months.  (b) Include any other accrued income receivable within 90 days.
(11) <i>Deposits</i>	The following may be included:  (a) cash and balances on current accounts and on <i>deposit</i> accounts with an <i>approved bank</i> or National Savings Bank which can be withdrawn within 90 days;  (b) money on <i>deposit</i> with a UK local authority which can be withdrawn within 90 days;  (c) money <i>deposited</i> and evidenced by a certificate of tax <i>deposit</i> .
(12) Other amounts due from Government bodies or local authorities	Include other amounts due from UK Government bodies or local authorities if they are agreed and due within 90 days.
(13) All other assets	Exclude in full.

**Table 13.12.3(2) Part II**

FCA

This table forms part of *rule 13.12.3*

<b>FIRMS IN CATEGORY B1</b>	
<b>Calculation of Liabilities</b>	
<b>LIABILITIES</b>	<b>ADJUSTMENTS</b>
(14) Secured Liabilities	<p>Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced as follows:</p> <p>(a) If the liabilities secured exceed 85% of the value of the land and buildings, then the excess is treated as a liability;</p> <p>(b) If the land and buildings have been valued by an independent professional valuer within the past three years, the value of the land and buildings is the amount certified by the valuer as their <i>market value</i>; otherwise it is their net book value.</p> <p>(If 60% of the value of the land and buildings which are subject to a charge exceeds the liabilities secured, then the amount of that excess may be treated as an asset.)</p>
(15) Subordinated loans	<p>Include in full, except any short-term subordinated loan in the standard form prescribed by the <i>FCA</i> which may be treated as capital up to the limits specified in <i>rules 13.12.5</i> and <i>13.12.5A</i>.</p>
(16) Commission on indemnity terms from the sale of <i>life policies</i> or <i>pension contracts</i>	<p>Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the <i>firm</i> has received on indemnity terms during the previous twelve months. This provision must be reasonable having regard to its circumstances and, in particular, its previous lapse ratio.</p>
(17) Short Positions	<p>Include a <i>net short position</i></p> <p>(a) valued at its <i>offer price</i>, and</p> <p>(b) increased using the applicable percentage rate in table <i>13.12.3A</i>.</p>
(18) Deficiency in <i>subsidiary</i>	<p>Include as a liability the amount by which the liabilities of any <i>subsidiary</i> (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the <i>firm</i> has not already made such a provision elsewhere in its financial statements.</p>
(19) Liability for tax	<p>Include as a liability a provision for taxation on the whole of the profits of its business up to its balance sheet date.</p>
(20) Unsettled <i>Securities Transactions - Cash against Documents</i>	<p>Include creditors where the <i>firm</i> has entered into a transaction on its own behalf in <i>securities</i> or <i>units in collective investment schemes</i> on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by</p>

	<p>(a) computing the difference between the agreed settlement price for those <i>investments</i> and their current <i>market value</i> where that difference is not in the <i>firm's</i> favour, and</p> <p>(b) multiplying that difference by the applicable percentage specified in table 13.12.3B.</p>
(21) Creditors relating to Unsettled Securities Transactions – Free Deliveries	<p>Include an amount for creditors where (acting on its behalf) the <i>firm</i> has delivered certificates of title for <i>securities</i> or <i>units in collective investment schemes</i> before receiving payment for them, or where a <i>firm</i> has bought such <i>investments</i> before receiving certificates of good title for them, as follows:</p> <p>(a) (if the <i>firm</i> has paid for them and not more than 3 days have passed since the payment was made) include in full:</p> <p>(b) (if more than 3 days have passed since the payment was made) include the full value of the <i>securities</i> at the current <i>offer price</i>.</p>
(22) <i>Over the counter derivatives</i>	<p>Include as a liability an amount for any positions the <i>firm</i> holds on its own behalf in such <i>derivatives</i> calculated by computing the credit equivalent of those positions in accordance with table 13.12.3C. In addition, bought <i>OTC derivatives</i> and covered <i>warrants</i> will be subject to table 13.12.3D.</p>
(23) Contingent Liabilities	<p>A <i>firm</i> must include a provision for any contingent liabilities which exist at its balance sheet date that must be made.</p>
(24) Long term liabilities	<p>Include as a liability any amount which falls due more than 3 years from the balance sheet date and is due to <i>connected persons</i>, in accordance with <i>rules</i> 13.12.5 and 13.12.5A.</p>
(25) Redeemable Preference Shares	<p>Include as a liability any redeemable preference <i>shares</i> which fall due within two years. If <i>shares</i> are not redeemable by the shareholder within two years, they must be treated in accordance with <i>rules</i> 13.12.5 and 13.12.5A.</p>
(26) <i>Net open foreign currency position</i>	<p>A <i>firm</i> must calculate its foreign exchange risk requirement in accordance with table 13.12.3D and include the amount as a liability.</p>
(27) All other liabilities	<p>Include in full.</p>

**Table 13.12.3A**

**FCA**

**This table forms part of rule 13.12.3**

<b>DISCOUNTS FOR INVESTMENTS</b>
The percentages in the table are applied to the <i>market value</i> (unless otherwise stated) or <i>gross positions</i> , i.e. both longs and shorts in each category; netting and

offsetting are prohibited. The long or short position in a particular investment is the net of any long or short positions held in that same investment.

Investment	Discount
<b>A. Debt</b>	
UK Government or local authority stocks:	
- with less than one year to final redemption	2%
- with more than one year but less than five years to final redemption	5%
- with five years or more to final redemption	10%
Debt security:	
- debt instruments issued or accepted by an <i>approved bank</i> with less than 90 days to final redemption	2%
- other debt instruments which are <i>marketable investments</i> with less than one year to final redemption	5%
- other debt instruments which are <i>marketable investments</i> with less than five years to final redemption	10%
- other debt instruments which are <i>marketable investments</i>	15%
- floating rate notes which are <i>marketable investments</i> :	
- with no more than 20 years to final redemption	5%
- with more than 20 years to final redemption	10%
<b>B. Equities</b>	
- other <i>investments</i> listed on a recognised or designated investment exchange	25%
- <i>shares</i> traded on a recognised or designated investment exchange	35%
- other <i>shares</i> for which there is a <i>market maker</i> in the UK	35%
<b>C. Derivatives</b>	
- <i>exchange traded futures</i>	4 x initial margin requirement
- <i>OTC futures</i>	Apply the appropriate percentage shown in A and B to the <i>market value</i> of the underlying position
- Purchased <i>options</i>	Apply the appropriate percentage shown in A and B to the <i>market value</i> of the underlying position

	but the result may be limited to the <i>market value</i> of the option
- <i>Contracts for differences</i>	20% of the <i>market value</i> of the contract
D. <i>Other Investments</i>	
- <i>Unit</i> linked bonds and <i>units</i> in <i>authorised unit trust schemes</i> (other than <i>higher volatility funds</i> and <i>property funds</i> ) or <i>regulated collective investment schemes</i>	25%
- <i>units</i> in <i>higher volatility funds</i> and <i>property funds</i>	50%
- with profit <i>life policies</i> (only applicable to <i>firms</i> other than <i>traded life policy market makers</i> )	20% of the <i>surrender value</i> of the <i>policy</i>
- <i>shares</i> in <i>subsidiary</i> companies and <i>shares</i> which are not <i>readily realisable securities</i> in <i>connected companies</i>	100%
- <i>traded endowment policies</i> : where a <i>traded life policy</i> is held for resale by a <i>firm</i> which is a <i>traded life policy market maker</i> .	
(a) for 3 months or less	0% of the <i>surrender value</i> of the <i>policy</i>
(b) for more than 3 months	10% of the <i>surrender value</i> of the <i>policy</i>
when a <i>traded life policy</i> is held by a <i>firm</i> which is a <i>traded life policy market maker</i> for investment	10% of the <i>surrender value</i> of the <i>policy</i>
- other	100%

**Table 13.12.3B**

**FCA**

This table forms part of *rule 13.12.3*

UNSETTLED SECURITIES TRANSACTIONS		
Number of <i>business days</i> after due settlement date	A %	B %
0 – 15	0	0

16 – 30	25	0
31 – 45	50	25
46 – 60	75	50
61 or more	100	75
over 90	100	100

Note 1: Column A applies to a transaction in a debt or debt-related instrument (unless the debt instrument is settled through the appropriate UK settlement system), and

Note 2: Column B applies in all other cases (and, in particular, applies to equity and equity-related instruments).

**Table 13.12.3C**

**FCA**

**This table forms part of *rule 13.12.3***

<b>OVER THE COUNTER DERIVATIVES</b>		
a. By attaching current <i>market values</i> to contracts (marking to market), obtain the current replacement cost of all contracts with positive values.		
b. To obtain a figure for potential future credit exposure (except in the case of single currency “floating/floating interest rate swaps” in which only the current replacement costs will be calculated), the notional principal amounts or values underlying the <i>firm's</i> aggregate positions are multiplied by the following percentages:		
<b>Residual Maturity</b>	<b>Interest Rate Contracts</b>	<b>Foreign Exchange Contracts</b>
One year or less	Nil	1%
More than 1 year	0.5%	5%
c. The credit equivalent is the sum of current replacement cost and potential future credit exposure.		

**Table 13.12.3D**

**FCA**

**This table forms part of *rule 13.12.3***

<b>FOREIGN EXCHANGE RISK</b>
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(a) A <i>firm</i> must deduct a foreign exchange risk requirement for all the following items which are denominated in a foreign currency:	
(i)	all assets and liabilities, including accrued interest, denominated in the currency (all <i>investments</i> at market or realisable value);
(ii)	any currency future, at the nominal value of the contract;
(iii)	any forward contract for the purchase or sale of the currency, at the contract value, including any future exchange of principal associated with currency swaps;
(iv)	any foreign currency <i>options</i> at the net delta (or delta-based) equivalent of the total book of such <i>options</i> ;
(v)	any non-currency option, at <i>market value</i> ;
(vi)	any irrevocable guarantee;
(vii)	any other off-balance sheet commitment to purchase or sell an asset denominated in that currency.
(b) The requirement must be calculated as follows:	
(i)	using the spot rate, convert the <i>net long position</i> and <i>net short position</i> in each foreign currency into the currency in which the <i>firm's annual financial statements</i> are reported;
(ii)	total the <i>net open long positions</i> and the <i>net open short positions</i> ;
(iii)	the higher of (i) and (ii) above is its <i>net open foreign currency position</i> ;
(iv)	multiply its <i>net open foreign currency position</i> by 10%;
(c) A <i>firm</i> may not include any future income or expense not yet accrued but fully hedged (subject to deduction of an appropriate risk requirement).	

**13.12.4 Short Term Subordinated Loans**

**13.12.4 R A Category B firm may treat subordinated loan as a financial resource, as specified in rules 13.12.5 to 5A, if the short term subordinated loan is eligible for such treatment in accordance with rule 13.12.4A;**

**FCA**

**13.12.4A R A short term subordinated loan is eligible for such treatment if:**

**FCA**

- (1) it has an original maturity of at least two years or, if it has no fixed term, it is subject to two years' notice of repayment;**
- (2) payment of interest is not permitted under the loan agreement unless after such payment a *firm* meet 120% of its financial resource requirement;**
- (3) repayment, prepayment or termination is only permitted under**

the loan agreement

- (a) on maturity, or on expiration of the period of notice, if after such payment or termination a *firm* meets 120% of its financial resources requirement; or
  - (b) on winding up after the claims of all other creditors and all outstanding debts have been settled;
- (4) it is in the standard form for short term subordinated loans prescribed by the *FCA*.

*Restrictions*

13.12.5 R A *Category B firm* must calculate:

**FCA**

- (1) the aggregate amount of its short term subordinated loans, its preference *shares* which are not redeemable within two years, and for a *Category B firm* other than a *Category B1 firm* its long term liabilities which are not secured on its assets, if they do not fall due more than three years from the balance sheet date, and are not due to *connected persons*;
- (2) the amount of the *firm's* total capital and reserves excluding preference *share* capital, less the amount of its intangible assets, multiplied by 400%.

13.12.5A R A *Category B firm* must treat as a liability in the calculation or its financial resources any amount by which the sum of 13.12.5(1) exceeds the product of 13.12.5(2).

**FCA**

**Appendix 13(1):**  
**Defined terms for Chapter 13**

[deleted]



## 14 Chapter 14: Consolidated Supervision for Investment Businesses

### 14.1 APPLICATION

14.1.1 R Subject to rule 14.1.2, *consolidated* supervision and this chapter apply to a *firm* which is a member of a group if:

FCA

- (1) It is:
  - (a) a *securities and futures firm*, subject to the financial rules in Chapter 3, which is a *broad scope firm* but not a *venture capital firm*; and
  - (b) [deleted]
  - (c) [deleted]
- (2) It is not a *BIPRU firm*.
- (3) [Deleted]
- (4) [Deleted]
- (5) [Deleted]

*Cases where consolidated supervision under this chapter will not apply*

14.1.2 R A *firm* is not subject to *consolidated supervision* under the rules in this Chapter where any of the following conditions are fulfilled:

FCA

- (1) 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*; or
- (2) the *firm* is a member of a *UK consolidation group* already included in the supervision on a consolidated basis of the group of which it is a member by the *FCA* or *PRA* under *BIPRU 8*.

14.1.3 G (1) [Deleted]

FCA

- (2) [Deleted]
- (3) Where there is more than one authorised *firm* in the group, subject to the rules of this chapter, one consolidated supervision return may be submitted on behalf of all the *firms* in the group in accordance with *SUP 16.3.25G*.

**Exemption from consolidated supervision**

**14.1.4 R A firm need not meet the requirements in rules 14.3.1 and 14.3.2 if:**

**FCA**

- (1) there is no *credit institution* in the group;
- (2) no *firm* in the group *deals in investments as principal*, except where it is an *operator* of a *collective investment scheme* dealing solely as a result of its activity of operating a *collective investment scheme*, or where the *firm's* positions fulfil the *CAD Article 3 exempting criteria*;
- (3) [Deleted]
- (4) the *firm* notifies the *FCA* of any serious risk that could undermine the financial stability of the group as soon as it becomes aware of that risk;
- (5) the *firm* reports to the *FCA* all group *large exposures* as at the end of each quarter, and within the period specified in *SUP 16*;
- (6) the *firm* meets the conditions in rule 14.1.5; and
- (7) the *firm* has first notified the *FCA* in writing that it intends to rely on this rule.

**14.1.5 R If the firm notifies the FCA under rule 14.1.4 that it will not apply the rules in this section, it must:**

**FCA**

- (1) submit to *FCA* a consolidated supervision return within the time period specified by *SUP 16*, together with a consolidated profit and loss account;
- (2) ensure that each *firm* in the group deducts from its solo financial resources any quantifiable *contingent liability* in respect of other group entities;
- (3) ensure that the solo financial resources requirement of each *firm* in the group incorporates the full value of the expenditures of the *firm* wherever they are incurred on behalf of the *firm*; and
- (4) make a note in its audited financial statements that it is not subject to regulatory consolidated capital requirements.

**14.1.6 G (1) [Deleted]**

**FCA**

- (2) The conditions in *rule* 14.1.5 aim to ensure that the *firm* is protected from weaknesses in other group entities.
- (3) In *rule* 14.1.5(2), *contingent liabilities* includes direct and indirect guarantees.
- (4) 14.1.5(3) aims to ensure that the expenditure-based requirement incorporates the *firm's* actual ongoing annual expenditures (including any share of depreciation on fixed assets) where these have been met by another group entity.
- (5) The *FCA* may require further information from the *firm* if it considers that the *firm's* consolidated financial position raises undue risks to consumers. It may also seek reassurance that the *firm* has sufficiently robust *client money* and asset controls - for example, it may require a *skilled person's* report. The *FCA* may also use its own *initiative power* to impose conditions on the *firm*. This could include raising additional capital or further limitations on the *firm's* intra-group exposures.
- (6) Rule 14.1.4(5) refers to *large exposures*, which should be measured against group consolidated own funds or (if this would result in all *exposures* being classified as *large exposures*) by aggregating all the *exposures* of the individual entities in the group and measuring them against the own funds of the individual *firm* giving rise to the consolidated supervision requirement. If there is more than one *firm* in the group giving rise to the consolidated supervision requirement, the group *large exposures* should be measured against the *firm* with the smallest own funds.

## 14.2 SCOPE OF CONSOLIDATION

14.2.1 R For the purposes of the rules in this chapter, a *firm's* group means the *firm* and:

FCA

- (1) any *EEA parent* in the group which is a *financial holding company*, a *credit institution*, or an *investment firm*;
- (2) any *credit institution*, *investment firm* or *financial institution* which is a *subsidiary* either of the *firm* or of the *firm's EEA parent* as defined in (1); and
- (3) any *credit institution*, *investment firm* or *financial institution* in which the *firm* or one of the entities in (1) or (2) holds a *participation*.

14.2.2 R If a group exists under rule 14.2.1, the *firm* must also include in the scope of consolidation any *ancillary services undertaking* and *asset management company* in the group.

FCA

14.2.3 G Rule 14.1.1 states what type of *firm* may be subject to consolidated supervision (trigger firm). Rule 14.2.1 states what type of relationship triggers the existence of a group for consolidated supervision purposes. Rules 14.2.1

FCA

and 14.2.2 specify what entities should be included in the scope of consolidated supervision.

