

THE GENERAL PRUDENTIAL SOURCEBOOK INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 149 (Evidential provisions);
 - (3) section 150(2) (Actions for damages);
 - (4) section 156 (General supplementary powers);
 - (5) section 157(1) (Guidance); and
 - (6) section 316(1) (Direction by Authority).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force as follows:
- (1) Chapters 1 and 2 of the General Prudential Sourcebook (GENPRU) as they apply to insurers and insurance special purpose vehicles come into force on 31 December 2006.
 - (2) Sections 1.5 and 2.3 of GENPRU come into force on 31 December 2006.
 - (3) The remainder of this instrument comes into force on 1 January 2007.

Amendments to the Handbook

- D. (1) The Financial Services Authority creates GENPRU to form a new module within the Prudential Standards block of its Handbook of Rules and Guidance in accordance with the following provisions:
- (a) each provision of the Integrated Prudential Sourcebook (PRU) listed in column (1) of the table in Annex A is redesignated to form part of GENPRU in accordance with the corresponding entry in column (2) of the table in Annex A;
 - (b) each provision of the Lloyd's sourcebook (LLD) listed in column (1) of the table in Annex A is redesignated to form part of GENPRU in accordance with the corresponding entry in column (2) of the table in Annex A;

- (c) the provisions in (a) and (b) designated as "Restated text" in column (3) of the table in paragraph D(2) are amended so that they read as set out in Annex B to this instrument;
 - (d) the provisions in (a) designated as "Amended text" in column (3) of the table in paragraph D(2) are amended in accordance with Annex C to this instrument;
 - (e) the Financial Services Authority makes the rules, gives the guidance and makes the requirements designated as "New text" in column (3) of the table in paragraph D(2); and
 - (f) all the above provisions are combined so that they appear in the appropriate numerical order.
- (2) The table referred to in paragraph D(1)(c) to (e) is as follows:

GENPRU	Current designation in PRU or LLD (where applicable)	How dealt with in this instrument
GENPRU 1.1	N/A	New text
GENPRU 1.2	PRU 1.2	Restated text
GENPRU 1.3	PRU 1.3	Restated text
GENPRU 1.3.55R and GENPRU 1.3.56G	N/A	New text
GENPRU 1.4	N/A	New text
GENPRU 1.5	LLD 18	Restated text
GENPRU 2.1	PRU 2.1	Restated text
GENPRU 2.1.26R	N/A	New text
GENPRU 2.2	PRU 2.2	Restated text
GENPRU 2.3	LLD 19	Restated text
GENPRU 2 Annex 1R	PRU 2.2.14R	Restated text
GENPRU 2 Annex 2R	N/A	New text
GENPRU 2 Annex 3R	N/A	New text
GENPRU 2 Annex 4R	N/A	New text
GENPRU 2 Annex 5R	N/A	New text
GENPRU 2 Annex 6R	N/A	New text
GENPRU 2 Annex 7R	PRU 2 Annex 1R	Restated text
GENPRU 2 Annex 8G	PRU 2 Annex 2G	Restated text
GENPRU 3.1	PRU 8.4	Amended text
GENPRU 3.2	PRU 8.5	Amended text
GENPRU 3 Annex 1R	PRU 8 Annex 1R	Amended text
GENPRU 3 Annex 2R	PRU 8 Annex 2R	Amended text
GENPRU 3 Annex 3G	PRU 8 Annex 3G	Amended text
GENPRU 3 Annex 4R	PRU 8 Annex 4R	Amended text

Citation

E. This instrument may be cited as the General Prudential Sourcebook Instrument 2006.

By order of the Board
25 October 2006

Annex A

Redesignation of PRU and LLD

- (1) The table referred to in paragraph D(1) of this instrument is as follows.
- (2) Where a reference in the Table in this Annex A is to a chapter and section only, the whole of the section listed in column (1) is redesignated as set out in column (2). The module, chapter and section of each provision is redesignated as set out in column (2); otherwise the numbering of the paragraphs in the redesignated section remains the same.

PRU provision: current location	Destination
1.2.1 R	GENPRU 1.2.1 R (2)
1.2.2 R	GENPRU 1.2.3 R
1.2.3 R	GENPRU 1.2.2 R
1.2.4 R	GENPRU 1.2.4 R
1.2.5 R	GENPRU 1.2.5 R
1.2.6 R	GENPRU 1.2.6 R
1.2.7 R	GENPRU 1.2.1 R (2)
1.2.8 G	GENPRU 1.2.7 G
1.2.9 G	GENPRU 1.2.8 G
1.2.10 G	GENPRU 1.2.9 G
1.2.11 G	GENPRU 1.2.10 G
1.2.12 G	GENPRU 1.2.11 G
1.2.13 G	GENPRU 1.2.17 G
1.2.14 G	GENPRU 1.2.13 G
1.2.15 G	GENPRU 1.2.15 G
1.2.16 G	GENPRU 1.2.16 G
1.2.18 G	GENPRU 1.2.18 G
1.2.19 G	GENPRU 1.2.19 G (1)
1.2.20 G	GENPRU 1.2.21 G (1)
1.2.21 G	GENPRU 1.2.20 G
1.2.22 R	GENPRU 1.2.26 R
1.2.23 G	GENPRU 1.2.27 G
1.2.24 G	GENPRU 1.2.28 G
1.2.25 G	GENPRU 1.2.29 G
1.2.26 R	GENPRU 1.2.30 R (1)
1.2.27 R	GENPRU 1.2.35 R
1.2.29 G	GENPRU 1.2.40 G
1.2.30 G	GENPRU 1.2.41 G
1.2.31 R	GENPRU 1.2.30 R (2)
1.2.32 G (2)	GENPRU 1.2.32 G (2)

PRU provision: current location	Destination
	GENPRU 1.2.37 R (1)
1.2.34 G	GENPRU 1.2.38 G
1.2.35 R	GENPRU 1.2.42 R
1.2.36 G	GENPRU 1.2.43 G
1.2.37 R	GENPRU 1.2.60 R
1.2.38 R	GENPRU 1.2.61 R
1.2.39 G	GENPRU 1.2.62 G
1.2.41 G	GENPRU 1.2.64 G
1.2.42 G	GENPRU 1.2.65 G
1.2.44 G	GENPRU 1.2.63 G
1.2.45 G	GENPRU 1.2.67 G
1.2.46 G	GENPRU 1.2.68 G
1.2.47 G	GENPRU 1.2.69 G
1.2.48 G	GENPRU 1.2.70 G
1.2.49 G	GENPRU 1.2.71 G
1.2.50 G	GENPRU 1.2.72 G
1.2.51 G	GENPRU 1.2.73 G
1.2.52 G	GENPRU 1.2.74 G
1.2.54 G	GENPRU 1.2.77 G
1.2.55 G	GENPRU 1.2.78 G
1.3.1 R	GENPRU 1.3.1 R
1.3.4 G	GENPRU 1.3.2 G
1.3.5 R	GENPRU 1.3.4 R
1.3.5A R	GENPRU 1.3.9 R (1)
1.3.5B R	GENPRU 1.3.9 R (2)
1.3.5C R	GENPRU 1.3.10R
1.3.6 G	GENPRU 1.3.5 G
1.3.7 G	GENPRU 1.3.6 G
1.3.8 G	GENPRU 1.3.7 G
1.3.10 G	GENPRU 1.3.3 G (2)
1.3.11 R	GENPRU 1.3.41 R
1.3.12 R	GENPRU 1.3.14 R
1.3.13 G	GENPRU 1.3.15 R
1.3.14 R	GENPRU 1.3.16 R
1.3.15 R	GENPRU 1.3.17 R
1.3.16 R	GENPRU 1.3.18 R
1.3.17 R	GENPRU 1.3.19 R
1.3.18 R	GENPRU 1.3.20 R
1.3.19 R	GENPRU 1.3.21 R
1.3.20 R	GENPRU 1.3.22 R
1.3.21 R	GENPRU 1.3.23 R
1.3.22 R	GENPRU 1.3.24 R
1.3.23 G	GENPRU 1.3.25 R
1.3.24 R	GENPRU 1.3.26 R
1.3.25 G	GENPRU 1.3.27 G

PRU provision: current location	Destination
1.3.26 R	GENPRU 1.3.30 R
1.3.27 R	GENPRU 1.3.31 R
1.3.28 R	GENPRU 1.3.32 R
1.3.29 R	GENPRU 1.3.33 R
1.3.30 R	GENPRU 1.3.34 R
1.3.31 R	GENPRU 1.3.43 R
1.3.32 G	GENPRU 1.3.44 G
1.3.33 R	GENPRU 1.3.45 R
1.3.34 R	GENPRU 1.3.46 R
1.3.35 R	GENPRU 1.3.47 R
1.3.36 R	GENPRU 1.3.48 R
1.3.37 R	GENPRU 1.3.49 R
1.3.38 R	GENPRU 1.3.50 R
1.3.39 R	GENPRU 1.3.51 R
1.3.40 G	GENPRU 1.3.52 G
1.3.41 G	GENPRU 1.3.53 G
1.3.42 G	GENPRU 1.3.54 G
1.3.43 R	GENPRU 1.3.57 R
2.1.1 R	GENPRU 2.1.1 R (2)
2.1.2 G	GENPRU 2.1.2 G
2.1.3 R	GENPRU 2.1.3 R
2.1.4 G	GENPRU 2.1.4 G
2.1.5 G	GENPRU 2.1.5 G
2.1.6 G	GENPRU 2.1.6 G
2.1.7 G	GENPRU 2.1.7 G
2.1.8 G	GENPRU 2.1.8 G
2.1.9 R	GENPRU 2.1.13 R
2.1.10 R	GENPRU 2.1.14 R
2.1.11 G	GENPRU 2.1.15 G
2.1.12 G	GENPRU 2.1.16 G
2.1.13 G	GENPRU 2.1.12 G
2.1.14 R	GENPRU 2.1.17 R
2.1.15 R	GENPRU 2.1.18 R
2.1.16 R	GENPRU 2.1.19 R
2.1.17 R	GENPRU 2.1.20 R
2.1.18 G	GENPRU 2.1.21 G
2.1.19 G	GENPRU 2.1.22 G
2.1.20 R	GENPRU 2.1.23 R
2.1.21 R	GENPRU 2.1.24 R
2.1.22 R	GENPRU 2.1.25 R
2.1.23 G	GENPRU 2.1.27 G
2.1.24 G	GENPRU 2.1.28 G
2.1.25 R	GENPRU 2.1.29 R
2.1.26 R	GENPRU 2.1.30 R
2.1.27 R	GENPRU 2.1.31 G

PRU provision: current location	Destination
2.1.28 G	GENPRU 2.1.32 G
2.1.29 R	GENPRU 2.1.33 R
2.1.30 R	GENPRU 2.1.34 R
2.1.31 G	GENPRU 2.1.35 G
2.1.32 R	GENPRU 2.1.36 R
2.1.33 G	GENPRU 2.1.37 G
2.1.34 R	GENPRU 2.1.38 R
2.1.35 G	GENPRU 2.1.39 G
2.1.36 R	GENPRU 2.1.9R
2.1.37 G	GENPRU 2.1.10 G
2.1.38 R	GENPRU 2.1.11 R
2.2.1 R	GENPRU 2.2.1 R (2)
2.2.2 G	GENPRU 2.2.2 G and 2.2.3 G
2.2.3 G	GENPRU 2.2.8 G
2.2.4 G	GENPRU 2.2.8 G
2.2.5 G	GENPRU 2.2.9 G
2.2.6 G	GENPRU 2.2.10 G
2.2.7 G	GENPRU 2.2.11 G
2.2.8 G	GENPRU 2.2.14 G
2.2.9 G	GENPRU 2.2.16 G
2.2.10 G	GENPRU 2.2.22 G
2.2.11 G	GENPRU 2.2.23 G
2.2.12 R	GENPRU 2.2.17 R
2.2.14 R	GENPRU 2 Annex 1R
2.2.15 G	GENPRU 2.2.24 G
2.2.16 R	GENPRU 2.2.32 R
2.2.17 R	GENPRU 2.2.33 R
2.2.18 R	GENPRU 2.2.34 R
2.2.19 G	GENPRU 2.2.36 G
2.2.20 R (1)	GENPRU 2.2.29 R
2.2.20 R (2)	GENPRU 2.2.30 R
2.2.21 G	GENPRU 2.2.31 G
2.2.22 G	GENPRU 2.2.25 G
2.2.22 G	GENPRU 2.2.26 R
2.2.23 R	GENPRU 2.2.37 R
2.2.24 R	GENPRU 2.2.28 R
2.2.25 G	GENPRU 2.2.40 G
2.2.26 R	GENPRU 2.2.41 R
2.2.27 R	GENPRU 2.2.62 R
2.2.28 R	GENPRU 2.2.63 R
2.2.29 R	GENPRU 2.2.64 R
2.2.30 R	GENPRU 2.2.65 R
2.2.31 R	GENPRU 2.2.81 R
2.2.32 G	GENPRU 2.2.67 G
2.2.33 G	GENPRU 2.2.69 G

PRU provision: current location	Destination
2.2.34 G	GENPRU 2.2.66 G
2.2.35 R	GENPRU 2.2.80 R
2.2.36 R	GENPRU 2.2.83 R
2.2.37 G	GENPRU 2.2.84 G
2.2.38 R	GENPRU 2.2.70 R
2.2.39 R	GENPRU 2.2.76 R
2.2.40 R	GENPRU 2.2.64 R (2)
2.2.50 R	GENPRU 2.2.109 R
2.2.51 G	GENPRU 2.2.110 G
2.2.52 R	GENPRU 2.2.113 R
2.2.53 R	Deleted
2.2.54 R	GENPRU 2.2.114 R
2.2.55 G	GENPRU 2.2.115 G
2.2.56 R	GENPRU 2.2.116 R
2.2.57 G	GENPRU 2.2.117 G
2.2.58 R	GENPRU 2.2.118 R
2.2.59 G	GENPRU 2.2.117 G
2.2.60 R	GENPRU 2.2.120 R
2.2.62 R	GENPRU 2.2.121 R
2.2.63 R	GENPRU 2.2.147 R
2.2.64 R	GENPRU 2.2.153 R (1)
2.2.65 R	GENPRU 2.2.138 R (2)
2.2.66 R	GENPRU 2.2.139 R
2.2.67 R	GENPRU 2.2.140 R
2.2.68 R	GENPRU 2.2.141 R
2.2.69 R	GENPRU 2.2.142 R
2.2.70 R	GENPRU 2.2.145 R
2.2.72 R	GENPRU 2.2.74 R
2.2.73 G	GENPRU 2.2.11 G
2.2.75 R	GENPRU 2.2.146 R (1)
2.2.76 R	GENPRU 2.2.85 R
2.2.77 R	GENPRU 2.2.87 R
2.2.78 R	GENPRU 2.2.105 R
2.2.79 G	GENPRU 2.2.106 G
2.2.80 R	GENPRU 2.2.107 R (1)
2.2.81 R	GENPRU 2.2.107 R (2)
2.2.82 R	GENPRU 2.2.102 R
2.2.83 G	GENPRU 2.2.103 G
2.2.84 R	GENPRU 2.2.155 R
2.2.85 G	GENPRU 2.2.156 G
2.2.86 R	GENPRU 2.2.251 R
2.2.87 G	GENPRU 2.2.252 G
2.2.88 G	GENPRU 2.2.253 G
2.2.89 R	GENPRU 2.2.255 R
2.2.90 R	GENPRU 2.2.256 R

PRU provision: current location	Destination
2.2.91 G	GENPRU 2.2.257 G
2.2.92 G	GENPRU 2.2.258 G
2.2.93 R	GENPRU 2.2.271 R
2.2.94 G	GENPRU 2.2.272 G
2.2.95 G	GENPRU 2.2.273 G
2.2.96 G	GENPRU 2.2.274 G
2.2.97 G	GENPRU 2.2.275 G
2.2.98 G	GENPRU 2.2.157 G
2.2.99 G	GENPRU 2.2.158 G
2.2.100 G	GENPRU 2.2.176 G
2.2.101 R	GENPRU 2.2.177 R
2.2.103 R	GENPRU 2.2.180 R
2.2.104 G	GENPRU 2.2.117 G
2.2.105 R	GENPRU 2.2.181 R
2.2.106 G	GENPRU 2.2.117 G
2.2.108 R	GENPRU 2.2.159 R
2.2.109 G	GENPRU 2.2.165 G
2.2.110 G	GENPRU 2.2.167 G
2.2.111 R	GENPRU 2.2.163 R
2.2.112 G	GENPRU 2.2.69 G
2.2.113 R	GENPRU 2.2.169 R
2.2.114 G	GENPRU 2.2.66 G
2.2.115 G	GENPRU 2.2.164 G
2.2.116 R	GENPRU 2.2.171 R
2.2.116A R	GENPRU 2.2.172 R
2.2.117 R	GENPRU 2.2.174 R
2.2.119 R	GENPRU 2.2.151 R
2.2.120 R	GENPRU 2.2.153 R (2)
2.2.121 R	GENPRU 2.2.146 R (2)
2.2.122 G	GENPRU 2.2.154 G
2.2.122 A R	GENPRU 2.2.195 G
2.2.123 R	GENPRU 2.2.194 R
2.2.123 A R	GENPRU 2.2.197 R
2.2.124 R	GENPRU 2.2.196 R
2.2.126 G	GENPRU 2.2.267 G
2.2.127 G	GENPRU 2.2.268 G
2.2.128 G	GENPRU 2.2.269 G
2 Annex 1 R	GENPRU 2 Annex 7R
2 Annex 2 G	GENPRU 2 Annex 8G
8.4.1 R	GENPRU 3.1.1 R
8.4.2 G	GENPRU 3.1.2 G
8.4.3 G	GENPRU 3.1.3 G
8.4.4 G	GENPRU 3.1.4 G
8.4.5 R	GENPRU 3.1.5 R
8.4.6 R	GENPRU 3.1.6 R

PRU provision: current location	Destination
8.4.7 R	GENPRU 3.1.7 R
8.4.8 R	GENPRU 3.1.8 R
8.4.9 R	GENPRU 3.1.9 R
8.4.10 R	GENPRU 3.1.10 R
8.4.11 R	GENPRU 3.1.11 R
8.4.12 R	GENPRU 3.1.12 R
8.4.13 G	GENPRU 3.1.13 G
8.4.14 G	GENPRU 3.1.14 G
8.4.15 G	GENPRU 3.1.15 G
8.4.16 G	GENPRU 3.1.16 G
8.4.17 G	GENPRU 3.1.17 G
8.4.18 G	GENPRU 3.1.18 G
8.4.19 G	GENPRU 3.1.19 G
8.4.20 G	GENPRU 3.1.20 G
8.4.21 G	GENPRU 3.1.21 G
8.4.22 G	GENPRU 3.1.22 G
8.4.23 G	GENPRU 3.1.23 G
8.4.24 G	GENPRU 3.1.24 G
8.4.25 R	GENPRU 3.1.25 R
8.4.26 R	GENPRU 3.1.26 R
8.4.27 R	GENPRU 3.1.27 R
8.4.28 R	GENPRU 3.1.28 R
8.4.29 R	GENPRU 3.1.29 R
8.4.30 R	GENPRU 3.1.30 R
8.4.31 R	GENPRU 3.1.31 R
8.4.32 G	GENPRU 3.1.32 G
8.4.33 G	GENPRU 3.1.33 G
8.4.34 R	GENPRU 3.1.34 R
8.4.35 R	GENPRU 3.1.35 R
8.4.36 R	GENPRU 3.1.36 R
8.4.39 R	GENPRU 3.1.39 R
8.5	GENPRU 3.2
8 Annex 1 R	GENPRU 8 Annex 1 R
8 Annex 2 R	GENPRU 8 Annex 2 R
8 Annex 3 G	GENPRU 8 Annex 3 G
8 Annex 4 R	GENPRU 8 Annex 4 R

LLD provision: Current location	Destination
18.2.1 R	GENPRU 1.5.1 R
18.2.2 R	GENPRU 1.5.2 R
18.2.3 G	GENPRU 1.5.3 G

18.2.4 G	GENPRU 1.5.4 G
18.2.5 D	GENPRU 1.5.5 D
18.2.6 G	GENPRU 1.5.6 G
18.2.7 R	GENPRU 1.5.7 R
18.2.8 G	GENPRU 1.5.8 G
18.2.9 G	GENPRU 1.5.9 G
18.3.1 R	GENPRU 1.5.10 R
18.3.2 R	GENPRU 1.5.11 R
18.3.4 R	GENPRU 1.5.12 R
18.3.5 R	GENPRU 1.5.13 R
18.3.6 R	GENPRU 1.5.14 R
18.3.7 R	GENPRU 1.5.15 R
18.3.8 R	GENPRU 1.5.16 R
18.3.11 R	GENPRU 1.5.17 R
18.3.12 R	GENPRU 1.5.18 R
18.3.13 R	GENPRU 1.5.19 R
18.3.14 G	GENPRU 1.5.20 G
18.3.15 R	GENPRU 1.5.21 R
18.3.16 R	GENPRU 1.5.22 R
18.3.17 R	GENPRU 1.5.23 R
18.3.18 G	GENPRU 1.5.24 G
18.3.19 R	GENPRU 1.5.25 R
18.3.20 G	GENPRU 1.5.26 G
18.4.1 R	INSPRU 8.6.1 R
18.4.2 R	INSPRU 8.6.2 R
19.2.1 R	GENPRU 2.3.1 R
19.2.2 R	GENPRU 2.3.2 R
19.2.3 G	GENPRU 2.3.3 G
19.2.4 G	GENPRU 2.3.4 G
19.2.5 R	GENPRU 2.3.5 R
19.2.6 R	GENPRU 2.3.6 R
19.2.7 R	GENPRU 2.3.7 R
19.2.8 R	GENPRU 2.3.8 R
19.2.9 R	GENPRU 2.3.9 R
19.2.10 R	GENPRU 2.3.10 R
19.2.11 R	GENPRU 2.3.11 R
19.2.12 G	GENPRU 2.3.12 G
19.2.13 R	GENPRU 2.3.13 R
19.2.14 G	GENPRU 2.3.14 G
19.2.15 R	GENPRU 2.3.15 R
19.3.1 R	GENPRU 2.3.16 R
19.3.2 G	GENPRU 2.3.17 G
19.3.3 R	GENPRU 2.3.18 R
19.3.4 R	GENPRU 2.3.19 R
19.3.5 R	GENPRU 2.3.20 R
19.3.6 R	GENPRU 2.3.21 R
19.3.7 R	GENPRU 2.3.22 R
19.3.8 G	GENPRU 2.3.23 G

19.3.9 R	GENPRU 2.3.24 R
19.3.10 R	GENPRU 2.3.25 R
19.3.11 R	GENPRU 2.3.26 R
19.3.12 R	GENPRU 2.3.27 R
19.3.13 R	GENPRU 2.3.28 R
19.3.14 R	GENPRU 2.3.29 R
19.3.15 R	GENPRU 2.3.30 R
19.3.16 R	GENPRU 2.3.31 R
19.3.17 R	GENPRU 2.3.32 R
19.3.18 R	GENPRU 2.3.33 R
19.3.19 R	GENPRU 2.3.34 R
19.3.20 G	GENPRU 2.3.35 G

Annex B

Chapters 1 and 2 of GENPRU

In this Annex new text is not underlined and text that is deleted is not shown.

GENPRU 1.1 Application and scope

1.1 Application

Application

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

1.1.2 G Broadly speaking however, *GENPRU* applies to:

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

Scope

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

1.2 Adequacy of financial resources

Application

1.2.1 R This section applies to:

- (1) a *BIPRU firm*;
- (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*; and
- (3) a *firm* to which *GENPRU 1.2.2R* applies.

1.2.2 R The *firms* referred to in *GENPRU 1.2.1R(3)* are:

- (1) an *incoming EEA firm* which:
 - (a) is a *full BCD credit institution*; and
 - (b) has a *branch* in the *United Kingdom*; and
- (2) a *third country BIPRU firm* which:
 - (a) is a *bank*; and
 - (b) has a *branch* in the *United Kingdom*.

1.2.3 R This section applies to a *firm* in *GENPRU 1.2.2R* in relation to *liquidity risk* only. Accordingly, for such a *firm*, the systems, processes and resources required by this section are only those that are required with respect to *liquidity risk*.

1.2.4 R For a *firm* described in *GENPRU 1.2.2R*, this section applies only with respect to the *branch*.

1.2.5 R This section applies to an *incoming EEA firm* only to the extent that the relevant matter is not reserved by the relevant *Single Market Directive* to the *firm's Home State regulator*.

1.2.6 R If an *insurer* carries on:

- (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* referred to in this section apply in full. The *guidance* in this section is also applicable to a *firm* that falls into *GENPRU* 1.2.2R. However, the *guidance* in this section only applies to such a *firm* in respect of *liquidity risk* and it should be read accordingly.
- 1.2.8 G In the case of an *incoming EEA firm* that is a *full BCD credit institution* and of a *third country BIPRU firm* that is a *bank*, this section only applies to its *United Kingdom branch*. However, as a *branch* is not itself a legal entity separate from the rest of a *firm*, this restriction does not mean that the rest of the *firm* can necessarily be left out of account when considering compliance with this section. For example, the availability of the *branch's* liquidity resources may be affected by general liquidity problems in the *firm*. Similarly, there may be liquidity resources elsewhere in the *firm* that are available to meet liquidity problems in the *branch*.
- 1.2.9 G One factor that may affect the degree to which it is necessary to take into account the *firm* as a whole is the extent to which the *firm* manages the liquidity of the *branch* on an autonomous basis, or includes the *branch* within integrated liquidity management of the *firm* as a whole. In the latter case, the requirement in the *general stress and scenario testing rule*, insofar as it applies to liquidity, to carry out scenario analyses may be satisfied by the *firm* meeting similar requirements set by the regulator in its home country in respect of the *firm* as whole, provided that the *firm* separately identifies the impacts on the *United Kingdom branch* of the scenarios analysed. However, in the case of an *incoming EEA firm*, the application of this section is further restricted by *GENPRU* 1.2.5R.
- 1.2.10 G The scope of application of this section is not restricted to *insurers* that are subject to the relevant EC Directives.
- 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, except as described in *GENPRU* 1.2.8G, 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*.

Purpose

- 1.2.12 G Adequate financial resources and adequate systems and controls are necessary for the effective management of prudential risks. This section therefore has requirements relating to both of these topics.
- 1.2.13 G This section amplifies *Principle 4*, under which a *firm* must maintain adequate financial resources. It is concerned with the adequacy of the financial resources that a *firm* needs to hold in order to be able to meet its liabilities as they fall due. These resources include both capital and liquidity resources.

- 1.2.14 G In the case of a *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 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 1.2.60R* provides that a *firm* should document that assessment. The *FSA* will review that assessment as part of its own assessment of the adequacy of a *firm's* capital. This review by the *FSA* forms part of the *FSA's* ARROW assessment of a *firm*.
- 1.2.16 G This section also has *rules* requiring a *firm* to carry out appropriate stress tests and scenario analyses for the risks it has previously identified and to establish the amount of financial resources needed in each of the circumstances and events considered in carrying out the stress tests and scenario analyses.
- 1.2.17 G The basic requirements in this section are drafted to apply to a *firm* on a solo basis. This section then goes on to describe when its requirements do and do not apply on a solo basis and on a consolidated basis (see *GENPRU 1.2.45R* to *GENPRU 1.2.47R* and *GENPRU 1.2.57R* to *GENPRU 1.2.58R*). It also sets out some details about how the solo requirements are adjusted when they are applied on a consolidated basis (see *GENPRU 1.2.48R* to *GENPRU 1.2.56G* and *GENPRU 1.2.59R*).

Outline of other related provisions

- 1.2.18 G *GENPRU 2.1* sets out the minimum *capital resources requirements* for a *firm*. *GENPRU 2.2* sets out how *capital resources* are defined and measured for the purpose of meeting the requirements of *GENPRU 2.1*.
- 1.2.19 G (1) *BIPRU 2.2* (Internal capital adequacy standards) and *INSRU 7.1* (Individual capital assessment) set out detailed *guidance* on how a *firm* should carry out the assessment referred to in *GENPRU 1.2.15G*. The more thorough, objective, and prudent a *firm's* assessment is, and can be demonstrated as being, the more reliance the *FSA* will be able to place on the results of that assessment.
- (2) *BIPRU 2.2* and *INSRU 7.1* also have information on how the *FSA* will review and respond to the assessments referred to in *GENPRU 1.2.15G*. 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 *FSA* thinks a *firm* should hold under the *overall financial adequacy rule* as it applies on a solo level and a consolidated level.
- 1.2.20 G *SYSC* sets out general *rules* and *guidance* on the establishment and maintenance of systems and controls.

- 1.2.21 G (1) *SYSC 11 sets out material on systems and controls that apply specifically to liquidity risk.*
- (2) Chapters LM and LS of *IPRU(BANK)* contain *guidance* on the *overall financial adequacy rule* so far as it relates to adequate liquidity for *banks* and the *firms* to which *GENPRU 1.2.2R* (Application of this section to certain non-*EEA firms*) applies.
- (3) Chapter 5 of volume 1 of *IPRU(BSOC)* contains *guidance* and an *evidential provision* on the *overall financial adequacy rule* so far as it relates to adequate liquidity for a *building society*.
- (4) *SYSC 11.1.21E* is an *evidential provision* relating to the *general stress and scenario testing rule* concerning stress testing and scenario analyses. *SYSC 11.1.24E* is *evidential provision* relating to the *overall Pillar 2 rule* about *contingency funding plans*.
- (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 G *BIPRU 2.3* contains *rules* and *guidance* on interest rate risk in the *non-trading book*. That material elaborates on the general obligation in the *overall Pillar 2 rule*.
- 1.2.23 G For a *BIPRU firm* using a *VaR model BIPRU 7.10.72R* (Risk management standards: Stress testing) sets out certain stress tests that the *firm* should carry out.
- 1.2.24 G *BIPRU 10.6.22R* (Stress testing of credit risk concentrations) sets out further stress tests that a *firm* should carry out if it uses certain approaches to collateral for the purposes of the *rules* about concentration risk.
- 1.2.25 G For a *BIPRU firm* using the *IRB approach BIPRU 4.3.39R* to *BIPRU 4.3.40R* 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 R 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.
- 1.2.27 G The liabilities referred to in the *overall financial adequacy rule* include a *firm's* contingent and prospective liabilities. It excludes liabilities that might arise from transactions that a *firm* has not entered into and which it could avoid, for example, by ceasing to trade. It includes liabilities or costs that arise as a consequence of strategies other than continuing as a going concern. It also includes claims that could be made against a *firm*, which ought to be paid in accordance with fair treatment of *customers*, even if such claims could not be legally enforced.

- 1.2.28 G A *firm* should therefore make its assessment of adequate financial resources on realistic valuation bases for assets and liabilities taking into account the actual amounts and timing of cash flows under realistic adverse projections.
- 1.2.29 G Risks may be addressed through holding capital to absorb losses that unexpectedly materialise. The ability to pay liabilities as they fall due also requires liquidity. Therefore, in assessing the adequacy of a *firm*'s financial resources, both capital and liquidity needs should be considered. A *firm* should also consider the quality of its financial resources such as the loss-absorbency of different types of capital and the time required to liquidate different types of asset. SYSC 11.1.24E is an *evidential provision* relating to the *overall financial adequacy rule* concerning *contingency funding plans*.

