

Policy Statement | PS7/13

Strengthening capital standards: implementing CRD IV, feedback and final rules

December 2013



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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This Policy Statement contains the final rules and supervisory statements to implement CRD IV

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1 Introduction

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to the responses to Consultation Paper 5/13 (the CP) and Chapters 7–9 of Occasional Consultation Paper 8/13 (the OCP), jointly the CPs. It should be read in conjunction with those documents. The PS contains the final rules and supervisory statements implementing the Capital Requirements Directive (2013/36/EU) (CRD) and the Capital Requirements Regulation (575/2013) (CRR), jointly CRD IV. It is relevant to banks, building societies, and PRA designated investment firms.

Feedback to responses

1.2 The PRA is required by the Financial Services and Markets Act 2000 (FSMA) to have regard to any representations made to the proposals in the consultation, and publish an account, in general terms, of those representations and its response to them.

1.3 The PRA received 31 responses to the CP and eight to the relevant chapters of the OCP.

1.4 The PS follows the same chapter structure as CP5/13. The responses and feedback to OCP Chapter 8 (Remuneration), and Chapter 9 (Initial capital exemption for small credit institutions), have been included in the Governance and Definition of Capital sections respectively. The PRA received no responses to Chapter 7 (Consequential and minor amendments) and will be making the changes to the rules and processes as proposed in the OCP. Where relevant, each section includes:

- Policy feedback: commenting on the most significant issues raised by respondents and noting those areas where the PRA is making a substantive change to the proposals contained in the CPs. Where an issue is not addressed, the PRA is maintaining the policy approach set out in the CPs;
- Clarifications: where the PRA considers it appropriate to use this PS to clarify issues of uncertainty raised in responses to the CPs;
- Ongoing policy development: in the CPs the PRA noted certain dependencies on ongoing work, both in the United Kingdom and at the European level. Where relevant, the PRA provides an update on this ongoing policy development in this subsection.

1.5 Several respondents raised questions about the timing and development of outputs that are the responsibility of the European Banking Authority (EBA), such as technical standards. Others challenged the content of such EBA material. These matters are the responsibility of the EBA and the PRA cannot respond on its behalf.

1.6 The PRA's final rules to implement CRD IV are contained in Appendix 1, and the supervisory statements are in Appendix 2.

PRA rulebook structure

1.7 The implementation of CRD IV is the first time that the PRA will make rules in the new Rulebook style. Firms should note the new Part and Chapter structure of the Rulebook instruments and the new style of drafting: concise rules, where possible, which set clear requirements. Firms should pay particular attention to the application section of the Part or Chapter the firms to which the rules apply. A central glossary and a Part specific glossary will be used to support specific rules.

1.8 The intention to move to the new style PRA Rulebook was set out in the PRA's approach document.⁽¹⁾ The PRA consulted on its proposed approach to the Rulebook in Chapter 10 of the OCP. The OCP also set out the PRA's aim to reshape all Handbook material inherited from the Financial Services Authority (FSA) into rules or supervisory statements, as appropriate, following the PRA's policy framework.

1.9 The Rulebook will contain rules and directions issued under FSMA powers. Supervisory statements will provide additional general guidance where necessary. Until the launch of the new Rulebook online site in 2015, the Rulebook will be implemented into the current online Handbook in PDF format, thus distinguishing the material from the PRA's inherited Handbook provisions.

(1) www.bankofengland.co.uk/publications/Documents/prapproach/bankingappr1304.pdf.

2 Capital buffers

2.1 The CP included draft rules necessary to implement the CRD provisions on capital buffers. The responses to the CP did not raise any issues in relation to the CRD capital buffers that would require a change to the approach set out in the CP. However, as noted in the CP, elements of the capital buffer framework require HM Treasury to designate the authority responsible for setting certain buffers and buffer rates in the United Kingdom. The PRA will make its final rules on buffers, in line with the CP proposals, once HM Treasury has made this designation. Rules on the CRD buffers are not therefore included in this Policy Statement.

3 Pillar 2

3.1 The PRA received a large number of responses to its proposals on Pillar 2, including responses to the specific questions. There were no responses relating to the supervisory statement on stress testing, scenario analysis and capital planning (SS6/13), which has been implemented with minor amendments.

Feedback to responses

Legal form of Pillar 2A

3.2 The PRA asked whether Pillar 2A should be set as:

- a) a firm-specific requirement under section 55M of FSMA to hold a specified amount of capital; or
- b) guidance on the capital the PRA believes a firm should hold to meet the overall financial adequacy rule.

3.3 Respondents argued that Pillar 2A should be set as guidance, in order both to tailor Pillar 2A to the circumstances of particular institutions and to allow the PRA to retain flexibility in setting appropriate capital standards in times of stress. The PRA has decided to continue to set Pillar 2A as guidance on the capital that the PRA considers a firm should hold in addition to meeting its Pillar 1 requirements, in order to comply with the overall financial adequacy rule. The supervisory statement on the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evolution Process (SREP) (SS5/13) was drafted as referring to guidance, and will therefore need no revision on this point.

Quality of capital for Pillar 2A

3.4 The PRA proposed that Pillar 2A risks be met with at least 56% Common Equity Tier 1 capital (CET1) from 2015, in line with the Pillar 1 ratios, and consulted on whether to move to firms meeting Pillar 2A in full with CET1 from 1 January 2016. In particular the PRA asked the following questions:

- What are the benefits and costs of a requirement to meet Pillar 2A risks with CET1?
- Should this requirement be phased in by 1 January 2016? If not, over what period should it be phased in?
- What implications are there of different minimum standards for the quality of eligible capital to be held against Pillar 1 and Pillar 2A risks?

3.5 A number of respondents recognised the benefits, in the form of increased resilience, of strengthening capital standards for Pillar 2A. They suggested, however, that the costs of meeting Pillar 2A solely with CET1 would significantly exceed any potential benefits. Respondents also argued that there would be adverse consequences arising from potential increases in the costs of capital for UK institutions relative to their overseas peers that would have to be passed on to customers with, they argued, a negative impact on the provision of credit to the real economy. Some respondents noted that the loss absorbency of Additional Tier 1 (AT1) capital has been strengthened and argued that it should play a greater part in meeting Pillar 2A. A significant number of respondents argued that capital resources for Pillar 2A should be of the same quality of capital as prescribed for Pillar 1 risks.

3.6 The PRA has considered these arguments and has decided that Pillar 2A risks should be met with the same quality of capital as Pillar 1 risks. Pillar 2A assesses those risks that are not captured, or not fully reflected in Pillar 1, and associates appropriate capital with that risk assessment. Pillar 2A is, therefore, a natural extension of the Pillar 1 evaluation of appropriate capital resources. In accordance with CRR Article 92, which specifies the quality of capital required to meet Pillar 1 requirements,⁽¹⁾ the PRA will expect firms to meet Pillar 2A with:

- at least 56% in CET1;
- no more than 44% in AT1; and
- at most 25% in Tier 2 capital.

3.7 The PRA expects firms to meet this standard by 1 January 2015 as previously proposed.

3.8 A large number of respondents argued that pension obligation risk only materialises when a firm reaches the point of non-viability, and it should therefore be met with Tier 2 capital and other eligible liabilities. The PRA notes that any deficit arising from pension obligation risk appears on a firm's balance sheet and any increase in the deficit reduces a firm's equity capital. The deficit varies year by year and is unpredictable. The PRA believes that pension obligation risks currently captured within Pillar 2A assessments can crystallise on a going-concern basis and are in this respect similar in

(1) The 8% Pillar 1 requirement is subject to the following minima under CRR Article 92, applicable from 1 January 2015 (transitional minima apply in 2014): CET1 minimum of 4.5%; Tier 1 (CET1 + AT1) minimum of 6%; Total Capital (Tier 1 + Tier 2) of 8%.

nature to other Pillar 2A risks. Accordingly, pension obligation risk should be met with capital resources of the same quality as those used to meet other Pillar 2A risks.

Relationship between Pillar 2A and the CRD buffers

3.9 In the CP, the PRA proposed that Pillar 2A capital should sit below the CRD combined buffer. Several banks pointed out that this stacking method would mean that the automatic distribution constraints apply at a significantly higher level of CET1. Respondents also argued that equity and AT1 investors would want to know the ratio at which automatic restrictions on distributions would be applied, which would lead to disclosure of Pillar 2A capital.

3.10 A small number of respondents proposed that an overall capital assessment, comprising Pillars 1 and 2A, might be run alongside the calculation of the capital requirements for Pillar 1 and the CRD buffers. However, this would allow firms to use the same CET1 capital to meet both the CRD buffers and Pillar 2A requirements set by the supervisor. Alternatively, it was proposed that Pillar 2A should sit above the CRD buffers. However, Pillar 2A capital is required to meet risks that are not captured, or are only partially captured, in the Pillar 1 framework. If a firm's capital is not sufficient to meet these risks, the firm does not have enough capital.

3.11 The PRA maintains the view that the proper interaction of Pillar 2A and the CRD buffers is as set out in the CP. The PRA is currently reviewing its approach to setting Pillar 2A capital and, as part of that review, the PRA will consider whether and, if so, to what extent firms should disclose Pillar 2A.

Further clarification

Basel I floor

3.12 A small number of respondents asked how the Basel I floor interacts with the requirements for Pillar 2A and the CRD buffers. The PRA takes this opportunity to clarify that the operation of the floor will not change: if the floor is higher than the sum of the minimum Pillar 1 capital requirement and Pillar 2A capital, a firm must meet the Basel I floor. The CRD buffers will sit on top of the Basel I floor. A firm may not meet the CRD buffers with any CET1 capital maintained to meet the Basel I floor.

Pillar 2 level of application

3.13 The PRA has further clarified in SS5/13 the scope of application of Individual Capital Guidance (ICG). In particular the PRA may set ICG on an individual basis where firms are not able to demonstrate that capital is adequately allocated between the different parts of the group or where there are impediments to the transfer of capital within the group.

Transitional issues

3.14 The introduction of CRD IV may have unintended consequences for the level of Pillar 2 capital requirements. For pension obligation risk, for example, firms currently using the Deficit Reduction Amount may see some element of double-counting with their pension obligation risk Pillar 2A capital as a result of fully deducting the accounting deficit from the start of 2014. Issues such as this will be temporary and supervisors will take them into account when they next review a firm's ICG. However, if a firm believes the impact is significant, in the first instance it should approach its supervisor with evidence of any such impact (such as providing a revised Pillar 2 assessment of the pension obligation risk in the above example), and the PRA will consider whether the ICG needs to be revised.

Future policy development

3.15 The PRA expects to consult on its approach to Pillar 2 during the course of 2014. The consultation will also cover the transition to the PRA buffer and the relationship between the PRA buffer and the concurrent stress testing exercise proposed by the FPC in March 2013, which is discussed further in *A framework for stress testing the UK banking system* (October 2013).⁽¹⁾ Until revisions to PRA rules and supervisory statements arising from this consultation take effect, firms will continue to be subject to the current ICG and CPB policy as described in SS5/13.

(1) www.bankofengland.co.uk/financialstability/fsc/Documents/discussionpaper1013.pdf.

4 Governance and Remuneration

4.1 The PRA did not ask any specific questions in the governance chapter of the CP but some respondents expressed views on the definition of significant firms and the limits on directorships. This section also contains feedback to Chapter 8 (Remuneration) of the OCP.

Feedback to responses

Definition of significant firms

4.2 The CRD imposes specific requirements on 'significant' firms, including establishing nomination and risk committees, and limits on a director's other directorships. Respondents asked for clarification of the meaning of 'significant' in this context. Only firms whose supervisor has indicated are impact category 1 or 2⁽¹⁾ should consider themselves as significant for the purposes of these requirements. The relevant chapters of SYSC⁽²⁾ reflect this, as shown in Appendix 1. The PRA's approach to proportionality in respect of remuneration committees is set out in LSS8/13 'Remuneration standards: the application of proportionality'.⁽³⁾

Limits on directorships

4.3 Many respondents raised concerns about the restrictions on numbers of directorships, arguing that this could shrink the pool of talent available for firms. Some asked for a transitional period or for guidance on when a waiver would need to be in place. The limits are set by the Directive. The PRA is obliged to implement them and has no discretion to apply a transitional period — although firms should note that this requirement does not come into force until 1 July 2014. Where a director wishes to hold an additional non-executive position, the firm will need to have applied for and received the relevant waiver before the rule comes into force.

Remuneration

4.4 The CP and OCP proposed copy out of the CRD IV requirements in relation to remuneration. The PRA received a small number of comments on these, but no objections, and therefore it will make the rules as proposed.

Further clarification

Qualification of directors of holding companies

4.5 The draft rules on which the PRA consulted included a rule (SYSC 4.3A.4R) requiring firms to ensure that the members of the management body of their financial holding company or mixed financial holding company are of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties. After further consideration the PRA

has decided not to introduce this rule, on the basis that the relevant CRD requirement⁽⁴⁾ can be implemented through the PRA's regulatory regime, currently the approved persons regime. The PRA believes that relying on an existing regulatory process is a more proportionate way to implement this provision than introducing an additional requirement. The PRA notes that, following recommendations from the Parliamentary Commission on Banking Standards, the approved persons regime is likely to be replaced by a senior persons regime which would then be the relevant regulatory framework for the purposes of implementing this provision.

Remuneration

4.6 The PRA expects the EBA to publish during 2014 a revision of the Committee of European Banking Supervisors (CEBS) guidelines on remuneration to incorporate the new remuneration provisions in CRD. The PRA will not revise LSS8/13 until the EBA issues its revised remuneration guidelines. In the interim, all Level 1 and 2 firms should consider that the bonus cap will be applicable to them. All PRA-authorized firms remain subject to the existing requirement to 'maintain an appropriate balance between fixed and variable remuneration'.

4.7 CRD requires firms wishing to increase the limit on variable remuneration (from a 1:1 ratio to fixed remuneration up to a 2:1 ratio) to obtain the approval of their shareholders, owners, or members. The PRA will expect firms to achieve this by seeking a resolution of the shareholders, owners or members of the ultimate EEA parent. For UK-headquartered banking groups or subsidiaries of EEA-headquartered groups, this would require the shareholders of the ultimate EEA parent to increase the ratio for the group as a whole. Where a firm is owned by a company that is, or companies that are, outside the scope of prudential consolidation of the firm under the CRD, the PRA would rely on appropriate resolutions by the parent companies as shareholders. In the case of UK subsidiaries of non-EEA firms, the PRA would accept a resolution of the immediate non-EEA parent company. Branches of non-EEA firms would require a vote by the shareholders of the non-EEA firm branching in.

(1) See Chapter II of the PRA's approach to banking supervision, October 2012.

(2) PRA Handbook — Senior Management Arrangements, Systems and Controls.

(3) www.bankofengland.co.uk/pr/Pages/publications/theremunerationcode.aspx.

(4) CRD Article 121.

Future policy development

4.8 The PRA will also address the recommendations on remuneration in the report of the Parliamentary Commission on Banking Standards through consultation on a revised Remuneration Code in 2014.

5 Passporting

5.1 The PRA did not ask any specific questions in the Passporting chapter of the CP. However, responses were received asking for clarification on the points set out below.

Further clarification

5.2 One respondent asked whether EEA branches in the United Kingdom will come under the sole supervision of their home state regulator and cease to be supervised on a stand-alone basis by the PRA once the relevant BIPRU⁽¹⁾ 12 provisions are dis-applied in relation to them. Once the Liquidity Coverage Requirement becomes applicable in accordance with the delegated acts adopted pursuant to CRR Article 460, home and host state regulators will have the same roles in relation to liquidity as they will from 1 January 2014 in relation to capital, in line with CRD Articles 49 to 51. The PRA will collaborate closely with home state authorities in order to effectively supervise the activities of branches operating in the United Kingdom under these provisions.

5.3 Two respondents asked the PRA to specify its approach to the liquidity treatment for branches of non-EEA credit institutions. The liquidity provisions in BIPRU 12 will be retained and will continue to apply to third country branches. The PRA approach to non-EEA credit institutions seeking to establish a branch in the United Kingdom will be set out in due course.

Future policy developments

5.4 The EBA has consulted on draft regulatory technical standards (RTS) and implementing technical standards (ITS) relating to passport notifications, and is expected to present the draft proposal to the European Commission by the end of 2013. The RTS specify the information required for a firm wishing to establish a branch in a Member State, while the ITS outline the procedure for notification (including common templates). Once these RTS and ITS come into force, the PRA will disapply its relevant notification requirements.

(1) Prudential sourcebook for Banks, Building Societies and Investment Firms.

6 Definition of capital

6.1 The PRA did not ask any specific questions in Chapter 6 (Definition of Capital) of the CP. However, a large number of responses were received on the policy proposals, including the deduction of holdings in financial sector entities in the same consolidation group, expectations on Additional Tier One (AT1) capital, transitional provisions, and the Basel I floors. This section also provides feedback on responses to Chapter 9 (Initial capital exemption for small credit institutions) of the OCP.

Feedback to responses

Deduction of holdings of own funds instruments issued by financial sector entities subject to consolidated supervision

6.2 The CP set out the PRA's intention to require deduction of significant investments in financial sector entities included in consolidated supervision, to be phased in over a transitional period to 1 January 2019.⁽¹⁾ The rationale for requiring this deduction is to ensure that sufficient group capital is located in the solo entities on which depositors and creditors more generally have claims, both on a going and gone concern basis. Some respondents raised the concern that the policy could conflict with resolution planning and commented that the proposed treatment could create an un-level playing field between Member States. One firm proposed that the current treatment for deduction from CET1 and Tier 2 could be maintained. However, this would not be in accordance with CRR provisions, which require deductions to be made from the corresponding tier of capital.

6.3 The implementation of the Independent Commission on Banking's recommendation on ring fencing, as well as the development of cross-border resolution plans, will have a bearing on the allocation of loss-absorbing capacity across a group's entities. While the PRA acknowledges firms' concerns over the impact of the requirement, it considers that the transitional period to 2019 is sufficient for firms to accommodate the deduction. Importantly the transition arrangements for the solo deduction are aligned with the timeframe of these other related initiatives. Therefore, the PRA will implement the proposals set out in the CP.

6.4 A few respondents also noted that the phased transition and threshold allowance would result in additional large exposures. After considering these arguments, the PRA has decided to amend the relevant rule for solo significant investment deductions, such that it is now a minimum

transition path. Therefore, firms will be able to mitigate the impact on their large exposures by subjecting up to 100% of their solo significant investments to the CRR deduction treatment, after allowing for related thresholds. Firms should engage with their supervisor where large exposures arise due to the transition path for solo significant investments.

Transitional provisions

6.5 Some respondents expressed concern that moving to an endpoint definition of CET1 on 1 January 2014, while transitioning in other elements of CRD IV, could have unforeseen consequences, as well as resulting in insufficient time for firms to update their capital planning. In particular, some respondents stressed that specific RTS still in the process of being finalised by the EBA could have a material impact on the definition of capital. Some respondents argued that the move to an endpoint deduction of deferred tax assets, would disproportionately penalise those firms that have been making losses in recent years and new market entrants which typically incur losses in the first few years of business. Finally, some respondents also raised concerns about the asymmetry of transitioning in the recognition of unrealised gains over five years while recognising unrealised losses in full from 1 January 2014.

6.6 The rationale for applying all filters and deductions from CET1 in full from 1 January 2014 (ie reaching the end point definition of CET1)⁽²⁾ is that CET1 will be the most important benchmark for solvency in the new framework. The PRA therefore believes that it should move to the end point definition of CET1 as soon as is permitted under CRR, on 1 January 2014.

6.7 In the case of unrealised gains, the CRR does not permit an end point treatment in 2014. Unrealised gains and losses will therefore be treated differently during 2014. The PRA will, however, allow recognition of all unrealised gains from 1 January 2015, as permitted by the CRR. The rules in Appendix 1 are amended accordingly. Further clarification on the application of CRR provisions on unrealised gains and losses is provided at paragraphs 6.17 and 6.18 of this PS.

(1) The relevant percentage for calculating the amount to be deducted during the transition period is set out in the PRA Rulebook. As set out in CP5/13, firms must apply the CRR deduction treatment to the relevant percentage and apply the appropriate risk weight in accordance with Article 49(4) to the remaining amount. The CRR deduction treatment is subject to Article 48 thresholds.

(2) The only exception will be the deduction of holdings of own funds instruments issued by financial sector entities subject to consolidated supervision as noted in the appropriate section above.

Additional Tier 1 (AT1)

6.8 Many respondents raised concerns about the PRA's supervisory statement on AT1 in relation to the minimum standards in CRR and argued that permanent write-down of AT1, at a trigger that may be higher than 5.125%, would put UK banks at a competitive disadvantage relative to other firms in the EEA and may make AT1 more difficult to issue.

6.9 The PRA's position on appropriate AT1 features does not call into question relevant provisions under CRR. The PRA is of the view that, depending on the circumstances, an instrument with a trigger of 5.125% CET1 may not convert in time to prevent the failure of a firm, and a temporary or partial write-down may make it more difficult for the firm to re-establish its capital position following a stress. Firms will wish to consider these factors when deciding how to exercise the choices available to them under CRR. The supervisory statement, CRD IV and capital (SS7/13) has been amended to make this expectation clear.

Basel I floors⁽¹⁾

6.10 Some respondents queried the example given in the draft supervisory statement of the application of the Basel I floor to Pillar 1 capital requirements, including noting that it appeared to give a different answer to that previously given in guidance by the FSA. As it was not the PRA's intention to change the underlying policy, the example has been amended in the supervisory statement on the Basel I floor (SS8/13) to make it consistent with the position set out previously.

6.11 The CRR allows competent authorities to apply the floor based on the standardised approach as opposed to on Basel I. In the draft of SS8/13 the PRA explained that it would allow the floor based on the standardised approach only in limited circumstances, including that the floor based on the standardised approach would not result in materially lower capital requirements in each case than a floor based on Basel I. A respondent noted the application of the floor based on Basel I did not provide an incentive to use the Internal Ratings-Based (IRB) approach for institutions which specialised in mortgages and were currently using the standardised approach. However, to allow the floor to be based on the standardised approach for such firms would create an un-level playing field in relation to similar firms who were early adopters of IRB and whose floors would still be based on Basel I. Further, the PRA considers that it would be inappropriate to waive the floor for firms which are materially disadvantaged by its application as that would undermine the purpose of the floor. The PRA therefore intends to retain the treatment proposed in the draft of SS8/13.

Small bank initial capital exemption

6.12 The OCP included a proposal to set a lower amount of initial capital for small credit institutions, a discretion allowed to Member States by CRD Article 12(5) whereby authorisation

could be granted to Small Specialist Banks (SSBs) with a minimum capital requirement of €1 million or £1 million, whichever is higher. Respondents to the OCP welcomed this proposal, and the PRA will proceed with the necessary rule changes. In response to an inquiry by one respondent, the PRA can confirm that lending to charities which meet the criteria of small and medium enterprises (SMEs) would come within the scope of lending to SMEs by authorised SSBs.

Further clarification

Treatment of banks' significant insurance holdings

6.13 Respondents asked whether the use of the embedded value method is permitted under the new regime in view of the proposed deletion of GENPRU 2.2.216 G. The PRA has clarified in SS7/13, that the embedded value method should not be used to value firms' significant investments in insurers. This is because the embedded value method could have the effect of inflating banks' CET1 with the value-in-force of an insurer's business.

Connected funding of a capital nature

6.14 The CP proposed retaining in substance existing GENPRU rules on Connected Lending of a Capital Nature (renamed 'Connected Funding of a Capital Nature (CFCN)'). While no objections were raised to the CFCN rule, respondents requested a number of clarifications, including the status of former GENPRU guidance and greater clarity on transitional treatment, disclosure and application to non-financial sector entities.

6.15 The CFCN rules may apply to both financial sector and non-financial sector entities and clearly state that firms must apply the relevant CRR capital treatment to CFCNs, including disclosure requirements. The PRA has amended the CFCN rules to make clear that firms must also apply the relevant capital treatment set out in the PRA Rulebook. This means that CFCN will be subject to the same phase-in arrangements as a holding of capital of the connected party and that lending to venture capital entities (in particular, the Business Growth Fund) is excluded from CFCN. Clarification of the remaining points is contained in the SS7/13, which now includes a restatement of the GENPRU guidance on CFCN.

Remedies

6.16 The draft of SS7/13 stated that in order to comply with CRR criteria on subordination, the PRA expects remedies in the event of default to be restricted, to the fullest extent permitted under the laws of the relevant jurisdictions, to petition for the winding-up of the firm or proving for the debt in liquidation or insolvency. One respondent asked for clarification of the scope of these restrictions. The PRA has amended SS7/13 to make it clear that the expectations in

(1) See also Section 2 on Capital Buffers, regarding interaction between the Basel I floor and the capital buffers.

relation to remedies are not intended to be more restrictive than the current rules in GENPRU.

Unrealised gains and losses

6.17 One respondent queried whether CRR Article 468, which requires firms to exclude all unrealised gains in 2014, does so only on Available-For-Sale (AFS) unrealised gains, or also on unrealised gains through the P and L. Another respondent asked whether and how gains and losses could be netted against each other when calculating the amounts subject to prudential treatment. Finally, one respondent queried whether the PRA would allow firms to filter out gains and losses on AFS central government exposures, using CRR Article 467(2), as the CP was silent on this.

6.18 The PRA interprets the CRR Article 468 treatment of unrealised gains during the transition in 2014 as applying to the AFS category and investment property reported in P and L only, and not to other unrealised gains through the P and L. In addition, the PRA considers that firms can net unrealised gains and losses at any level permitted within the constraints of the accounting framework, within as well as between relevant portfolios or legal entities. Finally, in relation to CRR Article 467(2), the PRA's general view is that in most cases a filter on AFS central government debt would not be appropriate because it would misstate the underlying solvency of the firm. Nonetheless, under CRR firms may apply for such permission and each case will be considered on its merits.

Prudent Valuation

6.19 The EBA is required under CRR Article 105 to publish a draft RTS on prudent valuation by 1 January 2014. Until the RTS comes into force the PRA expects firms to apply their own internally developed methodologies, as is currently required under GENPRU 1.3, to calculate any valuation adjustments resulting from the requirements of Article 105 and deduct them from CET1 as required by CRR Article 34.

7 Credit risk

7.1 Responses on the credit risk section addressed the specific questions raised in the CP, and some respondents also raised additional points in respect of the standardised approach, the internal ratings based approach (IRB), credit risk mitigation and securitisation.

Responses to Feedback

Standardised Approach

Residential real estate exposures: buy to let

7.2 The CRR requires that in order for an exposure to benefit from the 35% risk weight for loans fully and completely secured on residential real estate the risk of the borrower should not materially depend on cash flow from the underlying property. The CRR provides a derogation from this criterion where a competent authority publishes certain evidence and data, which the PRA proposed to do. Respondents supported the PRA's proposed approach. The PRA will therefore publish evidence of the long-established and well-developed nature of the UK residential mortgage market and relevant data on write-off rates for UK residential mortgages as a proxy for loss rates, pending the uniform collection of such loss data under COREP from 2014. The requisite evidence and data are published in the supervisory statement on the standardised approach (SS10/13).

Commercial real estate exposures

7.3 The CRR applies a 50% risk weight to loans fully and completely secured on commercial real estate (CRE) where specific criteria are met. In the CP, the PRA consulted on a rule introducing a stricter criterion for that 50% risk weight to apply to UK exposures. That rule requires annual average losses stemming from lending secured by mortgages on commercial property in the UK to not exceed 0.5% of risk-weighted exposure amounts over a representative period. The PRA invited comments on what might constitute a representative period for these purposes, and on the most appropriate means of addressing its concern on risk weights for CRE exposures. A number of respondents suggested further discussion with the industry to consider an appropriate representative period and the appropriateness of applying a variable risk weight. Accordingly, the PRA intends to engage in further discussion with the industry on these topics.

7.4 Some respondents also sought clarification of whether the stricter criterion proposed would apply also to CRE exposures located in other EEA States and of the treatment of exposures

secured on CRE outside the EEA. The rule Credit Risk 5 on which the PRA consulted applies only to exposures secured on CRE in the United Kingdom. CRR Article 124(5) explicitly covers the application of stricter criteria or higher risk weights for real estate in other Member States. In October 2013, the European Commission published a response to a question on the EBA website which clarifies that stricter criteria or higher risk weights may also be applied to exposures secured by real estate in third countries. In light of this clarification, the PRA intends to consult on a rule to impose a stricter criterion/higher risk weight for exposures secured on CRE in non-EEA states.

Internal Ratings Based Approach (IRB) Rating system approval

7.5 In the CP, the PRA consulted on a supervisory approach which included the expectation that an individual in a Significant Influence Function (SIF) would provide the PRA with an annual attestation that the CRR's requirement for approval of all material aspects of rating and estimation process had been met. The CP also invited comments on the appropriate level of seniority of individual for the purposes of SIF attestation, and on whether the proposed approach should apply to all risk types for which models are used to calculate regulatory capital.

7.6 The PRA has considered the comments received. Rather than specifying an appropriate level of SIF or SIFs for these purposes, the PRA considers it would be appropriate for firms to discuss and agree this with the PRA. The PRA will take account in such discussions of the firm's approach to meeting the CRR's governance requirements for IRB rating systems. Firms may consider different SIFs to be required to provide attestations in respect of different rating systems. However, the PRA would expect not to agree to more than two such SIFs providing attestations for IRB rating systems.

7.7 The PRA has revised the text relating to SIF attestations in the supervisory statement on Internal Ratings Based approaches (SS11/13) to clarify that the attestation should also confirm the extent of CRR compliance of a firm's rating systems that it is permitted to use for regulatory capital purposes, highlight the remediation plans in place to address areas of material non-compliance and identify aspects that the firm considers not to meet the PRA's expectations of rating systems.

7.8 The PRA has reflected on the extension of the process of SIF attestation to market, operational and counterparty credit risk models. The PRA considers such an extension would be appropriate and the relevant supervisory statements have been updated accordingly.

Definition of default — materiality threshold

7.9 In the CP, the PRA proposed to define specific materiality thresholds in relation to past due exposures, forming part of the definition of default, to cover the period before the implementation of the EBA's forthcoming technical standard on materiality thresholds. The PRA received feedback that making such a change on a temporary basis — in 2014 only prior to the application in 2015 of an EBA technical standard defining materiality for these purposes — was disproportionate, would require changes to systems, and might compel some firms to adopt a less conservative definition of default than that which they currently apply.

7.10 In the light of the responses received, the PRA intends not to specify materiality thresholds for the purposes of 2014 only. The draft rule proposed in the CP has been withdrawn.

Clarifications

Standardised Approach Lifetime mortgages⁽¹⁾

7.11 The CRR does not distinguish between lifetime mortgages and other types of residential mortgage in the way that the current BIPRU does. In CP5/13, the PRA proposed that firms should inform it of the difference in the capital requirement for lifetime mortgages exposures under the CRR and under the relevant BIPRU requirement. One respondent asked about the required nature and frequency of such reporting. The PRA intends to discuss this with firms as part of supervisory review work under Pillar 2.

Recognised exchanges

7.12 CRR Article 4(1)(72) defines 'recognised exchange'. The recognised exchange definition is used also in the definition of repurchase and reverse repurchase agreements, in defining own funds requirements for certain investment firms and in determining collateral eligibility (CRR Articles 4(1)(82), 96(1), 197(4) and (8), 198(1), 224 and 229).

7.13 CRR requires ESMA to produce draft technical standards by 31 December 2014 specifying recognised exchanges for the purposes of the CRR. One respondent asked for clarification on the list of recognised exchanges to be used before the ESMA technical standard is applied. Prior to the end of 2013, the PRA will set out the approach to be taken during 2014.

Internal Ratings Based Approach (IRB)

Definition of default — days past due

7.14 Some respondents requested further clarification on how the PRA will exercise its discretion in CRR Article 178(2)(d) to define default. For Public Sector Entities (PSEs) rating systems and retail residential mortgage rating systems built after 31 December 2013, firms will need to apply for permission from the PRA if they wish to use a 180 day definition of default in place of the 90 day definition of default defined in the CRR. Where a 180 day definition of default is used for such rating systems built prior to 1 January 2014 the PRA will issue permission in accordance with the process for applying for CRR permissions set out in the OCP.

7.15 The PRA does not expect to grant permission to use a 180 day definition of default for mortgages or retail exposures secured on small and medium-sized enterprise (SME) commercial real estate. The PRA has seen no evidence that this would enhance the quality of firms' estimates.

Discount rate

7.16 A number of respondents challenged the proposed PRA expectation for a discount rate of 9% p.a., reflecting the uncertainty in estimated cash flows from recoveries on defaulted assets. Those respondents stated that a 9% level was not supported by analysis and was not risk sensitive.

7.17 The PRA considers that the approach proposed represents a pragmatic response to the shortcomings in firms' approaches to setting discount rates. Such shortcomings were identified by the FSA's thematic review of LGD and EAD practices during 2011. That review found that there was no widely-accepted industry approach to determining appropriate discount rates, insufficient evidence of the appropriateness of rates; and a tendency to reduce discount rates over time. Nevertheless, the PRA recognises that the industry may have made progress in addressing these shortcomings and is open to considering the issue further. The PRA invites the industry collectively to develop a framework for such discount rates, for consideration by the PRA. In the interim, the PRA would expect a 9% floor to be applied.

(1) A lifetime mortgage is a residential mortgage where the capital component is fully repaid only after the occurrence of one or more events. See the PRA Handbook glossary for details:
<http://fshandbook.info/FS/glossary-html/handbook/Glossary/L?definition=C1294>.

Maturity

7.18 CRR Article 162(1) asks competent authorities to decide whether a firm should use the explicit maturity approach in determining IRB capital requirements for corporate, institution and sovereign exposures rather than using an implicit maturity approach. The CP did not address this issue directly and the PRA received questions from some firms on how this provision would be applied.

7.19 The PRA continues to expect all institutions to use the explicit maturity approach, as set out in CRR Article 162(2) to 162(3), for exposures covered by the Foundation IRB approach. This will be reflected in these institutions' permissions to use IRB, as well as in SS11/13. The explicit maturity approach is more risk sensitive than the implicit approach and will not impose any additional operational burden on affected firms as they are already use explicit maturity in accordance with BIPRU.

Changes to IRB rating systems

7.20 The PRA has made a number of amendments in SS11/13 to the process for pre-notifying model changes by specifying that firms' self-assessments against the CRR and supervisory statement should be sent to their PRA supervisor at the time the change is pre-notified.

Issues relevant for the Standardised Approach and the IRB approach

7.21 The following CRR provisions allow particular credit risk treatments to be applied to exposures to non-EEA ('third country') counterparties where the relevant non-EEA state applies prudential and supervisory requirements that are at least equivalent to those applied in the European Union:

- (i) the treatment of exposures to third country credit institutions, investment firms and clearing houses and exchanges as exposures to institutions for the purposes of CRR's credit risk rules (CRR Article 107(3));
- (ii) the definition of 'large financial sector entity' for the purposes of the IRB approach, a term which is used in scaling up the asset value correlation used to calculate conditional probability of default (CRR Article 142(1)(4));
- (iii) the application of sovereign risk weights lower than those prescribed by the CRR under the Standardised Approach to credit risk when they have been assigned by the relevant third country regulator (CRR Article 114(7) and 119);
- (iv) the treatment of exposures to non-EEA regional governments and local authorities as exposures to non-EEA sovereigns in certain circumstances (CRR Article 115(4));

- (v) the treatment of non-EEA public sector entities based on the credit assessment of the relevant non-EEA sovereign (CRR Article 116(1)); and
- (vi) the application of look-through provisions to CIUs in cases where the company owning the CIU is subject to equivalent supervision (CRR Article 132(3)).

7.22 The CRR empowers the European Commission to make decisions on whether a non-EEA state's prudential and supervisory requirements are equivalent to those of the EU. Pending those decisions by the Commission, the CRR allows national supervisors' determinations of third country equivalence made prior to 1 January 2014 to be used until the end of 2014. Some respondents asked the PRA to clarify the non-EEA states that it would treat as equivalent for these purposes.

7.23 Prior to the end of 2013, the PRA will set out the approach to be taken during 2014 in the absence of an equivalence determination by the European Commission.

Credit risk mitigation

IRB eligibility requirements for real estate collateral

7.24 One respondent asked for clarification of whether an equivalent derogation to that made under CRR Article 125(3) relating to residential property may be made under CRR Article 199(3). The PRA confirms that the evidence published by the PRA may be used to derogate from Article 199(3) as well as Article 125(3).

Securitisation

Significant risk transfer in the trading book

7.25 Some respondents asked how the PRA's significant risk transfer (SRT) notifications and permissions regime would apply to relevant transactions carried out in the regulatory trading book since the CRR has extended SRT provisions to the trading book. Credit Risk rule 3.1 has been amended to make explicit that the SRT notifications and permissions regime applies also to trading book transactions.

8 Counterparty credit risk

8.1 The PRA received several comments on the proposals in Chapter 8 (Counterparty credit risk) of the CP. Generally, the PRA is maintaining the proposals in the CP, but provide clarification on some points below.

Further clarification

Calculating own funds requirements for exposures to Central Counterparties: Identifying Qualifying Central Counterparties

8.2 The CRR allows for lower capital requirements for exposures to Qualifying Central Counterparties (QCCPs) than for exposures to non-qualifying CCPs. Information on the identification of QCCPs has been added to the counterparty credit risk supervisory statement (SS12/13). For the transitional period (defined in CRR Article 497) the following will be considered to be QCCPs, provided that the conditions specified in CRR Article 497 have been met: all CCPs listed on the Bank of England register of Recognised Clearing Houses; and those third country CCPs that currently provide clearing services to UK credit institutions or to their subsidiaries.

8.3 The PRA expects that this transitional provision will expire on 15 June 2014, unless extended by the European Commission by a further six months owing to exceptional circumstances. Once CCPs have been authorised in accordance with Article 14 of EMIR⁽¹⁾ or recognised in accordance with Article 25 of that Regulation, a link will be provided to the relevant register on the Bank of England website and the European Securities and Markets Authority website.

8.4 In accordance with CRR Article 311, if a QCCP no longer calculates the hypothetical capital (K_{ccp}) or ceases to be a QCCP, the PRA will notify UK institutions.

Inclusion of securities financing transactions (SFTs) in the scope of the CVA capital charge

8.5 In the CP, the PRA set out its expectations for including securities financing transactions (SFTs) in the scope of the own funds requirements for credit valuation adjustment (CVA) risk when the firm's CVA risk exposures arising from those transactions are material. The PRA was asked to provide more clarity on the identification of those SFTs which are in substance over-the-counter (OTC) derivative transactions and give rise to very similar risks as CVA risks. The definition of those SFTs has now been refined in SS12/13. Further, the PRA does not require firms to submit to it a report of the impact of

including those SFTs in the scope of the own funds requirements for CVA risk before making a decision on its materiality. Instead, firms should directly include those SFTs in the scope of the own funds requirements for CVA risks.

Process for post-approval changes for counterparty credit risk advanced model approaches

8.6 A small number of amendments were made to SS12/13 on post-approval changes for counterparty credit risk advanced model approaches to reflect the entry into force of the CRR. There is also further clarification on the non-exhaustive list of examples of changes leading to pre or post-notification.

CVA risk calculation

8.7 Respondents asked for guidance on the PRA's expectations related to permission to use the approach defined in Article 385 to calculate the own funds requirements for CVA risk. As only a small number of PRA authorised firms are eligible for the application of the original exposure method (OEM) and therefore are eligible to request this permission, the PRA has not set out further guidance. Any firm that wants to apply for this permission should contact the PRA.

SIF attestation of risk models

8.8 As set out in paragraph 7.8 above, SS12/13 has been updated to include guidance on annual SIF attestation of the internal models referred to in Part 3, Title II of the CRR.

(1) Regulation (EU) No 648/2012.

9 Market risk

9.1 The PRA received questions on its proposals for the approach to non-delta risk of options and the selection of stressed period for stressed value at risk (SVaR), as well as a request for clarification of the list of recognised stock exchanges.

Feedback to responses

Standardised approach for options — approach to capitalising non-delta risk of options

9.2 The EBA is required under CRR to draft an RTS on the treatment of non-delta risk of options. In the CP the PRA stated its expectation that, until this RTS comes into force, firms would use one of the approaches set out in the draft RTS appended to EBA/CP/2013/16.⁽¹⁾ Some respondents expressed concern that these RTS could change before they are adopted. The PRA expects that the approaches in the draft RTS are those most likely to comply with the final RTS.

Internal models — selection of stressed period for sVaR

9.3 In the CP, the PRA stated its expectation that for the purposes of sVaR, a stressed period should be identified at each legal entity level at which capital is reported. Some respondents argued that this is more restrictive than the EBA sVaR guidelines, which state that institutions can alternatively use the same stress period for all entities if they can provide evidence that this period is relevant to their portfolio. As a matter of principle, legal entities should be adequately capitalised; this is also the intention of the alternative approach in the EBA guidelines. The PRA considers that the best way to achieve this is for the sVaR for each entity to be based on a stressed period that maximises VaR for that entity, and has therefore retained this expectation.

Further clarification

Recognised stock exchanges for the purposes of CRR Article 336

9.4 CRR Article 336 states that positions listed on a stock exchange in a third country, where the exchange is recognised by the competent authorities, qualify for the specific risk own funds requirements in the second row of the table in Article 336. The market risk supervisory statement (SS13/13) sets out a list of stock exchanges in third countries that the PRA intends to recognise for the purposes of this rule. The PRA asked whether there are any third country stock exchanges that should be added or removed from the list. In response to the feedback received, the list is extended so that the following exchanges are recognised:

- National Stock Exchange of India
- Stock Exchange of Mumbai
- Shanghai Stock Exchange
- Taiwan Stock Exchange
- Indonesia Stock Exchange
- Kuala Lumpur Stock Exchange
- Stock Exchange of Thailand
- Dubai Financial Market

Exchanges that no longer exist have been removed from the list, which has also been updated where necessary to reflect name changes.

Synthetic futures

9.5 One respondent pointed out that synthetic futures are no longer relevant given the CRR approach to options. The PRA agrees, and have removed references to synthetic futures in SS13/13.

SIF attestation of risk models

9.6 As set out in paragraph 7.8 above, the SS13/13 has been updated to include guidance on annual SIF attestation of the internal models referred to in Part 3, Title IV of the CRR.

9.7 Other minor changes have been made to SS13/13 to improve readability and clarity.

(1) EBA consultation on draft RTS on non-delta risk of options in the standardised market risk approach — www.eba.europa.eu/documents/10180/205341/EBA-CP-on-non-delta-risk-of-options.pdf.

10 Operational risk

10.1 The PRA received no responses to the operational risk chapter of the CP, and will be adopting the supervisory statement on operational risk (SS14/13) as proposed.

10.2 As set out in paragraph 7.8 above, the SS14/13 has been updated to include guidance on SIF attestation of the advanced model approach approval process.

11 Groups

11.1 The PRA received requests for further clarification of the application of CRR Article 18(5) and the individual consolidation method. A supervisory statement on groups policy (SS15/13) has been issued which sets out the PRA's expectations. Firms should contact PRA supervisors with any further questions.

12 Large exposures

12.1 The PRA invited comments on the approach set out to the non-core large exposures group, and in particular on the capital impacts for firms with excess trading book exposures. Several respondents raised issues for further clarification.

Further clarification

12.2 Respondents asked about:

- how the pre-CRR PRA core UK and non-core large exposure groups regime fits within the CRR;
- the role of capital maintenance agreements between a firm and members of its non-core large exposures group;
- how to calculate the additional own funds requirements for excess trading book exposures when a firm has an intra-group exemption under the CRR;
- the application of the eligibility restrictions for lower tiers of capital when calculating the core UK group eligible capital; and
- how the PRA will assess the criteria outlined in CRR Article 400(2).

UK intra-group large exposures regime

12.3 CRR Article 113(6) allows a firm to apply a zero risk-weight to exposures to intra-group counterparties which meet the criteria set out in CRR Article 113(6)(a)–(e), subject to the prior approval of the PRA. Under CRR Article 400(1)(f), exposures from the firm to those counterparties are then exempt from the large exposures limit in CRR Article 395(1). The PRA set out in its draft supervisory statements on groups policy (SS15/13) and large exposures (SS16/13) its approach to considering such applications against the criteria set out in Article 113(6)(a)–(e).

12.4 The PRA intends to refer to the counterparties in respect of which a firm benefits from a large exposure limit exemption in this way as the 'core UK group'. This is consistent with the pre-CRR/PRA approach. As the exposures which come under the scope of the core UK group are exempted through the operation of the CRR, rather than through PRA rules, the PRA has defined the core UK group in PRA rules with reference to CRR Article 400(1)(f).

12.5 SS16/13 outlines that when firms are seeking to demonstrate that there are no current or foreseen material practical or legal impediments to the prompt transfer of own

funds or repayment of liabilities, the PRA expects that firms will include in their application a legally binding agreement between the firm and any counterparties which are not firms.

Non-core large exposures group.

12.6 Under CRR Article 400(2)(c) competent authorities may fully or partially exempt certain intra-group exposures from the large exposures limit. The PRA intends to use this discretion to enable an approach which is materially similar to the pre-CRR non-core large exposure group. In relation to applications for non-core large exposures group exemptions, the PRA will not expect firms to have capital maintenance agreements in place where the firm is able to demonstrate that such an agreement would be unlikely to be legally enforceable.

12.7 Clarification has been sought on how the exposures to the non-core large exposures group would interact with the calculation of additional own funds requirements applied to trading book exposures that exceed the large exposure limits set out in CRR Article 395(1). In response, the PRA has amended the rules and SS16/13 to clarify the interaction. The PRA intends to maintain the current approach as far as possible: additional own funds requirements will still be applicable to excess trading book exposures not exempted by the rules.

Capital eligibility

12.8 One respondent asked how the restrictions on the eligibility of lower tiers of capital are intended to be applied when calculating the core UK group eligible capital. In this context, the PRA expects firms to apply the definition of eligible capital found in CRR Article 4(71) after making the calculations for core UK group eligible capital as set out in the PRA rules.

CRR Article 400(2) exemptions

12.9 The PRA expects firms applying for exemptions in respect of CRR Article 400(2) to show how they meet the conditions set out in Article 400(3). The PRA will only grant permission where it is satisfied that the conditions are met.

13 Liquidity

13.1 In the CP, the PRA set out its intended approach to the national discretions for liquidity provided in the CRR as well as the consequential amendments to BIPRU 12.

13.2 Respondents questioned whether it was appropriate for the PRA to maintain a liquidity regime once the liquidity coverage requirement (LCR) is introduced. They were concerned that firms would be required to comply with the Individual Liquidity Guidance (ILG) and the LCR at the same time. Concerns were raised about ongoing uncertainty in the absence of a finalised LCR. Respondents also asked how the PRA's liquidity regime would evolve, including the setting of liquidity requirements on a firm by firm basis.

Feedback to responses

13.3 The ILG (or the simplified buffer requirement) issued by the PRA under its current liquidity framework will provide the standard for firms' liquid asset buffers and will be the primary measure⁽¹⁾ against which firms will be monitored until the LCR becomes the Pillar 1 standard for liquidity in 2015. While the CRR places an obligation on firms to report liquidity data from early 2014, formal monitoring of firms' compliance with the LCR standard will not commence until 2015. Following introduction of the LCR as the Pillar 1 standard the PRA will continue to carry out supervisory reviews of liquidity risk and, as provided for in the CRD, will continue to have the ability to take appropriate measures, including the ability to impose specific liquidity requirements.

Future developments

13.4 The Commission is to adopt further legislation by 30 June 2014 to specify the definition, calibration, calculation, and phase-in of the LCR for implementation in 2015. The PRA will consider, amongst other things, the Commission's delegated act as it comes to a view on the alterations to its liquidity framework that it considers appropriate.

(1) Specifically, ILG plus any offsetting liquidity which the PRA allows firms to recognise in line with its statement on liquidity published on 28 August 2013.

14 Reporting and disclosure

14.1 There were no specific consultation questions in the reporting and disclosure chapter of the CP. However, the PRA received several responses regarding its proposals. The responses outlined below address the main concerns raised by respondents.

Feedback to responses

Data item retention

14.2 COREP⁽¹⁾ replaces many of the existing data items. The PRA proposed to retain a number of data items that are considered to have no COREP equivalent — specifically FSA005 and FSA045. Respondents questioned whether the additional benefit gained from these data items outweighed the regulatory burden placed on firms in recording and submitting the data, especially for FSA045 where the COREP CR templates combine counterparty and credit risk data when reported at grade level.

14.3 Where firms are using internal models to calculate market risk, the PRA will collect information for Risks Not in VaR (RNIV) on a standardised basis. PRA will use this data to monitor the performance of the relevant firms' internal models and gain important information on systemic risks. FSA005 is revised to obtain only those data that are not contained in COREP.

14.4 FSA045 is retained to collect the detail of credit risk related data that is also not captured by COREP. FSA045 only applies to firms with an IRB permission. For this population, the PRA requires the data split between credit risk and counterparty credit risk to assess the risk profile of the relevant firm and to determine whether credit and counterparty credit risks are due to banking book or trading book activities, and thus identify those activities giving rise to material risk.

Further clarification

MFS1 and QFS1 for building societies

14.5 The PRA received comments from two respondents regarding these data items, and the extent of overlap with financial reporting (FINREP). With the introduction of FINREP from 1 July 2014, building societies will no longer be required to submit MFS1. QFS1 will still be required as at present. Even with the introduction of FINREP, firms will continue to report FSA001 and FSA002 at solo level and, for groups not submitting FINREP, at the consolidated level.

Scope of FINREP

14.6 In CP5/13 the PRA proposed to amend the rules and guidance for data items FSA001 and FSA002 in accordance with the requirement of certain firms to report under FINREP. Several respondents requested clarification as to the scope of FINREP. This is as set out in CRR Article 99. It is the responsibility of firms to understand the supervisory reporting requirements as they apply to their business.

Basis of consolidation

14.7 Firms also asked for clarification of the basis of consolidation to be used for FINREP. The accounting scope of consolidation is only relevant when considering if the regulated entity is preparing consolidated accounts under International Financial Reporting Standards (IFRS) and falls into scope of CRR Article 99(2). However, when reporting under FINREP it is the prudential scope of consolidation that applies, as per Annex V part 1, 3.11 of the (final draft) ITS on Supervisory Reporting

Disclosure of return on assets

14.8 Following requests for clarification from respondents, the PRA confirms that the balance sheet and net profit as published within the same annual report should be used to calculate the return on assets disclosure in the same annual report.