14.2.4

FCA

- G (1) A *firm's parent* is a *financial holding company* if it is either a *financial institution* or a *securities and futures firm* that is subject to the financial rules in Chapter 3 and that is a *broad scope firm* (but not a *venture capital firm*) and if its *subsidiary undertakings* carry out mainly *listed activities*, activities of a *credit institution* or activities undertaken by a Chapter 3 *broad scope firm*. For this purpose the *FCA* interprets the phrases 'mainly' or 'main business' to mean where the balance of business is over 40% of the relevant group or sub-group's balance sheet (measured on the basis of total assets) or profit and loss statement (measured on the basis of gross income). In addition, if the *firm's parent* has significant holdings in *insurance undertakings* or *reinsurance undertakings*, it is a *mixed financial holding company*, and the *firm* is subject to the rules in GENPRU 3.1 instead of the rules in this chapter. This is because a *parent* cannot be a *financial holding company* and a *mixed financial holding company* at the same time. GENPRU 3.1 sets out what constitutes significant insurance holdings (broadly more than 10% of the financial sector activities of the group). A *firm's parent* is a *financial holding company* and not regarded as a *mixed financial holding company* unless:
- (a) the parent has been notified by its *coordinator* that the group it heads is a *financial conglomerate* (in accordance with Article 4(2) of the *Financial Groups Directive*); and
  - (b) it has not been notified that the *coordinator* and the *relevant competent authorities* have agreed not to treat the group as a *financial conglomerate* in accordance with Article 3(3) of the *Financial Groups Directive*.
- (2) A *firm* with an ultimate non-EEA parent may also be subject to the provisions in GENPRU 3.2.
- (3) In the case where undertakings are linked to the domain of consolidation by a relationship within the meaning of article 12(1) of Directive (83/349/EEC), the *FCA* will determine how consolidation is to be carried out.

### Exclusions

14.2.5

FCA

- R A *firm* may, having first notified the *FCA* in writing, exclude from its group the following:
- (1) any entity the total assets of which are less than the smaller of the following two amounts:
- (a) 10 million euros; or
  - (b) 1% of the total assets of the group's *parent* or the undertaking that holds the *participation*;
- provided that the total assets of such entities do not**

collectively breach these limits.

- (2) **any entity the inclusion of which within the group would be misleading or inappropriate for the purposes of consolidated supervision.**

14.2.6

- G (1) The *FCA* may require a *firm* to provide information about the position in the group of any undertaking excluded from the consolidation under rule 14.2.5.

FCA

- (2) An exclusion under rule 14.2.5(2) would normally be appropriate when an entity would be excluded from the scope of consolidation under the relevant UK generally accepted accounting principles.

### 14.3 CONSOLIDATED SUPERVISION REQUIREMENT

- 14.3.1 R **A *firm* must at all times ensure that its group maintains group financial resources in excess of its group financial resources requirement.**

FCA

- 14.3.2 R **A *firm*, other than one which is defined in rule 14.1.1(1), must at all times comply with *large exposures* limits applied on a group basis.**

FCA

### 14.4 GROUP FINANCIAL RESOURCES

- 14.4.1 R **A *firm* must calculate its *group financial resources* on the basis of the consolidated accounts of the relevant group, subject to the adjustments in rule 14.4.2 and on the basis specified in rule 14.4.3.**

FCA

- 14.4.2 R (1) **If more than one *firm* in the group is subject to the rules of this chapter, *group financial resources* are defined according to the relevant rules applicable to the main firm in the group to which this chapter applies, with Tier 1 minority interests being allowed as Group Tier 1 capital and Tier 2 minority interests being allowed as Group Tier 2 capital.**

FCA

- (2) **In calculating the *group financial resources*, deductions should be made for intangible assets, material unaudited losses incurred since the balance sheet date and investments in own shares.**

- (3) ***Material holdings* and *material insurance holdings* must be recalculated on a group basis and deducted in arriving at the *group financial resources*.**

14.4.3 R Financial resources will be defined based upon the main *firm* in the group to which this chapter applies as follows:

FCA

- (1) if a *broad scope securities and futures firm* (excluding a *venture capital firm*), Table 3-61R;
- (2) [Deleted]
- (3) [Deleted]
- (4) [deleted]
- (5) [deleted]

14.4.4 G (1) The *FCA* interprets 'main' by reference to the share of the *firm's* business in the group, its contribution to the group's balance sheet (measured on the basis of total assets) or profit and loss statement (measured on the basis of gross income).

FCA

- (2) The form in *SUP* 16 Ann 19 R, together with the guidance in *SUP* 16 Ann 20G, shows the mechanics of the calculation.

14.4.5 G A *firm* may apply for a *waiver* of rule 14.4.1 to permit an aggregation approach to determine *group financial resources*. Any *waiver* application should guarantee future compliance with any relevant own funds limit.

FCA

## 14.5 GROUP FINANCIAL RESOURCES REQUIREMENT

14.5.1 R A *firm* must calculate its *group financial resources requirement* as the aggregate of:

FCA

- (1) the sum of the financial resources requirements of all group entities within the scope of consolidation calculated in accordance with rule 14.5.2, except that:
  - (a) requirements in respect of intra-group balances with other entities within the scope of consolidation should be excluded; and
  - (b) [deleted]
- (2) the sum of any adjustments that are made to each *firm's* financial resources, calculated on a solo basis in accordance with rule 14.4.3, in order to arrive at the amount of financial resources used to meet its solo financial resources requirement. These adjustments must exclude deductions in respect of the investment in and other relationships with other entities that are included within the scope of consolidation.

(3) [deleted]

The financial resources requirements of entities in which the group holds a *participation* must be included proportionately.

14.5.2 R Financial resources requirements for individual entities in the group are:

FCA

- (1) for *firms* regulated by the *FCA*, their regulatory capital requirement under *FCA* rules;
- (2) for entities regulated by an *EEA regulator* and which is subject to the local regulatory capital requirement of that regulator, that local regulatory capital requirement;
- (2A) for entities that are *recognised third country credit institutions* or *recognised third country investment firms* and which is subject to the local regulatory capital requirement of that regulator, that local regulatory capital requirement;
- (2B) for entities not in (2A) that are regulated by a *third country competent authority* named in the table in *BIPRU 8 Annex 3R* and which is subject to the local regulatory capital requirement of that regulator, that local regulatory capital requirement; and
- (3) for other entities in the group, a notional financial resources requirement calculated as if the entity were regulated by the *FCA*.

14.5.3 G (1) For the purposes of rule 14.5.2(3) the notional financial resources requirements of group entities should normally be calculated as if the entities were subject to the financial rules in IPRU(INV) relevant to the main *firm* in the group. The interpretation of 'main' given in 14.4.4 G applies here.

FCA

(2) For the purposes of calculating an expenditure-based requirement, no account should be taken of expenses that have been recharged to another entity included in the scope of consolidation. For example, in calculating the notional requirement for a service company, the expenditure-based requirement should be calculated net of recharged expenses. This is to avoid double counting of the expenses.

(3) [deleted]

14.5.4 G A *firm* may apply for a *waiver* of rule 14.5.1R, to permit a line-by-line approach to determine its *group financial resources requirement*. A *firm* should also demonstrate that calculating its requirement in this way does not result in a distortion of the *group financial resources requirement*.

FCA

## Appendix 14(1): Interpretation

### FCA

Glossary of defined terms for Chapter 14

If a defined term does not appear in the IPRU(INV) 14 glossary below, the definition appearing in the main Handbook *Glossary* applies.

<i>ancillary services undertaking</i>	an undertaking the principal activity of which consists of owning or managing property, managing data-processing services, or any other similar activity which is ancillary to the principal activity of one or more of the <i>firms</i> subject to this chapter.
<i>broad scope firm</i>	as in the Glossary in IPRU(INV) chapter 3.
<i>CAD Article 5 exempting criteria</i>	<p>the following criteria in respect of the <i>firm's</i> dealing positions:</p> <ul style="list-style-type: none"><li>- such positions arise only as a result of the <i>firm's</i> failure to match investors orders precisely;</li><li>- the total market value of all such positions is subject to a ceiling of 15% of the <i>firm's</i> initial capital; and</li><li>- such positions are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question.</li></ul>
<i>CAD investment firm</i>	a <i>firm</i> subject to the requirements of the <i>Capital Adequacy Directive</i> excluding a person to whom the CAD does not apply under Article 3.1(b) of that Directive.
<i>contingent liability</i>	<p>the meaning in FRS 12 which states that it is:</p> <ul style="list-style-type: none"><li>(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the entity's control or</li><li>(b) a present obligation that arises from past events but is not recognised because:<ul style="list-style-type: none"><li>(i) it is not probable that a transfer of economic benefits will be required to settle the obligation; or</li><li>(ii) the amount of the obligation cannot be measured with sufficient reliability.</li></ul></li></ul>
<i>consolidated supervision</i>	the application of the financial rules in the Interim Prudential sourcebook for investment businesses in accordance with rules and guidance in 14.1.1 to 14.5.4.
<i>EEA parent</i>	a <i>firm's</i> direct or indirect <i>parent</i> which has its head office in the <i>EEA</i> .
<i>financial holding company</i>	<p>an undertaking that satisfies the following conditions:</p> <ul style="list-style-type: none"><li>(a) it is:<ul style="list-style-type: none"><li>(i) a <i>financial institution</i>; or</li></ul></li></ul>

- (ii) a *firm* falling within *IPRU(INV) rule 14.1.1(1)*;
- (b) is *subsidiary undertakings* are either exclusively or mainly:
  - (i) *credit institutions*;
  - (ii) *investment firms*;
  - (iii) *broad scope firms* or *undertakings* carrying on activities which (if they were *firms* doing those activities in the *United Kingdom*) would make them *broad scope firms*; and
  - (iv) *financial institutions*,

one of which at least is a *credit institution*, a *firm* falling within *IPRU(INV) rule 14.1.1(1)* or an investment firm; and

- (c) it is not a *mixed financial holding company*.

<i>financial institution</i>	an undertaking other than a <i>credit institution</i> , the principal activity of which is to acquire holdings or to carry on a <i>listed activity</i> .
<i>group financial resources</i>	the resources of a <i>firm's</i> group calculated in accordance with rules 14.4 (Group financial resources).
<i>group financial resources requirement</i>	the requirement that a <i>firm's</i> group maintains financial resources calculated in accordance with the rules in 14.5 (Group financial resources requirement).
<i>investment firm</i>	<i>investment firm</i> as in the main <i>Glossary</i> except that it excludes persons to which the <i>MiFID</i> does not apply as a result of article 2 or 3 of the <i>MiFID</i> .
<i>Listed activity</i>	<p>a listed activity within the meaning of the <i>BCD</i>, that is one or more of the following activities:</p> <ul style="list-style-type: none"> <li>(a) lending;</li> <li>(b) financial leasing;</li> <li>(c) money transmission services;</li> <li>(d) issuing and administering means of payment;</li> <li>(e) guarantees and commitments;</li> <li>(f) trading for own account or for the account of customers in:           <ul style="list-style-type: none"> <li>(i) money market instruments (cheques, bills, certificates of deposit, etc);</li> <li>(ii) foreign exchange;</li> <li>(iii) financial futures and options;</li> <li>(iv) exchange and interest rate instruments;</li> <li>(v) transferable securities;</li> </ul> </li> </ul>

	(g) participation in share issues and the provision of services related to such issues;
	(h) corporate finance advice;
	(i) money broking;
	(j) portfolio management and advice; or
	(k) safekeeping and administration of securities.
<i>Material holding</i>	a holding of –
	(a) ordinary share capital and non cumulative preference share capital; or
	(b) subordinated loan and non fixed-term cumulative preference share capital,
	in a <i>credit institution</i> or a <i>financial institution</i> where –
	(i) (a) or (b) above exceeds 10% of the share capital plus share premium of the issuer; or
	(ii) the aggregate of (a) and (b) above exceeds 10% of the <i>firm's own funds</i> , before deducting the holding.
<i>Material insurance holding</i>	the higher of –
	(1) the book value of an <i>investment</i> held in an insurance undertaking, reinsurance undertaking, or insurance holding company ( <i>investment</i> for this purpose is either a <i>participation</i> or the <i>investment</i> in a <i>subsidiary</i> undertaking); or
	(2) the group's proportionate share of that undertaking's local or notional regulatory capital requirement."
<i>Non-trading book</i>	in relation to a <i>firm's</i> business or exposures, means any position, counterparty exposure or balance sheet item not falling within the definition of <i>trading book</i> .
<i>parent</i>	any parent undertaking as defined in section 1162 of the Companies Act 2006 and any undertaking which effectively exercises a dominant influence over another undertaking.
<i>participation</i>	a participation within the meaning of Article 17 of Directive 78/660/EEC or the ownership either direct or indirect of 20% or more of the voting rights or capital of another undertaking which is not a <i>subsidiary</i> .
<i>subsidiary</i>	as in section 1159(1) of the Companies Act 2006.
<i>trading book</i>	as in the Glossary in IPRU(INV) chapter 5.

## Annex A: LIMITED LIABILITY PARTNERSHIPS: ELIGIBLE MEMBERS' CAPITAL

### 1 Introduction

#### Application

- 1.1 [FCA] R This annex applies to any *firm* :
- (1) that is a *limited liability partnership*; and
  - (2) that is a kind of *firm* to whom the provisions of this sourcebook apply, or which is a *UCITS firm*.
- 1.2 [FCA] R In this annex, an expression in italics has the meaning given in the *Handbook Glossary*.
- 1.3 [FCA] G (1) *Firms* are reminded that a *limited liability partnership* incorporated under the Limited Liability Partnership Act 2000 is a *body corporate* with legal personality separate to that of its members and is not therefore a form of *partnership* for the purposes of this sourcebook.
- (2) A *limited liability partnership* is not a separate prudential categorisation under this sourcebook but a kind of *firm* for whom the appropriate provisions of this sourcebook are modified to the extent indicated in this annex.

#### Purpose

- 1.4 [FCA] G The purpose of this annex is to amplify *Principle 8* (Financial resources) which requires a *firm* to maintain adequate financial resources to meet its investment business commitments and to withstand the risks to which its business is subject. This annex imposes various conditions that must be satisfied for members' capital to count as "Tier 1" or equivalent grade capital in meeting the *limited liability partnership's* financial resources requirement. These conditions are made up of conditions specific to *limited liability partnerships* and general conditions based for the most part on those set out in article 57 of the *Banking Consolidation Directive*. This assists in the achievement of the *statutory objective* of consumer protection.
- 1.5 [FCA] G The following *rules* allow inclusion of members' capital within a *firm's* capital if it meets the conditions in this annex:

Chapter	<i>IPRU(INV) rule</i>	<b>How eligible LLP members' capital should be treated for the purposes of the <i>IPRU(INV) rule</i></b>
3	Table 3-61	<i>Eligible LLP members' capital</i> may be counted as Tier 1 capital under item "A" within Table 3-61.
5	Table 5.2.2 (1):	<i>Eligible LLP members' capital</i> may be counted as

	Item (1A)	Tier 1 capital within Category A of Table 5.2.2(1).
9	9.3.1	<i>Eligible LLP members' capital</i> may be counted as initial capital with <i>IPRU(NV)</i> 9.3.1
10	Table 10-61(1)A Table 10-61(1)B Table 10-62(2)A Table 10-62(2)B Table 10-62(2)C	<i>Eligible LLP members' capital</i> may be counted as initial capital within the relevant table.
13	Table 13.3.2(1) Table 13.10(2)  13.1A.7	<i>Eligible LLP members' capital</i> may be counted as <i>own funds</i> relating to companies in Table 13.3.2(1) and Table 13.10(2). <i>Eligible LLP members' capital</i> may be counted as initial capital within <i>IPRU(INV)</i> 13.1A.7.

## 2. CONDITIONS FOR USE OF MEMBERS' CAPITAL

### Members' capital of a limited liability partnership

2.1 R In this sourcebook, members' capital of a *limited liability partnership* may be included within a *firm's* resources if it complies with:

[FCA]

- (1) the specific conditions; and
- (2) the general conditions.

#### Specific conditions for eligibility

2.2 R The specific conditions are that:

[FCA]

- (1) members' capital is made up of the members' capital account; and
- (2) the members' capital account is an account:
  - (a) into which capital contributed by the members is paid; and
  - (b) from which under the terms of the *limited liability partnership* agreement an amount representing capital may be withdrawn by a member only if:
    - (i) he ceases to be a member and an equal amount is transferred to another such account by his former fellow members or any person replacing him as a member;
    - (ii) the *limited liability partnership* is wound up or otherwise dissolved; or

- (iii) the *firm* has ceased to be *authorised* or no longer has a *Part 4A permission*.

### **General conditions for eligibility**

- 2.3 [FCA] R The general conditions in respect of the members' capital are that:
- (1) it is fully paid and the proceeds are immediately and fully available to the *firm*;
  - (2) it is not capable of being redeemed at all (otherwise than in the circumstances set out in the specific conditions) or can only be redeemed on a winding up of the *firm*;
  - (3) any *coupon* is non-cumulative;
  - (4) it is able to absorb losses to allow the *firm* to continue trading;
  - (5) the amount of the item included is net of any foreseeable tax charge;
  - (6) it is available to the *firm* for unrestricted and immediate use to cover risks and losses as soon as they occur;
  - (7) it ranks for repayment on a winding up of the *firm* no higher than a *share* of a company incorporated under the Companies Act 2006 (whether or not it is such a *share*); and
  - (8) the *firm* is under no obligation to pay a *coupon* on it at any time.

### **Surplus eligible LLP members' capital**

- 2.4 [FCA] G If a *firm* has surplus *eligible LLP members' capital* that it wishes to repay in circumstances otherwise than those in the specific conditions, it may apply to the *FCA* for a *waiver* to allow it to do so. If a *firm* applies for such a *waiver* the information that the *firm* supplies to support the application might include:
- (1) a demonstration that the *firm* would have sufficient financial resources to meet its financial resources requirement immediately after the repayment; and
  - (2) a two to three year capital plan demonstrating that the *firm* would be able to meet the requirements in (1) and (2) at all times without needing further capital injections.

### **Limited liability partnership excess drawings**

- 2.5 [FCA] R A *firm* which is a *limited liability partnership* must in calculating its tier one capital in accordance with the requirements of any chapter of this sourcebook deduct the amount by which the aggregate of the amounts withdrawn by its members exceeds the profits of that *firm* ("*excess LLP members' drawings*"). Amounts of *eligible LLP*

*members' capital* repaid in accordance with the specific conditions are not to be included in this calculation.