Systems, strategies, processes and reviews

- 1.2.30 R A *firm* must have in place sound, effective and complete processes, strategies and systems:
- (1) to assess and maintain on an ongoing basis the amounts, types and distribution of financial resources, *capital resources* and internal capital that it considers adequate to cover:
 - (a) the nature and level of the risks to which it is or might be exposed;
 - (b) the risk in the *overall financial adequacy rule*; and
 - (c) the risk that the *firm* might not be able to meet its *CRR* in the future; and
 - (2) that enable it to identify and manage the major sources of risks referred to in (1), including the major sources of risk in each of the following categories where they are relevant to the *firm* given the nature and scale 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*); and
 - (k) pension obligation risk.
- 1.2.31 R (1) This *rule* defines some of the terms used in the *overall Pillar 2 rule*.
- (2) Residual risk means the risk that *credit risk mitigation* techniques used by the *firm* prove less effective than expected.
- (3) *Securitisation* risk includes the risk that the *capital resources* held by a *firm* in respect of assets which it has *securitised* are inadequate having regard to the economic substance of the transaction, including the degree of risk transfer achieved.
- (4) Business risk means any risk to a *firm* arising from changes in its business, including the risk that the *firm* may not be able to carry out its business plan and its desired strategy.
- (5) Pension obligation risk is the risk to a *firm* caused by its contractual or other liabilities to or with respect to a pension scheme (whether established for its employees or those of a related *company* or otherwise). It also means the risk that the *firm* will make payments or other contribution to or with respect to a pension scheme because of a moral obligation or because the *firm* considers that it needs to do so for some other reason.
- 1.2.32 G (1) This paragraph gives *guidance* on some of the terms used in the *overall Pillar 2 rule*.
- (2) Insurance risk refers to the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities.
- (3) Interest rate risk in the *non-trading book* is explained in *BIPRU 2.3* (Interest rate risk in the non-trading book).
- (4) In a narrow sense, business risk is the risk to a *firm* that it suffers losses because its income falls or is volatile relative to its fixed cost base. However, in a broader sense, it is exposure to a wide range of macro-economic, geopolitical, industry, regulatory and other external risks that might deflect a *firm* from its desired strategy and business plan. *GENPRU 1.2.73G* provides further *guidance* on business risk.
- (5) Further material on pension obligation risk can be found in *GENPRU 1.2.79G - GENPRU 1.2.86G*.
- 1.2.33 R (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* (Concentration risk 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 G In the *overall Pillar 2 rule*, internal capital refers to the financial resources of a *firm* which it treats as being held against the risks listed in the *overall Pillar 2 rule*. The obligation in that *rule* to assess the distribution of such capital refers, in relation to a *firm* making an assessment on a solo basis, for example, to the need to take account of circumstances where part of a *firm's* financial resources are held by a *branch* of that *firm* which are subject to restrictions on its ability to transfer that capital. An assessment of internal capital distribution might also take account of such of a *firm's* financial resources as may be ring-fenced in the event of its insolvency.
- 1.2.35 R The processes, strategies and systems required by the *overall Pillar 2 rule* must be comprehensive and proportionate to the nature, scale and complexity of the *firm's* activities.
- 1.2.36 R As part of its obligations under *GENPRU* 1.2.30R(1) (Main requirement relating to risk processes, strategies and systems), a *firm* must identify separately the amount of *tier one capital*, *tier two capital*, *tier three capital*, other capital eligible to form part of its *capital resources* and each category of capital (if any) that is not eligible to form part of its *capital resources* which it considers adequate for the purposes described in *GENPRU* 1.2.30R(1).
- 1.2.37 R The processes and systems required by the *overall Pillar 2 rule* must:
- (1) include an assessment of how it intends to deal with each of the major sources of risk identified in accordance with *GENPRU* 1.2.30R(2); and
 - (2) take into account the impact of diversification effects and how such effects are factored into the *firm's* systems for measuring 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* 1.2.60R (Documentation of risk assessments), document the approaches taken to manage these risks.
- 1.2.39 R A *firm* must:
- (1) carry out regularly the assessments required by the *overall Pillar 2 rule*; and

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

- 1.2.40 G A *firm* should carry out assessments of the sort described in the *overall Pillar 2 rule* and *GENPRU 1.2.39R* at least annually, or more frequently if changes in the business, strategy, nature or scale of its activities or operational environment suggest that the current level of financial resources is no longer adequate. The appropriateness of the internal process, and the degree of involvement of senior management in the process, will be taken into account by the *FSA* when reviewing a *firm's* assessment as part of the *FSA'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 G 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 R (1) As part of its obligation under the *overall Pillar 2 rule*, a *firm* must, for each of the major sources of risk identified in accordance with *GENPRU 1.2.30R(2)*, carry out stress tests and scenario analyses that are appropriate to the nature of those major sources of risk, as part of which the *firm* must:
- (a) take reasonable steps to identify an appropriate range of realistic adverse circumstances and events in which the risk identified crystallises; and
 - (b) estimate the financial resources the *firm* would need in each of the circumstances and events considered in order:
 - (i) to be able to meet its liabilities as they fall due;
 - (ii) to be able to meet the *CRR*;
 - (iii) to carry out the plans referred to in *GENPRU 1.2.37R(1)*; and
 - (iv) otherwise to meet, to the extent that it considers necessary, that major source of risk.
- (2) In carrying out the stress tests and scenario analyses in (1), a *BIPRU firm* with an *IRB permission* must incorporate and take into account the stress tests required to be carried out under *BIPRU 4.3.39R* to *BIPRU 4.3.40R* (Stress tests used in assessment of capital adequacy).

- (3) In carrying out the stress tests and scenario analyses in (1), a *BIPRU firm* must incorporate and take into account any other stress tests and scenario analyses that it is required to carry out under any other provision of the *Handbook*.

- 1.2.43 G Stress tests and scenario analyses should be carried out at least annually. A *firm* should, however, consider whether the nature of the major sources of risks identified by it in accordance with *GENPRU 1.2.30R(2)* (Main requirement relating to risk processes, strategies and systems) and their possible impact on its financial resources suggest that such tests and analyses should be carried out more frequently. For instance, a sudden change in the economic outlook may prompt a *firm* to revise the parameters of some of its stress tests and scenario analyses. Similarly, if a *firm* has recently become exposed to a particular sectoral concentration, it may wish to add some stress tests and scenario analyses in order to reflect that concentration. *SYSC 11.1.21E* 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 G (1) *GENPRU 1.2.45R - GENPRU 1.2.56G* 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 1.2.57R - GENPRU 1.2.59R* 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 R If an *insurer* is a member of an *insurance group* and *INSPRU 6.1.9R*, *INSPRU 6.1.10R* or *INSPRU 6.1.15R* (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 R The *ICAAP rules* do not apply on a solo basis to a *BIPRU firm* to which the *ICAAP rules*:
- (1) apply on a consolidated basis under *BIPRU 8.2.1R* (Basic consolidation rule for a *UK consolidation group*); or
- (2) apply on a sub-consolidated basis under *BIPRU 8.3.1R* (Basic consolidation rule for a *non-EEA sub- group*).
- 1.2.47 R 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 1.2.45R*;
 - (2) to a *BIPRU firm* to which those *rules* do not apply on a consolidated or sub-consolidated basis as referred to in *GENPRU 1.2.46R* (including a *BIPRU investment firm* with an *investment firm consolidation waiver*); and
 - (3) a *firm* referred to in *GENPRU 1.2.2R* (Application of this section to certain non-EEA firms).
- 1.2.48 R The requirements of the *ICAAP rules* as they apply on a consolidated basis must be carried out on the basis of the consolidated position of:
- (1) (if *GENPRU 1.2.45R* applies) that *insurance group*;
 - (2) (if *BIPRU 8.2.1R* (Basic consolidation rule for a *UK consolidation group*) applies) the *UK consolidation group* of which the *firm* is a member ; and
 - (3) (if *BIPRU 8.3.1R* (Basic consolidation rule for a *non-EEA sub- group*) applies) the *non-EEA sub-group* of which the *firm* is a member.
- 1.2.49 R (1) In accordance with the general principles in *GENPRU 1.2.48R* 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 1.2.59R* (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 1.2.48R* 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 G *GENPRU 1.2.49R* means that non-financial members of the *firm's* group are excluded from the *group* assessment. Notwithstanding the scope of *GENPRU 1.2.49R*, a *firm* should nevertheless take account of risks arising from the activities of those excluded members in its overall assessment of risk.
- 1.2.51 R (1) This *rule* relates to the assessment of the amounts, types and distribution of financial resources, *capital resources* and internal capital (referred to in this *rule* as "resources") under the *overall Pillar 2 rule* as applied on a consolidated basis and to the assessment of diversification effects as referred to in *GENPRU 1.2.37R(2)* as applied on a consolidated basis.
- (2) A *firm* must be able to explain how it has aggregated the risks referred to in the *overall Pillar 2 rule* and the resources required by each member of the relevant group as referred to in *GENPRU 1.2.49R(2)* and how it has taken into account any diversification benefits with respect to the group in question.
- (3) In particular, to the extent that the transferability of resources affects the assessment in (2), a *firm* must be able to explain how it has satisfied itself that resources are transferable between members of the group in question in the stressed cases and the scenarios referred to in the *general stress and scenario testing rule*.
- 1.2.52 R (1) A *firm* must allocate the total amount of financial resources, *capital resources* and internal capital identified as necessary under the *overall Pillar 2 rule* (as applied on a consolidated basis) between different parts of the relevant group (as defined in *GENPRU 1.2.49R*). *GENPRU 1.2.36R* (Identifying different tiers of capital) does not apply to this allocation.
- (2) The *firm* must carry out the allocation in (1) in a way that adequately reflects the nature, level and distribution of the risks to which the group is subject and the effect of any diversification benefits.
- 1.2.53 R A *firm* must also allocate the total amount of financial resources, *capital resources* and internal capital (referred to in this *rule* as "resources") identified as necessary under the *overall Pillar 2 rule* as applied on a consolidated basis between each *firm* which is a member of the relevant group (as defined in *GENPRU 1.2.49R*) on the following basis:

- (1) the amount allocated to each *firm* must be decided on the basis of the principles in *GENPRU* 1.2.52R(2); and
 - (2) if the process in (1) were carried out for each group member, the total so allocated would equal the total amount of resources identified as necessary under the *overall Pillar 2 rule* as applied on a consolidated basis.
- 1.2.54 G A *firm* to which the *ICAAP rules* apply on a consolidated basis need not prepare a consolidated basis assessment if such an assessment has been prepared by another member of its *group*. Where that is the case, a *firm* may adopt such an assessment as its own. A *firm* nevertheless remains responsible for the assessment.
- 1.2.55 G The purpose of *GENPRU* 1.2.51R - *GENPRU* 1.2.53R is to enable the *FSA* 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 *FSA* wishes to make this assessment is so that individual capital *guidance* which it gives is fair and comparable as between different *firms* and groups. Group diversification benefits which a *firm* might assert exist can be a material consideration in a capital adequacy assessment. Understanding the methods used to aggregate the different risks (for example, the correlation assumptions) is crucial to a proper evaluation of such benefits.
- 1.2.56 G Whereas a single legal entity can generally use its capital to absorb losses wherever they arise, there are often practical and legal restrictions on the ability of a group to do so. For instance:
- (1) capital which is held by overseas regulated *firms* may not be capable of being remitted to a *firm* in the *UK* which has suffered a loss;
 - (2) a *firm* which is insolvent or likely to become so may be obliged to look to the interests of its creditors first before transferring capital to other group *companies*; and
 - (3) a parent *company* may have to balance the interests of its shareholders against the protection of the creditors of a *subsidiary undertaking* which is or might become insolvent and may, rationally, conclude that a *subsidiary undertaking* should be allowed to fail rather than provide capital to support it.

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

- 1.2.57 R The *overall financial adequacy rule* applies to a *firm* on a solo basis whether or not it also applies to the *firm* on a consolidated basis.
- 1.2.58 R The *overall financial adequacy rule* applies to a *firm* on a consolidated basis if the *ICAAP rules* apply to it on a consolidated basis.

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

Documentation of risk assessments

- 1.2.60 R A *firm* must make a written record of the assessments required under this section. These assessments include assessments carried out on a consolidated basis and on a solo basis. In particular it must make a written record of:
- (1) the major sources of risk identified in accordance with *GENPRU 1.2.30R(2)* (Main requirement relating to risk processes, strategies and systems);
- (2) how it intends to deal with those risks; and
- (3) details of the stress tests and scenario analyses carried out and the resulting financial resources estimated to be required in accordance with the *general stress and scenario testing rule*.
- 1.2.61 R A *firm* must retain the records of its assessments referred to in *GENPRU 1.2.60R* for at least three years.
- 1.2.62 G Where a *firm* assesses the adequacy of its *CRR* in its particular circumstances in accordance with *BIPRU 2.2* (Internal capital adequacy standards) and *INSRU 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 1.2.60R*.

Additional guidance on stress tests and scenario analyses

- 1.2.63 G Both stress tests and scenario analyses can be undertaken by a *firm* to further a better understanding of the vulnerabilities that it faces under extreme conditions. They are based on the analysis of the impact of unlikely, but not impossible, events. These events can be financial, operational or legal or relate to any other risk that might have an economic impact on the *firm*.
- 1.2.64 G Stress testing typically refers to shifting the values of individual parameters that affect the financial position of a *firm* and determining the effect on the *firm's* financial position.

- 1.2.65 G Scenario analysis typically refers to a wider range of parameters being varied at the same time. Scenario analyses often examine the impact of adverse events on the *firm's* financial position, for example, simultaneous movements in a number of risk categories affecting all of a *firm's* business operations, such as business volumes, investment values and interest rate movements.
- 1.2.66 G There are three broad purposes of stress testing and scenario analysis. Firstly, it can be used as a means of quantifying how much capital might be absorbed if an adverse event or events occurred. As such it represents a simple 'what if' approach to estimating exposure to risks. This might be a proportionate approach to risk management for an unsophisticated business. Secondly, it can be used to provide a check on the outputs and accuracy of risk models; particularly, in identifying non-linear effects when aggregating risks. Thirdly, it can be used to explore the sensitivities in longer term business plans and how capital needs might change over time.
- 1.2.67 G The *general stress and scenario testing rule* requires a *firm*, as part of carrying out stress tests and scenario analyses, to take reasonable steps to identify an appropriate range of realistic circumstances and events in which a risk would crystallise. In particular:
- (1) a *firm* need only carry out stress tests and scenario analyses in so far as the circumstances or events are reasonably foreseeable, that is to say, their occurrence is not too remote a possibility; and
 - (2) a *firm* should also take into account the relative costs and benefits of carrying out the stress tests and scenario analyses in respect of the circumstances and events identified.
- 1.2.68 G Subject to *GENPRU 1.2.76G*, the purpose of stress tests and scenario analyses under the *general stress and scenario testing rule* is to test the adequacy of overall financial resources. Scenarios need only be identified, and their impact assessed, in so far as this facilitates that purpose. In particular, the nature, depth and detail of the analysis depend, in part, upon the *firm's* capital strength and the robustness of its risk prevention and risk mitigation measures.
- 1.2.69 G Both stress testing and scenario analyses are forward-looking analysis techniques, which seek to anticipate possible losses that might occur if an identified risk crystallises. In applying them, a *firm* should decide how far forward to look. This should depend upon:
- (1) how quickly it would be able to identify events or changes in circumstances that might lead to a risk crystallising resulting in a loss; and
 - (2) after it has identified the event or circumstance, how quickly and effectively it could act to prevent or mitigate any loss resulting from the risk crystallising and to reduce exposure to any further adverse event or change in circumstance.

- 1.2.70 G The time horizon over which stress tests and scenario analysis should be carried out should depend on the maturity and liquidity of the *positions* stressed. For example, for the *market risk* arising from the holding of investments this should depend upon:
- (1) the extent to which there is a regular, open and transparent market in those assets, which would allow fluctuations in the value of the investment to be more readily and quickly identified; and
 - (2) the extent to which the market in those assets is sufficiently liquid (and would remain liquid in the changed circumstances contemplated in the stress test or scenario analysis) to allow the *firm*, if needed, to sell, hedge or otherwise mitigate the risks relating to its holding so as to prevent or reduce exposure to future price fluctuations.
- 1.2.71 G In identifying scenarios, and assessing their impact, a *firm* should take into account, where material, how changes in circumstances might impact upon:
- (1) the nature, scale and mix of its future activities; and
 - (2) the behaviour of *counterparties*, and of the *firm* itself, including the exercise of choices (for example, options embedded in financial instruments or *contracts of insurance*).
- 1.2.72 G In determining whether it would have adequate financial resources in the event of each identified realistic adverse scenario, a *firm* should:
- (1) only include financial resources that could reasonably be relied upon as being available in the circumstances of the identified scenario; and
 - (2) take account of any legal or other restriction on the use of financial resources.
- 1.2.73 G
- (1) A *firm* should conduct stress tests and scenario analyses which project its financial position (both profitability and balance sheet position) so as to estimate both its *capital resources* and *capital resource requirements* throughout an economic or business cycle.
 - (2) 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. The length of time over which such projections would be appropriate will therefore vary, but typically might be between three and five years.
 - (3) The projections should be based on the *firm's* business plan, but flexed to incorporate adverse trading conditions and any changes in strategy which the *firm* could and would take in response to those conditions.

- (4) Changes in strategy might be necessary for instance because capital needed to be able to continue its business at existing volumes is eroded. A *firm* may also alter its capital management strategy to restrict distributions of profits or to raise additional capital. The combined effect on capital and retained earnings should be estimated. A *firm* should document how it would react to such economic and business risks.
- (5) The *FSA* will take the projections referred to in this paragraph and the plan referred to in (4) into account as part of its *SREP*. The purpose of examining them is to enable the *FSA* to judge, at an appropriate level of certainty, whether the *firm* will be able to meet its obligations throughout a recession.
- 1.2.74 G A *firm* may consider scenarios in which expected future profits will provide capital reserves against future risks. However, it would only be appropriate to take into account profits that can be foreseen with a reasonable degree of certainty as arising before the risk against which they are being held could possibly arise. In estimating future reserves, a *firm* should deduct future dividend payment estimates from projections of future profits.
- 1.2.75 G (1) A *firm* should assess the nature and severity of the economic recession or business cycle changes which are relevant to it given the nature and scale of its business. When projecting its *capital resources* and *CRR* a *firm* should consider a range of stresses and scenarios both in nature and severity.
- (2) Stress and scenario analyses should, in the first instance, be aligned with the risk appetite of the *firm* and the calibration of such stress and scenario analyses should be reconciled back 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) A *firm* with an *IRB permission* should ensure that the range of stresses and scenarios considered encompasses the severity of recession specified in BIPRU 4.3.40R (Stress tests used in assessment of capital adequacy), which is one that might be expected to occur once in a 25 year period. Other firms may also find that this a useful reference point when discussing their assessments with the *FSA*.
- (4) A *firm* may also consider scenarios in which the amount of capital it currently holds would be exhausted. This would provide useful information about the reasonableness or remoteness of such scenarios arising. Where a *firm* uses capital models as part of its risk management processes, considering the sensitivity of model results to variations around the most likely ruin scenario focuses testing on the most relevant scenarios.
- 1.2.76 G A *firm* should use the results of its stress testing and scenario analysis not only to assess capital needs, but also to decide if measures should be put in place to minimise the adverse effect on the *firm* if the risk covered by the stress or scenario test actually materialises. Such measures might be a contingency plan or might be more concrete risk mitigation steps.

- 1.2.77 G Additional *guidance* on stress tests and scenario analyses for the assessment of *capital resources* is available in *BIPRU 2.2* (Internal capital adequacy standards) and *INSPRU 7.1* (Individual capital assessment).
- 1.2.78 G Additional *guidance* in relation to stress tests and scenario analysis for *liquidity risk* is available in *SYSC 11* (Liquidity risk systems and controls).
- Pension obligation risk
- 1.2.79 G *GENPRU 1.2.80G - GENPRU 1.2.86G* contain *guidance* on the assessment required by *GENPRU 1.2.30R(2)(k)* (Pension risk).
- 1.2.80 G The pension scheme itself (i.e. the scheme's assets and liabilities) is not the focus of the risk assessment; it is the *firm's* obligations towards the pension scheme which is.
- 1.2.81 G If a *firm* has a current funding obligation in excess of normal contributions or there is a risk that such a funding obligation will arise then, when calculating available capital resources, it should reverse out any accounting deficit and replace this in its capital adequacy assessment with its best estimate, calculated in discussion with the scheme's actuaries or trustees, of the cash that will need to be paid into the scheme in addition to normal contributions over the foreseeable future. This may differ from the approach taken in assessing pension scheme risks for the purposes of calculating resources to meet the *CRR*, where a *firm* may not need to consider funding obligations beyond the next five years.
- 1.8.82 G A *firm* should assess the risks that increase its obligations towards the pension scheme that might lead to the *firm* not being able to pay its other liabilities as they fall due.
- 1.2.83 G A *firm* may wish to consider the following scenarios:
- (1) one in which the *firm* gets into difficulties with an effect on its ability to fund the pension scheme; and
 - (2) one in which the pension scheme position deteriorates (for example, because investment returns fall below expected returns or because of increases in life expectancy) with an effect on the *firm's* funding obligations; taking into account the management actions the *firm* could and would take.
- 1.2.84 G Scenarios in which a *firm's* employees suffer a loss or members of a pension scheme suffer a loss do not necessarily affect the *firm's* ability to pay its liabilities as they fall due.
- 1.2.85 G A *firm* should consider issues such as:
- (1) the extent to which trustees of the pension scheme or a pension regulator (such as the one created under the Pensions Act 2004) can compel a certain level of contributions or a one-off payment in adverse financial situations or in order to meet the minimum legal requirements under the scheme's trust deed and rules or under the applicable laws relating to the pension scheme;

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

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

1.3 Valuation

Application

1.3.1 R (1) This section of the *Handbook* applies to an *insurer*, unless it is:

(a) a *non-directive friendly society*;

(b) an *incoming EEA firm*; or

(c) 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 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 (1) In the case of a *BIPRU firm*, this section implements Article 74 of the *Banking Consolidation Directive*, Article 64(4) 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* 1.3.4R 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 Subject to *GENPRU* 1.3.9R to *GENPRU* 1.3.10R and *GENPRU* 1.3.36R, except where a *rule* in *GENPRU*, *BIPRU* or *INSPRU* provides for a different method of recognition or valuation, whenever a *rule* in *GENPRU*, *BIPRU* or *INSPRU* refers to an asset, liability, *exposure*, equity or income statement item, a *firm* must, for the purpose of that *rule*, recognise the asset, liability, *exposure*, equity or income statement item and measure its value in accordance with whichever of the following are applicable:

(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*; and

(6) the Companies Act 1985.

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

1.3.5 G Except where a *rule* in *GENPRU*, *BIPRU* or *INSPRU* makes different provision, *GENPRU* 1.3.4R 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 G In particular, unless an exception applies, *GENPRU* 1.3.4R should be applied for the purposes of *GENPRU*, *BIPRU* and *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* 1.3.7G);

(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 G In the case of an *insurer* or a *UK ISPV*, where assets or liabilities are securitised, *GENPRU* 1.3.4R only permits de-recognition where Financial Reporting Standard 5 (or, where applicable, International Accounting Standard 39) permits either de-recognition or the linked presentation. However, the *FSA* 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 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* 1.3.4R will result in such assets remaining on the balance sheet of the *insurer*.

General requirements: Adjustments to accounting values

- 1.3.9 R For the purposes of *GENPRU*, *BIPRU* and *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* 1.3.4R by subtracting any unrealised gains or adding back in any unrealised losses which are not attributable to changes in a benchmark interest rate;
 - (2) in respect of a *defined benefit occupational pension scheme*:
 - (a) a *firm* must derecognise any *defined benefit asset*;
 - (b) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*.
- 1.3.10 R An election made under *GENPRU* 1.3.9R(2) must be applied consistently for the purposes of *GENPRU*, *BIPRU* and *INSPRU* in respect of any one financial year.
- 1.3.11 G A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme*.
- 1.3.12 G The provisions of *GENPRU* 1.3.9R to *GENPRU* 1.3.10R and *GENPRU* 1.3.36R apply only to the extent that the items referred to in those paragraphs would otherwise be recognised under the accounting requirements applicable to the *firm*. Some of those requirements may only be relevant to a *firm* subject to *international accounting standards*.

General requirements: Methods of valuation and systems and controls

- 1.3.13 R
- (1) Except to the extent that *GENPRU*, *BIPRU* or *INSPRU* provide for another method of valuation, *GENPRU* 1.3.14R to *GENPRU* 1.3.34R (Marking to market, Marking to model, Independent price verification, Adjustments or reserves) apply:
 - (a) for the purposes set out in *GENPRU* 1.3.41R;
 - (b) for the purposes set out in *GENPRU* 1.3.39R; 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
- (b) reporting lines for the department accountable for the valuation process that are:
 - (i) clear and independent of the front office; and
 - (ii) ultimately to a main board executive director.

General requirements: Marking to market

- 1.3.14 R Wherever possible, a *firm* must use mark to market in order to measure the value of the investments and positions to which this *rule* applies under *GENPRU* 1.3.13R and *GENPRU* 1.3.38R to *GENPRU* 1.3.41R. Marking to market is valuation (on at least a daily basis in the case of the *trading book* positions of a *BIPRU firm*) at readily available close out prices from independent sources.
- 1.3.15 R For the purposes of *GENPRU* 1.3.14R, examples of readily available close out prices include exchange prices, screen prices, or quotes from several independent reputable brokers.
- 1.3.16 R 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.

General requirements: Marking to model

- 1.3.17 R Where marking to market is not possible, a *firm* must use mark to model in order to measure the value of the investments and positions to which this *rule* applies under *GENPRU* 1.3.13R and *GENPRU* 1.3.38R to *GENPRU* 1.3.41R. Marking to model is any valuation which has to be benchmarked, extrapolated or otherwise calculated from a market input. *GENPRU* 1.3.18R to *GENPRU* 1.3.25R apply when marking to model.
- 1.3.18 R When the model used is developed by the *firm*, that model must be:
 - (1) based on appropriate assumptions which have been assessed and challenged by suitably qualified parties independent of the development process;
 - (2) independently tested, including validation of the mathematics, assumptions, and software implementation; and
 - (3) (in the case of a *BIPRU firm*) developed or approved independently of the front office.

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

General requirements: Independent price verification

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

General requirements: Valuation adjustments or reserves

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

- 1.3.30 R A *firm* must establish and maintain procedures for considering valuation adjustments or reserves. These procedures must be compliant with the requirements set out in *GENPRU* 1.3.33R.
- 1.3.31 R A *firm* using third-party valuations, or marking to model, must consider whether valuation adjustments are necessary.
- 1.3.32 R A *firm* must consider the need for establishing reserves for less liquid positions and, on an ongoing basis, review their continued appropriateness in accordance with the requirements set out in *GENPRU* 1.3.33R. Less liquid positions could arise from both market events and institution-related situations e.g. concentration positions and/or stale positions.
- 1.3.33 R (1) This paragraph sets out the requirements referred to in *GENPRU* 1.3.30R and *GENPRU* 1.3.32R.
- (2) A *firm* must consider the following 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 *firm* must consider several factors when determining whether a valuation 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.
- 1.3.34 R If the result of establishing adjustments or reserves under *GENPRU* 1.3.29R to *GENPRU* 1.3.33R is a valuation which differs from the fair value determined in accordance with *GENPRU* 1.3.4R, a *firm* must reconcile the two valuations.
- 1.3.35 G Reconciliation differences under *GENPRU* 1.3.34R should not be reflected in the valuations under *GENPRU* 1.3 but should be disclosed to the *FSA* in prudential returns.

Specific requirements: BIPRU firms

Adjustments to accounting values

- 1.3.36 R (1) For the purposes of *GENPRU* and *BIPRU*, the adjustments in (2) and (3) apply to values calculated pursuant to *GENPRU* 1.3.4R in addition to those required by *GENPRU* 1.3.9R to *GENPRU* 1.3.10R.
- (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 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 G Provisions for equity instruments held in the available-for-sale category can be found in *GENPRU 2.2.185R*.
- Trading book and revaluations
- 1.3.38 R *GENPRU 1.3.39R* to *GENPRU 1.3.40R* apply only to a *BIPRU firm*.
- 1.3.39 R *Trading book* positions are subject to prudent valuation rules as specified in *GENPRU 1.3.14R* to *GENPRU 1.3.34R* (Marking to market, Marking to model, Independent price verification, Adjustments or reserves). In accordance with those *rules*, a *firm* must ensure that the value applied to each of its *trading book* 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.
- 1.3.40 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 R (1) For the purposes of *GENPRU* and *INSPRU*, an *insurer* or a *UK ISPV* must apply *GENPRU 1.3.14R* to *GENPRU 1.3.34R* (Marking to market, Marking to model, Independent price verification, 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* that invests only in *admissible assets* (including any *derivatives* or *quasi-derivatives* held by the scheme); and

(b) *derivatives and quasi-derivatives*

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

Shares in and debts due from related undertakings

- 1.3.42 R *GENPRU 1.3.43R* to *GENPRU 1.3.57R* apply only to *insurers*.
- 1.3.43 R *GENPRU 1.3.13R* and *GENPRU 1.3.41R* 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 1.3.47R*.
- 1.3.44 G The effect of *GENPRU 1.3.43R* 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 1.3.4R*. *Shares* in *related undertakings* referred to in *GENPRU 1.3.43R*(1) or (3) are valued by *insurers* in accordance with *GENPRU 1.3.45R* to *GENPRU 1.3.50R*.
- 1.3.45 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 1.3.43R*(1) or *GENPRU 1.3.43R*(3), a *firm* must value the *shares* held in accordance with *GENPRU 1.3.47R*.
- 1.3.46 R In relation to *shares* in, and *debts* due from, an *undertaking* referred to in *GENPRU 1.3.43R*(1), *GENPRU 1.3.45R* does not apply for the purposes of *GENPRU 2.2.256R* (Adjustments for regulated related undertakings other than insurance undertakings) and *INSPRU 6.1* (Group risk: Insurance groups).
- 1.3.47 R For the purposes of *GENPRU 1.3.45R*, the value of the *shares* held in an *undertaking* referred to in *GENPRU 1.3.43R*(1) or *GENPRU 1.3.43R*(3) is the sum of:
- (1) the regulatory surplus value of that *undertaking*; less
 - (2) for the purposes of *GENPRU 2.2.256R* (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* 6.1.41R(1).
- 1.3.48 R For the purposes of *GENPRU* 1.3.47R(1), the regulatory surplus value of an *undertaking* referred to in *GENPRU* 1.3.43R(1) or *GENPRU* 1.3.43R(3) is, subject to *GENPRU* 1.3.49R, 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 R (1) Subject to *GENPRU* 1.3.50R, for the purposes of *GENPRU* 1.3.48R, 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 R If the *individual capital resources requirement* of an *undertaking* in *GENPRU* 1.3.43R(1) that is a *subsidiary undertaking* exceeds total capital after deductions, then the full amount of the items referred to in *GENPRU* 1.3.49R(1) must be taken into account for the purposes of *GENPRU* 1.3.48R.
- 1.3.51 R For the purposes of *GENPRU* 1.3.47R to *GENPRU* 1.3.50R:
- (1) in relation to an *undertaking* referred to in *GENPRU* 1.3.43R(1):
 - (a) subject to (2), *individual capital resources requirement* has the meaning given by *INSPRU* 6.1.34R;
 - (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* 6.1.67R;
- (2) in relation to an *undertaking* referred to in *GENPRU* 1.3.43R(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 G *GENPRU* 1.3.47R to *GENPRU* 1.3.51R set out several different valuation bases for an *insurer's shares* in *related undertakings*. The regulatory surplus value (defined in *GENPRU* 1.3.48R) measures the *related undertaking's* own capital surplus or deficit. This is used: (i) in *GENPRU* 1.3.47R 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 G *GENPRU* 1.3.47R 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 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 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 G An *insurer* may value amounts recoverable from an *ISPV* if it obtains a *waiver* of *GENPRU* 1.3.55R under section 148 of the *Act*. The conditions that will need to be met, in addition to the statutory tests under section 148(4) of the *Act*, before the *FSA* will consider granting such a *waiver* are set out in *INSPRU* 1.6.13G to *INSPRU* 1.6.18G.

General insurance business: Community co-insurance operations -

1.3.57 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*,

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

GENPRU 1.4 Actions for damages

1.4 Actions for damages

1.4.1 R A contravention of the *rules* in *GENPRU* does not give rise to a right of action by a *private person* under section 150 of the *Act* (and each of those *rules* is specified under section 150(2) 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 R *GENPRU 1.2 applies to managing agents and to the Society in accordance with:*
- (1) for *managing agents*, *INSPRU 8.1.4R*; and
 - (2) for the *Society*, *INSPRU 8.1.2R*.
- 1.5.2 R *GENPRU 1.5.7R applies to members, pursuant to the insurance market direction in GENPRU 1.5.5D.*
- Insurance market direction
- 1.5.3 G The *insurance market direction* in *GENPRU 1.5.5D* is given under section 316(1) of the *Act* (Direction by Authority) and applies to *members*.
- 1.5.4 G The purpose of the *insurance market direction* in *GENPRU 1.5.5D* is to enable the *FSA* to make the rule in *GENPRU 1.5.7R* 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 D With effect from 1 January 2005, Part X 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 1.5.7R* to *GENPRU 1.5.9G*.
- 1.5.6 G Part X 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 X of the *Act* are to be read as references to *members* for the purposes of *GENPRU 1.5.7R* to *GENPRU 1.5.9G*.
- Members' obligation to maintain adequate financial resources
- 1.5.7 R 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 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 G In practice, compliance with the requirements described in *GENPRU* 1.5.8G is likely to have the effect that *members* comply with *GENPRU* 1.5.7R.

Application of *GENPRU* 1.3

- 1.5.10 R *GENPRU* 1.3 applies to *managing agents* and to the *Society* in accordance with:

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

Amounts receivable but not yet received

- 1.5.11 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* 1.5.17R to *GENPRU* 1.5.18R; 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 R When recognising and valuing assets held as *members' funds at Lloyd's* the *Society* may, if the conditions in *GENPRU* 1.5.13R 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 R The conditions referred to in *GENPRU* 1.5.12R 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 *FSA*; and
 - (2) issued by a *credit institution* or an *insurance undertaking*.
- 1.5.14 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 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 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 R For the purposes of *GENPRU* 1.5.15R(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*.
- 1.5.18 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 *FSA* 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*.
- 1.5.20 G The *FSA* would normally expect not less than six months' notice under *GENPRU* 1.5.19R.

Liabilities

- 1.5.21 R Subject to *GENPRU* 1.5.22R, the *Society* must recognise and value all of a *member's* liabilities in respect of its *insurance business*.
- 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.
- 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* 1.5.21R.
- 1.5.24 G The liabilities to be valued under *GENPRU* 1.5.21R and deducted under *GENPRU* 1.5.23R include:
- (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* 1.3.4R), any contingent liability relating to liabilities reinsured into Equitas Reinsurance Ltd; and
 - (5) amounts apportioned to *members* in respect of the *credit equalisation provision* under *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.
- 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* 1.3.4R. Depending on the circumstances, *managing agents* or the *Society* may need to disclose or account for such a liability.

2.1 Calculation of capital resources requirements

Application

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

Purpose

- 2.1.6 G *Principle 4* requires a *firm* to maintain adequate financial resources. *GENPRU 2* sets out provisions that deal specifically with the adequacy of that part of a *firm's* financial resources that consists of *capital resources*. The adequacy of a *firm's* *capital resources* needs to be assessed both by that *firm* and the *FSA*. Through its *rules*, the *FSA* 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 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 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 5a of the *UCITS Directive*.