Leverage

14.9 CRR Article 429 requires the leverage ratio to be calculated as the arithmetic mean of the monthly leverage ratios over a quarter. Respondents asked about the provision in Article 499 (3) which allows the PRA to permit firms until 31 December 2017 to calculate the leverage ratios on an end-of-quarter basis where it considers they do not have sufficient data quality to calculate on a month-end over the quarter basis. The PRA expects that firms would have sufficient data quality to calculate on the month-end average basis. However, where firms believe that they do not have sufficient data quality, they may apply for permission. Before granting permission to use the end-of-quarter basis, the PRA will assess applications on an individual basis.

(1) The EBA's common regulatory reporting framework.

15 Waivers and CRR Permissions

15.1 There were no responses to the CP on the treatment of PRA rule waivers under the CRR.

15.2 Waivers specified in Schedule 2 of the PRA Waivers rules will be treated as CRR Permissions, with existing conditions remaining in force. Waivers specified in Schedule 1 of the Rules will be treated as CRR Permissions with existing conditions remaining in force, provided firms confirm that they materially comply with the relevant rules and any conditions attached to the waivers, or firms have a remediation plan in place.

15.3 Any new condition to a waiver treated as a CRR Permission will take effect as a requirement under the CRR powers, or where it implements Article 101 or 104 of the CRD, as a requirement under section 55M FSMA. Firms may apply for such requirements.

15.4 Firms may appeal a refusal or variation of a CRR Permission or a requirement applied in relation to a CRR Permission. All CRR Permissions and requirements will be published on the Register.

15.5 The CRR contains many new provisions that require the approval, permission or consent of the PRA. It is for firms to consider the capital impact of not having such CRR Permissions in both reporting and disclosure terms.

16 Economic analysis

16.1 Some responses to the economic analysis in the CP were aimed at specific policy decisions rather than the economic analysis in Chapter 15. The economic analysis chapter was included to provide an estimate of the overall costs and benefits of the package of prudential measures. The cost-benefit analysis of specific policy choices was included in the chapters discussing each measure; these issues are addressed in the appropriate sections above.

16.2 The comments specific to Chapter 15 either questioned the PRA's assumptions or asked for further information on the PRA's analysis. These issues are addressed below by clarifying the PRA's assumptions using the existing analysis in the chapter and from the supporting research referenced in the text.

16.3 There were also a number of comments about specific elements of the economic analysis chapter. In conducting its analysis, the PRA considered all of the issues raised in the feedback received.

The Modigliani-Miller theorem

16.4 Some respondents questioned the PRA's assumptions about the extent to which the relative cost of debt and equity move in response to changes in the proportions of debt and equity on banks' balance sheets — the 'Modigliani-Miller theorem' (M-M). In its analysis, the PRA made no specific assumptions about the M-M theorem. Rather, it estimated the extent of changes to banks' funding costs in response to changes in capital ratios using an empirical analysis of actual movements in these variables over the past economic cycle. Consequently, the PRA's estimates take the outcome of the M-M theorem into account to the extent that it has influenced banks' behaviour in the past. Chapter 4 of FSA Occasional Paper 42⁽¹⁾ provides further discussion of the M-M theorem in the context of the PRA's estimates.

Firms' voluntary surplus of capital held over-and-above regulatory requirements

16.5 In the analysis, the PRA assumes that firms will shrink their voluntary surplus over regulatory requirements. The reasons for this assumption are explained in paragraph 15.26 of CP5/13. This is an assumption, and it may not be correct. Indeed, paragraphs 15.60–15.61 of the CP noted explicitly that the impact of CRD IV on aggregate capital ratios may have been underestimated. Table 15.F on page 56 of the CP therefore sets out estimates of the net benefits if banks in

aggregate hold up to an additional five percentage points of CET1 capital over the central scenario. The table indicates that the PRA expects that net benefits will be achieved by the overall policy package even if the impact on aggregate capital ratios has been underestimated significantly. The PRA considers that uncertainty over the shrinkage of banks' voluntary surplus over requirements is more than captured by this additional capital.

Calculating benefits of the overall package

16.6 Respondents acknowledged the challenges in measuring marginal and cumulative benefits of the various elements of CRD IV, although further clarification of how the PRA handled this in the economic analysis was requested. In particular, some respondents were unclear as to whether or not incremental benefits increased at a constant rate in the analysis. If benefits did increase at a constant rate, there was a question of whether the benefits of CRD IV may have been overstated as a whole. In fact the analysis recognised that the incremental benefits reduce as capital requirements increase. Table 15.F in the CP reflects this approach. Chapter 6 (Section 6.1.2) of FSA Occasional Paper 42 provides a more in-depth description of how the incremental and cumulative benefits of each element of the CRD IV package were measured and considered in the economic analysis.

The calibration of the CRD IV package used to estimate costs and benefits.

16.7 Several respondents misunderstood how the PRA treated the proposals to accelerate the changes in the definition of capital and to require 100% CET1 to cover Pillar 2 requirements. In particular, they thought that the economic analysis did not reflect these provisions. The PRA clarifies that the economic analysis reflects the wider macro-economic effects of both proposals. Table 15.J in the CP details the calibrations used in the analysis.

(1) See www.bankofengland.co.uk/pr/Pages/publications/banking/research.aspx.

Appendices

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- 1 Prudential sourcebook for banks, building societies and investment firms (Liquidity Standards) Amendment Instrument 2013

 - 2 Capital Requirements Regulation (Reporting) Amendment Instrument 2013

 - 3 Capital Requirements Directive (Governance And Remuneration) Amendment Instrument 2013

 - 4 Capital Requirements Directive (Passporting) Amendment Instrument 2013

 - 5 Capital Requirements Directive (Disapplication) Instrument 2013

 - 6 Capital Requirements Directive IV (Consequential Amendments) Instrument 2013

 - 7 PRA Rulebook CRR firms Instrument 2013

**PRUDENTIAL SOURCEBOOK FOR BANKS, BUILDING SOCIETIES AND
INVESTMENT FIRMS (LIQUIDITY STANDARDS) AMENDMENT
INSTRUMENT 2013**

Powers exercised

- A. The Prudential Regulation 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 137G (The PRA’s general rules); and
 - (2) section 137T (General supplementary powers).
- B. The rule-making powers referred to above are specified for the purpose of section 138G (Rule-making instruments) of the Act.

Pre-conditions to making

- C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority) (“FCA”), the PRA consulted the FCA. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

Commencement

- D. Part 1 of the Annex to this instrument comes into force on 1 January 2014.
- E. Part 2 of the Annex to this instrument comes into force on a date specified by subsequent PRA Board Instrument.

Amendments

- F. The Prudential sourcebook of Bank, Building Societies and Investment Firms (BIPRU) is amended in accordance with the Annex to this instrument.

Notes

- G. In the Annex to this instrument, the “notes” (indicated by “**Note:**”) are included for the convenience of readers but do not form part of the legislative text.

Citation

- H. This instrument may be cited as the Prudential sourcebook of Bank, Building Societies and Investment Firms (Liquidity Standards) Amendments Instrument 2013.

By order of the Board of the Prudential Regulation Authority

16 December 2013

Annex

**Amendments to the Prudential sourcebook for Banks, Building Societies and
Investment Firms (BIPRU)**

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

Part 1: Comes into force on 1 January 2014.

Liquidity standards

12.1 Application

12.1.1 R Subject to *BIPRU* 12.1.2R, *BIPRU* 12 applies to:

- (1) ~~a *BIPRU* firm~~ [deleted];
- (1A) a UK bank;
- (1B) a building society;
- (1C) a UK designated investment firm;
- (2) an incoming EEA firm which:
 - (a) is a ~~full BCD-CRD~~ credit institution; and
 - (b) has a branch in the United Kingdom; and
- (3) a third country *BIPRU* firm which:
 - (a) ~~is bank; and~~ [deleted]
 - (b) has a branch in the United Kingdom.

...

12.1.3 G ~~A firm that is an exempt full scope *BIPRU* investment firm is not an *HLAS BIPRU* firm.~~ [deleted]

12.1.4 R (1) ~~An exempt full scope *BIPRU* investment firm is a full scope *BIPRU* investment firm that at all times has total net assets which are less than or equal to 50 million.~~

- (2) ~~(In this rule, total net assets are the sum of a firm's total trading book assets and its total non-trading book assets, less the sum of its called up share capital, reserves and minority interests.~~

~~(3) (3) For the purpose of (2), the value attributed to each of the specified balance sheet items must be that which is reported to the FCA in the firm's most recent FSA001 data item. [deleted]~~

12.1.5 G ~~The effect of BIPRU 12.1.4R is therefore to require the firm to sum the values of cell entries 20A and 20B in data item FSA001 and deduct from that total the sum of the values of cell entries 42, 43 and 44 in the same data item. [deleted]~~

...

12.3 Liquidity risk management

...

12.3.4 R A firm must have in place robust strategies, policies, processes and systems that enable it to identify, measure, manage and monitor *liquidity risk* over an appropriate set of time horizons, including intra-day, so as to ensure that it maintains adequate levels of liquidity buffers. These strategies, policies, processes and systems must be tailored to business lines, currencies, branches and legal entities and must include adequate allocation mechanisms of liquidity costs, benefits and risks.

~~[Note: annex V paragraph 14 of the *Banking Consolidation Directive* article 86(1) of the *CRD*]~~

...

12.3.5 R ...

~~[Note: annex V paragraph 14a of the *Banking Consolidation Directive* article 86(2) (part) of the *CRD*]~~

...

12.3.7A R A firm must, taking into account the nature, scale and complexity of its activities, have liquidity risk profiles that are consistent with and not in excess of those required for a well-functioning and robust system.

~~[Note: article 86(3) of the *CRD*]~~

12.3.8 R ...

~~[Note: annex V paragraph 14a of the *Banking Consolidation Directive* article 86(2) (part) of the *CRD*]~~

...

12.3.22A R ...

~~[Note: annex V paragraph 16 of the *Banking Consolidation Directive* article 86(5) of the *CRD*]~~

12.3.22B R ...

~~[Note: annex V paragraph 17 of the *Banking Consolidation Directive* article 86(6) of the *CRD*]~~

12.3.27 R ...

~~[Note: annex V paragraph 15 of the *Banking Consolidation Directive* article 86(4) of the *CRD*]~~

12.4 Stress testing and contingency funding

12.4.-2 R ...

~~[Note: annex V paragraph 18 of the *Banking Consolidation Directive* article 86(7) of the *CRD*]~~

12.4.-1 R A *firm* must consider alternative scenarios on liquidity positions and on risk mitigants and must review ~~regularly~~ the assumptions underlying decisions concerning the funding position at least annually. For these purposes, alternative scenarios must address, in particular, off-balance sheet items and other contingent liabilities, including those of *securitisation special purpose entities (SSPEs)* or other special purpose entities, as referred to in the *EU CRR*, in relation to which the *firm* acts as *sponsor* or provides material liquidity support.

~~[Note: annex V paragraph 19 of the *Banking Consolidation Directive* article 86(8) of the *CRD*]~~

...

12.4.5A R A *firm* must consider the potential impact of institution-specific, market-wide and combined alternative scenarios. Different time ~~horizons~~ periods and varying degrees of stressed conditions must be considered.

~~[Note: annex V paragraph 20 of the *Banking Consolidation Directive* article 86(9) of the *CRD*]~~

...

12.4.10 R ...

~~[Note: annex V paragraph 21 of the *Banking Consolidation Directive* article 86(10) of the *CRD*]~~

- 12.4.11 R ~~In order to deal with liquidity crisis, a~~ A firm must have in place ~~contingency liquidity recovery~~ plans setting out adequate strategies and proper implementation measures in order to address possible liquidity shortfalls, including in relation to branches established in another EEA State. Those plans must be ~~regularly tested, at least annually,~~ updated on the basis of the outcome of the alternative scenarios set out in BIPRU 12.4.-1R, and be reported to and approved by the firm's governing body, so that internal policies and processes can be adjusted accordingly. A firm must take the necessary operational steps in advance to ensure that liquidity recovery plans can be implemented immediately.

[~~Note: annex V paragraph 22 of the Banking Consolidation Directive~~ article 86(11) (part) of the CRD]

- 12.4.11A R For a firm that is a CRD credit institution the operational steps referred to in BIPRU 12.4.11R must include holding collateral immediately available for central bank funding. This includes holding collateral where necessary in the currency of another EEA State, or currency of a non-EEA state to which the firm has exposures, and where operationally necessary within the territory of a Host State or non-EEA state to whose currency it is exposed.

[~~Note: article 86(11) (part) of the CRD~~ article 86(11) (part) of the CRD]

...

12.7 Liquid assets buffer

...

- 12.7.4 R ...

- (1) the central government or central bank in question has been assessed by at least two *eligible ECAs* as having a credit rating associated with ~~credit quality step~~ credit quality step 1 in the table set out in BIPRU 12 Annex 1R (Mapping of credit assessments of ECAs to credit quality steps) in the credit quality assessment scale published by the appropriate regulator for the purpose of BIPRU 3 (The Standardised Approach: mapping of the ECAs credit assessments to credit quality steps (Long term mapping)); and

...

...

- 12.7.6 R ...

- (1) the central bank in question has been assessed by at least two *eligible ECAs* as having a credit rating associated with ~~credit~~

~~quality step~~ credit quality step 1 in the table set out in *BIPRU 12 Annex 1R (Mapping of credit assessments of ECAIs to credit quality steps)* in the ~~credit quality assessment scale~~ published by the ~~appropriate regulator~~ for the purpose of *BIPRU 3 (The Standardised Approach: mapping of the ECAIs credit assessments to credit quality steps (Long term mapping))*; and

...

12.7.6A R ...

- (1) the *designated multilateral development bank* in question has been assessed by at least two *eligible ECAIs* as having a credit rating associated with ~~credit quality step~~ credit quality step 1 in the table set out in *BIPRU 12 Annex 1R (Mapping of credit assessments of ECAIs to credit quality steps)* in the ~~credit quality assessment scale~~ published by the ~~appropriate regulator~~ for the purpose of *BIPRU 3 (The Standardised Approach: mapping of the ECAIs' credit assessments to credit quality steps (Long term mapping))*; and

...

After BIPRU 12, insert the following new annex. The text is not underlined.

12 R Mapping of credit assessments of ECAIs to credit quality steps
Annex 1

Credit Quality Step	Fitch's assessment	Moody's assessments	S&P's assessments	DBRS' assessments
1	AAA to AA-	Aaa to Aa3	AAA to AA-	AAA to AAL
2	A+ to A-	A1 to A3	A+ to A-	AH to AL
3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	BBBH to BBBL
4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-	BBH to BBL
5	B+ to B-	B1 to B3	B+ to B-	BH to BL
6	CCC+ and below	Caa1 and below	CCC+ and below	CCCH and below

Part 2: Comes into force on a date specified by a subsequent PRA Board Instrument.

12.1 Application

12.1.1 R Subject to *BIPRU* 12.1.2R, *BIPRU* 12 applies to:

...

(2) ~~an incoming EEA firm which:~~

(a) ~~is a CRD credit institution; and~~

(b) ~~has a branch in the United Kingdom [deleted]; and~~

...

**CAPITAL REQUIREMENTS REGULATION (REPORTING) AMENDMENT
INSTRUMENT 2013**

Powers exercised

A. The Prudential Regulation 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 137G (The PRA’s general rules); and
- (2) section 137T (General supplementary powers);

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

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority) (“FCA”), the PRA consulted the FCA. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

Commencement

D. Part 1 to 3 of the Annex to this instrument comes into force on 1 January 2014.

E. Part 4 of the Annex to this instrument comes into force on 1 July 2014.

F. Part 5 of the Annex to this instrument shall come into force on the date specified by a subsequent PRA Board Instrument.

Amendments to the Handbook

G. The Supervisory manual (SUP) is amended in accordance with the Annex to this instrument.

Guidance

H. The Prudential Regulation Authority gives as guidance each provision in this Annex that is marked with a G.

Citation

I. This instrument may be cited as the Capital Requirements Regulation (Reporting) Amendment Instrument 2013.

By order of the Board of the Prudential Regulation Authority
16 December 2013

Annex

Amendments to the Supervision manual (SUP)

Part 1: Comes into force on 1 January 2014.

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

...

Notifications regarding financial information reporting under the EU CRR

- 16.3.19A R (1) A firm must notify the PRA if it is required to report financial information in accordance with Article 99 (2) of the EU CRR.
- (2) A firm must notify the PRA when it ceases to report financial information in accordance with Article 99 (2) of the EU CRR.
- 16.3.19B R A firm must notify the PRA if it adjusts its reporting reference dates for financial information under Article 99 of the EU CRR from the calendar year to its accounting year-end.

...

16.12 Integrated Regulatory Reporting

...

Purpose

- 16.12.2 G (1) *Principle 4* requires firms to maintain adequate financial resources. The Interim Prudential sourcebooks, *BIPRU*, ~~and *GENPRU* and *IFPRU*~~ set out the *appropriate regulator's* detailed capital adequacy requirements. By submitting regular data, firms enable the *appropriate regulator* to monitor their compliance with *Principle 4* and their prudential requirements. ~~in the Handbook.~~

...

...

- 16.12.3A G The following is designed to assist firms to understand how the reporting requirements set out in this chapter operate when the circumstances set out in SUP 16.12.3R(1)(a)(ii) apply.
- (1) Example 1
A ~~BIPRU 730K~~ firm UK designated investment firm that

undertakes activities in both *RAG 3* and *RAG 7*
 Overlaying the requirements of *RAG 3* (*data items*) with the requirements of *RAG 7* shows the following:

RAG 3 (<i>SUP 16.12.11R</i>) data items	RAG 7 (<i>SUP 16.12.22CR</i>) data items
...	...
Capital adequacy	Capital adequacy
Credit risk	Credit risk
Operational risk	Operational risk
Large exposures	Large exposures
UK integrated group large exposures <u>Exposures between core UK group and non-core large exposures group</u>	UK integrated group large exposures <u>Exposures between core UK group and non-core large exposures group</u>
...	...
Non EEA sub group	Non EEA sub group
...	...
Securitisation : non-trading book	Securitisation : non-trading book
...	...
Securitisation: trading book	Securitisation: trading book

...

The reporting frequency and submission times for items (b), (d) and (e) above are then derived from the rules applicable to *BIPRU firms* in *SUP 16.12.23R* and *SUP 16.12.24R*. Threshold conditions and fees and levies reports do not need to be submitted as they are not required under the lowest numbered of the two *RAGs* in this example, see *SUP 16.12.3R(1)(a)(iii)*.

- (2) Example 2
 A *UK bank* that is not a *FINREP firm* in *RAG 1* that also carries on activities in *RAG 5*
 Again, overlaying the *RAG 1* reporting requirements with the requirements for a *RAG 5 firm* gives the following:

<i>RAG 1 requirements (SUP 16.12.5R)</i>	<i>RAG 5 requirements (SUP 16.12.18AR)</i>
...	...
Capital adequacy	Capital Adequacy
Credit risk	
...	
Operational risk	
Large exposures	
UK integrated group large exposures <u>Exposures between core UK group and non-core large exposures group</u>	
...	
Non-EEA sub-group	
...	
Securitisation: non trading book	
...	
Securitisation: trading book	
	...

...

...

16.12.4 R Table of applicable rules containing *data items*, frequency and submission periods

(1)		(2)	(3)	(4)
<i>RAG number</i>	<i>Regulated Activities</i>	Provisions containing:		
...		
<i>RAG 3</i>	<ul style="list-style-type: none"> • dealing in investment as principal • dealing in 	<i>SUP 16.12.10R</i> <i>SUP 16.12.11R</i> or <u><i>SUP 16.12.11BR</i></u> for <i>UK</i>	<i>SUP 16.12.10R</i> <i>SUP 16.12.12R</i> or <u><i>SUP16.12.12A</i></u> <u><i>R for UK</i></u>	<i>SUP 16.12.10R</i> <i>SUP 16.12.13R</i>

	investments as agent <ul style="list-style-type: none"> • advising on investments (excluding retail investment activities) • arranging (bringing about) deals in investments (excluding retail investment activities) 	<i>designated investment firms</i>	<u><i>designated investment firms</i></u>	
RAG 4	<ul style="list-style-type: none"> • managing investments • establishing, operating or winding up a collective investment scheme - • establishing, operating or winding up a stakeholder pension scheme • establishing, operating or winding up a personal pension scheme ... 	<u>SUP 16.12.14R</u> <u>SUP 16.12.15R-or</u> <u>SUP 16.12.15BR</u> for UK <u><i>designated investment firms</i></u>	<u>SUP 16.12.14R</u> <u>SUP 16.12.16R or</u> <u>SUP16.12.16AR</u> for UK investment <u><i>firms</i></u>	<u>SUP 16.12.14R</u> <u>SUP 16.12.17R</u>
RAG 5	<i>home finance administration or home finance providing activity</i>	<u>SUP 16.12.18AR</u> and <u>SUP</u> <u>16.12.18BR</u>	<u>SUP 16.12.18AR</u> and <u>SUP</u> <u>16.12.18BR</u>	<u>SUP 16.12.18AR</u> and <u>SUP</u> <u>16.12.18BR</u>
...		
RAG 7	<ul style="list-style-type: none"> • retail investment activities • advising on pensions transfers & opt-outs • arranging (bringing about deals) in retail investments 	<u>SUP 16.12.22AR</u> or <u>SUP</u> <u>16.12.22CR</u> for <u>UK designated</u> <u><i>investment firms</i></u>	<u>SUP 16.12.23AR</u> and <u>SUP</u> <u>16.12.23R</u> for UK <u><i>designated investment firms</i></u>	<u>SUP 16.12.24R</u>
RAG 8	<ul style="list-style-type: none"> • making arrangements with a view to transactions in investments • operating a multilateral trading 	<u>SUP 16.12.25AR</u> or <u>SUP</u> <u>16.12.25CR</u> for <u>UK designated</u> <u><i>investment firms</i></u>	<u>SUP 16.12.26R</u>	<u>SUP 16.12.27R</u>

	facility			
...				

...

Regulated Activity Group 1

16.12.5 R The applicable *data items* and forms or reports referred to in *SUP* 16.12.4R are set out according to *firm* type in the table below:

Description of data item	Prudential category of firm, applicable data items and reporting format (Note 1)							
	<i>UK bank</i>	<i>Building society</i>	<i>Non-EEA bank</i>	<i>EEA bank that has permission to accept deposits, other than one with permission for cross border services only</i>	<i>EEA bank that does not have permission to accept deposits, other than one with permission for cross border services only</i>	[deleted]	<i>Credit union</i>	<i>Dormant account fund operator (note 15)</i>
...								
Capital adequacy	FSA003 (note 2)	FSA003 (note 2)					CQ; CY	
Credit risk	FSA004 (note 2)	FSA004 (note 2)						
...								
Operational risk	FSA007 (notes 2, 6)	FSA007 (notes 2, 6)						
Large exposures	FSA008 (note 2)	FSA008 (note 2)					CQ; CY	

UK integrated group large exposures <u>Exposures between core UK group and non-core large exposures group</u>	FSA018 (note 12)	FSA018 (note 12)						
...								
Non-EEA sub-group	FSA028 (note 8)							
...								
Securitisation: non-trading book	FSA046 (Notes 2 and 14)	FSA046 (Notes 2 and 14)						
...								
Securitisation: trading book	FSA058 (Notes 2 and 23)							
...								
Note 4	<p>This applies to a firm that is required to submit <i>data item</i> FSA003 and, at any time within the 12 months up to its latest <i>accounting reference date</i> ("the relevant period"), was reporting <i>data item</i> FSA005 ("Firm A") or not reporting this item ("Firm B"). In the case of Firm A it must report this <i>data item</i> if one or both of its last two submissions in the relevant period show that the threshold was exceeded. In the case of Firm B it must report this item if both the last two submissions in the relevant period show that the threshold has been exceeded. The threshold is exceeded where <i>data element</i> 93A in <i>data item</i> FSA003 is greater than £50 million, or its currency equivalent, at the relevant reporting date for the firm. For PRA-<i>authorised persons</i> lines 62 to 64 only are applicable. These lines apply to a firm that applies add-ons to their market risk capital calculation under the RNIV framework. For further guidance on how to complete the form refer to SUP 16 Annex 25AG.</p>							
...								
Note 6	<p>This is only applicable to a firm that has adopted, in whole or in part, either the <i>standardised approach</i>, <i>alternative standardised approach</i>, or <i>advanced measurement approach</i> under BIPRU 6. [deleted]</p>							

...	
Note 12	Members of a UK integrated group should only submit this data item at the UK integrated group level. Only applicable to a firm that has both a core UK group and a non-core large exposures group.
...	
Note 14	Only applicable to firms that hold securitisation positions, or are the originator or sponsor of securitisations of non trading book exposures. [deleted]
...	

16.12.6 R The applicable reporting frequencies for submission of *data items* and periods referred to in SUP 16.12.5R are set out in the table below according to *firm* type. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

<i>Data item</i>	Unconsolidated UK banks and building societies	Solo consolidated UK banks and building societies	Report on a UK consolidation group or, as applicable, defined liquidity group basis by UK banks and building societies	Other members of RAG 1
...				
FSA003	Quarterly or monthly (note 1)		Half yearly	
FSA004	Quarterly		Half yearly	
...				
FSA007	Annually			
FSA008	Quarterly			
...				
FSA028	Half yearly			
...				
FSA046	Quarterly			
...				
FSA058	Quarterly		Quarterly	
Note 1	Monthly submission only applicable if the firm has been notified in writing that it is required to report (when, on an annual review, it has two consecutive quarterly submissions of FSA003 showing data element 93A being greater than £50 million, or its			

	currency equivalent, and also greater than 50% of <i>data element 70A</i> - [deleted]
...	

16.12.7 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.6R, unless indicated otherwise.

<i>Data item</i>	Daily	Weekly	Monthly	Quarterly	Half yearly	Annual
...						
FSA003			<i>15 business days</i>	<i>20 business days</i>	<i>45 business days</i>	
FSA004				<i>20 business days</i>	<i>45 business days</i>	
...						
FSA007						6 months-]
FSA008				<i>20 business days (note 3)</i> <i>45 business days (note 4)</i>		
...						
FSA028					<i>30 business days</i>	
...						
FSA046				<i>20 business days (Note 3), 45 business days (Note 4)</i>		
...						
FSA058				<i>20 business days (Note 3), 45 business days (Note 4)</i>		
...						

...

- 16.12.11 R ~~The applicable *data items* referred to in SUP 16.12.4R are set out according to *firm* type in the table below: [deleted]~~
- [The table at SUP 16.12.11R is deleted in its entirety. The deleted text is not shown.]
- 16.12.11A G ~~The columns in the table in SUP 16.12.11R that deal with *BIPRU 50K firms* and *BIPRU 125K firms* cover some liquidity items that only have to be reported by an *ILAS BIPRU firm*. In fact a *BIPRU 50K firm* and a *BIPRU 125K firm* cannot be an *ILAS BIPRU firm*. One reason for drafting the table in this way is that the classification of *firms* into *ILAS BIPRU firms* and *non-ILAS BIPRU firms* is not based on the classification into *BIPRU 50K firms*, *BIPRU 125K firms* and *BIPRU 730K firms* and the drafting of the table emphasises that. Also, the table covers consolidated reports and the conditions about what sort of group has to supply what type of liquidity report do not always depend on how the individual *firm* is classified. [deleted]~~
- 16.12.11B R The applicable *data items* referred to in SUP 16.12.4R for *UK designated investment firms* are set out below:

<u>Description of <i>data item</i></u>	<u>Applicable <i>data item</i> (Note 1)</u>
<u><i>Annual report and accounts</i></u>	<u>No standard format</u>
<u><i>Annual report and accounts of the mixed-activity holding company (note 5)</i></u>	<u>No standard format</u>
<u><i>Solvency statement</i></u>	<u>No standard format (Note 6)</u>
<u><i>Balance sheet</i></u>	<u>FSA001 (Note 2)</u>
<u><i>Income statement</i></u>	<u>FSA002 (Note 2)</u>
<u><i>Market risk</i></u>	<u>FSA005 (notes 2, 19)</u>
<u><i>Market risk –supplementary</i></u>	<u>FSA006 (Note 3)</u>
<u><i>Exposures between core UK group and non-core large exposures group</i></u>	<u>FSA018 (Note 7)</u>
<u><i>Solo consolidation data</i></u>	<u>FSA016 (Note 9)</u>
<u><i>Pillar 2 questionnaire</i></u>	<u>FSA019 (Note 4)</u>
<u><i>IRB portfolio risk</i></u>	<u>FSA045 (Note 18)</u>
<u><i>Daily flows</i></u>	<u>FSA047 (Notes 10, 13, 15 and 16)</u>

<u>Enhanced Mismatch Report</u>	<u>FSA048 (Notes 10, 13, 15 and 16)</u>
<u>Liquidity Buffer Qualifying Securities</u>	<u>FSA050 (Notes 11, 14, 15 and 16)</u>
<u>Funding Concentration</u>	<u>FSA051 (Notes 11, 14, 15 and 16)</u>
<u>Pricing data</u>	<u>FSA052 (Notes 11, 15, 16 and 17)</u>
<u>Retail and corporate funding</u>	<u>FSA 053 (Notes 11, 14, 15 and 16)</u>
<u>Currency Analysis</u>	<u>FSA054 (Notes 11, 14, 15 and 16)</u>
<u>Systems and Controls Questionnaire</u>	<u>FSA055 (Notes 12 and 16)</u>

<u>Note 1</u>	<u>When submitting the completed <i>data item</i> required, a <i>firm</i> must use the format of the <i>data item</i> set out in SUP 16 Annex 24R. Guidance notes for completion of the data items are contained in SUP 16 Annex 25AG.</u>
<u>Note 2</u>	<u><i>Firms</i> that are members of a <i>consolidation group</i> are also required to submit this report on a <i>consolidation group basis</i>.</u>
<u>Note 3</u>	<u><i>Only applicable to firms with a VaR model permission.</i></u>
<u>Note 4</u>	<u>Only applicable to <i>UK designated investment firms</i> that: (a) are subject to consolidated supervision under the <i>EU CRR</i>, except those that are either included within the consolidated supervision of a group that includes a <i>UK credit institution</i>, or (b) are not subject to consolidated supervision under the <i>EU CRR</i>. <i>A UK designated investment firm</i> under (a) must complete the report on the basis of its <i>consolidation group</i>. <i>A UK designated investment firm</i> under (b) must complete the report on the basis of its solo position.</u>
<u>Note 5</u>	<u>Only applicable to a <i>firm</i> whose ultimate parent is a <i>mixed activity holding company</i>.</u>
<u>Note 6</u>	<u>Only applicable to a <i>firm</i> that is a <i>sole trader</i> or a <i>partnership</i>, when the report must be submitted by each <i>partner</i>.</u>

<u>Note 7</u>	<u>Only applicable to a firm that has both a core UK group and a non-core large exposures group.</u>
<u>Note 9</u>	<u>Only applicable to a firm with an individual consolidation permission.</u>
<u>Note 10</u>	<p><u>A firm must complete this item separately on each of the following bases (if applicable).</u></p> <p><u>(1) It must complete it on a solo basis. Therefore even if it has an individual consolidation permission it must complete the item on an unconsolidated basis by reference to the firm alone.</u></p> <p><u>(2) If it is a group liquidity reporting firm in a DLG by default and is a UK lead regulated firm, it must complete the item on the basis of that group.</u></p> <p><u>(3) If it is a group liquidity reporting firm in a UK DLG by modification, it must complete the item on the basis of that group.</u></p> <p><u>(4) If it is a group liquidity reporting firm in a non-UK DLG by modification, it must complete the item on the basis of that group.</u></p>
<u>Note 11</u>	<p><u>A firm must complete this item separately on each of the following bases that are applicable.</u></p> <p><u>(1) It must complete it on a solo basis unless it is a group liquidity reporting firm in a UK DLG by modification. Therefore even if it has an individual consolidation permission it must complete the item on an unconsolidated basis by reference to the firm alone.</u></p> <p><u>(2) If it is a group liquidity reporting firm in a UK DLG by modification, it must complete the item on the basis of that group.</u></p>
<u>Note 12</u>	<u>If it is a non-ILAS BIPRU firm, it must complete it on a solo basis. Therefore even if it has an individual consolidation permission it must complete the item on an unconsolidated basis by reference to the firm alone.</u>
<u>Note 13</u>	<p><u>(1) This item must be reported in the reporting currency.</u></p> <p><u>(2) If any data element is in a currency or currencies other than the reporting currency, all currencies (including the reporting currency) must be combined into a figure in the reporting currency.</u></p> <p><u>(3) In addition, all material currencies (which may include the reporting currency) must each be recorded separately (translated into the reporting currency).</u></p> <p><u>However if:</u></p> <p><u>(a) the reporting frequency is (whether under a rule or under a waiver) quarterly or less than quarterly; or</u></p> <p><u>(b) the only material currency is the reporting currency;</u></p>

	<p><u>(3) does not apply.</u></p> <p><u>(4) If there are more than three <i>material currencies</i> for this <i>data item</i>, (3) only applies to the three largest in amount. A <i>firm</i> must identify the largest in amount in accordance with the following procedure.</u></p> <p><u>(a) For each currency, take the largest of the asset or liability figure as referred to in the definition of <i>material currency</i>.</u></p> <p><u>(b) Take the three largest figures from the resulting list of amounts.</u></p> <p><u>(5) The date as at which the calculations for the purposes of the definition of <i>material currency</i> are carried out is the last day of the reporting period in question.</u></p> <p><u>(6) The reporting currency for this <i>data item</i> is whichever of the following currencies the <i>firm</i> chooses, namely USD (the United States Dollar), EUR (the euro), GBP (sterling), JPY (the Japanese Yen), CHF (the Swiss Franc), CAD (the Canadian Dollar) or SEK (the Swedish Krona).</u></p>
Note 14	Note 13 applies, except that paragraphs (3), (4) and (5) do not apply, meaning that <i>material currencies</i> must not be recorded separately.
Note 15	<u>Any changes to reporting requirements caused by a <i>firm</i> receiving an <i>intra-group liquidity modification</i> (or a variation to one) do not take effect until the first day of the next reporting period applicable under the changed reporting requirements for the <i>data item</i> in question if the <i>firm</i> receives that <i>intra-group liquidity modification</i> or variation part of the way through such a period. If the change is that the <i>firm</i> does not have to report a particular <i>data item</i> or does not have to report it at a particular <i>reporting level</i>, the <i>firm</i> must nevertheless report that item or at that <i>reporting level</i> for any reporting period that has already begun. This paragraph is subject to anything that the <i>intra-group liquidity modification</i> says to the contrary.</u>
Note 16	<u>FSA047, FSA048, FSA050, FSA051, FSA052, FSA053 and FSA054 must be completed by an <i>ILAS BIPRU firm</i>. An <i>ILAS BIPRU firm</i> does not need to complete FSA055. A <i>non-ILAS BIPRU firm</i> must complete FSA055 and does not need to complete FSA047, FSA048, FSA050, FSA051, FSA052, FSA053 and FSA054.</u>
Note 17	<u>This <i>data item</i> must be reported only in the currencies named in FSA052, so that liabilities in GBP are reported</u>

	<u>in GBP in rows 1 to 4, those in USD are reported in USD in rows 5 to 8, and those in Euro are reported in Euro in rows 9 to 12. Liabilities in other currencies are not to be reported.</u>
<u>Note 18</u>	<u>Only applicable to firms that have an IRB permission.</u>
<u>Note 19</u>	<u>Lines 62 to 64 only are applicable. These lines apply to a firm that applies add-ons to their market risk capital calculation under the RNIV framework. For further guidance on how to complete the form refer to SUP 16 Annex 25AG.</u>

- 16.12.12 R ~~The applicable reporting frequencies for data items referred to in SUP 16.12.4R are set out in the table below according to firm type. Reporting frequencies are calculated from a firm's accounting reference date, unless indicated otherwise. [deleted]~~

[The table at SUP 16.12.12R is being deleted in its entirety. The deleted text is not shown.]

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- 16.12.12A R The applicable reporting frequencies for data items referred to in SUP 16.12.4R are set out in the table below. Reporting frequencies are calculated from a firm's accounting reference date, unless indicated otherwise.

<u>Data item</u>	<u>Reporting frequency</u>
<u>Annual report and accounts</u>	<u>Annually</u>
<u>Annual report and accounts of the mixed-activity holding company</u>	<u>Annually</u>
<u>Solvency statement</u>	<u>Annually</u>
<u>FSA001</u>	<u>Quarterly</u>
<u>FSA002</u>	<u>Quarterly</u>
<u>FSA005</u>	<u>Quarterly</u>
<u>FSA006</u>	<u>Quarterly</u>
<u>FSA016</u>	<u>Half yearly</u>
<u>FSA018</u>	<u>Quarterly</u>
<u>FSA019</u>	<u>Annually</u>
<u>FSA045</u>	<u>Quarterly</u>

<u>FSA047</u>	<u>Daily, weekly, monthly or quarterly (Notes 1, 2 and 3)</u>
<u>FSA048</u>	<u>Daily, weekly, monthly or quarterly (Notes 1, 2 and 3)</u>
<u>FSA050</u>	<u>Monthly (Note 1)</u>
<u>FSA051</u>	<u>Monthly (Note 1)</u>
<u>FSA052</u>	<u>Weekly or monthly (Notes 1 and 4)</u>
<u>FSA053</u>	<u>Quarterly (Note 1)</u>
<u>FSA054</u>	<u>Quarterly (Note 1)</u>
<u>FSA055</u>	<u>Annually (Note 1)</u>

<u>Note 1</u>	<p><u>Reporting frequencies and reporting periods for this <i>data item</i> are calculated on a calendar year basis and not from a <i>firm's accounting reference date</i>. In particular:</u></p> <p><u>(1) A week means the period beginning on Saturday and ending on Friday.</u></p> <p><u>(2) A month begins on the first day of the calendar month and ends on the last day of that month.</u></p> <p><u>(3) Quarters end on 31 March, 30 June, 30 September and 31 December.</u></p> <p><u>(4) Daily means each <i>business day</i>.</u></p> <p><u>All periods are calculated by reference to London time.</u></p> <p><u>Any changes to reporting requirements caused by a <i>firm</i> receiving an <i>intra-group liquidity modification</i> (or a variation to one) do not take effect until the first day of the next reporting period applicable under the changed reporting requirements if the <i>firm</i> receives that <i>intra-group liquidity modification</i> or variation part of the way through such a period, unless the <i>intra-group liquidity modification</i> says otherwise.</u></p>
<u>Note 2</u>	<p><u>If the report is on a solo basis the reporting frequency is as follows:</u></p> <p><u>(1) if the <i>firm</i> does not have an <i>intra-group liquidity modification</i> the frequency is:</u></p>

	<p><u>(a) weekly if the firm is a standard frequency liquidity reporting firm; and</u></p> <p><u>(b) monthly if the firm is a low frequency liquidity reporting firm;</u></p> <p><u>(2) if the firm is a group liquidity reporting firm in a non-UK DLG by modification (firm level) the frequency is:</u></p> <p><u>(a) weekly if the firm is a standard frequency liquidity reporting firm; and</u></p> <p><u>(b) monthly if the firm is a low frequency liquidity reporting firm;</u></p> <p><u>(3) the frequency is quarterly if the firm is a group liquidity reporting firm in a UK DLG by modification.</u></p>
Note 3	<p><u>(1) If the reporting frequency is otherwise weekly, the item is to be reported on every business day if (and for as long as) there is a firm-specific liquidity stress or market liquidity stress in relation to the firm or group in question.</u></p> <p><u>(2) If the reporting frequency is otherwise monthly, the item is to be reported weekly if (and for as long as) there is a firm-specific liquidity stress or market liquidity stress in relation to the firm or group in question.</u></p> <p><u>(3) A firm must ensure that it would be able at all times to meet the requirements for daily or weekly reporting under paragraph (1) or (2) even if there is no firm-specific liquidity stress or market liquidity stress and none is expected.</u></p>
Note 4	<p><u>If the report is on a solo basis the reporting frequency is:</u></p> <p><u>(1) Weekly if the firm is a standard frequency liquidity reporting firm; and</u></p> <p><u>(2) Monthly if the firm is a low frequency liquidity reporting firm.</u></p>

- 16.12.13 R ~~The applicable due dates for submission referred to in SUP 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in SUP 16.12.12R, unless indicated otherwise. [deleted]~~

[The table at SUP 16.12.13R is deleted in its entirety. The deleted text

is not shown.]

16.12.13A R The applicable due dates for submission referred to in *SUP 16.12.4R* are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP 16.12.12AR*, unless indicated otherwise.

<u>Data item</u>	<u>Daily</u>	<u>Weekly</u>	<u>Monthly</u>	<u>Quarterly</u>	<u>Half yearly</u>	<u>Annual</u>
<u>Annual report and accounts</u>						<u>80 business days</u>
<u>Annual report and accounts of the mixed-activity holding company</u>						<u>7 months</u>
<u>Solvency statement</u>						<u>3 months</u>
<u>FSA001</u>				<u>20 business days</u>	<u>30 business days (Note 1); 45 business days (Note 2)</u>	
<u>FSA002</u>				<u>20 business days</u>	<u>30 business days (Note 1); 45 business days (Note 2)</u>	
<u>FSA005</u>				<u>20 business days</u>	<u>30 business days (Note 1); 45 business days (Note 2)</u>	
<u>FSA006</u>				<u>20 business days</u>		
<u>FSA016</u>					<u>30 business days</u>	
<u>FSA018</u>				<u>45 business days</u>		
<u>FSA019</u>						<u>2 months</u>

<u>FSA045</u>				<u>20 business days</u>	<u>30 business days (Note 1); 45 business days (Note 2)</u>	
<u>FSA047</u>	<u>22.00 hours (London time) on the business day immediately following the last day of the reporting period for the item in question</u>	<u>22.00 hours (London time) on the business day immediately following the last day of the reporting period for the item in question</u>	<u>15 business days</u>	<u>15 business days or one month (Note 3)</u>		
<u>FSA048</u>	<u>22.00 hours (London time) on the business day immediately following the last day of the reporting period for the item in question</u>	<u>22.00 hours (London time) on the business day immediately following the last day of the reporting period for the item in question</u>	<u>15 business days</u>	<u>15 business days or one month (Note 3)</u>		
<u>FSA050</u>			<u>15 business days</u>			
<u>FSA051</u>			<u>15 business days</u>			
<u>FSA052</u>		<u>22.00 hours (London time) on the business day immediately following the last day of the reporting period for the item in question</u>	<u>15 business days</u>			
<u>FSA053</u>				<u>15 business days</u>		
<u>FSA054</u>				<u>15 business days</u>		
<u>FSA055</u>						<u>15 business</u>

						<i>days</i>
<u>Note 1: For unconsolidated and solo-consolidated reports</u>						
<u>Note 2: For consolidation group reports</u>						
<u>Note 3: It is one <i>Month</i> if the report relates to a <i>non-UK DLG</i> by modification.</u>						

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Regulated Activity Group 4

- 16.12.15 R ~~The applicable *data items* referred to in SUP 16.12.4R according to type of *firm* are set out in the table below: [deleted]~~
[The table at SUP 16.12.15R is deleted in its entirety. The deleted text is not shown.]
- 16.12.15A G ~~The columns in the table in SUP 16.12.15R that deal with *BIPRU 50K firms* and *BIPRU 125K firms* cover some liquidity items that only have to be reported by an *ILAS BIPRU firm*. In fact a *BIPRU 50K firm* and a *BIPRU 125K firm* cannot be an *ILAS BIPRU firm*. One reason for drafting the table in this way is that the classification of firms into *ILAS BIPRU firms* and *non-ILAS BIPRU firms* is not based on the classification into *BIPRU 50K firms*, *BIPRU 125K firms* and *BIPRU 730K firms* and the drafting of the table emphasises that. Also, the table covers consolidated reports and the conditions about what sort of group has to supply what type of liquidity report do not always depend on how the individual *firm* is classified. [deleted]~~
- 16.12.15B R The applicable *data items* referred to in SUP 16.12.4R for *UK designated investment firms* are set out below:

<u>Description of <i>data item</i></u>	<u>Applicable data items (Note 1)</u>
<u><i>Annual report and accounts</i></u>	<u>No standard format</u>
<u><i>Annual report and accounts of the mixed-activity holding company (Note 19)</i></u>	<u>No standard format</u>
<u>Solvency statement (Note 20)</u>	<u>No standard format</u>
<u>Balance sheet</u>	<u>FSA001 (Note 2)</u>
<u>Income statement</u>	<u>FSA002 (Note 2)</u>
<u>Market risk</u>	<u>FSA005 (notes 2, 18)</u>

<u>Market risk – supplementary</u>	<u>FSA006 (Note 3)</u>
<u>Exposures between <i>core UK group</i> and <i>non-core large exposures group</i></u>	<u>FSA018 (Note 5)</u>
<u>Solo consolidation data</u>	<u>FSA016 (Note 6)</u>
<u>Pillar 2 questionnaire</u>	<u>FSA019 (Note 4)</u>
<u>Volumes and type of business (Note 15)</u>	<u>FSA038</u>
<u>UCITS (Note 16)</u>	<u>FSA042</u>
<u>IRB portfolio risk</u>	<u>FSA045 (note 17)</u>
<u>Daily Flows</u>	<u>FSA047 (Notes 7,10, 12 and 13)</u>
<u>Enhanced Mismatch Report</u>	<u>FSA048 (Notes 7, 10, 12 and 13)</u>
<u>Liquidity Buffer Qualifying Securities</u>	<u>FSA050 (Notes 8, 11, 12 and 13)</u>
<u>Funding Concentration</u>	<u>FSA051 (Notes 8, 11, 12 and 13)</u>
<u>Pricing data</u>	<u>FSA052 (Notes 8, 12, 13 and 14)</u>
<u>Retail and corporate funding</u>	<u>FSA053 (Notes 8, 11, 12 and 13)</u>
<u>Currency Analysis</u>	<u>FSA054 (Notes 8, 11, 12 and 13)</u>
<u>Systems and Control Questionnaire</u>	<u>FSA055 (Notes 9 and 13)</u>

<u>Note 1</u>	<u>When submitting the completed <i>data item</i> required, a <i>firm</i> must use the format of the <i>data item</i> set out in <i>SUP 16 Annex 24R</i>. Guidance notes for completion of the <i>data items</i> are contained in <i>SUP 16 Annex 25AG</i>.</u>
<u>Note 2</u>	<u><i>Firms</i> that are members of a <i>consolidation group</i> are also required to submit this report on a <i>consolidation group</i> basis.</u>
<u>Note 3</u>	<u>Only applicable to <i>firms</i> with a <i>VaR model permission</i>.</u>
<u>Note 4</u>	<u>Only applicable to <i>UK designated investment firms</i> that</u> :

	<p><u>(a) are subject to consolidated supervision under the EU CRR, except those that are either included within the consolidated supervision of a group that includes a UK credit institution,</u> or <u>(b) are not subject to consolidated supervision under the EU CRR.</u></p> <p><u>A UK designated investment firm under (a) must complete the report on the basis of its consolidation group. A UK designated investment firm under (b) must complete the report on the basis of its solo position.</u></p>
<u>Note 5</u>	<u>Only applicable to a firm that has both a core UK group and a non-core large exposures group.</u>
<u>Note 6</u>	<u>Only applicable to a firm that has an individual consolidation permission.</u>
<u>Note 7</u>	<p><u>A firm must complete this item separately on each of the following bases (if applicable).</u></p> <p><u>(1) It must complete it on a solo basis. Therefore even if it has an individual consolidation permission it must complete the item on an unconsolidated basis by reference to the firm alone.</u></p> <p><u>(2) If it is a group liquidity reporting firm in a DLG by default and is a UK lead regulated firm, it must complete the item on the basis of that group.</u></p> <p><u>(3) If it is a group liquidity reporting firm in a UK DLG by modification, it must complete the item on the basis of that group.</u></p> <p><u>(4) If it is a group liquidity reporting firm in a non-UK DLG by modification, it must complete the item on the basis of that group.</u></p>
<u>Note 8</u>	<p><u>A firm must complete this item separately on each of the following bases that are applicable.</u></p> <p><u>(1) It must complete it on a solo basis unless it is a group liquidity reporting firm in a UK DLG by modification. Therefore even if it has an individual consolidation permission it must complete the item on an unconsolidated basis by reference to the firm alone.</u></p> <p><u>(2) If it is a group liquidity reporting firm in a UK DLG</u></p>

	<u>by modification</u> , it must complete the item on the basis of that group.
<u>Note 9</u>	If it is a <i>non-ILAS BIPRU firm</i> , it must complete it on a solo basis. Therefore even if it has an <i>individual consolidation permission</i> it must complete the item on an unconsolidated basis by reference to the <i>firm</i> alone.
<u>Note 10</u>	<p>(1) This item must be reported in the reporting currency.</p> <p>(2) If any <i>data element</i> is in a currency or currencies other than the reporting currency, all currencies (including the reporting currency) must be combined into a figure in the reporting currency.</p> <p>(3) In addition, all <i>material currencies</i> (which may include the reporting currency) must each be recorded separately (translated into the reporting currency). However if:</p> <p>(a) the reporting frequency is (whether under a <i>rule</i> or under a <i>waiver</i>) quarterly or less than quarterly; or</p> <p>(b) the only <i>material currency</i> is the reporting currency;</p> <p>(3) does not apply.</p> <p>(4) If there are more than three <i>material currencies</i> for this <i>data item</i>, (3) only applies to the three largest in amount. A <i>firm</i> must identify the largest in amount in accordance with the following procedure.</p> <p>(a) For each currency, take the largest of the asset or liability figure as referred to in the definition of <i>material currency</i>.</p> <p>(b) Take the three largest figures from the resulting list of amounts.</p> <p>(5) The date as at which the calculations for the purposes of the definition of <i>material currency</i> are carried out is the last day of the reporting period in question.</p> <p>(6) The reporting currency for this <i>data item</i> is whichever of the following currencies the <i>firm</i> chooses, namely USD (the United States Dollar), EUR (the euro), GBP (sterling), JPY (the Japanese Yen), CHF (the Swiss Franc), CAD (the Canadian Dollar) or SEK (the Swedish Krona).</p>
<u>Note 11</u>	Note 10 applies, except that paragraphs (3), (4), and (5) do not apply, meaning that <i>material currencies</i> must

	<u>not be recorded separately.</u>
<u>Note 12</u>	<u>Any changes to reporting requirements caused by a firm receiving an <i>intra-group liquidity modification</i> (or a variation to one) do not take effect until the first day of the next reporting period applicable under the changed reporting requirements for the <i>data item</i> in question if the firm receives that <i>intra-group liquidity modification</i> or variation part of the way through such a period. If the change is that the <i>firm</i> does not have to report a particular <i>data item</i> or does not have to report it at a particular <i>reporting level</i>, the <i>firm</i> must nevertheless report that item or at that <i>reporting level</i> for any reporting period that has already begun. This paragraph is subject to anything that the <i>intra-group liquidity modification</i> says to the contrary.</u>
<u>Note 13</u>	<u>FSA047, FSA048, FSA050, FSA051, FSA052, FSA053 and FSA054 must be completed by an <i>ILAS BIPRU firm</i>. An <i>ILAS BIPRU firm</i> does not need to complete FSA055. A <i>non-ILAS BIPRU firm</i> must complete FSA055 and does not need to complete FSA047, FSA048, FSA050, FSA051, FSA052, FSA053 and FSA054.</u>
<u>Note 14</u>	<u>This <i>data item</i> must be reported only in the currencies named in FSA052, so that liabilities in GBP are reported in GBP in rows 1 to 4, those in USD are reported in USD in rows 5 to 8, and those in Euro are reported in Euro in rows 9 to 12. Liabilities in other currencies are not to be reported.</u>
<u>Note 15</u>	<u>Only applicable to <i>firms</i> that have a <i>managing investments permission</i>.</u>
<u>Note 16</u>	<u>Only applicable to <i>firms</i> that have <i>permission for establishing, operating or winding up a regulated collective investment scheme</i>.</u>
<u>Note 17</u>	<u>Only applicable to <i>firms</i> that have an <i>IRB permission</i>.</u>
<u>Note 18</u>	<u>Lines 63 to 64 only are applicable. These lines apply to a <i>firm</i> that applies add-ons to their market risk capital calculation under the <i>RNIV framework</i>.</u>
<u>Note 19</u>	<u>Only applicable to a <i>firm</i> whose ultimate parent is a <i>mixed activity holding company</i>.</u>
<u>Note 20</u>	<u>Only applicable to a <i>firm</i> that is a <i>sole trader</i> or a <i>partnership</i>, when the report must be submitted by each <i>partner</i>.</u>

- 16.12.16 R ~~The applicable reporting frequencies for *data items* referred to in SUP 16.12.15R are set out in the table below according to *firm* type. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise. [deleted]~~

[The table at SUP 16.12.16R is deleted in its entirety. The deleted text is not shown.]