ANNEX D

[Required Forms]

**Interim Prudential  
Sourcebook for  
Investment  
Businesses:  
Required Forms**



These forms are the required forms referred to in IPRU(INV) and are listed below (a short contents list appears at the beginning of each section of the annex):

IPRU(INV) Chapter	FORM
<b>2</b>	<b>Authorised professional firms</b>
	[FCA] 2.1 Bond
<b>3</b>	<b>Securities and Futures Firms which are not MiFID Investment Firms or which are Exempt BIPRU Commodities Firms</b>
	[FCA] 3.1 Approved Form of Subordinated Loan Agreement
	[FCA] 3.2 Form of Deed of Termination
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<b>5</b>	<b>Investment Management Firms (former IMRO Firms)</b>
	[FCA] 5.1 Prescribed Subordinated Loan Agreement
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<b>9</b>	<b>Exempt CAD Firms</b>
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<b>13</b>	<b>Personal Investment Firms (Former PIA Firms)</b>
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## 2. Authorised professional firms

Form  
[FCA] 2.1 Form of Bond

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2

**FORM OF BOND FOR AUTHORISED PROFESSIONAL  
FIRMS  
(SEE IPRU (INV) 2)**

**BY THIS BOND AS A DEED WE [ ] of [ ] (“the Principal”) and [ ] of [ ] (“the Surety”) as witnessed by its common seal (so that the Surety whose seal is affixed below shall alone be bound) are jointly and severally bound upon the terms and conditions herein set out to [ ] (“the Trustee”) in the sum of £[ ] ([sum in words]) or such other sum as may from time to time be agreed between the Surety and the Principal (“the Penalty Sum”).**

**WHEREAS:-**

- (1) The Trustee has consented to enter into this bond as trustee and to hold the rights and benefits under this bond upon trust for any Customer of the Principal in accordance with the terms of this bond.**
- (2) The Surety at the request of the Principal has agreed to be bound in the Penalty Sum upon the terms and conditions hereinafter contained.**

**NOW THIS DEED WITNESSES as follows:-**

- (1) For the purposes of this bond a claim shall arise if the following conditions are satisfied:-**
  - a. the Scheme has determined the Principal to be in default;**
  - b. the Trustee has determined to pay compensation to an eligible claimant whose claim is in respect of a Civil Liability incurred by the Principal in connection with its carrying on of Regulated Activities; and**
  - c. the claim in question relates to a Loss.**
- (2) The Surety and the Principal are held and firmly bound to the Trustee for the payment of any sum arising out of any claim under the provisions of Clause 1 hereof to the extent that any such claim exceeds the sum of fifty thousand pounds (£50,000) provided that the aggregate of any such sum or sums does not exceed the Penalty Sum.**
- (3) The Trustee hereby declares that it holds all its rights and benefits under this bond upon trust for the Customers in respect of whom or for which such claim or claims were made absolutely.**
- (4) The Trustee shall, insofar as it may lawfully do so, notify the Surety of any claim or Matter of which the Trustee is aware which may give rise to any claim hereunder such notice to be addressed to the Surety in writing at its address set out above or to such other address as may have been notified to the**

**Trustee in writing by the Surety and any such information which the Trustee shall when serving such notice designate as confidential shall be held and retained by the Surety in confidence.**

- (5) Payment of any sum to the Trustee in respect of any claim shall be due thirty (30) days after the giving of notice thereof pursuant to Clause 4 hereof the Surety shall pay any such sum or sums on demand.**
- (6) The Surety may give written notice to the Trustee sent by recorded delivery service to the address set out above or such other address as the Trustee shall from time to time advise in writing (and serving a copy of such notice upon the Principal) terminating its liability under this bond which liability shall accordingly cease sixty (60) days after receipt by the Trustee in writing of such notice (“the Termination Date”) save in respect of any claim rising out of anything notified by the Trustee to the Surety pursuant to Clause 4 prior to or within the period of six months after the Termination Date.**
- (7) Notwithstanding the Release or Discharge of the Principal the Surety shall remain liable in respect of any claim arising during the period in which this bond was in force or which shall be made within six months of the Termination Date.**
- (8) The Principal and its executors administrators or representatives whosoever jointly and severally agree and covenant with the Surety and the Trustee as follows:-**
  - a. That they shall and will from time to time and notwithstanding the Release or Discharge of the Principal indemnify the Surety and its successors and assigns from and against all claims losses costs and expenses which the Surety shall or otherwise might at any time sustain or be put to under or by virtue of this bond.**
  - b. That the Principal is an authorised professional firm which has Permission under the Act to carry on Regulated Activities and will give notice forthwith to the Surety in writing if it shall cease to have such Permission or if it shall become aware of any Matter which might give rise to it being declared in default by the Scheme.**
  - c. That the Principal will calculate the Penalty Sum that may be required under this bond from time to time so as to ensure that it complies with the Rules.**
  - d. That the persons named herein are duly authorised for an on behalf of the Principal to execute this bond in the manner appearing below.**
  - e. That the Trustee is irrevocably authorised to provide such information to the Surety as it shall think fit or as may be required for the purpose of making any claim and the Surety is irrevocably authorised to provide such information to the Trustee in relation to the obligations of the**

**Principal secured by this bond as it shall think fit.**

**f. That the Principal will duly and promptly pay the annual premium due in respect of this bond.**

**(9) In this bond words and expressions having capitalised initial letters shall have the meanings set out in this bond and where not so defined shall have the meanings set out in the Glossary annexed to the General Provisions Instrument 2001 and as the same may hereafter be varied amended or supplemented from time to time**

<b>“the Act”</b>	<b>means the Financial Services and Markets Act 2000 or any amendment or re-enactment of the provisions thereof;</b>
<b>“Civil Liability”</b>	<b>means a civil liability as defined in the Scheme Regulations;</b>
<b>“Customer”</b>	<b>means a customer as defined in the Scheme Regulations;</b>
<b>“Loss”</b>	<b>means a loss which has been the subject of a valid claim determined by the Scheme in respect of which the amount of the Civil Liability is in excess of £50,000;</b>
<b>“Matter”</b>	<b>means any proceedings initiated under the Act against the Principal in relation to its Regulated Activities;</b>
<b>“the Principal”</b>	<b>means the authorised professional firm named herein and includes each of the partners thereof where applicable;</b>
<b>"Release or Discharge"</b>	<b>means the release of the Principal in relation to the termination of any Authorisation under the provisions of the Act;</b>
<b>“Scheme”</b>	<b>means the Financial Services Compensation Scheme;</b>
<b>"Scheme Regulations"</b>	<b>means the Financial Services Compensation Scheme Regulations.</b>

**Save where the context otherwise requires words and expressions used herein and in the Act shall bear the meaning given to them in the singular shall include the plural.**

**IN WITNESS THEREOF the Principal acting by\*  
and\*  
as their duly authorised representatives and the Surety have executed and delivered  
this bond as a deed this                      day of**

**EXECUTED AND DELIVERED AS A DEED by**

**Witness** .....  
**Signature** .....  
**Occupation** .....  
**Address** .....  
.....

**EXECUTED AND DELIVERED AS A DEED by**

**Witness** .....  
**Signature** .....  
**Occupation** .....  
**Address** .....  
.....

**\*        Where appropriate this bond should be executed by the compliance partner  
          and the partner with overall responsibility for the Principal's Regulated  
          Activities**

### **3. Securities and Futures Firms which are not *MiFID* Investment Firms or which are Exempt BIPRU Commodities Firms**

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### **3.1 Approved Form of Subordinated Loan Agreement**

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#### **A. Front Page**

**THIS AGREEMENT** is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

**BETWEEN -**

- (1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement), and
- (2) **the Borrower** (as defined in the Standard Terms)

**WHEREAS** the Borrower wishes to use the Loan, or each Advance under the Facility (as those expressions are defined in the Standard Terms) as an eligible capital substitute in accordance with the *FCA's* rule [IPRU(INV) 3-63] and has fully disclosed to the *FCA* the circumstances giving rise to the Loan or Facility and the effective subordination of the Loan and each Advance.

**IT IS AGREED THAT** this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

## Schedule 1

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### B. Variable Terms

1. <b>Date of Agreement</b>	
2. <b>Effective Date</b>	
3. <b>Lender</b>	
4. <b>Address of Lender</b>	
5. <b>Borrower</b>	
6. <b>Address of Borrower</b>	

**7. The Loan or Facility**

With reference to paragraph 2 of the Standard Terms,

--

**8. Interest**

With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

--

**9. Repayment**

With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -

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**10. Additional terms**

With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

--

10. **Additional terms (contd)**

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11. **Jurisdiction**

With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

--	--

of

--	--

(b) by the Borrower -

--	--

of

--	--

## Schedule 2

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### C. Standard Terms

#### Interpretation

**1** (1) In this Agreement -

“**Advance**” means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“**Borrower**” means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

“**Business Day**” means any day except Saturday, Sunday or a bank or public holiday in England;

“**Effective Date**” means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

“**Excluded Liabilities**” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in the Insolvency of the Borrower;

“**Facility**” means the loan facility referred to in paragraph 2(2);

“**Financial Resources**” has the meaning given in the Financial Rules;

“**Financial Resources Requirement**” has the meaning given it in the Financial Rules;

“**Financial Rules**” means the rules in IPRU(INV) Chapter 3 in the *handbook*;

“**Insolvency**” means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“**Insolvency Officer**” means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

- 1 (1) **“Lender”** means the person identified as such in the Variable Terms and includes its permitted successors and assigns;

**“Liabilities”** means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

**“Loan”** means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

**“Partner”** means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

**“Senior Liabilities”** means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

**“Subordinated Liabilities”** means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

**“the FCA”** means The Financial Conduct Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

- (2) Any reference to any rules of the *FCA* is a reference to them as in force from time to time.
- (3) Reference to any gender includes a reference to all other genders.
- (4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

### **The Loan or Facility**

- 2 (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby **acknowledges** its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.

- (2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -

(a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;

(b) the Facility will be available until the last available date specified in the Variable Terms; and

- 2 (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.
- (3) The Lender and the Borrower undertake to provide the FCA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FCA in the request.

### **Interest**

- 3 Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

### **Repayment**

- 4 (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5(subordination).
- (2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).
- (3) (a) Unless the *FCA* otherwise permits, no repayment or prepayment of the Loan or any Advance may be made, in whole or in part, until five Business Days have elapsed from the *FCA* confirming in writing to the Borrower receipt of the Borrower's written notice of his intention to do so, except that -
  - (i) where, immediately after repayment or prepayment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement, the prior written approval of the *FCA* shall be obtained before any repayment or prepayment;
  - (ii) any notice under this sub-paragraph or the terms referred to in subparagraph (2) above shall be ineffective if -
    - (aa) the Insolvency of the Borrower commences before the date on which such notice expires; or
    - (bb) the *FCA* notifies the Borrower orally or in writing of its refusal to consent to such repayment or prepayment by the time such notice period expires.
- (b) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the *FCA*, except that where -
  - (i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement; or

- 4 (3) (b) (ii) before payment, the Insolvency of the Borrower commences,  
no such payment may be made without the prior written approval of the *FCA*.
- (4) If in respect of the Loan or any Advance default is made for a period of -
- (a) seven days or more in the payment of any principal due, or
  - (b) 14 days or more in the payment of any interest due,
- the Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the *FCA* of its intention to do so.
- (5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
- (6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -
- (a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;
  - (b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and
  - (c) the Lender has given seven Business Days' prior written notice to the *FCA* of its intention to institute such proceedings.
- (7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

## Subordination

- 5 (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -
- (a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -
    - (i) paragraph 4(3) has been complied with; and
    - (ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement;
  - (b) (if an order has been made or effective resolution passed for the Insolvency of the Borrower or, if a partnership, the Borrower is to be dissolved) the Borrower being “solvent” at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be “solvent”.
- (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be “solvent” if it is able to pay its debts (other than the Subordinated Liabilities) in full disregarding -
- (a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and
  - (b) the Excluded Liabilities.
- (3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.
- (4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FCA, shall in the absence of proven error be treated and accepted by the FCA, the Lender and the Borrower as correct and sufficient evidence of the Borrower’s solvency or Insolvency.

- 5** (5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -
- (a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or
  - (b) where such payment is prohibited under paragraph 4(3), the payment of such sum shall be void for all purposes.
- (6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.
- (7) Any sum so returned shall then be treated for the purposes of the Borrower's obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.
- (8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

### **Representations and undertakings of Borrower**

- 6** From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FCA -
- (a) secure all or any part of the Subordinated Liabilities;
  - (b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
  - (c) amend any document evidencing or providing for the Subordinated Liabilities;
  - (d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
  - (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or
  - (f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and
- other than as disclosed in writing to the FCA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

## **Representations and undertakings of Lender**

**7** From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FCA -

- (a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;
- (b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;
- (c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
- (d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
- (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or
- (f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FCA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

## **Borrower being a partnership**

**8** Where the Borrower is a partnership -

- (a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -
  - (i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FCA has agreed in writing to the release; and

- 8** (a) (ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FCA may consider necessary;
- (b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

### **Partial invalidity**

- 9** If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

### **The FCA and indemnity**

- 10** The FCA shall not, by virtue of having rights under this Agreement, be taken to be a trustee for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FCA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FCA as a consequence of it having rights, or taking action under this Agreement.

### **Additional terms**

- 11** Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

### **Entire agreement**

- 12** This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

### **Amendments**

- 13** Any amendments to this Agreement must be made by the prescribed Deed of Variation and any amendments made or purported to be made without the consent of the FCA shall be void. For the avoidance of doubt, nothing in this paragraph requires the FCA to be a party to this Agreement.

## **Notices to the FCA**

- 14** A notice given to the FCA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FCA has given to the sender written confirmation of its receipt.

## **Law**

- 15** This Agreement is governed by English law.

## **Jurisdiction**

- 16** For the benefit of the FCA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

## **Rights of the FCA**

- 17** Although not a party to the Agreement, the FCA may in its own right enforce a term of the Agreement to the extent that it purports to confer upon the FCA a benefit.



### 3.2 FORM OF DEED OF TERMINATION

**THIS DEED OF TERMINATION** is made on the ..... day of ..... 20.....

**BETWEEN -**

- (1) \* [insert full name of Lender] (registered in [England] number \*) whose registered office is at [*if an individual or partnership* of] \* (“the **Lender**”).
- (2) \* [insert full name of Borrower] (registered in [England] number \*) whose registered office is at [*if an individual or partnership* of] \* (“the **Borrower**”).
- (3) **The Financial Conduct Authority Limited** whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“**the FCA**”).

**WHEREAS -**

A subordinated loan agreement was entered in between the Lender (1); the Borrower (2); and the FCA (3) on [date] (“the Agreement”) pursuant to which the Lender agreed to make available to the Borrower a [Loan/Facility] of up to [£ ]. [insert brief details of any Variations] The parties to the Agreement now wish to terminate the Agreement.

**IT IS AGREED THAT -**

1. The Agreement shall be deemed terminated [in accordance with its terms] with effect from [the date of this Deed of Termination/insert relevant future date]. All obligations and liabilities arising before that date shall remain continuing.
2. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed .....  
Director

Signed .....  
Director/Secretary

*or*

Signed as a deed by  
[full names of individual partners of Lender]

(as such partners and as individuals)

Signed .....  
Partner

Signed.....  
Partner/Witness

*or*

Signed as a deed by [full name of Lender]  
*(if an individual)*

Signed.....

in the presence of

Signed.....  
Witness

Executed as a deed by [full name of Borrower]

..... Signed .....  
Director

Signed .....  
Director/Secretary

*or*

Signed as a deed by [full names of individual partners of Borrower] (as such partners and as individuals)

Signed.....  
Partner

Signed.....  
Partner/Witness

*or*

Signed as a deed by [full name of Borrower] (if an individual)

Signed.....

in the presence of

Signed.....  
Witness

The Common Seal of THE FINANCIAL CONDUCT AUTHORITY LIMITED was hereunto affixed in the presence of

Signed .....  
Authorised Signatory

Signed .....  
Authorised Signatory

### 3.3 FORM OF DEED OF VARIATION

**THIS DEED OF VARIATION** is made on the ..... day of ..... 20.....

**BETWEEN -**

- (1) \* [insert full name of Lender] (registered in [England] number \*) whose registered office is at [*if an individual or partnership of*] \* (“the **Lender**”);
- (2) \* [insert full name of Borrower] (registered in [England] number \*) whose registered office is at [*if an individual or partnership of*] \* (“the **Borrower**”);  
and
- (3) **The Financial Conduct Authority Limited** whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“the **FCA**”).

**WHEREAS -**

A subordinated loan agreement was entered into between the Lender (1); the Borrower (2); and the FCA (3) on [date] (“the Agreement”) pursuant to which the Lender agreed to make available to the Borrower a (Loan/Facility) of up to [£ ].

The parties to the Agreement now wish to vary the Agreement to [insert brief details].

**IT IS AGREED THAT -**

1. The Agreement shall be deemed varied [, in accordance with its terms,] from [the date of this Deed of Variation/insert relevant future date] so that the FCA is no longer a party to the agreement. Any obligation owed to or by, and any requirement for any consent or permission to be given to or by FCA shall be of no further effect. FCA is hereby released from each and every obligation owed by it under the Agreement. Although on execution of this deed the FCA is no longer a party to the Agreement, it may in its own right enforce a term of the Agreement to the extent that it purports to confer upon the FCA a benefit.

[insert additional clauses/details of amended clauses].

[to the extent that any term of the Agreement is inconsistent with their terms and conditions contained in the Approved Form, the terms and conditions in the Approved Form shall prevail (provided that for the purposes of this clause 1, in clauses 11 and 12 of the Approved Form, the expressions “Variable Terms” and “Agreement” shall be deemed to include references to the Agreement and this Deed)\*

2. All other terms and conditions of the Agreement remain unchanged.
3. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed .....  
Director

Signed .....  
Director/Secretary

*or*

Signed as a deed by [full names of individual partners of Lender] (as such partners and as individuals)

Signed.....  
Partner

Signed.....  
Partner/Witness

*or*

Signed as a deed by [full name of Lender] (if an individual)

Signed.....

in the presence of

Signed.....  
Witness

Executed as a deed by [full name of Borrower]

.....