Monitoring requirements

- 2.1.9 R A *firm* must at all times monitor whether it is complying with *GENPRU 2.1.13R* (the main capital adequacy *rule* for *insurers*) 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 G For the purposes of *GENPRU 2.1.9R*, a *firm* should have systems in place to enable it to be certain whether it has adequate *capital resources* to comply with *GENPRU 2.1.13R* 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 *FSA*.
- 2.1.11 R A *firm* must notify the *FSA* immediately of any breach, or expected breach, of *GENPRU 2.1.13R* (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 G The *FSA* may impose a higher capital requirement than the minimum requirement set out in this section as part of the *firm's Part IV 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 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 6.1.9R* (Requirement to maintain group capital), is deemed to comply with this *rule*.
- 2.1.14 R An *insurer* must comply with *GENPRU 2.1.13R* 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 2.1.26R*.
- 2.1.15 G In order to comply with *GENPRU 2.1.14R*, 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 1.5.30R* to *INSPRU 1.5.32G*). *INSPRU 1.5* (Internal-contagion risk) sets out the detailed requirements for the separation of *long-term* and *general insurance business*.
- 2.1.16 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 R The *CRR* for any *insurer* carrying on *general insurance business* is equal to the *MCR* in *GENPRU 2.1.24R* or, for a *pure reinsurer* or a *captive reinsurer* carrying on both *general insurance business* and *long-term insurance business*, in *GENPRU 2.1.26R*.
- 2.1.18 R The *CRR* for any *insurer* to which this *rule* applies (see *GENPRU 2.1.19R* and *GENPRU 2.1.20R*) is the higher of:
- (1) the *MCR* in *GENPRU 2.1.25R*; and
 - (2) the *ECR* in *GENPRU 2.1.38R*.
- 2.1.19 R Subject to *GENPRU 2.1.20R*, *GENPRU 2.1.18R* 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 2.1.18R*) have remained, less than £500 million.

- 2.1.20 R *GENPRU* 2.1.18R also applies to an *insurer* of a type listed in *GENPRU* 2.1.19R(3) if:
- (1) the *insurer* makes an election that *GENPRU* 2.1.18R is to apply to it; and
 - (2) that election is made by written notice given to the *FSA* in a way that complies with the requirements for written notice in *SUP* 15.7 (Form and method of notification).
- 2.1.21 G The effect of *GENPRU* 2.1.19R(3) is that an *insurer* to which *GENPRU* 2.1.18R applies because it has *with-profits insurance liabilities* of £500 million or more, will continue to be subject to *GENPRU* 2.1.18R even if its *with-profits insurance liabilities* fall below £500 million. However, if that happens, it may apply for a *waiver* from *GENPRU* 2.1.18R under section 148 of the *Act*. In exercising its discretion under section 148 of the *Act*, the *FSA* 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 G An *insurer* that has always had *with-profits insurance liabilities* of less than £500 million since *GENPRU* 2.1.18R came into force may wish to “opt in” to *GENPRU* 2.1.18R and therefore become a *realistic basis life firm*. By doing so, it becomes obliged to calculate a *with-profits insurance capital component* (see *GENPRU* 2.1.38R 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* 1.2.46R (Future net premiums: adjustment for deferred acquisition costs) and *INSPRU* 1.2.76R (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* 2.1.20R that *GENPRU* 2.1.18R 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* 2.1.18R under section 148 of the *Act*. In exercising its discretion under section 148 of the *Act*, the *FSA* 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 R The *CRR* for an *insurer* carrying on *long-term insurance business*, but to which *GENPRU* 2.1.18R does not apply, is equal to the *MCR* in *GENPRU* 2.1.25R or, for a *pure reinsurer* or a *captive reinsurer* carrying on both *general insurance business* and *long-term insurance business*, in *GENPRU* 2.1.26R.

Calculation of the *MCR* (Insurer only)

- 2.1.24 R Subject to *GENPRU* 2.1.26R, 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*.

2.1.25 R Subject to *GENPRU 2.1.26R*, for an *insurer* carrying on *long-term insurance business* 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 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 G The *MCR* gives effect to the EC Directive minimum requirements. For *general insurance business*, the EC Directive minimum is the higher of the *general insurance capital requirement* and the relevant *base capital resources requirement*. For *long-term insurance business*, the EC 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 EC 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 an *FSA* requirement that is additional to the EC minimum requirement for *long-term insurance business*.
- 2.1.28 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 R The amount of an *insurer's base capital resources requirement* is set out in the table in *GENPRU 2.1.30R*. If an *insurer* falls within one or more of the descriptions of type of *firm* set out in *GENPRU 2.1.30R*, its *base capital resources requirement* is the highest amount set out against the different types of *firm* within whose description it falls.

2.1.30 R Table: Base capital resources requirement for an insurer
This table belongs to *GENPRU 2.1.29R*

<i>Firm category</i>		Amount: Currency equivalent of
<i>General insurance business</i>		
<i>Liability insurer (classes 10-15)</i>	<i>Directive mutual</i>	€2.4 million
	<i>Non-directive insurer</i>	€300,000
	<i>Other (including mixed insurer but excluding pure reinsurer and captive reinsurer)</i>	€3.2 million
<i>Other insurer</i>	<i>Directive mutual</i>	€1.65 million
	<i>Non-directive insurer (classes 1 to 8, 16 or 18)</i>	€225,000
	<i>Non-directive insurer (classes 9 or 17)</i>	€150,000
	<i>Mixed insurer</i>	€3.2 million
	<i>Other (excluding pure reinsurer and captive reinsurer)</i>	€2.2 million
<i>Long-term insurance business</i>		
<i>Mutual</i>	<i>Directive</i>	€2.4 million
	<i>Non-directive</i>	€600,000
<i>Any other insurer (including mixed insurer but excluding pure reinsurer and captive reinsurer)</i>		€3.2 million
<i>All business (general insurance business and long-term insurance business)</i>		
<i>Pure reinsurer</i>		€3.2 million
<i>Captive reinsurer</i>		€1 million

- 2.1.31 G (1) Under the *Insurance Directives* the amount of the *base capital resources requirement* specified in the last column of the table in *GENPRU 2.1.30R* 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 *FSA* intends, so far as possible, to amend the amounts in *GENPRU 2.1.30R* for all such *firms* (and *GENPRU 2.3.9R* for the *base capital resources requirements* applying to Lloyd's) when an index-linked increase is required by the *Insurance Directives*. The *FSA* 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 2.1.30R* 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 2.1.31G* will be published on the *FSA* website.
- 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.

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:
- (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 *INSRU 1.1* (Capital resources requirement and technical provisions for insurance business).

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:

- (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).

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:

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

2.1.39 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 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 2.1.45R* (Calculation of the variable capital requirement for a BIPRU firm).

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

2.1.42 R At the time that it first becomes a *bank, building society* or *BIPRU investment firm*, a *firm* must hold *initial capital* of not less than the *base capital resources requirement* applicable to that *firm*.

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

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

Calculation of the variable capital requirement for a BIPRU firm

- 2.1.45 R Table: Calculation of the variable capital requirement for a BIPRU firm
This table belongs to *GENPRU 2.1.40R*

<i>Firm category</i>	<i>Capital requirement</i>	
<i>Bank, building society or full scope BIPRU investment firm</i>	the sum of the following:	
	(1)	the <i>credit risk capital requirement</i> ;
	(2)	the <i>market risk capital requirement</i> ; and
	(3)	the <i>operational risk capital requirement</i> .
<i>BIPRU limited activity firm</i>	the sum of the following:	
	(1)	the <i>credit risk capital requirement</i> ;
	(2)	the <i>market risk capital requirement</i> ; and
	(3)	the <i>fixed overheads requirement</i> .
<i>BIPRU limited licence firm (including UCITS investment firm)</i>	the higher of (1) and (2):	
	(1)	the sum of:
		(a) the <i>credit risk capital requirement</i> ; and
		(b) the <i>market risk capital requirement</i> ; and
	(2)	the <i>fixed overheads requirement</i> .

Adjustment of the variable capital requirement calculation for UCITS investment firms

- 2.1.46 R A *UCITS investment firm* must only calculate the variable capital requirement under *GENPRU 2.1.40R* in respect of *designated investment business*. For this purpose *scheme management activity* is excluded from *designated investment business*.

Calculation of the base capital resources requirement for a BIPRU firm

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

- 2.1.48 R Table: Base capital resources requirement for a BIPRU firm
This table belongs to *GENPRU 2.1.47R*

<i>Firm category</i>	Amount: Currency equivalent of
<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>	The amount specified in <i>UPRU 2.1.2R(1)</i> (Financial resources requirement). However the capital that a <i>firm</i> must hold in respect of that requirement is as defined by <i>GENPRU</i> and not as specified in that <i>rule</i> . The reference in that <i>rule</i> to initial capital does not therefore apply.

Definition of BIPRU 730K firm, BIPRU 125K firm and BIPRU 50K firm

- 2.1.49 G The terms *BIPRU 730K firm*, *BIPRU 125K firm* and *BIPRU 50K firm* are defined in *BIPRU 1.1* (Application and purpose). However for convenience the table in *GENPRU 2.1.50G* briefly summarises them.
- 2.1.50 G Table: Definition of BIPRU 730K firm, BIPRU 125K firm and BIPRU 50K firm
This table belongs to *GENPRU 2.1.49G*

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:
	(a)	reception and transmission of investors' orders for <i>financial instruments</i> ; or

Category of BIPRU investment firm	Definition		
		(b)	the execution of investors' orders for <i>financial instruments</i> ; or
		(c)	the management of individual portfolios of investments in <i>financial instruments</i> ; and
	(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:	
		(a)	reception and transmission of investors' orders for <i>financial instruments</i> ; or
		(b)	the execution of investors' orders for <i>financial instruments</i> ; or
		(c)	the management of individual portfolios of investments in <i>financial instruments</i> ; and
	(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 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 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 7.1.9R - BIPRU 7.1.13R* (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 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 2.1.54R*.
- 2.1.54 R For the purpose of *GENPRU 2.1.53R*, and subject to *GENPRU 2.1.55R* to *GENPRU 2.1.57R*, a *BIPRU investment firm's* relevant fixed expenditure is the amount described as total expenditure in its most recent audited *annual report and accounts*, less the following items (if they are included within such expenditure):
- (1) staff bonuses, except to the extent that they are guaranteed;
 - (2) employees' and directors' shares in profits, except to the extent that they are guaranteed;
 - (3) other appropriations of profits;
 - (4) shared commission and fees payable which are directly related to commission and fees receivable, which are included within total revenue;
 - (5) interest charges in respect of borrowings made to finance the acquisition of the *firm's readily realisable investments*;
 - (6) interest paid to customers on *client money*;
 - (7) interest paid to counterparties;

- (8) fees, brokerage and other charges paid to *clearing houses*, exchanges and *intermediate brokers* for the purposes of *executing*, registering or clearing transactions;
 - (9) foreign exchange losses; and
 - (10) other variable expenditure.
- 2.1.55 R The relevant fixed expenditure of a *firm* in the following circumstances is:
- (1) where its most recent audited *annual report and accounts* do not represent a twelve month period, an amount calculated in accordance with *GENPRU 2.1.54R*, pro-rated so as to produce an equivalent annual amount; and
 - (2) where it has not completed twelve months' trading, an amount based on forecast expenditure included in the budget for the first twelve months' trading, as submitted with its application for *authorisation*.
- 2.1.56 R A *firm* must adjust its relevant fixed expenditure calculation so far as necessary if and to the extent that since the date covered by the most recent audited *annual report and accounts* or (if *GENPRU 2.1.55R(2)* applies) since the budget was prepared:
- (1) its level of fixed expenditure changes materially; or
 - (2) its *regulated activities* comprised within its *permission* change.
- 2.1.57 R If a *firm* has a material proportion of its expenditure incurred on its behalf by third parties and such expenditure is not fully recharged to that *firm* then the *firm* must adjust its relevant fixed expenditure calculation by adding back in the whole of the difference between the amount of the expenditure and the amount recharged.
- 2.1.58 G For the purpose of *GENPRU 2.1.57R*, the *FSA* would consider as material 10% of a *firm's* expenditure incurred on its behalf by third parties.
- 2.1.59 G For the purpose of *GENPRU 2.1.54R* to *2.1.57R*, fixed expenditure is expenditure which is inelastic relative to fluctuations in a *firm's* levels of business. Fixed expenditure is likely to include most salaries and staff costs, office rent, payment for the rent or lease of office equipment, and insurance *premiums*. It may be viewed as the amount of funds which a *firm* would require to enable it to cease business in an orderly manner, should the need arise. This is not an exhaustive list of such expenditure and a *firm* will itself need to identify (taking appropriate advice where necessary) which costs amount to fixed expenditure.

Calculation of base capital resources requirement for banks authorised before 1993

- 2.1.60 R (1) This *rule* applies to a *bank* that meets the following conditions:

- (a) on 31 December 2006 it had the benefit of *IPRU(BANK) rule 3.3.12* (Reduced minimum capital requirement for a *bank* that is a *credit institution* which immediately before 1 January 1993 was authorised under the Banking Act 1987);
 - (b) the relevant amount (as referred to in *IPRU(BANK) rule 3.3.12*) applicable to it was below €5 million as at 31 December 2006; and
 - (c) on 1 January 2007 it did not comply with the *base capital resources requirement* as set out in the table in *GENPRU 2.1.48R* (€5 million requirement).
 - (2) Subject to (3), the applicable *base capital resources requirement* as at any time (the "relevant time") is the higher of:
 - (a) the relevant amount applicable to it under *IPRU(BANK) rule 3.3.12* as at 31 December 2006 as adjusted under *GENPRU 2.1.62R(2)*; and
 - (b) the highest amount of eligible *capital resources* which that *bank* has held between 1 January 2007 and the relevant time.
 - (3) This *rule* ceases to apply when:
 - (a) that *bank's* eligible *capital resources* at any time since 1 January 2007 equal or exceed €5 million; or
 - (b) a *person* (other than an existing controller) becomes the *parent undertaking* of that *bank*.
 - (4) If this *rule* ceases to apply under (3)(a) it continues not to apply if the *bank's* eligible *capital resources* later fall below €5 million.
- 2.1.61 G Where two or more *banks* merge, all of which individually have the benefit of *GENPRU 2.1.60R*, the *FSA* may agree in certain circumstances that the *base capital resources requirement* for the *bank* resulting from the merger may be the sum of the aggregate *capital resources* of the merged *banks*, calculated at the time of the merger, provided this figure is less than €5 million.
- 2.1.62 R For the purpose of *GENPRU 2.1.60R*:
- (1) an existing controller of a *bank* means:
 - (a) a *person* who has been a *parent undertaking* of that *bank* since 31 December 2006 or earlier; or
 - (b) a *person* who became a *parent undertaking* of that *bank* after 31 December 2006 but who, when he became a *parent undertaking* of that *bank*, was a *subsidiary undertaking* of an existing controller of that *bank*;

- (2) the relevant amount of capital as referred to in *GENPRU* 2.1.60R(2)(a) is adjusted by identifying the time as of which the amount of capital it was obliged to hold under *IPRU(BANK) rule* 3.3.12 as referred to in *GENPRU* 2.1.60R(2)(a) was fixed and then recalculating the capital resources it held at that time in accordance with the definition of eligible *capital resources* (as defined in (3)); and
- (3) eligible *capital resources* mean *capital resources* eligible under *GENPRU* 2.2 (Capital resources) to be used to meet the *base capital resources requirement*.

2.2 Capital resources

Application

2.2.1 R This section applies to:

- (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.

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).

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

Contents guide

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

2.2.6

G Table: Arrangement of GENPRU 2.2
This table belongs to *GENPRU 2.2.5G*

Topic	Location of text
Application and purpose of the <i>rules</i> in this section	<i>GENPRU 2.2.1R</i> to <i>GENPRU 2.2.4G</i>
<i>BIPRU firms</i> that only have simple types of <i>capital resources</i> (<i>simple capital issuers</i>)	<i>GENPRU 2.2.7G</i>
Principles underlying the definition of <i>capital resources</i>	<i>GENPRU 2.2.8G</i>
Which method of calculating <i>capital resources</i> applies to which type of <i>firm</i>	<i>GENPRU 2.2.17R</i> to <i>GENPRU 2.2.19R</i>
Purpose of the limits on the use of different forms of capital	<i>GENPRU 2.2.24G</i>
Use of higher tier capital in lower tiers	<i>GENPRU 2.2.25R</i> to <i>GENPRU 2.2.28R</i>
Calculation of <i>capital resources</i> for <i>insurers</i>	<i>GENPRU 2.2.22G</i> to <i>GENPRU 2.2.23G</i> ; <i>GENPRU 2 Annex 1R</i>
Limits on the use of different forms of capital for <i>insurers</i> (<i>capital resources gearing rules</i> for <i>insurers</i>)	<i>GENPRU 2.2.29R</i> to <i>GENPRU 2.2.41R</i>
Calculation of <i>capital resources</i> for <i>banks</i>	<i>GENPRU 2 Annex 2R</i>
Calculation of <i>capital resources</i> for <i>building societies</i>	<i>GENPRU 2 Annex 3R</i>
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)	<i>GENPRU 2.2.42R</i> to <i>GENPRU 2.2.45R</i> ; <i>GENPRU 2.2.47R</i> to <i>GENPRU 2.2.48R</i>
Limits on the use of different forms of capital for <i>banks</i> and <i>building societies</i> (<i>capital resources gearing rules</i>)	<i>GENPRU 2.2.29R</i> to <i>GENPRU 2.2.31G</i> ; <i>GENPRU 2.2.46R</i> ; <i>GENPRU 2.2.49R</i>
Calculation of <i>capital resources</i> for <i>BIPRU investment firms</i>	<i>GENPRU 2.2.20G</i> to <i>GENPRU 2.2.21G</i> ; <i>GENPRU 2 Annex 4R</i> to <i>GENPRU 2 Annex 6R</i>

Topic	Location of text
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)	<i>GENPRU 2.2.42R to GENPRU 2.2.45R; GENPRU 2.2.47R to GENPRU 2.2.48R</i>
Limits on the use of different forms of capital for <i>BIPRU investment firms</i> (<i>capital resources gearing rules</i>)	<i>GENPRU 2.2.29R to GENPRU 2.2.31G; GENPRU 2.2.46R; GENPRU 2.2.50R</i>
Example of how the <i>capital resources</i> calculation for <i>BIPRU firms</i> works	<i>GENPRU 2.2.51G to GENPRU 2.2.59G</i>
Capital used to meet the <i>base capital resources requirement</i> for <i>BIPRU firms</i>	<i>GENPRU 2.2.60R to GENPRU 2.2.61G</i>
<i>Tier one capital instruments: general</i>	<i>GENPRU 2.2.9G to 2.2.10G; GENPRU 2.2.62R to 2.2.69G; GENPRU 2.2.80R to GENPRU 2.2.82G</i>
<i>Core tier one capital: permanent share capital</i>	<i>GENPRU 2.2.83R to GENPRU 2.2.84G</i>
<i>Core tier one capital: profit and loss account and other reserves: material applicable to all firms</i>	<i>GENPRU 2.2.85R; GENPRU 2.2.87R to GENPRU 2.2.89G; GENPRU 2.2.91G</i>
<i>Core tier one capital: profit and loss account and other reserves: material specific to BIPRU firms</i>	<i>GENPRU 2.2.86R; GENPRU 2.2.90R; GENPRU 2.2.92G</i>
<i>Core tier one capital: provisions relating to partnerships and limited liability partnerships</i>	<i>GENPRU 2.2.93R to GENPRU 2.2.100R</i>
<i>Core tier one capital: share premium account</i>	<i>GENPRU 2.2.101R</i>
<i>Core tier one capital: externally verified interim net profits</i>	<i>GENPRU 2.2.102R to GENPRU 2.2.103G</i>
<i>Core tier one capital: valuation differences and fund for future appropriations for insurers</i>	<i>GENPRU 2.2.104R to GENPRU 2.2.108R</i>
<i>Tier one capital: perpetual non-cumulative preference shares</i>	<i>GENPRU 2.2.109R to GENPRU 2.2.110G</i>

Topic	Location of text
<i>Tier one capital: PIBS</i>	<i>GENPRU 2.2.76R; GENPRU 2.2.111R to GENPRU 2.2.112G</i>
<i>Innovative tier one capital (excluding issues through SPVs)</i>	<i>GENPRU 2.2.76R; GENPRU 2.2.113R to GENPRU 2.2.122G</i>
<i>Innovative tier one capital (issues through SPVs)</i>	<i>GENPRU 2.2.123R to GENPRU 2.2.137R</i>
<i>Tier one capital: conversion ratio</i>	<i>GENPRU 2.2.138R to GENPRU 2.2.144G</i>
<i>Tier one capital: requirement to have sufficient unissued stock</i>	<i>GENPRU 2.2.145R</i>
<i>Deductions from tier one capital resources</i>	<i>GENPRU 2.2.155R to GENPRU 2.2.156G</i>
<i>Tier two capital</i>	<i>GENPRU 2.2.11G; GENPRU 2.2.157G to GENPRU 2.2.197G</i>
<i>Deductions from tier one capital resources and tier two capital resources</i>	<i>GENPRU 2.2.202R to GENPRU 2.2.240G</i>
<i>Tier three capital</i>	<i>GENPRU 2.2.12G; GENPRU 2.2.241R to GENPRU 2.2.249R</i>
<i>Deductions from total capital resources</i>	<i>GENPRU 2.2.14G to GENPRU 2.2.16G; GENPRU 2.2.250R to GENPRU 2.2.265R</i>
<i>The effect of swaps</i>	<i>GENPRU 2.2.198R to GENPRU 2.2.201R</i>
<i>Step-ups (tier one capital and tier two capital)</i>	<i>GENPRU 2.2.76R; GENPRU 2.2.146R to GENPRU 2.2.154G</i>
<i>Redemption of tier one instruments</i>	<i>GENPRU 2.2.64(3); GENPRU 2.2.70R to GENPRU 2.2.79G;</i>
<i>Redemption of tier two instruments</i>	<i>GENPRU 2.2.172R to GENPRU 2.2.174R; GENPRU 2.2.177R to GENPRU 2.2.178R (upper tier two instruments); GENPRU 2.2.194R to GENPRU 2.2.197G (lower tier two instruments)</i>
<i>Non-standard capital instruments</i>	<i>GENPRU 2.2.13G</i>

Topic	Location of text
Standard form documentation for subordinated debt	<i>GENPRU 2.2.164G</i>
Public sector guarantees	<i>GENPRU 2.2.276G</i>
Other capital resources for insurers: unpaid <i>share</i> capital or <i>unpaid initial funds</i> and calls for supplementary contributions	<i>GENPRU 2.2.266R to GENPRU 2.2.269G</i>
Additional requirements for <i>insurers</i> carrying on <i>with-profits insurance business</i>	<i>GENPRU 2.2.270R to GENPRU 2.2.275G</i>

Simple capital issuers

- 2.2.7 G Parts of this section are irrelevant to a *BIPRU firm* whose *capital resources* consist of straightforward *capital instruments*. Therefore the *FSA's* Personal handbooks facility available on its website allows a *BIPRU firm* to screen out those parts of this section that are not relevant to a *simple capital issuer*. A *simple capital issuer* is a *BIPRU firm* that meets the following conditions:
- (1) it does not raise capital through a special purpose vehicle;
 - (2) it only includes *capital instruments* in its *tier one capital resources* consisting of ordinary *shares*, *PIBS* (relevant to *building societies* only), perpetual non-cumulative preference *shares* or partnership or *limited liability partnership* capital accounts (relevant to partnerships or *limited liability partnership* only);
 - (3) it only includes non-redeemable and non-convertible *capital instruments* in its *tier one capital resources*; and
 - (4) (if it includes *capital instruments* in its *tier one capital resources* on which *coupons* are payable) such *coupons* are non-cumulative, non-mandatory, in cash and not subject to a *step-up*.

Principles underlying the definition of capital resources

- 2.2.8 G The *FSA* 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 2.2.9G*. The *FSA* 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 *FSA* (which takes the form of a *waiver* under section 148 of the *Act*). Details of the individual components of capital are set out in the *capital resources table*.

Tier one capital

- 2.2.9 G *Tier one capital* typically has the following characteristics:
- (1) it is able to absorb losses;
 - (2) it is permanent;
 - (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 G The forms of capital that qualify for *tier one capital* are set out in the *capital resources table* and include, for example, *share capital*, reserves, partnership and *sole trader capital*, verified interim net profits and, for a *mutual*, the *initial fund* plus permanent members' accounts. *Tier one capital* is divided into *core tier one capital*, perpetual non-cumulative *preference shares*, *permanent interest-bearing shares (PIBS)* and *innovative tier one capital*.

Upper and lower tier two capital

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

Non-standard capital instruments

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

Deductions from capital

- 2.2.14 G Deductions should be made at the relevant stage of the calculation of *capital resources* to reflect capital that may not be available to the *firm* or assets of uncertain value (for example, holdings of intangible assets and assets that are inadmissible for an *insurer*, or, in the case of a *bank* or *building society*, where that *firm* has made investments in a *subsidiary undertaking* or in another *financial institution* or in respect of *participations* that it holds).
- 2.2.15 G Deductions should also be made, in the case of certain *BIPRU investment firms* for *illiquid assets* (see *GENPRU 2.2.19R*).
- 2.2.16 G A full list of deductions from *capital resources* is shown in the *capital resources table* applicable to the *firm*.

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

- 2.2.17 R A *firm* must calculate its *capital resources* in accordance with the version of the *capital resources table* applicable to the *firm*, subject to the *capital resources gearing rules*. The version of the *capital resources table* that applies to a *firm* is specified in the table in *GENPRU 2.2.19R*.
- 2.2.18 R In the case of a *BIPRU firm* the *capital resources table* also sets out how the *capital resources requirement* is deducted from *capital resources* in order to decide whether its *capital resources* equal or exceed its *capital resources requirement*.

2.2.19 R Table: Applicable capital resources calculation
This table belongs to *GENPRU 2.2.17R*

Type of <i>firm</i>	Location of <i>rules</i>	Remarks
<i>Insurer</i>	<i>GENPRU 2 Annex 1R</i>	
<i>Bank</i>	<i>GENPRU 2 Annex 2R</i>	
<i>Building society</i>	<i>GENPRU 2 Annex 3R</i>	
<i>BIPRU investment firm without an investment firm consolidation waiver</i>	<i>GENPRU 2 Annex 4R (Deducts material holdings)</i>	Applies to a <i>BIPRU investment firm</i> not using <i>GENPRU 2 Annex 5R</i> or <i>GENPRU 2 Annex 6R</i>
<i>BIPRU investment firm without an investment firm consolidation waiver</i>	<i>GENPRU 2 Annex 5R (Deducts illiquid assets)</i>	A <i>BIPRU investment firm</i> must give one <i>Month's</i> prior notice to the <i>FSA</i> before starting to use or stopping using this method
<i>BIPRU investment firm with an investment firm consolidation waiver</i>	<i>GENPRU 2 Annex 6R (Deducts illiquid assets and material holdings)</i>	A <i>firm</i> with an <i>investment firm consolidation waiver</i> must use this method. No other <i>BIPRU investment firm</i> may use it.

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

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

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

Calculation of capital resources: Insurers

2.2.22 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 2.2.23G*.

2.2.23 G Table: Approaches to calculating capital resources
This table belongs to *GENPRU 2.2.22G*

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	<u>550</u>	Total	<u>550</u>
Calculation of <i>capital resources</i> : eligible assets less foreseeable liabilities			
Total assets		550	
less intangible assets		(100)	
less inadmissible assets		(100)	
less liabilities (borrowings)		(100)	
<i>Capital resources</i>		<u>250</u>	
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>	<u>250</u>

Limits on the use of different forms of capital: General

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

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

- 2.2.25 R A *firm* may include in a *lower stage of capital*, *capital resources* which are eligible for inclusion in a *higher stage of capital* if the *capital resources gearing rules* would prevent the use of that capital in that *higher stage of capital*. However:
- (1) the *capital resources gearing rules* applicable to that *lower stage of capital* apply to *higher stage of capital* included in that *lower stage of capital*; and
 - (2) (subject to *GENPRU 2.2.26R*) the *rules* in *GENPRU* governing the eligibility of capital in that *lower stage of capital* continue to apply.
- 2.2.26 R An item of *tier one capital* which is included in a *firm's tier two capital resources* under *GENPRU 2.2.25R* is not subject to the requirement to obtain a legal opinion in *GENPRU 2.2.159R(12)*.
- 2.2.27 R A *BIPRU firm* may include in a *lower stage of capital*, *innovative tier one capital* that it is prohibited from using under *GENPRU 2.2.42R* (*BIPRU firms* may not use *innovative tier one capital* to meet the *CRR*). However:
- (1) the *capital resources gearing rules* applicable to that *lower stage of capital* apply to that *innovative tier one capital*; and
 - (2) (subject to *GENPRU 2.2.28R*) the *rules* in *GENPRU* governing the eligibility of capital in that *lower stage of capital* continue to apply.
- 2.2.28 R The requirement to obtain a legal opinion in *GENPRU 2.2.159R(12)* does not apply to *innovative tier one capital* treated under *GENPRU 2.2.27R* but the requirements to obtain a legal opinion in *GENPRU 2.2.118R* continue to apply.

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

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

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

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

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

- 2.2.31 G The purpose of the requirement in *GENPRU 2.2.29R* is to ensure that at least 50% of the *firm's tier one capital resources* (net of *tier one capital* deductions) is met by *core tier one capital* which provides maximum loss absorbency on a going concern basis to protect the *firm* from insolvency. Although a perpetual non-cumulative *preference share* or a *PIBS* is in legal form a *share*, it behaves in many ways like a perpetual fixed interest debt instrument. Within the 50% limit on non-*core tier one capital*, *GENPRU 2.2.30R* places a further sub-limit on the amount of *innovative tier one capital* that a *firm* may include in its *tier one capital resources*. This limit is 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 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 2.2.29R*, 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 R An *insurer* carrying on *long-term insurance business* must meet the higher of:
- (1) $\frac{1}{3}$ 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 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*.

2.2.35 R In *GENPRU 2.2.33R* and *GENPRU 2.2.34R*:

- (1) items listed at stage B (Perpetual non-cumulative preference shares) in the *capital resources table* may be included notwithstanding *GENPRU 2.2.29R*;
- (2) *innovative tier one capital* that meets the conditions (other than *GENPRU 2.2.159R(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 2.2.33R* or *GENPRU 2.2.34R*, as the case may be.

2.2.36 G The purposes of the requirements in *GENPRU 2.2.32R* to *GENPRU 2.2.34R* are to comply with the *Insurance Directives*' requirement that *insurers* maintain a *guarantee fund* of higher quality *capital resources* items and to ensure that at least 50% of the *insurer's capital resources* needed to meet its *MCR* provide maximum loss absorbency to protect the *insurer* from insolvency.

2.2.37 R Subject to *GENPRU 2.2.38R*, 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 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 2.2.29R*, 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 G In *GENPRU 2.2.38R* 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 G *GENPRU 2.2.37R* and *GENPRU 2.2.38R* give effect to the *Insurance Directives'* requirements that an *insurer's tier two capital resources* must not exceed its *tier one capital resources* and that no more than 25% of an *insurer's "required solvency margin"* should consist of *lower tier two capital resources*.

2.2.41 R An *insurer* that carries on both *long-term insurance business* and *general insurance business* must apply the relevant limits in *GENPRU 2.2.32R* to *GENPRU 2.2.38R* separately for each type of business.

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

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

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

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

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

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

2.2.45 R *GENPRU 2.2.44R* (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 2.2.47R* and except as may otherwise be stated in the relevant part of the *Handbook*.

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

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

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

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

2.2.47 R For the purposes of meeting:

- (1) the *market risk capital requirement*;
- (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 2.2.44R* (*GENPRU 2.2.48R* explains how to calculate how much *tier one capital* is required to meet the requirements in *GENPRU 2.2.44R*);
- (5) *tier two capital* to the extent that it:
 - (a) comes within the limits in *GENPRU 2.2.46R* (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 2.2.44R*;

(*GENPRU 2.2.48R* explains how to calculate how much *tier two capital* is required to meet the requirements in *GENPRU 2.2.44R*);

(6) *tier two capital* that cannot be used for the purposes in *GENPRU 2.2.44R* because it falls outside the limits in *GENPRU 2.2.46R*; and

(7) *tier three capital*.

2.2.48 R The amount of *tier one capital* and *tier two capital* that is not used to meet the requirements in *GENPRU 2.2.44R* as referred to in *GENPRU 2.2.47R*(4) and (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 2.2.44R*).

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

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

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

(2) its *upper tier three capital resources*;

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

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

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

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

Example of how the capital resources calculation for BIPRU firms works

2.2.51 G *GENPRU 2.2.52G* to *GENPRU 2.2.59G* 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 credit risk requirement of £100 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 2.2.52G*.