- 16.12.16A R The applicable reporting frequencies for *data items* referred to in SUP 16.12.15B are set out in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

<u><i>Data item</i></u>	<u>Reporting frequency</u>
<u><i>Annual report and accounts</i></u>	<u>Annually</u>
<u><i>Annual report and accounts of the mixed-activity holding company</i></u>	<u>Annually</u>
<u>Solvency statement</u>	<u>Annually</u>
<u>FSA001</u>	<u>Quarterly</u>
<u>FSA002</u>	<u>Quarterly</u>
<u>FSA005</u>	<u>Quarterly</u>
<u>FSA006</u>	<u>Quarterly</u>
<u>FSA016</u>	<u>Half yearly</u>
<u>FSA018</u>	<u>Quarterly</u>
<u>FSA019</u>	<u>Annually</u>
<u>FSA038</u>	<u>Half yearly</u>
<u>FSA042</u>	<u>Quarterly</u>
<u>FSA045</u>	<u>Quarterly</u>
<u>FSA047</u>	<u>Daily, weekly, monthly or quarterly (Notes 1, 2 and 3)</u>
<u>FSA048</u>	<u>Daily, weekly, monthly or quarterly (Notes 1, 2 and 3)</u>
<u>FSA050</u>	<u>Monthly (Note 1)</u>

<u>FSA051</u>	<u>Monthly (Note 1)</u>
<u>FSA052</u>	<u>Weekly or monthly (Notes 1 and 4)</u>
<u>FSA053</u>	<u>Quarterly (Note 1)</u>
<u>FSA054</u>	<u>Quarterly (Note 1)</u>
<u>FSA055</u>	<u>Annually (Note 1)</u>

<u>Note 1</u>	<p><u>Reporting frequencies and reporting periods for this data item are calculated on a calendar year basis and not from a firm's accounting reference date. In particular:</u></p> <p><u>(1) A week means the period beginning on Saturday and ending on Friday.</u></p> <p><u>(2) A month begins on the first day of the calendar month and ends on the last day of that month.</u></p> <p><u>(3) Quarters end on 31 March, 30 June, 30 September and 31 December.</u></p> <p><u>(4) Daily means each business day.</u></p> <p><u>All periods are calculated by reference to London time.</u></p> <p><u>Any changes to reporting requirements caused by a firm receiving an intra-group liquidity modification (or a variation to one) do not take effect until the first day of the next reporting period applicable under the changed reporting requirements if the firm receives that intra-group liquidity modification or variation part of the way through such a period, unless the intra-group liquidity modification says otherwise.</u></p>
<u>Note 2</u>	<p><u>If the report is on a solo basis the reporting frequency is as follows:</u></p> <p><u>(1) if the firm does not have an intra-group liquidity modification the frequency is:</u></p> <p><u>(a) weekly if the firm is a standard frequency liquidity reporting firm; and</u></p> <p><u>(b) monthly if the firm is a low frequency liquidity</u></p>

	<p><u>reporting firm;</u></p> <p><u>(2) if the firm is a group liquidity reporting firm in a non-UK DLG by modification (firm level) the frequency is:</u></p> <p><u>(a) weekly if the firm is a standard frequency liquidity reporting firm; and</u></p> <p><u>(b) monthly if the firm is a low frequency liquidity reporting firm;</u></p> <p><u>(3) the frequency is quarterly if the firm is a group liquidity reporting firm in a UK DLG by modification.</u></p>
<u>Note 3</u>	<p><u>(1) If the reporting frequency is otherwise weekly, the item is to be reported on every business day if (and for as long as) there is a firm-specific liquidity stress or market liquidity stress in relation to the firm or group in question.</u></p> <p><u>(2) If the reporting frequency is otherwise monthly, the item is to be reported weekly if (and for as long as) there is a firm-specific liquidity stress or market liquidity stress in relation to the firm or group in question.</u></p> <p><u>(3) A firm must ensure that it would be able at all times to meet the requirements for daily or weekly reporting under paragraph (1) or (2) even if there is no firm-specific liquidity stress or market liquidity stress and none is expected.</u></p>
<u>Note 4</u>	<p><u>If the report is on a solo basis the reporting frequency is as follows:</u></p> <p><u>(1) weekly if the firm is a standard frequency liquidity reporting firm; and</u></p> <p><u>(2) monthly if the firm is a low frequency liquidity reporting firm.</u></p>

- 16.12.17 R ~~The applicable due dates for submission referred to in SUP 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in SUP 16.12.16R, unless indicated otherwise.~~

[The table at SUP 16.12.15R is deleted in its entirety. The deleted text is not shown.]

16.12.17A R The applicable due dates for submission referred to in *SUP 16.12.4R* are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP 16.12.16AR*, unless indicated otherwise.

<i>Data item</i>	<u>Daily</u>	<u>Weekly</u>	<u>Monthly</u>	<u>Quarterly</u>	<u>Half yearly</u>	<u>Annual</u>
<u>Annual report and accounts</u>						<u>80 business days</u>
<u>Annual report and accounts of the mixed-activity holding company</u>						<u>7 months</u>
<u>Solvency statement</u>						<u>3 months</u>
<u>FSA001</u>				<u>20 business days</u>	<u>30 business days (Note 1); 45 business days (Note 2)</u>	
<u>FSA002</u>				<u>20 business days</u>	<u>30 business days (Note 1); 45 business days (Note 2)</u>	
<u>FSA005</u>				<u>20 business days</u>	<u>30 business days (Note 1); 45 business days (Note 2)</u>	
<u>FSA006</u>				<u>20 business days</u>		
<u>FSA016</u>				<u>30 business days</u>		
<u>FSA018</u>				<u>45 business days</u>		
<u>FSA019</u>						<u>2 months</u>

<u>FSA042</u>				<u>20 business days</u>		
<u>FSA045</u>				<u>20 business days</u>	<u>30 business days (Note 1); 45 business days (Note 2)</u>	
<u>FSA047</u>	<u>22.00 hours (London time) on the business day immediately following the last day of the reporting period for the item in question</u>	<u>22.00 hours (London time) on the business day immediately following the last day of the reporting period for the item in question</u>	<u>15 business days</u>	<u>15 business days or one month (Note 3)</u>		
<u>FSA048</u>	<u>22.00 hours (London time) on the business day immediately following the last day of the reporting period for the item in question</u>	<u>22.00 hours (London time) on the business day immediately following the last day of the reporting period for the item in question</u>	<u>15 business days</u>	<u>15 business days or one month (Note 3)</u>		
<u>FSA050</u>			<u>15 business days</u>			
<u>FSA051</u>			<u>15 business days</u>			
<u>FSA052</u>		<u>22.00 hours (London time) on the business day immediately following the last day of the reporting period for the item in question</u>	<u>15 business days</u>			
<u>FSA053</u>				<u>15 business days</u>		
<u>FSA054</u>				<u>15 business</u>		

				<i>days</i>		
<u>FSA055</u>						<u>15 business days</u>
<u>Note 1: For unconsolidated and solo-consolidated reports</u>						
<u>Note 2: For consolidation group reports</u>						
<u>Note 3: It is one Month if the report relates to a non-UK DLG by modification.</u>						

...

Regulated Activity Group 7

16.12.22A R ~~The applicable data items referred to in SUP 16.12.4R are set out according to type of firm in the table below:- [deleted]~~

[The table at SUP 16.12.22AR is deleted in its entirety. The deleted text is not shown.]

16.12.22B G ~~The columns in the table in SUP 16.12.22AR that deal with BIPRU 50K firms and BIPRU 125K firms cover some liquidity items that only have to be reported by an ILAS BIPRU firm. In fact a BIPRU 50K firm and a BIPRU 125K firm cannot be an ILAS BIPRU firm. One reason for drafting the table in this way is that the classification of firms into ILAS BIPRU firms and non-ILAS BIPRU firms is not based on the classification into BIPRU 50K firms, BIPRU 125K firms and BIPRU 730K firms and the drafting of the table emphasises that. Also, the table covers consolidated reports and the conditions about what sort of group has to supply what type of liquidity report do not always depend on how the individual firm is classified. [deleted]~~

16.12.22C R The applicable data items referred to in SUP 16.12.4R for UK designated investment firms are set out in the table below:

<u>Description of data item</u>	<u>Applicable data item (Note 1)</u>
<u>Annual report and accounts</u>	<u>No standard format</u>
<u>Annual report and accounts of the mixed-activity holding company (note 16)</u>	<u>No standard format</u>
<u>Solvency statement</u>	<u>No standard format (Note 17)</u>
<u>Balance sheet</u>	<u>FSA001 (Note 2)</u>
<u>Income statement</u>	<u>FSA 002 (note 2)</u>
<u>Market risk</u>	<u>FSA005 (notes 2, 20)</u>
<u>Market risk – supplementary</u>	<u>FSA006 (note 3)</u>

<u>Exposures between <i>core UK group</i> and <i>non-core large exposures group</i></u>	<u>FSA018 (note 18)</u>
<u>Solo consolidation data</u>	<u>FSA016</u>
<u>Pillar 2 questionnaire</u>	<u>FSA019 (note 4)</u>
<u>IRB portfolio risk</u>	<u>FSA045 (note 19)</u>
<u>Daily Flows</u>	<u>FSA047 (Notes 6, 9, 11 and 12)</u>
<u>Enhanced Mismatch Report</u>	<u>FSA048 (Notes 6, 9, 11 and 12)</u>
<u>Liquidity Buffer Qualifying Securities</u>	<u>FSA050 (Notes 7, 10, 11 and 12)</u>
<u>Funding Concentration</u>	<u>FSA051 (Notes 7, 10, 11 and 12)</u>
<u>Pricing Data</u>	<u>FSA052 (Note 7, 10, 12 and 13)</u>
<u>Retail and corporate funding</u>	<u>FSA053 (Notes 7, 10, 11 and 12)</u>
<u>Currency Analysis</u>	<u>FSA054 (Notes 7, 10, 11 and 12)</u>
<u>Systems and Controls Questionnaire</u>	<u>FSA055 (Notes 8 and 12)</u>

<u>Note 1</u>	<u>When submitting the completed <i>data item</i> required, a <i>firm</i> must use the format of the <i>data item</i> set out in <i>SUP 16 Annex 24R</i>. Guidance notes for completion of the <i>data items</i> are contained in <i>SUP 16 Annex 25A G</i>.</u>
<u>Note 2</u>	<u><i>Firms</i> that are members of a <i>consolidation group</i> are also required to submit this report on a <i>consolidation group basis</i>.</u>
<u>Note 3</u>	<u>Only applicable to <i>firms</i> with a <i>VaR model permission</i>.</u>
<u>Note 4</u>	<u>Only applicable to <i>UK designated investment firms</i> that: (a) are subject to consolidated supervision under the <i>EU CRR</i>, except those that are either included within the consolidated supervision of a group that includes a <i>UK credit institution</i> <u>or</u> (b) are not subject to consolidated supervision under the</u>

	<p><u>EU CRR.</u></p> <p><u>A UK designated investment firm under (a) must complete the report on the basis of its consolidation group. A UK designated investment firm under (b) or must complete the report on the basis of its solo position.</u></p>
<u>Note 6</u>	<p><u>A firm must complete this item separately on each of the following bases (if applicable).</u></p> <p><u>(1) It must complete it on a solo basis. Therefore even if it has an individual consolidation permission it must complete the item on an unconsolidated basis by reference to the firm alone.</u></p> <p><u>(2) If it is a group liquidity reporting firm in a DLG by default and is a UK lead regulated firm, it must complete the item on the basis of that group.</u></p> <p><u>(3) If it is a group liquidity reporting firm in a UK DLG by modification, it must complete the item on the basis of that group.</u></p> <p><u>(4) If it is a group liquidity reporting firm in a non-UK DLG by modification, it must complete the item on the basis of that group.</u></p>
<u>Note 7</u>	<p><u>A firm must complete this item separately on each of the following bases that are applicable.</u></p> <p><u>(1) It must complete it on a solo basis unless it is a group liquidity reporting firm in a UK DLG by modification. Therefore even if it has an individual consolidation permission it must complete the item on an unconsolidated basis by reference to the firm alone.</u></p> <p><u>(2) If it is a group liquidity reporting firm in a UK DLG by modification, it must complete the item on the basis of that group.</u></p>
<u>Note 8</u>	<p><u>If it is a non-ILAS BIPRU firm, it must complete it on a solo basis. Therefore even if it has an individual consolidation permission it must complete the item on an unconsolidated basis by reference to the firm alone.</u></p>
<u>Note 9</u>	<p><u>(1) This item must be reported in the reporting currency.</u></p> <p><u>(2) If any data element is in a currency or currencies other than the reporting currency, all currencies</u></p>

	<p><u>(including the reporting currency) must be combined into a figure in the reporting currency.</u></p> <p><u>(3) In addition, all <i>material currencies</i> (which may include the reporting currency) must each be recorded separately (translated into the reporting currency). However if:</u></p> <p><u>(a) the reporting frequency is (whether under a <i>rule</i> or under a <i>waiver</i>) quarterly or less than quarterly; or</u></p> <p><u>(b) the only <i>material currency</i> is the reporting currency;</u></p> <p><u>(3) does not apply.</u></p> <p><u>(4) If there are more than three <i>material currencies</i> for this <i>data item</i>, (3) only applies to the three largest in amount. A <i>firm</i> must identify the largest in amount in accordance with the following procedure.</u></p> <p><u>(a) For each currency, take the largest of the asset or liability figure as referred to in the definition of <i>material currency</i>.</u></p> <p><u>(b) Take the three largest figures from the resulting list of amounts.</u></p> <p><u>(5) The date as at which the calculations for the purposes of the definition of <i>material currency</i> are carried out is the last day of the reporting period in question.</u></p> <p><u>(6) The reporting currency for this <i>data item</i> is whichever of the following currencies the <i>firm</i> chooses, namely USD (the United States Dollar), EUR (the euro), GBP (sterling), JPY (the Japanese Yen), CHF (the Swiss Franc), CAD (the Canadian Dollar) or SEK (the Swedish Krona).</u></p>
Note 10	<p><u>Note 9 applies, except that paragraphs (3), (4) and (5) do not apply, meaning that <i>material currencies</i> must not be recorded separately.</u></p>
Note 11	<p><u>Any changes to reporting requirements caused by a <i>firm</i> receiving an <i>intra-group liquidity modification</i> (or a variation to one) do not take effect until the first day of the next reporting period applicable under the changed reporting requirements for the <i>data item</i> in question if the <i>firm</i> receives that <i>intra-group liquidity modification</i> or variation part of the way through such a period. If the</u></p>

	<u>change is that the <i>firm</i> does not have to report a particular <i>data item</i> or does not have to report it at a particular <i>reporting level</i>, the <i>firm</i> must nevertheless report that item or at that <i>reporting level</i> for any reporting period that has already begun. This paragraph is subject to anything that the <i>intra-group liquidity modification</i> says to the contrary.</u>
<u>Note 12</u>	<u>FSA047, FSA048, FSA050, FSA051, FSA052, FSA053 and FSA054 must be completed by an <i>ILAS BIPRU firm</i>. An <i>ILAS BIPRU firm</i> does not need to complete FSA055. A <i>non-ILAS BIPRU firm</i> must complete FSA055 and does not need to complete FSA047, FSA048, FSA050, FSA051, FSA052, FSA053 and FSA054.</u>
<u>Note 13</u>	<u>This <i>data item</i> must be reported only in the currencies named in FSA052, so that liabilities in GBP are reported in GBP in rows 1 to 4, those in USD are reported in USD in rows 5 to 8, and those in Euro are reported in Euro in rows 9 to 12. Liabilities in other currencies are not to be reported.</u>
<u>Note 15</u>	<u>This item applies only to firms that provide advice and related services to employers on <i>group personal pension schemes</i> and/or <i>group stakeholder pension schemes</i>.</u>
<u>Note 16</u>	<u>Only applicable to a <i>firm</i> whose ultimate parent is a <i>mixed-activity holding company</i>.</u>
<u>Note 17</u>	<u>Only applicable to a <i>firm</i> that is a <i>sole trader</i> or a <i>partnership</i>, when the report must be submitted by each <i>partner</i>.</u>
<u>Note 18</u>	<u>Only applicable to a <i>firm</i> that has both a <i>core UK group</i> and a <i>non-core large exposures group</i>.</u>
<u>Note 19</u>	<u>Only applicable to <i>firms</i> that have an <i>IRB permission</i>.</u>
<u>Note 20</u>	<u>Lines 62 to 64 only are applicable. These lines apply to a <i>firm</i> that applies add-ons to their market risk capital calculation under the <i>RNIV</i> framework. For further guidance on how to complete the form refer to <i>SUP 16 Annex 25AG</i>.</u>

- 16.12.23 R The applicable reporting frequencies for *data items* referred to in *SUP 16.12.22AR* are set out in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

<i>Data item</i>	Frequency
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	Unconsolidated <i>BIPRU</i> <i>investment firm</i> <i>UK designated</i> <i>investment firm</i>	Solo consolidated <i>BIPRU</i> <i>investment</i> <i>firm</i> <i>UK</i> <i>designated</i> <i>investment</i> <i>firm</i> with an <u>individual</u> <u>consolidation</u> <u>permission</u>	<i>UK</i> <i>Consolidation</i> <i>Group</i> or <i>defined</i> <i>liquidity group</i>	Annual regulated business revenue up to and including £5 million	Annual regulated business revenue over £5 million
...					
FSA003 [deleted]	Monthly, quarterly or half yearly (note 2)	Monthly, quarterly or half yearly (note 2)	Half yearly		
FSA004 [deleted]	Quarterly or half yearly (note 1)	Quarterly or half yearly (note 1)	Half yearly		
...					
FSA007 [deleted]	Annually (note 3)	Annually (note 3)	Annually (note 3)		
FSA008 [deleted]	Quarterly	Quarterly	Quarterly		
...					
FSA028 [deleted]	Half yearly	Half yearly			
...					
FSA046 [deleted]	Quarterly	Quarterly	Quarterly		
...					
FSA058 [deleted]	Quarterly	Quarterly	Quarterly		
...					
Note 1:	<i>BIPRU 730K firms</i> and <i>BIPRU 125K firms</i> – quarterly; <i>BIPRU 50K firms</i> – half yearly. <i>UK designated investment firms</i> – quarterly.				
Note 2	<i>BIPRU 730K firms</i> – monthly; <i>BIPRU 125K firms</i> – quarterly; <i>BIPRU 50K firms</i> – half yearly. [deleted]				
Note 3	The reporting date for this <i>data item</i> is six months after a <i>firm's</i> most recent <i>accounting</i>				

	<i>reference date</i> . [deleted]
...	

16.12.24 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.23R, unless indicated otherwise.

<i>Data Item</i>	Daily	Weekly	Monthly	Quarterly	Half yearly	Annual
...						
FSA003 [deleted]	15 <i>business days</i>			20 <i>business days</i>	30 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)	
FSA004 [deleted]				20 <i>business days</i>	30 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)	
...						
FSA007 [deleted]						2 months
FSA008 [deleted]				20 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)		
...						
FSA028 [deleted]					30 <i>business days</i>	
...						
FSA046 [deleted]				20 <i>business days</i> (Note 1); 45 <i>business days</i> (Note 2)		
...						
FSA058				20 <i>business days</i> (Note		

[deleted]				1), 45 business days (Note 2)		
...						

Regulated Activity Group 8

16.12.25A R The applicable *data items* referred to in SUP 16.12.4R are set out according to type of *firm* in the table below: [deleted]

[The table at SUP 16.12.25AR is deleted in its entirety. The deleted text is not shown.]

...

16.12.25B G The columns in the table in SUP 16.12.25AR that deal with *BIPRU 50K firms* and *BIPRU 125K firms* cover some liquidity items that only have to be reported by an *ILAS BIPRU firm*. In fact a *BIPRU 50K firm* and a *BIPRU 125K firm* cannot be an *ILAS BIPRU firm*. One reason for drafting the table in this way is that the classification of *firms* into *ILAS BIPRU firms* and *non-ILAS BIPRU firms* is not based on the classification into *BIPRU 50K firms*, *BIPRU 125K firms* and *BIPRU 730K firms* and the drafting of the table emphasises that. Also, the table covers consolidated reports and the conditions about what sort of group has to supply what type of liquidity report do not always depend on how the individual *firm* is classified. [deleted]

16.12.25C R The applicable *data items* referred to in SUP 16.12.4R are set out in the table below:

<u>Description of data item</u>	<u>Applicable data item (Note 1)</u>
<u>Annual report and accounts</u>	<u>No standard format</u>
<u>Annual report and accounts of the mixed-activity holding company (Note 5)</u>	<u>No standard format</u>
<u>Solvency statement (Note 6)</u>	<u>No standard format</u>
<u>Balance sheet</u>	<u>FSA001 (note 2)</u>
<u>Income statement</u>	<u>FSA002 (note 2)</u>
<u>Market risk</u>	<u>FSA005 (notes 2, 18)</u>
<u>Market risk – supplementary</u>	<u>FSA006 (Note 3)</u>

<u>Exposures between <i>core UK group</i> and <i>non-core large exposures group</i></u>	<u>FSA018 (note 7)</u>
<u>Solo consolidation data</u>	<u>FSA016 (note 8)</u>
<u>Pillar 2 questionnaire</u>	<u>FSA019 (note 4)</u>
<u>IRB portfolio risk</u>	<u>FSA045 (note 17)</u>
<u>Daily flows</u>	<u>FSA047 (Notes 9, 12, 14 and 15)</u>
<u>Enhanced Mismatch Report</u>	<u>FSA048 (Notes 9, 12, 14 and 15)</u>
<u>Liquidity Buffer Qualifying Securities</u>	<u>FSA050 (Notes 10, 13, 14 and 15)</u>
<u>Funding Concentration</u>	<u>FSA051 (Notes 10, 13, 14 and 15)</u>
<u>Pricing data</u>	<u>FSA052 (Notes 10, 14, 15 and 16)</u>
<u>Retail and corporate funding</u>	<u>FSA053 (Notes 10, 13, 14 and 15)</u>
<u>Currency Analysis</u>	<u>FSA054 (Notes 10, 13, 14 and 15)</u>
<u>Systems and Controls Questionnaire</u>	<u>FSA055 (Notes 11 and 15)</u>

<u>Note 1</u>	<u>When submitting the completed <i>data item</i> required, a <i>firm</i> must use the format of the <i>data item</i> set out in <i>SUP 16 Annex 24 R</i>. Guidance notes for completion of the data items are contained in <i>SUP 16 Annex 25A G</i>.</u>
<u>Note 2</u>	<u><i>Firms</i> that are members of a <i>consolidation group</i> are also required to submit this report on a <i>consolidation group</i> basis.</u>
<u>Note 3</u>	<u>Only applicable to <i>firms</i> with a <i>VaR model permission</i>.</u>
<u>Note 4</u>	<u>Only applicable to <i>UK designated investment firms</i> that : (a) are subject to consolidated supervision under the</u>

	<p><u>EU CRR, except those that are either included within the consolidated supervision of a group that includes a UK credit institution; or</u></p> <p><u>(b) are not subject to consolidated supervision under the EU CRR.</u></p> <p><u>A UK designated investment firm under (a) must complete the report on the basis of its consolidation group. A UK designated investment firm under (b) must complete the report on the basis of its solo position.</u></p>
<u>Note 5</u>	<u>Only applicable to a firm whose ultimate parent is a mixed-activity holding company.</u>
<u>Note 6</u>	<u>Only applicable to a firm that is a sole trader or a partnership, when the report must be submitted by each partner.</u>
<u>Note 7</u>	<u>Only applicable to a firm that has both a core UK group and a non-core large exposures group.</u>
<u>Note 8</u>	<u>Only applicable to a firm that has an individual consolidation permission.</u>
<u>Note 9</u>	<p><u>A firm must complete this item separately on each of the following bases (if applicable).</u></p> <p><u>(1) It must complete it on a solo basis. Therefore even if it has an individual consolidation permission it must complete the item on an unconsolidated basis by reference to the firm alone.</u></p> <p><u>(2) If it a group liquidity reporting firm in a DLG by default and is a UK lead regulated firm, it must complete the item on the basis of that group.</u></p> <p><u>(3) If it is a group liquidity reporting firm in a UK DLG by modification, it must complete the item on the basis of that group.</u></p> <p><u>(4) If it is a group liquidity reporting firm in a non-UK DLG by modification, it must complete the item on the basis of that group.</u></p>
<u>Note 10</u>	<p><u>A firm must complete this item separately on each of the following bases that are applicable.</u></p> <p><u>(1) It must complete it on a solo basis unless it is a group liquidity reporting firm in a UK DLG by modification. Therefore even if it has an individual consolidation permission it must complete the item on an unconsolidated basis by reference to the firm alone.</u></p> <p><u>(2) If it is a group liquidity reporting firm in a UK DLG by modification, it must complete the item on the basis</u></p>

	<u>of that group.</u>
<u>Note 11</u>	<u>If it is a <i>non-ILAS BIPRU firm</i>, it must complete it on a solo basis. Therefore even if it has an <i>individual consolidation permission</i> it must complete the item on an unconsolidated basis by reference to the <i>firm</i> alone.</u>
<u>Note 12</u>	<p><u>(1) This item must be reported in the reporting currency.</u></p> <p><u>(2) If any <i>data element</i> is in a currency or currencies other than the reporting currency, all currencies (including the reporting currency) must be combined into a figure in the reporting currency.</u></p> <p><u>(3) In addition, all <i>material currencies</i> (which may include the reporting currency) must each be recorded separately (translated into the reporting currency). However if:</u></p> <p><u>(a) the reporting frequency is (whether under a <i>rule</i> or under a <i>waiver</i>) quarterly or less than quarterly; or</u></p> <p><u>(b) the only <i>material currency</i> is the reporting currency;</u></p> <p><u>(3) does not apply.</u></p> <p><u>(4) If there are more than three <i>material currencies</i> for this <i>data item</i>, (3) only applies to the three largest in amount. A <i>firm</i> must identify the largest in amount in accordance with the following procedure.</u></p> <p><u>(a) For each currency, take the largest of the asset or liability figure as referred to in the definition of <i>material currency</i>.</u></p> <p><u>(b) Take the three largest figures from the resulting list of amounts.</u></p> <p><u>(5) The date as at which the calculations for the purposes of the definition of <i>material currency</i> are carried out is the last day of the reporting period in question.</u></p> <p><u>(6) The reporting currency for this <i>data item</i> is whichever of the following currencies the <i>firm</i> chooses, namely USD (the United States Dollar), EUR (the euro), GBP (sterling), JPY (the Japanese Yen), CHF (the Swiss Franc), CAD (the Canadian Dollar) or SEK (the Swedish Krona).</u></p>
<u>Note 13</u>	<u>Note 24 applies, except that paragraphs (3), (4) and (5) do not apply, meaning that <i>material currencies</i> must not be recorded separately.</u>
<u>Note 14</u>	<u>Any changes to reporting requirements caused by a <i>firm</i> receiving an <i>intra-group liquidity modification</i> (or a variation to one) do not take effect until the first day of the next reporting period applicable under the</u>

	<u>changed reporting requirements for the <i>data item</i> in question if the <i>firm</i> receives that <i>intra-group liquidity modification</i> or variation part of the way through such a period. If the change is that the <i>firm</i> does not have to report a particular <i>data item</i> or does not have to report it at a particular <i>reporting level</i>, the <i>firm</i> must nevertheless report that item or at that <i>reporting level</i> for any reporting period that has already begun. This paragraph is subject to anything that the <i>intra-group liquidity modification</i> says to the contrary.</u>
Note 15	<u>FSA047, FSA048, FSA050, FSA051, FSA052, FSA053 and FSA054 must be completed by an <i>ILAS BIPRU firm</i>. An <i>ILAS BIPRU firm</i> does not need to complete FSA055. A <i>non-ILAS BIPRU firm</i> must complete FSA055 and does not need to complete FSA047, FSA048, FSA050, FSA051, FSA052, FSA053 and FSA054.</u>
Note 16	<u>This <i>data item</i> must be reported only in the currencies named in FSA052, so that liabilities in GBP are reported in GBP in rows 1 to 4, those in USD are reported in USD in rows 5 to 8, and those in Euro are reported in Euro in rows 9 to 12. Liabilities in other currencies are not to be reported.</u>
Note 17	<u>Only applicable to <i>firms</i> that have an <i>IRB permission</i>.</u>
Note 18	<u>Lines 63 and 64 only are applicable. These lines apply to a <i>firm</i> that applies add-ons to their market risk capital calculation under the <i>RNIV framework</i>.</u>

- 16.12.26 R The applicable reporting frequencies for *data items* referred to in SUP 16.12.25AR are set out according to the type of *firm* in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise. ~~[deleted]~~

[The table at SUP 16.12.26R is deleted in its entirety. The deleted text is not shown.]

- 16.12.26A R The applicable reporting frequencies for *data items* referred to in SUP 16.12.25CR are set out in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

<u><i>Data item</i></u>	<u><i>UK designated investment firm</i></u>	<u><i>consolidation group or defined liquidity group</i></u>
<u><i>Annual reports and accounts</i></u>	<u>Annually</u>	<u>Annually</u>

<u>Annual report and accounts of the mixed-activity holding company</u>	<u>Annually</u>	<u>Annually</u>
<u>Solvency statement</u>	<u>Annually</u>	
<u>FSA001</u>	<u>Quarterly</u>	<u>Half yearly</u>
<u>FSA002</u>	<u>Quarterly</u>	<u>Half yearly</u>
<u>FSA005</u>	<u>Quarterly</u>	<u>Quarterly</u>
<u>FSA006</u>	<u>Quarterly</u>	
<u>FSA016</u>	<u>Half yearly</u>	
<u>FSA018</u>	<u>Quarterly</u>	
<u>FSA019</u>	<u>Annually</u>	<u>Annually</u>
<u>FSA045</u>	<u>Quarterly</u>	<u>Half yearly</u>
<u>FSA047</u>	<u>Daily, weekly, monthly or quarterly (Notes 1, 2 and 4)</u>	<u>Daily, weekly, monthly or quarterly (Notes 1, 3 and 4)</u>
<u>FSA048</u>	<u>Daily, weekly, monthly or quarterly (Notes 1, 2 and 4)</u>	<u>Daily, weekly, monthly or quarterly (Notes 1, 3 and 4)</u>
<u>FSA050</u>	<u>Monthly (Note 1)</u>	<u>Monthly (Note 1)</u>
<u>FSA051</u>	<u>Monthly (Note 1)</u>	<u>Monthly (note 1)</u>
<u>FSA052</u>	<u>Weekly or monthly (Notes 1 and 5)</u>	<u>Weekly or monthly (notes 1 and 6)</u>
<u>FSA053</u>	<u>Quarterly (Note 1)</u>	<u>Quarterly (Note 1)</u>
<u>FSA054</u>	<u>Quarterly (Note 1)</u>	<u>Quarterly (Note 1)</u>
<u>FSA055</u>	<u>Annually (Note 1)</u>	<u>Annually (Note 1)</u>

<u>Note 1</u>	<u>Reporting frequencies and reporting periods for this data item are calculated on a calendar year basis and not from a firm's accounting reference date. In particular: (1) A week means the period beginning on Saturday</u>
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	<p><u>and ending on Friday.</u></p> <p><u>(2) A month begins on the first day of the calendar month and ends on the last day of that month.</u></p> <p><u>(3) Quarters end on 31 March, 30 June, 30 September and 31 December.</u></p> <p><u>(4) Daily means each <i>business day</i>.</u></p> <p><u>All periods are calculated by reference to London time.</u></p> <p><u>Any changes to reporting requirements caused by a <i>firm</i> receiving an <i>intra-group liquidity modification</i> (or a variation to one) do not take effect until the first day of the next reporting period applicable under the changed reporting requirements if the <i>firm</i> receives that <i>intra-group liquidity modification</i> or variation part of the way through such a period, unless the <i>intra-group liquidity modification</i> says otherwise.</u></p>
<p><u>Note 2</u></p>	<p><u>If the report is on a solo basis the reporting frequency is as follows:</u></p> <p><u>(1) if the <i>firm</i> does not have an <i>intra-group liquidity modification</i> the frequency is:</u></p> <p><u>(a) weekly if the <i>firm</i> is a <i>standard frequency liquidity reporting firm</i>; and</u></p> <p><u>(b) monthly if the <i>firm</i> is a <i>low frequency liquidity reporting firm</i>;</u></p> <p><u>(2) if the <i>firm</i> is a <i>group liquidity reporting firm</i> in a <i>non-UK DLG by modification (firm level)</i> the frequency is:</u></p> <p><u>(a) weekly if the <i>firm</i> is a <i>standard frequency liquidity reporting firm</i>; and</u></p> <p><u>(b) monthly if the <i>firm</i> is a <i>low frequency liquidity reporting firm</i>;</u></p> <p><u>(3) the frequency is quarterly if the <i>firm</i> is a <i>group liquidity reporting firm</i> in a <i>UK DLG by modification</i>.</u></p>
<p><u>Note 3</u></p>	<p><u>(1) If the report is by reference to the <i>firm's DLG by default</i> the reporting frequency is:</u></p> <p><u>(a) weekly if the <i>group liquidity standard frequency reporting conditions</i> are met;</u></p> <p><u>(b) monthly if the <i>group liquidity low frequency reporting conditions</i> are met.</u></p> <p><u>(2) If the report is by reference to the <i>firm's UK DLG by modification</i> the reporting frequency is:</u></p> <p><u>(a) weekly if the <i>group liquidity standard frequency reporting conditions</i> are met;</u></p> <p><u>(b) monthly if the <i>group liquidity low frequency reporting conditions</i> are met.</u></p> <p><u>(3) If the report is by reference to the <i>firm's non-UK DLG by modification</i> the reporting frequency is quarterly.</u></p>

<u>Note 4</u>	<p>(1) <u>If the reporting frequency is otherwise weekly, the item is to be reported on every <i>business day</i> if (and for as long as) there is a <i>firm-specific liquidity stress</i> or <i>market liquidity stress</i> in relation to the <i>firm</i> or <i>group</i> in question.</u></p> <p>(2) <u>If the reporting frequency is otherwise monthly, the item is to be reported weekly if (and for as long as) there is a <i>firm-specific liquidity stress</i> or <i>market liquidity stress</i> in relation to the <i>firm</i> or <i>group</i> in question.</u></p> <p>(3) <u>A <i>firm</i> must ensure that it would be able at all times to meet the requirements for daily or weekly reporting under paragraph (1) or (2) even if there is no <i>firm-specific liquidity stress</i> or <i>market liquidity stress</i> and none is expected.</u></p>
<u>Note 5</u>	<p><u>If the report is on a solo basis the reporting frequency is as follows:</u></p> <p>(1) <u>weekly if the <i>firm</i> is a <i>standard frequency liquidity reporting firm</i>; and</u></p> <p>(2) <u>monthly if the <i>firm</i> is a <i>low frequency liquidity reporting firm</i>.</u></p>
<u>Note 6</u>	<p><u>If the report is by reference to the <i>firm's UK DLG by modification</i> the reporting frequency is:</u></p> <p>(1) <u>weekly if the <i>group liquidity standard frequency reporting conditions</i> are met;</u></p> <p>(2) <u>monthly if the <i>group liquidity low frequency reporting conditions</i> are met.</u></p>

16.12.27 R ~~The applicable due dates for submission referred to in SUP 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in SUP 16.12.26R, unless indicated otherwise.~~

[The table at SUP 16.12.15R is deleted in its entirety. The deleted text is not shown.]

16.12.27A R The applicable due dates for submission referred to in SUP 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in SUP 16.12.26R, unless indicated otherwise.

<u>Data item</u>	<u>Daily</u>	<u>Weekly</u>	<u>Monthly</u>	<u>Quarterly</u>	<u>Half yearly</u>	<u>Annual</u>
<u>Annual report and accounts</u>						<u>80 business days</u>
<u>Annual reconciliation</u>						<u>80 business days</u>

<u>Annual report and accounts of the mixed-activity holding company</u>						<u>7 months</u>
<u>Solvency statement</u>						<u>3 months</u>
<u>FSA001</u>				<u>20 business days</u>	<u>30 business days (Note 1); 45 business days (Note 2)</u>	
<u>FSA002</u>				<u>20 business days</u>	<u>30 business days (Note 1); 45 business days (Note 2)</u>	
<u>FSA005</u>				<u>20 business days</u>	<u>30 business days (Note 1); 45 business days (Note 2)</u>	
<u>FSA006</u>				<u>20 business days</u>	<u>30 business days (Note 1); 45 business days (Note 2)</u>	
<u>FSA016</u>					<u>30 business days</u>	
<u>FSA018</u>				<u>45 business days</u>		
<u>FSA019</u>						<u>2 months</u>
<u>FSA045</u>				<u>20 business days</u>	<u>30 business days (Note 1); 45 business days (Note 2)</u>	
<u>FSA047</u>	<u>22.00 hours (London time) on the business day immediately following</u>	<u>22.00 hours (London time) on the business day immediately following the</u>	<u>15 business days</u>	<u>15 business days or one month (Note 3)</u>		

	<u>the last day of the reporting period for the item in question</u>	<u>last day of the reporting period for the item in question</u>				
<u>FSA048</u>	<u>22.00 hours (London time) on the business day immediately following the last day of the reporting period for the item in question</u>	<u>22.00 hours (London time) on the business day immediately following the last day of the reporting period for the item in question</u>	<u>15 business days</u>	<u>15 business days or one month (Note 3)</u>		
<u>FSA050</u>			<u>15 business days</u>			
<u>FSA051</u>			<u>15 business days</u>			
<u>FSA052</u>		<u>22.00 hours (London time) on the business day immediately following the last day of the reporting period for the item in question</u>	<u>15 business days</u>			
<u>FSA053</u>				<u>15 business days</u>		
<u>FSA054</u>				<u>15 business days</u>		
<u>FSA055</u>						<u>15 business days</u>
<u>Note 1: For unconsolidated and solo-consolidated reports</u>						
<u>Note 2: For consolidation group reports</u>						
<u>Note 3: It is one Month if the report relates to a non-UK DLG by modification.</u>						

...

16.16 Prudent valuation reporting

16.16.1 R This section applies to a *UK bank, a UK designated investment firm*

or a ~~BIPRU 730k firm~~ full-scope IFPRU investment firm which meets the condition in SUP 16.16.2R.

...

Purpose

- 16.16.3 R (1) The purpose of this section is to set out the requirements for a *firm* specified in SUP 16.16.1R to report the outcomes of its prudent valuation assessments ~~under the prudent valuation rules in GENPRU 1.3.4R and GENPRU 1.3.14R to GENPRU 1.3.34R,~~ to the *appropriate regulator* and to do so in a standard format.
- (2) The purpose of collecting this data on the prudent valuation assessments made by a *firm* ~~under GENPRU 1.3.4R and GENPRU 1.3.14R to GENPRU 1.3.34R~~ is to assist the *appropriate regulator* to gain a wider understanding of the nature and sources of measurement uncertainty in fair-valued financial instruments, and to enable comparison of the nature and level of that measurement uncertainty across *firms* and over time

[Note: articles 24 and 105 of the EU CRR]

Reporting requirement

- 16.16.4 R (1) A *firm* to which this section applies must submit to the *appropriate regulator* quarterly (on a calendar year basis and not from a *firm's accounting reference date*), within six weeks of each quarter end, a Prudent Valuation Return in respect of its fair-value assessments ~~under GENPRU 1.3.4R and GENPRU 1.3.14R to GENPRU 1.3.34R~~ in the format set out in SUP 16 Annex 31AR.

...

- 16.16.5 R Where a *firm* to which SUP 16.16.4R applies is a member of a ~~UK~~ *consolidation group*, the *firm* must comply with SUP 16.16.4R:
- (1) on ~~a solo-~~ an individual consolidation basis if the *firm* has a ~~solo-consolidation waiver~~ an individual consolidation permission, or on an unconsolidated basis if the *firm* does not have a ~~solo-consolidation waiver~~ an individual consolidation permission; and
- (2) separately, on the basis of the consolidated financial position of the ~~UK~~ *consolidation group*. (*Firms' attention is drawn to SUP 16.3.25G regarding a single submission for all firms in the group.*)

...

16.17.3 R ...

- (7) This *rule* applies to:
- (a) ~~a *BIPRU firm*; and~~ a *building society*;
 - (b) ~~a *third country BIPRU firm*~~;
~~that:~~ a *bank*;
 - (c) a *designated investment firm*; and
 - (d) an *overseas firm* that:
 - (i) is not an *EEA firm*;
 - (ii) has its head office outside the *EEA*; and
 - (iii) would be a *bank, building society* or a *designated investment firm*, if it had been a *UK domestic firm*, had carried on all of its business in the United Kingdom and had obtained whatever authorisations for doing so as are required under the Act.

that:

- ~~(e) is not a *BIPRU limited licence firm* or a *BIPRU limited activity firm*~~; and
- ~~(d)~~ is not, and does not have, an *EEA parent institution*
- ~~(e)~~ or an *EEA parent financial holding company*;

and that *firm* had total assets equal to or greater than £50 billion on an unconsolidated basis on the *accounting reference date* immediately prior to the *firm's* last complete financial year.

- (8) This *rule* also applies to:
- (a) ~~a *BIPRU firm*~~; and a *building society*;
 - (b) ~~a *third country BIPRU firm*~~;
~~that:~~ a *bank*;
 - (c) a *designated investment firm*; and
 - (d) an *overseas firm* that:
 - (i) is not an *EEA firm*;

- (ii) has its head office outside the EEA; and;
- (iii) would be a bank, building society or a designated investment firm, if it had been a UK domestic firm, had carried on all of its business in the United Kingdom and had obtained whatever authorisations for doing so as are required under the Act.

that:

- (e) is not a ~~BIPRU limited licence firm~~ or a ~~BIPRU limited activity firm~~; and
- ~~(d)~~ is part of a UK lead regulated group;
- (e)

and that *firm* had total assets equal to or greater than £50 billion on an unconsolidated basis on the *accounting reference date* immediately prior to the *firm's* last complete financial year.

- (9) In this rule "total assets" means
 - (a) in relation to a ~~BIPRU firm~~, bank, building society or designated investment firm, ~~the firm's~~ its total assets as set out in its balance sheet on the relevant *accounting reference date*; and
 - (b) in relation to a ~~third country BIPRU firm~~ an overseas firm, the total assets of the overseas firm as set out in its balance sheet on the relevant *accounting reference date* that cover the activities of the branch operation in the *United Kingdom*.

High Earners Reporting Requirements

16.17.4 R ...

- (8) ~~A firm to which this section applies on the date it comes into effect must submit two reports by 31 December 2012: one for each of the previous two complete financial years that ended before this section came into force. [deleted]~~

...

- (10) This rule applies to a ~~BIPRU firm~~ and a ~~third country BIPRU firm~~ bank, building society and an investment firm that:

- (a) is not a ~~BIPRU~~ IFPRU limited licence firm or a ~~BIPRU~~ IFPRU limited activity firm; and
- ...
- (11) This rule also applies to a ~~BIPRU firm~~ and a ~~third country BIPRU firm~~ bank, building society and an investment firm that:
- (a) is not a ~~BIPRU~~ IFPRU limited licence firm or a ~~BIPRU~~ IFPRU limited activity firm; and
- ...
- (12) This rule also applies to a ~~BIPRU~~ IFPRU limited licence firm or a ~~BIPRU~~ IFPRU limited activity firm:
- ...
- (b) where that UK lead regulated group contains either: a BIPRU firm or a third country BIPRU firm that is not a BIPRU limited licence firm or a BIPRU limited activity firm.
- (i) a bank, building society or an investment firm that is not an IFPRU limited licence firm or an IFPRU limited activity firm; or
- (ii) an overseas firm that;
- (aa) is not an EEA firm;
- (bb) has its head office outside the EEA;
and
- (cc) would be a bank, building society or an investment firm that is not a IFPRU limited licence firm or IFPRU limited activity firm, if it had been a UK domestic firm, had carried on all of its business in the UK and had obtained whatever authorisations for doing so as are required under the Act.
- (13) This rule also applies to an overseas firm that:
- (a) is not an EEA firm;
- (b) has its head office outside the EEA;
- (c) would be a bank, building society or an investment firm that is not a IFPRU limited licence firm or

IFPRU limited activity firm, if it had been a UK domestic firm, had carried on all of its business in the UK and had obtained whatever authorisations for doing so as are required under the Act,

and either

- (d) is not, and does not have, an EEA parent institution or an EEA parent financial holding company; or
- (e) is part of a UK lead regulated group.

...

Part 2

16 Annex 25G Guidance notes for data items in SUP 16 Annex 24R.

SUP 16 Annex 25G is deleted and a new SUP 16 Annex 25AG is inserted. SUP 16 Annex 25AG is made in the same terms as SUP 16 Annex 25G save in so far as set out below:

In this Part, the text in the data item, the title of which is set out in column (1), is deleted, except as indicated in column (2).

(1)	(2)
FSA001 – Balance sheet	<p>Retain the text and amend as follows. (underlining indicates new text and striking through indicates deleted text):</p> <p>...</p> <p>Valuation</p> <p>Firms should follow their normal accounting practice wherever possible. As there is no direct linkage with FSA003, there is no need for the data to follow the valuation rules applicable for capital adequacy purposes eg in relation to adjustments to the accounting values set out in GENPRU 1.3.36R.</p> <p>Consolidation</p> <p>When reporting the balance sheet on a <i>UK consolidation group</i> basis, firms should where possible treat the consolidation group as a single entity (ie line-by-line) rather than on an aggregation basis. However, for the liabilities, in the same way as for the capital resources calculation figure in FSA003, the consolidation should only treat the group as a single entity (ie line-by-line).</p> <p>...</p>

	<p>Assets</p> <p>These are broken down between trading book assets, and those that are not trading book assets. Hence the items reported in column B will exclude the items reported in column A. If a firm cannot easily identify trading book assets, all assets should be reported in the non-trading book column.</p> <p>Firms can determine whether they have trading book or not. However, it is expected that a firm that identifies trading book profits in FSA002, or reports trading book profits in FSA003 (in data element 61A), should be able to identify trading book assets.</p> <p>However, even if a firm does not identify trading book assets, it does not preclude that firm from having foreign exchange and commodities risk in the <i>market risk capital requirement</i> (data element 93A) in FSA003.</p> <p>1 Is this report on behalf of a UK consolidation group?</p> <p>See BIPRU 8.2. Firms should answer yes or no.</p> <p>2 If yes, please list the firm reference numbers of the other firms in the UK consolidation group.</p> <p>Firms should list the reference numbers of all the firms included within the <i>UK consolidation group</i> in Column B.</p> <p>3 If no (to data element 1), is this a solo consolidated report?</p> <p>See BIPRU 2.1. Firms that have a solo consolidation waiver <u>an individual consolidation permission</u> should answer yes here.</p> <p>...</p> <p>8 Deposits with, and loans to, credit institutions</p> <p>For BIPRU-UK designated investment firms, this will include any bank balances. Overdrawn accounts with banks should be reported in data element 23A.</p> <p>...</p> <p>12 Investment in group undertakings</p> <p>...</p> <p>When completing this on a <i>UK consolidation group</i> basis, investments in subsidiary and associated companies should only include those companies that are excluded from the consolidation.</p>
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	<p>...</p> <p>16 Other intangible assets</p> <p>Include here intangible assets, other than goodwill. The value here may differ from that reported in FSA003—see GENPRU 2.2.155R and GENPRU 2.2.156G.</p> <p>...</p> <p>19 Other assets</p> <p>Include any other assets not reported elsewhere on FSA001, items in suspense (in the case of <i>UK banks and building societies</i>), and any assets in respect of trading settlement accounts.</p> <p>For UK <i>consolidation group</i> reports, any assets consolidated other than on a line-by-line basis may be reported here.</p> <p>...</p> <p>23A Deposits from banks and building societies, including overdrafts and loans from them</p> <p>For <i>BIPRU UK designated investment firms</i>, this element will contain any borrowings made from banks or building societies. Deposit-taking firms will include here deposits from other credit institutions.</p> <p>24A Customer accounts</p> <p>This is unlikely to be relevant for <i>BIPRU UK designated investment firms</i>.</p> <p>...</p> <p>31A Debt securities in issue, excluding covered bonds</p> <p>This data element is unlikely to be relevant to <i>BIPRU UK designated investment firms</i>.</p> <p>...</p> <p>32A Covered bonds</p> <p>This data element is unlikely to be relevant to <i>BIPRU UK designated investment firms</i>.</p> <p>...</p> <p>42A Called up share capital, including partnership, LLP and sole trader capital</p> <p>Exclude holdings by the firm of its own shares (although these holdings should be reported in FSA003) and also excess of drawings over profits for partnerships, LLPs or</p>
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	<p>sole traders (which are also reported in FSA003). <i>Building societies</i> should exclude <i>PIBS</i>, which should be reported in 38A.</p> <p>43A Reserves</p> <p>As firms may use figures compiled on the same basis as audited accounts, the figures presented here may differ from those reported in FSA003. This is because of the different valuation basis used for capital adequacy, as set out in <i>GENPRU 1.3</i>. Firms may use figures compiled on the same basis as audited accounts.</p> <p>44A Minority interests</p> <p>As firms may use figures compiled on the same basis as audited accounts, the figures presented here may differ from those reported in FSA003 as a memorandum item. This is because of the different valuation basis used for capital adequacy, as set out in <i>GENPRU 1.3</i>. Firms may use figures compiled on the same basis as audited accounts.</p> <p>...</p> <p>64A Client money held</p> <p>Provide the total amount of client money held at the reporting date. Firms should be identifying this already to ensure compliance with <i>CASS</i>. For <i>UK</i> <i>consolidation group</i> reports, firms should only include client money to which <i>CASS</i> applies.</p> <p>...</p>
FSA002 – Income statement	<p>Amend the text as follows. Underlining indicates new text and striking through indicates deleted text:</p> <p>...</p> <p>Valuation</p> <p>Firms should follow their normal accounting practice wherever possible. In this regard, the figure for profits reported here may differ from the figures reported at the same date in FSA003, primarily because of valuation differences that arise from the application of <i>GENPRU 1.3</i>.</p> <p>...</p> <p>Consolidation</p> <p>Firms reporting on a <i>UK consolidation group</i> basis can use the same accounting basis for consolidation as in their accounts, as long as the group on which it is based accords</p>

with the *UK consolidation group*. (~~On FSA003, such firms will, however, have to report their capital resources on a line-by-line basis under *BIPRU 8*, and firms may prefer to do so here too.~~)

...