Signed .....  
Director

Signed .....  
Director/Secretary

*or*

Signed as a deed by [full names of individual

partners of Borrower]  
(as such partners and as individuals)

Signed.....  
Partner

Signed.....  
Partner/Witness

*or*

Signed as a deed by [full name of Borrower]  
(*if an individual*)

Signed.....

in the presence of

Signed.....  
Witness

The Common Seal of THE FINANCIAL  
CONDUCT AUTHORITY LIMITED  
was hereunto affixed in the presence of

Signed .....  
Authorised Signatory

Signed .....  
Authorised Signatory

[FCA]

### 3.4 FORM OF GUARANTOR UNDERTAKING

This undertaking is entered into the [ ] day of [ ] 20[ ] by

[ ] (the "Guarantor") of [ ] in favour of

**The Financial Conduct Authority Limited** ("the FCA") whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS.

WHEREAS:-

- (A) By a subordinated loan agreement (the "Loan Agreement") [made on ]/ [of even date] between [ ] (the "Lender"), [ ] (the "Borrower") and the FCA, the Lender made available to the Borrower a loan [facility] on the terms and conditions contained in the Loan Agreement.
- (B) By a guarantee (the "Guarantee") made [of even date] between the Guarantor and the Lender, the Guarantor guaranteed the obligations of the Borrower to the Lender under the Loan Agreement on the terms and conditions contained in the Guarantee.

IT IS HEREBY AGREED as follows:-

- 1 The Guarantor hereby undertakes to the FCA that all and any rights which the Guarantor may have against the Borrower in respect of the Guarantee (whether by subrogation or otherwise howsoever) shall be subordinated on the same terms and conditions (mutatis mutandis) set out in the Loan Agreement (as amended from time to time) and further undertakes and confirms that the Guarantor will be bound by the terms of the Loan Agreement as if the Guarantor were a party to it in place of the Lender.
- 2 This undertaking is governed by English law.

IN WITNESS whereof this deed has been executed by the Guarantor on the date first above written.

Executed as a Deed by  
[ ]

Witness:.....

Witness's Name: .....

Witness's Address: .....

.....

## **3.5 Guidance Notes on Completion of Agreements**

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### **A GENERAL**

#### **Introduction**

1. These Notes are designed to accompany the Approved Forms of Subordinated Loan Agreement, each of which is in four parts: the front page, the Variable Terms in Schedule 1, the Standard Terms in Schedule 2 and the signature page. The parties will need to set out details of themselves and the transaction in the Variable Terms and complete the signature page. The front page and the Standard Terms should remain unaltered.
2. All communications with the FCA regarding the proposed Agreement should in the first instance be via the firm's usual contact.
3. Firms are advised to ensure that the appropriate form of subordinated loan agreement is used (Chap 9/Chap 3). This is, of course, dependent on the firm's authorisation categorisation. Should the firm's categorisation change, this should be discussed with the firm's usual contact as it is likely that any subordinated loan agreement in place will have to be revised.

#### **Preparation of the Agreement**

4.
  - (a) The form containing the Variable Terms may be completed or re-typed according to preference.
  - (b) Rather than re-type the Standard Terms (Schedule 2), firms should simply **photocopy Schedule 2 of the FCA precedent (or print it from the website) and include it as part of the original Agreement.**
5. [Deleted]

#### **Financial Rule IPRU(INV) 3-63**

6. Firms are referred to rule IPRU(INV) 3-63 on the use of subordinated loans, including restrictions on approved lenders, repayment provisions and gearing limits.

### **B NOTES ON VARIABLE TERMS**

#### **Dates**

7. If the **Effective Date of the Agreement** is to be different from the Date of the Agreement, care should be taken to record this in paragraph 2. Where this is the case, the Effective Date will normally be expected to be later than the Date of the Agreement. If the Effective Date is to be a date prior to the date of the Agreement (for example because the loan was drawn down before the Agreement was put in place), the firm will be expected to provide a reasonable explanation to the FCA as to why it was not possible to document the loan more promptly.

### **Addresses**

8. Paragraphs 4 and 6: The address given should be the firm's registered office or equivalent.

### **Partnerships**

9. Paragraph 5: Where the Borrower is a partnership, insert "See Additional Terms, paragraph 10( ) below" and in paragraph 10 of Schedule 1, insert the names and addresses of each of the partners.

### **The Loan or Facility**

10. Paragraph 7: Check that paragraph 2 of the Standard Terms accurately reflects the intentions of the parties.
11. Suggested wording for a loan is:  
"This is an agreement for the Loan of £[        ]."

12. Suggested wording for a facility is:

"This is an agreement for a Facility under which the Lender is committed to make Advances in pounds sterling to the Borrower up to a maximum amount of £[ ] until the last available date of the Facility being [.....(date) ].

The terms (if any) agreed between the parties on the mechanics of drawdown are as follows - ". \*

- \* For example, the parties may wish to provide that:

“Advances may be drawdown in integral multiples of £100,000.”.

### **Interest**

13. Paragraph 8: the FCA will be concerned if an excessive rate of interest compared with the market rate is charged. Broadly speaking a rate of interest will be regarded by the FCA as excessive if it is not a commercial one. Compound interest is not acceptable.

### **Repayment**

14. Irrespective of the form of agreement being used, the specified notice period runs from the date of drawdown and, therefore, where a loan is in the form of a facility, each advance must be for a minimum of the required period.
15. Repayment clauses have given rise to confusion in the past. Sample wordings are set out below.
16. Under rule IPRU(INV) 3-63(5), an amount repayable within three months of the effective date of the loan or advance is only acceptable as an eligible capital substitute in the absence of a waiver. A notice period of less than three months will accordingly require a waiver which will not normally be given. In many cases the most convenient approach is to provide for repayment on the expiry of three months written notice, such notice to be given to the FCA as well as to the other party to the agreement.
17. Paragraph 9: Examples of suggested wordings for either a fixed repayment date or repayment on notice in relation to IPRU(INV) 3 are as follows:
- (a) "The Borrower shall repay [the Loan/each Advance made to it] on the date which falls three months after the date of drawdown of the [Loan/relevant Advance]."
  - (b) "The Borrower shall repay [the Loan/each Advance made to it] three months after the date on which:
    - (a) the Borrower gives written notice to the Lender and to the FCA; or
    - (b) the Lender gives written notice to the Borrower and to the FCA."

Note: either (a) or (b) above by itself is sufficient.

- (c) "[The Loan / Each Advance made to the Borrower] shall be repayable on the date specified by notice in writing given by the Lender to the Borrower and to the FCA or notice in writing given by the Borrower to the Lender and to the FCA, in either case that date being not less than three months after the date on which the notice is given."

### **Additional terms**

18. Paragraph 10: Additional terms may be agreed between the borrower and lender such as those relating to -

- representations and warranties
- provision of financial and other information
- covenants
- costs and expenses
- taxes and increased costs
- mechanics of payment
- notices
- termination provisions.

However, they should not be inconsistent with the Agreement or the FCA rules. For example, any terms dealing with additional payments by the borrower (eg to compensate for taxes or increased costs) should be subject to the FCA's prior written consent. Covenants and additional representations and warranties should not be inconsistent with the existing representations and warranties in paragraphs 6 and 7 of the Standard Terms. Similarly, any notices clause should take into account paragraph 14 of the Standard Terms (notices to the FCA of no effect until receipt confirmed). Any inconsistency between the Variable Terms and the Standard Terms is resolved in favour of the Standard Terms (paragraph 11 of the Standard Terms).

The lender and borrower should note that the action which can be taken by the lender in response to any breach of representation, warranty or covenant by the borrower is considerably constrained by paragraphs 4 and 5 of the Standard Terms. Therefore the value to the lender of including additional representations, warranties or covenants is very limited.

19. See also note 9 above for the situation where the borrower is a partnership and notes 24 -25 below for additional terms relating to law and jurisdiction.

### **Law and jurisdiction**

20. If the borrower or lender is resident in another jurisdiction and does not have a branch office within the United Kingdom, paragraph 11 of the Variable Terms should be completed.
21. The borrower should not be appointed agent for service of process on the lender in case a dispute arises between them.

## **C NOTES ON STANDARD TERMS**

### **Representations and undertakings**

22. Paragraphs 6(f) and 7(f): The guarantor or other provider of security must waive its right of subrogation against the borrower until all Senior Liabilities of the borrower have been paid in full. A form of deed for this purpose is available from the FCA.
23. On the effect of other terms relating to the subordinated liabilities not contained in this Agreement, see also paragraph 12 of the Standard Terms.
24. Paragraphs 15 and 16: See Notes 24-25 above.

## **D SIGNATURE PAGE**

### **Arrangements for execution post FCA approval**

25. **Two identical original Agreements** (i.e. the front page, the two Schedules and the signature page, each copy stapled or otherwise bound together) should be prepared for signature. Firms and lenders may use any of the execution forms set out in Notes 34-35 below.

**E DEEDS OF VARIATION/ DEEDS OF TERMINATION**

- 26. Firms are advised to ensure that the appropriate standard form is used. These forms are available from the FCA on request.
- 27. The recitals to the deed should refer to the amount of the loan/ each advance and where applicable, briefly summarise the effect of any previous variation of the agreement and of variation of the original agreement which is currently proposed.
- 28. A variation or termination of a subordinated loan agreement can only be effected by the execution of a further deed. In particular, this means that the formalities for executing a deed (see note 34-36 below) must be observed for all deeds of variation or termination and that all parties to the original agreement must also be parties to the subsequent deed of variation or termination. Only the forms set out at Notes 35(1) and (2) or 36(2) below are appropriate for execution as a deed.
- 29. A deed of variation will be required where the parties wish to change the terms of a subordinated loan agreement eg. where the amount of the loan or advance is to be increased. A deed of termination is needed where the parties wish to bring to terminate an agreement that is in place before it would otherwise come to an end. This could occur, for example, where the firm wants to substitute a new lender. Please note that where a subordinated loan agreement is terminated in this way, all obligations and liabilities of the parties arising before the date of termination remain in effect.

**F Execution**

- 30. In the case of English, Welsh and Northern Irish companies, reference is made to section 43 of the Companies Act 2006 under which a company may contract:
  - by writing under its common seal, or
  - through any person acting under its authority, express or implied.

Section 44 of the Companies Act 2006 governs the execution of documents by English, Welsh and Northern Irish companies.

- 31. Suggested wordings for English companies are:

(1) THE COMMON SEAL OF

[                    ]  
was hereunto affixed  
in the presence of

.....  
Director

.....  
Director/secretary



**OR**

(2) EXECUTED as a deed by [            ] .....

in the presence of -

Signature of witness .....

Name of witness .....

Address of witness .....

.....

33. In the case of overseas companies or partnerships, appropriate wording should be used. If necessary, firms should obtain legal advice from lawyers qualified in the relevant jurisdiction.

## FORM OF APPROVED BANK BOND

### "A"

1. This Bond is issued by [ ] of [ ] ("the Bank") for the benefit of [ ] ("the Firm").
2. The Bank hereby IRREVOCABLY AND UNCONDITIONALLY undertakes to the Firm that forthwith upon receipt of a notice of demand in the form referred to in paragraph 3 of this Bond it shall pay to the Firm the sum of £[ ] ("the Bonded Amount").
3. The notice of demand referred to in paragraph 2 of this Bond is a notice duly executed by The Financial Conduct Authority Limited ("the FCA") on behalf of the Firm (pursuant to the power of attorney executed contemporaneously herewith) which :-
  - (i) is deposited at any time during the currency of this Bond at the address of the Bank set out in paragraph 1 of this Bond (or such other address as may be notified by the Bank in writing to the FCA for this purpose from time to time);
  - (ii) demands payment in full of the Bonded Amount; and
  - (iii) certifies that the Firm is in default of its financial resources requirement as determined in accordance with the rules in IPRU(INV) 3 in the *Handbook* ("the Financial Rules") as in force at the relevant time. The Bank shall not be entitled to inquire into or require proof of the facts stated in the notice of demand which, as between the Bank, the FCA and the Firm, shall be conclusive.
4. The Bank shall have no recourse to the assets of the Firm in respect of the Bonded Amount and no other person shall have recourse to the assets of the Firm in respect of the Bonded Amount until payment in respect of all present and future sums, liabilities and obligations payable or owing by the Firm (whether actual or contingent, jointly or severally or otherwise howsoever) has been made in full to all other creditors.
5. The Bank may not terminate the Bond unless -
  - (i) the Firm will have financial resources equal to at least 120% of its financial resources requirement as determined in accordance with the Financial Rules of the FCA as in force at the relevant time immediately after termination of the Bond; or
  - (ii) the Bank is authorised by the FCA to terminate the Bond.
6. This Bond will not be terminated before the date specified in paragraph 8 below through any act or default of the Firm or otherwise.
7. This Bond shall not be affected by any change in:-
  - (i) the constitution of the Bank or the Firm; or
  - (ii) the provisions of the Financial Rules of the FCA.

8. This Bond shall remain valid from the date of its issue until [ ] [and the Bank[and the Firm] hereby irrevocably submit to the non exclusive jurisdiction of the English courts and irrevocably appoint [ ] as agents for the service of process in the said jurisdiction].\*

9. This Bond shall be governed by and construed and take effect in all respects in accordance with English law.

EXECUTED as a deed this [ ] day of [ ] 20[ ].

THE COMMON SEAL of )  
[Bank] )  
was hereunto affixed )  
in the presence of:- )

\* Words in square brackets only necessary if the Bank or the Firm is incorporated outside the U.K.

## POWER OF ATTORNEY

BY THIS POWER OF ATTORNEY given on the [ ] day of [ ] a company [incorporated in the United Kingdom] having its registered office at [ ] ("the Company") appoints The Financial Conduct Authority Limited ("the FCA") whose registered office is 25 The North Colonnade, Canary Wharf, London, E14 5HS to be the true and lawful attorney of the Company for the following purpose:-

By way of security for the obligation of the Company to maintain sufficient financial resources as required by the rules in IPRU(INV) 3 of the *Handbook* as in force from time to time to demand payment on behalf of the Company of the sums payable pursuant to the terms of the Approved Bank Bond (annexed hereto marked "A") in the manner prescribed by the terms of such Approved Bank Bond.

The Company declares the authority hereby conferred to be irrevocable as long as the Company shall remain authorised to conduct investment business in the United Kingdom by the FCA.

The authority hereby conferred may be exercised on behalf of the FCA by any one of its officers or employees duly authorised in that regard by a resolution of the FCA's Board or a duly authorised committee thereof.

This Power of Attorney shall be governed by and construed and take effect in all respects in accordance with English law.

IN WITNESS WHEREOF this deed has been duly executed by the Company and it is intended to be and is hereby delivered the day and year first above written.

THE COMMON SEAL of )  
[Company] )  
was hereunto affixed )  
in the presence of:- )

### 3.7 APPROVED FORM OF UNDERTAKING

THIS UNDERTAKING is entered into the [ ] day of [ ] 20[ ] BETWEEN:

- (1) [ ] of [ ] ("the Covenantor");
- (2) THE FINANCIAL CONDUCT AUTHORITY LIMITED ("the FCA") whose registered office is 25 The North Colonnade, Canary Wharf, London, E14 5HS; and
- (3) [ ] of [ ] ("the Principal") [and [ ] of [ ], [ ] of [ ], and [ ] of [ ]] the individual partners of the Principal as such partners and as individuals \*\*] +].

WHEREAS:

- (A) The Principal is authorised to carry on one or more regulated activities in the United Kingdom (as defined under the Financial Services and Markets Act 2000) by the FCA.
- (B) The Principal is required pursuant to the Financial Rules to maintain a Financial Resources Requirement (and the FCA has agreed that such Financial Resources Requirement may in part be represented by one or more undertakings in the form hereof to the extent that any undertaking(s) will not exceed the excess of 30% of the Principal's Base Requirement over the value of any Approved Bank Bond.
- (C) The Principal has requested the Covenantor to give an undertaking to the FCA for the purposes of the Principal's Financial Resources Requirement which the Covenantor has agreed to do.

NOW IT IS HEREBY AGREED AND DECLARED as follows:

#### 1. Definitions

In this Undertaking:

**"Base Requirement"** has the meaning given in the Financial Rules;

**"Business Day"** means a day on which The International Stock Exchange of the United Kingdom Limited is open for business;

**"Excluded Liabilities"** means Liabilities which are expressed to be and in the opinion of the Insolvency Officer of the Principal [or, where relevant, the Insolvency Officer of a Partner\*\*], do, rank junior to the Subordinated Liabilities in the insolvency of the Principal;

**"Financial Resources"** has the meaning given in the Financial Rules;

**"Financial Resources Requirement"** has the meaning given in the Financial Rules;

**"the Financial Rules"** means the rules in IPRU(INV) 3 of the *Handbook*;

**"Insolvency"** means and includes liquidation, winding up, bankruptcy and sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Principal) or the equivalent in any other jurisdiction to which the Principal may be subject;

**"Insolvency Officer"** means and includes any person duly appointed to administer and distribute assets of the Principal in the course of the Principal's insolvency;

**"Liabilities"** means all present and future sums, liabilities and obligations payable or owing by the Principal [or any Partner\*\*] (whether actual or contingent, jointly or severally or otherwise howsoever); [**"Partner"** means an individual partner of the Principal\*\*];

**"Senior Liabilities"** means all Liabilities except all Liabilities in respect of any sums paid to the Principal under the terms of this Undertaking and Excluded Liabilities;

**"Subordinated Liabilities"** means all Liabilities to the Covenantor in respect of repayment of any sums paid to the Principal under the terms of this Undertaking. Any reference to any rules of the FCA is a reference to them as already amended and includes a reference to any revoked rules which may be remade with or without amendments, and to any future rules and/or amendments of them.