- 2.2.52 G Table: Example of the calculation of the capital resources of a BIPRU firm
This table belongs to *GENPRU 2.2.51G*

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 (excluding <i>innovative tier one instruments</i> – see <i>GENPRU 2.2.53G</i>)	Stage F	80
Total <i>tier two capital</i> (including <i>innovative tier one instruments</i> – see <i>GENPRU 2.2.53G</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> (<i>trading book profits</i>))	Stage Q	50
Total <i>capital resources</i>	Stage T	190

- 2.2.53 G *GENPRU 2.2.42R* (Limits on the use of innovative tier one capital) prohibits the inclusion of *innovative tier one instruments* in the *tier one capital* of a *BIPRU firm* for the purpose of meeting the *capital resources requirement*. Thus they are not included in the calculation of stage F of the *capital resources table*. Instead all *innovative tier one instruments* have been included in *tier two capital* in accordance with *GENPRU 2.2.25R* (Use of higher tiers of capital in lower tiers).
- 2.2.54 G In the example in the table in *GENPRU 2.2.52G* the *firm* has total *tier one capital* after deductions of £80. Its *tier two capital* of £80 is therefore the maximum permitted under *GENPRU 2.2.46R* (Tier two limits), that is 100% of *tier one capital*.
- 2.2.55 G The *credit 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 2.2.56G*.
- 2.2.56 G Table: Example of how capital resources of a BIPRU firm are measured against its capital resources requirement
This table belongs to *GENPRU 2.2.55G*

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 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 <i>GENPRU 2.2.49R</i> – see <i>GENPRU 2.2.57G</i>		

- 2.2.57 G The gearing limit in *GENPRU 2.2.49* (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 *tier one capital* used to meet market risk.
- 2.2.58 G In this example it is assumed that the maximum possible amount of *tier one capital* is carried forward to meet the market risk requirement. There are other options as to the allocation of *tier one capital* and *tier two capital* to the credit risk requirement. Therefore in this example the various tiers of *capital resources* are applied to meet the market risk requirement as follows:
- (1) the *tier one capital* used to meet market risk is £40;
 - (2) 250% of *tier one capital* used to meet market risk is £100; and
 - (3) the *upper tier three capital* used to meet market risk is £50.
- 2.2.59 G The 250% gearing limit is met as the limit of £100 is greater than the *upper tier three capital* of £50 used in this example.
- Capital used to meet the base capital resources requirement (BIPRU firm only)
- 2.2.60 R A *BIPRU firm* may use the *capital resources* used to meet the *base capital resources requirement* to meet any other part of the *capital resources requirement*.

- 2.2.61 G The explanation for *GENPRU 2.2.60R* can be found in *GENPRU 2.1.43G* (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*.

Tier one capital: General

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

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

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

- (1) *permanent share capital*;
- (2) *eligible partnership capital*;
- (3) *eligible LLP members' capital*;
- (4) *sole trader capital*;
- (5) a perpetual non-cumulative *preference share*;
- (6) (in the case of a *building society*) *PIBS*; and
- (7) an *innovative tier one instrument*.

General conditions for eligibility as tier one capital

- 2.2.64 R The conditions that an item of capital of a *firm* must comply with under *GENPRU 2.2.62R(3)* are as follows:

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

- (b) complies with the conditions in *GENPRU 2.2.70R* (Basic requirements for redeemability) and *GENPRU 2.2.76R* (Redeemable instrument subject to a *step-up*) ;
- (4) the item of capital meets the following conditions in relation to any *coupon*:
 - (a) the *firm* is under no obligation to pay a *coupon*; or
 - (b) (if the *firm* is obliged to pay the *coupon*) the *coupon* is payable in the form of an item of capital that is 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 in particular it complies with *GENPRU 2.2.80R* to *2.2.81R* (Loss absorption) and, in the case of an *innovative tier one instrument*, *GENPRU 2.2.116R* to *2.2.118R* (*Innovative tier one instrument* should not constitute a liability);
- (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 no higher than a *share* of a company incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 (whether or not it is such a *share*); and
- (10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9) and, where it applies, *GENPRU 2.2.271R* (Other requirements: insurers carrying on with-profits business (Insurer only)).

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

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

- 2.2.66 G *GENPRU* 2.2.65R is an example of the general principle in *GEN* 2.2.1 (Purposive interpretation). Its purpose is to emphasise that an item of capital does not meet the conditions for inclusion in *tier one capital* if in isolation it does meet those requirements but it fails to meet those requirements when other transactions are taken into account. Examples of such connected transactions might include guarantees or any other side agreement provided to the holders of the *capital instrument* by the *firm* or a connected party or a related transaction designed, for example, to enhance their security or to achieve a tax benefit, but which may compromise the loss absorption capacity or permanence of the original capital item.
- 2.2.67 G *GENPRU* 2.2.64R(2) is stricter than the Companies Act definition of fully paid, which only requires an undertaking to pay.
- 2.2.68 G The *FSA* considers that dividend pushers diminish the quality of capital by breaching the principle of complete discretion over *coupons* set out in *GENPRU* 2.2.64R(4). A dividend pusher operates so that, in a given period of time, payments must be made on senior securities if payments have previously been made on junior securities or securities ranking *pari passu*. As such, dividend pushers may not be included in the terms of *tier one capital*, unless the *firm* has the option to fund the “pushed payment” in stock.
- 2.2.69 G An item of capital does not comply with *GENPRU* 2.2.64R(10) if it is marketed as a *capital instrument* that would only qualify for a lower level of capital or on the basis that investing in it is like investing in an instrument in a lower tier of capital. For example, an undated *capital instrument* should not be marketed as a dated *capital instrument* if the terms of the *capital instrument* include an option by the issuer to redeem the *capital instrument* at a specified date in the future.

Redemption of tier one instruments

- 2.2.70 R A *firm* may not include a *capital instrument* in its *tier one capital resources*, unless its contractual terms are such that:
- (1) (if it is redeemable other than in circumstances set out in *GENPRU* 2.2.64R(3)(a) (redemption on a winding up)) it is redeemable only at the option of the *firm*; and
 - (2) the *firm* cannot exercise that redemption right:
 - (a) before the fifth anniversary of its date of issue;
 - (b) unless it has given notice to the *FSA* in accordance with *GENPRU* 2.2.74R; and
 - (c) unless at the time of exercise of that right it complies with the *main BIPRU firm Pillar 1 rules* and will continue to do so after redemption.
- 2.2.71 R A *firm* may include a term in a *tier one instrument* allowing the *firm* to redeem it before the date in *GENPRU* 2.2.70R(2)(a) if the following conditions are satisfied:

- (1) the other conditions in *GENPRU 2.2.70R* are met;
- (2) the circumstance that entitles the *firm* to exercise that right is a 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;
- (3) 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
- (4) the *firm's* right is conditional on it obtaining the *FSA's* consent in the form of a *waiver* of *GENPRU 2.2.72R*.

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

2.2.73 G The purpose of *GENPRU 2.2.71R* to *GENPRU 2.2.72R* 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 2.2.71R* 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 2.2.71R* says that the terms of the *tier one instrument* should provide that the *firm* should not be able to exercise that right without the *FSA's* consent. Any such consent will be given in the form of a *waiver* allowing early repayment. Thus although a *firm* may include a right to redeem early in the terms of a *tier one instrument* without the need to apply for a *waiver* the actual exercise of that right will require a *waiver*.

2.2.74 R A *firm* must not redeem any *tier one instrument* that it has included in its *tier one capital resources* unless it has notified the *FSA* of its intention at least one month before it does so.

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

Step-ups and redeemable tier one instruments

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

- (1) it is or may become subject to a *step-up*; or
- (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 2.2.70R(2)(a)* is amended by replacing "fifth anniversary" with "tenth anniversary".

Meaning of redemption

- 2.2.77 R (1) This *rule* applies to a *tier one instrument*, *tier two instrument* or *tier three instrument* (instrument A) that under its terms is exchanged for or converted into another instrument or is subject to a similar process.
- (2) This *rule* also applies to instrument A if under its terms it is redeemed out of the proceeds of the issue of new securities.
- (3) If the instrument with which instrument A is replaced is included in the *same stage of capital* or a *higher stage of capital* as instrument A, instrument A is treated as not having been redeemed or repaid for the purposes of *GENPRU 2.2.*
- (4) (3) does not apply to *GENPRU 2.2.114R* (Redeemable instrument likely to be repaid etc), *GENPRU 2.2.74R* (Notice of redemption of *tier one instruments*), *GENPRU 2.2.174R* (Notice of redemption of *tier two instruments*) or *GENPRU 2.2.245R* (so far as it relates to notice of redemption of *tier three instruments*).
- (5) (3) only applies if it would be reasonable (taking into account the economic substance) to treat the original instruments as continuing in issue on the same or a more favourable basis. The question of whether that basis is more or less favourable must be judged from the point of view of the adequacy of the *firm's capital resources*.
- 2.2.78 R (1) A *share* is not redeemable for the purposes of this section merely because the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 allows the *firm* that issued it to purchase it.
- (2) A *capital instrument* is not redeemable for the purposes of this section merely because the *firm* that issued it has a right to purchase it similar to the right in (1).
- 2.2.79 G This section generally uses the term repay and redeem interchangeably.

Loss absorption

- 2.2.80 R A *firm* may not include a *share* in its *tier one capital resources* unless (in addition to complying with the other relevant *rules* in *GENPRU 2.2*):
- (1) (in the case of a *firm* that is a company as defined in the Companies Act 1985 or the Companies (Northern Ireland) Order 1986) it is "called-up *share capital*" within the meaning given to that term in that Act or, as the case may be, that Order; or
- (2) (in the case of a *building society*) it is a "deferred share" as defined in the Building Societies (Deferred Shares) Order 1991; 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 R A *firm* may not include a *capital instrument* other than a *share* in its *tier one capital resources* unless it complies with GENPRU 2.2.80R(3).

2.2.82 G There are additional loss absorption requirements for *innovative tier one capital* in GENPRU 2.2.116R to 2.2.118R (*Innovative tier one instrument* should not constitute a liability).

Core tier one capital: permanent share capital

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

- (1) it is:
- (a) an ordinary *share*; or
 - (b) a *members' contribution*; or
 - (c) part of the *initial fund* of a *mutual*;
- (2) any *coupon* on it is not cumulative, the *firm* is under no obligation to pay a *coupon* in any circumstances and the *firm* has the right to choose the amount of any *coupon* that it pays; and
- (3) the terms upon which it is issued do not permit redemption and it is otherwise incapable of being redeemed to at least the same degree as an ordinary *share* issued by a company incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 (whether or not it is such a *share*).

2.2.84 G GENPRU 2.2.83R has the effect that the *firm* should be under no obligation to make any payment in respect of a *tier one instrument* if it is to form part of its *permanent share capital* unless and until the *firm* is wound up. A *tier one instrument* that forms part of *permanent share capital* should not therefore count as a liability before the *firm* is wound up. The fact that relevant company law permits the *firm* to make earlier repayment does not mean that the *tier one instruments* are not eligible. However, the *firm* should not be required by any contractual or other obligation arising out of the terms of that capital to repay *permanent share capital*. Similarly a *tier one instrument* may still qualify if company law allows dividends to be paid on this capital, provided the *firm* is not contractually or otherwise obliged to pay them. There should therefore be no fixed costs.

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

- 2.2.85 R (1) Negative amounts, including any interim net losses (but in the case of a *BIPRU investment firm*, only material interim net losses), must be deducted from profit and loss account and other reserves.
- (2) For these purposes material interim net losses mean unaudited interim losses arising from a *firm's trading book* and *non-trading book* business which exceed 10% of the sum of its *capital resources* calculated at stages A (Core tier one capital) and B (Perpetual non-cumulative preference shares) 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 R (1) This *rule* applies to *trading book* valuation adjustments or reserves referred to in *GENPRU 1.3.29R* to *GENPRU 1.3.35G* (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 2.2.85R*.
- (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 2.2.248R* (Net interim *trading book* profits) otherwise.

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

- 2.2.87 R Dividends must be deducted from reserves as soon as they are declared.

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

- 2.2.88 R A *firm* must account for a capital contribution as an increase in reserves and may, notwithstanding *GENPRU 2.2.63R*, count that increase in reserves as *core tier one capital*.
- 2.2.89 G An item of capital qualifies as a capital contribution if it is a gift of capital (and, as such, is not repayable) and a *coupon* is not payable on it.

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

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

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

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

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

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

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

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

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

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

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

- 2.2.95 R A *BIPRU firm* that is a partnership or a *limited liability partnership* may not include *eligible partnership capital* or *eligible LLP members' capital* in its *tier one capital resources* unless (in addition to *GENPRU 2.2.62R* (General conditions relating to *tier one capital*)) it complies with *GENPRU 2.2.83R(2)* (*Coupons* should not be cumulative or mandatory). However *GENPRU 2.2.64R(3)* (Redemption) is replaced by *GENPRU 2.2.93R* or *GENPRU 2.2.94R*.
- 2.2.96 G If a *firm* has surplus *eligible partnership capital* or *eligible LLP members' capital* that it wishes to repay in circumstances other than those set out in *GENPRU 2.2.93R* or *GENPRU 2.2.94R* it may apply to the *FSA* for a *waiver* to allow it to do so. If a *firm* applies for such a *waiver* the information that the *firm* supplies with the application might include:
- (1) a demonstration that the *firm* would have sufficient *capital resources* to meet its *capital resources requirement* immediately after the repayment;
 - (2) a demonstration that the *firm* would have sufficient financial resources to meet any *individual capital guidance* and the *firm's* latest assessment under the *overall Pillar 2 rule* immediately after the repayment; and
 - (3) a two to three year capital plan demonstrating that the *firm* would be able to meet the requirements in (1) and (2) at all times without needing further capital injections.

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

- 2.2.97 R The items *permanent share capital* and *share premium account* (which form part of *core tier one capital*) and perpetual non-cumulative *preference shares* (which forms stage B of the *capital resources table*) do not apply to a *BIPRU firm* that is a partnership or a *limited liability partnership*.
- 2.2.98 R Without prejudice to *GENPRU 2.2.62R* (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 1985 or the Companies (Northern Ireland) Order 1986.
- 2.2.99 G A *BIPRU firm* that is a partnership or a *limited liability partnership* should include profit and loss (taking into account interim losses or material interim net losses) in its *core tier one capital*.

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

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

Core tier one capital: Share premium account

- 2.2.101 R (1) A *firm* must include *share* premium account relating to the issue of a *share* forming part of its *core tier one capital* in its *core tier one capital*.
- (2) A *firm* must include *share* premium account relating to the issue of a *share* forming part of another tier of capital in that other tier.
- (3) A *firm* that is incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 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) (3) applies to a *firm* that is not incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 if its *share* premium account is subject to substantially the same or greater restraints on use than a *share* premium account falling into (3).

Core tier one capital: externally verified interim net profits

- 2.2.102 R Externally verified interim net profits are interim profits which have been verified by a *firm's* external auditors after deduction of tax, declared dividends and other appropriations.
- 2.2.103 G A *firm* may include interim profits before a formal decision has been taken only if these profits have been verified, in accordance with the relevant 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 R *GENPRU 2.2.104R* to *GENPRU 2.2.107R* only apply to an *insurer*.
- 2.2.105 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 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 2.2.251R* (Deductions from total capital: Inadmissible assets) and *GENPRU 2 Ann 7R* (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 2.2.107R*) and derecognition of any *defined benefit asset* in respect of a *defined benefit occupational pension scheme* (see *GENPRU 1.3.9R(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 1.2.79R(2)* (Reinsurance) result in a positive valuation difference.
- 2.2.107 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 IV 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 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.

Other tier one capital: perpetual non-cumulative preference shares

- 2.2.109 R 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 G The other main provisions relevant to the eligibility of a perpetual non-cumulative *preference share* for inclusion in *tier one capital* are *GENPRU 2.2.62R* (Tier one capital: General), *GENPRU 2.2.64R* (General conditions for eligibility as tier one capital), *GENPRU 2.2.65R* (Connected transactions), *GENPRU 2.2.70R* to *GENPRU 2.2.75R* (Redemption of *tier one instruments*) and *GENPRU 2.2.80R* (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*.

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

- 2.2.111 R A *building society* may include a *PIBS* at stage B of the calculation in the *capital resources table* if (in addition to satisfying all the other requirements in relation to *tier one capital*) it is a “deferred share” as defined in the Building Societies (Deferred Shares) Order 1991.

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

Other tier one capital: innovative tier one capital: general

- 2.2.113 R If 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

- 2.2.114 R If a *tier one instrument*, other than a *PIBS*:
- (1) is redeemable; and
 - (2) a reasonable *person* would think that:
 - (a) the *firm* is likely to redeem it; or
 - (b) the *firm* is likely to have an economic incentive to redeem it;

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

- 2.2.115 G Any feature that in conjunction with a call would make a *firm* more likely to redeem a *tier one instrument*, other than a *PIBS*, 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: innovative tier one capital: loss absorption

- 2.2.116 R A *firm* may include a *capital instrument* that is not a *share* in its *innovative tier one capital resources* if (in addition to satisfying all the other requirements in relation to *tier one capital* and *innovative tier one capital*) it satisfies the condition in this *rule*. In addition a *firm* may not include any other capital in its *innovative tier one capital resources* unless it satisfies the condition in this *rule*. The condition in this *rule* is that the *firm's* obligations under the instrument either:
- (1) do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986; or
 - (2) do constitute such a liability but the terms of the instrument are such that:
 - (a) any such liability is not relevant for the purposes of deciding whether:
 - (i) the *firm* is, or is likely to become, unable to pay its debts; or
 - (ii) its liabilities exceed its assets;

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

2.2.117 G The effect of *GENPRU 2.2.116R* 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* 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.

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

2.2.119 G For the purpose of *GENPRU 2.2.118R*, 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

2.2.120 R A *tier one instrument*, other than a *PIBS*, with a cumulative or mandatory *coupon* is an *innovative tier one instrument*.

Other tier one capital: innovative tier one capital: step-ups

2.2.121 R If:

- (1) a *potential tier one instrument*, other than a *PIBS*, 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 See *GENPRU 2.2.146R* to *GENPRU 2.2.154G* for further *rules* and *guidance* on *step-ups*.
- Other tier one capital: innovative tier one capital: indirectly issued tier one capital (BIPRU firm only)
- 2.2.123 R *GENPRU 2.2.123R* to *GENPRU 2.2.137R* apply to a *BIPRU firm*.
- 2.2.124 R (1) *GENPRU 2.2.123R* - *GENPRU 2.2.137R* 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 2.2.127R*, *GENPRU 2.2.129R* and *GENPRU 2.2.132R*; or
 - (a) (in any other case) *GENPRU 2.2.133R*.
- 2.2.125 R A *BIPRU firm* may only count capital to which *GENPRU 2.2.124R* applies as *innovative tier one capital*.
- 2.2.126 R For the purpose of *GENPRU 2.2*, an *SPV* is, in relation to a *BIPRU firm*, any *undertaking* whose main activity is to raise funds for that *firm* or for a *group* to which that *BIPRU firm* belongs.
- 2.2.127 R The *SPV* referred to in *GENPRU 2.2.124R(2)(a)* must satisfy the following conditions:
- (1) it is controlled by the *firm* and may not operate independently of the *firm*;
 - (2) the rights of investors in the *SPV* who do not belong to the *group* of the *BIPRU firm* in question are not such as to affect the ability of the *firm* to control the *SPV*; and
 - (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*.

- 2.2.128 G An *SPV* could take the form of a limited partnership. In such an arrangement, holders of a *capital instrument* issued by the *SPV* which do not belong to the *group* of the *BIPRU firm* in question should have no right to participate in the management of the partnership, whether under the partnership's constitutional documents or the transaction documents. In general, this means that they should be treated as limited partners. It is expected that the general partner, having control of the *SPV*, would be the *firm*.
- 2.2.129 R The *SPV* referred to in *GENPRU* 2.2.124R(2)(a) must fund its subscription for the capital issued by the *firm* by the issue of capital that satisfies the following conditions:
- (1) it must comply with the conditions for qualification as *tier one capital*, as amended by *GENPRU* 2.2.130R, as if the *SPV* was itself a *firm* seeking to include that capital in its *tier one capital resources*;
 - (2) its terms must include an obligation on the *firm* to substitute for the instrument issued by the *SPV* a *tier one instrument* issued by that *firm* that is not an *innovative tier one instrument* when the *capital resources* of the *firm* fall below, or are likely to fall below, its *capital resources requirement*;
 - (3) the conversion ratio in respect of the substitution described in (2) must be fixed when the *SPV* issues the *capital instrument*; and
 - (4) to the extent that investors have the benefit of an obligation by a *person* other than the *SPV*:
 - (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 *innovative tier one capital*.
- 2.2.130 R For the purpose of *GENPRU* 2.2.129R and *GENPRU* 2.2.132R, *GENPRU* 2.2.118R (Requirement to obtain a legal opinion) does not apply.
- 2.2.131 R In relation to the obligation to substitute described in *GENPRU* 2.2.129R(2), a *firm* must take all reasonable steps to ensure that it has at all times authorised and unissued *tier one instruments* that are not *innovative tier one instruments* (and the authority to issue them) sufficient to discharge its obligation to substitute.
- 2.2.132 R The capital which the *firm* seeks to include in its *capital resources* under *GENPRU* 2.2.124R(3)(a) must satisfy the following conditions:
- (1) it meets the conditions for inclusion in *tier one capital* (subject to *GENPRU* 2.2.130R);
 - (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:
- (a) under which an *SPV* directly or indirectly funds the subscription for capital issued by the *firm* as described in *GENPRU 2.2.124R*; 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 2.2.127R*.
- (4) Any capital to which (1) applies (other than the capital that is to be included in the *firm's capital resources*) must be in the form of capital that complies with *GENPRU 2.2.129R(1)* and (4), whether or not issued by an *SPV*.
- (5) The obligations in *GENPRU 2.2.129R(2)* and (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 2.2.124R*.
- (6) *GENPRU 2.2.132R* applies to the capital issued by the *firm* as referred to in *GENPRU 2.2.124R*. For these purposes references in *GENPRU 2.2.132R* to the instrument issued by the *SPV* are to the instrument referred to in (5).
- 2.2.134 G The purpose of *GENPRU 2.2.133R* 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* itself that is not an *innovative tier one instrument*.
- 2.2.135 R A *firm* which satisfies the conditions for the inclusion of capital set out in *GENPRU 2.2.124R*, must, in addition, if that transaction is in any respect unusual, notify the *FSA* at least one *Month* in advance of the date on which the *firm* intends to include that capital in its *capital resources*.
- 2.2.136 G The *FSA* 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 *FSA* would expect a *firm* to request individual *guidance* in such circumstances.
- 2.2.137 R A *firm* must ensure that, in relation to a transaction falling within *GENPRU 2.2.124R*:

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

Tier one capital: Conversion ratio

- 2.2.138 R (1) This *rule* applies to a *potential tier one instrument* if:
- (a) it is redeemable by the *firm* (ignoring *GENPRU 2.2.77R* (Meaning of redemption));
 - (b) it provides that if the issuer does not exercise that right or does not do so in specified circumstances the issuer must or may have to redeem it in whole or in part through the issue of *shares* eligible for inclusion in the *firm's tier one capital resources* or the instrument converts or may convert into such *shares*; and
 - (c) *GENPRU 2.2.77R* means that the obligation in (1)(b) is treated as not being inconsistent with *GENPRU 2.2.70R(1)* (*Tier one capital* should not be redeemable at the option of the holder).
- (2) A *firm* must not include a *potential tier one instrument* to which this *rule* applies in its *tier one capital resources* if:
- (a) the conversion ratio as at the date of redemption may be greater than the conversion ratio as at the time of issue by more than 200%; or
 - (b) the market price of the conversion instruments issued in relation to one unit of the original capital item (plus any cash element of the redemption) may be greater than the issue price of that original capital item.
- (3) All determinations under this *rule* are made as at the date of issue of the original capital item.
- 2.2.139 R In *GENPRU 2.2.138R* to *GENPRU 2.2.142R*:
- (1) the original capital item means the capital item that is being redeemed; and
 - (2) the conversion instrument means the *tier one capital* to be issued on its redemption.
- 2.2.140 R In *GENPRU 2.2.138R* to *GENPRU 2.2.142R*, the conversion ratio means the ratio of:
- (1) the number of units of the conversion instrument that the *firm* must issue to satisfy its redemption obligation (so far as it is to be satisfied by the issue of conversion instruments) in respect of one unit of the original capital item; to

- (2) one unit of the original capital item.
- 2.2.141 R In *GENPRU* 2.2.138R to *GENPRU* 2.2.142R, the conversion ratio as at the date of issue of the original capital item is calculated as if the original capital item were redeemable at that time.
- 2.2.142 R If the conversion instruments or the original capital item are subdivided or consolidated or subject to any other occurrence that would otherwise result in like not being compared with like, the conversion ratio calculation in *GENPRU* 2.2.138R must be adjusted accordingly.
- 2.2.143 G (1) The significance of the limitations on conversion in *GENPRU* 2.2.138R(2) can be seen in the example in this paragraph.
- (2) A *firm* issues innovative notes with a par value of £100 each. The terms of the instrument provide that if the instrument is not called at par at the first call date the notes convert into a variable number of ordinary *shares*.
- (3) If the market price of the ordinary *shares* is 400 pence per share on the day of issue of the innovative notes then the maximum number of ordinary *shares* (M) that a single £100 par value innovative note can be converted into is calculated as follows:
- (a) $M = \text{Par value of innovative instrument} * 200\% / \text{market value of ordinary share};$
- (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 G (1) In addition to the maximum conversion ratio of 200%, *GENPRU* 2.2.138R(2) (b) does not permit a *firm* to issue *shares* that would have a market value that exceeds the issue price of the instrument being redeemed.
- (2) In the example in *GENPRU* 2.2.143G, if the market value of the ordinary *shares* was 250 pence at the conversion date, the maximum number of ordinary *shares* that may be issued to satisfy the redemption of one of the £100 par value innovative notes would be 40 (= £100 / £2.5).

Tier one capital: Requirement to have sufficient unissued stock

- 2.2.145 R (1) This *rule* applies to a *potential tier one instrument* of a *firm* where either:
- (a) the redemption proceeds; or
 - (b) any *coupon* on that capital item;
- can be satisfied by the issue of another *capital instrument*.
- (2) A *firm* may only include an item of capital to which this *rule* applies in its *tier one capital resources* if the *firm* has authorised and unissued *capital instruments* of the kind in question (and the authority to issue them):
- (a) that are sufficient to satisfy all such payments then due; and
 - (b) are of such amount as is prudent in respect of such payments that could become due in the future.

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

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

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

- 2.2.147 R (1) A *firm* may not include in its *tier one capital resources* a *tier one instrument* that is or may be subject to a *step-up* that does not meet the definition of moderate in the press release of the Basle Committee on Banking Supervision of 27th October 1998 called "Instruments eligible for inclusion in Tier 1 capital".
- (2) For the purpose of (1) the words in that press release "than, at national supervisory discretion, either" are replaced by "than the higher of the following two amounts".
- (3) The calculations required by this *rule* and *GENPRU 2.2.151R* must be carried out as at the date of issue of the relevant instrument.
- 2.2.148 G The effect of *GENPRU 2.2.147R* is that for inclusion in *tier one capital resources*, *step-ups* in instruments should be moderate. A moderate *step-up* for these purposes is one which results in an increase over the initial rate that is no greater than the higher of the following two amounts:

- (1) 100 basis points, less the swap spread between the initial index basis and the stepped-up index basis; or
 - (2) 50% of the initial credit spread, less the swap spread between the initial index basis and the stepped-up index basis.
- 2.2.149 G If a *coupon* paid on an item of capital is initially set at a specified spread above an index (the initial index basis), and the *coupon* moves to being set relative to another index (the stepped up index basis), there will be an implied *step-up* (positive or negative) even if the specified spread does not change. This is because each index may itself include a spread relative to the risk free rate and this spread may differ between the two indexes. The deduction of the swap spread in *GENPRU* 2.2.148G(1) and (2) above adjusts for this difference.
- 2.2.150 G Where the *step-up* involves a conversion from fixed to floating (or vice versa), or a switch in basis index, the swap spread should be fixed at pricing date, reflecting the differential in pricing between indices at the time. The significance of deducting the swap spread can be seen by the following example:
- (1) the pricing date:
 - (a) 10 year gilts (G) = 5.5% (the initial index basis);
 - (b) 3 month LIBOR is the stepped up index basis and the 10 year mid swap rate (L) = 5.9%;
 - (c) initial fixed *coupon* rate = G + 200bp;
 - (d) swap spread = 0.4% (= 5.9% - 5.5%);
 - (e) initial fixed coupon rate = 7.5%;
 - (f) the swap spread shows that there is 40bps of spread in the stepped up index basis relative to the initial index basis; and
 - (g) the initial fixed coupon rate of 7.5% is equivalent to the mid swap rate + 160bp, or L + 200bp – the swap spread;
 - (2) pricing of *stepped-up* rate at year 10 with *step-up* of 100bp without deducting swap spread:
 - (a) *stepped-up* floating rate = L + 200 + 100bp step-up = 8.9%; and
 - (b) effective *step-up* from initial fixed rate of 140bp (= 8.9% - 7.5%); and
 - (3) pricing of *stepped-up* rate at year 10 with step-up of 100bp with deduction of the swap spread:
 - (a) *stepped-up* floating *coupon* rate = L + 200 less 40bp swap spread (difference between 5.5% and 5.9%) + 100bp step-up = 8.5%

(b) effective *step-up* from initial rate of 100bp (= 8.5% - 7.5%).

2.2.151 R (1) Subject to (2), if a *tier two instrument* is or may be subject to a *step-up* that does not meet the definition of moderate in the press release of the Basle Committee on Banking Supervision referred to in *GENPRU 2.2.147R(1)* as adjusted under *GENPRU 2.2.147R(2)*, the first date that a *step-up* can take effect is deemed to be its final maturity date if that date is before its actual maturity date.

(2) If a *tier two instrument*:

(a) is or may be subject to a *step-up* during the period beginning on the fifth anniversary of the date of issue of that item and ending immediately before the tenth anniversary of the date of issue; and

(b) the *step-up* or possible *step-up* is one which may result in an increase over the initial rate that is greater than 50 basis points, less the swap spread between the initial index basis and the stepped-up index basis (all these terms must be interpreted in accordance with *GENPRU 2.2.147R*);

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

2.2.152 R An instrument does not breach *GENPRU 2.2.147R* or as the case may be, is not subject to a deemed maturity date under *GENPRU 2.2.151R*, 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 2.2.147R*) or *tier two capital resources* (in the case of *GENPRU 2.2.151R*);

(2) (if there has been no more than one previous issue of the existing stock) the existing stock complied with those limits on its date of issue;

(3) (if there has been more than one previous issue of the existing stock) the first such issue of the existing stock complied with those limits on its date of issue; and

(4) the result of the *step-up* on the instrument to which this *rule* applies is that the *coupon* on that instrument and the *coupon* on the existing stock is the same.

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

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

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

Deductions from tier one: Intangible assets

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

Tier two capital: General

- 2.2.157 G *Tier two capital resources* are split into upper and lower tiers. A major distinction between *upper* and *lower tier two capital* is that only perpetual instruments may be included in *upper tier two capital* whereas dated instruments, such as fixed term *preference shares* and dated subordinated debt, may be included in *lower tier two capital*.
- 2.2.158 G *Tier two instruments* are *capital instruments* that combine the features of debt and equity in that they are structured like debt, but exhibit some of the loss absorption and funding flexibility features of equity.

General conditions for eligibility as tier two capital instruments

- 2.2.159 R A *capital instrument* must not form part of the *tier two capital resources* of a *firm* unless it meets the following conditions:
- (1) the claims of the creditors must rank behind those of all unsubordinated creditors;
 - (2) the only events of default must be non-payment of any amount falling due under the terms of the *capital instrument* or the winding-up of the *firm* and any such event of default must not prejudice the subordination in (1);
 - (3) to the fullest extent permitted under the laws of the relevant jurisdictions, the remedies available to the subordinated creditor in the event of non-payment or other breach of the terms of the *capital instrument* must (subject to *GENPRU 2.2.161R*) 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 2.2.161R*; 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 2.2.172R* (Repayment at the option of the issuer) or *GENPRU 2.2.194R(2)* (Repayment of *lower tier two capital* at the option of the holder) and any remedy described in (4)(a) to (c) must not prejudice this requirement;
- (6) the debt agreement or terms of the *capital instrument* are governed by the law of England and Wales, or of Scotland or of Northern Ireland;
- (7) to the fullest extent permitted under the laws of the relevant jurisdictions, creditors must waive their right to set off amounts they owe the *firm* against subordinated amounts included in the *firm's capital resources* owed to them by the *firm*;
- (8) the terms of the *capital instrument* must be set out in a written agreement that contains terms that provide for the conditions set out in (1) to (7);
- (9) the debt must be unsecured and fully paid up;
- (10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9) and, where it applies, *GENPRU 2.2.271R* (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 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 2.2.159R*.

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

- 2.2.161 R A *capital instrument* may be included in a *firm's tier two capital resources* even though the remedies available to the subordinated creditor go beyond those referred to in *GENPRU 2.2.159R(3)*, if the following conditions are satisfied:
- (1) those remedies are not available for failure to pay any amount of principal, interest or expenses or in respect of any other payment obligation; and
 - (2) those remedies do not in substance amount to remedies to recover payment of the amounts in (1).
- 2.2.162 G If damages are a remedy that cannot be excluded as referred to in *GENPRU 2.2.159R(3)* those damages should be subordinated in accordance with *GENPRU 2.2.159R(1)*. Damages permitted by *GENPRU 2.2.161R* should also be subordinated in accordance with *GENPRU 2.2.159R(1)*.