Trading book

Data elements in column A relate only the trading book. Firms should identify their trading book profits separately from the non-trading book profits wherever possible. ~~Firms that intend to include ‘net interim trading book profit and loss’ in data element 61A in FSA003 should complete this column. It is optional for other firms. See *BIPRU 1.2* for the definition of the trading book.~~

...

2B Interest income

...

Elements 3B to 6B break this down in more detail, but only 4B and 6B are likely to be relevant for *BIPRU UK designated investment firms*.

...

4B Of which: Retail unsecured loans (including bank deposits)

For *BIPRU UK designated investment firms*, this will include interest paid by banks or building societies on deposits with them.

...

5B Of which: Card accounts

This is unlikely to be relevant for *BIPRU UK designated investment firms*.

...

18B of which: Foreign exchange

This is unlikely to be relevant for *BIPRU UK designated investment firms*.

...

20B Gains (losses) arising from non-trading instruments

	<p>This element is unlikely to be relevant for <i>BIPRU UK designated investment firms</i>.</p> <p>...</p> <p>21B Realised gains (losses) on financial assets & liabilities (other than HFT and FVTPL)</p> <p>This element is unlikely to be relevant for <i>BIPRU UK designated investment firms</i>.</p> <p>...</p> <p>23B Other operating income</p> <p>This is unlikely to be relevant for <i>BIPRU UK designated investment firms</i>.</p> <p>...</p> <p>24B Gains (losses) on disposals of HFS non-current assets & discontinued operations</p> <p>This is unlikely to be relevant for <i>BIPRU UK designated investment firms</i>.</p> <p>...</p> <p>26B Interest paid</p> <p>...</p> <p>For <i>BIPRU UK designated investment firms</i>, this is likely to be limited to interest paid, or overdraft charges paid, to banks (also detailed in 27B) or on intra-group loans (detailed in 30B) or on other deposits (detailed in 31B).</p> <p>...</p> <p>27B Of which: Bank and building society deposits</p> <p>In the case of <i>BIPRU UK designated investment firms</i>, this will include interest payments to banks for loans or overdrafts.</p> <p>...</p> <p>28B Of which: Retail deposits</p> <p>This will not be relevant for <i>BIPRU UK designated investment firms</i>.</p> <p>...</p> <p>29B Of which: Corporate deposits</p>
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	<p>This will not be relevant for <i><u>BIPRU UK designated investment firms</u></i>.</p> <p>...</p> <p>30B Of which: Intra-group deposits</p> <p>This will only be relevant for <i><u>BIPRU UK designated investment firms</u></i> that have borrowed money from other group companies.</p> <p>...</p> <p>31B Of which: On other items</p> <p>This will only be relevant for <i><u>BIPRU UK designated investment firms</u></i> if they have issued bonds, interest rate swaps for hedging purposes or commercial paper.</p> <p>...</p> <p>46B Net profit (loss)</p> <p>This is the total profit (loss) after tax, before accounting for any minority interests, (which only get reported on FSA003).</p> <p>...</p>
FSA003 - Capital Adequacy	
FSA004 – Credit Risk	
FSA005 – Market Risk	<p>Delete the text and substitute with the following (new text is not underlined):</p> <p>FSA005 – Market risk</p> <p>This data item provides the PRA with information on Risks Not in VaR (RNIV) on a standardised basis.</p> <p>Completion of data item</p> <p>All cells not specifically referred to below should be left blank.</p> <p>62 Grand total PRR</p> <p>Firms should input “0” in order for all validations to succeed</p> <p>63 Add-ons</p> <p>This comprises the add-ons under the RNIV framework.</p>

	<p>64 Total Add-ons</p> <p>The total of items 1 to n in 63</p> <p>FSA005 – Market risk validations</p> <p>Internal validations</p> <p>Data elements are referenced by row then column.</p> <table border="1" data-bbox="539 656 1321 712"> <tr> <td>53</td> <td>64G</td> <td>=</td> <td>SUM (63B)</td> </tr> </table>	53	64G	=	SUM (63B)
53	64G	=	SUM (63B)		
FSA006- Market	<p>Amend the text as follows. Underlining indicates new text and striking through indicates deleted text:</p> <p>...</p> <p>This data item has similarities to CEBS' COREP Tables MKR SA TDI, MKR SA EQU and IM Details⁺, but reflects the Rules and wording in the Handbook, omits elements which are not in our view relevant in the UK, and combines some other elements. The numbers in parenthesis and italics show the corresponding element(s) in CEBS' Tables and are only provided for information purposes to identify the linkage to the CEBS' data.</p> <p>Valuation</p> <p>For the general policy on valuation, please see the <u>rules and guidance set out in GENPRU 1.3-relevant provisions of the EU CRR.</u></p> <p>...</p> <p>1A Closing P&L data</p> <p>This is the daily figure calculated under BIPRU 7.10.100R.</p> <p>1B VaR confidence level</p> <p>The number reported here will remain constant throughout the period, and is determined in accordance with BIPRU 7.10.98R.</p> <p>{CEBS' MKR IM Details column 5}</p> <p>1C Holding period (days)</p> <p>The number reported here will remain constant throughout the period, and is determined in accordance with BIPRU</p>				

	<p>7.10.98R. [CEBS' MKR IM Details column 9]</p> <p>1D Business unit code</p> <p>This will record the codes for the major business units, typically ones the firm uses itself, that has previously been agreed with the appropriate regulator. See <i>BIPRU 7.10.93G</i>.</p> <p>1E Currency</p> <p>This identifies the VaR reporting currency. See <i>BIPRU 7.10.113R</i>.</p> <p>1F Value at Risk</p> <p>This is the <i>One day VaR measure</i> calculated in accordance with <i>BIPRU 7.10.98R</i>. <u>Article 365 of the EU CRR</u>. [CEBS' MKR IM Details column 12]</p> <p>1G — BIPRU 7.10 cleaned P&L</p> <p>This is the figure calculated in under <i>BIPRU 7.10.100R</i>. [CEBS' MKR IM Details column 15]</p> <p>1H — Starting P&L date</p> <p>This is the date defined under <i>BIPRU 7.10.100R</i>.</p> <p>1J Date on which VaR computed</p> <p>This is the date when the VaR is computed under <i>BIPRU 7.10.115R</i>.</p> <p>1K Last date VaR historic data updated</p> <p>This is the last date on which this has been updated under <i>BIPRU 7.10.34R</i>.</p> <p>1L — Add-on VaR</p> <p>This is the figure calculated in accordance with <i>BIPRU 7.10.113R</i>. [Includes CEBS' MKR IM Details column 11]</p> <p>1M — BIPRU 7.10 hypothetical P&L</p> <p>This is the figure calculated in accordance with <i>BIPRU 7.10.112G</i>. [CEBS' MKR IM Details column 14]</p>
FSA007 – Operational Risk	
FSA008 – Large Exposures	

FSA009 – Key data validations	
FSA015 - Sectoral information, including arrears and impairment	<p>Amend the text as follows. Underlining indicates new text and striking through indicates deleted text:</p> <p>...</p> <p>Valuation</p> <p>For the general policy on valuation, please see the rules and guidance set out in GENPRU 1.3. <u>relevant provisions in the EU CRR.</u></p> <p>...</p>
FSA016 – Solo consolidation data	<p>Amend the text as follows. Underlining indicates new text and striking through indicates deleted text:</p> <p>...</p> <p>2A – Book value of investments included in solo-consolidation – EEA incorporated</p> <p>This is the book value of EEA- incorporated investments that are included within the firm’s solo-consolidated reporting under BIPRU 2.1, in the unconsolidated accounts of the firm.</p> <p>3A – Book value of investments included in solo-consolidation – non-EEA incorporated</p> <p>This is the book value of non-EEA incorporated investments that are included within the firm’s solo-consolidated reporting under BIPRU 2.1, in the unconsolidated accounts of the firm.</p> <p>...</p>
FSA018 – UK integrated group large exposures	<p>Delete the text and substitute with the following (new text is not underlined):</p> <p>FSA018 – Exposures from the core UK group to the non-core large exposures group</p> <p>This data item is only applicable to <i>firms</i> that have both a <i>core UK group permission</i> and an <i>NCLEG trading book permission</i> or an <i>NCLEG non-trading book permission</i>. It captures information on <i>exposures</i> from the members of a <i>firm’s core UK group</i> (and the <i>firm</i>) to members of a <i>firm’s non-core large exposures group</i>. A single report is required in respect of exposures from all members of the <i>firm’s core UK group</i> (and the <i>firm</i>), reflecting the exposures at the reporting date.</p> <p>FSA018 was originally constructed to capture information on the level of exposures from the UK integrated group to the diverse blocks and residual blocks, reflecting the intra-</p>

	<p>group large exposures regime in operation pre-2011. However, <i>firms</i> should interpret this form on the basis of the <i>core UK group</i> and <i>non-core large exposures group</i> respectively, and follow the specific instructions provided for the individual data cells.</p> <p>Valuation Unless indicated otherwise, the valuation of data elements should follow article 390 of the <i>EU CRR</i>.</p> <p>Currency You should report in the currency of your annual audited accounts (i.e. in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen). Figures should be reported in 000s.</p> <p>Data elements These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B. Individual rows within an element are identified as 2B.1, 2B.2 etc.</p> <p>General</p> <p>1 Ignore.</p> <p>2 Firm Reference Numbers List the Firm Reference Numbers for all the authorised firms in the <i>firm's core UK group</i> only. Firms should be listed sequentially in 2A, with the Firm Reference Numbers being entered in 2B. Ignore cell 2C.</p> <p>3A Core UK group eligible capital This is <i>core UK group eligible capital</i>.</p> <p>4A Exposure number Complete one line in relation to Section 4B. Ignore line marked 'Total'.</p> <p>4B Non-core large exposures group Complete one line only in respect of aggregate exposures of all members of the <i>core UK group</i> (and the <i>firm</i>) to all members of the <i>non-core large exposures group</i>.</p> <p>4C Gross exposure Report here the gross exposures (non-trading book and trading book) of all members of the <i>firm's core UK group</i> (and the <i>firm</i>) to all members of the <i>non-core large exposures group</i>.</p> <p>4D % of core UK group eligible capital</p>
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	<p>This is column C as a percentage of data element 3A (<i>core UK group eligible capital</i>). It should be entered to two decimal places, omitting the % sign.</p> <p>4E Exposure after credit risk mitigation This is the figure reported in column C after credit risk mitigation. This figure is subsequently broken down in columns F to M.</p> <p>4F Amount of the exposure that is exempt That part of the amount reported in column E that is exempted, whether under the <i>firm's NCLEG non trading book permission</i> or its <i>NCLEG trading book permission</i>.</p> <p>4G % of core UK group eligible capital This is column F as a percentage of data element 3A (<i>core UK group eligible capital</i>). It should be entered to two decimal places, omitting the % sign.</p> <p>4H Amount of the exposure that is not exempt and is in the non-trading book That part of the exposure reported in column E that is not exempt and is in the <i>non-trading book</i>.</p> <p>4J % of core UK group eligible capital This is column H as a percentage of <i>core UK group eligible capital</i>. It should be entered to two decimal places, omitting the % sign.</p> <p>4K Amount of the exposure that is not exempt and is in the trading book Ignore.</p> <p>4L % of core UK group eligible capital Ignore.</p> <p>4M Aggregate % of core UK group eligible capital Ignore.</p> <p>4N CNCOM . Ignore</p>
FSA019 – Pillar 2 questionnaire	<p>Amend the text as follows. Underlining indicates new text and striking through indicates deleted text:</p> <p>...</p> <p>Valuation</p> <p>For the general policy on valuation, please see the rules and guidance set out in GENPRU 1.3 <u>the relevant</u></p>

	<p>provisions in the <i>EU CRR</i>.</p> <p>...</p> <p>1B Does GENPRU 1.2 apply to your firm?</p> <p>See GENPRU 1.2.1R and GENPRU 1.2.44G to GENPRU 1.2.59R. <u>the rules on Internal Capital Adequacy Assessment in the PRA Rulebook</u>. The answer is either 'Yes' or 'No'.</p> <p>2B How much capital do you consider adequate for the nature, scale and complexity of your firm's activities in line with its Internal Capital Adequacy Assessment Process (ICAAP)?</p> <p>See GENPRU 1.2.26R. <u>2.1 PRA Rulebook</u>. Enter the figure in 000s.</p> <p>3B What is the actual amount of capital resource that your firm holds at the accounting reference date?</p> <p>See GENPRU 1.2.26R. <u>2.1 PRA Rulebook</u>. Enter the figure in 000s.</p> <p>4B Have you documented your ICAAP?</p> <p>See GENPRU 1.2.60R. <u>13.1 PRA Rulebook</u>. The answer is either 'Yes' or 'No'.</p> <p>5B When did you last review the ICAAP?</p> <p>See GENPRU 1.2.39R and GENPRU 1.2.40G. <u>3.4 PRA Rulebook</u>. The answer should be in 'ddmmyy' format.</p> <p>...</p> <p>8B What is the ratio of dealing errors in relation to the total number of transactions your firm has undertaken in the last 12 months?</p> <p>See GENPRU 1.2.30R. <u>3.1 PRA Rulebook</u>. This figure should be a percentage to one decimal place.</p> <p>9B Have you considered your firm's risk appetite when developing its ICAAP?</p> <p>See GENPRU 1.2.75G (2). The answer is either 'Yes' or 'No'.</p> <p>10B and 11B In your ICAAP, have you considered the impact of an economic downturn on your firm's</p>
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	<p>financial capital, and your business plans?</p> <p>See GENPRU 1.2.30R (1) and GENPRU 1.2.73R (1). <u>3.1 PRA Rulebook</u>. The answer to each question is either ‘Yes’ or ‘No’.</p> <p>12A to 23A Is your firm exposed to the risks listed</p> <p>See GENPRU 1.2.30R. <u>3.1 PRA Rulebook</u>. The answer to each question is either ‘Yes’ or ‘No’.</p> <p>...</p> <p>29B Does your firm deduct illiquid assets as set out in GENPRU 2.2.17R to GENPRU 2.2.19R?</p> <p>See GENPRU 1.2.30R, GENPRU 2.2.17R to GENPRU 2.2.19R, and GENPRU 2.2.260R to GENPRU 2.2.262G. The answer is either ‘Yes’ or ‘No’.</p> <p>30B Does your firm have sufficient liquidity to meet your liabilities as they fall due in the circumstances of an orderly wind down?</p> <p>See GENPRU 1.2.30R. <u>3.1 PRA Rulebook</u>. The answer is either ‘Yes’ or ‘No’.</p> <p>31B Report the amount of illiquid assets</p> <p>See GENPRU 1.2.30R, and GENPRU 2.2.260R to GENPRU 2.2.262G. This number should be entered in integers.</p> <p>32B Do you use credit risk mitigation techniques?</p> <p>See GENPRU 1.2.30R. <u>3.1 PRA Rulebook</u>. The answer is either ‘Yes’ or ‘No’.</p> <p>33B If so, have you considered in your ICAAP the fact that those techniques may not fully work as anticipated?</p> <p>This is only relevant if you answered ‘Yes’ to data element 32B. See GENPRU 1.2.30R. <u>3.1 PRA Rulebook</u>. The answer is either ‘Yes’ or ‘No’.</p> <p>34B Have you securitised assets in the last 12 months?</p> <p>See GENPRU 1.2.30R. <u>3.1 PRA Rulebook</u>. The answer is either ‘Yes’ or ‘No’.</p>
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	<p>35B Do you use an internal model as described in BIPRU 7.10 to calculate your regulatory market risk?</p> <p>See BIPRU 7.10. The answer is either ‘Yes’ or ‘No’.</p> <p>36B If so, have you taken the results of the market risk stress tests in your ICAAP into account?</p> <p>This is only relevant if you answered ‘Yes’ to data element 35B. See BIPRU 7.10, BIPRU 7.10.72R and BIPRU 7.10.73G. The answer is either ‘Yes’ or ‘No’.</p> <p>37B Report the result of a 200 basis point shock to interest rate on your firm’s economic value</p> <p>See BIPRU 2.3.7R (2). <u>9.1 and 9.2 PRA Rulebook</u>. Enter the figure in 000s.</p> <p>38B Does the result of the above stress test exceed 20% of your capital resources?</p> <p>See BIPRU 2.3.7R (3). <u>9.2 PRA Rulebook</u>. The answer to this is either ‘Yes’ or ‘No’.</p> <p>39B Would the valuation adjustments required under GENPRU 1.3.35G enable you to sell out of hedge your firm’s positions within a short period without incurring material losses under normal market conditions?</p> <p>See GENPRU 1.3.29R to GENPRU 1.3.35G. The answer to this is either ‘Yes’ or ‘No’.</p> <p>...</p>
FSA028 – Non EEA-sub group	
FSA045 – IRB portfolio risk	<p>Amend the text as follows. Underlining indicates new text and striking through indicates deleted text:</p> <p>This data enables the appropriate regulator to understand the relationship between cyclical and capital requirements under the CRD, help mitigate the risk of financial instability or economic recession, and be in a position to influence/contribute to international discussions on this. The information provided should be used to calculate that <i>firm’s</i> capital requirements. <i>Firms</i> should submit the data in their own PD bands.</p> <p>...</p>

	<p>Credit risk</p> <p>...</p> <p>Exposure at default estimate</p> <p>Calculate in accordance with BIPRU 4 the <u>EU CRR provisions relating to the IRB approach</u>. This should be the downturn EAD.</p> <p>Maturity</p> <p>This is the exposure weighted average maturity in days. <u>It should take into account the maturity floor and ceiling.</u></p> <p>PD – Probability of default</p> <p>The probability of default of a counterparty over a one year period, calculated in accordance with BIPRU 4 the <u>EU CRR provisions relating to the IRB approach</u>. This should be the long-run PD and take into account the 0.03% PD floor.</p> <p>LGD – Loss given default</p> <p>The ratio of the loss on an <i>exposure</i> due to the default of a counterparty to the amount outstanding at default, calculated in accordance with BIPRU 4 the <u>EU CRR provisions relating to the IRB approach</u>. This should be the downturn LGD.</p> <p>Expected loss</p> <p>Calculate in accordance with BIPRU 4 the <u>EU CRR provisions relating to the IRB approach</u>.</p> <p>Risk weighted exposure amount</p> <p>Calculate in accordance with BIPRU 4 the <u>EU CRR provisions relating to the IRB approach</u>. The SME-supporting factor according to CRR Article 501 should be <u>excluded</u>.</p> <p>Counterparty credit risk</p> <p>...</p> <p>Exposure at default estimate</p> <p>Calculate in accordance with BIPRU 4 the <u>EU CRR provisions relating to the IRB approach</u>. This should be the downturn EAD.</p> <p>...</p> <p>PD – Probability of default</p> <p>The probability of default of a counterparty over a one year</p>
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	<p>period, calculated in accordance with <u>BIPRU 4 the EU CRR provisions relating to the IRB approach</u>. This should be the long-run PD and take into account the 0.03% PD floor.</p> <p>LGD – Loss given default</p> <p>The ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default, calculated in accordance with <u>BIPRU 4 the EU CRR provisions relating to the IRB approach</u>. This should be the downturn LGD.</p> <p>Expected loss</p> <p>Calculate in accordance with <u>BIPRU 4 the EU CRR provisions relating to the IRB approach</u>.</p> <p>Risk weighted exposure amount</p> <p>Calculate in accordance with <u>BIPRU 4 the EU CRR provisions relating to the IRB approach</u>.</p> <p>...</p>
FSA046 – Securitisation: Non- Trading Book	
FSA048 – Enhanced Mismatch Report	<p>Amend the text as follows. Underlining indicates new text and striking through indicates deleted text:</p> <p>...</p> <p>Valuation</p> <p>Except where outlined, a <i>firm</i> should follow the <u>appropriate regulator’s rules and guidance on valuation set out in GENPRU 1.3 relevant provisions in the EU CRR</u>. A <i>firm</i> not subject to GENPRU 1.3, for example, an incoming EEA firm <u>the EU CRR</u>, should follow its applicable accounting standards.</p> <p>...</p> <p>7 Other high quality central bank, supranational and central government debt</p> <p>A <i>firm</i> should report in this row the unencumbered balances and the contractual securities flows of any securities not reported in line 6 or 8 whose obligor is a central government, <i>multilateral development bank</i> or central bank whose credit rating maps to <i>credit quality step 2</i> or above in the credit quality assessment scale <u>scale published by the appropriate regulator for the purpose of BIPRU 3 Articles 111 – 141 of the EU CRR</u> (the Standardised Approach to Credit Risk: mapping of the ECAs credit assessment to credit quality steps (Long term</p>

mapping)).

...

9 Own-name securities and transferable whole-loans

A *firm* should report in this row (i) the unencumbered balances and contractual securities flows of any own-name covered bonds and asset-backed securities that it holds secured by the *firm's* assets where the credit rating of such *exposures* has a credit rating associated with *credit quality step 2* or above in the ~~*credit quality assessment scale*~~ scale published by the appropriate regulator for the purpose of ~~BIPRU 3~~ Articles 111 – 141 of the *EU CRR* (the Standardised Approach to Credit Risk: mapping of the ECAIs credit assessment to credit quality steps (Long term mapping)) or *credit quality step 1* in the case of short-term mapping (ii) the unencumbered balances and maturity flows of any whole-loans whose credit rating is associated with *credit quality step 2* or above in the ~~*credit quality assessment scale*~~ scale published by the appropriate regulator for the purpose of ~~BIPRU 3~~ Articles 111 – 141 of the *EU CRR* (the Standardised Approach to Credit Risk: mapping of the ECAIs credit assessment to credit quality steps (Long term mapping)) or *credit quality step 1* in the case of short-term mapping where such *exposures* are held on the *firm's* balance sheet for which there is no operational or contractual impediment to their being transferred to a third party.

...

10 High quality asset-backed securities

A *firm* should report in this row the unencumbered balances and contractual securities flows of any asset backed securities that it holds where the credit rating of such *exposures* is associated with *credit quality step 2* or above in the ~~*credit quality assessment scale*~~ scale published by the appropriate regulator for the purpose of ~~BIPRU 3~~ Articles 111 – 141 of the *EU CRR* (the Standardised Approach to Credit Risk: mapping of the ECAIs credit assessment to credit quality steps (Long term mapping)) or *credit quality step 1* in the case of short-term mapping, provided that such *exposure* is the most senior tranche of the issuing *securitisation special purpose entity*. All asset backed securities that are not included in this row should be reported in row 17.

...

11 High quality covered bonds

A *firm* should report in this row the unencumbered balances and contractual securities flows of all covered bonds, where the credit rating of such *exposures* is associated with *credit quality step 2* or above in the ~~*credit*~~

~~quality assessment scale~~ scale published by the appropriate regulator for the purpose of ~~BIPRU 3~~ Articles 111 – 141 of the ~~EU CRR~~ (the Standardised Approach to Credit Risk: mapping of the ECAIs credit assessment to credit quality steps (Long term mapping)) or *credit quality step 1* in the case of short-term mapping.

...

12 Securities issued by group entities

...

(2) the credit rating of such *exposures* is associated with *credit quality step 2* or above in the ~~credit quality assessment scale~~ scale published by the ~~appropriate regulator~~ for the purpose of ~~BIPRU 3~~ Articles 111 – 141 of the ~~EU CRR~~ (the Standardised Approach to Credit Risk: mapping of the ECAIs credit assessment to credit quality steps (Long term mapping)) or *credit quality step 1* in the case of short-term mapping.

...

13 High quality corporate bonds (UK credit institutions)

A *firm* should report in this row the unencumbered balances and contractual securities flows of all senior corporate bonds that it holds whose obligor is a credit institution incorporated in the *United Kingdom*, if the credit rating of such *exposures* is associated with *credit quality step 2* or above in the ~~credit quality assessment scale~~ scale published by the ~~appropriate regulator~~ for the purpose of ~~BIPRU 3~~ Articles 111 – 141 of the ~~EU CRR~~ (the Standardised Approach to Credit Risk: mapping of the ECAIs credit assessment to credit quality steps (Long term mapping)) or *credit quality step 1* in the case of short-term mapping.

...

14 High quality corporate bonds (non-UK credit institutions)

A *firm* should report in this row the unencumbered balances and contractual securities flows of all senior corporate bonds that it holds whose obligor is a credit institution not incorporated in the *United Kingdom*, if the credit rating of such *exposures* is associated with *credit quality step 2* or above in the ~~credit quality assessment scale~~ scale published by the ~~appropriate regulator~~ for the purpose of ~~BIPRU 3~~ Articles 111 – 141 of the ~~EU CRR~~ (the Standardised Approach to Credit Risk: mapping of the ECAIs credit assessment to credit quality steps (Long term mapping)) or *credit quality step 1* in the case of short-term mapping.

...

In addition a *firm* should include any securities whose

	<p>obligor is a local government, state or municipality in this line, whose credit rating is associated with <i>credit quality step 2</i> or above in the <i>credit quality assessment scale</i> <u>scale published by the appropriate regulator</u> for the purpose of BIPRU 3 <u>Articles 111 – 141 of the <i>EU CRR</i></u> (the Standardised Approach to Credit Risk: mapping of the ECAIs credit assessment to credit quality steps (Long term mapping)) or <i>credit quality step 1</i> in the case of short-term mapping.</p> <p>15 High quality corporate bonds (excluding credit institutions)</p> <p>A <i>firm</i> should report in this row the unencumbered balances and contractual securities flows of all senior corporate bonds that it holds whose obligor is not a credit institution, if the credit rating of such <i>exposures</i> is associated with <i>credit quality step 2</i> or above in the <i>credit quality assessment scale</i> <u>scale published by the appropriate regulator</u> for the purpose of BIPRU 3 <u>Articles 111 – 141 of the <i>EU CRR</i></u> (the Standardised Approach to Credit Risk: mapping of the ECAIs credit assessment to credit quality steps (Long term mapping)) or <i>credit quality step 1</i> in the case of short-term mapping.</p> <p>In addition a <i>firm</i> should include any securities whose obligor is a local government, state or municipality in this line, whose credit rating is associated with <i>credit quality step 2</i> or above in the <i>credit quality assessment scale</i> <u>scale published by the appropriate regulator</u> for the purpose of BIPRU 3 <u>Articles 111 – 141 of the <i>EU CRR</i></u> (the Standardised Approach to Credit Risk: mapping of the ECAIs credit assessment to credit quality steps (Long term mapping)) or <i>credit quality step 1</i> in the case of short-term mapping.</p> <p>16 Equities included in major indices</p> <p>A <i>firm</i> should report in this row the unencumbered balances and contractual securities flows of all equities that it holds to the extent they are constituents one or more of the <u>relevant indices listed in the table at <i>BIPRU 7.3.39R</i></u>.</p> <p>...</p>
FSA052 – Pricing Data	<p>Amend the text as follows. Underlining indicates new text and striking through indicates deleted text:</p> <p>...</p> <p>Valuation</p> <p>Except where outlined, a <i>firm</i> should follow the <i>appropriate regulator's rules and guidance on set out in GENPRU 1.3</i> <u>relevant provisions in the <i>EU CRR</i></u>. A <i>firm</i> not subject to <i>GENPRU 1.3</i> <u>the <i>EU CRR</i></u>, such as an <i>incoming EEA firm</i>, should follow its applicable</p>

	accounting standards. ...
FSA053 – Retail, SME and Large Enterprises Type B Funding	... Valuation Except where outlined, a <i>firm</i> should follow the <u>appropriate regulator’s rules and guidance on set out in GENPRU 1.3</u> relevant provisions in the <i>EU CRR</i> . A <i>firm</i> not subject to <u>GENPRU 1.3</u> the <i>EU CRR</i> , such as an <i>incoming EEA firm</i> , should follow its applicable accounting standards. ...
FSA058 – Securitisation: Trading Book	

Part 3

SUP 16 Annex 31BG Guidance notes for data items in SUP 16 Annex 31AR

SUP 16 Annex 31BG is amended as set out below. Underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

This return provides the *appropriate regulator* with a point-in-time estimate of the valuation uncertainty around a *firm’s* fair-value positions in the context of the size and risk of its positions. The value of the positions at the downside end of the spread of valuation uncertainty will be equivalent to the prudent valuation of the *firm’s* positions as determined using the rules laid out in GENPRU 1.3.4R and GENPRU 1.3.14R to 1.3.34R articles 24, 34 and 105 of the *EU CRR*.

...

Row 1-12 Asset Class Granularity

...

The split between ‘Exotic’ and ‘Vanilla’ positions is defined in the same way that products are categorised for the purposes of CAD2 recognition. The definition of a portfolio type is based on the regulatory classes for CAD2 recognition, split by asset class. ‘Vanilla’ positions are those positions referred to in BIPRU 7.10.21G(1) and (2) and include products with linear pay-offs in the underlying risk factor (whether securities or derivatives) and products with European, American and Bermudan put and call options (including caps,, floors and swaptions). All other fair-valued positions are included within the ‘Exotic’ portfolios and the broad classes of positions are set out in BIPRU 7.10.21G(3) and (4). BIPRU 7.6.18R provides further granularity on the definitions used in BIRPU 7.10.21G.

‘Vanilla’ positions are the following positions:

- linear products, which comprise securities with linear pay-offs (e.g., bonds and equities) and derivative products which have linear pay-offs in the underlying risk factor (e.g., interest rate swaps, FRAs, total return swaps);

- European, American and Bermudan put and call options (including caps, floors and swaptions) and investment with these features.

All other fair-valued positions are included within the 'Exotic' portfolios. ~~and the broad classes of positions are set out in *BIPRU 7.10.21G(3)* and (4). *BIPRU 7.6.18R* provides further granularity on the definitions used in *BIPRU 7.10.21G*.~~

...

Part 4: Comes into force on 1 July 2014.

[**Note to reader:** The text marked with “*” includes text that Part 1 of the Annex amends.]

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

16.12.4 R Table of applicable rules containing *data items*, frequency and submission periods

	(1)	(2)	(3)	(4)
RAG number	Regulated Activities	Provisions containing:		
		applicable <i>data items</i>	reporting frequency/period	due date
RAG 1	<ul style="list-style-type: none"> • accepting deposits • <i>meeting of repayment claims</i> • <i>managing dormant account funds (including the investment of such funds)</i> 	<u>SUP 16.12.5R₂ except FSA001 and FSA002 on consolidated basis for FINREP firms</u>	SUP 16.12.6 R	SUP 16.12.7R
...				
RAG 3	<ul style="list-style-type: none"> • dealing in investment as principal • dealing in investments as agent • advising on investments (excluding retail investment activities) • arranging (bringing about) deals in investments (excluding retail investment activities) 	SUP 16.12.10R SUP 16.12.11R or SUP 16.12.11BR for <i>UK designated investment firms*</i> , <u>except FSA001 and FSA002 on consolidated basis for FINREP firms</u>	SUP 16.12.10R SUP 16.12.12R or SUP 16.12.12AR for <i>UK designated investment firms*</i>	SUP 16.12.10R SUP 16.12.13R
RAG 4	<ul style="list-style-type: none"> • managing investments • establishing, operating or winding up a regulated collective investment scheme • establishing, 	SUP 16.12.14R SUP 16.12.15R or SUP 16.12.15BR for <i>UK designated investment firms*</i> , <u>except FSA001 and FSA002 on consolidated basis</u>	SUP 16.12.14R SUP 16.12.16R or SUP 16.12.16AR for <i>UK designated investment firms*</i>	SUP 16.12.14R SUP 16.12.17R

	operating or winding up an unregulated collective investment scheme <ul style="list-style-type: none"> • establishing, operating or winding up a stakeholder pension scheme • establishing, operating or winding up a personal pension scheme 	<u>for FINREP firms</u>		
...				
RAG 7	<ul style="list-style-type: none"> • retail investment activities • advising on pensions transfers & opt-outs • arranging (bringing about deals) in retail investments 	<i>SUP 16.12.22AR and SUP 16.12.22CR for UK designated investment firms*, <u>except FSA001 and FSA002 on consolidated basis for FINREP firms</u></i>	<i>SUP 16.12.23R and SUPP 16.12.23R for UK designated investment firms*</i>	<i>SUP 16.12.24R</i>
RAG 8	<ul style="list-style-type: none"> • making arrangements with a view to transactions in investments • operating a multilateral trading facility 	<i>SUP 16.12.25AR or SUP 16.12.25CR for UK designated investment firms*, <u>except FSA001 and FSA002 on consolidated basis for FINREP firms</u></i>	<i>SUP 16.12.26R</i>	<i>SUP 16.12.27R</i>
...				

Part 5: Comes into force on a date specified by a subsequent PRA Board Instrument

16.12 Integrated Regulatory Reporting

Application

16.12.1 G The effect of SUP 16.1.1R is that this section applies to every *firm* carrying on business set out in column (1) of SUP 16.12.4R except:

(1)

(1B) an EEA bank;

...

...

Reporting requirement

16.12.3 R (1) Any *firm* permitted to carry on any of the activities within each of the RAGs set out in column (1) of the table in SUP 16.12.4R must:

(a) ...

...

(iv) in the case of a *non-EEA bank*, ~~or an EEA bank (whether or not it has permission for accepting deposits) other than one with permission for cross border services only~~, any *data items* submitted should, unless indicated otherwise, only cover the activities of the branch operation in the *United Kingdom*;

in the format specified as applicable to the *firm* in the provision referred to in column (2);

...

...

16.12.4A G ~~RAG 1 includes an incoming EEA firm exercising a BCD right through a UK branch. [deleted]~~

...

Regulated Activity Group 1

16.12.5 R The applicable *data items* and forms or reports referred to in SUP

16.12.4R are set out according to *firm* type in the table below:

Description of <i>data item</i>	Prudential category of <i>firm</i> , applicable <i>data items</i> and reporting format (Note 1)							
	<i>UK bank</i>	<i>Building society</i>	<i>Non-EEA bank</i>	<i>EEA bank that has permission to accept deposits, other than one with permission for cross border services only</i> [deleted]	<i>EEA bank that does not have permission to accept deposits, other than one with permission for cross border services only</i> [deleted]	[deleted]	<i>Credit union</i>	<i>Dormant account fund operator</i> (note 15)
...								
Daily Flows	FSA047 (Notes 16, 20 and 22)	FSA047 (Notes 16, 20 and 22)	FSA047 (Notes 16, 18, 20 and 22)	FSA047 (Notes 16, 18, 20 and 22)	FSA047 (Notes 16, 18, 20 and 22)			
Enhanced Mismatch Report	FSA048 (Notes 16, 20 and 22)	FSA048 (Notes 16, 20 and 22)	FSA048 (Notes 16, 18, 20 and 22)	FSA048 (Notes 16, 18, 20 and 22)	FSA048 (Notes 16, 18, 20 and 22)			
Liquidity Buffer Qualifying Securities	FSA050 (Notes 17, 21 and 22)	FSA050 (Notes 17, 21 and 22)	FSA050 (Notes 17, 19, 21 and 22)	FSA050 (Notes 17, 19, 21 and 22)	FSA050 (Notes 17, 19, 21 and 22)			
Funding Concentration	FSA051 (Notes 17, 21 and 22)	FSA051 (Notes 17, 21 and 22)	FSA051 (Notes 17, 19, 21 and 22)	FSA051 (Notes 17, 19, 21 and 22)	FSA051 (Notes 17, 19, 21 and 22)			
Pricing data	FSA052 (Notes 17, 22 and 24)	FSA052 (Notes 17, 22 and 24)	FSA052 (Notes 17, 19, 22 and 24)	FSA052 (Notes 17, 19, 22 and 24)	FSA052 (Notes 17, 19, 22 and 24)			

Retail and corporate funding	FSA053 (Notes 17, 21 and 22)	FSA053 (Notes 17, 21 and 22)	FSA053 (Notes 17, 19, 21 and 22)	FSA053 (Notes 17, 19, 21 and 22)	FSA053 (Notes 17, 19, 21 and 22)			
Currency Analysis	FSA054 (Notes 17, 21 and 22)	FSA054 (Notes 17, 21 and 22)	FSA054 (Notes 17, 19, 21 and 22)	FSA054 (Notes 17, 19, 21 and 22)	FSA054 (Notes 17, 19, 21 and 22)			
...								

...

**CAPITAL REQUIREMENTS DIRECTIVE (GOVERNANCE AND
REMUNERATION) AMENDMENT
INSTRUMENT 2013**

Powers exercised

- A. The Prudential Regulation 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 137G (The PRA’s general rules);
 - (2) section 137H (General rules about remuneration); and
 - (3) section 137T (General supplementary powers);
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Pre-conditions to making

- C. In accordance with section 138J of the Act (Consultation by the PRA, the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

Commencement

- D. This instrument comes into force on 1 January 2014, except for Part 2 of Annex A which comes into force on 1 July 2014.

Amendments to the Handbook

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

Notes and Guidance

- F. In Annex B to this instrument, the “notes” (indicated by “**Note:**”) are included for the convenience of readers but do not form part of the legislative text.
- G. The Prudential Regulation Authority gives as guidance each provision in the Annex marked with a G.

Citation

- H. This instrument may be cited as the Capital Requirements Directive (Governance and Remuneration) Amendment Instrument 2013.

By order of the Board of the Prudential Regulation Authority
16 December 2013

Annex

Amendments to the Senior Management Arrangements, Systems and Control manual (SYSC)

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

Part 1: Comes into force on the 1 January 2014.

SYSC 1 Annex 1 Detailed application of SYSC

Part 3	Tables summarising the application of the common platform requirements to different types of firm			
...				
Provision SYSC 4	COLUMN A Application to a common platform firm other than to a UCITS investment firm	COLUMN A+ Application to a UCITS management company	COLUMN A++ Application to a full-scope UK AIFM of an authorised AIF	COLUMN B Application to all other firms apart from insurers, managing agents the Society, and full-scope UK AIFMs of unauthorised AIFs
SYSC 4.1.1 R [FCA] [PRA]	Rule but SYSC 4.1.1R(2) applies only to a <i>BIPRU firm</i>	Rule but SYSC 4.1.1R(2) applies only to a <i>BIPRU firm</i>	Rule but SYSC 4.1.1R(2) applies only to a <i>BIPRU firm</i>	Rule but SYSC 4.1.1R(2) applies only to a <i>third country BIPRU firm</i>
...				
SYSC 4.1.3 R [FCA] [PRA]	Rule applies only to a <i>BIPRU firm</i> [deleted]	Rule for a <i>UCITS investment firm</i> ; otherwise not applicable [deleted]	Not applicable [deleted]	Not applicable [deleted]
...				
<u>SYSC 4.3A.1R</u> [FCA] [PRA]	<u>Rule applicable to <i>CRR firms</i></u>	<u>Rule for a <i>CRR firm</i> that is a <i>UCITS investment firm</i></u>	<u>Not applicable</u>	<u>Not applicable</u>
<u>SYSC 4.3A.2R</u> [FCA]	<u>Rule applicable to <i>CRR firms</i></u>	<u>Rule for a <i>CRR firm</i> that is a <i>UCITS</i></u>	<u>Not applicable</u>	<u>Not applicable</u>

[PRA]		<i>investment firm</i>		
<u>SYSC 4.3A.3R</u> [FCA] [PRA]	<u>Rule applicable to CRR firms</u>	<u>Rule for a CRR firm that is a UCITS investment firm</u>	<u>Not applicable</u>	<u>Not applicable</u>
<u>SYSC 4.3A.4R</u> [FCA] [PRA]	<u>Rule applicable to CRR firms</u>	<u>Rule for a CRR firm that is a UCITS investment firm</u>	<u>Not applicable</u>	<u>Not applicable</u>
<u>SYSC 4.3A.5R</u> [FCA] [PRA]	<u>Rule applicable to CRR firms</u>	<u>Rule for a CRR firm that is a UCITS investment firm</u>	<u>Not applicable</u>	<u>Not applicable</u>
...				
<u>SYSC 4.3A.7R</u> [FCA] [PRA]	<u>Rule applicable to CRR firms</u>	<u>Rule for a CRR firm that is a UCITS investment firm</u>	<u>Not applicable</u>	<u>Not applicable</u>
<u>SYSC 4.3A.8R</u> [FCA] [PRA]	<u>Rule applicable to CRR firms</u>	<u>Rule for a CRR firm that is a UCITS investment firm</u>	<u>Not applicable</u>	<u>Not applicable</u>
<u>SYSC 4.3A.9R</u> [FCA] [PRA]	<u>Rule applicable to CRR firms</u>	<u>Rule for a CRR firm that is a UCITS investment firm</u>	<u>Not applicable</u>	<u>Not applicable</u>
<u>SYSC 4.3A.10R</u> [FCA] [PRA]	<u>Rule applicable to CRR firms</u>	<u>Rule for a CRR firm that is a UCITS investment firm</u>	<u>Not applicable</u>	<u>Not applicable</u>
<u>SYSC 4.3A.11R</u> [FCA] [PRA]	<u>Rule applicable to CRR firms</u>	<u>Rule for a CRR firm that is a UCITS investment firm</u>	<u>Not applicable</u>	<u>Not applicable</u>
...				

Provision SYSC 7	COLUMN A Application to a common platform firm other than to a UCITS investment firm	COLUMN A+ Application to a UCITS management company	COLUMN A++ Application to a full-scope UK AIFM of an authorised AIF	COLUMN B Application to all other firms apart from insurers, managing agents, the Society, and full-scope UK AIFMs of unauthorised AIFs
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...				
SYSC 7.1.8 G (1)(2) [FCA] [PRA]	(1) Guidance applies to a <i>BIPRU firm</i> (2) Guidance [deleted]	(1) Guidance for a <i>UCITS investment firm</i> ; otherwise not applicable (2) Guidance [deleted]	Not applicable [deleted]	(1) Not applicable (2) Guidance [deleted]
...				
SYSC 7.1.17R [FCA] [PRA]	Rule applies to a <i>CRR firm</i>	Rule for a <i>UCITS investment firm</i> that is a <i>CRR firm</i> , otherwise not applicable	Not applicable	Not applicable
SYSC 7.1.18R [FCA] [PRA]	Rule applies to a <i>CRR firm</i>	Rule for a <i>UCITS investment firm</i> that is a <i>CRR firm</i> , otherwise not applicable	Not applicable	Not applicable
SYSC 7.1.19R [FCA] [PRA]	Rule applies to a <i>CRR firm</i>	Rule for a <i>UCITS investment firm</i> that is a <i>CRR firm</i> , otherwise not applicable	Not applicable	Not applicable
SYSC 7.1.20R [FCA] [PRA]	Rule applies to a <i>CRR firm</i>	Rule for a <i>UCITS investment firm</i> that is a <i>CRR firm</i> , otherwise not applicable	Not applicable	Not applicable
SYSC 7.1.21R [FCA] [PRA]	Rule applies to a <i>CRR firm</i>	Rule for a <i>UCITS investment firm</i> that is a <i>CRR firm</i> , otherwise not applicable	Not applicable	Not applicable
SYSC 7.1.22R [FCA] [PRA]	Rule applies to a <i>CRR firm</i>	Rule for a <i>UCITS investment firm</i> that is a <i>CRR firm</i> , otherwise not applicable	Not applicable	Not applicable

4.1 General requirements

- 4.1.1 R (1) ...
- (2) ~~A BIPRU firm and a third country BIPRU firm must comply with the Remuneration Code. [deleted]~~

[~~Note: article 22(1) of the Banking Consolidation Directive~~ article 74 (1) of *CRD*, article 13(5) second paragraph of *MiFID*, article 12(1)(a) of the *UCITS Directive*, and article 18(1) of *AIFMD*]

- 4.1.2 R For a *common platform firm*, the arrangements, processes and mechanisms referred to in SYSC 4.1.1R must be comprehensive and proportionate to the nature, scale and complexity of the risks inherent in the business model and of the common platform firm's activities and must take into account the specific technical criteria described in SYSC 4.1.7R, SYSC 5.1.7R, SYSC 7 and (for a firm to which SYSC 19A applies) (for a BIPRU firm and a third country BIPRU firm) SYSC 19A.

[~~Note: article 22(2) of the Banking Consolidation Directive~~ article 74 (2) of *CRD*]

...

Mechanisms and procedures for a ~~BIPRU~~ firm

- 4.1.3 R ~~A BIPRU firm must ensure that its internal control mechanisms and administrative and accounting procedures permit the verification of its compliance with rules adopted in accordance with the Capital Adequacy Directive at all times.~~
- [~~Note: article 35(1) final sentence of the Capital Adequacy Directive~~]
[deleted]

...

- 4.1.15 R (1) A firm must have in place appropriate procedures for its employees to report breaches internally through a specific, independent and autonomous channel.
- (2) The channel in (1) may be provided through arrangements provided for by social partners.

[~~Note: article 71 (3) of *CRD*~~]

...

4.2 Persons who effectively direct the business

...

- 4.2.2 R A *common platform firm*, a *management company*, a *full scope UK AIFM* and the *UK branch of a non-EEA bank* must ensure that its management is undertaken by at least two persons meeting the requirements laid down in SYSC 4.2.1R and, for a *full-scope UK AIFM*,

SYSC 4.2.7R.

[**Note:** article 9(4) first paragraph of *MiFID*, article 7(1)(b) of the *UCITS Directive*, article 8(1)(c) of *AIFMD* and ~~11(1) first paragraph of the *Banking Consolidation Directive*~~ article 13(1) of *CRD*]

...

4.3A **CRR firms**

Management body

4.3A.1 R A CRR firm must ensure that the *management body* defines, oversees and is accountable for the implementation of governance arrangements that ensure effective and prudent management of the *firm*, including the segregation of duties in the organisation and the prevention of conflicts of interest. The *firm* must ensure that the *management body*:

- (1) has overall responsibility for the firm;
- (2) approves and oversees implementation of the *firm*'s strategic objectives, risk strategy and internal governance;
- (3) ensures the integrity of the *firm*'s accounting and financial reporting systems, including financial and operational controls and compliance with the *regulatory system*.
- (4) oversees the process of disclosure and communications;
- (5) has responsibility for providing effective oversight of *senior management*.
- (6) monitors and periodically assesses the effectiveness of the *firm*'s governance arrangements and takes appropriate steps to address any deficiencies.

[**Note:** article 88(1) of *CRD*]

4.3A.2 R A CRR firm must ensure that the chairman of the *firm*'s *management body* does not exercise simultaneously the *chief executive function* within the same *firm*.

[**Note:** article 88(1)(e) of *CRD*]

4.3A.3 R A CRR firm must ensure that the members of the *management body* of the *firm*:

- (1) are of sufficiently good repute;

- (2) possess sufficient knowledge, skills and experience to perform their duties;
- (3) possess adequate collective knowledge, skills and experience to understand the *firm's* activities, including the main risks;
- (4) reflect an adequately broad range of experiences;
- (5) commit sufficient time to perform their functions in the *firm*; and
- (6) act with honesty, integrity and independence of mind to effectively assess and challenge the decisions of *senior management* where necessary and to effectively oversee and monitor management decision-making.

[Note: article 91(1)-(2) and (7)-(8) of the *CRD*]

4.3A.4 R A *CRR firm* must devote adequate human and financial resources to the induction and training of members of the *management body*.

[Note: article 91(9) of the *CRD*]

4.3A.5 R A *CRR firm* must ensure that the members of the *management body* of the *firm* do not hold more directorships than is appropriate taking into account individual circumstances and the nature, scale and complexity of the *firm's* activities.

[Note: article 91(3) of the *CRD*]

...

4.3A.7 R For the purposes of SYSC 4.3A.5R and SYSC 4.3A.6R:

- (1) directorships in organisations which do not pursue predominantly commercial objectives shall not count; and
- (2) the following shall count as a single directorship:
 - (a) executive or non-executive directorships held within the same *group*; or
 - (b) executive or non-executive directorships held within:
 - (i) *firms* that are members of the same institutional protection scheme provided that the conditions set out in Article 113(7) of the *CRR* are fulfilled; or
 - (ii) *undertakings* (including non-financial entities) in which the *firm* holds a *qualifying*

holding.

[**Note:** article 91(4) and (5) of the *CRD*]

Nomination Committee

- 4.3A.8 R A *CRR firm* that is significant must:
- (1) establish a nomination committee composed of members of the *management body* who do not perform any executive function in the *firm*;
 - (2) ensure that the nomination committee is able to use any forms of resources the nomination committee deems appropriate, including external advice; and
 - (3) ensure that the nomination committee receives appropriate funding.

[**Note:** article 88(2) of the *CRD*]

4.3A.8A G In *SYSC 4.3A.8R* a ‘*CRR firm that is significant*’ means a deposit-taker or designated investment firm whose size, interconnectedness, complexity and business type gives it the capacity to cause some disruption to the UK financial system (and through that to economic activity more widely) by failing or by carrying on its business in an unsafe manner.