2. In consideration of the FCA agreeing to take this Undertaking into account for the purpose of determining compliance by the Principal with its Financial Resources Requirement the Covenantor with intent to bind its successors and assigns and any body corporate with which it may amalgamate or merge HEREBY UNDERTAKES with and to the FCA and the Principal that at any time after the occurrence of any Event of Default specified in paragraph 6 hereof ("Event of Default") and notwithstanding that any other Event of Default may have occurred prior thereto the Covenantor will on demand in writing made upon it by the FCA accompanied by a certificate of the FCA as referred to in paragraph 9 hereof ("the Certificate") pay to the Principal or as the case may be the FCA (as determined in accordance with paragraph 3 below) the sum of £[ ] ("the Specified Amount").
3. In the case of an Event of Default falling within any of sub-paragraphs (1)(a), (1)(b) or (1)(c) of paragraph 6 below the sum to be paid pursuant to paragraph 2 above shall be paid to the FCA to be used at its discretion for any lawful purpose of the FCA , and in the case of an Event of Default falling within sub-paragraph (1)(d) of paragraph 6 below the sum to be paid pursuant to paragraph 2 above shall be paid to the Principal.
4. The liability of the Covenantor hereunder shall not be affected or discharged and the Covenantor shall not be released from its obligations hereunder by any act, omission, matter or thing whatsoever whereby, if the Covenantor was treated as a surety, guarantor or cautioner for the Principal, its liability would or might have been so affected or discharged or it might have been so released.
5. the FCA may without notification to or the consent of the Covenantor and without affecting or discharging the Covenantor's liability hereunder or releasing the Covenantor from its obligations hereunder from time to time waive or omit or fail to exercise or delay exercising its rights hereunder in respect of any Event of Default and any such waiver, omission, failure or delay shall not prejudice or affect the FCA 's rights hereunder in respect of that Event of Default (except in the case of a waiver) or any other or further Event of Default (whether or not of the same kind).
6. (1) The following shall be Events of Default for the purposes hereof:
  - (a) the Principal is deemed to be insolvent (as determined in accordance with sub-paragraph (2) below);
  - (b) the Principal is unable or admits its inability to pay its debts as they fall due or makes a general assignment for the benefit of, or a compensation with, its creditors;

- (c) an encumbrancer takes possession or a receiver, judicial factor, or similar officer is appointed over all or any part of the undertaking or assets of the Principal;
- (d) the Principal shall in the bona fide opinion of the FCA have failed to maintain an excess of Financial Resources over its Financial Resources Requirement and in the bona fide opinion of the FCA shall not have remedied the same within seven days after being required by the FCA to restore the deficiency.

[(2) The Principal is deemed to become insolvent:

- (a) on the making of a winding-up order against it; or
- (b) on the passing of a resolution for a voluntary winding up in a case in which no statutory declaration has been made under Section 89 of the Insolvency Act 1986 or Article 534 of the Companies (Northern Ireland) Order 1986; or
- (c) on the holding of a creditors meeting summoned under Section 95 of that Act or Article 54 of that Order; or
- (d) on the appointment of an administrator for it under Section 9 of that Act; or
- (e) the occurrence of an event corresponding as nearly as may be to any of those mentioned in sub-paragraphs (a) to (d) above in any other jurisdiction to which the Principal may be subject.\*]

[(2) The Principal is deemed to become insolvent:

- (a) in England and Wales on the making of a winding-up order against it under any provision of the Insolvency Act 1986 as applied by an order under Section 420 of that Act; or
- (b) in Scotland, on the making of an award of sequestration on the estate of the partnership; or
- (c) in Northern Ireland, on the making of an adjudication of bankruptcy against any one of the partners; or
- (d) elsewhere on the occurrence of an event corresponding as nearly as may be to any of those mentioned above in this sub-paragraph.\*\*]

[(2) The Principal is deemed to become insolvent if:

- (a) in England and Wales, a bankruptcy order is made against him; or in Scotland, an award of sequestration is made on his estate; or
- (b) in Scotland, and award of sequestration is made on his estate; or
- (c) in Northern Ireland, an adjudication of bankruptcy is made against him; or
- (d) elsewhere than in the United Kingdom, there occurs in relation to him any event corresponding to those mentioned above in this paragraph. \*  
\* \*]

7. This Undertaking shall be a continuing undertaking and shall apply irrespective of, and shall not be affected or discharged by, any matter relating to the compliance at any time by the Principal with its Financial Resources Requirement and in particular (but without limitation) the fact (if such be the case) that the Principal at any time complies or is able to comply with the Financial Resources Requirement without making use of this Undertaking or taking the same into account for the purposes of its Financial Resources Requirement.
8. This Undertaking shall apply in relation to any Event of Default occurring at or before the close of business on the earliest (if any) to occur of the following dates ("the Termination Date"):
  - (a) if the Covenantor gives the FCA not less than six months' written notice of its desire to terminate this Undertaking with effect from the date (being a date falling on or after the second anniversary of the date hereof) specified therein, such specified date;
  - (b) if the FCA and the Covenantor agree in writing to terminate this Undertaking with effect from the date specified in such agreement, such specified date; and
  - (c) if this Undertaking shall cease with effect from any day to be eligible to represent (in whole or in part) the Financial Resources Requirement to be maintained by the Principal pursuant to the Financial Rules, the date falling two business days after such day:

provided that no demand may be made upon the Covenantor hereunder later than midnight on the thirtieth business day after the Termination Date.

9.
  - (a) In any demand proceedings or otherwise under this Undertaking the occurrence of any Event of Default shall be conclusively proved by a certificate signed by a duly authorised signatory of the FCA which shall specify the Event of Default which has occurred and to which the certificate relates and shall give brief particulars thereof.
  - (b) If the FCA requires the Principal to remedy a breach of its Financial Resources Requirement as referred to in paragraph 6(1)(d) hereof, it shall notify the Covenantor thereof as soon as reasonably practicable thereafter.
10. A demand shall be duly made upon the Covenantor hereunder if it is signed by a duly authorised signatory of the FCA (accompanied by evidence reasonably satisfactory to the Covenantor of the signatory's authority) and is addressed to the Covenantor at its registered office [principal place of business in the United Kingdom] and posted by first-class mail and (if it has not been received prior thereto) the Covenantor shall be taken to have received such demand forty-eight hours after it is posted.
11. (1) The rights of the Covenantor to repayment of any sums paid to the Principal or, as the case may be, reimbursement by the Principal of any sums paid to the FCA under the terms of this Undertaking are subordinated to the Senior Liabilities and accordingly repayment of any such sums is conditional upon:
  - (a) (if an order has not been made or an effective resolution passed for the insolvency of the Principal) the Principal being in compliance with its Financial Resources Requirement prevailing at the time of payment by the Principal, and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that, subject to sub-paragraph (2) below, the Principal could make such payment and still be in compliance with such Financial Resources Requirement immediately thereafter;
  - (b) (if an order has been made or effective resolution passed for the insolvency of the Principal) [or if the Principal shall be

dissolved\*\*] the Principal being solvent at the time of payment by the Principal, and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Principal could make such payment and still be solvent immediately thereafter. For the purposes of this sub-paragraph, the Principal shall be solvent if it is able to pay its debts in full and in determining whether the Principal is solvent there shall be disregarded obligations which are not payable or capable of being established or determined in the insolvency of the Principal and the Excluded Liabilities.

- (2) No payment of the Subordinated Liabilities shall be made at any time pursuant to sub-paragraph (1)(a) above unless:
  - (a) the Principal has given to the FCA prior written notification that it proposes to make such payment; and
  - (b) the FCA has notified the Principal in writing that it consents to such proposed payment.

The Principal shall give or procure that there are given to the FCA such information and auditor's certificate in relation to such proposed payment as the FCA may require.

- (3) For the purposes of sub-paragraph (1)(b) above a report given at any relevant time as to the solvency of the Principal by its Insolvency Officer, in form and substance acceptable to the FCA, shall in the absence of proven error be treated and accepted by the FCA, the Covenantor and the Principal as correct and sufficient evidence thereof.
- (4) If the Covenantor shall receive from the Principal [or any Partner\*\*] payment of any sum in respect of the Subordinated Liabilities when any of the terms and conditions referred to in sub-paragraphs (1) or (2) above is not satisfied the payment of such sum shall be void for all purposes and [such sums shall be received by the Covenantor upon trust to return the same to the Principal+++] [the Covenantor shall at any time thereafter be bound to return such sum to the Principal or, as the case may be, its Insolvency Officer+] (and any sums so returned shall then be treated for the purposes of the Principal's obligations hereunder as if they had not been paid by the Principal and its original payment shall be deemed not to have discharged any of the obligations of the Principal hereunder). A request to the Covenantor for return of any sum under the foregoing provisions of this sub-paragraph (4) shall be in writing and shall be made by or on behalf of the Principal or, as the case may be, its Insolvency Officer.

12. The Covenantor will not without the prior written consent of the FCA :

- (i) assign or purport to assign to any person the whole or any part of the Subordinated Liabilities;
- (ii) purport to retain or set off at any time any amount payable by it to the Principal [or any Partner\* \*] against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Undertaking; amend any document evidencing or providing for the Subordinated Liabilities;
- (iii) amend any document evidencing or providing for the Subordinated Liabilities;

- (iv) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Undertaking;
  - (v) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected;
  - (vi) take any security from any person for all or any part of the Subordinated Liabilities, and the Covenantor shall, upon obtaining security in breach of this Undertaking, hold the same [on trust for+++][as agent of and for the benefit of+] the Principal.
13. The Covenantor acknowledges that the FCA would seek to enforce any breach of the undertaking of the Covenantor contained in Clause 2 hereof by seeking an order for specific performance thereof and the Covenantor acknowledges that an order for specific performance would be the remedy appropriate to be granted to the FCA for such a breach.
14. This Undertaking forms the entire agreement as to the agreement of the Covenantor to provide an undertaking in relation to the Principal's Financial Resources Requirement. If there are any other terms relating thereto existing at the date hereof and not comprised in this Undertaking such terms shall be of no further force and effect. No variation of or amendment to this Undertaking shall be of any effect unless it is in writing subscribed by all the parties hereto. Any amendment to this Undertaking made or purported to be made without the consent of the FCA shall be void.
- [15. This Undertaking shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Principal by the retirement of the present partners or [either] [any] of them or the assumption of new partners or by a change of name it being provided that:
- (a) A retired partner shall continue to be liable for the payment of all sums due hereunder and implementation of all other obligations herein contained until such time as the Bank and the remaining partner[s] shall agree in writing to release a retired partner from such obligations; and
  - (b) In the event of a new partner being assumed as a partner of the Principal the other partners shall procure that said assumed partner shall become bound to the Covenantor as a party to these presents and shall execute such addendum hereto as the Covenantor and the FCA may consider necessary. \*\*] +]
- [16. The Principal and the Partners hereby acknowledge to the Covenantor and the FCA that subject to the foregoing provisions of the Agreement they will be jointly and severally liable to the Covenantor for any sum paid by the Covenantor hereunder and that irrespective of whether such sum was paid by the Covenantor to the Principal or to the FCA . \*\*] +]
17. This Undertaking is governed by [English law+++++] [the law of Scotland+] [Northern Irish law+++++] [, and for the benefit of the FCA solely the Covenantor irrevocably submits to the jurisdiction of the [English Courts+++++] [Court of Session, Scotland+] [Northern Irish Courts+++++] and appoints [ ] as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that such non-exclusivity prejudices the submission to such jurisdiction].

**Notes:**

- (1) To be executed by the Covenantor under seal - other parties to execute either under seal or under hand.
- (2) Words in brackets throughout this document marked with a single asterisk are for use where the Principal is a corporation, those marked with a double asterisk are for use where the Principal is a partnership, and those marked with a triple asterisk where the Principal is an individual.
- (3) Words in brackets marked with a single cross are for use where the agreement is governed by Scottish law, with two crosses where the agreement is governed by either Scottish or Northern Irish law, three crosses where it is governed by either English or Northern Irish law, four crosses where it is governed by Northern Irish law and five crosses where it is governed by English law. Thus, for instance, words marked ++\* \* would be for use where the Borrower is a partnership and the agreement is governed by either Scottish or Northern Irish law.
- (4) Words in brackets in paragraph 17 above only required where either the Covenantor or the Principal (or both) are not incorporated in any part of the United Kingdom.

**Investment Management Firms  
(former IMRO Firms)**

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**PRESCRIBED SUBORDINATED LOAN AGREEMENT**

THIS SUBORDINATED LOAN AGREEMENT is made the \_\_\_\_ day of \_\_\_\_ 20\_\_\_\_  
between:

- (1) [ \_\_\_\_ ] of [ \_\_\_\_ ] (“the Lender” which term includes its permitted successors and assigns);
- (2) [ \_\_\_\_ ] of [ \_\_\_\_ ] (“the Borrower” which term includes its permitted successors and assigns).

**WHEREAS**

- (A) The Borrower is [has applied to be] regulated by FCA.
- (B) The Borrower is required to maintain financial resources to meet the provisions of Chapter 5 of the Interim Prudential Sourcebook as they apply to the Borrower at any particular time.
- (C) The Lender has agreed to lend [has lent] to the Borrower an amount as set out herein upon and subject to the terms and conditions contained in this Agreement.

NOW IT IS HEREBY AGREED as follows:

- 1. Definitions In this Agreement:
  - “Business Day”  
means a day on which banks are open for all banking business in London;
  - “FCA”  
means the Financial Conduct Authority;
  - “Interest Amount”  
in respect of an Interest Period means the amount of interest payable in respect of such Interest Period calculated by applying the Rate of Interest in respect of such Interest Period to the average amount (calculated on a daily basis) of the principal of the Loan (together with any interest due but unpaid) outstanding during such Interest Period and multiplying the resulting sum by a fraction of which the numerator is equal to the actual number of days in the Interest Period concerned and the denominator is equal to 365;

“Interest Payment Date”

means [ ] and [ ] in each year;

“Interest Period”

means the period starting on the day following an Interest Payment Date and ending on the next following Interest Payment Date provided that the First Interest Period shall commence on the date hereof and end on the next following Interest Payment Date;

“Interim Prudential Sourcebook”

means the Interim Prudential Sourcebook for Investment Businesses made by the FCA;

“LIBOR”

in respect of an Interest Period means the rate determined by such London clearing bank as the Lender and Borrower shall agree to be the arithmetic mean (rounded to the nearest 1/16 of one per cent) of the offered quotations for 6 months sterling deposits in the London inter bank market at 11.00am (London time) on the Business Day prior to the commencement of such Interest Period;

“Loan”

means the Principal Amount (as defined in Clause 2) together with interest accrued thereon as may be outstanding from time to time;

“Rate of Interest”

in respect of an Interest Period means an amount expressed as a percentage per annum equal to the sum of LIBOR in respect of such Interest Period (expressed as a percentage per annum) and [ ] per cent per annum;

“Senior Creditors”

means all such persons who are:

- (a) unsubordinated creditors of the Borrower; or
- (b) subordinated creditors of the Borrower other than those whose claims are expressed to rank and do rank, pari passu with or junior to the claims of the Lender hereunder.

Clause headings in this Agreement are inserted for ease of reference only and shall not affect the construction of this Agreement.

2. The Loan

- (a) The Lender [hereby agrees to advance]/[has on [ ] advanced] to the Borrower by way of loan the principal amount of [ ] (the “Principal Amount”) upon and subject to the terms and conditions contained in this Agreement.
- [(b) [Upon signature hereof]/[On [ ]] the Lender shall pay, or procure the payment of, the Principal Amount to the Borrower in freely available funds at its account number [ ] with [ ] bank.]

3. Interest

- (a) Subject to the provisions of Clause 7 of this Agreement:
  - (i) the Borrower will until repayment of the Loan in full pay to the Lender interest on the Loan or on any part or parts thereof for the time being remaining due hereunder in accordance with a written notice given by the Lender to the Borrower;
  - (ii) on each Interest Payment Date the Borrower shall pay to the Lender the Interest Amount in respect of the Interest Period ending on such Interest Payment Date;

provided that at no time during the continuance of this Agreement shall the Rate of Interest exceed an annual rate of 5 per cent above LIBOR.

		(b) No payment on account of interest shall be made at any time to the extent that such payment would cause the Borrower to be in breach of rule 5.2.1(1) of Chapter 5 of the Interim Prudential Sourcebook (or any equivalent Rule for the time being in force). Any amount of interest whose payment is deferred under this provision shall be paid when and to the extent that the Borrower would not be in breach of rule 5.2.1(1) of the Interim Prudential Sourcebook after such payment. [The Agreement may make provision for interest on interest.]
4.	Early Repayment	<p>Subject to the provisions of Clause 7 of this Agreement the Borrower may make an early repayment of the whole or any part of the Loan provided that:</p> <p>(a) the written consent of FCA to such repayment is first obtained by the Borrower;</p> <p>(b) the Borrower must give to the Lender not less than one Business Day's prior notice of its intention to make such repayment, specifying the amount thereof and the date on which it is to be made (such notice to be ineffective if the winding up of the Borrower commences before the date on which such notice expires); and</p> <p>(c) the Borrower shall simultaneously pay all interest accrued to the date of repayment.</p>
5.	Repayment of the Loan	<p>Subject to the provisions of Clause 7 of this Agreement the Loan shall be repayable upon the expiry of [ ] months' written notice given by the Lender to the Borrower provided that:</p> <p>(a) such notice shall expire on a day falling after [five] [two] years from the date of [drawdown] [hereof]; and</p> <p>(b) the prior written consent of FCA to the repayment has first been obtained by the Borrower and not withdrawn; but</p> <p>(c) such notice shall cease to have effect if the winding up of the Borrower commences before the date on which such notice expires.</p>
6.	Event of Default	<p>Subject to the provisions of Clauses 7 and 10 of this Agreement:</p> <p>(a) if default is made for a period of five Business Days or more in the payment of any of the principal amount of the Loan [or for a period of 15 Business Days or more in the payment of any of the interest due in respect of the Loan] the Lender may, after taking such preliminary steps or actions as may be necessary, institute proceedings to wind up the Borrower;</p>

- (b) if an order is made or an effective resolution is passed for the winding up of the Borrower, the Loan shall forthwith become repayable.