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

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

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

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

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

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

- 2.2.166 G *GENPRU 2.2.159R(3)* allows a *capital instrument* to form part of the *tier two capital resources* even though the laws of the relevant jurisdiction do not allow remedies to be limited in the way described there. For example it is not possible to limit certain remedies in the case of an issue in the United States that is SEC-registered and subject to the provisions of the Trust Indenture Act.
- 2.2.167 G The purpose of *GENPRU 2.2.159R(7)* is to ensure that all of the *firm's* assets are available to *consumers* ahead of subordinated creditors. The waiver should apply both before and during liquidation or administration.
- 2.2.168 G The *guidance* in *GENPRU 2.2.119G* (Employee may give legal opinion) also applies for the purpose of *GENPRU 2.2.159R(12)* and *GENPRU 2.2.163R*.

Tier two capital instruments: Connected transactions

- 2.2.169 R An item of capital does not comply with *GENPRU 2.2.159R* (General conditions for eligibility as tier two *capital instruments*) or *GENPRU 2.2.177R* (Upper tier two capital: General) if the issue of that item of capital by the *firm* is connected with one or more other transactions which, when taken together with the issue of that item, could result in that item of capital no longer displaying all of the characteristics set out in whichever of those *rules* apply.
- 2.2.170 G *GENPRU 2.2.66G* (*Guidance on GENPRU 2.2.65R*) applies to *GENPRU 2.2.169R* in the same way as it does to *GENPRU 2.2.65R* (The equivalent of *GENPRU 2.2.169R* in relation to *tier one capital*).

Amendment of tier two instruments

- 2.2.171 R A *firm* must not amend the terms of the capital or the documents referred to in *GENPRU 2.2.159R(8)* unless:
- (1) at least one *Month* before the amendment is due to take effect, the *firm* has given the *FSA* notice in writing of the proposed amendment and the *FSA* has not objected; and
 - (2) that notice includes confirmation that the legal opinions referred to in *GENPRU 2.2.159R(12)* and, if applicable, *GENPRU 2.2.163R* (General conditions for eligibility as tier two *capital instruments*: Alternative governing laws) and *GENPRU 2.2.181R* (Legal opinions for *upper tier two instruments*), continue in full force and effect in relation to the terms of the debt and documents after any proposed amendment.

Redemption of tier two instruments

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

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

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

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

before the date of the proposed repayment (unless that *firm* intends to repay an instrument on its final maturity date) providing details of how it will meet its *capital resources requirement* after such repayment.

Tier two capital: step-ups

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

Upper tier two capital: General

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

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

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

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

(5) the terms of the instrument are such that either the instrument or debt is not redeemable or repayable or it is repayable or redeemable only at the option of the *firm*.

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

2.2.179 G For the purpose of *GENPRU 2.2.177R(2)*, *GENPRU 2.2.68G* (Dividend pushers) applies equally in relation to the inclusion of an instrument in *upper tier two capital resources*.

Upper tier two capital: Loss absorption

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

(1) do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986; or

(2) do constitute such a liability but the terms of the instrument are such that:

(a) any such liability is not relevant for the purposes of deciding whether:

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

(ii) its liabilities exceed its assets;

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

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

Upper tier two capital: Legal opinions

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

Upper tier two capital: Guidance

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

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

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

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

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

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

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

- 2.2.187 R A *BIPRU firm* which adopts the *standardised approach* to credit risk may include general/collective provisions in its *tier two capital resources* only if:
- (1) they are freely available to the *firm*;
 - (2) their existence is disclosed in internal accounting records; and

- (3) their amount is determined by the management of the *firm*, verified by independent auditors and notified to the *FSA*.

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 2.2.187R* may not exceed 1.25% of the sum of the following:

- (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.

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 4.3.8R* (Treatment of expected loss amounts), up to 0.6% of the *risk weighted exposure amounts* calculated under that approach.

2.2.191 R A *BIPRU firm* calculating *risk weighted exposure amounts* under the *IRB approach* may not include in its *capital resources* value adjustments and provisions included in the calculation in *BIPRU 4.3.8R* (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 2.2.190R*.

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

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

Lower tier two capital

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

- (1) it has an original maturity of at least five years; or

- (2) it is redeemable on notice from the holder, but the period of notice of repayment required to be given by the holder is five years or more.
- 2.2.195 G A *firm* may include perpetual *capital instruments* that do not meet the conditions in *GENPRU 2.2.177R* (Eligibility conditions for *upper tier two capital*) in *lower tier two capital resources* if they meet the general conditions described in *GENPRU 2.2.159R* (General conditions for eligibility as tier two *capital instruments*).
- 2.2.196 R (1) For the purposes of calculating the amount of a *lower tier two instrument* which may be included in a *firm's capital resources*:
- (a) in the case of an instrument with a fixed maturity date, in the final five years to maturity; and
- (b) in the case of an instrument with or without a fixed maturity date but where five years' or more notice of redemption or repayment has been given, in the final five years to the date of redemption or repayment;
- the principal amount must be amortised on a straight line basis.
- (2) If a *firm* gives notice of the redemption or repayment of a *lower tier two instrument* and (1) does not apply, the *firm* must no longer include it in its *lower tier two capital resources*.
- 2.2.197 G If a *firm* wishes to include in *lower tier two capital resources* an instrument with or without a fixed maturity date but where less than five years' notice of redemption or repayment has been given, it should seek individual *guidance* from the *FSA*.

The effect of swaps on debt capital

- 2.2.198 R *GENPRU 2.2.198R* to *GENPRU 2.2.201R* 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 1.3.4R* (General requirements: accounting principles to be applied) (a "debt instrument").
- 2.2.199 R A *firm* must recognise for the purpose of this section any effect that changes in exchange rates or interest rates have on a debt instrument (as defined in *GENPRU 2.2.198R*) under the accounting framework to which the *firm* is subject as referred to in *GENPRU 1.3.4R* (General requirements: accounting principles to be applied).
- 2.2.200 R A *firm* must recognise, in accordance with *GENPRU 2.2.201R*, the effect of a *foreign currency* hedge on a debt instrument (as defined in *GENPRU 2.2.198R*) 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 1.3.4R* (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 2.2.64R* to *GENPRU 2.2.65R* (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 2.2.159R* to *GENPRU 2.2.169R* (General conditions for eligibility as tier two capital instruments) as modified, in the case of an *upper tier three instrument*, by *GENPRU 2.2.244R* (Application of *tier two capital rules* to *tier three capital debt*) except as follows:
 - (a) *GENPRU 2.2.159R(9)* only applies to the extent that it requires that hedge to be unsecured; and
 - (b) *GENPRU 2.2.159R(12)* (legal opinion) does not apply.

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

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

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

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

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

- (1) a *credit institution* or *financial institution*;
- (2) an *undertaking* whose exclusive or main activities are a direct extension of banking or concern services ancillary to banking, such as leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity; or
- (3) an *insurer*.

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

- (1) (if the *firm* has one or more *qualifying holdings* that exceeds 15% of its relevant *capital resources*) the sum of such excesses; and

- (2) to the extent not already deducted in (1), the amount by which the sum of each of that *firm's qualifying holdings* exceeds 60% of its relevant *capital resources*.

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

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

2.2.207 R The following are not included as *qualifying holdings*:

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

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

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

2.2.209 R A *material holding* is:

- (1) 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

- (2) 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 (1) 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
 - (3) 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 (1) or (2) 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
 - (4) a *material insurance holding*.
- 2.2.210 G For the purpose of the definition of a *material holding*, *share* capital includes *preference shares*. *Share* premium should be taken into account when determining the amount of *share* capital.
- 2.2.211 R When calculating the size of its *material holdings* a *firm* must only include an actual holding (that is, a long cash position). A *firm* must not net such holdings with a short position.
- 2.2.212 R A *material insurance holding* means the holdings of a *BIPRU firm* of items of the type set out in *GENPRU 2.2.213R* in any:
- (1) *insurance undertaking*; or
 - (2) *insurance holding company*;
- that fulfils one of the following conditions:
- (3) it is a *subsidiary undertaking* of that *firm*; or
 - (4) that *firm* holds a *participation* in it.
- 2.2.213 R An item falls into this provision for the purpose of *GENPRU 2.2.212R* 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 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 1R* (Method 3 of the capital adequacy calculations for financial conglomerates).

2.2.215 R For the purpose of the definition of a *material holding*, holdings must be valued using the valuation method which the holder uses for its external financial reporting purposes.

- 2.2.216 G
- (1) This paragraph gives *guidance* on how the calculation under *GENPRU 2.2.214R(1)* should be carried out where an *insurance undertaking* is accounted for using the embedded value method.
 - (2) On acquisition, any “goodwill” element (that is, the difference between the acquisition value according to the embedded value method and the actual investment) should be deducted from *tier one capital resources*.
 - (3) The embedded value should be deducted from the total of *tier one capital resources* and *tier two capital resources*.
 - (4) Post-acquisition, where the embedded value of the *undertaking* increases, the increase should be added to reserves, while the new embedded value is deducted from total *capital resources*.
 - (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.

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

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

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

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

- (1) a *credit institution*; or

(2) a *financial institution*;

that satisfies the following conditions:

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

2.2.220 R For the purpose of *GENPRU 2.2.219R*, a relevant rule means a *rule* in *GENPRU*, *BIPRU* or *INSRU* or any other capital adequacy or solvency requirements of the *FSA* 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 *GENPRU 2.2.221R* to *GENPRU 2.2.235G* only apply to a *bank*.

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

2.2.223 R A *bank* must not deduct any item as *connected lending of a capital nature* to the extent that it falls to be deducted at Part 1 of stage M of the calculation in the *capital resources table* (Deductions for *material holdings*, *qualifying holdings* and certain other items) or as a *reciprocal cross-holding*.

2.2.224 R For the purpose of the *rules* in this section about *connected lending of a capital nature* and in relation to a *bank*, a connected party means another *person* (“P”) who fulfils at least one of the following conditions and is not solo-consolidated with the *bank* under *BIPRU 2.1* (Solo consolidation):

- (1) P is *closely related* to the *bank*; or
- (2) P is an *associate* of the *bank*; or
- (3) the same *persons* significantly influence the *governing body* of P and the *bank*.

- 2.2.225 R For the purpose of *GENPRU 2.2.224R*, in relation to a *person* (“P”) to which a *bank* has an *exposure* when P is acting on his own behalf and also an *exposure* to P when P acts in his capacity as a trustee, custodian or general partner of an investment trust, unit trust, venture capital or other investment fund, pension fund or similar fund (a “fund”) the *bank* may choose to treat this latter *exposure* as an *exposure* to the fund, unless such treatment would be misleading.
- 2.2.226 G *BIPRU 10.3.13G (Guidance on BIPRU 10.3.12R)* applies to *GENPRU 2.2.225R* as it applies to *BIPRU 10.3.12R* (Exposures to trustees for concentration risk purposes).
- 2.2.227 R A loan is *connected lending of a capital nature* if:
- (1) it is made by the *bank* to a connected party; and
 - (2) it falls into *GENPRU 2.2.228R*.
- 2.2.228 R A loan falls into this *rule* for the purposes of *GENPRU 2.2.227R(2)* if, whether through contractual, structural, reputational or other factors:
- (1) based on the terms of the loan and the other knowledge available to the *bank*, the borrower would be able to consider it from the point of view of its characteristics as capital as being similar to *share* capital or subordinated debt; or
 - (2) the position of the lender from the point of view of maturity and repayment is inferior to that of the senior unsecured and unsubordinated creditors of the borrower.
- 2.2.229 R A loan is also *connected lending of a capital nature* if:
- (1) it funds directly or indirectly a loan to a connected party of the *bank* falling into *GENPRU 2.2.229R* or an investment in the capital of a connected party of the *bank*; and
 - (2) it falls into *GENPRU 2.2.228R*.
- 2.2.230 G It is likely that a loan is not *connected lending of a capital nature* if:
- (1) it is secured by collateral that is eligible for the purposes of *credit risk mitigation* under the *standardised approach* to credit risk as set out in *BIPRU 5.4 (Financial collateral)* and *BIPRU 5.5 (Other funded credit risk mitigation)* ; or
 - (2) it is repayable on demand (and should be treated as such for accounting purposes by the borrower and lender) and the *bank* can demonstrate that there are no potential obstacles to exercising the right to repay, whether contractual or otherwise.
- 2.2.231 R A guarantee is *connected lending of a capital nature* if it is a guarantee by the *bank* of a loan from a third party to a connected party of the *bank* and:

- (1) the loan meets the requirements of *GENPRU 2.2.228R*; or
 - (2) the rights that the *bank* would have against the borrower with respect to the guarantee meet the requirements of *GENPRU 2.2.228R(2)*.
- 2.2.232 R A guarantee is also *connected lending of a capital nature* if it is a guarantee by the *bank* of a loan falling into *GENPRU 2.2.229R(1)*; and
- (1) the loan meets the conditions in *GENPRU 2.2.228R*; or
 - (2) the guarantee meets the conditions in *GENPRU 2.2.231R(2)*.
- 2.2.233 R The amount of a guarantee that constitutes *connected lending of a capital nature* that a *firm* must deduct is the amount guaranteed.
- 2.2.234 G A loan may initially fall outside the definition of *connected lending of a capital nature* but later fall into it. For example, if the initial lending to a connected party is subsequently downstreamed to another connected party the relationship between the *bank* and the ultimate borrower may be such that, looking at the arrangements as a whole, the *undertaking* to which the *bank* lends is able to regard the loan to it as being capable of absorbing losses.
- 2.2.235 G Lending to a connected party will not normally be *connected lending of a capital nature* where that party:
- (1) is acting as a vehicle to pass funding to an unconnected party; and
 - (2) has no other creditors whose claims could be senior to those of the lender.

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

- 2.2.236 R A *BIPRU firm* calculating *risk weighted exposure amounts* under the *IRB approach* must deduct:
- (1) any negative amounts arising from the calculation in *BIPRU 4.3.8R* (Treatment of expected loss amounts); and
 - (2) any *expected loss amounts* calculated in accordance with *BIPRU 4.7.12R* (*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 4.7.17R* (*Expected loss amounts* under the *PD/LGD approach*).

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

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

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

- 2.2.238 R *GENPRU 2.2.238R* to *GENPRU 2.2.241G* 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 2.2.236R*; and
- (3) *securitisation positions* referred to in *GENPRU 2.2.237R*.

- 2.2.239 R (1) The treatment in the *capital resources table* of the deductions in *GENPRU 2.2.238R* 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 2.2.238R* must deduct 50% of the total amount of those deductions at stage E (Deductions from tier one capital) and 50% at stage J (Deductions from tier two capital) of the calculation in the *capital resources table* after the application of the *capital resources gearing rules*.
- (4) To the extent that half of the total of:
- (a) *material holdings*;
 - (b) *expected loss* amounts and other negative amounts; and
 - (c) *securitisation positions*;

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

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

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

- 2.2.241 R *GENPRU 2.2.241R to GENPRU 2.2.245R only apply to a BIPRU firm.*
- 2.2.242 R *A BIPRU firm may include subordinated debt in its upper tier three capital resources only if:*
- (1) *it has an original maturity of at least two years or is subject to at least two years' notice of repayment; and*
 - (2) *payment of interest or principal is permitted only if, after that payment, the firm's capital resources would be not less than its capital resources requirement.*
- 2.2.243 R *A BIPRU firm which includes subordinated debt in its tier three capital resources must notify the FSA one month in advance of all payments of either interest or principal made when the firm's capital resources are less than 120% of its capital resources requirement.*
- 2.2.244 R *The rules in the table in GENPRU 2.2.245R apply to short term subordinated debt that a BIPRU firm includes in its tier three capital resources in the same way that they apply to a firm's tier two capital resources with the adjustments in that table.*
- 2.2.245 R *Table: Application of tier two capital rules to tier three debt*
This table belongs to GENPRU 2.2.244R

<i>Tier two capital rule</i>	<i>Adjustment</i>
<i>GENPRU 2.2.159R (General conditions for eligibility as tier two capital)</i>	<p>The references in <i>GENPRU 2.2.159R(5)</i> (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 <i>GENPRU 2.2.242R(1)</i> (<i>Upper tier three capital</i> should have maturity or notice period of at least two years)</p> <p>The reference in <i>GENPRU 2.2.159R(10)</i> (Description of <i>tier two capital</i> in marketing documents) to <i>GENPRU 2.2.271R</i> (Other requirements: insurers carrying on with-profits business (Insurer only)) does not apply</p>
<i>GENPRU 2.2.160R (Holder of a non-deferred share of a building society to be treated as a senior creditor)</i>	

<i>Tier two capital rule</i>	Adjustment
<i>GENPRU 2.2.161R</i> (Additional remedies)	
<i>GENPRU 2.2.163R</i> (Legal opinion where debt subject to a law of a country outside the <i>United Kingdom</i>)	
<i>GENPRU 2.2.169R</i> (Ineligibility as <i>tier two capital</i> owing to connected transactions)	The reference to <i>GENPRU 2.2.177R</i> (General eligibility conditions for <i>upper tier two capital</i>) does not apply
<i>GENPRU 2.2.171R</i> (Amendments to terms of the <i>capital instrument</i>)	
<i>GENPRU 2.2.172R</i> to <i>GENPRU 2.2.173R</i> (Redeemability at the option of the issuer)	
<i>GENPRU 2.2.174R</i> (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 R *GENPRU 2.2.246R* to *GENPRU 2.2.249R* only apply to a *BIPRU firm*.
- 2.2.247 R A *BIPRU firm's* net interim *trading book* profits mean its net *trading book* profits adjusted as follows:
- (1) they are net of any foreseeable charges or dividends and less net losses on its other business; and
 - (2) a *firm* must not take into account items that have already been included in the calculation of *capital resources* as part of the calculation of the following items:
 - (a) interim net profits (see stage (A) of the *capital resources table*); or
 - (b) interim net losses or material interim net losses (see stage (A) of the *capital resources table*); or
 - (c) profit and loss and other reserves (see stage (A) of the *capital resources table*).

- 2.2.248 R *Trading book* profits and losses, other than those losses to which *GENPRU* 2.2.86R(2) (Valuation adjustment and reserves) refers, originating from valuation adjustments or reserves as referred to in *GENPRU* 1.3.29R to *GENPRU* 1.3.35G (Valuation adjustments or reserves) must be included in the calculation of net interim *trading book* profits and be added to or deducted from *tier three capital resources*.
- 2.2.249 R *Trading book* valuation adjustments or reserves as referred to in *GENPRU* 1.3.29R to *GENPRU* 1.3.35G which exceed those made under the accounting framework to which a *firm* is subject must be treated in accordance with *GENPRU* 2.2.248R if not required to be treated under *GENPRU* 2.2.86R(2).

Deductions from total capital: Inadmissible assets (insurers only)

- 2.2.250 R *GENPRU* 2.2.250R to *GENPRU* 2.2.253G only apply to an *insurer*.
- 2.2.251 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 Ann 7R (Admissible assets in insurance), unless the asset is held to cover *property-linked liabilities* or *index-linked liabilities* under *INSPRU* 3.1.57R or *INSPRU* 3.1.58R (Covering linked liabilities).
- 2.2.252 G *GENPRU* 2.2.251R does not apply to intangible assets which should be deducted from *tier one capital resources* under *GENPRU* 2.2.155R (Deductions from tier one: Intangible assets).
- 2.2.253 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 R *GENPRU* 2.2.254R to *GENPRU* 2.2.258G only apply to an *insurer*.
- 2.2.255 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*.

- 2.2.256 R 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 1.3.47R* (Shares in and debts due from related undertakings).
- 2.2.257 G For the purposes of *GENPRU 2.2.255R*, investments must be valued at their accounting book value in accordance with *GENPRU 1.3.4R* (General requirements: accounting principles to be applied).
- 2.2.258 G *Related undertakings* which are also *insurance undertakings* are not included in *GENPRU 2.2.256R* because an *insurer* that is a *participating insurance undertaking* is subject to the requirements of *INSRU 6.1* (Group Risk: Insurance Groups).

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

- 2.2.259 R *GENPRU 2.2.259R* to *GENPRU 2.2.262G* only apply to a *BIPRU investment firm*.
- 2.2.260 R *Illiquid assets* means illiquid assets including
- (1) tangible fixed assets (except land and buildings if they are used by a *firm* as security for loans, but this exclusion is only up to the value of the principal outstanding on the loans); or
 - (2) any holdings in the *capital resources* of *credit institutions* or *financial institutions*, except to the extent that:
 - (a) they have already been deducted as a *material holding*; or
 - (b) they are *shares* which are included in a *firm's trading book* and included in the calculation of the *firm's market risk capital requirement*; or
 - (3) holdings of other *securities* which are not *readily realisable securities*; or
 - (4) deficiencies of net assets in *subsidiary undertakings*; or
 - (5) deposits which are not repayable within 90 days (except for payments in connection with margined *futures* or *options* contracts); or
 - (6) loans and other amounts owed to a *firm* except where they are due to be repaid within 90 days; or
 - (7) physical stocks except for *positions* in *physical commodities* which are included in the calculation of a *firm's commodity PRR*.

- 2.2.261 G If a loan or other amount owing to a *firm* was originally due to be paid more than 90 days from the date of the making of the loan or the incurring of the payment obligation, as the case may be, it may be treated as liquid for the purposes of *GENPRU 2.2.260R(6)* where through the passage of time the remaining time to the contractual repayment date falls below 90 days.
- 2.2.262 G If a loan or other amount is due to be paid within 90 days (whether measured by reference to original or remaining maturity), a *firm* should consider whether it can reasonably expect the amount owing to be paid within that period. If the *firm* cannot reasonably expect it to be paid within that period the *firm* should treat it as illiquid.

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

- 2.2.263 R *GENPRU 2.2.263R* to *GENPRU 2.2.265R* only apply to a *bank* or *building society*.
- 2.2.264 R (1) The *excess trading book position* is the excess of:
- (a) a *bank* or *building society's* aggregate net long (including notional *trading book positions* in *shares*, subordinated debt or any other interest in the capital of *credit institutions* or *financial institutions*;
- over;
- (b) 25% of that *firm's* *capital resources* calculated at stage T (Total capital after deductions) of the *capital resources table* (calculated before deduction of the *excess trading book position*).
- (2) Only the excess amount calculated under (1) must be deducted.
- 2.2.265 R The *standard market risk PRR rules* apply for establishing what is a net *position* and the amount and value of that *position* for the purposes of *GENPRU 2.2.264R*, 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 G *GENPRU 2.2.266G* to *GENPRU 2.2.269G* only apply to an *insurer*.
- 2.2.267 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 148 of the *Act* (Modification or waiver of rules).

- 2.2.268 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 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 R *GENPRU 2.2.270R* to *GENPRU 2.2.275G* only apply to an *insurer*.
- 2.2.271 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 *Principle 6* (Customers' interests).
- 2.2.272 G The purpose of *GENPRU 2.2.271R* 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 to treat *customers* fairly in setting discretionary benefits. (*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 G *GENPRU 2.2.271R* 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 G *GENPRU 2.2.64R(10)* and *GENPRU 2.2.159R(10)* contain provisions concerning the marketing of a *capital instrument*. In relation to a *firm* to which *GENPRU 2.2.271R* applies, in order to comply with *GENPRU 2.2.64R(10)* and *GENPRU 2.2.159R(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 G (1) *Upper tier two instruments* should meet the requirements of *GENPRU 2.2.177R(3)* which goes beyond the requirement in *GENPRU 2.2.271R(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 2.2.271R(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 2.2.159R(2)* for *firms* carrying on *with-profits insurance business*.
- (2) For *firms* which are *realistic basis life firms* compliance with *GENPRU 2.2.271R(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 *FSA 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 2.2.271R(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 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 8.1.2R.*
- 2.3.2 R *GENPRU 2.1.38R to GENPRU 2.1.39G apply to managing agents in accordance with INSPRU 8.1.4R.*
- 2.3.3 G *GENPRU 2.1.13R 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.*
- 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.*

Calculation of the MCR

- 2.3.5 R For the purposes of *GENPRU 2.1.24R*, the *Society* must calculate the *MCR* in respect of the *general insurance business* of each *member* as the higher of:
- (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 *member*, calculated according to *GENPRU 2.3.11R*.
- 2.3.6 R For the purposes of *GENPRU 2.3.5R(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 2.3.11R*.
- 2.3.7 R For the purposes of *GENPRU 2.1.25R*, 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 R For the purposes of *GENPRU 2.3.7R(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 2.3.7R(2)* to the aggregate of the results of *GENPRU 2.3.7R(2)* for all *members*.

Calculation of the base capital resources requirement

2.3.9 R The amount of the *base capital resources requirement* for the *members* in aggregate is:

- (1) for *general insurance business*, €3.2 million; and
- (2) for *long-term insurance business*, €3.2 million.

Calculation of the general insurance capital requirement

2.3.10 R For the purposes of *GENPRU 2.1.34R*, 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 R The *Society* must determine the *general insurance capital requirement* for each *member* by apportioning the result of *GENPRU 2.3.10R* 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 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 8.2.16R*).

2.3.13 R The *Society* must calculate the *general insurance capital requirement* it would have to determine under *GENPRU 2.1.34R* 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 2.3.13R* 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 2.3.11R*.

Application of *GENPRU 2.2*

- 2.3.16 R Subject to *GENPRU 2.3.18R*, *GENPRU 2.3.19R* and *GENPRU 2.3.21R*, *GENPRU 2.2* applies to *managing agents* and to the *Society* in accordance with:

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

- 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 2.2.32R* to *GENPRU 2.2.41R* (Limits on the use of different forms of capital) do not apply to *managing agents*.

- 2.3.19 R *GENPRU 2.2.32R* to *GENPRU 2.2.41R* (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 R *GENPRU 2.2.74R* does not apply to the *Society* or to *managing agents*.

- 2.3.21 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 2.3.25R; and

- (2) the *Society's capital resources* excluding callable contributions.

Calculation of capital resources

- 2.3.22 R *The capital resources table* applies with the modifications that:
- (1) *core tier one capital* includes *Lloyd's members' contributions* in accordance with GENPRU 2.3.34R, subject, in the case of letters of credit, guarantees and verifiable sums arising out of life assurance policies, to compliance with GENPRU 1.5.8R to GENPRU 1.5.12R; and
- (2) the *Society* may also recognise and value *callable contributions*, pursuant to GENPRU 2.3.24R.
- 2.3.23 G *Lloyd's member's contributions* are *admissible assets* under GENPRU 2.3.34R 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 R In calculating its *capital resources*, the *Society* may, subject to GENPRU 1.5.13R to GENPRU 1.5.14R, recognise and value *callable contributions*.
- 2.3.25 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 1.5.18R.
- 2.3.26 R In order to comply with GENPRU 2.1.13R 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 2.3.25R; 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 R For the purposes of *GENPRU 2.3.26R(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 R The *Society* must calculate each *member's* share of the amount of *capital resources* required to comply with *GENPRU 2.2.33R* as the higher of:

- (1) $\frac{1}{3}$ 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 2.3.7R(2)*.

2.3.29 R For the purposes of *GENPRU 2.2.34R*, the *Society* must ensure that the aggregate *capital resources* supporting the *insurance business* of all the *members* meet the higher of:

- (1) $\frac{1}{3}$ of the *general insurance capital requirement* for the *members* in aggregate;
- (2) $\frac{1}{3}$ of the *Society GICR*; and
- (3) the *base capital resources requirement*;

with the sum of the items listed in *GENPRU 2.2.34R*.

2.3.30 R The *Society* must calculate each *member's* share of the amount of *capital resources* required to comply with *GENPRU 2.2.34R* as the higher of:

- (1) $\frac{1}{3}$ of the *general insurance capital requirement* for the *members* in aggregate;
- (2) $\frac{1}{3}$ 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 2.3.11R*.

Characteristics of tier one capital

2.3.31 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 2.2.64R(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 2.2.64R(5)* to *GENPRU 2.2.64R(10)*.

Adjustments for related undertakings

- 2.3.32 R *GENPRU 2.2.256R* (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 2.2.256R*.
- 2.3.33 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 R In the case of *members*, *Lloyd's members' contributions* are included in *GENPRU 2 Annex 7R* 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 G The effect of *GENPRU 2.3.34R* is that *Lloyd's members' contributions*, including letters of credit, guarantees and life assurance policies, are *admissible assets*.

GENPRU 2 Annex 1R

Capital resources table for an insurer

Capital resources calculation for an insurer		
Type of capital	Related text	Stage
Core tier one capital		(A)
<i>Permanent share capital</i>	<i>GENPRU 2.2.83R</i>	
Profit and loss account and other reserves (taking into account interim net losses)	<i>GENPRU 2.2.85R; GENPRU 2.2.87R to GENPRU 2.2.88R</i>	
<i>Share premium account</i>	<i>GENPRU 2.2.101R</i>	
Externally verified interim net profits	<i>GENPRU 2.2.102R</i>	
Positive valuation differences	<i>GENPRU 2.2.105R</i>	
Fund for future appropriations	<i>GENPRU 2.2.108R</i>	
Perpetual non-cumulative preference shares		(B)
Perpetual non-cumulative <i>preference shares</i>	<i>GENPRU 2.2.109R</i>	
Innovative tier one capital		(C)
<i>Innovative tier one instruments</i>	<i>GENPRU 2.2.113R to GENPRU 2.2.121R</i>	
Total tier one capital before deductions = A+B+C		(D)
Deductions from tier one capital		(E)
Investments in own <i>shares</i>	None	
Intangible assets	<i>GENPRU 2.2.155R</i>	
Amounts deducted from <i>technical provisions</i> for discounting and other negative valuation differences	<i>GENPRU 2.2.105R to GENPRU 2.2.107R</i>	
Total tier one capital after deductions = D-E		(F)

Capital resources calculation for an insurer		
Type of capital	Related text	Stage
Upper tier two capital		(G)
Perpetual cumulative <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.181R</i>	
Perpetual subordinated debt	See previous entry	
Perpetual subordinated securities	See previous entry	
Lower tier two capital		(H)
Fixed term <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.175G; GENPRU 2.2.194R to GENPRU 2.2.196R</i>	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Positive adjustments for related undertakings		(J)
<i>Related undertakings that are regulated related undertakings (other than insurance undertakings)</i>	<i>GENPRU 2.2.256R</i>	
Total capital after positive adjustments for insurance undertakings but before deductions = F + I + J		(K)
Deductions from total capital		(L)
Inadmissible assets	<i>GENPRU 2.2.250R to GENPRU 2.2.251R; GENPRU 2 Annex 7R</i>	
Assets in excess of <i>market risk</i> and <i>counterparty</i> limits	<i>INSPRU 2.1.22R</i>	
<i>Related undertakings that are ancillary services undertakings</i>	<i>GENPRU 2.2.255R</i>	

Capital resources calculation for an insurer		
Type of capital	Related text	Stage
Negative adjustments for <i>related undertakings</i> that are <i>regulated related undertakings</i> (other than <i>insurance undertakings</i>)	<i>GENPRU 2.2.256R</i>	
Total capital after deductions = K - L		(M)
Other capital resources*		(N)
Unpaid <i>share</i> capital or, in the case of a <i>mutual, unpaid initial funds</i> and calls for supplementary contributions	<i>GENPRU 2.2.266G</i> to <i>GENPRU 2.2.269G</i>	
<i>Implicit items</i>	<i>GENPRU 2 Annex 8G</i>	
Total capital resources after deductions = M + N		(O)
* Items in section (N) of the table can be included in <i>capital resources</i> if subject to a <i>waiver</i> under section 148 of the <i>Act</i> .		
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.		

GENPRU 2 Annex 2R

Capital resources table for a bank

The capital resources calculation for a bank		
Type of capital	Related text	Stage
Core tier one capital		(A)
<i>Permanent share capital</i>	<i>GENPRU 2.2.83R</i>	
Profit and loss account and other reserves (taking into account interim net losses)	<i>GENPRU 2.2.85R to 2.2.90R</i>	
<i>Eligible partnership capital</i>	<i>GENPRU 2.2.93R; GENPRU 2.2.95R</i>	
<i>Eligible LLP members' capital</i>	<i>GENPRU 2.2.94R; GENPRU 2.2.95R</i>	
<i>Share premium account</i>	<i>GENPRU 2.2.101R</i>	
Externally verified interim net profits	<i>GENPRU 2.2.102R</i>	
Perpetual non-cumulative preference shares		(B)
Perpetual non-cumulative <i>preference shares</i>	<i>GENPRU 2.2.109R</i>	
Innovative tier one capital		(C)
<i>Innovative tier one instruments</i>	<i>GENPRU 2.2.113R to GENPRU 2.2.137R</i>	
Total tier one capital before deductions = A+B+C		(D)
Deductions from tier one capital		(E)
Investments in own <i>shares</i>	None	
Intangible assets	<i>GENPRU 2.2.155R</i>	
Excess of drawings over profits for partnerships and <i>limited liability partnerships</i>	<i>GENPRU 2.2.100R</i>	
Net losses on equities held in the available-for- sale financial asset category	<i>GENPRU 2.2.185R</i>	

The capital resources calculation for a bank		
Type of capital	Related text	Stage
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier one capital after deductions = D-E		(F)
Upper tier two capital		(G)
Perpetual cumulative <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.181R</i>	
Perpetual subordinated debt	See previous entry	
Perpetual subordinated securities	See previous entry	
Revaluation reserves	<i>GENPRU 2.2.185R</i>	
General/collective provisions	<i>GENPRU 2.2.187R to GENPRU 2.2.189R</i>	
Surplus provisions	<i>GENPRU 2.2.190R to GENPRU 2.2.193R</i>	
Lower tier two capital		(H)
Fixed term <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.174R; GENPRU 2.2.194R to GENPRU 2.2.196R</i>	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier two capital after deductions = I - J		(K)
Total tier one capital plus tier two capital = F+K		(L)

The capital resources calculation for a bank		
Type of capital	Related text	Stage
Deductions from the totals of tier one and two		(M)
<i>Qualifying holdings</i>	<i>GENPRU 2.2.202R to GENPRU 2.2.207R</i>	(Part 1 of stage M)
<i>Material holdings</i>	<i>GENPRU 2.2.208R to GENPRU 2.2.215R</i>	
<i>Expected loss amounts and other negative amounts</i>	<i>GENPRU 2.2.236R</i>	
<i>Securitisation positions</i>	<i>GENPRU 2.2.237R</i>	
<i>Reciprocal cross-holdings</i>	<i>GENPRU 2.2.217R to GENPRU 2.2.220R</i>	
Investments in <i>subsidiary undertakings</i> and <i>participations</i> which are not <i>material holdings</i> or <i>qualifying holdings</i>	None	(Part 2 of stage M)
<i>Connected lending of a capital nature</i>	<i>GENPRU 2.2.221R to GENPRU 2.2.233R</i>	
Total tier one capital plus tier two capital after deductions = L-M		(N)
<p>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.</p>		
Upper tier three		(O)
Short term subordinated debt	<i>GENPRU 2.2.241R to GENPRU 2.2.245R</i>	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	<i>GENPRU 2.2.246R to GENPRU 2.2.249R</i>	

The capital resources calculation for a bank		
Type of capital	Related text	Stage
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>	<i>GENPRU 2.2.263R to GENPRU 2.2.265R</i>	
<i>Free deliveries</i>	<i>BIPRU 14.4</i>	
Total capital after deductions (R – S)		(T)
<p>In calculating whether a bank's capital resources exceed its capital resources requirement, the market risk capital requirement and the concentration risk capital component 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*.