- 4.3A.9 R A *CRR firm* that has a nomination committee must ensure that the nomination committee:
- (1) engage a broad set of qualities and competences when recruiting members to the *management body* and for that purpose puts in place a policy promoting diversity on the *management body*;
 - (2) identifies and recommends for approval, by the *management body* or by general meeting, candidates to fill *management body* vacancies, having evaluated the balance of knowledge, skills, diversity and experience of the *management body*;
 - (3) prepares a description of the roles and capabilities for a particular appointment, and assesses the time commitment required;
 - (4) decides on a target for the representation of the underrepresented gender in the *management body* and prepares a policy on how to increase the number of the underrepresented gender in the *management body* in order to meet that target;

- (5) periodically, and at least annually, assesses the structure, size, composition and performance of the *management body* and makes recommendations to the *management body* with regard to any changes;
- (6) periodically, and at least annually, assesses the knowledge, skills and experience of individual members of the *management body* and of the *management body* collectively, and reports this to the *management body*;
- (7) periodically reviews the policy of the *management body* for selection and appointment of *senior management* and makes recommendations to the *management body*;
- (8) in performing its duties, and to the extent possible, on an ongoing basis, takes account of the need to ensure that the *management body*'s decision making is not dominated by any one individual or small group of individuals in a manner that is detrimental to the interest of the *firm* as a whole;

[Note: article 88(2) and article 91(10) of the *CRD*]

4.3A.10 R A *CRR firm* that does not have a nomination committee must engage a broad set of qualities and competences when recruiting members to the *management body*. For that purpose a *CRR firm* that does not have a nomination committee must put in place a policy promoting diversity on the *management body*.

[Note: article 91(10) of the *CRD*]

Website

4.3A.11 R A *CRR firm* that maintains a website must explain on the website how it complies with the requirements of *SYSC* 4.3A.1R to *SYSC* 4.3A.3R and *SYSC* 4.3A.4R to *SYSC* 4.3A.11R.

[Note: article 96 of the *CRD*]

...

7.1 Risk control

...

7.1.4 R The ~~*senior personnel*~~ *management body* of a *common platform firm* must approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating the risks the *firm* is or might be exposed to, including those posed by the macroeconomic environment in which it operates in relation to the status of the business cycle.

[~~Note: annex V paragraph 2 of the *Banking Consolidation Directive* article 76(1) of *CRD*~~]

...

- 7.1.7B G In setting the method of determining the *remuneration* of *employees* involved in the risk management function, ~~*BIPRU firms*~~ *firms* that *SYSC 19A applies to* will also need to comply with the *Remuneration Code*.
- 7.1.8 G (1) ~~*SYSC 4.1.3R* requires a *BIPRU firm* to ensure that its internal control mechanisms and administrative and accounting procedures permit the verification of its compliance with *rules* adopted in accordance with the *Capital Adequacy Directive* at all times. In complying with this obligation, a *BIPRU firm* should document the organisation and responsibilities of its risk management function and it should document its risk management framework setting out how the risks in the business are identified, measured, monitored and controlled.~~ [deleted]

...

Credit and counterparty risk

- 7.1.9 R ~~A *BIPRU firm* must base credit granting on sound and well-defined criteria and clearly establish the process for approving, amending, renewing, and re-financing credits.~~ [Note: annex V paragraph 3 of the *Banking Consolidation Directive* [deleted]
- 7.1.10 R ~~A *BIPRU firm* must operate through effective systems the ongoing administration and monitoring of its various credit risk-bearing portfolios and exposures, including for identifying and managing problem credits and for making adequate value adjustments and provisions.~~ [Note: annex V paragraph 4 of the *Banking Consolidation Directive* [deleted]
- 7.1.11 R ~~A *BIPRU firm* must adequately diversify credit portfolios given its target market and overall credit strategy.~~ [Note: annex V paragraph 5 of the *Banking Consolidation Directive* [deleted]
- 7.1.12 G ~~The documentation maintained by a *BIPRU firm* under *SYSC 4.1.3 R* should include its policy for credit risk, including its risk appetite and provisioning policy and should describe how it measures, monitors and controls that risk. This should include descriptions of the systems used to ensure that the policy is correctly implemented.~~ [deleted]

Residual risk

- 7.1.13 R ~~A *BIPRU firm* must address and control by means of written policies and procedures the risk that recognised credit risk mitigation techniques~~

used by it prove less effective than expected.

~~[Note: annex V paragraph 6 of the *Banking Consolidation Directive*]
[deleted]~~

Market risk

- 7.1.14 R ~~A *BIPRU firm* must implement policies and processes for the measurement and management of all material sources and effects of market risks.
[Note: annex V paragraph 10 of the *Banking Consolidation Directive*]
[deleted]~~

Interest rate risk

- 7.1.15 R ~~A *BIPRU firm* must implement systems to evaluate and manage the risk arising from potential changes in interest rates as they affect a *BIPRU firm's* non-trading activities.
[Note: annex V paragraph 11 of the *Banking Consolidation Directive*]
[deleted]~~

Operational risk

- 7.1.16 R ~~A *BIPRU firm* must implement policies and processes to evaluate and manage the exposure to operational risk, including to low-frequency high severity events. Without prejudice to the definition of *operational risk*, *BIPRU firms* must articulate what constitutes operational risk for the purposes of those policies and procedures.
[Note: annex V paragraph 12 of the *Banking Consolidation Directive*]
[deleted]~~
- 7.1.16A G ~~In meeting the general standard referred to in SYSC 7.1.16R, a *BIPRU firm* that undertakes market-related activities should be able to demonstrate to the *appropriate regulator*:~~
- ~~(1) in the case of a *BIPRU firm* calculating its *ORCR* using the *basic indicator approach* or *standardised approach*, that it has considered; or~~
 - ~~(2) in the case of a *BIPRU firm* with an *AMA permission*, compliance with~~
- ~~the Committee of European Banking Supervisors Guidelines on the management of operational risk in market-related activities, published in October 2010. These can be found at [http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Management-of-op-risk/CEBS-2010-216-\(Guidelines-on-the-management-of-op.aspx](http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Management-of-op-risk/CEBS-2010-216-(Guidelines-on-the-management-of-op.aspx) [deleted]~~
- 7.1.16B G ~~In meeting the general standards referred to in SYSC 7.1.16R, a *firm* with *AMA approval* should be able to demonstrate to the *appropriate regulator* that it has considered and complies with Section III of the European Banking Authority's Guidelines on the Advanced~~

Measurement Approach (AMA) – Extensions and Changes published in January 2012. These can be found at [http://eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2012/EBA_BS_2011_209_final_\(EBA_GL_on_AMA_extensions_and_changes\).pdf](http://eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2012/EBA_BS_2011_209_final_(EBA_GL_on_AMA_extensions_and_changes).pdf) [deleted]

Additional rules for CRR firms

- 7.1.17 R (1) The *management body* of a *CRR firm* has overall responsibility for risk management. It must devote sufficient time to the consideration of risk issues.
- (2) The *management body* of a *CRR firm* must be actively involved in and ensure that adequate resources are allocated to the management of all material risks addressed in the *rules* implementing the *CRD* and in the *CRR* as well as in the valuation of assets, the use of external ratings and internal models related to those risks.
- (3) A *CRR firm* must establish reporting lines to the *management body* that cover all material risks and risk management policies and changes thereof.

[Note: article 76(2) of *CRD*]

- 7.1.18 R (1) A *CRR firm* that is significant must establish a risk committee composed of members of the *management body* who do not perform any executive function in the *firm*. Members of the risk committee must have appropriate knowledge, skills and expertise to fully understand and monitor the risk strategy and the risk appetite of the *firm*.
- (2) The risk committee must advise the *management body* on the institution's overall current and future risk appetite and assist the *management body* in overseeing the implementation of that strategy by *senior management*.
- (3) The risk committee must review whether prices of liabilities and assets offered to clients take fully into account the *firm's* business model and risk strategy. Where prices do not properly reflect risks in accordance with the business model and risk strategy, the risk committee must present a remedy plan to the *management body*.

[Note: article 76(3) of *CRD*]

- 7.1.18A G In SYSC 7.1.18R a '*CRR firm* that is *significant*' means a deposit-taker or designated investment firm whose size, interconnectedness, complexity and business type gives it the capacity to cause some

disruption to the UK financial system (and through that to economic activity more widely) by failing or by carrying on its business in an unsafe manner.

- 7.1.19 R (1) A CRR firm must ensure that the *management body* in its supervisory function and, where a risk committee has been established, the risk committee have adequate access to information on the risk profile of the *firm* and, if necessary and appropriate, to the risk management function and to external expert advice.
- (2) The *management body* in its supervisory function and, where one has been established, the risk committee must determine the nature, the amount, the format, and the frequency of the information on risk which it is to receive.
- [**Note:** article 76 (4) of CRD]
- 7.1.20 R In order to assist in the establishment of sound remuneration policies and practices, the risk committee must, without prejudice to the tasks of the remuneration committee, examine whether incentives provided by the remuneration system take into consideration risk, capital, liquidity and the likelihood and timing of earnings.
- [**Note:** article 76 (4) of CRD]
- 7.1.21 R (1) A CRR firm's risk management function (SYSC 7.1.6R) must be independent from the operational functions and have sufficient authority, stature, resources and access to the *management body*.
- (2) The risk management function must ensure that all material risks are identified, measured and properly reported. It must be actively involved in elaborating the *firm's* risk strategy and in all material risk management decisions and it must be able to deliver a complete view of the whole range of risks of the *firm*.
- (3) A CRR firm must ensure that the risk management function is able to report directly to the *management body* in its supervisory function, independent from *senior management* and that it can raise concerns and warn the *management body*, where appropriate, where specific risk developments affect or may affect the *firm*, without prejudice to the responsibilities of the *management body* in its supervisory and/or managerial functions pursuant to the CRD and the CRR.
- [**Note:** article 76(5) of CRD]
- 7.1.22 R The head of the risk management function must be an independent senior manager with distinct responsibility for the risk management function. Where the nature, scale and complexity of the activities of the CRR firm do not justify a specially appointed person, another senior person within the *firm* may fulfil that function, provided there is no conflict of interest. The head of the risk management function must not

be removed without prior approval of the *management body* and must be able to have direct access to the *management body* where necessary.

[Note: Article 76(5) of CRD]

12.1 Application

...

~~BIPRU firms and other firms to which BIPRU 8 applies~~ CRR firms and non-CRR firms that are parent financial holding companies in a Member State

12.1.13 R If this *rule* applies under SYSC 12.1.14R to a *firm*, the *firm* must:

...

- (2) ensure that the risk management processes and internal control mechanisms at the level of any *UK-consolidation group* or non-*EEA sub-group* of which it is a member comply with the obligations set out in the following provisions on a consolidated (or sub-consolidated) basis:
 - (a) SYSC 4.1.1R and SYSC 4.1.2R;
 - (b) SYSC 4.1.7R;
 - (bA) SYSC 4.3A;
 - (c) SYSC 5.1.7 R;
 - (d) SYSC 7
 - (dA) the *Remuneration Code*;
 - (e) BIPRU 12.3.4R, BIPRU 12.3.5R, BIPRU 12.3.7A R, BIPRU 12.3.8R-(3), BIPRU 12.3.22AR, BIPRU 12.3.22BR, BIPRU 12.3.27R, BIPRU 12.4.-2R, BIPRU 12.4.-1R, BIPRU 12.4.5AR, BIPRU 12.4.10R, and BIPRU 12.4.11R and BIPRU 12.4.11A R;
 - (f) ~~BIPRU 2.3.7 R (1); [deleted];~~
 - (g) ~~BIPRU 9.1.6 R and BIPRU 9.13.21 R (Liquidity Plans); [deleted];~~
 - (h) ~~BIPRU 10.12.3 R (Concentration risk policies); [deleted].~~

[Note: ~~article 73(3) of the Banking Consolidation Directive~~ article 109(2) of CRD]

- (3) ensure that compliance with the obligations in (2) enables the consolidation group or the non-EEA sub-group to have arrangements, processes and mechanisms that are consistent and well integrated and that any data relevant to the purpose of supervision can be produced.

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

12.1.14 R SYSC 12.1.13R applies to a *firm* that is:

...

- (2) ~~a BIPRU firm~~ a CRR firm; or
- (3) ~~a non-BIPRU firm~~ non-CRR firm that is a *parent financial holding company in a Member State* and is a member of a *UK consolidation group*.

12.1.15 R In the case of a *firm* that:

- (1) is a ~~BIPRU firm~~ CRR firm; and

...

...

19A.1 General application and purpose

...

19A.1.1 R (1) The *Remuneration Code* applies to: ~~BIPRU firm~~ and a *third country BIPRU firm*.

(a) a building society;

(b) a bank;

(c) an investment firm;

(d) an overseas firm that;

(i) is not an EEA firm;

(ii) has its head office outside the EEA; and

(iii) would be a firm referred to in (a), (b) or (c) if it had been a UK domestic firm, had carried on all of its business in the United Kingdom and had obtained whatever authorisations for doing so as are required under the Act.

- (2) In relation to a ~~third country BIPRU firm~~ firm that falls under

(1)(d), the *Remuneration Code* applies only in relation to activities carried on from an establishment in the *United Kingdom*.

...

...

19A.1.3 R (1) A firm must apply the remuneration requirements in SYSC 19A.3 other than SYSC 19A.3.44R(3) and SYSC 19.3.44AR in relation to:

(a)(1) ...

(b)(2) ...

(c)(3) ...

[**Note:** article 3(2) of the Third Capital Requirements Directive (Directive 2010/76/EU)]

(2) A firm must apply the remuneration requirements in SYSC 19A.3.44R(3) and SYSC 19.3.44AR in relation to remuneration awarded for services provided or performance from the year 2014 onwards, whether due on the basis of contracts concluded before, on or after 31 December 2013.

[**Note:** article 162(3) of CRD]

...

19A.1.6 G (1) ...

(2) The *Remuneration Code* implements the main provisions of the ~~Third Capital Requirements Directive (Directive 2010/76/EU)~~ CRD which relate to *remuneration*. The Committee of European Banking Supervisors published Guidelines on Remuneration Policies and Practices on 10 December 2010. ~~Provisions of the Third Capital Requirements Directive relating to Pillar 3 disclosures of information relating to remuneration have been implemented through amendments to BIPRU 11 (specifically the rules and guidance in BIPRU 11.5.18R to BIPRU 11.5.21G).~~ Provisions of the Capital Requirements (Amendment) Regulations 2012 (SI 2012/917) together with the European Banking Authority's Guidelines to article 22(3) and (5) of the *Banking Consolidation Directive* relating to the collection of *remuneration* benchmarking information and *high earners* information have been implemented through SUP 16 Annex 33AR and SUP 16 Annex 34AR. The Guidelines can be found at <http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2012/EBA-GL-2012-04---GL-4-on->

remuneration-benchmarking-exercise-.pdf and
<http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2012/EBA-GL-2012-05---GL-5-on-remuneration-data-collection-exercise-.pdf>.

...

19A.2 General requirement

19A.2.1 R ...

[~~Note: Article 22(1) of the *Banking Consolidation Directive* article 74(1) of *CRD*~~]

...

19A.3 Remuneration principles for banks, building societies and investment firms

19A.3.1 R (1) ...

(2) ...

[~~Note: Paragraph 23 (final, unnumbered point) of Annex V to the *Banking Consolidation Directive* article 92(1) of *CRD*~~]

19A.3.2 G SYSC 12.1.13R(2)(dA) requires the *firm* to ensure that the risk management processes and internal control mechanisms at the level of any *UK consolidation group* or *non-EEA sub-group* of which a *firm* is a member comply with the obligations set out in this section on a consolidated (or sub-consolidated) basis. In the *appropriate regulator's* view, the requirement to apply this section at *group*, *parent undertaking* and *subsidiary undertaking* levels (as provided for in SYSC 19A.3.1R(1)) is in line with the requirements in ~~article 73(3) of the *Banking Consolidation Directive*~~ article 109(2) of *CRD* article concerning the application of systems and controls requirements to *groups* (as implemented in SYSC 12.1.13R).

...

19A.3.3 R (1) ...

(2) ...

(3) ...

[~~Note: Paragraph 23 of Annex V to the *Banking Consolidation Directive* article 92(2) of *CRD*~~]

...

[**Note:** In addition to the *guidance* in this section which relates to the

remuneration principles proportionality rule, the FSA gave guidance on the division of *firms* into categories for the purpose of providing a framework for the operation of the *remuneration principles proportionality rule*. ~~This guidance was published in Policy Statement 10/20 Revising the Remuneration Code and is available at www.fca.org.uk/your-fca. This guidance has been adopted by the FCA and is available in the FCA website at <http://www.fca.org.uk/firms/markets/international-markets/remuneration-code>.]~~

...

19A.3.4 R ...

[~~Note: paragraph 23 of Annex V to the *Banking Consolidation Directive* article 92(2) of CRD~~]

...

19A.3.7 R ...

[~~Note: Paragraph 23(a) of Annex V to the *Banking Consolidation Directive* article 92(2)(a) of CRD~~]

19A.3.8 R ...

[~~Note: Paragraph 23(b) of Annex V to the *Banking Consolidation Directive* article 92(2)(b) of CRD~~]

19A.3.9 R ...

[~~Note: Paragraph 23(b) of Annex V to the *Banking Consolidation Directive* Article 92(2)(b) of CRD~~]

19A.3.10 R

A *firm* must ensure that its ~~*governing management*~~ *body* in its *supervisory function* adopts and periodically reviews the general principles of the *remuneration* policy and is responsible for overseeing its implementation.

[~~Note: Paragraph 23(c) of Annex V to the *Banking Consolidation Directive* article 92(2)(c) of CRD and Standard 1 of the FSB Compensation Standards~~]

19A.3.11 R

A *firm* must ensure that the implementation of the *remuneration* policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for *remuneration* adopted by the ~~*governing management*~~ *body* in its *supervisory function*.

[~~Note: article 92(2)(d) of CRD Paragraph 23(d) of Annex V to the *Banking Consolidation Directive* and Standard 1 of the FSB~~]

Compensation Standards]

- 19A.3.12 R (1) A *CRR* firm that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities must establish a *remuneration* committee.
- (2) ...
- (3) The chairman and the members of the *remuneration* committee must be members of the ~~*governing management*~~ *body* who do not perform any executive function in the *firm*.
- (4) The *remuneration* committee must be responsible for the preparation of decisions regarding *remuneration*, including those which have implications for the risk and risk management of the *firm* and which are to be taken by the ~~*governing management*~~ *body in its supervisory function*.
- (5) When preparing such decisions, the *remuneration* committee must take into account the long-term interests of shareholders, investors and other stakeholders in the *firm* and the public interest.

[~~Note: Paragraph 24 of Annex V of the *Banking Consolidation Directive* article 95 of *CRD* and Standard 1 of the *FSB Compensation Standards*~~]

...

- 19A.3.12A R A firm that maintains a website must explain on the website how it complies with the *Remuneration Code*.

[Note: article 96 of *CRD*]

...

- 19A.3.14 R ...

[~~Note: Paragraph 23(e) of Annex V to the *Banking Consolidation Directive* article 92(2)(e) of *CRD* and Standard 2 of the *FSB Compensation Standards*~~]

...

- 19A.3.16 R ...

[~~Note: Paragraph 23(f) of Annex V to the *Banking Consolidation Directive* article 92(2)(f) of *CRD*~~]

...

- 19A.3.18 R ...

[~~Note: Paragraph 23(i) of Annex V to the Banking Consolidation Directive article 94(1)(c) of CRD and Standard 3 of the FSB Compensation Standards~~]

...

Remuneration Principle 7: Exceptional government intervention

- 19A.3.20 R A *firm* that benefits from exceptional government intervention must ensure that:
- (1) ...
 - (2) it restructures *remuneration* in a manner aligned with sound risk management and long-term growth, including when appropriate establishing limits to the *remuneration* of ~~senior personnel~~ members of its management body; and
 - (3) no variable *remuneration* is paid to members of its senior personnel management body unless this is justified.

[~~Note: Paragraph 23(k) of Annex V to the Banking Consolidation Directive article 93 of CRD and Standard 10 of the FSB Compensation Standards~~]

- 19A.3.21 G The *appropriate regulator* would normally expect it to be appropriate for the ban on paying variable *remuneration* to ~~senior personnel~~ members of the management body of a *firm* that benefits from exceptional government intervention to apply only in relation to ~~senior personnel~~ members of the management body who were in office at the time that the intervention was required.

Remuneration Principle 8: Profit-based measurement and risk adjustment

- 19A.3.22 R (1) ...
- (2) ...

[~~Note: Paragraph 23(n) of Annex V to the Banking Consolidation Directive article 94(1)(j), (k) of CRD and Standard 4 of the FSB Compensation Standards~~]

...

- 19A.3.27 R A *firm* must ensure that its total variable *remuneration* is generally considerably contracted where subdued or negative financial performance of the *firm* occurs, taking into account both current *remuneration* and reductions in payouts of amounts previously earned, including through malus or clawback arrangements.

[~~Note: Paragraph 23(q) of Annex V to the Banking Consolidation Directive article 94(1)(n) of CRD and Standard 5 of the FSB~~]

Compensation Standards]

...

Remuneration Principle 9: Pension policy

19A.3.29 R *A firm must ensure that:*

(1) ...

...

(3) ~~in the case of when~~ *an employee reaching reaches* retirement, *discretionary pension benefits* are paid to the *employee* in the form of instruments referred to in SYSC 19A.3.47R(1) and subject to a five-year retention period.~~[Note: Paragraph 23(r) of Annex V to the Banking Consolidation Directive article 94(1)(o) of CRD]~~

Remuneration Principle 10: Personal investment strategies

19A.3.30 R (1) ...

(2) ...

~~[Note: Paragraph 23(s) of Annex V to the Banking Consolidation Directive article 94(1)(p) of CRD and Standard 14 of the FSB Compensation Standards]~~

...

Remuneration Principle 11: ~~Avoidance of~~ Non-compliance with the Remuneration Code19A.3.32 R *A firm must ensure that variable remuneration is not paid through vehicles or methods that facilitate the avoidance of non-compliance with the Remuneration Code.*~~[Note: Paragraph 23(t) of Annex V to the Banking Consolidation Directive article 94(1)(q) of CRD]~~

...

19A.3.35A R *A firm must ensure that the remuneration policy makes a clear distinction between criteria for setting:*(1) *basic fixed remuneration that primarily reflects an employee's professional experience and organisational responsibility as set out in the employee's job description and terms of employment; and*

- (2) variable remuneration that reflects performance in excess of that required to fulfil the employee's job description and terms of employment and that is subject to performance adjustment in accordance with the Remuneration Code.

[**Note:** article 92(2)(g) of *CRD*]

...

Remuneration Principle 12(b): Remuneration structures – assessment of performance

19A.3.36 R A firm must ensure that where remuneration is performance-related:

(1) ...

(2) ...

[**Note:** Paragraph 23(g) of Annex V to the *Banking Consolidation Directive* article 94(1)(a) of *CRD* and Standard 6 of the *FSB Compensation Standards*]

...

19A.3.38 R ...

[**Note:** Paragraph 23(h) of Annex V to the *Banking Consolidation Directive* article 94(1)(b) of *CRD*]

...

19A.3.40 R A firm must ensure that guaranteed variable remuneration is not part of prospective remuneration plans. A firm must not award, pay or provide guaranteed variable remuneration unless it:

(1) it is exceptional;

(2) it occurs in the context of hiring new Remuneration Code staff; and

(3) the firm has a sound and strong capital base; and

(34) it is limited to the first year of service.

[**Note:** Paragraph 23(j) of Annex V to the *Banking Consolidation Directive* article 94(1)(d) and (e) of *CRD* and Standard 11 of the *FSB Compensation Standards*]

19A.3.40A R A firm must ensure that remuneration packages relating to compensation for, or buy out from, an employee's contracts in previous employment align with the long term interests of the firm and are subject to appropriate retention, deferral and performance and

clawback arrangements.

[**Note:** article 94(1)(i) of *CRD*]

...

- 19A.3.44 R A *firm* must set appropriate ratios between the fixed and variable components of total *remuneration* and ensure that:
- (1) fixed and variable components of total *remuneration* are appropriately balanced; ~~and~~
 - (2) the fixed component represents a sufficiently high proportion of the total *remuneration* to allow the operation of a fully flexible policy on variable *remuneration* components, including the possibility to pay no variable *remuneration* component; ~~and-~~
 - (3) subject to SYSC 19A.3.44AR, the ratio of the variable component of total *remuneration* to the fixed component does not exceed 1:1.

- 19A.3.44A R A *firm* may set a ratio between the fixed and the variable components of total *remuneration* that exceeds 1:1 provided the ratio:
- (1) does not exceed 1:2; and
 - (2) is approved by the shareholders or owners or members of the *firm* in accordance with SYSC 19A.3.44BR.

[**Note:** article 94(1)(g)(ii) of *CRD*]

- 19A.3.44B R A *firm* must ensure that any approval by the shareholders or owners or members of the *firm* of a ratio that exceeds 1:1 is carried out in accordance with the following procedure:
- (1) the *firm* must give reasonable notice to all shareholders or owners or members of the *firm* that the *firm* intends to seek approval of a ratio that exceeds 1:1;
 - (2) the *firm* must make a detailed recommendation to all shareholders or owners or members of the *firm* giving the reasons for, and the scope of, the approval sought, including the number of staff affected, their functions and the expected impact on the requirement to maintain a sound capital base;
 - (3) the *firm* must, without delay, inform the *appropriate regulator* of the recommendation to its shareholders or owners or members, including the proposed ratio and the reasons therefor and must demonstrate to the *appropriate regulator* that the proposed higher ratio does not conflict with the *firm's* obligations under the *CRD* and the *CRR*, having regard in

particular to the *firm's own funds* obligations;

- (4) the *firm* must ensure that *employees* who have an interest in the proposed higher ratio are not allowed to exercise, directly or indirectly, any voting rights they may have as shareholders or owners or members of the *firm* in respect of the approval sought; and
- (5) the higher ratio is approved by a majority of:
- (a) at least 66% of shareholders or owners or members of the *firm*, provided that at least 50% of the shareholders or owners or members are represented; or
- (b) at least 75% of shareholders or owners or members of the *firm* if less than 50% of the shareholders, members or owners are represented.

[Note: article 94(1)(g)(ii) of CRD]

19A.3.44C R A *firm* must notify without delay the *appropriate regulator* of the decisions taken by its shareholders or members or owners including any approved higher maximum ratio.

[Note: article 94(1)(g)(ii) of CRD]

19A.3.44D R A *firm* may apply a discount rate to a maximum of 25% of an *employee's* total variable remuneration provided it is paid in instruments that are deferred for a period of not less than five years.

[Note: article 94(1)(g)(iii) of CRD]

Remuneration Principle 12(e): Remuneration structures - payments related to early termination

19A.3.45 R A *firm* must ensure that payments ~~related~~ relating to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure or misconduct.

[Note: ~~Paragraph 23(m) of Annex V to the Banking Consolidation Directive~~ article 94(1)(h) of CRD and Standard 12 of the FSB Compensation Standards]

...

19A.3.47 R (1) A *firm* must ensure that a substantial portion, which is at least 50%, of any variable remuneration consists of an appropriate balance of:

(a) ...

(b) where appropriate, ~~capital instruments which are~~

~~eligible for inclusion at stage B1 of the calculation in the *capital resources table*, where applicable that possible other instruments which are eligible as Additional Tier 1 instruments or are eligible as Tier 2 instruments or other instruments that can be fully converted to Common Equity Tier 1 instruments or written down, that in each case- adequately reflects the credit quality of the *firm* as a going concern and are appropriate for use as variable remuneration.~~

(2) ...

~~[Note: Paragraph 23(o) of Annex V to the *Banking Consolidation Directive* article 94(1)(l) of *CRD* and Standard 8 of the *FSB Compensation Standards*]~~

...

19A.3.49 R (1) ...

...

(5) ...

~~[Note: Paragraph 23(p) of Annex V to the *Banking Consolidation Directive* article 94(1)(m) of *CRD* and Standards 6 and 7 of the *FSB Compensation Standards*]~~

(6) ...

...

19A.3.51 R A *firm* must ensure that any variable *remuneration*, including a deferred portion, is paid or vests only if it is sustainable according to the financial situation of the *firm* as a whole, and justified according to ~~to~~ on the basis of the performance of the *firm*, the business unit and the individual concerned.

~~[Note: Paragraph 23(q) of Annex V to the *Banking Consolidation Directive* article 94(1)(n) of *CRD* and Standards 6 and 9 of the *FSB Compensation Standards*]~~

19A.3.51A R A *firm* must:

- (1) ensure that any of the total variable *remuneration* is subject to malus or clawback arrangements;
- (2) set specific criteria for the application of malus and clawback; and
- (3) ensure that the criteria for the application of malus and clawback in particular cover situations where the *employee*:

- (a) participated in or was responsible for conduct which resulted in significant losses to the firm;
- (b) failed to meet appropriate standards of fitness and propriety.

[Note: article 94(1)(n) of CRD and Standards 6 and 9 of the FSB Compensation Standards]

...

19A.3.54 R (1) ...

...

- (1B) Condition 1 is that the firm is a *UK bank*, a *building society*, a *designated investment firm*, or a relevant ~~BIPRU 730k firm~~ IFPRU 730k firm that has relevant total assets exceeding £50 billion.

...

- (1D) Condition 2 is that the firm:

- (a) is a *full credit institution*, a relevant ~~BIPRU 730k firm~~ a designated investment firm, a relevant IFPRU 730k firm or a relevant ~~third country BIPRU 730k firm~~ third country IFPRU 730k firm; and
- (b) is part of a *group* containing a *firm* that has relevant total assets exceeding £50 billion and that is a *UK bank*, a *building society*, a *designated investment firm* or a relevant ~~BIPRU 730k firm~~ IFPRU 730k firm.

- (1E) In this rule:

- (a) a "relevant ~~BIPRU 730k firm~~ IFPRU 730k firm" is any ~~BIPRU 730k firm~~ IFPRU 730k firm that is not a *limited activity firm* or a *limited licence firm*;
- (b) a "relevant ~~third country BIPRU 730k firm~~ IFPRU 730k firm" is any ~~third country BIPRU 730k firm~~ IFPRU 730k firm that is not a *limited activity firm* or a *limited licence firm*; and
- (c) ...

...

Part 2: Comes into force on 1 July 2014.

1 Annex 1 Detailed application of SYSC

...

Part 3	Tables summarising the application of the common platform requirements to different types of firm			
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...

Provision SYSC 4	COLUMN A Application to a common platform firm other than to a UCITS investment firm	COLUMN A+ Application to a UCITS management company	COLUMN A++ Application to a full-scope UK AIFM of an authorised AIF	COLUMN B Application to all other firms apart from insurers, managing agents, the Society, and full-scope UK AIFMs of unauthorised AIFs
...				
<u>SYSC 4.3A.6R</u> [FCA] [PRA]	<u>Rule applicable to CRR firms</u>	Rule for a <u>CRR firm</u> that is a <u>UCITS investment firm</u>	<u>Not applicable</u>	<u>Not applicable</u>
...				

4.3A.6 R (1) A CRR firm that is significant must ensure that the members of the management body of the firm do not hold more than one of the following combinations of directorship in any organisation at the same time:

- (a) one executive directorship with two non-executive directorships; and
- (b) four non-executive directorships.

(2) Paragraph (1) does not apply to members of the management body that represent the United Kingdom.

[Note: article 91(3) of the CRD]

4.3A.6A G In SYSC 4.3A.6AR a ‘CRR firm that is significant’ means a deposit-taker or designated investment firm whose size, interconnectedness, complexity and business type gives it the capacity to cause some disruption to the UK financial system (and through that to economic activity more widely) by

failing or by carrying on its business in an unsafe manner.

**CAPITAL REQUIREMENTS DIRECTIVE (PASSPORTING) AMENDMENT
INSTRUMENT 2013**

Powers exercised

- A. The Prudential Regulation 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 137G (The PRA’s general rules);
 - (2) section 137T (General supplementary powers); and
 - (3) paragraphs 19(10) and 20(4C) of Schedule 3 (Exercise of passport rights by UK firms).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

- C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority) (“FCA”), the PRA consulted the FCA. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

Commencement

- D. Part 1 of the Annex to this instrument comes into force on 1 January 2014.
- E. Part 2 of the Annex to this instrument shall come into force on a date specified by a subsequent PRA Board Instrument.

Amendments

- F. The Supervisory manual (SUP) is amended in accordance with the Annex to this instrument.

Notes and Guidance

- G. In the Annex to this instrument, the “notes” (indicated by “**Note:**”) are included for the convenience of readers but do not form part of the legislative text.
- H. The Prudential Regulation Authority gives as guidance each provision in the Annex that is marked with a G.

Citation

- I. This instrument may be cited as the Capital Requirements Directive (Passporting) Amendment Instrument 2013.

By order of the Board of the Prudential Regulation Authority
16 December 2013

Annex

Amendments to the Supervision manual (SUP)

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

Part 1: Comes into force on 1 January 2014.

13.2 Introduction

13.2.1 G This chapter gives *guidance* to *UK firms*. In most cases *UK firms* will be *authorised persons* under the *Act*. However, under the ~~*Banking Consolidation Directive*~~ *CRD*, a subsidiary of a *firm* which is a *credit institution* which meets the criteria set out in that Directive also has an *EEA right*. Such an unauthorised subsidiary is known as a *financial institution*. References in this chapter to a *UK firm* include a *financial institution*.

...

13.3 Establishing a branch in another EEA State

...

13.3.2 G A *UK firm* other than a *UK pure reinsurer* cannot establish a *branch* in another *EEA State* for the first time under an *EEA right* unless the conditions in paragraphs 19 of Part III of Schedule 3 to the *Act* are satisfied. It is an offence for a *UK firm* which is not an *authorised person* to contravene this prohibition (paragraph 21 of Part III of Schedule 3 to the *Act*). These conditions are that:

- (1) the *UK firm* has given the *appropriate UK regulator*, in accordance with the *appropriate UK regulator's rules* (see SUP 13.5.1R) or the directly applicable regulations made under the CRD (see SUP 13.5.1C), notice of its intention to establish a *branch* (known as a *notice of intention*) which:
 - (a) identifies the activities which it seeks to carry on through the *branch*; and
 - (b) includes such other information as may be specified by the *appropriate UK regulator* (see SUP 13.5.1R) or by the directly applicable regulations made under the CRD (see SUP 13.5.1C);
- (2) the *appropriate UK regulator* has given a notice (known as a *consent notice*) to the *Host State regulator*,

...

- 13.3.5 G (1) If the *UK firm's EEA right* derives from the ~~*Banking Consolidation Directive CRD*~~ or *MiFID*, the *appropriate UK regulator* will give the *Host State regulator* a *consent notice* within three *months* unless it has reason to doubt the adequacy of a *UK firm's* resources or its administrative structure. The *Host State regulator* then has a further two *months* to notify the *applicable provisions* (if any) and prepare for the supervision, as appropriate, of the *UK firm*, or in the case of a *MiFID investment firm*, to inform the *UK firm* that a *branch* can be established.

...

13.4 Providing cross border services into another EEA State

...

- 13.4.4 G (1) If the *UK firm's EEA right* derives from *MiFID*, the ~~*Banking Consolidation Directive CRD*~~ or the *UCITS Directive*, paragraph 20(3) of Part III of Schedule 3 to the Act requires the *appropriate UK regulator* to send a copy of the *notice of intention* to the *Host State Regulator* within *one month* of receipt. A *UK firm* passporting under the ~~*Banking Consolidation Directive CRD*~~ may start providing *cross border services* as soon as it satisfies the relevant conditions (see *SUP* 13.4.2G).

...

13.5 Notices of intention

- 13.5.1 R A *UK firm*, other than a *UK pure reinsurer* or a *CRD credit institution*, wishing to establish a *branch* in a particular *EEA State* for the first time under an *EEA right* other than under the *auction regulation* must submit a *notice of intention* in the form set out in *SUP* 13 Annex 1R.

...

- 13.5.2 R A *UK firm* wishing to provide *cross border services* into a particular *EEA State* for the first time under an *EEA right* other than under the *auction regulation* must submit a notice in the form set out in:

...

- (2) ~~*Sup*~~*SUP* 13 Annex 4R if the *UK firm* is passporting under the ~~*Banking Consolidation Directive CRD*~~; or

...

- 13.5.6 G (1) A *UK firm* passporting under the ~~*Banking Consolidation Directive CRD*~~, the *Insurance Directives* or the *Reinsurance Directive* may have to submit the *requisite details* or relevant details in the language of the *Host State* as well as in English.

For a *UK firm* passporting under the *Insurance Directives* this translated document will not include the relevant UK details. Further information is available from the *PRA* authorisations team.

...

13.6 Changes to branches

- 13.6.1 G Where a *UK firm* is exercising an *EEA right*, other than under the *Insurance Mediation Directive* (see *SUP* 13.6.9AG) or the *Reinsurance Directive* (see *SUP* 13.6.9BR) or the *CRD*, and has established a *branch* in another *EEA State*, any changes to the details of the *branch* are governed by the *EEA Passport Rights Regulations*. ...

...

Firms passporting under the ~~Banking Consolidation Directive~~ *CRD* and the *UCITS Directive*.

- 13.6.4 G If a *UK firm* has exercised an *EEA right*, under the ~~*Banking Consolidation Directive*~~ *CRD* or the *UCITS Directive*, and established a *branch* in another *EEA State*, regulation 11(1) states that the *UK firm* must not make a change in the *requisite details* of the *branch* (see *SUP* 13 Annex 1), unless it has satisfied the requirements of regulation 11(2), or, where the change arises from circumstances beyond the *UK firm's* control, regulation 11(3) (see *SUP* 13.6.10G).

...

- 13.6.13 G If a *UK firm* is passporting under the ~~*Banking Consolidation Directive*~~ *CRD*, then regulation 11(7) provides that the *PRA* may not refuse to consent to a change unless, having regard to the change and to the *EEA* activities the *UK firm* is seeking to carry on, it doubts the adequacy of the administrative structure or the financial situation of the *UK firm*. In reaching its determination, the *PRA* may have regard to the adequacy of management, systems and the presence of relevant skills needed for the *EEA* activities to be carried on.

...

Firms passporting under the ~~Banking Consolidation Directive~~ *CRD* and *Insurance Mediation Directive*

- 13.7.11 G A *UK firm* providing *cross border services* under the ~~*Banking Consolidative Directive*~~ *CRD* or *Insurance Mediation Directive* is not required to supply a change to the details of *cross border services* notice.
- 13.8.2 G *UK firms* passporting under the ~~*Banking Consolidative Directive*~~ *CRD*

or the *Insurance Directives* may be required to submit the change to details notice in the language of the *Host State* as well as in English.

...

13.10 Applicable provisions

- 13.10.2 G *UK firms* passporting under the ~~*Banking Consolidation Directive*~~ *CRD* should note that, under the Directive, the *Host State* is responsible, together with the *PRA*, for monitoring the liquidity of a *branch* established by a *UK firm* in another *EEA State*.

...

13 Annex 1 **Passporting: Notification of intention to establish a branch in another EEA state**

- R This annex consists of only one or more forms. Forms can be completed online now by visiting: <http://www.fsa.gov.uk/Pages/doing/index.shtml>
<http://www.bankofengland.co.uk/pr/Pages/authorisations/passporting/notifying.aspx>
 The forms are also to be found through the following address:
Passporting: Notification of intention to establish a branch in another EEA state - SUP 13 Annex 1

In the *SUP 13 Annex 1* form, on page 1 substitute ‘Capital Requirements Directive’ for ‘Banking Consolidation Directive’.

.....

13 Annex 4 **Passporting: ~~Banking Consolidation Directive~~ Capital Requirements Directive**

- R This annex consists of only one or more forms. Forms can be completed online now by visiting: <http://www.fsa.gov.uk/Pages/doing/index.shtml>
<http://www.bankofengland.co.uk/pr/Pages/authorisations/passporting/notifying.aspx>

The forms are also to be found through the following address:

Passporting: ~~Banking Consolidation Directive~~ Capital Requirements Directive - SUP 13 Annex 4

Throughout the form in *SUP 13 Annex 4* substitute ‘Capital Requirements Directive’ for ‘Banking Consolidation Directive’ and ‘CRD’ for ‘BCD’.

13A Qualifying for authorisation under the Act

...

- 13A.1.3 G (1) Under the *Gibraltar Order* made under section 409 of the *Act*, a Gibraltar firm is treated as an *EEA firm* under Schedule 3 to the *Act* if it is:
- ...
- (b) authorised in Gibraltar under the ~~*Banking Consolidation Directive*~~ *CRD*; or
- (c) authorised in Gibraltar under the *Insurance Mediation Directive*; or

...

The notification procedure

...

- 13A.5.3 G (2) For the purposes of paragraph 14(1)(b) of Part II of Schedule 3 to the *Act*, the information to be contained in the regulator’s notice has been prescribed under regulation 3 of the *EEA Passport Rights Regulations* and in the case of *CRD*, the information has been prescribed in the technical standards issued pursuant to and under Article 39 of the *CRD*.
- 13A.5.4 G (1) Unless the *EEA firm* (other than an *EEA pure reinsurer* or an *EEA firm* that received authorisation under article 18 of the *auction regulation*) is passporting under the *Insurance Mediation Directive*, if the *appropriate UK regulator* receives a regulator's notice or, where no notice is required (~~in the case of an *EEA firm* passporting under the *Banking Consolidation Directive*~~), is informed of the *EEA firm's* intention to provide *cross border services* into the *United Kingdom*, the *appropriate UK regulator* will, under paragraphs 14(2) and 14(3) of Part II of Schedule 3 to the *Act*, notify the *EEA firm* of the *applicable provisions* (if any) within two *months* of the *day* on which the *appropriate UK regulator* received the regulator's notice or was informed of the *EEA firm's* intention.

13A Annex 1 G Application of the Handbook to Incoming EEA Firms

1.		
....		
(1) Module of Handbook	(2) Potential application to an incoming EEA firm with respect to activities carried on from an establishment of the firm (or its appointed representative) in the United Kingdom	(3) Potential application to an incoming EEA firm with respect to activities carried on other than from an establishment of the firm (or its appointed representative) in the United Kingdom
<i>PRIN</i>	The <i>Principles</i> apply only in so far as responsibility for the matter in question is not reserved by an <i>EU</i> instrument to the <i>firm's Home State regulator (PRIN 3.1.1R(1))</i> . For an <i>incoming EEA firm</i> which is a BCD <i>CRD credit institution</i> without a <i>top-up permission</i> , <i>Principle 4</i> applies only in relation to the liquidity of a branch established in the <i>United Kingdom (PRIN 3.1.1 R (2))</i> .	
...		
<i>BIPRU</i>	<i>EEA firms</i> are subject to the prudential standards of their home state regulator (<i>BIPRU 1.1.7 R</i> and <i>BIPRU 1.1.9 G</i>). However, <i>BIPRU 12</i> applies to an <i>EEA firm</i> as respects the activities of its <i>UK branch</i> , but in relation	Does not apply if the <i>firm</i> has <i>permission</i> only for <i>cross border services</i> and does not carry on <i>regulated activities</i> in the <i>United Kingdom</i>.

	to liquidity risk only.	
...		
<u>IFPRU</u>	<u>EEA firms that are investment firms (as defined in the EU CRR) are subject to the EU CRR as implemented by their home state regulator (IFPRU 1.1.5R).</u>	<u>Does not apply if the firm has permission only for cross border services and does not carry on regulated activities in the United Kingdom.</u>
...		
COMP	Applies, except in relation to the <i>passported activities of a MiFID investment firm, a BCD-CRD credit institution (other than an electronic money institution within the meaning of article 1(3)(a) of the E-Money Directive that has the right to benefit from the mutual recognition arrangements under the Banking Consolidation Directive-CRD), an IMD insurance intermediary or a UCITS management company carrying on non-core services under Article 6.3 of the UCITS Directive and an incoming AIFM branch carrying on either AIFM management functions for an unauthorised AIF or non-core services under article 6.4 of AIFMD (see the definition of "participant firm"). However, a firm specified above may be able to apply for top-up cover in relation to its passported activities</i>	Does not apply in relation to the passported activities of an <i>MiFID investment firm, a BCD-CRD credit institution, an IMD insurance intermediary or a UCITS management company carrying on non-core services under article 6.3 of the UCITS Directive or an incoming EEA AIFM regarding AIFM management functions carried on for an unauthorised AIF or non-core services under article 6.4.</i> ⁸ Otherwise, COMP may apply, but the coverage of the compensation scheme is limited for non-UK activities (see COMP 5)

	(see COMP 14 (Participation by EEA Firms)).	
--	---	--

13A Annex 2 G Matters reserved to a Home State regulator

Introduction		
...		
Requirements in the interest of the general good		
2.	The <i>Single Market Directives</i> , and the <i>Treaty</i> (as interpreted by the European Court of Justice) adopt broadly similar approaches to reserving responsibility to the <i>Home State regulator</i> . To summarise, the <i>FCA</i> or <i>PRA</i> , as <i>Host State regulator</i> , is entitled to impose requirements with respect to activities carried on within the <i>United Kingdom</i> if these can be justified in the interests of the "general good" and are imposed in a non-discriminatory way. This general proposition is subject to the following in relation to activities passported under the <i>Single Market Directives</i> :	
	(1)	...
	...	
	(3)	for a BCD <u>CRD</u> <i>credit institution</i> , the <i>PRA</i> or <i>FCA</i> , as <i>Host State regulator</i> , is jointly responsible with the <i>Home State regulator</i> under article 41 <u>156</u> of the <i>Banking Consolidation Directive</i> <u><i>CRD</i></u> for supervision of the liquidity of a <i>branch</i> in the <i>United Kingdom</i> ;
	(4)	for a <i>MiFID investment firm</i> including a BCD - <u>CRD</u> <i>credit institution</i> (which is a <i>MiFID investment firm</i>), the protection of <i>clients'</i> money and <i>clients'</i> assets is reserved to the <i>Home State regulator</i> under <i>MiFID</i> ; and
	(5)	responsibility for participation in compensation schemes for BCD <u>CRD</u> <i>credit institutions</i> and <i>MiFID investment firm</i> is reserved in most cases to the <i>Home State regulator</i> under the <i>Deposit Guarantee Directive</i> and the <i>Investor Compensation Directive</i> .
...		

14.1 Application and Purpose

...

- 14.1.3 G (1) Under the *Gibraltar Order* made under section 409 of the *Act*, a *Gibraltar firm* is treated as an *EEA firm* under Schedule 3 to the *Act* if it is:

- (a) authorised in Gibraltar under the *Insurance Directives*; or
- (b) authorised in Gibraltar under the ~~*Banking Consolidation Directive*~~ CRD; or

...

Purpose

- 14.1.4 G This chapter gives *guidance* on the *Act* and the *EEA Passport Rights Regulations* made under the *Act*, for an *incoming EEA firm* which has established a *branch* in, or is providing *cross border services* into, the *United Kingdom* and wishes to change the details of the *branch* or *cross border services*.

Note: An *EEA bank* is required to comply with the requirements set out in the directly applicable regulations adopted under Articles 35, 36 and 39 CRD.

...

14.2 Changes to branch details

...

Firms passporting under the ~~*Banking Consolidation Directive*~~ CRD and the UCITS Directive

- 14.2.2 G (1) Where an *incoming EEA firm* passporting under the ~~*Banking Consolidation Directive*~~ CRD or the *UCITS Directive* has established a *branch* in the *United Kingdom*, regulation 4 states that it must not make a change in the *requisite details* of the *branch* unless it has complied with the relevant requirements.

...

Changes arising from circumstances beyond the control of an incoming EEA firm passporting under the ~~*Banking Consolidation Directive*~~ CRD, UCITS Directive or Insurance Directive

...

14.6 Cancelling qualification for authorisation

Incoming EEA firms

- 14.6.1 G Section 34 of the *Act* states that an *incoming EEA firm* no longer qualifies for *authorisation* under Schedule 3 to the *Act* if it ceases to be an *incoming EEA firm* as a result of:

- (1) ...

- (2) ceasing to have an *EEA right* in circumstances in which *EEA* authorisation is not required; this is relevant to a *financial institution* that is a subsidiary of a *credit institution* (of the kind mentioned in Article ~~19~~ 34 of the ~~*Banking Consolidation Directive-CRD*~~) which fulfils the conditions in articles ~~18~~ and 19 33 and 34 of that *Directive*.

...

Financial institutions giving up right to authorisation

- 14.6.4 G Where a *financial institution* (that is a subsidiary of a *credit institution*) is passporting under the ~~*Banking Consolidation Directive-CRD*~~ (see *SUP* 14.6.1G (2)), regulation 9(1) states that the *incoming EEA firm* may request the *PRA* to direct that its qualification for *authorisation* under Schedule 3 to the *Act* is cancelled from such date as may be specified in the direction.

...

15.1 Application

...

- 15.1.3 G In some cases, the application of provisions set out in *SUP* 15 Annex 1 depends on whether responsibility is reserved to a *Home State regulator*. ~~*SYSC App 1*~~ contains *guidance* on this.

...

Breaches of rules and other requirements in or under the Act

- 15.3.11 R (1) A *firm* must notify the *appropriate regulator* of:
- (a) ...
 - ...
 - (d)
 - (da) a breach of a directly applicable provision in *the EU CRR* or any directly applicable regulations made under *CRD* or *the EU CRR*; or
 - (e) ...

...

15 Annex 1 Application of SUP 15 to incoming EEA firms and incoming Treaty firms

R

Applicable sections		Application
<i>SUP 15.1, SUP 15.2</i>	Application, Purpose	Apply in full
<i>SUP 15.3.1R to SUP 15.3.6 G</i>	Matters having a serious regulatory impact	<i>SUP 15.3.1R does not apply, otherwise apply in full</i> <u>Apply in so far as responsibility for the matter in question is not reserved by an EU instrument to the firm's Home State regulator</u>
....		
<i>SUP 15.3.11 R to SUP 15.3.14 G</i>
<i>SUP 15.3.15 R to SUP 15.3.16 G</i>
<i>SUP 15.3.17 R to SUP 15.3.20 G</i>

...

App3 Guidance on passporting issues

App 3.3.6 G (1) The European Commission has not produce an interpretative communication on *MiFID*. It is arguable, however, that the principles in the communication on the Second Banking Directive can be applied to *investment services and activities*. This is because Chapter II of Title II of *MiFID* (containing provisions relating to operating conditions for investment firms) also applies to the *investment services and activities* of firms operating under the *Banking Consolidation Directive*, which is repealed and replaced by the *CRD*.