7. Subordination

Notwithstanding the provisions of Clauses 4, 5 and 6 of this Agreement, the rights of the Lender in respect of the Loan are subordinated in all respects to the rights of Senior Creditors in respect of amounts outstanding to them payable by the Borrower (“Senior Liabilities”) and accordingly payment of any amount (whether in respect of principal, interest or otherwise and whether by way of repayment or prepayment) of the Loan shall be in all respects conditional upon compliance with the provisions below:

- (a) The written consent of FCA to such payment is first obtained by the Borrower.
- (b) (i) If at any time or from time to time an order has been made or an effective resolution passed for the winding up of the Borrower, then any payment of any amount (whether in respect of principal, interest or otherwise and whether by way of repayment or prepayment) of the Loan which under any other Clause of this Agreement would fall due for payment whilst the Borrower was insolvent or in insolvent liquidation will not fall so due, and instead such payment will become due for payment only if and when and to the extent that the Borrower could make such payment in whole or in part and still be solvent (whether or not it was in liquidation) thereafter. [Interest pursuant to Clause 3 hereof will continue to accrue on each and every such payment which is suspended under this Clause. Any payment suspended under this Clause but ultimately made will be made according to the amount of principal or interest (as the case may be) due to the Lender and in the event of both principal and interest being so suspended, payment will be made on account of principal before any payment is made on account of interest, but such alteration in order of payment will not prejudice the right of the Lender (which the Borrower acknowledges and confirms) to receive, subject to this Clause 7(b)(i) the full amount to which it would have been entitled if monies from time to time available for payment had been applied instead on account of interest before principal].

(ii) For the purposes of Clause 7(a) and (b) the Borrower may, and will whenever requested by the Lender whilst any payment remains suspended, procure a report or opinion by its auditors or (if it is in liquidation) by its liquidator as to whether or not the Borrower would be solvent at any time in any circumstances or whether or to what extent any payment in respect of the Loan could be made without infringing the provisions of this Sub-Clause and in the absence of proven error such report or opinion shall be treated and accepted by the Borrower and the Lender as correct and sufficient evidence of such fact.

(iii) Nothing in this Clause shall prevent the Lender from presenting or supporting any petition to wind up the Borrower, and the Borrower shall not put forward or rely on the provisions of this Clause as a ground for opposing any petition presented or supported by the Lender.

8. Payments

Subject to the provisions of Clause 7 of this Agreement:

- (a) all payments to be made by the Borrower hereunder shall be made in immediately available funds before [ ] on the date on which payment is due in such manner as the Lender may from time to time direct;
- (b) if any sum becomes due for payment pursuant to this Agreement on a day which is not a Business Day, such payment shall be made on the next succeeding Business Day and interest shall be adjusted accordingly;
- (c) all sums payable by the Borrower hereunder shall be paid in full without set off or counter claim and free and clear of and without deduction or withholding for or on account of any present or future taxes, duties or other charges. If any payment shall be subject to any such tax or if the Borrower shall be required by law to make any such deduction or withholding, the Borrower will pay such tax, will ensure that such payment, deduction or withholding, will not exceed the minimum legal liability therefore and will simultaneously pay to the Lender such additional amounts as will result in the Lender receiving a net amount equal to the full amount which the Lender would have received had no such payment, deduction or withholding been required.

9.	Regulatory Consent	<p>The Lender will not without the prior written consent of FCA:</p> <ul style="list-style-type: none"> <li>(a) assign or purport to assign to any person this Agreement or the whole or any part of its rights against the Borrower in respect of the Loan;</li> <li>(b) purport to retain or set off at any time any amount of the Loan against any amount otherwise payable by it to the Borrower except to the extent that payment of such amount of the Loan would be permitted at such time by this Agreement;</li> <li>(c) amend or waive or concur in amending or waiving the terms of this Agreement;</li> <li>(d) attempt to obtain repayment of the whole or any part of the Loan otherwise than in accordance with the terms of this Agreement;</li> <li>(e) take or omit to take any action whereby the subordination of the Loan or any part thereof as provided for in Clause 7 of this Agreement might be terminated, impaired or adversely affected; or</li> <li>(f) take any security from any person for all or any part of the Loan and so that the Lender shall, upon obtaining security in breach of this Clause, hold the same on trust for the Borrower.</li> </ul>
10.	Sole Remedy	<p>The Lender shall not be entitled to any remedy against the Borrower in respect of any default by the Borrower in repayment or prepayment of the Loan, or to enforce any other term of this Agreement, other than to institute proceedings to wind up the Borrower, provided always that the Borrower shall not, by the institution of such proceedings, become or be obliged to pay any sums or sum sooner than the same would otherwise have been payable by it pursuant to this Agreement.</p>
11.	Trust	<p>Any amounts paid by the Borrower or received or recovered by the Lender or any security taken from any person in respect of the Loan in breach of the provisions of this Agreement and any distributions of any kind or character in respect of the Loan received or recovered by the Lender otherwise than in accordance with the provisions of this Agreement shall be held on trust by the Lender to return the same to the Borrower, or where applicable, the liquidator or other similar such officer.</p>

12.	Entire Agreement	The Borrower and the Lender acknowledge that this Agreement forms the entire agreement relating to the Loan. If there are any other terms relating to the Loan existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.
13.	Continuing Obligations	The obligations of the Borrower and Lender hereunder shall be continuing obligations and shall be and remain fully effective until the repayment of the Loan in full in accordance with the provisions of this Agreement.
14.	Governing Law	This Agreement shall be governed by and construed in accordance with the laws of England and each of the parties hereby irrevocably submits to the non-exclusive jurisdiction of the Courts of England and Wales, Scotland and Northern Ireland.
15.	Rights of the FCA	Although not a party to the agreement, the FCA may in its own right enforce a term of the agreement to the extent that it purports to confer upon the FCA a benefit.
16.	Notices	<p>Any notice of demand to be given or made hereunder may be delivered by hand or sent by first class registered or pre-paid post to the recipient at the address first above mentioned or such other address as it shall last notify to each of the other parties hereto. Such notice shall be deemed to have been received:</p> <p>(a) if delivered by hand, on the day of delivery;</p> <p>(b) if sent by first class registered or pre-paid post three days after the date of despatch (as to which the sender's certificate shall be conclusive).</p>
17.	Counterparts	<p>This Agreement may be executed in any number of counterparts and by the different parties hereto on separate counterparts, each of which when so executed and delivered shall be an original, but all the counterparts shall together constitute one and the same instrument.</p> <p>IN WITNESS whereof the parties hereto have executed this Agreement as a deed the day and date first above written.</p>

## Notes for Prescribed Subordinated Loan Agreement

These notes accompany the *prescribed subordinated loan agreement* and are intended to assist those who are or propose to be regulated by FCA. These notes relate solely to the mechanical drafting aspects of the prescribed agreement.

These notes refer to the Clauses in the order in which they appear in the prescribed agreement.

1. Parties Complete the name, registered number and registered office of the Lender and the Borrower.
2. Loan The Specimen Agreement provides for two alternative ways of advancing the Loan:
  - (a) one advance on the date of the Agreement; or
  - (b) one advance at a date other than the date of the Agreement. Firms are requested to specify clearly the date of the advance.
3. Interest The maximum rate of interest is 5 per cent above LIBOR. However, if a fixed rate of interest is charged, the Interest Rate must not exceed 5 per cent above LIBOR on the date the Loan is first taken out.

If the Loan is to be free of interest:

  - (a) Clause 3 should be deleted and replaced by the words “The Loan shall be interest-free”; and
  - (b) the definitions of “Interest Amount”, “Interest Payment Date”, “Interest Period”, LIBOR and “Rate of Interest” should be deleted and consequential changes should be made to Clauses 4(c), 6(a), 7(preamble), 7(b)(i), and 8(b) accordingly.
4. Repayment The specified date of repayment must not be less than two years after:
  - (a) the date of the Agreement; or
  - (b) where the principal amount was advanced after the date of the Agreement, the date the principal amount was advanced.

5.	Execution	The date of the Agreement is the date on which execution of the Agreement by all parties is completed. Execution must accord with the laws and regulations governing the execution of documents in the jurisdiction of the Firm's principal place of business (e.g. a company whose principal place of business is in England, Wales and Northern Ireland must observe the requirements of Part 4 of the Companies Act 2006).
6.	Number of copies of Agreements	Three copies of the Agreement should be executed by both the Lender and the Borrower and forwarded to FCA. FCA will retain one original Agreement and return the other two copies to the Firm.

PRESCRIBED QUALIFYING UNDERTAKING

**THIS UNDERTAKING IS ENTERED INTO**

**THE DAY OF 20 BETWEEN**

- (1) [ ] of [ ] (“the Bank” or “Holding Company”)
- (2) FINANCIAL CONDUCT AUTHORITY whose registered office is at 25 The North Colonnade, Canary Wharf, London E14 5HS (“FCA”) and
- (3) [ ] of [ ] (“the Principal”)

**WHEREAS**

- (A) The Principal is regulated by FCA
- (B) The Principal is required to maintain financial resources to meet the provisions of Chapter 5 of the Interim Prudential Sourcebook as they apply to the Principal and FCA has agreed that the Financial Resources Requirement may in part be represented by one or more undertakings in the form hereof
- (C) The Principal has requested the Bank or Holding Company to give an undertaking to FCA for the purposes of the Principal’s Financial Resources Requirement which the Bank or Holding Company has agreed to do

**NOW THESE PRESENT WITNESS** and it is hereby agreed and declared as follows:

**1.** In this Undertaking:

“Business Day”

means a day on which the Bank or Holding Company is open for business;

“Excluded Liabilities”

means Liabilities which are expressed to be and in the opinion of the liquidator of the Principal, do, rank junior to the Subordinated Liabilities in such liquidation;

“Financial Resources Requirement”

means the amount of liquid capital which the Principal is, pursuant to the Rules, required to maintain at any particular time;

“Interim Prudential Sourcebook”

means the Interim Prudential Sourcebook for Investment Businesses made by the FCA;

“Liabilities”

means all present and future sums, liabilities and obligations payable or owing by the Principal (whether actual or contingent, jointly or severally or otherwise howsoever);

“Senior Liabilities” means all Liabilities except all Liabilities in respect of any sums paid to the Principal under the terms of this Undertaking and Excluded Liabilities;

“Subordinated Liabilities”

means all Liabilities of the Principal to the Bank or Holding Company in respect of repayment of any sums paid to the Principal under the terms of this Undertaking;

“the Rules”

means the Rules of FCA from time to time; the term

“liquid capital”

has the meaning ascribed to it in the Rules;

any reference to an enactment is a reference to it as already amended and includes a reference to any repealed enactment which it may re-enact, with or without amendments, and to any future re-enactment and/or amendment of it.

2. (a) In consideration of FCA agreeing to take this Undertaking into account for the purpose of determining compliance by the Principal with its Financial Resources Requirement the Bank or Holding Company with intent to bind its successors and assigns and any body corporate with which it may amalgamate or merge HEREBY UNDERTAKES with and to FCA and the Principal that at any time after the occurrence of any Event of Default specified in paragraph 5 hereof (“Event of Default”) and notwithstanding that any other Event of Default may have occurred prior thereto the Bank or Holding Company will on demand in writing made upon it by FCA accompanied by a certificate of FCA as referred to in paragraph 8 hereof (“the Certificate”) pay to the Principal the sum of £[ ] (“the Specified Amount”).  
  
(b) The Bank or Holding Company shall pay the Specified Amount to such account of the Principal as FCA may specify.
3. The liability of the Bank or Holding Company hereunder shall not be affected or discharged and the Bank or Holding Company shall not be released from its obligations hereunder by any act, omission, matter or thing whatsoever whereby, if the Bank or Holding Company was treated as a surety or guarantor for the Principal, its liability would or might have been so affected or discharged or it might have been so released.
4. FCA may without notification to or the consent of the Bank or Holding Company and without affecting or discharging the Bank’s or the Holding Company’s liability hereunder or releasing the Bank or Holding Company from its obligations hereunder from time to time waive or omit or fail to exercise or delay exercising its rights hereunder in respect of any Event of Default and any such waiver, omission, failure or delay shall not prejudice or affect FCA’s rights hereunder in respect of that Event of Default (except in the case of a waiver) or any other or further Event of Default (whether or not of the same kind).

5. The following shall be Events of Default for the purposes hereof:
- (a) the Principal is deemed to be unable to pay its debts in accordance with Section 123 of the Insolvency Act 1986;
  - (b) the Principal is unable or admits its inability to pay its debts as they fall due or makes a general assignment for the benefit of, or a composition with, its creditors;
  - (c) an encumbrancer takes possession, or a receiver, administrator or similar officer is appointed, of all or any part of the undertaking or assets of the Principal;
  - (d) the Principal shall in the opinion of FCA be in breach of its Financial Resources Requirement and in the opinion of FCA shall not have remedied such breach within 5 Business Days after being required by FCA to restore the deficiency.
6. This Undertaking shall be a continuing undertaking and shall apply irrespective of, and shall not be affected or discharged by, any matter relating to the compliance at any time by the Principal with its Financial Resources Requirement and in particular (but without limitation) the fact (if such be the case) that the Principal at any time complies or is able to comply with the Financial Resources Requirement without making use of this Undertaking or taking the same into account for the purposes of its Financial Resources Requirement.
7. This Undertaking shall apply in relation to any Event of Default occurring at or before the close of business on the earliest (if any) to occur of the following dates (“the Termination Date”):
- (a) if the Bank or Holding Company gives FCA not less than six months’ written notice of its desire to terminate this Undertaking with effect from the date (being a date falling on or after the second anniversary of the date hereof) specified therein, such specified date;
  - (b) if FCA and the Bank or Holding Company agree in writing to terminate this Undertaking with effect from the date specified in such agreement, such specified date; and
  - (c) if this Undertaking shall cease with effect from any day to be eligible to represent (in whole or in part) the Financial Resources Requirement to be maintained by the Principal pursuant to the Rules, the date falling two Business Days after such day. Provided that no demand may be made upon the Bank or Holding Company hereunder later than midnight on the thirtieth Business Day after the Termination Date.
8. (a) In any demand proceedings or otherwise under this Undertaking the occurrence of any Event of Default shall be conclusively proved by a certificate signed by a duly authorised signatory of FCA which shall specify the Event of Default which has occurred and to which the certificate relates and shall give brief particulars thereof.
- (b) If FCA requires the Principal to remedy a breach of its Financial Resources Requirement as referred to in paragraph 5(d) hereof, it shall notify the Bank or Holding Company thereof as soon as reasonably practicable thereafter.

9. A demand shall be duly made upon the Bank or Holding Company hereunder if it is signed by a duly authorised signatory of FCA (accompanied by evidence reasonably satisfactory to the Bank or Holding Company of the signatory's authority) and is addressed to the Bank or Holding Company at its registered office [principal place of business in the UK] and posted by first class mail and (if it has not been received prior thereto) the Bank or Holding Company shall be taken to have received such demand forty-eight hours after it is posted.
10. (a) The rights of the Bank or Holding Company to repayment of any sums paid to the Principal under the terms of this Undertaking are subordinated to the Senior Liabilities and accordingly repayment of any such sums is conditional upon:
- (i) (if an order has not been made or an effective resolution passed for the winding up of the Principal) the Principal being in compliance with its Financial Resources Requirement prevailing at the time of payment by the Principal and no such payment which would otherwise fall due will fall so due except to the extent that, subject to sub-paragraph (b) below, the Principal could make such payment and still be in compliance with such Financial Resources Requirement immediately thereafter;
  - (ii) (if an order has been made or effective resolution passed for the winding up of the Principal) the Principal being solvent at the time of payment by the Principal and accordingly no such payment which would otherwise fall due for payment will fall due except to the extent that the Principal could make such payment and still be solvent immediately thereafter. For the purposes of this sub-paragraph, the Principal shall be solvent if it is able to pay its debts in full and in determining whether the Principal is solvent for the purposes of this sub-paragraph there shall be disregarded obligations which are not payable or capable of being established or determined in the winding up of the Principal and the Excluded Liabilities.
- (b) No payment of the Subordinated Liabilities shall be made at any time pursuant to sub-paragraph (a)(i) above unless:
- (i) the Principal has given to FCA prior written notification that it proposes to make such payment; and
  - (ii) FCA has notified the Principal in writing that it consents to such proposed payment.
- The Principal shall give or procure that there are given to FCA such information and auditor's certificate in relation to such proposed payment as FCA may require.
- (c) For the purposes of sub-paragraph (a)(ii) above a report given at any relevant time as to the solvency of the Principal by its liquidator, in form and substance acceptable to FCA, shall in the absence of proven error be treated and accepted by FCA, the Bank or Holding Company and the Principal as correct and sufficient evidence thereof.

(d) If the Bank or Holding Company shall receive from the Principal payment of any sum in respect of the Subordinated Liabilities when any of the terms and conditions referred to in sub-paragraphs (a) or (b) above is not satisfied the payment of such sum shall be void for all purposes and such sums shall be received by the Bank or Holding Company upon trust to return the same to the Principal and the Bank or Holding Company shall at any time thereafter be bound to return such sum to the Principal or, as the case may be, its liquidator (and any sums so returned shall then be treated for the purposes of the Principal's obligations hereunder as if they had not been paid by the Principal and its original payment shall be deemed not to have discharged any of the obligations of the Principal hereunder). A request to the Bank or Holding Company for return of any sum under the foregoing provisions of this sub-paragraph (d) shall be in writing and shall be made by or on behalf of the Principal or, as the case may be, its liquidator.