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

GENPRU 2 Annex 3R

Capital resources table for a building society

The capital resources calculation for a building society		
Type of capital	Related text	Stage
Core tier one capital		(A)
Profit and loss account and other reserves (taking into account interim net losses)	<i>GENPRU 2.2.85R to 2.2.90R</i>	
Externally verified interim net profits	<i>GENPRU 2.2.102R</i>	
Perpetual non-cumulative preference shares		(B)
<i>PIBS</i>	<i>GENPRU 2.2.111R</i>	
Innovative tier one capital		(C)
<i>Innovative tier one instruments</i>	<i>GENPRU 2.2.113R to GENPRU 2.2.137R</i>	
Total tier one capital before deductions = A+B+C		(D)
Deductions from tier one capital		(E)
Investments in own <i>shares</i>	None	
Intangible assets	<i>GENPRU 2.2.155R</i>	
Net losses on equities held in the available-for-sale financial asset category	<i>GENPRU 2.2.185R</i>	
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier one capital after deductions = D-E		(F)
Upper tier two capital		(G)
Perpetual subordinated debt	<i>GENPRU 2.2.159R to GENPRU 2.2.181R</i>	
Perpetual subordinated securities	See previous entry	

The capital resources calculation for a building society		
Type of capital	Related text	Stage
Revaluation reserves	<i>GENPRU 2.2.185R</i>	
General/collective provisions	<i>GENPRU 2.2.187R to GENPRU 2.2.189R</i>	
Surplus provisions	<i>GENPRU 2.2.190R to GENPRU 2.2.193R</i>	
Lower tier two capital		(H)
Long term subordinated debt	<i>GENPRU 2.2.159R to GENPRU 2.2.174R; GENPRU 2.2.194R to GENPRU 2.2.196R</i>	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier two capital after deductions = I - J		(K)
Total tier one capital plus tier two capital = F+K		(L)
Deductions from the totals of tier one and two		(M)
<i>Qualifying holdings</i>	<i>GENPRU 2.2.202R to GENPRU 2.2.207R</i>	
<i>Material holdings</i>	<i>GENPRU 2.2.208R to GENPRU 2.2.215R</i>	(Part 1 of stage M)
<i>Expected loss amounts and other negative amounts</i>	<i>GENPRU 2.2.236R</i>	
<i>Securitisation positions</i>	<i>GENPRU 2.2.237R</i>	

The capital resources calculation for a building society		
Type of capital	Related text	Stage
<i>Reciprocal cross-holdings</i>	<i>GENPRU 2.2.217R to GENPRU 2.2.220R</i>	(Part 2 of stage M)
Investments in <i>subsidiary undertakings</i> and <i>participations</i> which are not <i>material holdings</i> or <i>qualifying holdings</i>	None	
Total tier one capital plus tier two capital after deductions = L-M		(N)
<p>In calculating whether a <i>building society's</i> capital resources exceed its capital resources requirement: (1) the credit risk capital component, the operational risk capital requirement and the counterparty risk capital component; or (2) the base capital resources requirement; as the case may be, must be deducted here.</p>		
Upper tier three		(O)
Short term subordinated debt	<i>GENPRU 2.2.241R to GENPRU 2.2.245R</i>	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	<i>GENPRU 2.2.246R to GENPRU 2.2.249R</i>	
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>	<i>GENPRU 2.2.263R to GENPRU 2.2.265R</i>	
<i>Free deliveries</i>	<i>BIPRU 14.4</i>	
Total capital after deductions (R – S)		(T)

The capital resources calculation for a building society		
Type of capital	Related text	Stage
<p>In calculating whether a <i>building society'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 *building society's capital resources* are less than its *capital resources requirement*.

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

GENPRU 2 Annex 4R

Capital resources table for a BIPRU investment firm deducting material holdings

The capital resources calculation for an investment firm deducting material holdings		
Type of capital	Related text	Stage
Core tier one capital		(A)
<i>Permanent share capital</i>	<i>GENPRU 2.2.83R</i>	
Profit and loss account and other reserves (taking into account material interim net losses)	<i>GENPRU 2.2.85R to 2.2.90R</i>	
<i>Eligible partnership capital</i>	<i>GENPRU 2.2.93R; GENPRU 2.2.95R</i>	
<i>Eligible LLP members' capital</i>	<i>GENPRU 2.2.94R; GENPRU 2.2.95R</i>	
<i>Sole trader capital</i>	None	
<i>Share premium account</i>	<i>GENPRU 2.2.101R</i>	
Externally verified interim net profits	<i>GENPRU 2.2.102R</i>	
Perpetual non-cumulative preference shares		(B)
Perpetual non-cumulative <i>preference shares</i>	<i>GENPRU 2.2.109R</i>	
Innovative tier one capital		(C)
<i>Innovative tier one instruments</i>	<i>GENPRU 2.2.113R to GENPRU 2.2.137R</i>	
Total tier one capital before deductions = A+B+C		(D)
Deductions from tier one capital		(E)
Investments in own <i>shares</i>	None	
Intangible assets	<i>GENPRU 2.2.155R</i>	
Excess of drawings over profits for partnerships, <i>limited liability partnerships</i> and <i>sole traders</i>	<i>GENPRU 2.2.100R;</i> 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
Net losses on equities held in the available-for-sale financial asset category	<i>GENPRU 2.2.185R</i>	
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier one capital after deductions = D-E		(F)
Upper tier two capital		(G)
Perpetual cumulative <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.181R</i>	
Perpetual subordinated debt	See previous entry	
Perpetual subordinated securities	See previous entry	
Revaluation reserves	<i>GENPRU 2.2.185R</i>	
General/collective provisions	<i>GENPRU 2.2.187R to GENPRU 2.2.189R</i>	
Surplus provisions	<i>GENPRU 2.2.190R to GENPRU 2.2.193R</i>	
Lower tier two capital		(H)
Fixed term <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.174R; GENPRU 2.2.194R to GENPRU 2.2.196R</i>	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier two capital after deductions = I - J		(K)

The capital resources calculation for an investment firm deducting material holdings		
Type of capital	Related text	Stage
Total tier one capital plus tier two capital = F+K		(L)
Deductions from the totals of tier one and two		(M)
<i>Material holdings</i>	<i>GENPRU 2.2.208R to GENPRU 2.2.215R</i>	
<i>Expected loss amounts and other negative amounts</i>	<i>GENPRU 2.2.236R</i>	(Part 1 of stage M)
<i>Securitisation positions</i>	<i>GENPRU 2.2.237R</i>	
<i>Reciprocal cross-holdings</i>	<i>GENPRU 2.2.217R to GENPRU 2.2.220R</i>	(Part 2 of stage M)
Total tier one capital plus tier two capital after deductions = L-M		(N)
<p>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.</p>		
Upper tier three		(O)
Short term subordinated debt	<i>GENPRU 2.2.241R to GENPRU 2.2.245R</i>	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	<i>GENPRU 2.2.246R to GENPRU 2.2.249R</i>	
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)

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

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

GENPRU 2Annex 5R

Capital resources table for a BIPRU investment firm deducting illiquid assets

The capital resources calculation for an investment firm that deducts illiquid assets		
Type of capital	Related text	Stage
Core tier one capital		(A)
<i>Permanent share capital</i>	<i>GENPRU 2.2.83R</i>	
Profit and loss account and other reserves (taking into account material interim net losses)	<i>GENPRU 2.2.85R to 2.2.90R</i>	
<i>Eligible partnership capital</i>	<i>GENPRU 2.2.93R; GENPRU 2.2.95R</i>	
<i>Eligible LLP members' capital</i>	<i>GENPRU 2.2.94R; GENPRU 2.2.95R</i>	
<i>Sole trader capital</i>	None	
<i>Share premium account</i>	<i>GENPRU 2.2.101R</i>	
Externally verified interim net profits	<i>GENPRU 2.2.102R</i>	
Perpetual non-cumulative preference shares		(B)
Perpetual non-cumulative <i>preference shares</i>	<i>GENPRU 2.2.109R</i>	
Innovative tier one capital		(C)
<i>Innovative tier one instruments</i>	<i>GENPRU 2.2.113R to GENPRU 2.2.137R</i>	
Total tier one capital before deductions = A+B+C		(D)
Deductions from tier one capital		(E)
Investments in own <i>shares</i>	None	
Intangible assets	<i>GENPRU 2.2.155R</i>	
Excess of drawings over profits for partnerships, <i>limited liability partnerships</i> and <i>sole traders</i>	<i>GENPRU 2.2.100R;</i> 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
Net losses on equities held in the available-for-sale financial asset category	<i>GENPRU 2.2.185R</i>	
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier one capital after deductions = D-E		(F)
Upper tier two capital		(G)
Perpetual cumulative <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.181R</i>	
Perpetual subordinated debt	See previous entry	
Perpetual subordinated securities	See previous entry	
Revaluation reserves	<i>GENPRU 2.2.185R</i>	
General/collective provisions	<i>GENPRU 2.2.187R to GENPRU 2.2.189R</i>	
Surplus provisions	<i>GENPRU 2.2.190R to GENPRU 2.2.193R</i>	
Lower tier two capital		(H)
Fixed term <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.174R; GENPRU 2.2.194R to GENPRU 2.2.196R</i>	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier two capital after deductions = I - J		(K)

The capital resources calculation for an investment firm that deducts illiquid assets		
Type of capital	Related text	Stage
Total tier one capital plus tier two capital = F+K		(L)
Deductions from the totals of tier one and two		(M)
<i>Expected loss</i> amounts and other negative amounts	GENPRU 2.2.236R	(Part 1 of stage M)
<i>Securitisation positions</i>	GENPRU 2.2.237R	
<i>Reciprocal cross-holdings</i>	GENPRU 2.2.217R to GENPRU 2.2.220R	(Part 2 of stage M)
Total tier one capital plus tier two capital after deductions = L-M		(N)
<p>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.</p>		
Upper tier three		(O)
Short term subordinated debt	GENPRU 2.2.241R to GENPRU 2.2.245R	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	GENPRU 2.2.246R to GENPRU 2.2.249R	
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)
Deductions from total capital		(S)

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

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

GENPRU 2 Annex 6R

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

Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision		
Type of capital	Related text	Stage
Core tier one capital		(A)
<i>Permanent share capital</i>	<i>GENPRU 2.2.83R</i>	
Profit and loss account and other reserves (taking into account material interim net losses)	<i>GENPRU 2.2.85R to 2.2.90R</i>	
<i>Eligible partnership capital</i>	<i>GENPRU 2.2.93R; GENPRU 2.2.95R</i>	
<i>Eligible LLP members' capital</i>	<i>GENPRU 2.2.94R; GENPRU 2.2.95R</i>	
<i>Sole trader capital</i>	None	
<i>Share premium account</i>	<i>GENPRU 2.2.101R</i>	
Externally verified interim net profits	<i>GENPRU 2.2.102R</i>	
Perpetual non-cumulative preference shares		(B)
Perpetual non-cumulative <i>preference shares</i>	<i>GENPRU 2.2.109R</i>	
Innovative tier one capital		(C)
<i>Innovative tier one instruments</i>	<i>GENPRU 2.2.113R to GENPRU 2.2.137R</i>	
Total tier one capital before deductions = A+B+C		(D)
Deductions from tier one capital		(E)

Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision		
Type of capital	Related text	Stage
Investments in own <i>shares</i>	None	(Part 1 of stage E)
Intangible assets	<i>GENPRU 2.2.155R</i>	
Excess of drawings over profits for partnerships, <i>limited liability partnerships</i> and <i>sole traders</i>	<i>GENPRU 2.2.100R</i> ; there is no related text for <i>sole traders</i>	
Net losses on equities held in the available-for-sale financial asset category	<i>GENPRU 2.2.185R</i>	(Part 1 of stage E)
(For certain limited purposes only certain additional deductions are made here. This line does not include <i>material holdings</i> .)	<i>GENPRU 2.2.239R(2) to (4)</i>	
<i>Material holdings</i> falling into Note (4)	Note (4) of Part 2 of this table; <i>GENPRU 2.2.208R to GENPRU 2.2.215R</i>	(Part 2 of stage E)
(For certain limited purposes only certain additional deductions of <i>material holdings</i> are made here)	Note (5) of Part 2 of this table; <i>GENPRU 2.2.239R(2) to (4)</i>	(Part 3 of stage E)
Total tier one capital after deductions = D-E		(F)
Upper tier two capital		(G)
Perpetual cumulative <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.181R</i>	
Perpetual subordinated debt	See previous entry	
Perpetual subordinated securities	See previous entry	
Revaluation reserves	<i>GENPRU 2.2.185R</i>	
General/collective provisions	<i>GENPRU 2.2.187R to GENPRU 2.2.189R</i>	

Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision		
Type of capital	Related text	Stage
Surplus provisions	<i>GENPRU 2.2.190R to GENPRU 2.2.193R</i>	
Lower tier two capital		(H)
Fixed term <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.174R; GENPRU 2.2.194R to GENPRU 2.2.196R</i>	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	Note (5) of Part 2 of this table; <i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier two capital after deductions = I - J		(K)
Total tier one capital plus tier two capital = F+K		(L)
Deductions from the totals of tier one and two		(M)
<i>Material holdings</i> falling into Note (5)	Note (5) of Part 2 of this table; <i>GENPRU 2.2.208R to GENPRU 2.2.215R</i>	(Part 1 of stage M)
Contingent liabilities	Note (6) of Part 2 of this table	
<i>Expected loss</i> amounts and other negative amounts	<i>GENPRU 2.2.236R</i>	
<i>Securitisation positions</i>	<i>GENPRU 2.2.237R</i>	
<i>Reciprocal cross-holdings</i>	<i>GENPRU 2.2.217R to GENPRU 2.2.220R</i>	(Part 2 of stage M)

Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision		
Type of capital	Related text	Stage
Total tier one capital plus tier two capital after deductions = L-M		(N)
<p>In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i>: (1) the <i>credit risk capital component</i>, the <i>operational risk capital requirement</i> (if applicable) 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.</p>		
Upper tier three		(O)
Short term subordinated debt	<i>GENPRU 2.2.241R to GENPRU 2.2.245R</i>	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	<i>GENPRU 2.2.246R to GENPRU 2.2.249R</i>	
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)
Deductions from total capital		(S)
<i>Illiquid assets</i>	<i>GENPRU 2.2.259R to GENPRU 2.2.260R</i>	
<i>Free deliveries</i>	<i>BIPRU 14.4</i>	
Total capital after deductions = R-S		(T)
<p>In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i>, the <i>market risk capital requirement</i>, 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 (3): Stage C must be omitted except where *capital resources* are being used for a purpose for which *innovative tier one capital* may be used (see *GENPRU 2.2.27R*).

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

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

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*.

GENPRU 2 Annex 7R

Admissible assets in insurance

- (1) 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 *UCITS schemes*, *non-UCITS retail schemes*, *recognised schemes* and any other *collective investment scheme* that invests only in *admissible assets* (including any *derivatives* or *quasi-derivatives* held by the scheme);
 - (e) land, buildings and immovable property rights;
 - (f) an *approved derivative* or *quasi-derivative* transaction that satisfies the conditions in *INSPRU 3.2.5R* or an *approved stock lending* transaction that satisfies the conditions in *INSPRU 3.2.36R*.
- (2) 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*.
- (3) 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.

* A *firm* may treat amounts recoverable from an *ISPV* as an *admissible asset* if it obtains a *waiver* under section 148 of the *Act*. The conditions that will need to be met, in addition to the statutory tests under section 148(4) of the *Act*, before the *FSA* will consider granting such a *waiver* are set out in *INSPRU* 1.6.13G to *INSPRU* 1.6.18G.

G Implicit items under the Act

1	<p>The <i>capital resources table</i> does not permit <i>implicit items</i> to be included in the calculation of a <i>firm's capital resources</i>, except subject to a <i>waiver</i> under section 148 of the <i>Act</i>. Article 27(4) of the <i>Consolidated Life Directive</i> states that <i>implicit items</i> can be included in the calculation of a <i>firm's capital resources</i>, within limits, provided that the supervisory authority agrees. Certain <i>implicit items</i>, however, are not eligible for inclusion beyond 31 December 2009 (see paragraph 5). The <i>FSA</i> may be prepared to grant a <i>waiver</i> from the <i>capital resources table</i> to allow <i>implicit items</i>, in line with the purpose of the <i>Consolidated Life Directive</i>, and provided the conditions as set out in article 27(4) of the <i>Consolidated Life Directive</i> are met. Such a <i>waiver</i> would allow an <i>implicit item</i> to count towards the <i>firm's capital resources</i> available to count against its <i>capital resources requirement (CRR)</i> set out for <i>realistic basis life firms</i> in <i>GENPRU 2.1.18R</i> and for <i>regulatory basis only life firms</i> in <i>GENPRU 2.1.23R</i>. An <i>implicit item</i> may potentially count as <i>tier one capital</i> (but not <i>core tier one capital</i>) or <i>tier two capital</i>. Where a <i>waiver</i> is granted allowing an <i>implicit item</i> as <i>tier one capital</i>, the value of the <i>implicit item</i> so allowed must be included at stage B of the <i>capital resources table</i>. If the application of the value of the <i>implicit item</i> is restricted by <i>GENPRU 2.2.29R</i>, which requires that at least 50% of a <i>firm's tier one capital resources</i> must be accounted for by <i>core tier one capital</i>, the remainder may be included at stage G of the calculation in the <i>capital resources table</i>, subject to <i>GENPRU 2.2.31R</i>. An <i>implicit item</i> treated as <i>tier two capital</i> will also be included at stage G of the calculation, again subject to <i>GENPRU 2.2.81R</i>. Article 29(1) of the <i>Consolidated Life Directive</i> requires that <i>implicit items</i> be excluded from the capital eligible to cover the <i>guarantee fund</i>. Under <i>GENPRU 2.2.33R</i> a <i>firm</i> must meet the <i>guarantee fund</i> from the sum of the items listed at stages A, B, G and H of the <i>capital resources table</i> less the sum of the items listed at stage E of the <i>capital resources table</i>. The <i>FSA</i> will only grant an <i>implicit items waiver</i> if the <i>waiver</i> includes a modification to <i>GENPRU 2.2.33R</i> to ensure that the <i>implicit item</i> does not count towards meeting the <i>guarantee fund</i>.</p>
2	<p>Under section 148 of the <i>Act</i>, the <i>FSA</i> may, on the application of a <i>firm</i>, grant a <i>waiver</i> from <i>PRU</i>. There are general requirements that must be met before any <i>waiver</i> can be granted. As explained in SUP 8, the <i>FSA</i> may not give a <i>waiver</i> unless the <i>FSA</i> is satisfied that:</p>
	<p>(1) compliance by the <i>firm</i> with the <i>rules</i> will be unduly burdensome, or would not achieve the purpose for which the <i>rules</i> were made; and</p>
	<p>(2) the <i>waiver</i> would not result in undue risk to <i>persons</i> whose</p>

	interests the <i>rules</i> are intended to protect.
3	<p>The <i>FSA</i> 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 <i>rule</i> or whether a <i>rule</i> is framed in a way that would make compliance difficult in view of the <i>firm's</i> circumstances. For example, the <i>firm</i> may demonstrate that if an <i>implicit item</i> were not allowed, the <i>firm</i> would either have to suffer increased (and unwarranted) costs in injecting further <i>capital resources</i> or operate with a lower equity backing ratio (see case studies in paragraph 43). Even if a <i>firm</i> can demonstrate a case for an <i>implicit item waiver</i>, it should not assume that the <i>FSA</i> will grant the <i>waiver</i> requested, or that any <i>waiver</i> will be granted for the full amount of the <i>implicit item</i> which could be granted, as set out in this annex. The <i>FSA</i> will consider each application on its own merits, and taking into account all relevant circumstances, including the financial situation and business prospects of the <i>firm</i>.</p>
4	<p><i>Implicit items</i> are economic reserves which are contained within the long-term insurance business provisions. Article 27(4) of the <i>Consolidated Life Directive</i> identifies three types of <i>implicit item</i>, in respect of: future profits, <i>zillmerisation</i> and hidden reserves. This annex is intended to amplify the <i>guidance</i> in <i>SUP 8</i> relating to the granting of <i>waivers</i> for <i>implicit items</i> and to provide <i>guidance</i> on other aspects. Whilst this <i>guidance</i> applies to applications for <i>waivers</i> for <i>implicit items</i> generally, for a <i>realistic basis life firm</i>, to the extent that an <i>implicit item</i> is allocated to a <i>with-profits fund</i>, this <i>guidance</i> relates to <i>implicit items</i> for the purposes of determining the <i>regulatory value of assets</i> (see <i>INSPRU 1.4.24R</i>).</p>
5	<p>The <i>Consolidated Life Directive</i> (reflecting the changes introduced by the <i>Solvency 1 Directive</i>) requires member states to end a <i>firm's</i> ability to take into account future profits <i>implicit items</i> by (at the latest) 31 December 2009. Until then, the maximum amount of the <i>implicit item</i> relating to future profits permitted under the <i>Consolidated Life Directive</i> is limited to 50% of the product of the estimated annual profits and the average period to run (not exceeding six years) on the <i>policies</i> in the portfolio. The <i>Consolidated Life Directive</i> 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 <i>Solvency 1 Directive</i> take effect for financial years beginning on or after 1 January 2004. However, the <i>Consolidated Life Directive</i> allows for a transitional period of five years, which runs from 20 March 2002 (the publication date of the <i>Solvency 1 Directive</i>), for <i>firms</i> to become fully compliant with these new requirements. <i>Firms</i> will need to consider the potential impact of these changes when engaging in future capital planning. When applying for an <i>implicit item waiver</i> a <i>firm</i> should provide the <i>FSA</i> with a plan showing how the <i>firm</i> intends to maintain its capital adequacy over the</p>

	period to 31 December 2009. <i>Firms</i> should also be aware that the <i>FSA</i> will typically only grant <i>waivers</i> for a maximum of 12 months.
Future Profits	
6	The future profits <i>implicit item</i> allows <i>firms</i> to take credit for margins in the <i>mathematical reserves</i> 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	<i>Zillmerisation</i> is an allowance for acquisition costs that are expected, under prudent assumptions, to be recoverable from future <i>premiums</i> . <i>Firms</i> can make a direct adjustment to their reserves for <i>zillmerisation</i> , subject to the <i>rules</i> on <i>mathematical reserves</i> . However, where no such adjustment has been made, the <i>FSA</i> will consider an application for a <i>waiver</i> to take into account an <i>implicit item</i> .
Hidden reserves	
8	Hidden reserves are reserves resulting from the underestimation of assets (other than <i>mathematical reserves</i>).
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 <i>firms</i> to the <i>FSA</i> . This <i>guidance</i> should also be read in conjunction with the general requirements relating to the <i>waiver</i> process described in <i>SUP</i> 8. The <i>FSA</i> expects that applications for <i>waivers</i> in respect of future profits and <i>zillmerising</i> will not normally be considered to pass the "not result in undue risk to persons whose interests the <i>rules</i> are intended to protect" test unless the relevant criteria set out in this <i>guidance</i> have been satisfied and an application for such a <i>waiver</i> may require further criteria to be satisfied for this test to be passed. As set out below, <i>waivers</i> in respect of either <i>zillmerising</i> or hidden reserves will not normally be given except in very exceptional circumstances.
Timing	
10	A <i>long-term insurer</i> may apply to the <i>FSA</i> for a <i>waiver</i> in respect of <i>implicit items</i> . A <i>waiver</i> will not apply retrospectively (see <i>SUP</i> 8.3.6G). Consequently, applications intended for a particular accounting reference date will normally need to be made well before

	that reference date. Applications by <i>firms</i> must be made to the <i>FSA</i> in writing and include the relevant details specified under <i>SUP</i> 8.3.3D. Given the uncertainty in predicting the future, <i>waivers</i> 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 <i>capital resources requirement</i> is to be met, with and without the <i>waiver</i> . Clearly, up-to-date information may not be available before the <i>financial year-end</i> . In some cases information from the previous year-end's <i>return</i> may be used, as long as any known significant changes in the structure of the <i>firm</i> , or the assumptions used, have been taken into account.
12	If the application for a <i>waiver</i> is granted, when a <i>firm</i> submits its next <i>return</i> the amount of the <i>implicit item</i> shown should not exceed that supported by the <i>firm's</i> calculations as at the valuation date. In the event that the amount of the future profits item calculated by the <i>firm</i> based on these updated assumptions is less than the amount calculated at the time of the <i>firm's</i> <i>waiver</i> application, the lower figure should be used in the <i>return</i> .
13	An <i>implicit item</i> in respect of <i>zillmerising</i> 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 <i>waiver</i> will be dependent on the overall <i>capital resources</i> of the <i>firm</i> . <i>Waivers</i> in respect of these <i>implicit items</i> will, therefore, only be made in relation to the position shown in a particular set of <i>returns</i> and it will be essential for <i>firms</i> to submit applications to the <i>FSA</i> well in advance of the latest date for the submission of the relevant <i>return</i> .
14	<i>Waivers</i> may be withdrawn by the <i>FSA</i> at any time (e.g. where the <i>FSA</i> considers the amount in respect of which a <i>waiver</i> has been given can no longer be justified). This may be as a result of changes in the <i>firm's</i> position or as a result of queries arising on scrutiny of the <i>returns</i> .
Information to be submitted	
15	An application for a <i>waiver</i> (which includes an application for an extension to or other variation of a <i>waiver</i>) should be prepared using the standard application form for a <i>waiver</i> (see <i>SUP</i> 8 Annex 2D). In addition, the application should be accompanied by full supporting information to enable the <i>FSA</i> 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 <i>implicit items</i> that a <i>firm</i> wishes to count against its <i>capital resources requirement</i> and whether it proposes to treat the <i>implicit item</i> as <i>tier one capital</i> or <i>tier two capital</i> . In order to assess an application, the <i>FSA</i> needs information as to the make-up of

	<p>the <i>firm's capital resources</i>, 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 <i>firm's long-term insurance fund</i> or <i>funds</i> and between the <i>firm's with-profits funds</i> and <i>non-profit funds</i>. An explanation as to the appropriateness of the proposed treatment of the <i>implicit item</i> under the <i>capital resources table</i> should also be provided, including a demonstration that, in allowing for <i>implicit items</i>, there has been no double counting of future margins and that the basis for valuing such margins is prudent.</p>
16	<p>The <i>FSA</i> recognises that the assessment of the insurance <i>technical provisions</i> reflects the contractual obligations of the <i>firm</i>. <i>Implicit items</i> are therefore margins over and above an economic assessment in these <i>technical provisions</i> only. Non-contractual "constructive" obligations arising from a <i>firm's</i> regulatory duty to treat <i>customers</i> fairly e.g. regarding future terminal bonuses, are not fully captured by the <i>technical provisions</i>. A <i>firm</i> must instead be satisfied that it has sufficient <i>capital resources</i> at all times to meet its obligations under <i>Principle 6</i>. The granting of a <i>waiver</i> for an <i>implicit item</i> does not in any way detract from this requirement and a <i>firm</i> will need to be satisfied that this condition is still met.</p>
17	<p>As a minimum, applications for a future profits <i>implicit item</i> 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 <i>IPRU(INS)</i>, the abstract of the valuation report for the realistic valuation, Appendix 9.4A of <i>IPRU(INS)</i> and Forms 51, 52, 53, 54 and 58. For a <i>zillmerisation</i> <i>implicit item</i>, only those items noted above forming part of the abstract valuation report will normally be needed. Applications for a <i>waiver</i> in respect of a hidden reserves <i>implicit item</i> will normally be considered only if accompanied by the information which is contained in the annual regulatory <i>returns</i>. In particular, the balance sheet forms, <i>long-term insurance business</i> revenue accounts, and abstract of the valuation report as set out in Appendices 9.1, 9.3 and 9.4 of <i>IPRU(INS)</i> should be provided. This is not to say that a full regulatory <i>return</i> 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.</p>
18	<p>The following supporting information relating to the calculation of the amounts claimed should be supplied for each type of <i>implicit item</i> in respect of which a <i>waiver</i> is sought:</p> <p>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 <i>financial years</i> up to the date of the most recent available valuation under <i>rule 9.4</i> of <i>IPRU(INS)</i> which has been submitted to the <i>FSA</i> 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</p>

	<p>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.</p> <p><i>Zillmerising</i>: the categories of contracts for which an item has been calculated and the percentages of the <i>relevant capital sum</i> in respect of which an adjustment has been made.</p> <p>Hidden reserves: particulars, with supporting evidence, of the undervaluation of assets for which recognition is sought.</p>
Continuous monitoring by firms	
19	<p><i>Firms</i> 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.</p> <p><i>Firms</i> should also re-evaluate whether an application to vary an <i>implicit item waiver</i> should be made whenever circumstances have changed. In the event that circumstances have changed such that an amendment is appropriate, the <i>firm</i> must contact the <i>FSA</i> as quickly as possible in accordance with <i>Principle 11</i>. (See <i>SUP 8.5.1R</i>). In this context, the <i>FSA</i> would expect notice of any matter that materially impacts on the <i>firm's</i> financial condition, or any <i>waivers</i> granted.</p>
Future profits - factors to take into account when submitting calculations to support waiver applications	
20	<p>Where an application is made in respect of a <i>firm</i> which has separate <i>with-profits funds</i> and <i>non-profit funds</i>, the <i>firm</i> should ensure that the <i>capital resources requirement</i> in respect of the <i>non-profit fund</i> is not covered by future profits attributable to <i>policyholders</i> arising in the <i>with-profits fund</i>. Furthermore, for a <i>realistic basis life firm</i> the amount of the <i>implicit item</i> allocated to each <i>with-profits fund</i> should be calculated separately, as the amount allocated to each <i>with-profits fund</i> will be taken into consideration in the calculation of the <i>with-profits insurance capital component</i> (see <i>INSPRU 1.4.24R</i>).</p>
21	<p><i>Firms</i> 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 <i>Consolidated Life Directive</i>), which relate to past profits.</p>
Future profits - prospective calculation	
22	<p>The application for a <i>waiver</i> should be supported by details of a prospective calculation of future profits arising from in-force business. The information supplied to the <i>FSA</i> 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 <i>implicit items</i> will no longer be permitted under the <i>Consolidated Life Directive</i>. Where a <i>firm</i> first applies for an <i>implicit items waiver</i> after <i>GENPRU 2.2</i> comes into effect, under the</p>

	<p>prospective calculation a <i>firm</i> should only take into consideration future profits that are expected to emerge in the period up to 31 December 2009. <i>Implicit item waivers</i> granted before <i>GENPRU 2.2</i> comes into effect will continue to operate under the terms of those <i>waivers</i>, but an application to vary the terms of such a <i>waiver</i>, for example to extend the effective period, is an application for a new <i>waiver</i> for which a <i>firm</i> should usually only take into consideration future profits that are expected to emerge in the period up to 31 December 2009.</p>
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Assumptions	
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23	<p>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 <i>with-profits business</i>, the assumptions for future investment returns should not capitalise future bonus loadings except where the <i>with-profits policyholders</i> 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 <i>implicit item</i> would be sufficient to support the amount of the <i>implicit item</i> under each scenario described for use in determining the <i>resilience capital requirement</i> - where the <i>waiver</i> relates to an <i>implicit item</i> allocated to more than one fund, this should be demonstrated separately for that element of the <i>implicit item</i> allocated to each fund. For an <i>implicit item</i> allocated to a <i>with-profits fund</i>, proper allowance should be made for any shareholder transfers to ensure that the <i>implicit item</i> 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.</p>
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Other limitations on the extent to which waivers for implicit items will be granted to a realistic basis life firm	
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24	<p>Where a <i>waiver</i> in respect of an <i>implicit item</i> is granted to a <i>realistic basis life firm</i> additional limits may apply by reference to a comparison of <i>realistic excess capital</i> and <i>regulatory excess capital</i></p>
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	including allowance for the effect of the <i>waiver</i> . Where the <i>waiver</i> relates to an <i>implicit item</i> allocated partly or entirely to a <i>with-profits fund</i> , the <i>waiver</i> will contain a limitation to the effect that the <i>regulatory excess capital</i> for that <i>with-profits fund</i> , allowing for the effect of the <i>waiver</i> , may not exceed that fund's <i>realistic excess capital</i> . This limitation will apply on an ongoing basis so that, for example, in the case of an <i>implicit item</i> allocated to a <i>with-profits fund</i> , the amount of the <i>implicit item</i> would be limited to zero whenever the <i>regulatory excess capital</i> exceeded the <i>realistic excess capital</i> 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 <i>capital resources requirement</i> 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 <i>reinsurance</i> 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 <i>INSPRU</i> 1.4.45R(2)(c) for the present value of future profits relating to non-profit business written in a <i>non-profit fund</i> . The information supplied to the <i>FSA</i> should identify the amount and reason for any adjustments made to the calculation of the prospective amount of future profits.
26	The <i>firm</i> should confirm to the <i>FSA</i> 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 <i>implicit item</i> relating to future profits permitted under the <i>Consolidated Life Directive</i> 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 <i>policies</i> in the portfolio. Article 27(4) of the <i>Consolidated Life Directive</i> also imposes a further limit on the amount of the <i>implicit item</i> equal to 25% of the lower of:
	(1) the <i>firm's capital resources</i> ; and
	(2) the higher of its <i>base capital resources requirement</i> for <i>long-term insurance business</i> and its <i>long-term insurance capital requirement</i> .