(2) ...

...

App 3.9 Mapping of MiFID, ~~Banking Consolidation Directive~~ CRD, UCITS Directive and Insurance Mediation Directive to the Regulated Activities Order

App 3.9.1 G The following Tables 1, 2, 2A and 2B provide an outline of the *regulated activities* and *specified investments* that may be of relevance to *firms* considering undertaking *passport activities* under the ~~Banking Consolidation Directive~~ CRD, MiFID, the UCITS Directive and the Insurance Mediation Directive. The tables may be of assistance to UK firms that are thinking of offering financial services in another EEA State and to EEA firms that may offer those services in the United Kingdom.

App 3.9.2 G The tables provide a general indication of the *investments* and activities specified in the Regulated Activities Order that may correspond to categories provided for in the ~~Banking Consolidation Directive~~ CRD, MiFID, the UCITS Directive of the Insurance Mediation Directive. The tables do not provide definitive guidance as to whether a firm is carrying on an activity that is capable of being passported, nor do the tables take account of exceptions that remove the effect of articles. Whether a firm is carrying on a passported activity will depend on the particular circumstances of the firm. If a firm's activities give rise to potential passporting issues, it should obtain specialist advice on the relevant issues.

...

App 3.9.4 Activities set out in Annex 1 of the ~~BCD~~ CRD

	Table 1: BCD <u>CRD</u> activities		Part II RAO Activities	Part III RAO Investments
	1.	Acceptance of Taking deposits and other repayable funds from the public	Article 5	Article 74
	...			
	15.	Issuing electric money	Article 9B	Article 74A
	...			
<p>Note 1 : The services and activities provided for in Sections A and B of Annex I of MiFID when referring to the <i>financial instruments</i> provided for in Section C of Annex I of that Directive are subject to mutual recognition according to the BCD <u>CRD</u> from 1 November 2007 January 2013. See the table at SUP App 3.9.5G below for mapping of MiFID investment services and activities. For further details relating to this residual category, please see the “Banking Consolidation Directive” “CRD” section of the passporting forms entitled “Notification of intention to establish a branch in another EEA State” and “Notification of intention to provide cross border services in another EEA State”.</p>				

Part 2: Comes into force on date specified by a subsequent PRA Board instrument.

13A Annex 1 Application of the Handbook to Incoming EEA Firms

...		
(1) Module of Handbook	(2) Potential application to an incoming EEA firm with respect to activities carried on from an establishment of the firm (or its appointed representative) in the United Kingdom	(3) Potential application to an incoming EEA firm with respect to activities carried on other than from an establishment of the firm (or its appointed representative) in the United Kingdom
<i>PRIN</i>	The <i>Principles</i> apply only in so far as responsibility for the matter in question is not reserved by an <i>EU</i> instrument to the <i>firm's Home State regulator (PRIN 3.1.1R(1))</i> . For an incoming EEA firm which is a CRD credit institution without a top-up permission, Principle 4 applies only in relation to the liquidity of a branch established in the United Kingdom (PRIN 3.1.1R(2)).	...
....		
<i>BIPRU</i>	<i>BIPRU 12</i> applies to an <i>EEA firm</i> as respects the activities of its <i>UK branch</i>, but in relation to <i>liquidity risk</i> only.	
...		
<i>SUP</i>	SUP 16 (Reporting requirements) Parts of this chapter may apply if the <i>firm</i> has a <i>top-up permission</i> or if the <i>firm</i> is: (a) a <i>bank</i> ; or [deleted]
...		

13A Annex 2 Matters reserved to a Home State regulator

Introduction	
...	
Requirements in the interest of the general good	
2.	The Single Market Directives, and the Treaty (as interpreted by the European Court of Justice) adopt broadly similar approaches to reserving responsibility to the Home State regulator. To summarise, the FCA or PRA, as Host State regulator, is entitled to impose requirements with respect to activities carried on within the United Kingdom if these can be justified in the interests of the "general good" and are imposed in a non-discriminatory way. This general proposition is subject to the following in relation to activities passported under the Single Market Directives:
(1)
(2)
(3)	for a CRD credit institution, the PRA or FCA, as Host State regulator, is jointly responsible with the Home State regulator under article 156 of the CRD for supervision of the liquidity of a branch in the United Kingdom [deleted]
...	

**CAPITAL REQUIREMENTS DIRECTIVE (DISAPPLICATION)
INSTRUMENT 2013**

Powers exercised

- A. The Prudential Regulation 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 137G (the PRA’s general rules); and
 - (2) section 137T (general supplementary powers).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.
- C. The Prudential Regulation Authority gives as guidance each provision in the Annex marked with a G.

Pre-conditions to making

- D. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority) (“FCA”), the PRA consulted the FCA. After consulting, the PRA published a draft of proposed amended rules and had regard to representations made.

Commencement

- E. This instrument comes into force on 1 January 2014.

Amendments

- F. The General Prudential sourcebook (GENPRU) is amended in accordance with Annex A to this instrument.
- G. The Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU) is amended in accordance with Annex B to this instrument.

Citation

- H. This instrument may be cited as the Capital Requirements Directive (Disapplication) Instrument 2013.

By order of the Board of the Prudential Regulation Authority
16 December 2013

Annex A

Amendments to the General Prudential sourcebook (GENPRU)

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

Application

1.1 Application

...

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. [deleted]~~

1.1.2-A G Further, GENPRU also broadly applies to:

- (1) an insurer;
- (2) groups containing an insurer.

...

1.2 Adequacy of financial resources

Application

1.2.1 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. [deleted]~~

1.2.1A R This section also applies to an insurer, unless it is:

- (1) a non-directive friendly society; or
- (2) a Swiss general insurer; or
- (3) an EEA-deposit insurer; or
- (4) an incoming EEA firm; or
- (5) an incoming Treaty firm.

1.2.2A R ~~In relation to any provision in this section which applies to a BIPRU firm, a reference in that provision to "financial resources" does not constitute a reference to "liquidity resources". [deleted]~~

1.2.3A G In relation to:

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

~~BIPRU 12 contains rules and guidance in relation to the adequacy of that firm's liquidity resources. [deleted]~~

...

1.2.11 G The adequacy of a firm's financial resources needs to be assessed in relation to all the activities of the firm and the risks to which they give rise and so this section applies to a firm in relation to the whole of its business. ~~In the case of a collective portfolio management investment firm this means that this section also applies to its activities in relation to the management of AIFs and/or UCITS.~~

Purpose

...

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

liquidity resources. As noted in ~~GENPRU 1.2.3AG~~, however, the ~~appropriate regulator's rules and guidance~~ in relation to the adequacy of the liquidity resources of a ~~BIPRU firm~~ are set out in ~~BIPRU 12~~.

- 1.2.14 G ~~In the case of a bank or building society this section implements Article 123 and (in part) Annex XI of the Banking Consolidation Directive. In the case of a BIPRU investment firm this section implements Article 34 of the Capital Adequacy Directive so far as that Article applies Article 123 of the Banking Consolidation Directive. [deleted]~~

...

Outline of other related provisions

...

- 1.2.21 G (1) SYSC 11 sets out material on systems and controls that apply specifically to *liquidity risk* as that concept relates to an *insurer*.

(2) [deleted]

(2A) ~~BIPRU 12 sets out material on systems and controls that apply specifically to liquidity risk in relation to a BIPRU firm, a branch of an incoming EEA firm that is a full BCD credit institution and a branch of a third country BIPRU firm that is a bank. [deleted]~~

(3) [deleted]

...

(5) ~~GENPRU 2.2 (Adequacy of financial resources) requires certain BIPRU investment firms to deduct illiquid assets when calculating their capital resources. [deleted]~~

...

- 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. [deleted]~~

- 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. [deleted]~~

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

- 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). [deleted]~~

Requirement to have adequate financial resources

...

- 1.2.26A G ~~BIPRU 12 contains rules and guidance in relation to the adequacy of a BIPRU firm's liquidity resources. Consistent with GENPRU 1.2.2AR, in assessing the adequacy of its liquidity resources, a BIPRU firm should do so by reference to the overall liquidity adequacy rule, rather than the overall financial adequacy rule. [deleted]~~

...

Systems, strategies, processes and reviews

...

- 1.2.33 R ...
- (2) ~~In the case of a BIPRU firm the processes, strategies and systems relating to concentration risk must include those necessary to ensure compliance with BIPRU 10 (Large exposures requirements). [deleted]~~

...

...

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

...

- 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). [deleted]~~

- 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*). [deleted]~~

1.2.47A R The ICAAP rules apply on a solo basis to an insurer to which those rules do not apply on a consolidated basis under *GENPRU 1.2.45R*.

...

Capital planning

...

1.2.78 G Additional *guidance* in relation to stress tests and scenario analysis for *liquidity risk* as that concept relates to an *insurer* is available in *SYSC 11* (Liquidity risk systems and controls). ~~*BIPRU 12* sets out the main *Handbook* provisions in relation to *liquidity risk* for a *BIPRU firm*.~~

...

1.3 Valuation

Application

- 1.3.1 R (1) ~~This section of the *Handbook* applies to an *insurer*, unless it is:~~
- ~~(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*. [deleted]~~

- 1.3.1A R (1) This section of the *Handbook* also 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* also applies to a *UK ISPV*.

Purpose

...

- 1.3.3 G (1) ~~In the case of a *BIPRU firm*, this section implements Article 74 of the *Banking Consolidation Directive*, Articles 64(4) and 64(5) of the *Banking Consolidation Directive* (Own funds) and Article 33 and Part B of Annex VII of the *Capital Adequacy Directive*. [deleted]~~

...

General requirements: Accounting principles to be applied

- 1.3.4 R Subject to *GENPRU* 1.3.9R to *GENPRU* 1.3.10R and *GENPRU* 1.3.36R, except where a *rule* in *GENPRU*, *BIPRU* or *INSPRU* provides for a different method of recognition or valuation, whenever a *rule* in *GENPRU*, *BIPRU* or *INSPRU* refers to an asset, liability, *exposure*, equity or income statement item, a *firm* must, for the purpose of that *rule*, recognise the asset, liability, *exposure*, equity or income statement item and measure its value in accordance with whichever of the following are applicable:

...

- (4) ~~the *Building Societies* (Accounts and Related Provisions) Regulation 1998; [deleted]~~

...

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

...

- 1.3.35A G ~~*UK banks* and *BIPRU 730k firms* are reminded that they may, in respect of their prudent valuation assessments under *GENPRU* 1.3.4R and *GENPRU* 1.3.14R to *GENPRU* 1.3.34R, be subject to the requirement under *SUP* 16.16.4R to submit a Prudent Valuation Return to the appropriate regulator. [deleted]~~

Specific requirements: *BIPRU* firms

- 1.3.36 R Adjustments to accounting values
- (1) ~~For the purposes of *GENPRU* and *BIPRU*, the adjustments in (2) and (3) apply to values calculated pursuant to *GENPRU* 1.3.4R 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, or formerly held, in the available-for-sale category.

(3) ~~A BIPRU investment firm must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.~~

(4) ~~The items referred to in (2) and (3) must be excluded from capital resources. [deleted]~~

1.3.37 G ~~Provisions for equity instruments held in the available-for-sale category can be found in GENPRU 2.2.185R. [deleted]~~

Trading book and other fair-valued positions, and revaluations

1.3.38 R ~~GENPRU 1.3.39R to GENPRU 1.3.40R apply only to a BIPRU firm. [deleted]~~

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

1.3.40 R ~~Trading book positions must be re-valued at least daily. [deleted]~~

...

Capital

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. [deleted]~~

2.1.1A R Except as indicated in SUP 2.1.60R, this section applies to an insurer, unless it is:

- (1) a non-directive friendly society; or
- (2) a Swiss general insurer; or
- (3) an EEA-deposit insurer; or
- (4) an incoming EEA firm; or
- (5) an incoming Treaty firm.

Purpose

...

- 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 collective portfolio management investment firm this section implements article 9 of AIFMD and (in part) Article 7 of the UCITS Directive. [deleted]~~

2.1.8A G 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.

...

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). [deleted]~~
- 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). [deleted]~~
- 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. [deleted]~~
- 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. [deleted]~~
- 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. [deleted]~~

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. [deleted]~~
- [The table at GENPRU 2.1.45R is deleted in its entirety. The deleted text is not shown.]

...

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. [deleted]~~

Table: Base capital resources requirement for a BIPRU firm

- 2.1.48 R ~~This table belongs to GENPRU 2.1.47R. [deleted]~~
- [The table in GENPRU 2.1.48R is deleted in its entirety. The deleted text is not shown.]

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. [deleted]~~

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

- 2.1.50 G ~~This table belongs to *GENPRU 2.1.49G* [deleted]~~
[The table at *GENPRU 2.1.50G* is deleted in its entirety. The deleted text is not shown.]

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*. [deleted]~~

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. [deleted]~~

...

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

...

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. [deleted]~~

2.2.1A R This section applies to an insurer unless it is:

- (1) a non-directive friendly society; or
- (2) a Swiss general insurer; or
- (3) an EEA-deposit insurer; or
- (4) an incoming EEA firm; or

(5) an incoming Treaty firm.

Purpose

...

- 2.2.4 G ~~This section also implements minimum EC standards for the composition of *capital resources* required to be held by a *BIPRU firm*. In particular it implements 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)(e) (in part) and paragraphs 13–15 of Part B of Annex VII of the *Capital Adequacy Directive* (2006/49/EC). [deleted]~~

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. [deleted]~~

Table: Arrangement of GENPRU 2.2

- 2.2.6 G ~~This table belongs to *GENPRU 2.2.5G* [deleted]~~
[The table in *GENPRU 2.2.6G* is deleted in its entirety. The deleted text is not shown.]

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*. [deleted]~~

...

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*). [deleted]~~

...

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. [deleted]~~

- 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. [deleted]~~

Table: Applicable capital resources calculation

- 2.2.19 R This table belongs to ~~GENPRU 2.2.17R~~ [deleted]
[The table in *GENPRU 2.2.19R* is deleted in its entirety. The deleted text is not shown.]

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 appropriate regulator, illiquid assets. [deleted]~~
- 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. [deleted]~~

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.~~

...

- 2.2.28 R ~~In the case of a BIPRU firm, the requirement to obtain a legal opinion in GENPRU 2.2.159R(12) does not apply to hybrid capital treated~~

~~under GENPRU 2.2.25R but the requirements to obtain a legal opinion in GENPRU 2.2.118R continue to apply. [deleted]~~

...

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

- 2.2.30A R ~~In relation to the tier one capital resources of a BIPRU firm, calculated at stage F of the calculation in the capital resources table (Total tier one capital after deductions):~~
- ~~(1) no more than 50% may be accounted for by hybrid capital;~~
 - ~~(2) no more than 35% may be accounted for by hybrid capital included at stages B2 and C of the calculation in the capital resources table; and~~
 - ~~(3) no more than 15% may be accounted for by hybrid capital included at stage C of the calculation in the capital resources table. [deleted]~~

...

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

- 2.2.44 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. [deleted]~~
- 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. [deleted]~~

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*. [deleted]~~

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*. [deleted]~~

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)(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*). [deleted]~~

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 GENPRU 2.2.47R(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(1) and (2) as established by GENPRU 2.2.48R. [deleted]~~
- 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. [deleted]~~

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 combined credit, operational and counterparty risk requirement of £100 (of which £10 is due to counterparty risk) and a market risk requirement of £90, making a total capital requirement of £190. Its ~~capital resources~~ are as set out in the table in ~~GENPRU 2.2.52G. [deleted]~~

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

- 2.2.52 G This table belongs to ~~GENPRU 2.2.51G [deleted]~~
- [The table at ~~GENPRU 2.2.52G~~ is deleted in its entirety. The deleted text is not shown.]
- ...
- 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. [deleted]~~

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

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

- 2.2.56 G ~~This table belongs to *GENPRU 2.2.55G* [deleted]~~
 [The table in *GENPRU 2.2.55G* is deleted in its entirety. The deleted text is not shown.]
- 2.2.57 G ~~The gearing limit in *GENPRU 2.2.49R* (Combined tier two and tier three limits) requires that the *upper tier three capital* used to meet the market risk requirement does not exceed 250% of the relevant *tier one capital*. [deleted]~~
- 2.2.58 G ~~In this example it is assumed that the maximum possible amount of *tier one capital* is carried forward to meet the market risk requirement. There are other options as to the allocation of *tier one capital* and *tier two capital* to the credit, operational and counterparty risk requirement. In order to calculate the relevant *tier one capital* for the *upper tier three* gearing limit in accordance with *GENPRU 2.2.49R* it is first necessary to allocate *tier one capital* and *tier two capital* to the individual credit, operational and counterparty risk requirements. This allocation process underlies the calculation of the overall amount referred to in *GENPRU 2.2.48R*. The calculation in *GENPRU 2.2.49R(3)* and *GENPRU 2.2.49R(4)* then focuses on the *tier one* element of this earlier calculation.~~
~~In this worked example, if it is assumed that the counterparty risk requirement has been met by *tier one capital*, the relevant *tier one capital* for gearing is £50. This is because the deductions of £20 and the credit and operational risk requirements of £90 have been met by *tier two capital* in the first instance. However, the total sum of deductions and credit and operational risk requirements exceed the *tier two capital* amount of £80 by £30. Hence the £80 of *tier one capital* has been reduced by £30 to leave £50.~~
~~In practical terms, the same result is achieved for the relevant *tier one capital* for gearing by taking the amount carried forward to meet market risk of £40 and adding back the £10 in respect of the counterparty risk requirement. Again, there are other options as to the allocation to credit, operational and counterparty risk of the constituent elements of Stage N of the *capital resources table*.~~
~~The outcome of these calculations can be summarised as follows:[deleted]~~
- (1) ~~the relevant *tier one capital* for the gearing calculation is £50; [deleted]~~

(2) ~~250% of the relevant tier one capital is £125; and [deleted]~~

(3) ~~the upper tier three capital used to meet market risk is £50. [deleted]~~

2.2.59 G ~~The 250% gearing limit is met as the limit of £125 is greater than the upper tier three capital of £50 used in this example. [deleted]~~

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. [deleted]~~

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. [deleted]~~

...

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

...

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

(1) ~~the capital instrument is affected by a dividend stopper; and~~

(2) ~~the dividend stopper operates in a way that hinders recapitalisation. [deleted]~~

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

...

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

2.2.69A R ~~A BIPRU firm must not make a payment of a coupon on an item of hybrid capital if the firm has no distributable reserves. [deleted]~~

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

~~its capital resources requirement. [deleted]~~

- 2.2.69C R ~~A BIPRU firm must not pay a coupon on an item of hybrid capital in the form of core tier one capital in accordance with GENPRU 2.2.64R(4)(b) unless:~~
- ~~(1) the firm meets its capital resources requirement; and~~
 - ~~(2) such a substituted payment preserves the firm's financial resources. [deleted]~~
- 2.2.69D G ~~The appropriate regulator considers that a BIPRU firm's financial resources are not preserved under GENPRU 2.2.69CR(2) unless, among other things, the conditions of the substituted payment are that:~~
- ~~(1) there is no decrease in the amount of the firm's core tier one capital;~~
 - ~~(2) the deferred coupon is satisfied without delay using newly issued core tier one capital that has an aggregate fair value no more than the amount of the coupon;~~
 - ~~(3) the firm is not obliged to find new investors for the newly issued instruments; and~~
 - ~~(4) if the holder of the newly issued instruments subsequently sells the instruments and the sale proceeds are less than the value of the coupon, the firm is not obliged to issue further new instruments to cover the loss incurred by the holder of the instruments. [deleted]~~
- 2.2.69E R ~~A BIPRU firm must cancel the payment of a coupon if circumstances arise whereby the payment of the coupon by newly issued instruments, in accordance with GENPRU 2.2.64R(4)(b), does not comply with the requirements of GENPRU 2.2.69CR. [deleted]~~
- 2.2.69F G (1) ~~In relation to the cancellation or deferral of the payment of a coupon in accordance with GENPRU 2.2.64R(4) and GENPRU 2.2.64R(5), GENPRU 2.2.68AR, or GENPRU 2.2.69BR, the appropriate regulator expects that situations where a coupon may need to be cancelled or deferred will be resolved through analysis and discussion between the firm and the appropriate regulator. If the appropriate regulator and the firm do not agree on the cancellation or deferral of the payment of a coupon, then the appropriate regulator may consider using its powers under 55J of the Act to, on its own initiative, vary a firm's Part 4A permission to require it to cancel or defer a coupon in accordance with the appropriate regulator's view of the financial and solvency situation of the firm.~~
- (2) ~~In considering a firm's financial and solvency situation, the appropriate regulator will normally take into account, among~~

other things, the following:

- (a) ~~the firm's financial and solvency position before and after the payment of the coupon, in particular whether that payment, or other foreseeable internal and external events or circumstances, may increase the risk of the firm breaching its capital resources requirement or the overall financial adequacy rule;~~
 - (b) ~~an appropriately stressed capital plan, covering 3-5 years, which includes the effect of the proposed payment of the coupon; and~~
 - (c) ~~an evaluation of the risks to which the firm is or might be exposed and whether the level of tier one capital ensures the coverage of those risks, including stress tests on the main risks showing potential loss under different scenarios.~~
- (3) ~~If the BIPRU firm is required to cancel or defer the payment of a coupon by the appropriate regulator, it may still be able to pay the coupon by way of newly issued core tier one capital in accordance with GENPRU 2.2.64 R(4)(b) and GENPRU 2.2.69C R. The appropriate regulator may consider using its powers under 55J of the Act to, on its own initiative, vary a firm's Part 4A permission to impose conditions on the use of such a mechanism or to require its cancellation, based on the factors outlined in this guidance. [deleted]~~

Redemption of tier one instruments

...

- 2.2.70A G ~~In the case of a BIPRU firm, an incentive to redeem is a feature of a capital instrument that would lead a reasonable market participant to have an expectation that the firm will redeem the instrument. The appropriate regulator considers that interest rate step-ups and principal stock settlements, in conjunction with a call option, are incentives to redeem. Only instruments with moderate incentives to redeem are permitted as tier one capital, in accordance with the limited conversion ratio in GENPRU 2.2.138R and the rule on step-ups in GENPRU 2.2.147R. [deleted]~~

...

- 2.2.74B R ~~If a BIPRU firm does not comply with its capital resources requirement or if the redemption of any dated tier one instrument would cause it to breach its capital resources requirement, it must suspend the redemption of its dated tier one instruments. [deleted]~~

...

Purchases of tier one instruments: BIPRU firm only

- 2.2.79A R ~~A BIPRU firm must not purchase a tier one instrument that it has included in its tier one capital resources unless:~~
- ~~(1) the firm initiates the purchase;~~
 - ~~(2) [deleted]~~
 - ~~(3) the firm has given notice to the appropriate regulator in accordance with GENPRU 2.2.79GR; and~~
 - ~~(4) (in the case of hybrid capital) it is on or after the fifth anniversary of the date of issue of the instrument. [deleted]~~
- 2.2.79B G ~~In exceptional circumstances a BIPRU firm may apply for a waiver of GENPRU 2.2.79AR(4) under section 138A (Modification or waiver of rules) of the Act. [deleted]~~
- 2.2.79C R ~~GENPRU 2.2.79AR(4) does not apply if:~~
- ~~(1) the firm replaces the capital instrument it intends to purchase with a capital instrument that is included in a higher stage of capital or the same stage of capital; and~~
 - ~~(2) the replacement capital instrument has already been issued. [deleted]~~
- 2.2.79D R ~~GENPRU 2.2.79AR(4) does not apply if:~~
- ~~(1) the firm intends to hold the purchased instrument for a temporary period as market maker; and~~
 - ~~(2) the purchased instruments held by the firm do not exceed the lower of:~~
 - ~~(a) 10% of the relevant issuance; or~~
 - ~~(b) 3% of the firm's total issued hybrid capital. [deleted]~~
- 2.2.79E G ~~In the circumstances provided for in GENPRU 2.2.79DR, a firm would purchase the instrument and, instead of cancelling it, the firm would hold the instrument for a temporary period. In that case a firm should have in place adequate policies to take into account any relevant regulations and rules, which include those relating to market abuse. [deleted]~~
- 2.2.79F R ~~For the purposes of calculating its tier one capital resources, a firm must deduct the amount of any item of hybrid capital which it then holds. [deleted]~~

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

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

2.2.79H G ~~The appropriate regulator considers that:~~

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

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

2.2.79J R ~~If a BIPRU firm announces the purchase of any tier one instrument, the firm must no longer include that instrument in its tier one capital~~

resources. [deleted]

2.2.79K R ~~If a *BIPRU firm* does not comply with its *capital resources requirement*, or if the purchase of any *tier one instrument* would cause it to breach its *capital resources requirement*, it must suspend the purchase of *tier one instruments*.~~ [deleted]

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

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 2006 it is "called-up *share* capital" within the meaning given to that term in that Act; or

(2) ~~(in the case of a *building society*) it is a *deferred share*; or~~ [deleted]

(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).

...

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*.

(d) ~~a *deferred share*~~; [deleted]

...

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

2.2.83A R ~~The conditions that a BIPRU firm's permanent share capital must comply with under GENPRU 2.2.83AR(4) or that a BIPRU firm's eligible partnership capital or eligible LLP members' capital must comply with under GENPRU 2.2.95R are as follows:~~

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

~~liquidation of the *firm* the holders have a claim on the residual assets remaining after satisfaction of all prior claims that is proportional to their holding and do not have a priority claim or a fixed claim for the nominal amount of their holding;~~

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

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

2.2.83C R ~~A *BIPRU firm* must not pay a *coupon* on a *tier one instrument* included in stage A of the *capital resources table* if it has no distributable reserves. [deleted]~~

2.2.83D G ~~A *BIPRU firm* may disclose its dividend policy, provided that the policy only reflects the current intention of the *firm* and does not undermine the *firm's* right to choose the amount of any *coupon* that it pays. [deleted]~~

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

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

- ~~(1) the *capital instrument* satisfies all other conditions for eligibility as *core tier one capital* set out in *GENPRU* 2.2.83R to *GENPRU* 2.2.83AR;~~
- ~~(2) the *coupon* limit has been imposed by law or the constitutional~~

documents of the *firm*;

- (3) ~~the objective of the limit is to protect the capital reserves of the *firm*;~~
- (4) ~~the *firm* continues to have the effective right to choose the amount of any *coupon* that it pays;~~
- (5) ~~all other *capital instruments* issued by the *firm* and included in stage A of the *capital resources table*:

 - (a) ~~meet the conditions set out in *GENPRU 2.2.83R(2)*, *GENPRU 2.2.83R(3)* and *GENPRU 2.2.83AR* (General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only)); and~~
 - (b) ~~if subject to a *coupon* limit, are subject to the same *coupon* limit; and~~~~
- (6) ~~any preferential *coupon* on a *capital instrument* included in stage A of the *capital resources table*, arising as a result of the inclusion of a *coupon* limit on another *capital instrument*, must be restricted to a fixed multiple of the *coupon* payment on the *capital instrument* that is subject to the *coupon* limit. *GENPRU 2.2.83AR(2)* to (3) do not prevent a *capital instrument* from being included in stage A of the *capital resources table* if the only reason for those prohibitions not being met is that a preferential *coupon* arises, and is restricted, in the manner referred to in this paragraph (6). [deleted]~~

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

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

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

- (1) ~~a *coupon* arising on a *capital instrument* which is not subject to an explicit *coupon* limit within its terms of issue is likely to be preferential to a *coupon* on a *capital instrument* included in the same stage of *capital* which is subject to a *coupon* limit; and~~

- (2) ~~the preference so arising should be restricted so that it is not an unlimited preference. [deleted]~~

Core tier one capital: additional information

- 2.2.84 G In the case of an *insurer*, *GENPRU 2.2.83R(2)* and *GENPRU 2.2.83R(3)* have the effect that the *firm* should be under no obligation to make any payment in respect of a *tier one instrument* if it is to form part of its *permanent share capital* unless and until the *firm* is wound up. A *tier one instrument* that forms part of *permanent share capital* should not therefore count as a liability before the *firm* is wound up. The fact that relevant company law permits the *firm* to make earlier repayment does not mean that the *tier one instruments* are not eligible. However, the *firm* should not be required by any contractual or other obligation arising out of the terms of that capital to repay *permanent share capital*. Similarly a *tier one instrument* may still qualify if company law allows dividends to be paid on this capital, provided the *firm* is not contractually or otherwise obliged to pay them. There should therefore be no fixed costs. ~~*GENPRU 2.2.83AR* to *GENPRU 2.2.83FR* impose more specific conditions on *coupon* payment and winding up which are applicable to *BIPRU firms*.~~

...

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

- 2.2.85 R (1) ~~Negative amounts, including any interim net losses (but in the case of a *BIPRU investment firm*, only material interim net losses), must be deducted from profit and loss account and other reserves.~~
- (2) ~~For these purposes material interim net losses mean unaudited interim losses arising from a *firm's trading book* and *non-trading book* business which exceed 10% of the sum of its *capital resources* calculated at stage A (Core tier one capital) in the *capital resources table*.~~
- (3) ~~If interim losses as referred to in (2) exceed the 10% figure in (2) then a *BIPRU investment firm* must deduct the whole amount of those losses and not just the excess. [deleted]~~
- 2.2.85A R (1) In the case of an insurer, negative amounts, including any interim net losses, must be deducted from profit and loss account and other reserves.
- (2) For these purposes material interim net losses mean unaudited interim losses arising from a *firm's trading book* and *non-trading book* business which exceed 10% of the sum of its *capital resources* calculated at stage A (Core tier one capital) in the

capital resources table.

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 1.3.35AG (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. [deleted]~~

...

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. [deleted]~~

...

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. [deleted]~~

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;~~

- (b) ~~the partnership is wound up or otherwise dissolved; or~~
- (c) ~~the *BIPRU firm* has ceased to be *authorised* or no longer has a *Part 4A permission*. [deleted]~~

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;~~
 - (b) ~~the *limited liability partnership* is wound up or otherwise dissolved; or~~
 - (c) ~~the *BIPRU firm* has ceased to be *authorised* or no longer has a *Part 4A permission*. [deleted]~~

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) and *GENPRU 2.2.83AR* to *GENPRU 2.2.83CR* (General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only). However, *GENPRU 2.2.64R(3)* (Redemption), *GENPRU 2.2.83AR(5)* (Capital repayment) and *GENPRU 2.2.83AR(12)* (Characteristics in contract) are replaced by *GENPRU 2.2.93R* or *GENPRU 2.2.94R*. [deleted]~~

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 *appropriate regulator* for a *waiver* to allow it to do so. If a *firm* applies for such a *waiver* the information that the *firm* supplies with the application might include:~~

- (1) ~~a demonstration that the *firm* would have sufficient *capital resources* to meet its *capital resources requirement* immediately after the repayment;~~

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

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) do not apply to a BIPRU firm that is a partnership or a limited liability partnership. [deleted]~~
- 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 2006. [deleted]~~
- 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. [deleted]~~

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. [deleted]~~

...

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

- 2.2.108A R ~~A building society may include a deferred share at stage A of the calculation in the capital resources table if (in addition to satisfying all the other requirements in relation to tier one capital) it is permanent share capital and is otherwise equivalent to an ordinary share in terms of its capital qualities, taking into account the specific constitution of building societies under the Building Societies Act 1986. [deleted]~~
- 2.2.108B G ~~The other main provisions relevant to inclusion of a deferred share in tier one capital are GENPRU 2.2.62R (Tier one capital: General),~~

~~GENPRU 2.2.64R (General conditions for eligibility as tier one capital), GENPRU 2.2.65R (Connected transactions) and GENPRU 2.2.80R (Loss absorption): [deleted]~~

...

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

2.2.115A R ~~A BIPRU firm must not include a capital instrument at stage B1 of the calculation in the capital resources table unless (in addition to satisfying all the other requirements in relation to tier one capital and hybrid capital) its contractual terms are such that:~~

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

2.2.115B G ~~The intention of GENPRU 2.2.115AR is to ensure that capital instruments included in stage B1 of the calculation in the capital resources table have the same permanence as core tier one capital; the~~

~~presence of a call option for these instruments may reduce their permanence. [deleted]~~

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

~~date of its issue. [deleted]~~

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

Other tier one capital: loss absorption

...

- 2.2.116A R ~~A *BIPRU firm* must not include a *capital instrument* that is not a *share* at stage B1, B2 or C of the calculation in the *capital resources table* unless (in addition to satisfying all the other requirements in relation to *tier one capital* and *hybrid capital*) the *firm's* obligations under the instrument either:~~

- ~~(1) do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986; or~~
- ~~(2) do constitute such a liability but the terms of the instrument are such that:

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

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

...

- 2.2.117A R ~~A *BIPRU firm* must not include a *capital instrument* at stage B1, B2 or C of the calculation in the *capital resources table* unless (in addition to satisfying all the other requirements in relation to *tier one capital* and *hybrid capital*) its contractual terms provide for a mechanism within the instrument which:~~

- ~~(1) is clearly defined and legally certain;~~
- ~~(2) is disclosed and transparent to the market;~~
- ~~(3) makes the recapitalisation of the *firm* more likely by adequately reducing the potential future outflows to a holder of the *capital instrument* at certain trigger points;~~
- ~~(4) enables the *firm*, at and after the trigger points, to operate the mechanism; and~~
- ~~(5) when initiated, operates in one of the following ways:

 - ~~(a) the principal of the instrument is written down permanently; or~~
 - ~~(b) the principal of the instrument is written down temporarily. During the write down period any *coupon* payable on the instrument must be cancelled and any related dividend stoppers and pushers must operate in a way that does not hinder recapitalisation; or~~
 - ~~(c) the instrument is converted into *core tier one capital*. The maximum number of *capital instruments* which are *core tier one capital* into which it must be converted must:

 - ~~(i) be determined at the date of its issue;~~
 - ~~(ii) be determined on the basis of the market value of those other instruments at the date of its issue;~~
 - ~~(iii) have an aggregate value no more than 150% of its par value; and~~
 - ~~(iv) not increase if the share price decreases; or~~~~
 - ~~(d) an alternative process applies which has the same or greater effect on the likelihood of recapitalisation as (a), (b), and (c). [deleted]~~~~

2.2.117B R ~~The trigger points required by *GENPRU 2.2.117AR(3)* must:~~

- ~~(1) be clearly defined within the instrument and legally certain;~~
- ~~(2) be disclosed and transparent to the market; and~~
- ~~(3) be prudent and timely, and include trigger points which occur:

 - ~~(a) before a breach of the *firm's capital resources requirement* and both:

 - ~~(i) when the *firm's* losses lead to a significant reduction~~~~~~

~~of the *firm's* retained earnings or other reserves which causes a significant deterioration of the *firm's* financial and solvency conditions; and~~

~~(ii) when it is reasonably foreseeable that the events described in (i) will occur; and~~

~~(b) when the *firm* is in breach of its *capital resources requirement*. [deleted]~~

2.2.117C G (1) ~~The effects of the mechanisms described in *GENPRU 2.2.117A R* will be more meaningful if they happen immediately after losses cause a significant deterioration of the financial as well as the solvency situation and even before the reserves are exhausted.~~

~~(2) If a *firm* does not operate the loss absorption mechanism in a prudent and timely way, then the *appropriate regulator* may consider using its powers under 55J of the *Act* to, on its own initiative, vary the *firm's Part 4A permission* to require it to operate the mechanism. [deleted]~~

...

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

...

Other tier one capital: hybrid 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*. [deleted]~~

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~~
- (b) ~~(in any other case) GENPRU 2.2.133R. [deleted]~~
- 2.2.125 R ~~A BIPRU firm may only count capital to which GENPRU 2.2.124R applies at stage C of the calculation in the capital resources table. [deleted]~~
- 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. [deleted]~~
- 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;~~
- (3) ~~all or virtually all of its exposures (calculated by reference to the amount) consist of exposures to the firm or to that firm's group; and~~
- (4) ~~it is incorporated under, and governed by, the laws and jurisdiction of England and Wales, Scotland or Northern Ireland. [deleted]~~
- 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. [deleted]~~
- 2.2.128A R ~~GENPRU 2.2.127R(4) does not apply if the firm has conducted a properly reasoned analysis confirming that any potential risks, including legal and operational risks, associated with cross border issues, which undermine the quality of the capital for the issuer, that arise from an SPV not being incorporated under or governed by the laws and jurisdiction of England and Wales, Scotland or Northern Ireland, are adequately mitigated. [deleted]~~

- 2.2.128B R ~~The analysis must be set out in writing and dated before the date of issue of the *capital instrument* and the *firm* must be able to show that the analysis has been fully considered as part of its decision to proceed with the issue. The analysis must be conducted by a person or persons appropriately qualified to assess the relevant risks and that person may be an independent adviser or an employee of the *firm* who is not part of the business unit responsible for the transaction (including the drafting of the issue documentation). [deleted]~~
- 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) (a) its terms must include an obligation on the *firm* that, in the event of a collapse of the *SPV* structure, and if the mechanism contained within the instrument under *GENPRU 2.2.117AR* is a conversion, the *firm* must substitute the *capital instrument* issued by the *SPV* with *core tier one capital* issued by the *firm*; and~~
 - ~~(b) there must be no obstacle to the *firm's* issue of new securities;~~
 - ~~(3) the conversion ratio in respect of the substitution described in (2) must be fixed when the *SPV* issues the *capital instrument*;~~
 - ~~(4) to the extent that investors have the benefit of an obligation by a *person* other than the *SPV*:~~
 - ~~(a) that obligation must be one owed by a member of the *firm's* group; and~~
 - ~~(b) the extent of that obligation must be no greater than would be permitted by *GENPRU* if that obligation formed part of the terms of a *capital instrument* issued by that member which complied with the *rules* in *GENPRU* relating to *tier one capital* included at stage C of the calculation in the *capital resources table*; and~~
 - ~~(5) if the *SPV* structure collapses, the holder of it has no better a claim against the *firm* than a holder of the same type of instrument directly issued by the *firm*. [deleted]~~
- 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. [deleted]~~

- 2.2.131 R ~~In relation to the obligation to substitute described in *GENPRU 2.2.129 R(2)*, a *firm* must take all reasonable steps to ensure that it has at all times authorised and unissued *capital instruments* which are *core tier one capital* (and the authority to issue them) sufficient to discharge its obligation to substitute. [deleted]~~
- 2.2.131A G ~~*GENPRU 2.2.129 R(2)* and *GENPRU 2.2.131R* allow a *firm* to replace the capital issued by the *SPV* with *capital instrument* which are *core tier one capital*. [deleted]~~
- 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*. [deleted]~~
- 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 *GENPRU 2.2.129R(4)*, whether or not issued by an *SPV*.~~
 - ~~(5) The obligations in *GENPRU 2.2.129R(2)* and *GENPRU 2.2.129R(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). [deleted]~~

- 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 which complies with GENPRU 2.2.129R(2). [deleted]~~
- 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 appropriate regulator at least one Month in advance of the date on which the firm intends to include that capital in its capital resources. [deleted]~~
- 2.2.136 G ~~The appropriate regulator is likely to consider as unusual a transaction which involves the raising by the firm of tier one capital through a subsidiary undertaking of that firm that is not an SPV. The appropriate regulator would expect a firm to request individual guidance in such circumstances. [deleted]~~
- 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. [deleted]~~

...

Deductions from tier one: Intangible assets

- 2.2.156 G ~~Intangible assets include goodwill as defined in accordance with the requirements referred to in GENPRU 1.3.4R (General requirements: accounting principles to be applied) applicable to the firm. The treatment of deferred acquisition cost assets for BIPRU investment firms is dealt with in GENPRU 1.3 (Valuation); they should not be deducted as an intangible asset. [deleted]~~
- 2.2.156A 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.

...

General conditions for eligibility as tier two capital instruments

...

- 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*. [deleted]~~

...

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*. [deleted]~~
- 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). [deleted]~~

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 appropriate regulator. [deleted]~~
- 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. [deleted]~~
- 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. [deleted]~~

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. [deleted]~~
- 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. [deleted]~~
- 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%. [deleted]~~

- 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. [deleted]~~
- ...
- 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*. [deleted]~~
- 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*. [deleted]~~
- 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*. [deleted]~~
- 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*. [deleted]~~
- 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). [deleted]~~

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. [deleted]~~

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. [deleted]~~

2.2.209 R (1) Subject to (2) and (3), a *material holding* is:

- (a) ~~a BIPRU firm's holdings of shares and any other interest in the capital of an individual credit institution or financial institution (held in the non trading book or the trading book or both) exceeding 10% of the share capital of the issuer, and, where this is the case, any holdings of subordinated debt of the same issuer are also included as a material holding; the full amount of the holding is a material holding; or~~
- (b) ~~a BIPRU firm's holdings of shares, any other interest in the capital and subordinated debt in an individual credit institution or financial institution (held in the non trading book or the trading book or both) not deducted under (a) if the total amount of such holdings exceeds 10% of that firm's capital resources at stage N (Total tier one capital plus tier two capital after deductions) of the calculation in the capital resources table (calculated before deduction of its material holdings); only the excess amount is a material~~

~~holding; or~~

- ~~(c) a bank or building society's aggregate holdings in the non-trading book of shares, any other interest in the capital, and subordinated debt in all credit institutions or financial institutions not deducted under (a) or (b) if the total amount of such holdings exceeds 10% of that firm's capital resources at stage N of the calculation in the capital resources table (calculated before deduction of its material holdings); only the excess amount is a material holding; or~~
- ~~(d) a material insurance holding.~~

~~(2) If a BIPRU firm holds shares in the capital of Business Growth Fund plc or another financial institution which makes venture capital investments (in this section and its related annexes, a "Venture Capital Investor") and the following conditions are met:~~

- ~~(a) the sole business of the Venture Capital Investor is the making of venture capital investments together with the performance of ancillary activities in relation to the administration of the venture capital investments;~~
- ~~(b) none of the venture capital investments made by the Venture Capital Investor is an investment (direct or indirect) in:

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

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

~~(3) If a BIPRU firm holds shares in the capital of a subsidiary undertaking which is a financial institution solely by reason of its principal activity being the acquiring of holdings and which in~~

~~turn holds (directly or indirectly) shares in the capital of a Venture Capital Investor (in this section and its related annexes, a "Venture Capital Holding Company") and the following conditions are met:~~

- ~~(a) the Venture Capital Investor meets the conditions in (2)(a) and (b);~~
- ~~(b) the Venture Capital Holding Company is included in the firm's UK consolidation group in accordance with BIPRU 8.5;~~
- ~~(c) the proportion of the value of the Venture Capital Holding Company attributable to investment in Venture Capital Investors and the proportion of the value of the Venture Capital Holding Company attributable to investment in other investments can be identified and valued on a regular basis; and~~
- ~~(d) the firm assigns a risk weight to its exposure to the proportion of the Venture Capital Holding Company that represents the value of its investment in Venture Capital Investors as if it were an equity exposure to which the simple risk weight approach is applied as set out in BIPRU 4.7.9R to BIPRU 4.7.12R (and in calculating its capital resources requirement the firm must assign a risk weight to that exposure in accordance with those rules and notwithstanding that those rules would not otherwise apply to that calculation);~~

~~the proportion of the firm's investment in the Venture Capital Holding Company that represents the value of its investment in Venture Capital Investors may be ignored for the purposes of determining whether there is a material holding. The proportion of the firm's investment in the Venture Capital Holding Company that represents the value of other investments is a material holding. [deleted]~~

- 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. [deleted]~~
- 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. [deleted]~~
- 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. [deleted]~~

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. [deleted]~~

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). [deleted]~~

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. [deleted]~~

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. [deleted]~~

- 2.2.216A G (1) ~~This paragraph gives *guidance* as to the amount to be deducted at Part 2 of stage M (Deductions from the totals of tier one and two) of *GENPRU 2 Annex 2R* (Capital resources table for a bank) and *GENPRU 2 Annex 3R* (Capital resources table for a building society) in respect of investments in *subsidiary undertakings* and *participations* (excluding any amount which is already deducted as *material holdings* or *qualifying holdings*).~~
- ~~(2) The effect of those *rules* is to achieve the deduction of all investments in *subsidiary undertakings* and *participations* for *banks* and *building societies* by ensuring that amounts not already deducted under other *rules* are accounted for at this stage of the calculation of *capital resources*, except where the investment has been made in:~~
- ~~(a) a Venture Capital Investor and the conditions in *GENPRU 2.2.209R(2)* are met; or~~
- ~~(b) a Venture Capital Holding Company and the conditions in *GENPRU 2.2.209R(3)* are met;~~
- ~~(3) The following investments in *subsidiary undertakings* and *participations* should be deducted at this stage:~~
- ~~(a) those not deducted in Part 1 of stage M because of the operation of the thresholds in *GENPRU 2.2.205R* (on *qualifying holdings*) and *GENPRU 2.2.209R* (on *material holdings*); and~~
- ~~(b) those which do not meet the definition of *qualifying holding* or *material holding*, but excluding investments in Venture Capital Investors which are ignored in accordance with *GENPRU 2.2.209R(2)* and investments in Venture Capital Holding Companies which are ignored in accordance with *GENPRU 2.2.209R(3)*, for the purposes of determining whether there is a *material holding*.~~
- ~~(4) For example, an investment in an *undertaking* which is not a *qualifying holding* under *GENPRU 2.2.204R(2)* (on the definition of a non financial undertaking), that is whose exclusive or main activities are a direct extension of banking or concern services ancillary to banking, such as leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity, should be~~

~~deducted at this stage. [deleted]~~

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. [deleted]~~
- 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). [deleted]~~
- 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. [deleted]~~
- 2.2.220 R ~~For the purpose of GENPRU 2.2.219 R, a relevant rule means a rule in GENPRU, BIPRU or INSPRU or any other capital adequacy or solvency requirements of the appropriate regulator or any other regulator, territory or country. [deleted]~~

Deductions from tiers one and two: Connected lending of a capital nature (bank only)

- 2.2.221 R (1) ~~GENPRU 2.2.221R to GENPRU 2.2.235G only apply to a bank.~~
- (2) ~~If a firm has elected to ignore an investment in a Venture Capital Investor or a Venture Capital Holding Company in accordance~~

- ~~with GENPRU 2.2.209R(2) or (3), for the purposes of determining whether there is a *material holding*, GENPRU 2.2.221R to GENPRU 2.2.233R do not apply to any lending by the *firm* to that Venture Capital Investor or Venture Capital Holding Company, provided that any lending to the Venture Capital Holding Company is made to and deployed by the *firm* solely in connection with the Venture Capital Investor. [deleted]~~
- 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. [deleted]~~
- 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*. [deleted]~~
- 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*. [deleted]~~
- 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. [deleted]
- 2.2.226 G ~~BIPRU 10.3.13G (*Guidance on exposures to trustees*) applies to GENPRU 2.2.225R. [deleted]~~
- 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. [deleted]~~
- 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. [deleted]~~
- 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 2.2.228R* or an investment in the capital of a connected party of the *bank*; and~~
- (2) ~~it falls into *GENPRU 2.2.228R*. [deleted]~~
- 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. [deleted]~~
- 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)*. [deleted]~~
- 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)*. [deleted]~~
- 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. [deleted]~~

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. [deleted]~~

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. [deleted]~~

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*). [deleted]~~

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 following:~~

- ~~(1) the exposure amount of *securitisation positions* which receive a *risk weight* of 1250% under *BIPRU 9* (Securitisation), unless the *firm* includes the *securitisation positions* in its calculation of *risk weighted exposure amounts* (see *BIPRU 9.10* (Reduction in risk-weighted exposure amounts)); and~~
- ~~(2) the exposure amount of *securitisation positions* in the *trading book* that would receive a *risk weight* of 1250% if they were in the *firm's non-trading book*. [deleted]~~

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 2.2.241R 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. [deleted]~~
- 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. [deleted]~~
- 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. [deleted]~~

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. [deleted]~~
- 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. [deleted]~~

2.2.243 R ~~A BIPRU firm which includes subordinated debt in its tier three capital resources must notify the appropriate regulator one month in advance of all payments of either interest or principal made when the firm's capital resources are less than 120% of its capital resources requirement. [deleted]~~

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. [deleted]~~

2.2.245 R ~~Table: Application of tier two capital rules to tier three debt This table belongs to GENPRU 2.2.244R~~

[The table in GENPRU 2.2.245R is deleted in its entirety. The deleted text is not shown.]

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. [deleted]~~

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). [deleted]~~

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 1.3.35AG (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*. [deleted]

- 2.2.249 R ~~*Trading book* valuation adjustments or reserves as referred to in GENPRU 1.3.29R to GENPRU 1.3.35AG 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 2.2.86 R(2). [deleted]~~

...

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*. [deleted]~~

- 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*. [deleted]~~

- 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. [deleted]~~

- 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. [deleted]~~

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. [deleted]~~

- 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. [deleted]~~

- 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. [deleted]~~

...

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. [deleted]~~

...

2 Annex 1 Capital resources table for an insurer

R	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 2.2.85AR; GENPRU 2.2.87R to GENPRU 2.2.88R</i>	
	...		

2 Annex 2 ~~Capital resources table for a bank~~

[deleted]

[*GENPRU 2 Annex 2R* is deleted in its entirety. The deleted text is not shown.]

2 Annex 3 ~~Capital resources table for a building society~~

[deleted]

[*GENPRU 2 Annex 3R* is deleted in its entirety. The deleted text is not shown.]

2 Annex 4 ~~Capital resources table for a BIPRU investment firm deducting material holdings~~

[deleted]

[*GENPRU 2 Annex 4R* is deleted in its entirety. The deleted text is not shown.]

2 Annex 5 ~~Capital resources table for a BIPRU investment firm deducting illiquid assets~~

[deleted]

[*GENPRU 2 Annex 5R* is deleted in its entirety. The deleted text is not shown.]

...