- 11.** The Bank or Holding Company will not without the prior written consent of FCA:
- (i) assign or purport to assign to any person the whole or any part of the Subordinated Liabilities;
  - (ii) purport to retain or set-off at any time any amount payable by it to the Principal against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Undertaking;
  - (iii) amend any document evidencing or providing for the Subordinated Liabilities;
  - (iv) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Undertaking;
  - (v) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected;
  - (vi) take any security from any person for all or any part of the Subordinated Liabilities, and the Bank or Holding Company shall, upon obtaining security in breach of this undertaking, hold the same on trust for the Principal.
- 12.** The Bank or Holding Company acknowledges that FCA would seek to enforce any breach of the Undertaking of the Bank or Holding Company contained in Clause 2 hereof by seeking an order for specific performance thereof and the Bank or Holding Company acknowledges that an order for specific performance would be the remedy appropriate to be granted to FCA for such a breach.
- 13.** This Undertaking forms the entire Agreement as to the agreement of the Bank or Holding Company to provide an undertaking in relation to the Principal's Financial Resources Requirement. If there are any other terms relating thereto existing at the date hereof and not comprised in this Undertaking such terms shall be of no further force and effect. No variation of or amendment to this Undertaking shall be of any effect unless it is in writing subscribed by all the parties hereto. Any amendment to this Undertaking made or purported to be made without the consent of FCA shall be void.

- 14.** This Undertaking is governed by English law [ and for the benefit of FCA solely the Bank or Holding Company irrevocably submits to the jurisdiction of the Courts of England and Wales, Scotland and Northern Ireland and appoints [ ] as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that such non-exclusivity prejudices the submission to such jurisdiction].
- (1) *To be executed by the Bank or Holding Company under seal—other parties to execute either under seal or under hand.*
- (2) *Words in brackets in 9 and 14 above are required only where either the Bank or Holding Company or the Principal (or both) are not incorporated in any part of the UK.*
- (3) *Where the Principal is not a company, the provisions of the Undertaking shall (in agreement with FCA) be amended as appropriate to reflect the legal status of the Principal.*

## 9 Exempt CAD Firms

	Form	Page
[FCA]	9.1 Long Term Subordinated Loan Agreement	2
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## **9.1 Approved Form of Long-Term Subordinated Loan Agreement**

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### **A. Front Page**

**THIS AGREEMENT** is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

#### **BETWEEN -**

- (1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement), and
- (2) **the Borrower** (as defined in the Standard Terms)

**WHEREAS** the Borrower wishes to use the Loan, or each Advance under the Facility (as those expressions are defined in the Standard Terms) in accordance with FCA rule IPRU(INV) 9.5 and has fully disclosed to the FCA the circumstances giving rise to the Loan or Facility and the effective Subordination of the Loan and each Advance.

**IT IS AGREED THAT** this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

## Schedule 1

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### B. Variable Terms

1. <b>Date of Agreement</b>	
2. <b>Effective Date</b>	
3. <b>Lender</b>	
4. <b>Address of Lender</b>	
5. <b>Borrower</b>	
6. <b>Address of Borrower</b>	

**7. The Loan or Facility**

With reference to paragraph 2 of the Standard Terms,

--

**8. Interest**

With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

--

**9. Repayment**

With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -

Notes to paragraph 9 -

1. The repayment date for the Loan must be one or more of -
  - a date not less than five years from the date of drawdown,
  - a date not less than five years from the Borrower giving notice in writing to the Lender and the FCA, or
  - a date not less than five years from the Lender giving notice in writing to the Borrower and the FCA.
2. Where this Agreement is for a loan facility each Advance must be treated separately and have a repayment date not less than five years from the date of drawdown, or be subject to not less than five years' notice or have and be subject to both.

10. **Additional terms**

With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

--	--

11. **Jurisdiction** With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

of

(b) by the Borrower -

of

## Schedule 2

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### C. Standard Terms

#### Interpretation

**1** (1) In this Agreement -

“**Advance**” means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“**Borrower**” means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

“**Business Day**” means any day except Saturday, Sunday or a bank or public holiday in England;

“**Effective Date**” means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

“**Excluded Liabilities**” means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

“**Facility**” means the loan facility referred to in paragraph 2(2);

“**Financial Resources**” has the meaning given in the Financial Rules;

“**Financial Resources Requirement**” has the meaning given it in the Financial Rules;

“**Financial Rules**” means the rules in IPRU(INV) Chapter 9 in the *handbook*;

“**Insolvency**” means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

“**Insolvency Officer**” means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower’s Insolvency;

- 1** (1) **“Lender”** means the person identified as such in the Variable Terms and includes its permitted successors and assigns;

**“Liabilities”** means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

**“Loan”** means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

**“Partner”** means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

**“Senior Liabilities”** means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

**“Subordinated Liabilities”** means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

**“the FCA”** means The Financial Conduct Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

- (2) Any reference to any rules of the FCA is a reference to them as in force from time to time.
- (3) Reference to any gender includes a reference to all other genders.
- (4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

### **The Loan or Facility**

- 2** (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby **acknowledges** its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.

- (2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -

(a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;

(b) the Facility will be available until the last available date specified in the Variable Terms; and

- 2 (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.
- (3) The Lender and the Borrower undertake to provide the FCA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FCA in the request.

### **Interest**

- 3 Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

### **Repayment**

- 4 (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5(subordination).
- (2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).
- (3) (a) Except where the FCA otherwise permits, no repayment or prepayment of the Loan or any Advance may be made, in whole or in part, before the relevant repayment date provided for in paragraph 9 of the Variable Terms.
- (b) At the request of the Borrower, the FCA may permit the early repayment or prepayment of the Loan or any Advance, in whole or in part, only where, immediately after such repayment or prepayment, the Borrower's Financial Resources would be greater than 100% of its Financial Resources Requirement.
- (c) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the FCA, except that where -
  - (i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement; or
  - (ii) before payment, the Insolvency of the Borrower commences,no such payment may be made without the prior written consent of the FCA.
- (4) If in respect of the Loan or any Advance default is made for a period of -
  - (a) seven days or more in the payment of any principal due, or
  - (b) 14 days or more in the payment of any interest due,

- 4
- (4) The Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the FCA of its intention to do so.
  - (5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
  - (6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -
    - (a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;
    - (b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and
    - (c) the Lender has given seven Business Days' prior written notice to the FCA of its intention to institute such proceedings.
  - (7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

#### **Subordination**

- 5
- (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -
    - (a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -
      - (i) paragraph 4(3) has been complied with; and

- 5
- (1) (a) (ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and
    - (b) the Borrower being “solvent” at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be “solvent”.
  - (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be “solvent” if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding -
    - (a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and
    - (b) the Excluded Liabilities.
  - (3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.
  - (4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FCA, shall in the absence of proven error be treated and accepted by the FCA, the Lender and the Borrower as correct and sufficient evidence of the Borrower’s solvency or Insolvency.
  - (5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -
    - (a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or
    - (b) where such payment is prohibited under paragraph 4(3), the payment of such sum shall be void for all purposes.
  - (6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.
  - (7) Any sum so returned shall then be treated for the purposes of the Borrower’s obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.
  - (8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

## **Representations and undertakings of Borrower**

**6** From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FCA -

- (a) secure all or any part of the Subordinated Liabilities;
- (b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
- (c) amend any document evidencing or providing for the Subordinated Liabilities;
- (d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
- (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or
- (f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and

other than as disclosed in writing to the FCA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

## **Representations and undertakings of Lender**

**7** From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FCA -

- (a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;
- (b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;
- (c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
- (d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
- (e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or

- 7 (f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FCA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

### **Borrower being a partnership**

- 8 Where the Borrower is a partnership -

- (a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -

- (i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FCA has agreed in writing to the release; and

- (ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FCA may consider necessary;

- (b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

### **Partial invalidity**

- 9 If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

### **The FCA and indemnity**

- 10 The FCA shall not, by virtue of having rights under this Agreement, be taken to be a trustee or other fiduciary for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FCA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FCA as a consequence of it having rights, or taking action under this Agreement.

### **Additional terms**

- 11** Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

### **Entire agreement**

- 12** This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

### **Amendments**

- 13** Any amendments to this Agreement must be made by the prescribed Deed of Variation and any amendments made or purported to be made without the consent of the FCA shall be void. For the avoidance of doubt, nothing in this paragraph requires the FCA to be a party to this Agreement.

### **Notices to the FCA**

- 14** A notice given to the FCA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FCA has given to the sender written confirmation of its receipt.

### **Law**

- 15** This Agreement is governed by English law.

### **Jurisdiction**

- 16** For the benefit of the FCA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

### **Rights of the FCA**

- 17** Although not a party to the Agreement, the FCA may in its own right enforce a term of the Agreement to the extent that it purports to confer upon the FCA a benefit

## **10.2 [deleted]**

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### 9.3 FORM OF DEED OF TERMINATION

**THIS DEED OF TERMINATION** is made on the ..... day of ..... 20....

**BETWEEN -**

- (1) \* [insert full name of Lender] (registered in [England] number \*) whose registered office is at [*if an individual or partnership of*] \* (“the **Lender**”).
- (2) \* [insert full name of Borrower] (registered in [England] number \*) whose registered office is at [*if an individual or partnership of*] \* (“the **Borrower**”).
- (3) **The Financial Conduct Authority Limited** whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“**the FCA**”).

**WHEREAS -**

A subordinated loan agreement was entered in between the Lender (1); the Borrower (2); and the FCA (3) on [date] (“the Agreement”) pursuant to which the Lender agreed to make available to the Borrower a [Loan/Facility] of up to [£ ]. [insert brief details of any Variations] The parties to the Agreement now wish to terminate the Agreement.

**IT IS AGREED THAT -**

1. The Agreement shall be deemed terminated [in accordance with its terms] with effect from [the date of this Deed of Termination/insert relevant future date]. All obligations and liabilities arising before that date shall remain continuing.
2. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed .....  
Director

Signed .....  
Director/Secretary

*or*

Signed as a deed by  
[full names of individual partners of Lender]  
(as such partners and as individuals)

Signed.....  
Partner

Signed.....  
Partner/Witness

*or*

Signed as a deed by [full name of Lender]  
(if an individual)

Signed.....

in the presence of

Signed.....  
Witness

Executed as a deed by [full name of Borrower]

.....

Signed .....  
Director

Signed .....  
Director/Secretary

*or*

Signed as a deed by [full names of individual  
partners of Borrower]  
(as such partners and as individuals)

Signed.....  
Partner

Signed.....  
Partner/Witness

*or*

Signed as a deed by [full name of Borrower]  
(if an individual)

Signed.....

in the presence of

Signed.....  
Witness

The Common Seal of THE FINANCIAL  
CONDUCT AUTHORITY LIMITED  
was hereunto affixed in the presence of

Signed .....  
Authorised Signatory

Signed .....  
Authorised Signatory

## 9.4 FORM OF DEED OF VARIATION

**THIS DEED OF VARIATION** is made on the ..... day of ..... 2.....

### **BETWEEN -**

- (1) \* [insert full name of Lender] (registered in [England] number \*) whose registered office is at [*if an individual or partnership of*] \* (“the **Lender**”);
- (2) \* [insert full name of Borrower] (registered in [England] number \*) whose registered office is at [*if an individual or partnership of*] \* (“the **Borrower**”); and
- (3) **The Financial Conduct Authority Limited** whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“**the FCA**”).

### **WHEREAS -**

A subordinated loan agreement was entered into between the Lender (1); the Borrower (2); and the FCA (3) on [date] 199 (“the Agreement”) pursuant to which the Lender agreed to make available to the Borrower a (Loan/Facility) of up to [£ ].

The parties to the Agreement now wish to vary the Agreement to [insert brief details].

### **IT IS AGREED THAT -**

1. The Agreement shall be deemed varied [, in accordance with its terms,] from [the date of this Deed of Variation/insert relevant future date] so that the FCA is no longer a party to the Agreement. Any obligation owed to or by, and any requirement for any consent or permission to be given to or by, FCA shall be of no further effect. FCA is hereby released from each and every obligation owed by it under the Agreement. Although on the execution of this deed the FCA is no longer a party to the Agreement, it may in its own right enforce a term of the Agreement to the extent that it purports to confer upon the FCA a benefit.

[insert additional clauses/details of amended clauses].

to the extent that any term of the Agreement is inconsistent with their terms and conditions contained in the Approved Form, the terms and conditions in the Approved Form shall prevail (provided that for the purposes of this clause 1, in clauses 11 and 12 of the Approved Form, the expressions “Variable Terms” and “Agreement” shall be deemed to include references to the Agreement and this Deed.

2. All other terms and conditions of the Agreement remain unchanged.
3. This Deed is governed by English Law.

---

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed .....  
Director

Signed .....  
Director/Secretary

*or*

Signed as a deed by  
[full names of individual partners of Lender]  
(as such partners and as individuals)

Signed.....  
Partner

Signed.....  
Partner/Witness

*or*

Signed as a deed by [full name of Lender]  
(if an individual)

Signed.....

in the presence of

Signed.....  
Witness

Executed as a deed by [full name of Borrower]

.....

Signed .....  
Director

Signed .....  
Director/Secretary

*or*

Signed as a deed by [full names of individual

partners of Borrower]  
(as such partners and as individuals)

Signed.....  
Partner

Signed.....  
Partner/Witness

*or*

Signed as a deed by [full name of Borrower]  
(*if an individual*)

Signed.....

in the presence of

Signed.....  
Witness

The Common Seal of THE FINANCIAL  
CONDUCT AUTHORITY LIMITED was  
hereunto affixed in the presence of

Signed .....  
Authorised Signatory

Signed .....  
Authorised Signatory

## 9.5 FORM OF GUARANTOR UNDERTAKING

This undertaking is entered into the [ ] day of [ ] 20[ ] by

[ ] (the "Guarantor") of [ ] in favour of

**The Financial Conduct Authority Limited** ("the FCA") whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS.

WHEREAS:-

- (A) By a subordinated loan agreement (the "Loan Agreement") made [of even date] between [ ] (the "Lender"), [ ] (the "Borrower") and the FCA, the Lender made available to the Borrower a loan [facility] on the terms and conditions contained in the Loan Agreement.
- (B) By a guarantee (the "Guarantee") made [of even date] between the Guarantor and the Lender, the Guarantor guaranteed the obligations of the Borrower to the Lender under the Loan Agreement on the terms and conditions contained in the Guarantee.

IT IS HEREBY AGREED as follows:-

- 1 The Guarantor hereby undertakes to the FCA that all and any rights which the Guarantor may have against the Borrower in respect of the Guarantee (whether by subrogation or otherwise howsoever) shall be subordinated on the same terms and conditions (mutatis mutandis) set out in the Loan Agreement (as amended from time to time) and further undertakes and confirms that the Guarantor will be bound by the terms of the Loan Agreement as if the Guarantor were a party to it in place of the Lender.
- 2 This undertaking is governed by English law.

IN WITNESS whereof this deed has been executed by the Guarantor on the date first above written.

Executed as a Deed by

[ ]

Witness:.....

Witness's Name: .....

Witness's Address:.....

.....



## **10.6 [deleted]**

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## **10.7 [deleted]**

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## 9.8 Guidance Notes on Completion of Agreements

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### A GENERAL

#### Introduction

1. These Notes are designed to accompany the Approved Forms of Subordinated Loan Agreement, each of which is in four parts: the front page, the Variable Terms in Schedule 1, the Standard Terms in Schedule 2 and the signature page. The parties will need to set out details of themselves and the transaction in the Variable Terms and complete the signature page. The front page and the Standard Terms should remain unaltered.
2. All communications with the FCA regarding the proposed Agreement should in the first instance be via the firm's inspector.
3. Firms are advised to ensure that the appropriate form of subordinated loan agreement is used (Chap 9/Chap 3). This is, of course, dependent on the firm's authorisation categorisation. Should the firm's categorisation change, this should be discussed with the firm's usual contact as it is likely that any subordinated loan agreement in place will have to be revised.

#### Preparation of the Agreement

4. (a) The form containing the Variable Terms may be completed or re-typed according to preference.  
(b) Rather than re-type the Standard Terms (Schedule 2), firms should simply **photocopy Schedule 2 of the FCA precedent or print it from the website and include it as part of the original Agreement.**
5. [Deleted]

#### Financial Rules

6. Firms are referred to rule IPRU(INV) 9.5 on the use of subordinated loans, including restrictions on approved lenders, repayment provisions and gearing limits.

### B NOTES ON VARIABLE TERMS

#### Dates

7. If the **Effective Date of the Agreement** is to be different from the Date of the Agreement, care should be taken to record this in paragraph 2. Where this is the case,

the Effective Date will normally be expected to be later than the Date of the Agreement. If the Effective Date is to be a date prior to the date of the Agreement (for example because the loan was drawn down before the Agreement was put in place), the firm will be expected to provide a reasonable explanation to the FCA as to why it was not possible to document the loan more promptly.

### **Addresses**

8. Paragraphs 4 and 6: The address given should be the firm's registered office or equivalent.

### **Partnerships**

9. Paragraph 5: Where the Borrower is a partnership, insert "See Additional Terms, paragraph 10( ) below" and in paragraph 10 of Schedule 1, insert the names and addresses of each of the partners.

### **The Loan or Facility**

10. Paragraph 7: Check that paragraph 2 of the Standard Terms accurately reflects the intentions of the parties.
11. Suggested wording for a loan is:

"This is an agreement for the Loan of £[ ]."

12. Suggested wording for a facility is:

"This is an agreement for a Facility under which the Lender is committed to make Advances in pounds sterling to the Borrower up to a maximum amount of £[ ] until the last available date of the Facility being [.....(date) ].

The terms (if any) agreed between the parties on the mechanics of drawdown are as follows - ". \*

- \* For example, the parties may wish to provide that:

"Advances may be drawdown in integral multiples of £100,000."