	Once the transitional period set out in article 71(1) of the <i>Consolidated Life Directive</i> has expired in 2007 (see paragraph 5), the <i>FSA</i> will not allow a <i>waiver</i> 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 <i>long-term insurance fund</i> over the last five <i>financial years</i> up to the date of the most recent available valuation which has been submitted to the <i>FSA</i> prior to, or together with, the application. For this purpose, deficiencies arising should be treated as negative surpluses. Where a <i>firm's financial year</i> 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 <i>firm</i> (or out of the <i>firm</i>) 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 <i>firm</i> has been carrying on <i>long-term insurance business</i> 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 <i>long-term insurance business</i> 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	<p>The inclusion of investment income arising from the assets representing the explicit components of <i>capital resources</i> (as part of the estimated annual profit for the purpose of determining the future profits <i>implicit item</i>) 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 <i>FSA</i> to grant a <i>waiver</i> which would enable a <i>firm</i> to meet the <i>capital resources requirement</i> 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.</p>
32	<p>The definition of the estimated annual profit as the surplus arising in the <i>long-term insurance fund</i> 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 <i>capital resources</i> carried within the <i>long-term insurance fund</i> (e.g. surplus carried forward or investment reserves), but the amount of such investment income is not separately identified in the <i>return</i>.</p>
33	<p>Where there is reason to suspect that the elimination of any such double-counting would reduce a <i>firm's capital resources</i> to close to or below the required level, or would otherwise be significant, the <i>FSA</i> will request this information with a view to taking account of this factor in determining the amount of the <i>implicit item</i>. Additional information concerning investment income should be furnished with an application for a <i>waiver</i>, if a <i>firm</i> believes that any double-counting would fall into one of the categories mentioned above.</p>
Average period to run	
34	<p>The average number of years remaining to run on <i>policies</i> should be calculated on the basis of the weighted average of the periods for individual <i>contracts of insurance</i>, 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 <i>firm</i> considers will give results similar to the full calculation, will be accepted. In particular, the <i>FSA</i> 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 <i>returns</i>. A <i>firm</i> 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</p>

	about its accuracy.
35	Calculations will normally be requested only for the main categories of <i>insurance business</i> , accounting for not less than 90% of the <i>mathematical reserves</i> , except where there are grounds for expecting that the exclusion of certain categories of <i>policies</i> under this provision might have a significant effect on the resulting average period to run. Detailed calculations will not be required where a <i>waiver</i> is sought in respect of a low multiple of the annual profits, well within the average period to run for the <i>firm</i> .
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 <i>firm</i> 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 <i>contracts of insurance</i> , based on the actual experience of the <i>firm</i> 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 <i>long-term insurance contracts</i> 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 <i>firm</i> is satisfied that this will result in sufficient allowance being made having regard to the <i>firm's</i> 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 <i>Consolidated Life Directive</i> (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 <i>implicit item</i> .
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

	<p>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 <i>implicit item</i> for which a <i>waiver</i> is sought should be based on prudent assumptions tending, if anything, to underestimate the average period to run.</p>
Zillmerising	
41	<p>The <i>FSA</i> does not normally expect to grant <i>waivers</i> permitting <i>implicit items</i> due to <i>zillmerisation</i> except in very exceptional circumstances. <i>Zillmerisation</i> is an allowance for acquisition costs that are expected, under prudent assumptions, to be recoverable from future <i>premiums</i>. <i>Firms</i> can make a direct adjustment to their reserves for <i>zillmerisation</i>, subject to the requirements on <i>mathematical reserves</i> set out in <i>INSPRU</i> 1.3.43R, 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 <i>mathematical reserves</i>, the <i>FSA</i> will consider an application for an <i>implicit item</i>, if the amount is consistent with the amount that would have been allowed as an adjustment to <i>mathematical reserves</i> under <i>INSPRU</i> 1.3.43R.</p>
Hidden reserves	
42	<p>The <i>FSA</i> will grant <i>waivers</i> permitting <i>implicit items</i> due to hidden reserves only in very exceptional circumstances. These items relate to hidden reserves resulting from the underestimation of assets. The <i>rules</i> for the valuation of assets and liabilities (see <i>GENPRU</i> 1.3) which apply to assets and liabilities other than <i>mathematical reserves</i> are based on the valuation used by the <i>firm</i> 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.</p>
Case studies on "unduly burdensome"	
43	<p>Some examples of situations where the existing <i>rules</i> might be considered to be unduly burdensome are given below:</p>
	<ul style="list-style-type: none"> • A <i>firm</i> writes <i>with-profits business</i>. The <i>firm's</i> investment policy is affected by its published financial position. Application of the <i>rules</i> without an <i>implicit item</i> would result in the <i>firm</i> adopting a lower equity backing ratio. It may be possible to demonstrate that, in the circumstances, it would be unduly burdensome to require the <i>firm</i> to incur costs (which might prejudice <i>policyholders</i>) resulting from the lower equity backing ratio, rather than take allowance for an <i>implicit item</i>.
	<ul style="list-style-type: none"> • A <i>firm</i> 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 <i>rules</i>. It may be possible to demonstrate that it is unduly burdensome for the <i>firm</i> to recognise the cost of acquiring the

	assets whilst giving no value to the asset acquired.
•	A <i>firm</i> has a block of in-force business, on which the future profits may be reasonably estimated. Application of the <i>rules</i> without an <i>implicit item</i> 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 <i>firm</i> , to require it to incur the costs involved in the injection of further capital rather than take allowance for an <i>implicit item</i> .
•	A <i>firm</i> has purchased matching assets for guaranteed annuity liabilities. The operation of the asset and liability valuation <i>rules</i> 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 <i>firm</i> to incur the costs involved in the injection of further capital rather than take allowance for an <i>implicit item</i> .
Conditions which will typically be applied to implicit items waivers	
Limits	
44	Where <i>implicit items waivers</i> 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 <i>wavers</i> will normally only last for 12 months.
Publicity	
45	The <i>FSA</i> will publish the <i>waiver</i> (see <i>SUP</i> 8.6 and <i>SUP</i> 8.7). Public disclosure is standard practice unless the <i>FSA</i> is satisfied that publication is inappropriate or unnecessary (see section 148 of the <i>Act</i>). Any request that a direction not be published should be made to the <i>FSA</i> in writing with grounds in support, as set out in <i>SUP</i> 8.6. Disclosure of a <i>waiver</i> will normally be required in the <i>firm's</i> annual <i>returns</i> .

Annex C

Chapter 3 of GENPRU

In this Annex the text shown is redesignated text. Where changes are to be made to the redesignated text, new text is underlined and text that is deleted is shown as struck-through.

3.1 ~~8.4~~ Cross sector groups

Application

- ~~8.4.13.1.1~~ R (1) *GENPRU 8.43.1* 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 3.18.4* 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 3.18.4.25* (Capital adequacy requirements: high level requirement), *GENPRU 3.18.4.26R* (Capital adequacy requirements: application of Method 4 from Annex I of the Financial Groups Directive), *GENPRU 3.18.4.29R* (Capital adequacy requirements: application of Methods 1, 2 or 3 from Annex I of the Financial Groups Directive) and *GENPRU 3.18.4.35R* (Risk concentration and intra group transactions: the main rule) do not apply with respect to a *third-country financial conglomerate*.

Purpose

3.1.28.4.2 G GENPRU 3.18.4 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 3.28.5;
- (2) *SUP 15.9* contains notification *rules* for members of *financial conglomerates*;
- (3) material on reporting obligations can be found in *SUP 16.7.7382R* and *SUP 16.7.7483R*; and
- (4) material on systems and controls in *financial conglomerates* can be found in PRU 8.1SYSC 12.

Introduction: identifying a financial conglomerate

3.1.3
8.4.3

- G (1) In general the process in (2) to (8) applies for identifying *financial conglomerates*.
- (2) *Competent authorities* that have authorised *regulated entities* should try to identify any *consolidation group* that is a *financial conglomerate*. If a *competent authority* is of the opinion that a *regulated entity* authorised by that *competent authority* is a member of a *consolidation group* which may be a *financial conglomerate* it should communicate its view to the other *competent authorities* concerned.
- (3) A *competent authority* may start (as described in (2)) the process of deciding whether a group is a *financial conglomerate* even if it would not be the *coordinator*.
- (4) A member of a group may also start that process by notifying one of the *competent authorities* that have authorised group members that its group may be a *financial conglomerate*, for example by notification under *SUP 15.9*.
- (5) If a group member gives a notification in accordance with (4), that does not automatically mean that the group should be treated as a *financial conglomerate*. The process described in (6) to (9) still applies.
- (6) The *competent authority* that would be *coordinator* will take the lead in establishing whether a group is a *financial conglomerate* once the process has been started as described in (2) and (3).
- (7) The process of establishing whether a group is a *financial conglomerate* will normally involve discussions between the *financial conglomerate* and the *competent authorities* concerned.

- (8) A *financial conglomerate* should be notified by its *coordinator* that it has been identified as a *financial conglomerate* and of the appointment of the *coordinator*. The notification should be given to the *parent undertaking* at the head of the group or, in the absence of a *parent undertaking*, the *regulated entity* with the largest balance sheet total in the *most important financial sector*. That notification does not of itself make a group into a *financial conglomerate*; whether or not a group is a *financial conglomerate* is governed by the definition of *financial conglomerate* as set out in GENPRU 3.1 8.4.
- (9) GENPRU 3 8 Ann 3 4G is a questionnaire (together with its explanatory notes) that the *FSA* 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

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

Definition of financial conglomerate: basic definition

- 3.1.5
8.4.5 R A *financial conglomerate* means a *consolidation group* that is identified as a *financial conglomerate* in accordance with the decision tree in GENPRU 3 8 Ann 43R.

Definition of financial conglomerate: sub-groups

- 3.1.6
8.4.6 R A *consolidation group* is not prevented from being a *financial conglomerate* because it is part of a wider:
- (1) *consolidation group*; or
 - (2) *financial conglomerate*; or
 - (3) group of persons linked in some other way.

Definition of financial conglomerate: the financial sectors: general

- 3.1.7
8.4.7 R For the purpose of the definition of *financial conglomerate*, there are two *financial sectors* as follows:
- (1) the *banking sector* and the *investment services sector*, taken together; and
 - (2) the *insurance sector*.

- 3.1.8
8.4.8 R (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*.

Definition of financial conglomerate: adjustment of the percentages

3.1.9
8.4.9 R Once a *financial conglomerate* has become a *financial conglomerate* and subject to supervision in accordance with the *Financial Groups Directive*, the figures in the *financial conglomerate definition decision tree* are altered as follows:

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

3.1.10
8.4.10 R The alteration in GENPRU 3.1.98.4.9R 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 3.1.98.4.9R; and
- (2) covers the three years following that date.

Definition of financial conglomerate: balance sheet totals

3.1.11
8.4.11 R The calculations referred to in the *financial conglomerate definition decision tree* regarding the balance sheet must be made on the basis of the aggregated balance sheet total of the members of the *consolidation group*, according to their annual accounts. For the purposes of this calculation, *undertakings* in which a *participation* is held must be taken into account as regards the amount of their balance sheet total corresponding to the aggregated proportional share held by the *consolidation group*. However, where consolidated accounts are available, they must be used instead of aggregated accounts.

Definition of financial conglomerate: solvency requirement

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

Definition of financial conglomerate: discretionary changes to the definition

3.1.13
8.4.13

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

- (1) change the definition of *financial conglomerate* and the obligations applying with respect to a *financial conglomerate*;
- (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
8.4.14

G The capital adequacy provisions of GENPRU 3.1.18.4 are designed to be applied to *EEA-based financial conglomerates*.

3.1.15
8.4.15

G GENPRU 3.1.25.4.25R is a high level capital adequacy *rule*. It applies whether or not the *FSA* is the *coordinator* of the *financial conglomerate* concerned.

3.1.16
8.4.16

G GENPRU 3.1.26.4.26R to GENPRU 3.1.31.4.31R and GENPRU 38 Ann 1R implement the detailed capital adequacy requirements of the *Financial Groups Directive*. They only deal with a *financial conglomerate* for which the *FSA* 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
8.4.17

G 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 3.1.29.4.29R to GENPRU 3.1.31.4.31R and Part 1 of GENPRU 38 Ann 1R.
- (2) Method 2 calculates capital adequacy using a deduction and aggregation approach. It is implemented by GENPRU 3.1.29.4.29R to GENPRU 3.1.31.4.31R and Part 2 of GENPRU 38 Ann 1R.
- (3) Method 3 calculates capital adequacy using book values and the deduction of capital requirements. It is implemented by GENPRU 3.1.29.4.29R to GENPRU 3.1.31.4.31R and Part 3 of GENPRU 38 Ann 1R.

- (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 3.1.268.4.26R to GENPRU 3.1.288.4.28R, GENPRU 3.1.308.4.30R and Part 4 of GENPRU 38 Ann 1R.

3.1.18
8.4.18

- G Part 4 of GENPRU 38 Ann 1R (Use of Method 4 from Annex I of the *Financial Conglomerates Directive*) applies the *FSA's sectoral rules* with respect to the *financial conglomerate* as a whole, with some adjustments. Where Part 4 of GENPRU 38 Ann 1R applies the *FSA'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
8.4.19

- G Paragraph 5.75 of GENPRU 38 Ann 1R (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 *FSA*, 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
8.4.20

- G (1) In the following cases, the *FSA* (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 *FSA*; or
 - (b) the only *relevant competent authority* for the *financial conglomerate* is the *FSA*.
- (2) GENPRU 3.1.288.4.28R automatically applies Method 4 from Annex I of the *Financial Groups Directive* in these circumstances except in the cases set out in GENPRU 3.1.288.4.28R(1)(e) and GENPRU 3.1.288.4.28R(1)(f). The process in GENPRU 3.1.228.4.22G does not apply.

3.1.21
8.4.21

- G Where GENPRU 3.1.208.4.20G 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
8.4.22 G The method of calculating capital adequacy chosen in respect of a *financial conglomerate* as described in GENPRU 3.1.218.4.21G will be applied with respect to that *financial conglomerate* by varying the *Part IV 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 38 Ann 1R is to be applied with respect to that *financial conglomerate*. The powers in the *Act* relating to *waivers* and varying a *firm's Part IV 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 3.18.4 and GENPRU 38 Ann 1R if that is necessary to reflect the consultations referred to in GENPRU 3.1.218.4.21G.
- 3.1.23
8.4.23 G If there is more than one *firm* in a *financial conglomerate* with a *Part IV permission*, the *FSA* would not normally expect to apply the *requirement* described in GENPRU 3.1.228.4.22G to all of them. Normally it will only be necessary to apply it to one.
- 3.1.24
8.4.24 G The *FSA* expects that in all or most cases falling into GENPRU 3.1.218.4.21G, the *rules* in Part 4 of GENPRU 38 Ann 1R will be applied.
- Capital adequacy requirements: high level requirement
- 3.1.25
8.4.25 R (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
8.4.26 R If this *rule* applies under GENPRU 3.1.278.4.27R 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 38 Ann 1R (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
8.4.27 R GENPRU 3.1.268.4.26R 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 3.1.288.4.28R is satisfied; or

- (2) this *rule* is applied to the *firm* with respect to that *financial conglomerate* as described in GENPRU 3.1.308.4.30R.

Capital adequacy requirements: compulsory application of Method 4 from Annex I of the Financial Groups Directive

3.1.28
8.4.28

- R (1) The condition in this *rule* is satisfied for the purpose of GENPRU 3.1.278.4.27R(1) with respect to a *firm* and a *financial conglomerate* of which it is a member (with the result that GENPRU 3.1.268.4.26R 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 *FSA* is *coordinator* of that *financial conglomerate*;
 - (b) the *financial conglomerate* is not part of a wider *FSA regulated EEA financial conglomerate*;
 - (c) the *financial conglomerate* is not an *FSA regulated EEA financial conglomerate* under another *rule* or under paragraph (b) of the definition of *FSA regulated EEA financial conglomerate* (application of supplementary supervision through a *firm's Part IV 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 *FSA*;
 - (e) this *rule* is not disapplied under paragraph 5.75 of GENPRU 38 Ann 1R (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 3.1.268.4.26R applies to a *firm* with respect to a *financial conglomerate* of which it is a member under GENPRU 3.1.278.4.27R(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
8.4.29 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~~8.4.30~~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 IV permission to apply Annex I of the Financial Groups Directive

3.1.30
8.4.30 R With respect to a *firm* and a *financial conglomerate* of which it is a member:

(1) GENPRU 3.1.26~~8.4.26~~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~~8.4.27~~R(2); or

(2) GENPRU 3.1.29~~8.4.29~~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 IV permission* contains a *requirement* obliging the *firm* to comply with GENPRU 3.1.26~~8.4.26~~R or, as the case may be, GENPRU 3.1.29~~8.4.29~~R.

3.1.31
8.4.31 R If GENPRU 3.1.29~~8.4.29~~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~~8~~ Ann 1R is specified in the *requirement* referred to in GENPRU 3.1.30~~8.4.30~~R.

Risk concentration and intra-group transactions: introduction

3.1.32
8.4.32 G GENPRU 3.1.35~~8.4.35~~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
8.4.33 G Articles 7(3) (Risk concentration) and 8(3) (Intra-group transactions) and Annex II (Technical application of the provisions on intra-group transactions and risk concentration) of the *Financial Groups Directive* say that Member States may apply at the level of the *financial conglomerate* the provisions of the *sectoral rules* on *risk concentrations* and *intra-group transactions*. GENPRU 3.1~~8.4~~ does not take up that option, although the *FSA* may impose such obligations on a case by case basis.

Risk concentration and intra-group transactions: application

- 3.1.34
8.4.34 R GENPRU 3.1.358.4.35R 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 an *FSA regulated EEA financial conglomerate*.

Risk concentration and intra group transactions: the main rule

- 3.1.35
8.4.35 R A *firm* must ensure that the *sectoral rules* regarding *risk concentration* and *intra-group transactions* of the *most important financial sector* in the *financial conglomerate* referred to in GENPRU 3.1.348.4.34R are complied with with respect to that *financial sector* as a whole, including the *mixed financial holding company*. The *FSA's sectoral rules* for these purposes are those identified in the table in GENPRU 3.1.368.4.36R.

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

- 3.1.36
8.4.36 R Table: application of sectoral rules
This table belongs to GENPRU 3.1.358.4.35R

The most important financial sector	Applicable sectoral rules	
	Risk concentration	Intra-group transactions
<i>Banking and investment services sector</i>	Rules 3.3.13, 3.3.19 and 3.3.21 of chapter GN of IPRU(BANK) (as they apply to large exposures on a consolidated basis) <u>BIPRU 8.9 (Consolidated concentration risk requirements) including BIPRU TP as it applies to a UK consolidation group.</u>	Rules 3.3.13, 3.3.19 and 3.3.21 of chapter GN of IPRU(BANK) (as they apply to large exposures on a solo basis) <u>BIPRU 10 (Concentration Risk) including BIPRU TP as it applies on a solo basis and relates to BIPRU 10.</u>
<i>Insurance sector</i>	None	<i>Rule 9.39 of IPRU(INS)</i>
<i>Investment services sector</i>	Rule 14.3.2 in Chapter 14 of IPRU(INV)	Rule 10-190 in Chapter 10 of IPRU(INV) as it applies on a solo basis
Note:	The <i>rules</i> as applied in column three apply without any concession or exemption for exposures to other group members.	

The most important financial sector	Applicable sectoral rules	
	Risk concentration	Intra-group transactions
Note	The decision tree in paragraph 4.5 of <u>GENPRU 38 Ann 1R</u> applies for the purpose of identifying the <i>most important financial sector</i> .	
Note	<u>Any waiver granted to a member of the financial conglomerate, on a solo or consolidated basis, shall not apply in respect of the financial conglomerate for the purposes of GENPRU 3.1.36R.</u>	

- 3.1.37 R (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 (1) This rule applies for the purposes of the definitions of:
- (a) a concentration risk group counterparty; and
- (b) a consolidation concentration risk group counterparty;
- as they apply for the purposes of the rules for the banking and investment services sector as applied by GENPRU 3.1.36R.
- (2) For the purposes of BIPRU 3.2.27R(1)(a) and (b) (as they apply to the definition in GENPRU 3.1.38R(1)(a)), the conditions are also satisfied if the counterparty and the firm are included within the scope of consolidated supervision on a full basis with respect to the same financial conglomerate under GENPRU 3.1 or the relevant implementation measures in another EEA State for the Financial Groups Directive.
- (3) Subject to (4), for the purposes of BIPRU 8.9.11R(3) (as it applies to the definition in GENPRU 3.1.38R(1)(b)), the conditions are also satisfied if the counterparty and the firm are included within the scope of consolidated supervision on a full basis with respect to the same financial conglomerate under GENPRU 3.1 or the relevant implementation measures in another EEA State for the Financial Groups Directive.
- (4) BIPRU 8.9.11R(3)(a) does not apply.
- 8.4.37 G The material in IPRU(BANK) that has particular application to the rules in IPRU(BANK) referred to in the table in PRU 8.4.36R is:
- (1) (in the case of column 2) Chapter LE as it applies on a consolidated basis;
- (2) (in the case of column 3) Chapter LE as it applies on a solo basis.

8.4.38 G ~~The table in PRU 8.4.36R does not refer to the rules for building societies as a building society cannot have a mixed financial holding company as a parent.~~

The financial sectors: asset management companies

- ~~3.1.39~~
~~8.4.39~~ 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 3.1.26R~~~~8.4.26R~~ to ~~GENPRU 3.1.36R~~~~8.4.36R~~;
- (b) ~~GENPRU 38~~ Ann 1R (Capital adequacy calculations for financial conglomerates) and ~~GENPRU 38~~ Ann 2R (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 *FSA* 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 *FSA* 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 *FSA* 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
- (b) an asset management company is an investment firm.

3.28.5 Third-country groups

Application

3.2.1
8.5.1 R *GENPRU 3.28.5* 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
8.5.2 G *GENPRU 3.28.5* implements in part Article 18 of the *Financial Groups Directive* and Article ~~143~~^{56a} of the *Banking Consolidation Directive*.

Equivalence

3.2.3
8.5.3 G The first question that must be asked about a *third-country financial group* is whether the *EEA regulated entities* in that *third-country group* are subject to supervision by a *third-country competent authority*, which is equivalent to that provided for by the *Financial Groups Directive* (in the case of a *financial conglomerate*) or the *EEA prudential sectoral legislation* for the *banking sector* or the *investment services sector* (in the case of a *banking and investment group*). Article 18(1) of the *Financial Groups Directive* sets out the process for establishing equivalence with respect to *third-country financial conglomerates* and ~~the first three paragraphs of Article 143 (1) and (2)~~^{56a} of the *Banking Consolidation Directive* does so with respect to *third-country banking and investment groups*.

Other methods: General

3.2.4
8.5.4 G If the supervision of a *third-country group* by a *third-country competent authority* does not meet the equivalence test referred to in *GENPRU 3.2.38.5.3G*, *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
8.5.5 G If the supervision of a *third-country group* by a *third-country competent authority* does not meet the equivalence test referred to in GENPRU 3.2.38.5.3G, a *competent authority* may, rather than take the measures described in GENPRU 3.2.48.5.4G, 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
8.5.6 G The *FSA* believes that it will only be right to adopt the option in GENPRU 3.2.58.5.5G in response to very unusual group structures.
- 3.2.7
8.5.7 G GENPRU 3.2.88.5.8R and GENPRU 3.2.98.5.9R and GENPRU 38 Ann 2 set out *rules* to deal with the situation covered in GENPRU 3.2.58.5.5G. Those *rules* do not apply automatically. Instead, they can only be applied with respect to a particular *third-country group* through the *Part IV permission* of a *firm* in that *third-country group*. Broadly speaking the procedure described in GENPRU 3.1.228.4.22G also applies to this process.

Supervision by analogy: rules for third-country conglomerates

- 3.2.8
8.5.8 R If the *Part IV 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 38 Ann 2R, as adjusted by Part 3 of that annex.

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

- 3.2.9
8.5.9 R If the *Part IV 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 38 Ann 2R, as adjusted by Part 3 of that annex.

GENPRU 38 Ann 1R

Capital adequacy calculations for financial conglomerates (GENPRU 3.1.268-4.26R and GENPRU 3.1.298-4.29R)

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

Capital resources	1.1	The <i>conglomerate capital resources</i> of a <i>financial conglomerate</i> calculated in accordance with this Part are the capital of that <i>financial conglomerate</i> , calculated on an accounting consolidation basis, that qualifies under paragraph 1.2.	
	1.2	The elements of capital that qualify for the purposes of paragraph 1.1 are those that qualify in accordance with the <i>applicable sectoral rules</i> , in accordance with the following:	
		(1)	the <i>conglomerate capital resources requirement</i> is divided up in accordance with the contribution of each <i>financial sector</i> to it; and
		(2)	the portion of the <i>conglomerate capital resources requirement</i> attributable to a particular <i>financial sector</i> must be met by capital resources that are eligible in accordance with the <i>applicable sectoral rules</i> for that <i>financial sector</i> .
Capital resources requirement	1.3	The <i>conglomerate capital resources requirement</i> of a <i>financial conglomerate</i> calculated in accordance with this Part is equal to the sum of the capital adequacy and solvency requirements for each <i>financial sector</i> calculated in accordance with the <i>applicable sectoral rules</i> for that <i>financial sector</i> .	
Consolidation	1.4	The information required for the purpose of establishing whether or not a <i>firm</i> is complying with <u>GENPRU 3.1.298-4.29R</u> (insofar as the definitions in this Part are applied for the purpose of that <i>rule</i>) must be based on the consolidated accounts of the <i>financial conglomerate</i> , together with such other sources of information as appropriate.	
	1.5	The <i>applicable sectoral rules</i> that are applied under this Part are the <i>applicable sectoral consolidation rules</i> . Other <i>applicable sectoral rules</i> must be applied if required.	

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

Capital resources	2.1	<p>The <i>conglomerate capital resources</i> of a <i>financial conglomerate</i> calculated in accordance with this Part are equal to the sum of the following amounts (so far as they qualify under paragraph 2.3) for each member of the <i>overall financial sector</i>:</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.</p>
	2.2	<p>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.</p>
	2.3	<p>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>.</p>
Capital resources requirement	2.4	<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 <i>solo capital resources requirement</i> for each member of the <i>financial conglomerate</i> that is in the <i>overall financial sector</i>.</p>
Partial inclusion	2.5	<p>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.</p>
Accounts	2.6	<p>The information required for the purpose of establishing whether or not a <i>firm</i> is complying with <u>GENPRU 3.1.298.4.29R</u> (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.</p>

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.
	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	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>(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 <u>GENPRU 3.1.298.4-29R</u> (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 3.1.268.4.26R are those relating to capital adequacy and solvency set out in the table in paragraph 4.2.
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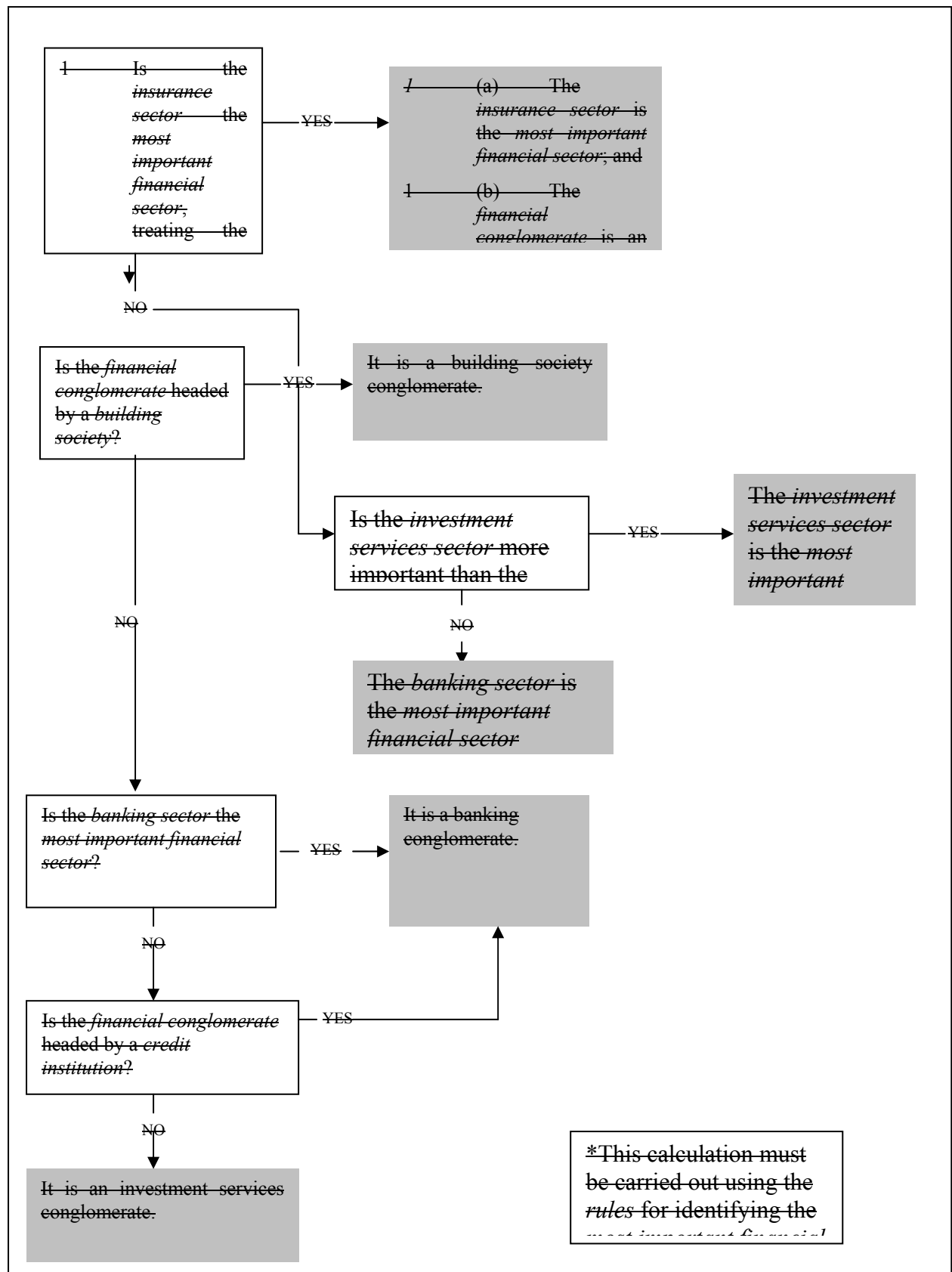
- 5 Table: Paragraph 4.2: Application of sectoral consolidation rules

Type of financial conglomerate	Applicable sectoral consolidation rules
<i>Banking and investment services conglomerate</i>	BIPRU 8 and BIPRU TP, subject to paragraph 4.5 <i>IPRU(BANK) Chapter GN rule 3.3.13 (as it applies on a consolidated basis), subject to paragraph 4.7.</i>
<i>Insurance conglomerate</i>	INSPRU 6.1 <i>PRU 8.3</i> amended in accordance with Part 5.
<i>Building society conglomerate</i>	IPRU(BSOC) (Volume 1) Chapter 1, rule 1.2.1 (as it applies on a consolidated basis).
<i>Investment services conglomerate</i>	Chapter 14 of <i>IPRU(INV)</i> .