2 Annex 8 **Guidance on applications for waivers relating to Implicit itemsk**

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 138A 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 appropriate regulator <u>PRA</u> 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 2.2.31G</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 2.2.81 R</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 appropriate regulator <u>PRA</u> 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 138A of the <i>Act</i>, the appropriate regulator <u>PRA</u> 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 <i>SUP 8</i>, the appropriate regulator <u>PRA</u> may not give a <i>waiver</i> unless the appropriate regulator <u>PRA</u> is satisfied that:</p>
...	
3	<p>The appropriate regulator <u>PRA</u> will assess compliance with the</p>

	<p>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 appropriate regulator <u>PRA</u> will grant the <i>capital resources</i> requested, or that any <i>capital resources</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 appropriate regulator <u>PRA</u> 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>
	...
5	<p>The <i>Consolidated Life Directive</i> (reflecting the changes introduced by the Solvency 1 Directive) 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>fFirms</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 appropriate regulator <u>PRA</u> with a plan showing how the <i>firm</i> intends to maintain its capital adequacy over the period to 31 December 2009. <i>fFirms</i> should also be aware that the appropriate regulator <u>PRA</u> will typically only grant <i>waivers</i> for a maximum of 12 months.</p>
	...
	Zillmerisation
7	<p><i>Zillmerisation</i> is an allowance for acquisition costs that are expected, under prudent assumptions, to be recoverable from</p>

	<p>future <i>premiums</i>. F<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 appropriate regulator <u>PRA</u> will consider an application for a <i>waiver</i> to take into account an <i>implicit item</i>.</p>
	...
	Process for applying for a waiver, including limits applicable when a waiver is granted
9	<p>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 appropriate regulator <u>PRA</u>. 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 8</i>. The appropriate regulator <u>PRA</u> 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 rules are intended to protect" "<u>would not adversely affect the advancement of any of the PRA's objectives</u>" test unless the relevant criteria set out in this <i>guidance</i> have been satisfied and an application for such a 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.</p>
	Timing
10	<p>A <i>long-term insurer</i> may apply to the appropriate regulator <u>PRA</u> for a <i>waiver</i> in respect of <i>implicit items</i>. A <i>waiver</i> will not apply retrospectively (see <i>SUP 8.3.6G</i>). 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 appropriate regulator <u>PRA</u> in writing and include the relevant details specified under <i>SUP 8.3.3D</i>. 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.</p>
	...
13	<p>An <i>implicit item waiver</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 appropriate regulator <u>PRA</u> well in advance of the latest date for the submission of the relevant</p>

	<i>return.</i>
14	<i>Waivers</i> may be withdrawn by the appropriate regulator <u>PRA</u> at any time (e.g. where the appropriate regulator <u>PRA</u> 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>capital resources 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>capital resources</i> (see <i>SUP 8 Annex 2D</i>). In addition, the application should be accompanied by full supporting information to enable the appropriate regulator <u>PRA</u> 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 appropriate regulator <u>PRA</u> needs information as to the make-up of 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.
...	
17	As a minimum, applications for a future profits <i>implicit item waiver</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 implicit item implicit item waiver</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

	<p>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: 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 appropriate regulator <u>PRA</u> prior to, or together with, the application, and the amounts and nature of any exceptional items left out of account; the method used for calculating the average period to run and the results for each of the main categories of business, both before and after allowing for premature termination (where the calculation has been made in two stages); and the basis on which this allowance has been made. <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. 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. f<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 appropriate regulator <u>PRA</u> as quickly as possible in accordance with Principle 11. (See <i>SUP 8.5.1 R</i>). In this context, the appropriate regulator <u>PRA</u> 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	
...	
21	<p>f<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</p>

	relate to past profits.
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 appropriate regulator <u>PRA</u> 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 item waiver</i> after <i>GENPRU 2.2</i> comes into effect, under the 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>
Assumptions	
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 waiver</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</p>

	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.
Other limitations on the extent to which waivers for implicit items will be granted to a realistic basis life firm	
24	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> including allowance for the effect of the <i>capital resources</i> . Where the <i>capital resources 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>capital resources</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) 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 appropriate regulator <i>PRA</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 appropriate regulator <i>PRA</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	
...	
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 appropriate regulator <u>PRA</u> 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.
...	
Double counting	
31	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 appropriate regulator <u>PRA</u> to grant a <i>capital resources 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.
...	
33	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 appropriate regulator <u>PRA</u> 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.
Average period to run	
34	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 appropriate regulator <u>PRA</u> 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 about its accuracy.
...	
Zillmerising	
41	The appropriate regulator <u>PRA</u> does not normally expect to grant a waivers <u>waiver</u> 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 appropriate regulator <u>PRA</u> will consider an application for an <i>implicit item waiver</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.
Hidden reserves	
42	The appropriate regulator <u>PRA</u> 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.
Case studies on "unduly burdensome"	
43	Some examples of situations where the existing <i>rules</i> might be considered to be unduly burdensome are given below:
	<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 waiver</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 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 waiver</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>.
	•
	...
Publicity	
45	The appropriate regulator <u>PRA</u> will publish the <i>capital resources</i> (see <i>SUP 8.6</i> and <i>SUP 8.7</i>). Public disclosure is standard practice unless the appropriate regulator <u>PRA</u> is satisfied that publication is inappropriate or unnecessary (see section 138 <u>AB</u> of the <i>Act</i>). Any request that a direction not be published should be made to the appropriate regulator <u>PRA</u> in writing with grounds in support, as set out in <i>SUP 8.6</i> . Disclosure of a <i>waiver</i> will normally be required in the <i>firm's</i> annual <i>returns</i> .

...

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TP 8 Miscellaneous capital resources definitions for BIPRU firms

~~Miscellaneous capital resources definitions for BIPRU firms~~ [deleted]

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TP 8A Further miscellaneous capital resources definitions for BIPRU firms

~~Further miscellaneous capital resources definitions for BIPRU firms~~ [deleted]

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TP 8B Miscellaneous capital resources definitions for BIPRU firms: Core tier one capital

~~Miscellaneous capital resources definitions for BIPRU firms: Core tier one capital~~ [deleted]

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TP 9 Individual capital guidance for BIPRU firms

~~Individual capital guidance for BIPRU firms~~ [deleted]

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Sch 2 Notification and reporting requirements

G ...

Handbook reference	Matter to be notified	Contents of notification	Trigger events	Time allowed
...				
<i>GENPRU</i> 2.2.19R	Intention to deduct <i>illiquid</i>	Fact of intention	Intention to start or stop	One month prior to

[deleted]	<i>assets rather than material holdings</i>		using method in column 2	change of method
...				
<i>GENPRU 2.2.79GR</i> [deleted]	Intention to purchase a <i>tier one instrument</i> in accordance with <i>GENPRU 2.2.79AR</i>	Fact of intention and details of the <i>firm's</i> position after the purchase in order to show how, over an appropriate timescale, adequately stressed, and without planned recourse to the capital markets, it will meet its <i>capital resources requirement</i> and have sufficient financial resources to meet the <i>overall financial adequacy rule</i>	Intention to purchase	At least one month prior to becoming committed to purchase
<i>GENPRU 2.2.83BR</i> [deleted]	Intention to include in stage A of the <i>capital resources table</i> different classes of the same <i>share</i> type that meet the conditions in <i>GENPRU 2.2.83R</i> and <i>GENPRU 2.2.83AR</i> but have differences in voting rights.	Fact of intention.	Intention to include in stage A of the <i>capital resources table</i> classes of the same <i>share</i> type that have different voting rights.	At least one month before the <i>shares</i> are issued or (in the case of existing issued <i>shares</i>) the differences in voting rights take effect.
<i>GENPRU 2.2.83FR</i> [deleted]	Intention by a <i>building society</i> to issue a <i>capital instrument</i> that includes a <i>coupon limit</i> in its terms of issuance in accordance with <i>GENPRU 2.2.83ER</i> .	Fact of intention.	Intention to issue a <i>capital instrument</i> that includes a <i>coupon limit</i> .	At least one month before the intended date of issue.

<i>GENPRU</i> 2.2.135R [deleted]	Intention to include an unusual transaction in capital under <i>GENPRU</i> 2.2.124R	Fact of intention.	Intention to include in capital	At least one month prior to inclusion of that capital in <i>capital resources</i>
...				
<i>GENPRU</i> 2.2.243R [deleted]	Intention to pay interest or principal on subordinated debt included in <i>tier three capital resources</i> if the <i>firm's capital resources</i> are less than 120% of its <i>capital resources requirement</i>	Fact of intention	Intention to pay	One month prior to any payment of interest or principal
<i>GENPRU</i> 2.2.245R [deleted]	Intention to repay (other than on contractual repayment date) <i>tier three capital resources</i>	Fact of intention and details of how the <i>firm</i> will meet its <i>capital resources requirement</i> after such repayment	Intention to repay	One month prior to repayment

Annex B

Amendments to the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)

The entirety of BIPRU is deleted save for:

- BIPRU 12;
- BIPRU, Schedule 3; and
- BIPRU Schedule 6.

The deleted text is not shown.

**CAPITAL REQUIREMENTS DIRECTIVE IV (CONSEQUENTIAL AMENDMENTS)
INSTRUMENT 2013**

Powers exercised

- A. The Prudential Regulation 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 137G (The PRA’s general rules);
 - (2) section 137T (General supplementary powers);
 - (3) section 138D (Actions for damages);
 - (4) section 213 (The compensation scheme); and
 - (5) paragraph 31 (Fees) of schedule 1ZB (The Prudential Regulation Authority).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Pre-conditions to making

- C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority) (“FCA”), the PRA consulted the FCA. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

Commencement

- D. This instrument comes into force on 1 January 2014.

Amendments to the PRA Handbook

- E. The modules of the PRA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes in this instrument listed in column (2) below.

(1)	(2)
Glossary of definitions	Annex A
Principles for Businesses (PRIN)	Annex B
Senior Management Arrangements, Systems and Controls sourcebook (SYSC)	Annex C
General Provisions (GEN)	Annex D
Fees manual (FEES)	Annex E
General Prudential sourcebook (GENPRU)	Annex F
Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)	Annex G
Interim Prudential sourcebook for Friendly Societies (IPRU(FSOC))	Annex H
Interim Prudential sourcebook for Investment Businesses (IPRU(INV))	Annex I
Supervision manual (SUP)	Annex J

Compensation sourcebook (COMP)	Annex K
Credit Unions New sourcebook (CREDS)	Annex L

Notes

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

Citation

- G. This instrument may be cited as the Capital Requirements Directive IV (Consequential Amendments) Instrument 2013.

By order of the Board of the Prudential Regulation Authority

16 December 2013

Annex A

Amendments to the Glossary of definitions

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

Part 1: New definitions

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

- | | | |
|---------------------------------------|--|---|
| <i>article 12(1)
relationship</i> | (A) (in the <i>PRA Handbook</i>): | means a relationship where <i>undertakings</i> are linked by a relationship within the meaning of article 12(1) of Directive 83/349 EEC. |
| ... | | |
| <i>article 18(5)
relationship</i> | (A) (in the <i>PRA Handbook</i>): | the relationship where there are participations or capital ties other than those referred to in article 18(1) and (2) of the <i>EU CRR</i> (Methods for prudential consolidation). |
| ... | | |
| <i>consolidated situation</i> | (A) (in the <i>PRA Handbook</i>): | the situation that results from applying the requirements of the <i>EU CRR</i> in accordance with Part One, Title II, Chapter 2 of the <i>EU CRR</i> to an <i>institution</i> as if that <i>institution</i> formed, together with one or more other <i>institutions</i> , a single <i>institution</i> . |
| ... | | |
| <i>core UK group</i> | (A) (<u>in the <i>PRA Handbook</i></u>): | <u>has the meaning given in the <i>PRA Rulebook</i>: Large Exposures rules.</u> |
| ... | | |
| <i>core UK group eligible capital</i> | (A) (in the <i>PRA Handbook</i>): | has the meaning given in the <i>PRA Rulebook</i> : Large |

Exposures rules.

...

core UK group permission

(A) (in the PRA Handbook):

has the meaning given in the PRA Rulebook: Large Exposures rules.

...

CRR firm

(A) (in the PRA Handbook):

for the purposes of SYSC means *UK banks, buildings society and investment firms* that are subject to the *EU CRR*.

...

designated investment firm

(A) (in the PRA Handbook):

an *authorised person* that has been designated by the PRA under article 3 of the *PRA-regulated Activities Order*.

...

EU CRR

(A) (in the PRA Handbook):

Regulation of the European Parliament and the Council on prudential requirements for credit institutions and investment firms (Regulation (EU) No 575/2013) and amending Regulation (EU) No 648/2012.

...

FINREP firm

(A) (in the PRA Handbook):

- (a) a *credit institution* or *investment firm* subject to the *EU CRR* that is also subject to article 4 of Regulation (EC) No 1606/2002; or
- (b) a *credit institution* other than one referred to in Article 4 of Regulation (EC) No 1606/2002 that prepares its consolidated accounts in conformity with the international accounting standards adopted in accordance with the procedure laid down in article 6(2) of that Regulation.

[Note: article 99 of the *EU CRR*]

...

IFPRU investment firm (A) (in the *PRA Handbook*):

an *investment firm*, as defined in article 4(1)(2) of the *EU CRR* that satisfies the following conditions:

- (a) it is an *FCA-authorised firm*;
- (b) its head office is in the *UK*; and
- (c) it is not:
 - (i) an *incoming EEA firm*;
 - (ii) an *incoming Treaty firm*;
 - (iii) any other *overseas firm*;
 - (iv) a *designated investment firm*;
 - (v) an *insurer*; or
 - (vi) an *ICVC*.

...

IFPRU limited-activity firm (A) (in the *PRA Handbook*):

a *limited activity firm* that meets the following conditions:

- (a) it is an *FCA-authorised firm*;
- (b) its head office is in the *UK*; and
- (c) it is not:
 - (i) an *incoming EEA firm*;
 - (ii) an *incoming Treaty firm*;
 - (iii) any other *overseas firm*;
 - (iv) a *designated investment firm*;
 - (v) an *insurer*; or

IFPRU limited-licence firm (A) (in the *PRA Handbook*):

a *limited activity firm* that meets the following conditions:

- (a) it is an *FCA-authorised firm*;
- (b) its head office is in the *UK*; and
- (c) it is not:
 - (i) an *incoming EEA firm*;
 - (ii) an *incoming Treaty firm*;
 - (iii) any other *overseas firm*;
 - (iv) a *designated investment firm*;
 - (v) an *insurer*; or
 - (i) an *incoming EEA firm*;

...

management body (A) (in the *PRA Handbook*):

(in accordance with article 3(7) of *CRD*) the *governing body* and *senior personnel* of a *CRR firm* who are empowered to set the *firm's* strategy, objectives and overall direction, and which oversee and monitor management decision-making.

management body in its supervisory function (A) (in the *PRA Handbook*):

the *management body* acting in its role of overseeing and monitoring management decision-making.

...

NCLEG non-trading book permission (A) (in the *PRA Handbook*):

has the meaning given in the *PRA Rulebook*: Large Exposures rules.

...

NCLEG trading book permission (A) (in the *PRA Handbook*):

has the meaning given in the *PRA Rulebook*: Large Exposures rules.

...

non-core large (A) (in the *PRA Handbook*):

exposures group

has the meaning given in the *PRA Rulebook: Large Exposures rules*.

...

own funds requirements (A) (in the *PRA Handbook*):

as defined in article 92 (Own funds requirements) of the *EU CRR*.

...

PRA-regulated Activities Order (A) (in the *PRA Handbook*):

[Financial Services and Markets Act 2000 \(PRA-regulated Activities\) Order 2013 \(SI 2013/556\)](#).

...

tier 2 instruments (A) (in the *PRA Handbook*):

a capital instrument that qualify as tier 2 instruments under article 62 of the *EU CRR*.

...

UK designated investment firm (A) (in the *PRA Handbook*):

(in *BIPRU 12* and *SUP 16*) a *designated investment firm* which is a *body corporate* or *partnership* formed under the law of any part of the *UK*.

Amend the following definitions as shown.

AMA permission

an *Article 129 implementing measure*, a *requirement* or a *waiver* that requires a *BIPRU firm* or ~~an institution~~ a *CAD investment firm* to use the *advanced measurement approach* to *operational risk* on a solo basis or, if the context requires, a consolidated basis.

approved credit institution

a *credit institution* recognised or permitted under the law of an *EEA State* to carry on any of the activities set out in

Annex 1 to the ~~Banking Consolidation Directive~~ CRD.

<i>Branch</i>	<p>(a) (in relation to a <i>credit institution</i>):</p> <p>(i) ...</p> <p>(ii) for the purposes of the Banking Consolidation Directive <u>CRD</u> and in accordance with article 38 of the <u>CRD</u>, any number of places of business set up in the same <i>EEA State</i> by a <i>credit institution</i> with headquarters in another <i>EEA State</i> are to be regarded as a single <i>branch</i>;</p> <p>...</p>
<i>capital resources gearing rules</i>	<p>(1) ...</p> <p>(2) (in relation to a bank or building society) GENPRU 2.2.29R, GENPRU 2.2.30R, GENPRU 2.2.46R and GENPRU 2.2.49R. [deleted]</p> <p>(3) (in relation to a BIPRU investment firm) GENPRU 2.2.30R, GENPRU 2.2.46R and GENPRU 2.2.49R and GENPRU 2.2.50R. [deleted]</p>
<i>capital resources table</i>	<p>(in relation to an <i>insurer</i> or <i>BIPRU firm</i>) the table specified in <i>GENPRU 2.2.19R</i> (Applicable capital resources calculation) which in summary is as follows:</p> <p>(1) (in the case of an <i>insurer</i>) <i>GENPRU 2 Annex 1R</i>.;</p> <p>(2) (in the case of a bank) GENPRU 2 Annex 2R; [deleted]</p> <p>(3) (in the case of a building society) GENPRU 2 Annex 3R; and [deleted]</p> <p>(4) (in relation to a BIPRU investment firm) whichever of the tables in GENPRU 2 Annex 4R, GENPRU 2 Annex 5R or GENPRU 2 Annex 6R applies to the firm under GENPRU 2.2.19R. [deleted]</p>
<i>CCR internal model method permission</i>	<p>an <i>Article 129 implementing measure</i>, <i>Article 129 permission</i>, a requirement or a waiver that requires a <i>BIPRU firm</i> or an institution a <u>CAD investment firm</u> to use the <i>CCR internal model method</i>.</p>
<i>common platform firm</i>	<p>a <i>firm</i> that is:</p> <p>(a) a <i>BIPRU firm</i>; or</p>

- (aa) a bank; or
- (ab) a building society; or
- (ac) a designated investment firm; or
- (ad) an IFPRU investment firm; or
- ...
- consolidation group*
- (1) the following:
- ...
- (2) (in SYSC) the undertakings included in the scope of prudential consolidation to the extent and in the manner prescribed in Part One, Title II, Chapter 2, Sections 2 and 3 of the EU CRR and IFPRU 8.1.3R to IFPRU 8.1.4R (Prudential consolidation) for which the FCA is the consolidating supervisor under [article 111 of the CRD].
- (3) For the purposes of SUP 16, the group of undertakings which are included in the consolidated situation of a parent institution in a Member State, an EEA parent institution, an EEA parent financial holding company or an EEA parent mixed financial holding company (including any undertaking which is included in that consolidation because of an Article 12(1) relationship, Article 18(5) relationship or Article 18 relationship).
- consumer*
- ...
- (D) (for the purposes of (2A)(b)):
- (a) “credit institution” means:
- (i) a credit institution authorised under the banking consolidation directive CRD;
or
- ...
- core concentration risk group counterparty*
- ~~(in relation to a firm) a counterparty which is its parent undertaking, its subsidiary undertaking or a subsidiary undertaking of its parent undertaking, provided that (in each case) both the counterparty and the firm are:~~
- ~~(a) included within the scope of consolidation on a full basis with respect to the same UK consolidation group;~~

and

- (b) ~~(where relevant) held by one or more intermediate parent undertaking or financial holding company, all of which are incorporated in the United Kingdom.~~

...

counterparty credit risk

- (1) (in accordance with Part 1 of Annex III of the *Banking Consolidation Directive* (Definitions) and for the purposes of *BIPRU*) the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
- (2) (other than in (1)) has the meaning as used in the *EU CRR*.

covered bond

...

- (2) (in accordance with point 68 of Part 1 of Annex VI of the *Banking Consolidation Directive* (Exposures in the form of covered bonds) and for the purposes of the IRB approach or the *standardised approach* to credit risk in *BIPRU*) a covered bond as defined in (1) collateralised in accordance with *BIPRU* 3.4.107R (Exposures in the form of covered bonds).

...

CRD implementation measure

(in relation to a *person* and for the purposes of *GENPRU* and *BIPRU* (except in *GENPRU* 3), a provision of the *Banking Consolidation Directive* or the *Capital Adequacy Directive* and an *EEA State* other than the *United Kingdom*) a measure implementing that provision of that Directive for that type of *person* in that *EEA State*.

credit institution

- (1) ~~(except in *REC*) (in accordance with articles 4(1) and 107 of the *BCD*):~~
- (a) ~~an undertaking whose business is to receive deposits and other repayable funds from the public and to grant credits for its own account has the meaning in article 4(1)(1) of the *EU CRR*; or~~
- (b) [deleted]
- (c) [deleted]
- (d) ~~for the purpose of *BIPRU* 10 (Large exposures requirements) it means:~~

- (i) ~~a credit institution defined by (1)(a) to (1)(b) that has been authorised in an EEA State; or~~
- (ii) ~~any private or public undertaking which meets the definition in (1)(a)–(1)(b) and which has been authorised in a non-EEA State. [deleted]~~

~~(see also BCD credit institution, full credit institution, full BCD credit institution and Zone A credit institution.)~~

- (2) (in *REC*) and in *SUP* 11 (Controllers and close links and *SUP* 16 (Reporting requirements)):
 - (a) a credit institution authorised under the ~~Banking Consolidation Directive~~ CRD;
 - (b) an institution which would satisfy the requirements for authorisation as a credit institution under the ~~Banking Consolidation Directive~~ CRD if it had its registered office (or if it does not have a registered office, its head office) in an *EEA State*.
- (3) (in relation to the definition of *electronic money issuer*) a credit institution as defined by (1)(a) and includes a branch of the credit institution within the meaning of ~~Article 4(3) of the Banking Consolidation Directive~~ article 4(1)(17) of the EU CRR which is situated within the *EEA* and which has its head office in a territory outside the *EEA* in accordance with ~~Article 38 of the Banking Consolidation Directive~~ article 47 of the CRD.

DGD claim

a *claim*, in relation to a *protected deposit*, against a ~~BCD~~ CRD credit institution, whether established in the *United Kingdom* or in another *EEA State*.

DLG by default

...

For these purposes:

- (iii) *credit institution* has the meaning used in *SUP* 16 (Reporting requirements), namely either of the following:

- (A) a credit institution authorised under the *Banking Consolidation Directive CRD*; or
- (B) an institution which would satisfy the requirements for authorisation as a credit institution under the *Banking Consolidation Directive CRD* if it had its registered office (or if it does not have a registered office, its head office) in an *EEA State*; and

...

EEA bank

an *incoming EEA firm* which is a ~~BCD~~ CRD *credit institution*.

EEA firm

(in accordance with paragraph 5 of Schedule 3 to the Act (EEA Passport Rights)) any of the following, if it does not have its relevant office in the *United Kingdom*:

...

- (b) a *credit institution* (as defined in article 4(1)(1) of the *Banking Consolidation Directive EU CRR*);
- (c) a financial institution (as defined in article 4(5)(1)(26) of the *Banking Consolidation Directive EU CRR*) which is a subsidiary of the kind mentioned in article 24 34 of the *CRD* and which fulfils the conditions in articles 23 33 and 24 34;

...

energy market participant

a *firm*:

...

- (b) which is not an *authorised professional firm, bank, BIPRU investment firm* (unless it is an *exempt BIPRU commodities firm*), *IFPRU investment firm* (unless it is an *exempt IFPRU commodities firm*), *building society, credit union, friendly society, ICVC, insurer, MiFID investment firm* (unless it is an *exempt BIPRU commodities firm* or *exempt IFPRU commodities firm*), *media firm, oil market participant, service company, insurance intermediary, home finance administrator, home finance provider, incoming EEA firm* (without a *top-up permission*), or *incoming Treaty firm* without a *top-up permission*).

fee-paying electronic money issuer

any of the following when they issue *electronic money*:

	...
	(d) a <i>full credit institution</i> , including a branch of the <i>full credit institution</i> within the meaning of article 4(3) (17) of the BCD <u>EU CRR</u> which is situated within the <i>EEA</i> and which has its head office in a territory outside the <i>EEA</i> in accordance with article 38 47 of the BCD <u>EU CRR</u> ;
	...
<i>fixed overheads requirement</i>	(1) (except in <i>IPRU(INV)</i> and for the purposes of <u><i>GENPRU</i></u> (except in <u><i>GENPRU</i></u> 3) and <u><i>BIPRU</i></u> (except in <u><i>BIPRU</i></u> 12)) the part of the <i>capital resources requirement</i> calculated in accordance with <u><i>GENPRU</i></u> 2.1.53R (Calculation of the fixed overheads requirement).
	...
<i>full BCD <u>CRD</u> credit institution</i>	a BCD <u>CRD</u> <i>credit institution</i> that falls within paragraph (1)(a) of the definition of <i>credit institution</i> .
<i>Home State</i>	(1) (in relation to a <i>credit institution</i>) the <i>EEA State</i> in which the <i>credit institution</i> has been authorised in accordance with the <i>Banking Consolidation Directive</i> <u><i>CRD</i></u> .
	...
<i>Institution</i>	(1) (in accordance with Article 3(1)(c) of the <i>Capital Adequacy Directive</i> and Article 4(6) of the <i>Banking Consolidation Directive (Definitions)</i> and for the purposes of <u><i>GENPRU</i></u> and <u><i>BIPRU</i></u>) a <i>credit institution</i> or a <i>CAD investment firm</i> , whether or not it is incorporated in, or has its head office in, an <u><i>EEA State</i></u> has the meaning in article 4(1)(3) of the <u><i>EU CRR</i></u> .
	(2) (for the purposes of <u><i>GENPRU</i></u> and <u><i>BIPRU</i></u>) includes a <u><i>CAD investment firm</i></u> .
<i>Investment firm</i>	...
	(5) (in <u><i>SYSC 19A</i></u>) a <i>firm</i> in (3) except for a <u><i>BIPRU firm</i></u>
<i>investment management firm</i>	(subject to <i>BIPRU TP 1.3R (Revised definition of investment management firm for certain transitional purposes)</i>); a <i>firm</i> whose <i>permitted activities</i> include <i>designated investment business</i> , which is not an <i>authorised professional firm</i> , bank, <i>BIPRU IFPRU investment firm</i> , <u><i>BIPRU firm</i></u> , <i>building society</i> , <i>collective portfolio management firm</i> , <i>credit union</i> ,

energy market participant, friendly society, ICVC, insurer, media firm, oil market participant, service company, incoming EEA firm (without a top-up permission), incoming Treaty firm (without a top-up permission), or UCITS qualifier (without a top-up permission), whose permission does not include a requirement that it comply with IPRU(INV) 3 or IPRU(INV) 13 (Personal investment firms) and which is within (a), (b) or (c):

...

IRB approach

one of the following:

- (a) the adjusted method of calculating the *credit risk capital component* set out in BIPRU 4 (IRB approach) and BIPRU 9.12 (Calculation of risk weighted exposure amounts under the internal ratings based approach), including that approach as applied under BIPRU 14 (Capital requirements for settlement and counterparty risk);
- (b) (where the approach in (a) is being applied on a consolidated basis) the method in (a) as applied on a consolidated basis in accordance with BIPRU 8 (Group risk - consolidation); or
- (c) when the reference is to the rules of or administered by a *regulatory body* other than the ²⁶ *appropriate regulator*,²⁶ whatever corresponds to the approach in (a) or (b), as the case may be, under those rules.

large exposure

~~has the meaning set out in BIPRU 10.5.1 R, which in summary is the total exposure of a firm to a counterparty, or a group of connected clients, whether in the firm's non-trading book or trading book or both, and counterparties falling within BIPRU 10.10A.1 R within the trading book, which in aggregate equals or exceeds 10% of the firm's capital resources.~~

(A) (In the *PRA Handbook*):

has the meaning given in the *PRA Rulebook: Large Exposures rules*.

listed activity

an activity listed in Annex 1 to the ~~*Banking Consolidation Directive CRD*~~.

main BIPRU firm Pillar 1 rules

GENPRU 2.1.40R (Variable capital requirement for BIPRU firms), GENPRU 2.1.41R (Base capital resources)

requirement for *BIPRU firms*), *GENPRU 2.1.48R* (Table: Base capital resources requirement for a *BIPRU firm*) and, where applicable, ~~*GENPRU 2.1.60 R* (Calculation of base capital resources requirement for banks authorised before 1993).~~

MiFID investment firm

...

(in full) a *firm* which is:

...

- (2) a ~~*BCD CRD credit institution*~~ (only when providing an *investment service or activity* in relation to the *rules* implementing the Articles referred to in Article 1(2) of *MiFID*);

...

mixed-activity holding company

~~one of the following:~~

- (a) ~~(in accordance with Article 4(20) of the *Banking Consolidation Directive (Definitions)*) a *parent undertaking*, other than a *financial mixed-activity holding company*, a *credit institution* or a *mixed financial holding company*, the *subsidiary undertakings* of which include at least one *credit institution*; or~~
- (b) ~~(in accordance with Articles 2(2) and 37(1) of the *Capital Adequacy Directive (Supervision on a consolidated basis)* and in relation to a *banking and investment group* without any *credit institutions* in it) a *parent undertaking*, other than a *financial holding company*, an *investment firm* or a *mixed financial holding company*, the *subsidiary undertakings* of which include at least one *investment firm*.~~

has the meaning given to the definition of “mixed activity holding company” in article 4(1)(22) of the *EU CRR*.

multilateral development bank

...

- (b) ~~for the purposes of the *standardised approach* to credit risk the following are considered to be a *multilateral development bank*: [deleted]~~

...

oil market participant

a *firm*:

- (b) which is not an *authorised professional firm, bank, BIPRU investment firm*, (unless it is an *exempt BIPRU commodities firm*), *IFPRU investment firm* (unless it is an *exempt IFPRU commodities firm*), *building society, credit union, friendly society, ICVC, insurer, MiFID investment firm* (unless it is an *exempt BIPRU commodities firm or exempt IFPRU commodities firm*), *media firm, service company, insurance intermediary, home finance administrator, mortgage intermediary, home finance provider, incoming EEA firm* (without a *top-up permission*), or *incoming Treaty firm* (without a *top-up permission*).

operational risk

...

- (2) (~~except in COLL and FUND~~ in *GENPRU* (except *GENPRU 3* (Cross sector groups) and *BIPRU* (except *BIPRU 12* (Liquidity Standards))) (in accordance with Article 4(22) of the *Banking Consolidation Directive*) the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.

- (3) (in *GENPRU 3, IFPRU, and BIPRU 12*) has the meaning in Article 4(1)(52) of the *EU CRR*.

option

...

but so that for the purposes of calculating capital requirements for *BIPRU firms* and ~~*BIPRU 10* (Large exposures requirements)~~ it also includes any of the items listed in the table in *BIPRU 7.6.18R* (Option PRR: methods for different types of option) and any case settled option.

own funds

- (1) (in *GENPRU* (except *GENPRU 3* (Cross sector groups) and *BIPRU* (except *BIPRU 12* (Liquidity standards))) own funds described in articles 56 to 57 of the *Banking Consolidation Directive*.

...

- (5) ((*except in (1) to (4)*) has the meaning in article 4(1)(118) of the *EU CRR*.

parent financial holding company in a Member State

- (1) (in *GENPRU* (except *GENPRU 3*) and *BIPRU* (except *BIPRU 12*)) (in accordance with Article 4(15) of the *Banking Consolidation Directive* (Definitions) and Article 3 of the *Capital Adequacy Directive* (Definitions)) a *financial holding company* which is not itself a *subsidiary undertaking* of an *institution* authorised in the same *EEA State*, or of a *financial*

holding company or mixed financial holding company established in the same EEA State.

- | | |
|---|--|
| <i>parent institution in a Member State</i> | <p>(2) <u>(except in (1)) has the meaning in article 4(1)(30) of the EU CRR.</u></p> <p>(1) <u>(in GENPRU (except GENPRU 3) and BIPRU (except BIPRU 12))</u> (in accordance with Article 4(14) of the <i>Banking Consolidation Directive</i> and Article 3 of the <i>Capital Adequacy Directive (Definitions)</i>) an <i>institution</i> which has an <i>institution</i> or a <i>financial institution</i> as a <i>subsidiary undertaking</i> or which holds a <i>participation</i> in such an <i>institution</i>, and which is not itself a <i>subsidiary undertaking</i> of another <i>institution</i> authorised in the same <i>EEA State</i>, or of a <i>financial holding company or mixed financial holding company</i> established in the same <i>EEA State</i>.</p> <p>(2) <u>(except in (1)) has the meaning in article 4(1)(28) of the EU CRR.</u></p> |
| <i>parent mixed financial holding company in a Member State</i> | <p>(1) <u>(in GENPRU (except GENPRU 3) and BIPRU (except BIPRU 12))</u> (in accordance with Article 4(15a) of the <i>Banking Consolidation Directive (Definitions)</i>) a <i>mixed financial holding company</i> which is not itself a <i>subsidiary undertaking</i> of an <i>institution</i> authorised in the same <i>EEA State</i>, or of a <i>financial holding company or mixed financial holding company</i> established in the same <i>EEA State</i>.</p> <p>(2) <u>(except in (1)) has the meaning in article 4(1)(32) of the EU CRR.</u></p> |
| <i>parent undertaking</i> | <p>(1) ...</p> <p>(c) for the purposes of <i>BIPRU (except BIPRU 12)</i>, <i>GENPRU (except GENPRU 3)</i> and <i>INSPRU</i> as they apply on a consolidated basis, for the purposes of BIPRU 10 (Large exposures requirements) and for the purposes of <i>SYSC 12 (Group risk systems and controls requirement)</i> and <i>SYSC 19A 19C (Remuneration Code for BIPRU firms)</i> and in relation to whether an <i>undertaking</i> is a <i>parent undertaking</i>) an <i>undertaking</i> which has the following relationship to another <i>undertaking</i> ("S"):</p> <p>...</p> <p>...</p> |

	(3) <u>(for the purposes of GENPRU 3, BIPRU 12, IFPRU and SYSC 19A (Remuneration Code)) has the meaning in article 4(1)(15) of the EU CRR but so that (in accordance with article 2(9) of the Financial Groups Directive) article 4(1)(15)(b) applies for the purpose of GENPRU 3.</u>
Participation	(1) (for the purposes of UPRU and GENPRU (except GENPRU 3) and for the purposes of BIPRU (except BIPRU 12) and INSPRU as they apply on a consolidated basis): ... (2) <u>(except in (1)) has the meaning in article 4(1)(35) of the EU CRR.</u>
permanent interest bearing shares	any shares of a class defined as deferred shares for the purposes of section 119 of the Building Societies Act 1986 which are issued as permanent interest bearing shares and on terms which qualify them as own funds for the purposes of the Banking Consolidation Directive <u>EU CRR</u> .
personal investment firm	(subject to BIPRU TP 1 (Revised definition of personal investment firm for certain transitional purposes)) a firm whose permitted activities include designated investment business, which is not an authorised professional firm, bank, BIPRU IFPRU investment firm, BIPRU firm, building society, collective portfolio management firm, credit union, energy market participant, ICVC, insurer, media firm, oil market participant, service company, incoming EEA firm (without a top-up permission), incoming Treaty firm (without a top-up permission) or UCITS qualifier (without a top-up permission), whose permission does not include a requirement that it comply with IPRU(INV) 3 (Securities and futures firms) or 5 (Investment management firms), and which is within (a), (b) or (c): ...
recognised third country investment firm	a CAD investment firm that satisfies the following conditions: ... (d) that investment firm is subject to and complies with prudential rules of or administered by that third country competent authority that are at least as stringent as those laid down in the EEA prudential sectoral legislation for the investment services sector <u>Banking Consolidation Directive and the Capital Adequacy</u>

Directive as applied under the third paragraph of article 95(2) of the EU CRR.

<i>regulatory system</i>	the arrangements for regulating a <i>firm</i> or other <i>person</i> in or under the <i>Act</i> , including the <i>threshold conditions</i> , the <i>Principles</i> and other <i>rules</i> , the <i>Statements of Principle</i> , codes and <i>guidance</i> and including any relevant directly applicable provisions of a Directive or Regulation such as those contained in the <i>MiFID implementing Directive</i> , and the <i>MiFID Regulation</i> and the <i>EU CRR</i> .
<i>remuneration</i>	any form of remuneration, including salaries, <i>discretionary pension benefits</i> and benefits of any kind. [Note: paragraph 23 of Annex V to the <i>Banking Consolidation Directive</i> article 92(2) of <i>CRD</i>]
<i>Remuneration Code staff</i>	(for a <i>BIPRU CRR firm</i> and a <i>third country BIPRU firm</i> <u>an overseas firm in SYSC 19A1.1.1R(1)(f)</u>) has the meaning given in SYSC 19A.3.4 R. ...
<i>repurchase transaction</i>	(in accordance with Article 3(1)(m) of the <i>Capital Adequacy Directive</i> and Article 4(33) of the <i>Banking Consolidation Directive</i> (Definitions) <u>and for the purposes of <i>BIPRU</i></u>) any agreement in which an <i>undertaking</i> or its counterparty transfers securities or <i>commodities</i> or guaranteed rights relating to title to securities or <i>commodities</i> where that guarantee is issued by a <i>designated investment exchange</i> or <i>recognised investment exchange</i> which holds the rights to the securities or <i>commodities</i> and the agreement does not allow an <i>undertaking</i> to transfer or pledge a particular security or <i>commodity</i> to more than one counterparty at one time, subject to a commitment to repurchase them or substituted securities or <i>commodities</i> of the same description at a specified price on a future date specified, or to be specified, by the transferor, being a <i>repurchase agreement</i> for the <i>undertaking</i> selling the securities or <i>commodities</i> and a <i>reverse repurchase agreement</i> for the <i>undertaking</i> buying them.
<i>risk weight</i>	(in relation to an <i>exposure</i> <u>for the purposes of <i>BIPRU</i></u>) a degree of risk expressed as a percentage assigned to that <i>exposure</i> in accordance with whichever is applicable of the <i>standardised approach</i> to credit risk and the <i>IRB approach</i> , including (in relation to a <i>securitisation position</i>) under <i>BIPRU</i> 9 (Securitisation).
<i>risk weighted exposure amount</i>	(in relation to an <i>exposure</i> <u>for the purposes of <i>BIPRU</i></u>) the value of an <i>exposure</i> for the purposes of the calculation of the <i>credit risk capital component</i> after application of a <i>risk</i>

weight.

securities and futures firm

(subject to *BIPRU TP 1* (~~Revised definition of securities and futures firm for certain transitional purposes~~)) a firm whose permitted activities include *designated investment business* or *bidding in emissions auctions*, which is not an *authorised professional firm*, *bank*, *BIPRU investment firm* (unless it is an *exempt BIPRU commodities firm*), *IFPRU investment firm* (unless it is an *exempt IFPRU investment firm*), *building society*, *collective portfolio management firm*, *credit union*, *friendly society*, *ICVC*, *insurer*, *media firm*, *service company*, *incoming EEA firm* (without a *top-up permission*), *incoming Treaty firm* (without a *top-up permission*) or *UCITS qualifier* (without a *top-up permission*), whose permission does not include a requirement that it comply with *IPRU(INV) 5* (Investment management firms) or 13 (Personal investment firms), and which is within (a), (b), (c), (d), (e), (f), (g), (ga) or (h):

...

(g) an *exempt BIPRU commodities firm*;

(ga) an *exempt IFPRU commodities firm*;

...

securities or commodities lending or borrowing transaction

(in accordance with Article 4(34) of the *Banking Consolidation Directive* and Article 3(1)(n) of the *Capital Adequacy Directive* (Definitions) and for the purposes of *BIPRU*) any transaction in which an *undertaking* or its counterparty transfers securities or *commodities* against appropriate collateral subject to a commitment that the borrower will return equivalent securities or *commodities* at some future date or when requested to do so by the transferor, that transaction being *securities or commodities lending* for the *undertaking* transferring the securities or *commodities* and being *securities or commodities borrowing* for the *undertaking* to which they are transferred.

securitisation position

(in accordance with Article 4(40) (Definitions) and Article 96 (Securitisation) of the *Banking Consolidation Directive* and for the purposes of *BIPRU*) an *exposure* to a *securitisation* within the meaning of paragraph (2) of the definition of securitisation; and so that:

...

securitisation special purpose entity

(in accordance with Article 4(44) of the *Banking Consolidation Directive* (Definitions) and for the purposes of *BIPRU*) a corporation, trust or other entity, other than a *credit*

institution, organised for carrying on a *securitisation* or *securitisations* (within the meaning of paragraph (2) of the definition of *securitisation*), the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the *SSPE* from those of the *originator*, and the holders of the beneficial interests in which have the right to pledge or exchange those interests without restriction.

securitised exposure

(for the purposes of *BIPRU*) an *exposure* in the pool of *exposures* that has been securitised, either via a *traditional securitisation* or a *synthetic securitisation*. The cash-flows generated by the securitised exposures are used to make payments to the *securitisation positions*.

Single Market Directives

(a) the *Banking Consolidation Directive* (to the extent it applies to *CAD investment firms*)

(aa) the *CRD*;

...

standardised approach

(for the purposes of *BIPRU*) one of the following:

...

third country BIPRU firm

(1) (in *BIPRU* (except in *BIPRU 12* (Liquidity standards)) and *SYSC 19C*) an *overseas firm* that:

...

(2) (in *BIPRU 12* (Liquidity standards)) an *overseas firm* that:

(a) is a *bank*;

(b) is not an *EEA firm*; and

(c) has its head office outside the *EEA*.

trading book

...

(2) (in *BIPRU*, and *GENPRU*, *BSOCS* and *IPRU(INV) 11* and in relation to a *BIPRU firm*) has the meaning in *BIPRU 1.2* (Definition of the trading book) which is in summary, all that *firm's positions* in *CRD financial instruments* and *commodities* held either with trading intent or in order to hedge other elements of the *trading book*, and which are either free of any restrictive covenants on their tradability or able to be hedged.

...

- (4) (in IFPRU and in relation to an IFPRU investment firm) has the meaning in article 4(1)(86) of the EU CRR.

UK consolidation group

...

- (A) (In the PRA Handbook):

The group of undertakings which are included in the consolidated situation of a parent institution in a Member State, an EEA parent institution, an EEA parent financial holding company or an EEA parent mixed financial holding company (including any undertaking which is included in that consolidation because of an Article 12(1) relationship, Article 18(5) relationship or Article 18 relationship).

UK lead regulated firm

...

For the purposes of this definition:

- (a) Consolidated supervision of a group of *persons* means supervision of the adequacy of financial and other resources of that group on a consolidated basis consolidated basis. For example, this includes supervision under BIPRU 8 (Group risk consolidation).
- (d) It is not relevant whether or not any supervision by another *regulatory body* has been assessed as equivalent under the CRD and EU CRR or the *Financial Groups Directive*.
- (e) If the group is a *consolidation group* or *financial conglomerate* of which the FCA or the PRA is lead regulator that is headed by an *undertaking* that is not itself the *subsidiary undertaking* of another *undertaking* the *firm* is a 'UK lead regulated firm'.

...

Amend the following definitions and re-position them in the appropriate alphabetical position.

~~BCD~~ CRD *credit institution* a *credit institution* that has its registered office (or, if it has no registered office, its head office) in an *EEA State*, excluding an *institution* to which the ~~BCD~~ CRD does not

apply under article 2 of the ~~BCD~~ CRD (see also *full ~~BCD~~ CRD credit institution.*).

~~CAD~~ CRD bank

a bank which uses the *Capital Adequacy Directive* EU CRR to measure the capital requirement on its trading book.

Delete the following definitions altogether. The deleted text is not shown.

advanced prudential calculation approach permission

cash assimilated instrument

CNCOM

concentration risk capital component

connected lending of a capital nature

consolidated operational risk requirement

consolidated requirement component

consolidation UK integrated group

consolidation wider integrated group

conversion factor

credit enhancement

credit valuation adjustment

default

effective expected positive exposure

eligible institution

financial derivative instrument

free delivery

funded credit protection

group of connected clients

individual CNCOM

individual counterparty CNCOM

lending firm

master netting agreement internal models approach permission

matched principal exemption conditions

non-core concentration risk group counterparty

non-core large exposure group

one-sided credit valuation adjustment

payment leg

probability of default

protection buyer

protections seller

PRR item

public sector entity

qualifying equity index

risk capital requirement

secured lending transaction

simple capital issuer

specific risk position risk adjustment

standard market risk PRR rules

stressed VaR

synthetic securitisation

third country BIPRU 730K firm

total exposure

trading book concentration risk excess

traditional securitisation

tranche

unfunded credit protection

value at risk

VaR measure

VaR model position

Annex B

Amendments to the Principles for Business (PRIN)

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

3 Rules about application

3.1 Who?

3.1.1 R *PRIN* applies to every *firm*, except that:

- (1) for an *incoming EEA firm* or an *incoming Treaty firm*, the *Principles* apply only in so far as responsibility for the matter in question is not reserved by an *EU* instrument to the *firm's Home State regulator*;
- (2) for an *incoming EEA firm* which is a ~~BCD~~ CRD *credit institution* without a *top-up permission*, *Principle 4* applies only in relation to the liquidity of a *branch* established in the *United Kingdom*

...

...

3.1.3 G *PRIN* 3.1.1R(2) reflects article 41 156 of the ~~*Banking Consolidation Directive*~~ CRD which provides that the *Host State regulator* retains responsibility in cooperation with the *Home State regulator* for the supervision of the liquidity of a *branch* of a ~~BCD~~ CRD *credit institution*.

...

Annex C

Amendments to the Senior Management, Systems and Controls sourcebook (SYSC)

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

4 General Organisational Requirements

4.1 General requirements

...

Business continuity

...

4.1.7 R ...

[**Note:** article 5(3) of the *MiFID implementing Directive*, annex V paragraph 13 of the *Banking Consolidation Directive*, ~~and~~ article 4(3) of the *UCITS implementing Directive* and article 85(2) of the *CRD*.]

...

4.2 Persons who effectively direct the business

...

4.2.1 R ...

[**Note:** article 9(1) of *MiFID*, article 7(1)(b) of the *UCITS Directive*, article 8(1)(c) of *AIFMD*, ~~and~~ article 11(1) of the *Banking Consolidation Directive* and article 13(1) of the *CRD*.]

...

5 Employees, agents and other relevant persons

5.1 Skills, knowledge and expertise

...

Segregation of functions

...

5.1.7 R The *senior personnel* of a *common platform firm* must define arrangements concerning the segregation of duties within the *firm* and the prevention of conflicts of interest.

[**Note:** article 88 of the CRD and annex V paragraph 1 of the *Banking Consolidation Directive*].

...

6 Compliance, internal audit and financial crime

6.1 Compliance

...

6.1.4-A G In setting the method of determining the *remuneration of relevant persons* involved in the compliance function;

(1) *firms that SYSC 19A applies to will also need to comply with the Remuneration Code; and*

(2) *BIPRU firms will also need to comply with the BIPRU Remuneration Code.*

...

21 Risk control: additional guidance

21.1 Risk control: guidance on governance arrangements

...

21.1.2 G (1) A Chief Risk Officer should:

(a) ...

...

(j) provide risk-focused advice and information into the setting and individual application of the *firm's remuneration policy*. (~~Where the *Remuneration Code* applies, see in particular SYSC 19A.3.15E. Where the *BIPRU Remuneration Code* applies, see in particular SYSC 19C.3.15E.~~)

Annex D

Amendments to the General Provisions (GEN)

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

2 **Interpreting the Handbook**

...

2.2 **Interpreting the Handbook**

...

2.2.25 G Examples of rules being interpreted as cut back by *GEN 2.2.23R* include the following:

(1) ~~*BIPRU 4* imposes capital requirements that, for a *PRA-authorised person* such as a *bank*, are the exclusive responsibility of the *PRA*; accordingly this section is not applied by the *FCA* to a *PRA-authorised person*.~~[deleted]

(2) *SYSC 6.1.1R* requires a *firm* to maintain adequate policies and procedures to ensure compliance with its obligations under the *regulatory system*; *SYSC 6.1.1R* should be interpreted:

...

(b) as applied by the *PRA* in respect of a *PRA-authorised person's* compliance with those regulatory obligations that are the responsibility of the *PRA* (for example, in respect of a *bank* maintaining policies and procedures to ensure compliance with financial resources requirements in *BIPRU* [the *PRA* Rulebook and the *EU CRR*]).

...

Annex E

Amendments to the Fees manual (FEES)

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

3.2 Obligation to pay fees

...

3.2.7A

(1) Fee payer	(2) Fee payable	(3) Due date
...		
<p>(f) Either:</p> <p>(i) a <i>firm</i> applying to the <i>appropriate regulator</i> for permission to use one of the <i>advanced prudential calculation approaches</i> <u><i>internal approaches</i></u> listed in <i>FEES</i> 3 Annex 6-R <u>6BR</u> (or guidance on its availability), including any future proposed amendments to those approaches or (in the case of any application being made for such permission to the <i>appropriate regulator</i> as <i>EEA consolidated supervisor consolidating supervisor</i> <u><i>consolidating supervisor</i></u> under the <i>Capital Requirements Regulations 2006 EU CRR</i> any <i>firm</i> making such an application; or</p> <p>(ii) in the case of an application to a <i>Home State regulator</i> <u><i>the consolidating supervisor</i></u> other than the <i>appropriate regulator</i> for the use of the <i>Internal</i></p>	<p>(a) Unless (2) applies, <i>FEES</i> 3 Annex 6-R <u>6BR</u>. (2) (a) Unless (b) applies a <i>firm</i> submitting a second application for the permission or <i>guidance</i> described in column (1) within 12 months of the first application (where the fee was paid in accordance with (1)) must pay 50% of the fee applicable to it under <i>FEES</i> 3 Annex 6-R <u>6BR</u>, but only in respect of that second application.</p> <p>(b) No fee is payable by a <i>firm</i> in relation to a successful application for a permission based on a minded to grant decision in respect of the same matter following a complete application for <i>guidance</i> in accordance with prescribed submission requirements.</p> <p>(c) No fee is payable where the <i>Home State regulator</i> <u><i>consolidating supervisor</i></u> has requested the assistance described in paragraph (f)(ii) <u>(f)(ii)</u> of column 1 except in</p>	<p>Where the <i>firm</i> has made an application directly to the <i>appropriate regulator</i>, on or before the date the application is made, otherwise within 30 days after the <i>appropriate regulator</i> notifies the <i>firm</i> that its <i>EEA parent's Home State regulator</i> <u><i>consolidating supervisor</i></u> has requested assistance.</p>

<p>Ratings Based IRB approach and the <i>Home State regulator</i> consolidating supervisor requesting the <i>appropriate regulator's</i> assistance in accordance with the <i>Capital Requirements Regulations 2006 EU CRR</i>, any firm to which the <i>appropriate regulator</i> would have to apply any decision to permit the use of that approach.</p>	<p>the cases specified in <i>FEES 3 Annex 6</i> R <u>6B</u>.</p>	
--	---	--

...