### **Interest**

13. Paragraph 8: the FCA will be concerned if an excessive rate of interest compared with the market rate is charged. Broadly speaking a rate of interest will be regarded by the FCA as excessive if it is not a commercial one. Compound interest is not acceptable.

### **Repayment**

14. Irrespective of the form of agreement being used, the specified notice period runs from the date of drawdown and, therefore, where a loan is in the form of a facility, each advance must be for a minimum of the required period.
15. Repayment clauses have given rise to confusion in the past. The wording of such clauses will differ depending on which form is being used. Sample wordings for each of these forms of agreement are set out below.

***Long-term form***

16. Firms are advised that for a long-term form the repayment date must be a specified date not less than 5 years from one or more of:

- the date of drawdown;
- the borrower giving notice in writing to the lender and the FCA; or
- the lender giving notice in writing to the borrower and the FCA.

17. Paragraph 9: Examples of suggested wordings for either a fixed repayment date or repayment on notice for a long-term form are as follows:

(a) "The Borrower shall repay [the Loan/each Advance made to it] on the [date which falls five years after the date] [fifth anniversary]of drawdown of the [Loan/relevant Advance]."

(b) "The Borrower shall repay [the Loan/each Advance made to it] five years after the date on which:

(a) the Borrower gives written notice to the Lender and to the FCA; or

(b) the Lender gives written notice to the Borrower and to the FCA."

Note: either (a) or (b) above by itself is sufficient.

(c) "[The Loan / Each Advance made to the Borrower] shall be repayable on the date specified by notice in writing given by the Lender to the Borrower and to the FCA or notice in writing given by the Borrower to the Lender and to the FCA, in either case that date being not less than five years after the date on which the notice is given."

18 [deleted]

19 [deleted]

**Additional terms**

20. Paragraph 10: Additional terms may be agreed between the borrower and lender such as those relating to -

- representations and warranties
- provision of financial and other information
- covenants
- costs and expenses
- taxes and increased costs
- mechanics of payment
- notices
- termination provisions.

However, they should not be inconsistent with the Agreement or the FCA rules. For example, any terms dealing with additional payments by the borrower (eg to compensate for taxes or increased costs) should be subject to the FCA's prior written consent. Covenants and additional representations and warranties should not be inconsistent with the existing representations and warranties in paragraphs 6 and 7 of the Standard Terms. Similarly, any notices clause should take into account paragraph 14 of the Standard Terms (notices to the FCA of no effect until receipt confirmed). Any inconsistency between the Variable Terms and the Standard Terms is resolved in favour of the Standard Terms (paragraph 11 of the Standard Terms).

21. The lender and borrower should note that the action which can be taken by the lender in response to any breach of representation, warranty or covenant by the borrower is considerably constrained by paragraphs 4 and 5 of the Standard Terms. Therefore the value to the lender of including additional representations, warranties or covenants is very limited.

22. See also note 9 above for the situation where the borrower is a partnership and notes 24 -25 below for additional terms relating to law and jurisdiction.

### **Law and jurisdiction**

23. If the borrower or lender is resident in another jurisdiction and does not have a branch office within the United Kingdom, paragraph 11 of the Variable Terms should be completed.

24. The borrower should not be appointed agent for service of process on the lender in case a dispute arises between them.

## **C NOTES ON STANDARD TERMS**

### **Representations and undertakings**

25. Paragraphs 6(f) and 7(f): The guarantor or other provider of security must waive its right of subrogation against the borrower until all Senior Liabilities of the borrower have been paid in full. A form of deed for this purpose is available from the FCA.
26. On the effect of other terms relating to the subordinated liabilities not contained in this Agreement, see also paragraph 12 of the Standard Terms.
27. Paragraphs 15 and 16: See Notes 24-25 above.

## **D SIGNATURE PAGE**

### **Arrangements for execution**

28. **Two identical original Agreements** (i.e. the front page, the two Schedules and the signature page, each copy stapled or otherwise bound together) should be prepared for signature. Firms and lenders may use any of the execution forms set out in Notes 34-35 below.

## **E DEEDS OF VARIATION/ DEEDS OF TERMINATION**

30. Firms are advised to ensure that the appropriate standard the FCA form is used. These forms are available from the FCA on request.
31. The recitals to the deed should refer to the amount of the loan/ each advance and where applicable, briefly summarise the effect of any previous variation of the agreement and of variation of the original agreement which is currently proposed.
32. A variation or termination of a subordinated loan agreement can only be effected by the execution of a further deed. In particular, this means that the formalities for executing a deed (see note 34-36 below) must be observed for all deeds of variation or termination and that all parties to the original agreement must also be parties to the subsequent deed of variation or termination. Only the forms set out at Notes 35(1) and (2) or 36(2) below are appropriate for execution as a deed.
33. A deed of variation will be required where the parties wish to change the terms of a subordinated loan agreement eg. where the amount of the loan or advance is to be increased. A deed of termination is needed where the parties wish to bring to terminate an agreement that is in place before it would otherwise come to an end. This could occur, for example, where the firm wants to substitute a new lender. Please note that where a subordinated loan agreement is terminated in this way, all obligations and liabilities of the parties arising before the date of termination remain in effect.

## **F Execution**

34. In the case of English, Welsh and Northern Irish companies, reference is made to section 43 of the Companies Act 2006 under which a company may contract:
- by writing under its common seal, or
  - through any person acting under its authority, express or implied.

Section 44 of the Companies Act 2006 governs the execution of documents by English, Welsh, and Northern Irish companies.





## 13      **Personal Investment Firms (former PIA firms)**

	Form	Page
[FCA]	13.1      Form of subordinated loan (with guidance notes)	2

## 13.1 FORM OF SUBORDINATED LOAN AGREEMENT FOR PERSONAL INVESTMENT FIRMS (SEE IPRU (INV) 13)

### NOTES FOR COMPLETION OF THIS DOCUMENT

*This subordinated loan Agreement is to be used for injecting additional funds into a firm on a semi-permanent basis. This loan should normally be made in cash. You should speak to FCA before completing the Agreement if you intend to make the loan by a transfer or assignment of assets.*

- (1) *This is the standard form prescribed by FCA for long term or short term subordinated loans. A long term subordinated loan must have an original maturity of at least five years or, where it has no fixed term, be subject to five years' notice of repayment; a short term subordinated loan must have an original maturity of at least two years or, where it has no fixed term, be subject to two years' notice of repayment. Delete from the heading and from paragraph 4(2) (Repayment of the Loan) whichever period in brackets is not relevant.*
- (2) *In paragraph 2, you should insert the Effective Date of the Loan, that is, the date on which the Lender will make the advance, if this differs from the date of the Agreement.*
- (3) *Words in brackets marked with a double asterisk \*\* are for use where the Borrower is a partnership.*

#### Governing Law

Number of crosses	Governing Law
+	Scottish
++	Scottish or Northern Irish
+++	English or Northern Irish
++++	Northern Irish
+++++	English

*Example: Words marked ++\*\* will be for use where the Borrower is a partnership and the Agreement is governed by either Scottish or Northern Irish law.*

- (4) *Words in round brackets in paragraph 10 are only required where either the Lender or Borrower (or both) is not incorporated in any part of the United Kingdom.*
- (5) *You should speak to FCA before changing or amending this standard form (for example, by adding provisions relating to the terms of the Loan to be made to the Borrower by the Lender). FCA reserves the right to make a charge for considering any non-standard agreement.*

**BETWEEN:-**

- (1) [ ] of ] of  
 [ ]  
 (the "Lender" which term includes its permitted successors and assigns); and
  
- (2) [ ] of ] of  
 [ ]  
 (the "Borrower" which term includes its permitted successors and assigns); [and  
 [ ] of ] of  
 [ ],  
 [ ] of ] of  
 [ ] and ] and  
 [ ] of ] of  
 [ ]  
 the individual partners of the Borrower as such partners and as individuals]

**IT IS AGREED AS FOLLOWS:-**

**1. DEFINITIONS**

In this agreement:-

**"Effective Date"** means the date on which this Agreement is to take effect being the date of the Agreement unless otherwise stated in paragraph 2;

**"Excluded Liabilities"** means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

**"Financial Resource Requirement"** means 120 per cent. of the minimum amount of financial resources which the Borrower is required by FCA to maintain at any particular time in compliance with the Rules in chapter 13 of the Interim Prudential Sourcebook ("IPRU (INV)") and any provisions amending or replacing them;

**"Insolvency"** means and includes liquidation, winding up, bankruptcy, sequestration, administration or dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

**"Insolvency Officer"** means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower's Insolvency;

**"Liabilities"** means all present and future sums, liabilities and obligations payable or owing by the Borrower [or any Partner \*\*] (whether actual or contingent, jointly or severally or otherwise howsoever);

“**Loan**” means the indebtedness of the Borrower to the Lender referred to in paragraph 2 as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

[ “**Partner**” means an individual partner of the Borrower\*\*];

“**Rules**” means the Rules of FCA from time to time in force;

“**Senior Liabilities**” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“**Subordinated Liabilities**” means all Liabilities to the Lender in respect of the Loan and all interest payable thereon.

## 2. LOAN

The Borrower hereby acknowledges its indebtedness to the Lender in the sum of [ ] as an unsecured loan upon and subject to the terms and conditions of this Agreement.

*[Note: This paragraph may be adapted to reflect the actual basis on which the unsecured Loan arises and, if applicable, how it is to be drawn down. Members are requested to specify clearly the Effective Date of the Loan if it will differ from the date of the Agreement.]*

## 3. INTEREST

Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan in full the Borrower will [the Borrower and the partners hereby bind and oblige themselves jointly and severally to +\*\*] pay to the Lender interest on the Loan or on any part or parts of it for the time being remaining due under this Agreement such interest to be calculated and to be payable as provided below.

*[Enter details of interest calculations and manner and time of payments. The rate of interest is not to exceed an annual rate of five per cent. above the London Inter-Bank Offered Rate for deposits of the currency in question for the relevant interest period or (where a fixed rate of interest is charged) give per cent. per annum above such rate at the date the Loan is first taken out.]*

## 4. REPAYMENT OF THE LOAN

- (1) The provisions of this paragraph are subject to the provisions of paragraph 5.
- (2) Except where the Borrower has obtained FCA’s prior written consent and that consent has not been withdrawn, **no** repayment or prepayment of the Loan shall be made, in whole or in part, earlier than a date:
  - (a) not less than [five years] [two years] from the date on which the Loan was first made; or

- (b) not less than [five years] [two years] from the date on which the Borrower gave notice in writing to the Lender and FCA, or
  - (c) not less than [five years] [two years] from the date on which the Lender gave notice in writing to the Borrower and FCA.
- (3) If default is made for a period of 7 days or more in the payment of any principal due in respect of the Loan or for a period of 14 days or more in the payment of any interest due in respect of the Loan the Lender may, in order to enforce payment, at its discretion and after taking such preliminary steps as may be necessary and after notifying FCA, institute proceedings for the Insolvency of the Borrower [or the Insolvency of all or any Partners\*\*]. If an order is made or an effective resolution is passed for the winding up of the Borrower, the Loan shall become repayable.
- (4) The Lender may at its discretion, subject to the provisions which follow, institute proceedings for the Insolvency of the Borrower [or the Insolvency of all or any Partners\*\*] to enforce any obligation, condition or provision binding on the Borrower [or on all or any Partners\*\*+] under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan) provided that the borrower [or any Partner\*\*] shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it. The Lender may only institute such proceedings to enforce the obligations referred to above if (i) the default is not remedied to the satisfaction of the Lender within 60 days after notice of such default is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender (with a copy to FCA) requiring the default to be remedied and (ii) the Lender has taken all preliminary steps required to be taken by it prior to the institution of such proceedings.
- (5) No remedy against the Borrower [or any Partner\*\*] other than as specifically provided by this paragraph shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower [or any Partners\*\*] of any of its obligations under this Agreement.

## 5. SUBORDINATION

- (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount whether principal (by way of repayment or prepayment), interest or otherwise, of the Subordinated Liabilities is conditional upon:-
  - (a) (if an order has **not** been made or an effective resolution passed for the Insolvency of the Borrower) the Borrower being in compliance with its Financial Resource Requirement prevailing at the time of payment by the Borrower; and accordingly no such amount which would otherwise

fall due for payment shall be payable except to the extent that repayment under paragraph 4(2) above is permitted and the Borrower could make such payment and still be in compliance with its Financial Resource Requirement immediately thereafter; and

- (b) (if an order has been made or an effective resolution has been passed for the Insolvency of the Borrower [or if the Borrower shall be dissolved\*\*]) the Borrower being solvent at the time of payment by the Borrower; and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be solvent immediately thereafter. For the purposes of this sub-paragraph, the Borrower shall be solvent if it is able to pay its debts in full and in determining whether the Borrower is solvent for the purposes of this sub-paragraph there shall be disregarded obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower.
- (2) (a) No payment of the Subordinated Liabilities (other than in respect of interest) shall be made at any time under sub-paragraph (1) above unless the Borrower has obtained FCA's prior written consent to such payment and that consent has not been withdrawn.
  - (b) The Borrower shall give or ensure that there are given to FCA such information and auditor's certificate in relation to the proposed payment as FCA may require.
- (3) Payments of interest at a rate not exceeding the rate provided in paragraph 3 may be made to the extent permitted by sub-paragraph (1) above without prior notification to FCA.
  - (4) For the purposes of sub-paragraph (1)(b) above a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to FCA, shall in the absence of proven error be treated and accepted by FCA, the Lender and the Borrower as correct and sufficient evidence of the Borrower's solvency.
  - (5) If the Lender shall receive from the Borrower [or any Partner\*\*] payment of any sum in respect of the Subordinated Liabilities where repayment is prohibited under paragraph 4(2) or when any of the terms and conditions referred to in sub-paragraphs (1) or (2) above is not satisfied the payment of such sum shall be void for all purposes and [any such sum shall be received by the Lender upon trust to return the same to the Borrower+++] [the Lender shall at any time thereafter be bound to return such sum to the Borrower, or, as the case may be, its Insolvency Officer+] (and any sum so returned shall then be treated for the purposes of the Borrower's obligations under this Agreement as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower). A request to the Lender for return of any sum under the foregoing provisions of this sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

## **6. UNDERTAKINGS OF BORROWER**

From and after the date of this Agreement (or the Effective Date if earlier), the Borrower will not [and no Partner will\*\*] without the prior written consent of FCA:-

- (1) secure all or any part of the Subordinated Liabilities;
- (2) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;
- (3) amend any document evidencing or providing for the Subordinated Liabilities;
- (4) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;
- (5) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected.

## **7. DOCUMENTATION**

This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date of this Agreement and not comprised in it such terms shall be of no further force and effect. No variation of or amendment to this Agreement shall be of any effect unless it is in writing signed by all the parties. Any amendment to this Agreement made or purported to be made without the consent of FCA shall be void. For the avoidance of doubt, nothing in this paragraph requires the FCA to be a party to this agreement.

## **8. UNDERTAKINGS OF LENDER**

The Lender will not without the prior written consent of FCA:-

- (1) assign or purport to assign to any person the whole or any part of the Subordinated Liabilities;
- (2) purport to retain or set-off at any time any amount payable by it to the Borrower [or any Partner\*\*] against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or setoff in breach of this provision to the Borrower and such retention or set-off shall be deemed not to have occurred;
- (3) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;
- (4) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;

- (5) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected;
- (6) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining security, guarantee or indemnity in breach of this undertaking, hold the same [on trust for +++] [as agent of and for the benefit of ++] the Borrower.

*[Note: Before giving its consent to a transaction falling under paragraph 8(6), FCA will need to be satisfied that the provider of security has waived his rights of subrogation against the Borrower until all Senior Liabilities of the Borrower have been paid in full.]*

9. [This Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present partners or [either] [any] of them or the assumption of new Partners or by a change of name it being provided that:-

- (a) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligation contained in it until such time as the Lender and the remaining Partner[s] shall agree in writing to release a retired Partner from such obligations and FCA has given its written consent to the release; and
- (b) in the event of a new partner being assumed as a Partner of the Borrower the other partners shall procure that the said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum to it as the Lender and FCA may consider necessary.

The obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally. \*\*+]

## 10. LAW [AND JURISDICTION]

- (1) This Agreement is governed by [English law +++++] [the law of Scotland +] [the law of Northern Ireland +++++] and, for the benefit of FCA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the [English Courts +++++] [Court of Session, Scotland +] [Northern Irish Courts +++++] (and, to the extent that it does not have a place of business within this jurisdiction, appoints [*name and address of agent for service*] as agent for receipt of service of process in such courts). Such jurisdiction shall be non-exclusive except to the extent that such non-exclusivity prejudices the submission to such jurisdiction.
- (2) Although not a party to the agreement, the FCA may in its own right enforce a term of the agreement to the extent that it purports to confer upon the FCA a benefit.

IN WITNESS whereof the parties hereto have duly executed this Agreement as a Deed the day and year first above written.

(EXECUTED AS A DEED and DELIVERED by  
(the Lender  
(and signed by:

**Director**

**Director/Secretary**

*or*

(SIGNED and DELIVERED as a DEED  
by the individual partners of the Lender  
(as such partners and as individuals  
(in the presence of:

*or*

SIGNED and DELIVERED as a DEED by  
the Lender (*if an individual*)  
in the presence of:

(EXECUTED AS A DEED and DELIVERED by  
(the Borrower  
(and signed by:

**Director**

**Director/Secretary**

*or*

(SIGNED and DELIVERED as a DEED  
(by the individual partners or the Borrower  
(as such partners and as individuals  
(in the presence of:

*or*

*SIGNED and DELIVERED as a DEED by  
the Borrower (if an individual)  
in the presence of:*

Dated this                      day of                      20

**BETWEEN**

**the Lender**

and

**the Borrower**

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**SUBORDINATED  
LOAN AGREEMENT**

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