<p><u>Types of financial conglomerate</u></p>	<p>4.3</p>	<p>(1) <u>This paragraph sets out how to determine the category of <i>financial conglomerate</i> for the purposes of paragraphs 4.1 and 4.2.</u></p> <p>(2) <u>If there is an <i>EEA regulated entity</i> at the head of the <i>financial conglomerate</i>, then:</u></p> <p>(a) <u>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</u></p> <p>(b) <u>if that entity is in the <i>insurance sector</i>, the <i>financial conglomerate</i> is an <i>insurance conglomerate</i>.</u></p> <p>(3) <u>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>.</u></p> <p>(4) <u>If (2) and (3) does not apply, it is an <i>insurance conglomerate</i>.</u></p>
<p>How to apply chapter 14 of IPRU(INV)</p>	<p>4.3</p>	<p>Where chapter 14 of <i>IPRU(INV)</i> applies:</p> <p>(1) the <i>main investment services undertaking</i> is treated as being the main firm for the purpose of rule 14.4.2 of chapter 14 of <i>IPRU(INV)</i>;</p> <p>(2) if the <i>main investment services undertaking</i> is not subject to any of the <i>FSA's sectoral rules</i> applied by chapter 14 of <i>IPRU(INV)</i>, then the <i>FSA's sectoral rules</i> that are applied are those that would do so if:</p> <p>(a) it were a <i>UK domestic firm</i>; and</p> <p>(b) it had a <i>permission</i> that includes all the <i>regulated activities</i> that it would need to have in its <i>Part IV permission</i> if it carried on all its activities in the <i>United Kingdom</i>.</p>
<p>The different types of financial conglomerate</p>	<p>4.4</p>	<p>(1) The decision tree in paragraph 4.5:</p> <p>(a) decides into which of the categories listed in the table in paragraph 4.2 a <i>financial conglomerate</i> falls; and</p> <p>(b) modifies the definition of the <i>most important financial sector</i> for the purposes of <i>PRU 8 Ann 1R</i> and for the purposes of any other provision in <i>PRU 8 (Group risk)</i> that applies that decision tree.</p>

(2) Paragraph 6.1(2) (*financial institution allocated to the banking sector*) and paragraph 6.1(3) (*allocation of asset management companies*) apply for the purpose of 4.4 and the table in paragraph 4.5.

7 Table: Paragraph 4.5: Types of financial conglomerate and definition of most important financial sector



8 Table

A mixed financial holding company	4.46	<p>A <i>mixed financial holding company</i> must be treated in the same way as:</p> <ol style="list-style-type: none"> (1) a <i>financial holding company</i> (if the rules in <u>BIPRU 8 IPRU(BANK)</u> or <u>IPRU(INV)</u> are applied; or (2) an <i>insurance holding company</i> (if the rules in <u>INSPRU 6.1 PRU 8.3</u> are applied).
E-money	4.57	<p>If there are no <i>full credit institutions</i> or <i>investment firms</i> in a <i>banking and investment services conglomerate</i> but there are one or more <i>e-money issuers</i>, the <i>sectoral rules</i> in <u>BIPRU 8 IPRU(BANK)</u> are amended as follows :</p> <ol style="list-style-type: none"> (1) the rules in <i>ELM</i> that apply on a solo basis must be used to establish the capital requirement for the <i>e- money issuers</i>; and (2) for the purpose of (1), those rules in <i>ELM</i> shall be amended by calculating the amount of the deductions in respect of <i>ownership shares</i> and capital falling into <i>ELM 2.4.17R(6)</i> in accordance with paragraph 3.3(2).

9 Table: PART 5: Principles applicable to all methods

Transferability of capital	5.1	<p>Capital may not be included in:</p> <ol style="list-style-type: none"> (1) a <i>firm's conglomerate capital resources</i> under <u>GENPRU 3.1.298-4.29R</u>; or (2) in the capital resources of the <i>financial conglomerate</i> for the purposes of <u>GENPRU 3.1.268-4.26R</u>; <p>if the effectiveness of the transferability and availability of the capital across the different members of the <i>financial conglomerate</i> is insufficient, given the objectives (as referred to in the third unnumbered sub-paragraph of paragraph 2(ii) of Annex I of the <i>Financial Groups Directive</i> (Technical principles)) of the capital adequacy rules for <i>financial conglomerates</i>.</p>
Double counting	5.2	<p>Capital must not be included in:</p>

<p>Cross sectoral capital</p>	<p>(1) a <i>firm's conglomerate capital resources</i> under <u>GENPRU 3.1.298.4.29R</u>; or</p> <p>(2) the capital resources of the <i>financial conglomerate</i> for the purposes of <u>GENPRU 3.1.268.4.26R</u>;</p> <p>if:</p> <p>(3) it would involve double counting or multiple use of the same capital; or</p> <p>(4) it results from any inappropriate intra-group creation of capital.</p> <p>5.3 In accordance with the second sub-paragraph of paragraph 2(ii) of Section I of Annex I of the <i>Financial Groups Directive</i> (Other technical principles and insofar as not already required in Parts 1-3):</p> <p>(1) the solvency requirements for each different <i>financial sector</i> represented in a <i>financial conglomerate</i> required by <u>GENPRU 3.1.268.4.26R</u> or, as the case may be, <u>GENPRU 3.1.298.4.29R</u> must be covered by own funds elements in accordance with the corresponding <i>applicable sectoral rules</i>; and</p> <p>(2) if there is a deficit of own funds at the <i>financial conglomerate</i> level, only cross sectoral capital (as referred to in that sub-paragraph) shall qualify for verification of compliance with the additional solvency requirement required by <u>GENPRU 3.1.268.4.26R</u> or, as the case may be, <u>GENPRU 3.1.298.4.29R</u>.</p>
<p>Application of sectoral rules; <u>General</u></p>	<p>5.4 The following adjustments apply to the <i>applicable sectoral rules</i> as they are applied by the <i>rules</i> in this annex.</p> <p>(1) The scope of those <i>rules</i> will be extended to cover any <i>mixed financial holding company</i> and each other member of the <i>overall financial sector</i>.</p> <p>(2) If any of those <i>rules</i> would otherwise not apply to a situation in which they are applied by <u>GENPRU 38 Ann 1R</u>, those <i>rules</i> nevertheless still apply (and in particular, any of those <i>rules</i> that would otherwise have the effect of disapplying consolidated supervision (or, in the case of the <i>insurance sector</i>, supplementary supervision) do not apply).</p> <p>(3) (If it would not otherwise have been included) an <i>ancillary investment services undertaking</i> is included in the <i>investment services sector</i>.</p>

Application
of sectoral
rules:
Insurance
sector

5.5

- (3) (If it would not otherwise have been included) an *ancillary insurance services undertaking* is included in the *insurance sector*.
- 4) ~~(In relation to the *insurance sector*) 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 drafted by reference to assets and liabilities into a hard limit requiring capital to be held at or above specified levels. 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 (5).~~
- (46) The scope of ~~the~~ those *rules* is amended so as to remove restrictions relating to where members of the *financial conglomerate* 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*.
- (57) (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

		<p style="text-align: center;"><u>net assets of an amount at or above certain levels;</u></p> <p><u>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.</u></p>
<p><u>Application of sectoral rules:</u> <u>Banking sector and investment services sector</u></p>	<p>5.6</p>	<p><u>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.</u></p> <ol style="list-style-type: none"> (1) <u>References in those rules to non-EEA sub-groups do not apply.</u> (2) <u>(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.</u> (3) <u>Any investment firm consolidation waivers granted to members of the financial conglomerate do not apply.</u> (4) <u>(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 approach permission that applies for the purpose of BIPRU 8 does not apply.</u> (5) <u>(For the purposes of Parts 1 to 4), BIPRU 8.5.9R and BIPRU 8.5.10R do not apply.</u> (6) <u>(For the purposes of Parts 1 to 4), where the financial conglomerate does not include a credit institution, the method in GENPRU 2 Annex 4R must be used for calculating the capital resources and BIPRU 8.6.8R does not apply.</u>
<p>No capital ties</p>	<p>5.7 5</p>	<p>(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 <u>GENPRU 3.1.288-4.28R(1)</u> (Capital adequacy requirements: Compulsory application of Method 4</p>

from Annex I of the Financial Groups Directive).

(2) If:

- (a) GENPRU 3.1.268.4.26R (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 3.1.288.4.28R; 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 3.1.288.4.28R continues to apply. Otherwise GENPRU 3.1.288.4.28R does not apply with respect to a *financial conglomerate* falling into (1).

(3) If GENPRU 3.1.288.4.28R applies with respect to a *financial conglomerate* in accordance with (2) the peripheral members must be excluded from the calculations under GENPRU 3.1.268.4.26R.

(4) If:

- (a) GENPRU 3.1.268.4.26R applies with respect to a *financial conglomerate* falling into (1) under GENPRU 3.1.278.4.27R(2) (Use of *Part IV permission* to apply Annex I of the *Financial Groups Directive*); or
- (b) GENPRU 3.1.298.4.49R (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 3.1.308.4.30R; and
- (d) GENPRU 3.1.268.4.26R or GENPRU 3.1.298.4.29R, 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 3.1.268.4.26R applies to a *firm* with respect to a *financial conglomerate* of which it is a member under GENPRU 3.1.278.4.27R(1) (automatic application of Method 4 from Annex I of the *Financial Groups Directive* on satisfaction of the condition in GENPRU 3.1.288.4.28R), the disapplication of GENPRU 3.1.288.4.28R under (2) ceases to apply with respect to that *financial conglomerate*.

<p>Defining the financial sectors</p>	<p>6.1</p>	<p>For the purposes of Parts 1 to 3 of this annex (but, unless specified otherwise in paragraph 4.4, not for the purposes of the definition of <i>most important financial sector</i>):</p> <p>(1) the banking sector and the investment services sector are considered separately;</p> <p>(2) if a financial institution could otherwise fall into both the banking sector and the investment services sector, it must be allocated to the banking sector;</p> <p>(13) an asset management company is allocated in accordance with GENPRU 3.1.398.4.39R; and</p> <p>(24) a mixed financial holding company must be treated as being a member of the most important financial sector.</p>
<p><u>Solo capital resources requirement: Banking sector and investment service sector</u></p>	<p>6.2</p>	<p>(1) <u>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.</u></p> <p>(2) <u>The solo capital resources requirement of a building society is its CRR.</u></p> <p>(3) <u>The solo capital resources requirement of an e-money issuer is:</u></p> <p>(a) <u>(in the case of ELMI) the capital resources requirement that applies to it under ELM; or</u></p> <p>(b) <u>(in any other case) the capital resources requirement that would apply to it under ELM if it were an ELMI incorporated in the United Kingdom.</u></p> <p>(4) <u>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.</u></p> <p>(5) <u>If:</u></p>

- (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 calculated in accordance with the rules for calculating the CRR of:

- (d) (if there is a limited activity firm in the financial conglomerate), a BIPRU limited activity firm; or
- (e) (in any other case), a BIPRU limited licence firm.

(6) If:

- (a) the financial conglomerate does not include a credit institution; and
- (b) (5) does not apply;

the solo capital resources requirement for any undertaking in the banking sector or the investment services sector is calculated in accordance with the rules for calculating the CRR of a full scope BIPRU investment firm.

(7) Any CRR calculated under a BIPRU TP may be used for the purposes of the solo capital resources requirement in this rule in the same way that the CRR can be used under BIPRU 8.

Solo capital resources requirement: application of rules

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

Solo capital resources requirement: Insurance sector

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

(2) Subject to (3), the solo capital resources requirement of an undertaking in the insurance sector is the capital resources

		<p>requirement identified in <i>INSPRU</i> 6.1.34R (1) to (8) as applying to that <i>undertaking</i>.</p> <p>(3) <u><i>INSPRU</i> 6.1.34R (1)(b) does not apply for the purposes of this annex.</u></p>
<p><u>Solo capital resources requirement: EEA firms in the banking sector or investment services sector</u></p>	<p>6.5</p>	<p><u>The solo capital resources requirement for an EEA regulated entity (other than a BIPRU firm, an insurer or an EEA insurer) that is subject to the solo capital adequacy sectoral rules for its financial sector of the competent authority that authorised it is equal to the amount of capital it is obliged to hold under those sectoral rules provided that the following conditions are satisfied:</u></p> <p>(1) <u>(for the purposes of the banking sector and the investment services sector) those sectoral rules must correspond to the FSA's sectoral rules identified in paragraph 6.2 as applying to that financial sector;</u></p> <p>(2) <u>the entity must be subject to those sectoral rules in (1); and</u></p> <p>(3) <u>paragraph 6.3 applies to the entity and those sectoral rules.</u></p>
<p><u>Solo capital resources requirement: non-EEA firms subject to equivalent regimes in the banking sector or investment services sector</u></p>	<p>6.6</p>	<p><u>The solo capital resources requirement for a recognised third country credit institution or a recognised third country investment firm is the amount of capital resources that it is obliged to hold under the sectoral rules for its financial sector that apply to it in the state or territory in which it has its head office provided that:</u></p> <p>(1) <u>there is no reason for the firm applying the rules in this annex to believe that the use of those sectoral rules would produce a lower figure than would be produced under paragraph 6.2; and</u></p> <p>(2) <u>paragraph 6.3 applies to the entity and those sectoral rules.</u></p>
<p>Solo capital resources requirement: mixed financial holding</p>	<p>6.7 4</p>	<p>The solo capital resources requirement of a mixed financial holding company is a notional capital requirement. It is the capital adequacy requirement that applies to regulated entities in the most important financial sector under the table in paragraph 6.108.</p>

company		
Solo-capital resources requirement: UK-domestic firms	6.2	The <i>solo-capital resources requirement</i> for a <i>regulated entity</i> that is a <i>UK domestic firm</i> is its solo-regulatory capital requirement under the <i>FSA's sectoral rules</i> for its <i>financial sector</i> applicable to it.
Solo-capital resources requirement: EEA firms	6.3	The <i>solo-capital resources requirement</i> for an <i>EEA regulated entity</i> that is subject to the solo-capital adequacy <i>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 resources it is obliged to hold under those <i>sectoral rules</i> .
Solo-capital resources requirement: non-EEA firms subject to equivalent regimes	6.5	<p>The <i>solo-capital resources requirement</i> for a <i>regulated entity</i> that:</p> <ul style="list-style-type: none"> (1) does not fall into paragraphs 6.2 to 6.4; (2) is subject to any of the <i>sectoral rules</i> referred to in paragraph 6.6 applicable to its <i>financial sector</i>; and (3) is incorporated in and has its head-office in: <ul style="list-style-type: none"> (a) (where the <i>sectoral rules</i> in (2) are for the <i>banking sector</i> or the <i>investment services sector</i>) the same state or territory as the regulator for those <i>sectoral rules</i>, as referred to in paragraph 6.6(1) or 6.6(2)); or (b) (where the <i>sectoral rules</i> in (2) are for the <i>insurance sector</i>) the designated state or territory in question, as referred to in 6.6(3);
		is equal to the amount of capital resources it is obliged to hold under those <i>sectoral rules</i> . However, where 3(b) would otherwise apply, paragraph 6.7 may be applied instead.
	6.6	The <i>sectoral rules</i> referred to in paragraph 6.5 are:
		(1) (for the <i>banking sector</i>) the <i>sectoral rules</i> of or administered by one of the regulators listed in Appendix D of chapter CS of <i>IPRU(BANK)</i> ;
		(2) (for the <i>investment services sector</i>) the <i>sectoral rules</i> of or administered by one of the regulators listed in Appendix 59 of chapter 10 of <i>IPRU(INV)</i> ; and
		(3) (for the <i>insurance sector</i>) the <i>sectoral rules</i> of the states or territories referred to in the definition of designated states or territories in chapter 11 of <i>IPRU(INS)</i> (Definitions), but

<p>Solo capital resources: other members</p>	<p style="text-align: center;">excluding EEA States.</p> <p>6.7 The solo capital resources requirement for:</p> <p>(1) any of the following:</p> <ul style="list-style-type: none"> (a) a UK domestic firm; (b) an EEA regulated entity; or (c) a regulated entity that is incorporated in and has its head office in one of the states or territories referred to in paragraphs 6.5; <p>that is not subject to the solo capital adequacy sectoral rules referred to in paragraph 6.2, 6.3, or 6.6 (including in a case in which this paragraph applies under (i) of the definition of sectoral rules); and</p> <p>(2) any member of a financial conglomerate in the overall financial sector otherwise not treated under paragraphs 6.2 to 6.6;</p> <p>is a notional capital requirement. It is the capital resources requirement that would apply to it under the following rules:</p> <ul style="list-style-type: none"> (3) (in the case of an asset management company) the rules in Chapter 7 of IPRU(INV); and (4) (in any other case), the rules applicable to its financial sector under the table in paragraph 6.8.
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11 Table: Paragraph 6.8: The FSA's sectoral rules for the solo capital resources requirement

Financial sector	FSA's sectoral rules
<i>Banking sector</i>	The <i>FSA's sectoral rules for banks</i> , except that <i>e-money issuers</i> are subject to <i>ELM</i> .
<i>Insurance sector</i>	The <i>FSA's sectoral rules for insurance undertakings</i> .
<i>Investment services sector</i>	(1) The <i>rules in IPRU(INV)</i> that would apply on the assumptions in paragraph 4.3(2). (2) (If (1) does not result in the application of any <i>rules in IPRU(INV)</i>) the <i>rules in IPRU(INV)</i> that would be applied to it under <i>rule 14.5.2 of Chapter 14 of IPRU(INV)</i> (<i>Group financial resources requirement</i>).

12 Table

Solo capital resources requirement: the insurance sector	6.8 ⁹	References to capital requirements in the provisions of <i>GENPRU 38 Ann 1R</i> defining <i>solo capital resources requirement</i> must be interpreted in accordance with paragraph 5.4 (5) .
Applicable sectoral consolidation rules	6.9 ¹⁰	The <i>applicable sectoral consolidation rules</i> for a <i>financial sector</i> are the <i>FSA's sectoral rules</i> about capital adequacy and solvency on a consolidated basis that are applied in the table in paragraph 6.10 4 .

13 Table: Paragraph 6.104: Application of sectoral consolidation rules

Financial sector	Type of financial conglomerate	FSA's sectoral rules
<i>Banking sector</i>	<i>Building society conglomerate</i>	The rules for building societies.
	Any other type	The rules for banks - <u>BIPRU 8 and BIPRU TP</u> , as adjusted under paragraph 4.5
<i>Insurance sector</i>	N/A	The rules for insurance undertakings-INSRU 6.1.
<i>Investment services sector</i>	N/A	The rules for investment firms BIPRU 8 and BIPRU TP
Note 1: Paragraph 4.6 applies for the purposes of those rules.		

14 Table:

Applicable sectoral consolidation rules (contd.) <u>Part 5</u>	6.12 <u>1</u>	<p>The rules referred to in the third column of the table in paragraph 6.11 are as follows: <u>This Part 6 is subject to Part 5 of this Annex.</u></p> <p>(1) the rules for building societies are the ones for <i>building society conglomerates</i> listed in the table in paragraph 4.2;</p> <p>(2) the rules for banks are the ones for <i>banking conglomerates</i> listed in the table in paragraph 4.2 as adjusted under paragraph 4.7;</p> <p>(3) the rules for insurance undertakings are whichever of the ones for <i>insurance conglomerates</i> that are applied by the table in paragraph 4.2; and</p> <p>(4) the rules for investment firms are the ones for <i>investment services conglomerates</i> listed in the table in paragraph 4.2 as applied under paragraph 4.3 (How to apply chapter 14 of IPRU(INV)).</p>
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GENPRU 38 Ann 2R

Prudential rules for third country groups (GENPRU 3.2.88.5.8R to GENPRU 3.2.98.5.9R)

1 Table: PART 1: Third-country financial conglomerates

1.1	This Part of this annex sets out the <i>rules</i> with which a <i>firm</i> must comply under <u>GENPRU 3.2.88.5.8R</u> with respect to a <i>financial conglomerate</i> of which it is a member.
1.2	A <i>firm</i> must comply, with respect to the <i>financial conglomerate</i> referred to in paragraph 1.1, with whichever of <u>GENPRU 3.1.268.4.26R</u> and <u>GENPRU 3.1.298.4.29R</u> is applied under paragraph 1.3.
1.3	For the purposes of paragraph 1.2: <ol style="list-style-type: none">(1) the <i>rule</i> in <u>GENPRU 3.18.4</u> that applies as referred to in paragraph 1.2 is the one that is specified by the <i>requirement</i> referred to in <u>GENPRU 3.2.88.5.8R</u>;(2) (where <u>GENPRU 3.1.298.4.29R</u> is applied) the definitions of <i>conglomerate capital resources</i> and <i>conglomerate capital resources requirement</i> that apply for the purposes of that <i>rule</i> are the ones from whichever of Part 1, Part 2 or Part 3 of <u>GENPRU 38 Ann 1R</u> is specified in that <i>requirement</i>; and(3) the <i>rules</i> so applied (including those in <u>GENPRU 38 Ann 1R</u>) are adjusted in accordance with paragraph 3.1.
1.4	If the condition in Articles 7(4) and 8(4) of the <i>Financial Groups Directive</i> is satisfied (the <i>financial conglomerate</i> is headed by a <i>mixed financial holding company</i>) with respect to the <i>financial conglomerate</i> referred to in paragraph 1.1 the <i>firm</i> must also comply with <u>GENPRU 3.1.358.4.35R</u> (as adjusted in accordance with paragraph 3.1) with respect to that <i>financial conglomerate</i> .
1.5	A <i>firm</i> must comply with the following with respect to the <i>financial conglomerate</i> referred to in paragraph 1.1: <ol style="list-style-type: none">(1) <u>SYSC 12 PRU 8.1</u> (as it applies to <i>financial conglomerates</i> and as adjusted under paragraph 3.1); and(2) <u>GENPRU 3.1.258.4.25R</u>.

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

2.1	This Part of this annex sets out the <i>rules</i> with which a <i>firm</i> must comply under GENPRU 3.2.98.5.9R with respect to a <i>third-country banking and investment group</i> of which it is a member.
2.2	A <i>firm</i> must comply with one of the sets of <i>rules</i> specified in paragraph 2.3 as adjusted under paragraph 3.1 with respect to the <i>third-country banking and investment group</i> referred to in paragraph 2.1.
2.3	The <i>rules</i> referred to in paragraph 2.2 are as follows: <ol style="list-style-type: none"> (1) the <i>applicable sectoral consolidation rules</i> in BIPRU 8IPRU(BANK); or (2) the applicable sectoral consolidation rules for the investment services sector; or (23) the <i>rules</i> in <i>ELM 7</i>.
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 PRU 8.1 (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: <ol style="list-style-type: none"> (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>.
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GENPRU 38 Ann 3G: CLASSIFICATION OF GROUPS (GENPRU 3.1.38.4.3G)

(form ref)

Part 1 : General Information

A	Name of Group:																									
B	Name of FSA supervisor:																									
C	Name of entity at head of the group:																									
D	Type of entity at head of the group: (select one of D1, D2, D3 and D4)	<table border="0" style="width: 100%;"><tr><td style="border: 1px solid black; width: 30px; text-align: center;">D1</td><td style="padding-left: 10px;">EU regulated entity country of authorisation</td><td style="border: 1px solid black; width: 180px; height: 30px;"></td></tr><tr><td style="border: 1px solid black; width: 30px; text-align: center;">(a)</td><td style="padding-left: 10px;">Credit institution</td><td style="border: 1px solid black; width: 30px; height: 20px;"></td></tr><tr><td style="border: 1px solid black; width: 30px; text-align: center;">(b)</td><td style="padding-left: 10px;">Investment firm</td><td style="border: 1px solid black; width: 30px; height: 20px;"></td></tr><tr><td style="border: 1px solid black; width: 30px; text-align: center;">(c)</td><td style="padding-left: 10px;">Insurance firm</td><td style="border: 1px solid black; width: 30px; height: 20px;"></td></tr><tr><td colspan="3" style="text-align: right; padding-right: 10px;">(tick one)</td></tr><tr><td style="border: 1px solid black; width: 30px; text-align: center;">D2</td><td style="padding-left: 10px;">EU non-regulated entity country of location</td><td style="border: 1px solid black; width: 180px; height: 30px;"></td></tr><tr><td style="border: 1px solid black; width: 30px; text-align: center;">D3</td><td style="padding-left: 10px;">Non-EU regulated entity country of authorisation</td><td style="border: 1px solid black; width: 180px; height: 30px;"></td></tr><tr><td style="border: 1px solid black; width: 30px; text-align: center;">D4</td><td style="padding-left: 10px;">Non- EU non-regulated entity country of location</td><td style="border: 1px solid black; width: 180px; height: 30px;"></td></tr></table>	D1	EU regulated entity country of authorisation		(a)	Credit institution		(b)	Investment firm		(c)	Insurance firm		(tick one)			D2	EU non-regulated entity country of location		D3	Non-EU regulated entity country of authorisation		D4	Non- EU non-regulated entity country of location	
D1	EU regulated entity country of authorisation																									
(a)	Credit institution																									
(b)	Investment firm																									
(c)	Insurance firm																									
(tick one)																										
D2	EU non-regulated entity country of location																									
D3	Non-EU regulated entity country of authorisation																									
D4	Non- EU non-regulated entity country of location																									
E	Year-end for group consolidation purposes																									

Part 2 : Threshold Information

F1	Is at least one of the entities in the group within the insurance sector and at least one in the banking/investment sector?	<input type="checkbox"/> Yes	<input type="checkbox"/> No (go to part 3)
F2	For D2 & D4 groups only: enter the ratio of the balance sheet total of the financial sectors in the group to the balance sheet total of the group as a whole. <i>Enter percentage in box*.</i>	<input type="text"/>	%
F3	What is the smallest financial sector?	<input type="checkbox"/>	Insurance
		<input type="checkbox"/>	Banking/Investment
F4	Ratio of balance sheet total of smallest financial sector to the balance sheet total of the financial sector entities in the group. <i>Enter percentage in box*.</i>	<input type="text"/>	%
F5	Ratio of the solvency requirement of the smallest financial sector to the solvency requirements of the total financial sector entities in the group. <i>Enter percentage in box*.</i>	<input type="text"/>	%
F6	What is the balance sheet total of the smallest financial sector in the group (identified in F3)*?	<input type="text"/>	(€'m)

*see guidance notes on a recommended method of calculation

Part 3: Conclusion on reason for becoming a financial conglomerate

G Select **ONE** of the following based on the answers in section 1 & 2.

If answer to F1 is NO or if none of the following are met then select type Z:

Z		Not a conglomerate.
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If the group is category D1 or D3 and the average of F4 and F5 is greater than 10% then select type i.

i		Conglomerate headed by a regulated institution with significant cross sector activities. [article 3(2)]
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If the group is category D1 or D3 and the average of F4 and F5 is less than 10% but F6 is greater than €6bn then select ii.

ii		Possible conglomerate headed by a regulated institution with presumed significant cross sector activities. [article 3(3)]
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If the group is category D2 or D4 and the answer to F2 is greater than 40% AND the average of F4 and F5 is greater than 10% then select type iii.

iii		Conglomerate headed by non-regulated entity with significant cross sector activities. [article 3(1) & 3(2)]
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If the group is category D2 or D4 and the answer to F2 is greater than 40% AND the average of F4 and F5 is less than 10% but F6 is greater than €6bn then select type iv.

iv		Possible conglomerate headed by non-regulated entity with presumed significant cross sector activities. [article 3(1) & 3(3)]
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Part 4: Other relevant information

H1	<p>Who do you think are the relevant competent authorities for your group (i.e. supervisors in EEA States in which the group has significant regulated activity)?</p> <p>See article 2 (17)(a) for definition of relevant competent authorities.</p>	
H2	<p>Who do you think should be the likely coordinator for the group (i.e. EEA supervisor of the group's most important regulated activity in the EU)?</p> <p>See article 10(1) and 10(2).</p>	
H3	<p>Do you consider that balance sheet value and solvency requirements were an appropriate criterion to determine whether a group is financial and whether cross sector activities exist? If not, do you consider there are other parameters (as referred to in article 3(5)) that would be more appropriate?</p>	
H4	<p>Do you have any other relevant comments?</p> <p>(use continuation sheet if necessary)</p>	

GENPRU 38 Ann 3G: Guidance Notes for Classification of Groups

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 FSA 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 FSA 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 FSA'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 IPRU Banks CS 10 Appendix A
 - **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 FSA 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 FSA 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 FSA that would apply to the type of entity ~~(that is EEA prudential sectoral legislation—see Glossary)~~. However, you can use EEA rules or local rules in the circumstances set out in Part 6 of GENPRU 3 Ann 1R. ~~for convenience, you may choose to use either EEA rules, FSA rules or local rules.~~ 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 FSA. 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 FSA 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. ~~Required Minimum Margin:~~

(a) ~~UK firms, Form 9: for general insurance business = capital resources requirement [line 29]; for long term insurance business = capital resources requirement (higher of Minimum Capital Requirement and Enhanced Capital Resources Requirement) [line 52].~~

(b) ~~Overseas firms, either:~~

- ~~• the local requirement*;~~
- ~~• the EU minimum; or~~
- ~~• the FSA requirement.~~

~~* N.B. local requirements may only be used if they are at least equivalent to the EU minimum (designated states or territories). However, local requirements of a non-designated state or territory may be used if the resulting ratio in F5 is significantly below the 10% threshold (for this purpose "significantly below" may be taken to mean <5%).~~

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:

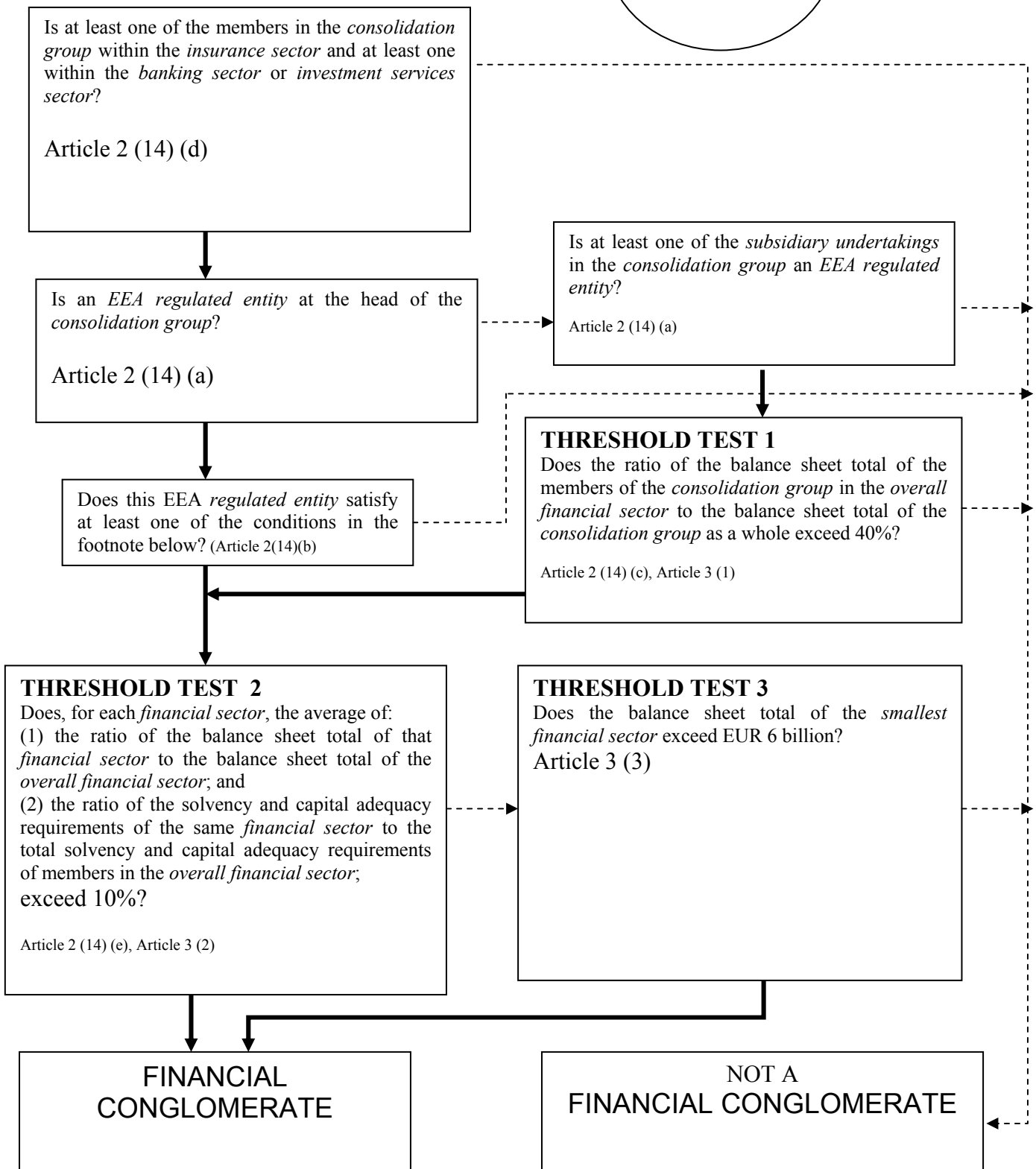
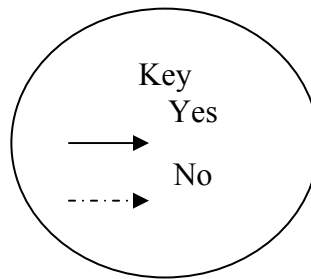
$$(B\% + D\%)/2 = BI\%$$

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%

GENPRU 38 Ann 4R (see GENPRU 3.18.4.5R)



Footnote: The conditions are that the *EEA regulated entity* at the head of the *consolidation group*:

(1) is a *parent undertaking* of a member of the *consolidation group* in the *overall financial sector*;

- (2) has a *participation* in a member of the *consolidation group* that is in the *overall financial sector*; or
- (3) has a *consolidation Article 12(1) relationship* with a member of the *consolidation group* that is in the *overall financial sector*.