Delete FEES 3 Annex 6 and add FEES 3 Annex 6B

Annex 6B **Part 1**

<p><u>R</u></p>	<p><u>Fees payable in relation to internal approaches that require permission under Part Three of the <i>EU CRR</i> other than internal model method for counterparty credit risk:</u></p> <p><u>(1) Subject to (3), for applications made to the <i>appropriate regulator</i> to authorise a new internal approach:</u></p> <p><u>(i) where the application relates to <i>CRD credit institutions</i> or <i>designated investment firms</i> and to five or more significant overseas entities within the same group (Group 1) and the application is for a permission to use one of the internal approaches in Tables 1 or 2 or guidance on the availability of such a permission, the fees in Table 1 are applicable.</u></p> <p><u>(ii) for all other <i>CRD credit institutions</i> or <i>designated investment firms</i> the fees in Table 2 are applicable.</u></p> <p><u>(2) Subject to (3), for applications made to the consolidating supervisor other than the <i>appropriate regulator</i> for a joint decision under Article 20 of the <i>EU CRR</i> on the use of one of the internal approaches in Tables 1 or 2 and where the <i>appropriate regulator</i> is requested to assist the consolidating supervisor, the fees in Table 1 and Table 2 are applicable if the <i>firm</i> concerned meets the following conditions :</u></p> <p><u>(i) it is a <i>CRD credit institution</i>; and</u></p> <p><u>(ii) the <i>firm</i> does not fall within Group 4 as defined in Table 2.</u></p> <p><u>(3) If however the application or request for assistance is in relation to the use</u></p>
-----------------	--

of the Advanced IRB approach and the *appropriate regulator* (in the case of (1)) or the relevant consolidating supervisor (in the case of (2)) has already granted permission for the use of the Foundation IRB approach then table 3 applies.

(4) References to the internal approaches in Tables 1, 2 and 3 shall be construed as follows:

(i) Foundation IRB means the *internal approach* for credit risk referred to in Article 143(1) of the *EU CRR*;

(ii) Advanced IRB means the internal approach for credit risk referred to in Article 151(4) and (9) of the *EU CRR*; and

(iii) AMA means the internal approach for operational risk referred to in 312(2) of the *EU CRR*.

(5) All fees are shown in £.

Table 1

<u>Application Group</u>	<u>Description of Group</u>	<u>Application fee</u>		
		<u>Advanced IRB ('000)</u>	<u>Foundation IRB ('000)</u>	<u>AMA ('000)</u>
<u>Group 1</u>	<u>Five or more significant overseas entities as described in more detail in the definition of Group 1 in the introduction to Part 1 of this Annex</u>	<u>268</u>	<u>232</u>	<u>181</u>

Table 2

<u>Application Group</u>	<u>Description of Group</u>		<u>Application fee</u>		
	<u>Modified eligible liabilities</u>	<u>Number of traders as at 31 December prior to the PRA's fee year in which the fee is payable</u>	<u>Advanced IRB ('000)</u>	<u>Foundation IRB ('000)</u>	<u>AMA ('000)</u>
<u>Group 2</u>	<u>>40,000</u>	<u>>200</u>	<u>232</u>	<u>198</u>	<u>146</u>

<u>Group 3</u>	<u>≥5,000 – 40,000</u>	<u>26-200</u>	<u>94</u>	<u>72</u>	<u>51</u>
<u>Group 4</u>	<u>0-5,000</u>	<u>0-25</u>	<u>42</u>	<u>30</u>	<u>24</u>

(1) For the purposes of Table 2, a firm's A.1 or A10 tariff data for the relevant period will be used to provide the value of modified eligible liabilities or number of traders.

Table 3 (Advanced IRB approach where the appropriate regulator or the consolidating supervisor has already given permission to use Foundation IRB)

<u>Application Group</u>	<u>Advanced IRB Application fee</u>
<u>Group 1</u>	<u>67,000</u>
<u>Group 2</u>	<u>58,000</u>
<u>Group 3</u>	<u>23,500</u>
<u>Group 4</u>	<u>10,500</u>
<u>The four application groups have the same meaning as they do in Tables 1 and 2</u>	

Part 2

R Fees payable in relation to the application for a permission to use the internal model method for counterparty credit risk under Article 283 of the EU CRR: 54,000

...

6 Financial Services Compensation Scheme Funding

...

6.6 Incoming EEA firms

6.6.1 **R** If an *incoming EEA firm*, which is a ~~BCD~~ *CRD credit institution*, an *IMD insurance intermediary* or *MiFID investment firm*, is a *participant firm*, the *FSCS* must give the *firm* such discount (if any) as is appropriate on the share of any levy it would otherwise be required to pay, taking account of the nature of the levy and the extent of the compensation coverage provided by the firm's *Home State* scheme.

Annex F

Amendments to the General Prudential sourcebook (GENPRU)

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

3 Cross sector groups

3.1 Application

...

- 3.1.16 G *GENPRU 3.1.26 29R* to *GENPRU 3.1.31R* and *GENPRU 3 Annex 1R* implement the detailed capital adequacy requirements of the *Financial Groups Directive*. They only deal with a *financial conglomerate* for which the *appropriate regulator* is the *coordinator*. If another *competent authority* is *coordinator* of a *financial conglomerate*, those *rules* do not apply with respect to that *financial conglomerate* and instead that *coordinator* will be responsible for implementing those detailed requirements.

...

Risk concentration and intragroup transactions: the main rule

- 3.1.35 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 3.1.34R* are complied with with respect to that *financial sector* as a whole, including the *mixed financial holding company*. The ~~*appropriate regulator's*~~ *sectoral rules* for these purposes are those identified in the table in *GENPRU 3.1.36R*.

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

- 3.1.36 R Table: application of sectoral rules
This table belongs to *GENPRU 3.1.35R*

The most important financial sector	Applicable sectoral rules	
	Risk concentration	Intra-group transactions
<i>Banking and investment</i>	<i>BIPRU 8.9A</i>	<i>BIPRU 10 (Large</i>

<i>services sector</i>	(Consolidated large exposure requirements) including <i>BIPRU TP</i> as it applies to a <i>UK consolidation group</i> : the <i>EU CRR</i>	exposures requirements) including <i>BIPRU TP</i> as it applies on a solo basis and relates to <i>BIPRU 10</i> : Part Four of the <i>EU CRR</i>
...		

3.1.37 R (1) Where the *sectoral 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*.

...

3.1.38 R (1) This *rule* applies for the purposes of the definitions of:

(a) a *core concentration risk group counterparty*; and

(b) a *non-core concentration risk group counterparty*;

as they apply for the purposes of the *rules* for the *banking and investment services sector* as applied by *GENPRU 3.1.36R*. [deleted]

(2) For the purposes of *BIPRU 10.9A.4R(1)* and *BIPRU 10.9A.4R(2)* (as they apply to the definitions in *GENPRU 3.1.38R(1)*), the conditions are also satisfied if the *counterparty* and the *firm* are included within the scope of consolidated supervision on a full basis with respect to the same *financial conglomerate* under *GENPRU 3.1* or the relevant implementation measures in another *EEA State* for the *Financial Groups Directive*. [deleted]

...

The financial sectors: asset management companies and alternative investment fund managers

3.1.39 R (1) ...

(2) An *asset management company* or an *alternative investment fund manager* is in the *overall financial sector* and is a *regulated entity* for the purpose of:

...

- (c) any other provision of the *Handbook* or *PRA Rulebook* relating to the supervision of *financial conglomerates*.

...

- (5) This *rule* applies even if:
- (a) a *UCITS management company* is a ~~BIPRU~~ an IFPRU investment firm; or
- (b) an *asset management company* or an alternative investment fund manager is an *investment firm*.

3.2 Third-country groups

...

Purpose

- 3.2.2 G *GENPRU* 3.2 implements in part Article 18 of the *Financial Groups Directive* and Article ~~143~~ 127 of the *Banking Consolidation Directive* CRD.

Equivalence

- 3.2.3 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 Article ~~143 (1) and (2)~~ of the *Banking Consolidation Directive* 127(1) and (2) of the *CRD* does so with respect to *third-country banking and investment groups*.

Other methods: General

- 3.2.4 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* 3.2.3G, the methods set out in the CRD and EU CRR will apply or *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

...

3.2.7 G *GENPRU 3.2.8R and GENPRU 3.2.9R and GENPRU 3 Annex 2R set out rules to deal with the situation covered in GENPRU 3.2.5G. Those rules do not apply automatically. Instead, they can only be applied with respect to a particular third-country group through the Part 4A permission of a firm in that third-country group. Broadly speaking the procedure described in GENPRU 3.1.22G also applies to this process.*

...

3 Annex 1 Capital adequacy calculations for financial conglomerates (GENPRU 3.1.29R)

R

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

...

7 Table

A mixed financial holding company	4.4	<p><i>A mixed financial holding company must be treated in the same way as:</i></p> <p><i>(1) a financial holding company (if the rules in BIPRU 8 Part One, Title II, Chapter 2 of the EU CRR and the PRA Rulebook are applied); or</i></p> <p><i>(2) an insurance holding company (if the rules in INSPRU 6.1 are applied).</i></p>
-----------------------------------	-----	--

8 Table: PART 5: Principles applicable to all methods

Transfer-ability of capital	5.1	<p>Capital may not be included in:</p> <p>(1) a firm's conglomerate capital resources under GENPRU 3.1.29R; or,</p> <p>(2) in the capital resources of the financial conglomerate for the purposes of GENPRU 3.1.26R;</p>
-----------------------------	-----	---

		...
Double counting	5.2	<p>Capital must not be included in:</p> <p>(1) a firm's conglomerate capital resources under GENPRU 3.1.29R ; or</p> <p>(2) the capital resources of the financial conglomerate for the purposes of GENPRU 3.1.26R;</p> <p>if:</p> <p>(3)(1) it would involve double counting or multiple use of the same capital; or</p> <p>(4)(2) it results from any inappropriate intra-group creation of capital.</p>
Cross sectoral capital	5.3	<p>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 GENPRU 3.1.26R or, as the case may be, GENPRU 3.1.29R 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 GENPRU 3.1.26R or, as the case may be, GENPRU 3.1.29R.</p>
		...
Application of sectoral rules: Banking sector and investment services sector	5.6	<p>The <u>In relation to a BIPRU firm that is a member of a financial conglomerate where there are no credit institutions or investment firms, the following</u> adjustments apply to the <i>applicable sectoral rules</i> for the <i>banking sector</i> and the <i>investment services sector</i> as they are applied by the <i>rules</i> in this annex.</p> <p>(1) References in those <i>rules</i> to <i>non-EEA sub-groups</i> do not apply.</p>

		<p>(2) (For the purposes of Parts 1 and 2), where those <i>rules</i> require a group to be treated as if it were a single <i>undertaking</i>, those <i>rules</i> apply to the <i>banking sector</i> and <i>investment services sector</i> taken together. <u>[deleted]</u></p> <p>...</p> <p><u>(Other than as above) the CRD and EU CRR applies for the banking sector and the investment services sector.</u></p>
No capital ties	5.7	<p>(1) This <i>rule</i> deals with a <i>financial conglomerate</i> in which some of the members are not linked by capital ties at the time of the notification referred to in GENPRU 3.1.28R(1) <u>3.1.29AR</u> (Capital adequacy requirements: Application of <u>Method 1</u> or <u>2</u> from Annex I of the Financial Groups Directive).</p> <p>(2) If:</p> <p>(a) GENPRU 3.1.26R (Capital adequacy requirements: Application of Annex I of the Financial Groups Directive) would otherwise apply with respect to a <i>financial conglomerate</i> under GENPRU 3.1.28R; and</p> <p>(b) all members of that <i>financial conglomerate</i> 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 <i>regulated entities</i> in a <i>financial conglomerate</i> (the "peripheral members"); GENPRU 3.1.28R continues to apply. Otherwise GENPRU 3.1.28R does not apply with respect to a <i>financial conglomerate</i> falling into (1). <u>[deleted]</u></p> <p>(3) If GENPRU 3.1.28R applies with respect to a <i>financial conglomerate</i> in accordance with (2) the peripheral members must be excluded from the calculations under GENPRU 3.1.26R. <u>[deleted]</u></p> <p>(4) If:</p> <p>(a) GENPRU 3.1.26R applies with respect to <i>financial conglomerate</i> falling into (1) under GENPRU 3.1.27R(2) (Use of <i>Part 4A</i> permission to apply Annex I of the <i>Financial</i></p>

		<p>Groups Directive); or [deleted]</p> <p>(b) <i>GENPRU</i> 3.1.29R (Capital adequacy requirements: Application of Methods 1, 2 or 3 <u>Method 1 or 2</u> from Annex I of the Financial Groups Directive) applies with respect to a <i>financial conglomerate</i> falling into (1);</p> <p>then:</p> <p>(c) the treatment of the links in (1) (including the treatment of any <i>solvency deficit</i>) is as provided for <u>in whichever of Part 1 or Part 2 of <i>GENPRU</i> 3 Annex 1R the firm has, under <i>GENPRU</i> 3.1.30R, indicated to the <u>appropriate regulator it will apply or, if applicable, in the requirement referred to in <i>GENPRU</i> 3.1.30R 3.1.31R;</u> and</u></p> <p>(d) <i>GENPRU</i> 3.1.26R or <i>GENPRU</i> 3.1.29R ; as the case may be, <u>apply</u> applies even if the <i>applicable sectoral rules</i> do not deal with how <i>undertakings</i> not linked by capital ties are to be dealt with for the purposes of consolidated supervision (or, in the case of the <i>insurance sector</i>, supplementary supervision).</p> <p>(5) Once <i>GENPRU</i> 3.1.26R applies to a firm with respect to a <i>financial conglomerate</i> of which it is a member under <i>GENPRU</i> 3.1.27R(1) (automatic application of Method 4 from Annex I of the <i>Financial Groups Directive</i> on satisfaction of the condition in <i>GENPRU</i> 3.1.28R), the disapplication of <i>GENPRU</i> 3.1.28R under (2) ceases to apply with respect to that <i>financial conglomerate</i>. [deleted]</p>
--	--	--

9 Table: PART 6: Definitions used in this Annex

...		
Solo capital resources requirement: Banking sector and investment service sector	6.2	<p>(1) The <i>solo capital resources requirement</i> of an <i>undertaking</i> in the <i>banking sector</i> or the <i>investment services sector</i> must be calculated in accordance with this <i>rule</i>, subject to paragraphs 6.5 and 6.6.</p> <p>(2) The <i>solo capital resources requirement</i> of a</p>

	<p><i>building society is its CRR <u>own funds requirements</u>.</i></p> <p>...</p> <p>(4) If there is a <i>credit institution</i> in the <i>financial conglomerate</i>, the <i>solo capital resources requirement</i> for any <i>undertaking</i> in the <i>banking sector</i> or the <i>investment services sector</i> is, subject to (2) and (3), calculated in accordance with the rules <u>EU CRR</u> for calculating the CRR <u>own funds requirements</u> of a <i>bank</i> that is a BIPRU firm.</p> <p>(5) If:</p> <p>(a) the <i>financial conglomerate</i> does not include a <i>credit institution</i>;</p> <p>(b) there is at least one CAD <i>investment firm</i> in the <i>financial conglomerate</i>; and</p> <p>(c) all the CAD <i>investment firms</i> in the <i>financial conglomerate</i> are <i>limited licence firms</i> or <i>limited activity firms</i>;</p> <p>the <i>solo capital resources requirement</i> for any <i>undertaking</i> in the <i>banking sector</i> or the <i>investment services sector</i> is calculated in accordance with the rules <u>EU CRR</u> for calculating the CRR <u>own funds requirements</u> of:</p> <p>(d) (if there is a <i>limited activity firm</i> in the <i>financial conglomerate</i>), a BIPRU <u>an IFPRU</u> <i>limited activity firm</i>; or</p> <p>(e) (in any other case), a BIPRU <u>an IFPRU</u> <i>limited licence firm</i>.</p> <p>(6) If:</p> <p>(a) the <i>financial conglomerate</i> does not include a <i>credit institution</i>; and</p> <p>(b) (5) does not apply;</p> <p>the <i>solo capital resources requirement</i> for any <i>undertaking</i> in the <i>banking sector</i> or the <i>investment services sector</i> is calculated in accordance with the rules <u>EU CRR</u> for calculating the CRR <u>own funds</u></p>
--	---

		<p><u>requirements of a full scope BIPRU IFPRU investment firm.</u></p> <p>(7) <u>In relation to a BIPRU firm that is a member of a financial conglomerate where there are no credit institutions or investment firms, Any any CRR capital resources requirements</u> calculated under a BIPRU TP may be used for the purposes of the <i>solo capital resources requirement</i> in this rule in the same way that the <u>CRR capital resources requirements</u> can be used under BIPRU 8.</p>
...		
Solo capital resources requirement: EEA firms in the banking sector or investment services sector	6.5	<p>The <i>solo capital resources requirement</i> for an EEA regulated entity (other than a <i>bank, building society, designated investment firm, IFPRU investment firm, BIPRU firm, an insurer or an EEA insurer</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 it is obliged to hold under those <i>sectoral rules</i> provided that the following conditions are satisfied:</p> <p>...</p>
		...
...		

...

11 Table: Paragraph 6.10: Application of sectoral consolidation rules

Financial sector	Appropriate regulator's sectoral <u>Sectoral</u> rules
<i>Banking sector</i>	<u>BIPRU 8 and BIPRU TP, as adjusted under paragraph 4.5 Part One, Title II, Chapter 2 of the EU CRR and the PRA Rulebook</u>
<i>Insurance sector</i>	<u>INSPRU 6.1</u>
<i>Investment services sector</i>	<u>BIPRU 8 and BIPRU TP (in relation to a designated investment firm or IFPRU investment firm which is a member</u>

	<p><u>of a financial conglomerate for which the PRA is the coordinator) Part One, Title II, Chapter 2 of the EU CRR and the PRA Rulebook;</u></p> <p><u>(in relation to an IFPRU investment firm which is a member of a financial conglomerate for which the FCA is the coordinator) Part One, Title II, Chapter 2 of the EU CRR and IFPRU 8.1;</u></p> <p><u>(in relation to a BIPRU firm that is a member of a financial conglomerate where there are no credit institutions or investment firms for which the FCA is the coordinator) BIPRU 8 and BIPRU TP.</u></p>
--	--

...

3 Annex 2 Prudential rules for third country groups (GENPRU 3.2.8R to GENPRU 3.2.9R)

R

1 Table: PART 1: Third-country financial conglomerates

...	
1.2	A firm must comply, with respect to the <i>financial conglomerate</i> referred to in paragraph 1.1, with whichever of GENPRU 3.1.26R and GENPRU 3.1.29R is as applied under paragraph 1.3.
1.3	<p>For the purposes of paragraph 1.2:</p> <p>(1) the rule in GENPRU 3.1 that applies as referred to in paragraph 1.2 is the one that is specified by the requirement referred to in GENPRU 3.2.8R ; [deleted]</p> <p>(2) (where GENPRU 3.1.29R is applied) the definitions of <i>conglomerate capital resources</i> and <i>conglomerate capital resources requirement</i> that apply for the purposes of that rule are the ones from whichever of Part 1; <u>or Part 2</u> or Part 3 of GENPRU 3 Annex 1R is specified in that requirement <u>the requirement referred to in GENPRU 3.2.8R</u>; and</p> <p>...</p>
...	

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

...	
2.3	<p>The rules referred to in paragraph 2.2 are as follows:</p> <p>(1) the <i>applicable sectoral consolidation rules</i> in BIPRU 8 <u>paragraph 6.10 of</u></p>

	<u>GENPRU 3 Annex 1R</u> ; or (2) the <i>rules</i> in <i>ELM 7</i> .
...	

3 Annex 3 **Guidance Notes for Classification of Groups**

G

...

Please note the following:

...

(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~~ Capital Requirements Directive 2013/36/EU

- **insurance** activities are listed in - IPRU Insurers Annex 11.1 and 11.2 ~~p 163-168~~.

...

Annex G

Amendments to the Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)

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

4 Capital resources

4.2 Capital resources requirements

...

Capital resources requirement: firms carrying on regulated activities including designated investment business

4.2.5 R The capital resources requirement for a *firm* (other than a *credit union*) carrying on *regulated activities*, including *designated investment business*, is the higher of:

...

- (2) the financial resource requirement which is applied by the Interim Prudential sourcebook for investment businesses, the Prudential sourcebook for Investment Firms and the *EU CRR* or the General Prudential sourcebook and the Prudential sourcebook for Banks, Building Societies and Investment Firms.

...

4.4 Calculation of capital resources

The calculation of a firm's capital resources

4.4.1 R (1) ...

- (2) If the *firm* is subject to the Interim Prudential sourcebook for investment businesses, the Prudential sourcebook for Investment Firms and the *EU CRR*, the General Prudential sourcebook, the Prudential sourcebook for Banks, Building Societies and Investment Firms or the Credit Unions sourcebook, the capital resources are the higher of:

- (a) the amount calculated under (1); and
- (b) the financial resources calculated under those sourcebooks and regulations.

Annex H

Amendments to the Interim Prudential sourcebook for Friendly Societies (IPRU(FSOC))

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

7 Chapter 7: Definitions

PART I DEFINITIONS

7.1 In this Part of the *IPRU(FSOC)*, unless the contrary intention appears, the following definitions apply.

...
<i>approved credit institution</i> means an institution recognised or permitted under the law of an <i>EEA State</i> to carry on any of the activities set out in Annex 1 to the <i>Banking Consolidation Directive</i> <u><i>CRD</i></u> ;
...

Annex I

Amendments to the Interim Prudential sourcebook for Investment Businesses (IPRU(INV))

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

1 Chapter 1: Application and General Provisions

1.1 PURPOSE

1.1.1 ~~Before 1 January 2007, the Interim Prudential Sourcebook for Investment Businesses (IPRU(INV)) was the part of the *Handbook* that dealt with capital requirements for *investment firms* subject to the position risk requirements of the previous version of the *Capital Adequacy Directive*. Now, however, *investment firms* which are subject to the risk-based capital requirements of the *Capital Adequacy Directive* are subject to the General Prudential sourcebook (GENPRU) and the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU). [deleted]~~

...

1.2 APPLICATION

...

1.2.2 R (1) ...

(2) IPRU(INV) does not apply to:

...

(b) a *media firm*; or

(c) a *BIPRU investment firm* (unless it is an *exempt BIPRU commodities firm*); or

(d) an IFPRU investment firm (unless it is an exempt IFPRU commodities firm).

...

1.2.3 G For the avoidance of doubt, *IPRU(INV)* does not apply to any of the following:

...

(b) ...

(ba) a designated investment firm; or

(c) ...

...

1.2.5 R Table

This table belongs to IPRU(INV) 1.2.4R

...	
<i>Securities and futures firm</i> (which is an <i>exempt BIPRU commodities firm</i> or an <i>exempt IFPRU commodities firm</i>)	Chapters 1 and 3
...	

...

4 Chapter 4: Lloyd's firms

...

4.2 Purpose

...

4.2.4 G A *members'* adviser is not regulated by the *Society* and accordingly this chapter specifies the financial resource and accounting requirements to be met. *Firms* which fall within the scope of this chapter will be *firms* with *permission* only to advise persons on *syndicate* participation at Lloyd's. The nature of that advisory business is akin to corporate finance advice and so the applicable requirements are those in *IPRU(INV)* 3 relevant to *firms* giving corporate finance advice. *Firms* with other permissions will fall within the scope of other chapters of *IPRU(INV)*, *GENPRU*, *BIPRU*, *IFPRU* (and the *EU CRR*) or *INSPRU*.

...

Annex J

Amendments to the Supervision manual (SUP)

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

3.1.10 G Other relevant sections of the Handbook (see SUP 3.1.9G)

<i>Friendly society</i>	<i>IPRU(FSOC)</i>
<i>Insurer (other than a friendly society)</i>	<i>IPRU(INS)</i>
<i>Investment management firm, personal investment firm, securities and futures firm (other than <u>IFPRU investment firms</u> and <u>BIPRU investment firms</u>)</i>	<i>IPRU(INV)</i>
<i>UCITS firm</i>	<i>(UPRU)</i>
<i>Society of Lloyd's and Lloyd's managing agents</i>	<i>IPRU(INS)</i>

...

11.8 Changes in the circumstances of existing controllers

11.8.1 R A firm must notify the appropriate regulator immediately it becomes aware of any of the following matters in respect of one or more of its controllers:

...

- (4) if a controller, who is authorised in another EEA State as a MiFID investment firm, ~~BCD~~ CRD credit institution or UCITS management company or under the Insurance Directives or the Insurance Mediation Directive, ceases to be so authorised (registered in the case of an IMD insurance intermediary).

...

Annex K

Amendments to the Compensation sourcebook (COMP)

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

1 Introduction and Overview

...

1.4 EEA Firms

- 1.4.1 G *Incoming EEA firms* which are conducting *regulated activities* in the *United Kingdom* under a ~~BCD~~ CRD, *IMD* or *MiFID* passport are not required to participate in the *compensation scheme* in relation to those *passported activities*. They may apply to obtain the cover of, or ‘top-up’ into, the *compensation scheme* if there is no cover provided by the *incoming EEA firm’s Home State* compensation scheme or if the level or scope of the cover is less than that provided by the *compensation scheme*. This is covered by *COMP 14*.

Annex L

Amendments to the Credit Unions New sourcebook (CREDS)

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

- 2.2.2 G For *credit unions*, the arrangements, processes and mechanisms referred to in SYSC 4.1.1R should be comprehensive and proportionate to the nature, scale, and complexity of the risks inherent in the business model and of the *credit union's* activities. That is the effect of SYSC 4.1.2R and SYSC 4.1.2AG.

PRA RULEBOOK CRR FIRMS INSTRUMENT 2013

Powers exercised

- A. The Prudential Regulation Authority (the “PRA”) 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 137G (The PRA’s general rules); and
 - (2) section 137T (General supplementary powers)
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Pre-conditions to making

- C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook CRR Firms Instrument 2013

- D. The PRA makes the rules in Annexes A to M of this instrument.

Part	Annex
Glossary	Annex A
Internal Capital Adequacy Assessment	Annex B
Definition of Capital	Annex C
Benchmarking of internal approaches	Annex D
Credit Risk	Annex E
Counterparty credit risk	Annex F
Market Risk	Annex G
Groups	Annex H
Large Exposures	Annex I
Public Disclosure	Annex J
Waivers Transitional Provisions	Annex K
Interpretation	Annex L
Permissions	Annex M

Commencement

- E. This instrument comes into force on 1 January 2014, except for Rule 2.2 in Annex D which comes into force on the date specified by subsequent PRA Board Instrument.

Citation

- F. This instrument may be cited as the PRA Rulebook CRR Firms Instrument 2013.

By order of the Board of the Prudential Regulation Authority

16 December 2013

Annex A

Glossary

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

After [...] insert the following new Part.

building society

has the meaning given in section 119 of the Building Societies Act 1986.

CRD

means Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

credit union

has the meaning given in section 31 of the Credit Unions Act 1979.

CRR

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

CRR firm

means a *UK bank*, a *building society* or a *UK designated investment firm*.

EBA

means the European Banking Authority.

firm

means a *PRA-authorised person* within the meaning of section 2B(5) of *FSMA*.

FSMA

means the Financial Services and Markets Act 2000.

market risk

means the risk that arises from fluctuations in values of, or income from assets, or in interest or exchange rates.

PRA

means the Prudential Regulation Authority.

third country

means a territory or country that is not an *EEA State*.

UK bank

means a *UK undertaking* that has permission under Part 4A of *FSMA* to carry on the *regulated activity* of accepting deposits and is a *credit institution*, but is not a *credit union*, *friendly society* or a *building society*.

UK designated investment firm

means a *UK undertaking* that is an investment firm that has been designated by the *PRA* under Article 3 of Financial Services and Markets Act 2000 (PRA-regulated Activities) Order (S.I. 2013/556).

UK undertaking

means an undertaking within the meaning of section 1161(1) of the Companies Act 2006 (meaning of “undertaking” and related expressions) whose registered office or, if the undertaking does not have a registered office, whose head office is in any part of the *UK*.

UK

means *United Kingdom*.

unregulated activity

means an activity that is not a *regulated activity*.

Annex B

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

Part

INTERNAL CAPITAL ADEQUACY ASSESSMENT

Chapter content

- 1 APPLICATION AND DEFINITIONS
- 2 ADEQUACY OF FINANCIAL RESOURCES
- 3 STRATEGIES, PROCESSES AND SYSTEMS
- 4 CREDIT AND COUNTERPARTY RISK
- 5 RESIDUAL RISK
- 6 CONCENTRATION RISK
- 7 SECURITISATION RISK
- 8 MARKET RISK
- 9 INTEREST RISK ARISING FROM NON-TRADING BOOK ACTIVITIES
- 10 OPERATIONAL RISK
- 11 RISK OF EXCESSIVE LEVERAGE
- 12 STRESS TESTS AND SCENARIO ANALYSIS
- 13 DOCUMENTATION OF RISK ASSESSMENTS
- 14 APPLICATION OF THIS PART ON AN INDIVIDUAL BASIS, A CONSOLIDATED BASIS AND A SUB-CONSOLIDATED BASIS

Links

1 APPLICATION AND DEFINITIONS

1.1 This Part applies to every *firm* that is a *CRR firm*.

1.2 In this Part the following definitions shall apply:

Article 12(1) relationship

means a relationship where undertakings are linked by a relationship within the meaning of Article 12(1) Directive 83/349/EEC.

business risk

means any risk to a *firm* arising from:

- (1) changes in its business, including:
 - (a) the acute risk to earnings posed by falling or volatile income; and
 - (b) the broader risk of a *firm's* business model or strategy proving inappropriate due to macroeconomic, geopolitical, industry, regulatory or other factors; or
- (2) its remuneration policy.

consolidation group

means the undertakings included in the scope of consolidation pursuant to Articles 18(1), 18(8), 19(1), 19(3) and 23 of the CRR and Groups 2.1- 2.3.

central counterparty

has the meaning given in point (1) of Article 2 of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, central counterparties and trade repositories.

financial conglomerate

has the meaning given in point (14) of Article 2 of Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate.

group

means in relation to a *person* ("A"), A and any *person*:

- (a) who has relationship with A of the kind specified in s. 421 of *FSMA*;
- (b) who is a member of the same *financial conglomerate* as A;
- (c) who has a *Article 12(1)* relationship with A;
- (d) who has a *Article 12(1)* relationship with any *person* who falls into (a);
- (e) who is a *subsidiary* of a person in (c) or (d) ;

- (f) who is member of the same *consolidation group* as A; or
- (g) whose omission from an assessment of the risks to A of A's connection to any person coming within (a)-(f) or an assessment of the financial resources available to such persons would be misleading.

group risk

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

ICAAP rules

means the rules in Chapter 3 (Strategies, processes, and systems), Chapter 12 (Stress test and scenario analysis) and Chapter 13 (Documentation of risk assessments).

liquidity risk

means the risk that a *firm* although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure such resources only at excessive cost.

market risk

means the risk that arises from fluctuations in values of or income from assets or in interest or exchange rates.

parent financial holding company in a Member State

means (in accordance with point (26) of Article 1(1) of the *CRD*) a *financial holding company* which is not itself a *subsidiary* of an *institution* authorised in the same *EEA State*, or of a *financial holding company* or *mixed financial holding company* set up in the same *EEA State*.

parent institution in a Member State

means (in accordance with point (24) of Article 1(1) of the *CRD*) an *institution* authorised in an *EEA State* which has an *institution* or *financial institution* as *subsidiary* or which holds a *participation* in such an *institution* or *financial institution*, and which is not itself a *subsidiary* of another *institution* authorised in the same *EEA State* or of a *financial holding company* or *mixed financial holding company* set up in the same *EEA State*.

parent mixed financial holding company in a Member State

means (in accordance with point (28) of Article 1(1) of the *CRD*) a *mixed financial holding company* which is not itself a *subsidiary* of an *institution* authorised in the same *EEA State*, or of a *financial holding company* or *mixed financial holding company* set up in the same *EEA State*.

pension obligation risk

means:

- (1) 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); or
- (2) the risk that the *firm* will make payments or other contributions 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.

residual risk

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

risk control rules

means the rules in Chapter 4 to Chapter 11 of this Part.

- 1.3 Unless otherwise defined, any italicised expression used in this Part and in the *CRR* has the same meaning as in the *CRR*.

2 ADEQUACY OF FINANCIAL RESOURCES

Overall financial adequacy rule

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

3 STRATEGIES, PROCESSES AND SYSTEMS

Overall Pillar 2 rule

- 3.1 A *firm* must have in place sound, effective and comprehensive strategies, processes and systems:
- (1) to assess and maintain on an ongoing basis the amounts, types and distribution of financial resources, *own funds* and internal capital that it considers adequate to cover:
 - (a) the nature and level of the risks to which it is or might be exposed;
 - (b) the risk in the overall financial adequacy rule in 2.1; and
 - (c) the risk that the *firm* might not be able to meet the obligations in Part Three of the *CRR* in the future;
 - (2) that enable it to identify and manage the major sources of risk referred to in (1) including the major sources of risk in each of the following categories where they are relevant to the *firm* given the nature and scale of its business:

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

[Note: Art 73 (part) of the CRD]

- 3.2 As part of its obligations under the overall Pillar 2 rule in 3.1, a *firm* must identify separately the amount of *common equity tier one capital*, *additional tier one capital* and *tier two capital* and each category of capital (if any) that is not eligible to form part of its *own funds* which it considers adequate for the purposes described in the overall Pillar 2 rule.
- 3.3 The processes, strategies and systems required by the overall Pillar 2 rule in 3.1 must be comprehensive and proportionate to the nature, scale and complexity of the *firm's* activities.
- 3.4 A *firm* must:
 - (1) carry out regularly the assessments required by the overall Pillar 2 rule in 3.1; and
 - (2) carry out regularly assessments of the processes, strategies and systems required by the overall Pillar 2 rule in 3.1 to ensure they remain comprehensive and proportionate to the nature, scale and complexity of the *firm's* activities.

[Note: Art 73(part) of the CRD]

- 3.5 As part of its obligations under the overall Pillar 2 rule in 3.1, a *firm* must:
 - (1) make an assessment of the firm-wide impact of the risks identified in accordance with that rule, to which end a *firm* must aggregate the risks across its various business lines and units, taking appropriate account of any correlation between risks; and
 - (2) take into account the stress tests that the *firm* is required to carry out under the general stress test and scenario analysis rule in 12.1 and any stress tests that the *firm* is required to carry out under the *CRR*.

4 CREDIT AND COUNTERPARTY RISK

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

[Note: Art 79(a) of the CRD]

- 4.2 A *firm* must have internal methodologies that:
- (1) enable it to assess the credit risk of exposures to individual obligors, securities or *securitisation positions* and credit risk at the portfolio level;
 - (2) do not rely solely or mechanically on external credit ratings; and
 - (3) where its *own funds* requirements under Part Three of the *CRR* are based on a rating by an *ECAI* or based on the fact that an exposure is unrated, enable the *firm* to consider other relevant information for assessing its allocation of financial resources and internal capital.

[Note: Art 79(b) of the CRD]

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

[Note: Art 79(c) of the CRD]

- 4.4 A *firm* must adequately diversify credit portfolios given its target markets and overall credit strategy.

[Note Art 79(d) of the CRD]

5 RESIDUAL RISK

- 5.1 A *firm* must address and control, by means which include written policies and procedures, the risk that recognised credit risk mitigation techniques used by it prove less effective than expected.

[Note: Art 80 of the CRD]

6 CONCENTRATION RISK

- 6.1 A *firm* must address and control, by means which include written policies and procedures, the concentration risk arising from:
- (1) exposures to each counterparty including central counterparties, groups of connected counterparties and counterparties in the same economic sector, geographic region or from the same activity or commodity;

- (2) the application of credit risk mitigation techniques; and
- (3) risks associated with large indirect credit exposures such as a single collateral issuer.

[Note: Art 81 of CRD]

7 SECURITISATION RISK

- 7.1 A *firm* must evaluate and address through appropriate policies and procedures the risks arising from *securitisation* transactions in relation to which the *firm* is investor, *originator* or *sponsor*, including reputational risks, to ensure in particular that the economic substance of the transaction is fully reflected in risk assessment and management decisions.

[Note: Art 82(1) of CRD]

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

[Note Art 82(2) of the CRD]

8 MARKET RISK

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

[Note: Art 83(1) of the CRD]

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

[Note: Art 83(2) of the CRD]

- 8.3 A *firm's* financial resources and internal capital must be adequate for material market risks that are not subject to an *own funds* requirement.
- 8.4 A *firm* which has, in calculating *own funds* requirements for position risk in accordance with Part Three, Title IV, Chapter 2 of the *CRR*, netted off its positions in one or more of the equities constituting a stock-index against one or more positions in the stock-index future or other stock-index product, must have adequate financial resources and internal capital to cover the basis risk of loss caused by the future's or other product's value not moving fully in line with that of its constituent equities.
- 8.5 A *firm* using the treatment in Article 345 of the *CRR* must ensure that it holds sufficient financial resources and internal capital against the risk of loss which exists between the time of the initial commitment and the following working day.

[Note: Art 83(3) of the CRD]

- 8.6 As part of its obligations under the overall Pillar 2 rule in 3.1, a *firm* must consider whether the value adjustments and provisions taken for positions and portfolios in the *trading book* enable

the *firm* to sell or hedge out its positions within a short period without incurring material losses under normal market conditions.

[Note: Art 98(4) of the CRD]

9 INTEREST RISK ARISING FROM NON-TRADING BOOK ACTIVITIES

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

[Note: Art 84 of the CRD]

9.2 As part of its obligations under the overall Pillar 2 rule in 3.1, a *firm* must carry out an evaluation of its exposure to the interest rate risk arising from its non-trading activities.

9.3 The evaluation under 9.2 must cover the effect of a sudden and unexpected change in interest rates of 200 basis points in both directions.

9.4 A *firm* must immediately notify the *PRA* if any evaluation under this *rule* suggests that, as a result of the change in interest rates described in 9.3, the economic value of the *firm* would decline by more than 20% of its *own funds*.

9.5 A *firm* must carry out the evaluation under 9.2 as frequently as necessary for it to be reasonably satisfied that it has at all times a sufficient understanding of the degree to which it is exposed to the risks referred to in 9.2 and the nature of that exposure. In any case it must carry out those evaluations no less frequently than once a year.

[Note: Art 98(5) of the CRD]

10 OPERATIONAL RISK

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

[Note: Art 85(1) of the CRD]

10.2 A *firm* must have in place adequate contingency and business continuity plans aimed at ensuring that in the case of a severe business disruption the *firm* is able to operate on an ongoing basis and that any losses are limited.

[Note: Art 85(2) of the CRD]

11 RISK OF EXCESSIVE LEVERAGE

11.1 A *firm* must have in place policies and procedures for the identification, management and monitoring of the *risk of excessive leverage*.

- 11.2 Those policies and procedures must include, as an indicator for the *risk of excessive leverage*, the leverage ratio determined in accordance with Article 429 of the *CRR* and mismatches between assets and obligations.

[Note: Art 87(1) of the *CRD*]

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

[Note: Art 87(2) of the *CRD*]

12 STRESS TESTS AND SCENARIO ANALYSIS

General stress test and scenario analysis rule

- 12.1 As part of its obligation under the overall Pillar 2 rule in 3.1, a *firm* must, for the major sources of risk identified in accordance with that rule, carry out stress tests and scenario analyses that are appropriate to the nature, scale and complexity of those major sources of risk and to the nature, scale and complexity of the *firm's* business.
- 12.2 In carrying out the stress tests and scenario analyses in 12.1, a *firm* must identify an appropriate range of adverse circumstances of varying nature, severity and duration relevant to its business and risk profile and consider the exposure of the *firm* to those circumstances, including:
- (a) circumstances and events occurring over a protracted period of time;
 - (b) sudden and severe events, such as market shocks or other similar events; and
 - (c) some combination of the circumstances and events described in (a) and (b), which may include a sudden and severe market event followed by an economic recession.
- 12.3 In carrying out the stress tests and scenario analyses in 12.1, the *firm* must estimate the financial resources that it would need in order to continue to meet the overall financial adequacy rule in 2.1 and the obligations laid down in Part Three of the *CRR* under the adverse circumstances being considered.
- 12.4 In carrying out the stress tests and scenario analyses in 12.1, the *firm* must assess how risks aggregate across business lines or units, any material non-linear or contingent risks and how risk correlations may increase in stressed conditions.

13 DOCUMENTATION OF RISK ASSESSMENTS

- 13.1 A *firm* must make a written record of the assessments required under this Part. These assessments must include assessments carried out on a consolidated basis and on an individual basis. In particular it must make a written record of:

- (a) the major sources of risk identified in accordance with the overall Pillar 2 rule in 3.1;
 - (b) how it intends to deal with those risks; and
 - (c) details of the stress tests and scenario analyses carried out, including any assumptions made in relation to scenario design, and the resulting financial resources estimated to be required in accordance with the general stress test and scenario analysis rule in 12.1.
- 13.2 A *firm* must maintain the records referred to in 13.1 for at least three years.

14 APPLICATION OF THIS PART ON AN INDIVIDUAL BASIS, A CONSOLIDATED BASIS AND A SUB-CONSOLIDATED BASIS

The ICAAP rules

- 14.1 A *firm* that is neither a *subsidiary of a parent undertaking* incorporated in or formed under the law of any part of the *UK* nor a *parent undertaking* must comply with the *ICAAP rules* on an individual basis.

- 14.2 A *firm* that is not a member of a *consolidation group* must comply with the *ICAAP rules* on an individual basis.

[Note: Art 108(1) of the CRD]

- 14.3 A *firm* which is a *parent institution in a Member State* must comply with the *ICAAP rules* on a *consolidated basis*.
- 14.4 A *firm* controlled by a *parent financial holding company in a Member State* or a *parent mixed financial holding company in a Member State* must comply with the *ICAAP rules* on the basis of the *consolidated situation* of that holding company, if the *PRA* is responsible for supervision of the *firm* on a *consolidated basis* under Article 111 of the *CRD*.

[Note: Art 108(2) and 108(3) of the CRD]

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

[Note: Art 108(4) of the CRD]

- 14.6 If the *ICAAP rules* apply to a *firm* on a *consolidated basis* or on a *sub-consolidated basis* the *firm* must carry out consolidation to the extent and in the manner prescribed in Articles 18(1), 18(8), 19(1), 19(3), 23 and 24(1) of the *CRR* and Groups 2.1-2.3.
- 14.7 For the purpose of the *ICAAP rules* as they apply on a *consolidated basis* or on a *sub-consolidated basis*:

- (1) the *firm* must ensure that the *consolidation group* has the processes, strategies and systems required by the overall Pillar 2 rule in 3.1;
 - (2) the risks to which the overall Pillar 2 rule in 3.1 and the general stress test and scenario analysis rule refer are those risks as they apply to each member of the *consolidation group*;
 - (3) the reference in the overall Pillar 2 rule in 3.1 to amounts and types of financial resources, *own funds* and internal capital (referred to in this *rule* as resources) must be read as being to the amounts and types that the *firm* considers should be held by the members of the *consolidation group*;
 - (4) other references to resources must be read as being to resources of the members of the *consolidation group*;
 - (5) the reference in the overall Pillar 2 rule in 3.1 to the distribution of resources must be read as including a reference to the distribution between members of the *consolidation group*;
 - (6) the reference in the overall Pillar 2 rule in 3.1 to the overall financial adequacy rule in 2.1 must be read as being to that *rule* as adjusted under 14.14-14.16 (level of application of the overall financial adequacy rule);
 - (7) a *firm* must be able to explain how it has aggregated the risks referred to in the overall Pillar 2 rule in 3.1 and the financial resources, *own funds* and internal capital required by each member of the *consolidation group*; and
 - (8) 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 test and scenario analysis rule in 12.1.
- 14.8 A *firm* must allocate the total amount of financial resources, *own funds* and internal capital identified as necessary under the overall Pillar 2 rule in 3.1 (as applied on a *consolidated basis* or on a *sub-consolidated basis*) between different parts of the *consolidation group*.
- 14.9 The *firm* must carry out the allocation in 14.8 in a way that adequately reflects the nature, level and distribution of the risks to which the *consolidation group* is subject.
- 14.10 A *firm* must also allocate the total amount of financial resources, *own funds* and internal capital identified as necessary under the overall Pillar 2 rule in 3.1 as applied on a *consolidated basis* or on a *sub-consolidated basis* between each *firm* which is a member of the *consolidated group* on the following basis:
- (a) the amount allocated to each *firm* must be decided on the basis of the principles in 14.9; and
 - (b) if the process in (a) were carried out for each group member, the total so allocated would equal the total amount of financial resources, *own funds* and internal capital identified as necessary under the overall Pillar 2 rule in 3.1 as applied on a *consolidated basis* or on a *sub-consolidated basis*.

The risk control rules

- 14.11 The *risk control rules* apply to a *firm* on an individual basis whether or not they also apply to the firm on a *consolidated basis* or *sub-consolidated basis*.

[Note: Art 109(1) (part) of the CRD]

- 14.12 Where a *firm* is a member of a *consolidation group*, the *firm* must ensure that the risk management processes and internal control mechanisms at the level of the *consolidation group* of which it is a member comply with the obligations set out in the *risk control rules* on a *consolidated basis* (or a *sub-consolidated basis*).
- 14.13 Compliance with the obligations referred to in 14.12 must enable the *consolidation group* to have arrangements, processes and mechanisms that are consistent and well integrated and that any data relevant to the purpose of supervision can be produced.

[Note: Art 109(2) (part) of the CRD]

Level of application of the overall financial adequacy rule

- 14.14 The overall financial adequacy rule in 2.1 applies to a *firm* on an individual basis whether or not it also applies to the *firm* on a *consolidated basis* or *sub-consolidated basis*.
- 14.15 The overall financial adequacy rule in 2.1 applies to a *firm* on a *consolidated basis* if the *ICAAP rules* apply to it on a *consolidated basis* and applies to a *firm* on a *sub-consolidated basis* if the *ICAAP rules* apply to it on a *sub-consolidated basis*.
- 14.16 When the overall financial adequacy rule in 2.1 applies on a *consolidated basis* or *sub-consolidated basis*, the *firm* must ensure that at all times its *consolidation group* maintains overall financial resources, including *own funds* and liquidity resources, which are adequate, both as to amount and quality, to ensure that there is no significant risk that the liabilities of any members of its *consolidation group* cannot be met as they fall due.

Annex C

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

Part

DEFINITION OF CAPITAL

Chapter content

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- 3 QUALIFYING HOLDINGS OUTSIDE THE FINANCIAL SECTOR
- 4 CONNECTED FUNDING OF A CAPITAL NATURE
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Links

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to every *firm* that is a *CRR firm*.

1.2 In this Part the following definitions shall apply:

Small specialist bank

a *bank* that has capital resources equal to or in excess of the base capital resources requirement for a *small specialist bank* in 12.1 but less than the base capital resources requirement of a *bank* and that carries out one or more of the following activities:

- (1) provides current and savings accounts;
- (2) lending to *small and medium-sized enterprises*;
- (3) lending secured by mortgages on residential property.

1.3 Unless otherwise defined, any italicised expression used in this Part and in the *CRR* has the same meaning as in the *CRR*.

2 HOLDINGS OF OWN FUNDS INSTRUMENTS ISSUED BY FINANCIAL SECTOR ENTITIES INCLUDED IN THE SCOPE OF CONSOLIDATED SUPERVISION

2.1 For the purposes of calculating *own funds* on an individual basis and a *sub-consolidated basis*, *firms* subject to supervision on a *consolidated basis* must deduct at least the relevant percentage of holdings of *own funds instruments* issued by *financial sector entities* included in the scope of consolidated supervision in accordance with Part Two of the *CRR*, except where the exception in 2.3 or 2.6 applies.

2.2 For the purposes of 2.1 the relevant percentage is as follows:

- (1) 50% for the period from 1 January 2014 to 31 December 2014;
- (2) 60% for the period from 1 January 2015 to 31 December 2015;
- (3) 70% for the period from 1 January 2016 to 31 December 2016;
- (4) 80% for the period from 1 January 2017 to 31 December 2017;
- (5) 90% for the period from 1 January 2018 to 31 December 2018; and
- (6) 100% for the period after 31 December 2018.

- 2.3 A *firm* must not apply the deduction in 2.1 to its holdings of *own funds instruments* issued by a venture capital investor that is included in the scope of consolidated supervision of the *firm*.
- 2.4 For the purposes of this Chapter, a venture capital investor is a *financial institution*, in relation to which:
- (1) the sole purpose is to make venture capital investments and carry out unregulated activities in relation to the administration of venture capital investments; and
 - (2) none of its venture capital investments is in a *credit institution* or a *financial institution*, the principal activity of which is to perform any activity other than the acquisition of holdings in other undertakings (within the meaning of section 1161(1) of the Companies Act 2006).
- 2.5 For the purposes of this Chapter, a venture capital investment is a designated investment which, at the time the investment is made, is:
- (1) in a new or developing company or venture; or
 - (2) in a management buy-out or buy-in; or
 - (3) made as a means of financing the investee company or venture and accompanied by a right of consultation, or rights to information, or board representation, or management rights; or
 - (4) acquired with a view to, or in order to, facilitate a transaction falling within (1) to (3).
- 2.6 For the purposes of this Chapter, a designated investment is a security or contractually-based investment specified in Articles 76 to 85 and 89 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.
- 2.7 A *firm* must not apply the deduction in 2.1 to that percentage of its holdings of *own funds instruments* issued by a venture capital holding company included in the scope of consolidated supervision of the *firm* that represents the value of the venture capital holding company's investment in venture capital investors.
- 2.8 For the purposes of this Chapter, a venture capital holding company is a *financial institution*, in respect of which:
- (1) it is a *financial institution* solely by reason of its principal activity being the acquiring of holdings;
 - (2) it holds shares (in the meaning of section 76 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001) in a venture capital investor; and
 - (3) the proportion of the value of the venture capital holding company attributable to investment in Venture Capital Investors and the proportion of the value of the venture capital holding company attributable to other investments can be identified and valued on a regular basis

[Note: Art 49(2) of the CRR]

3 QUALIFYING HOLDINGS OUTSIDE THE FINANCIAL SECTOR

- 3.1 In respect of the qualifying holdings described in Article 89(1) and (2) of the *CRR*, a *firm* must, in accordance with Article 89(3), comply with the requirement in Article 89(3)(a).

[Note: Art 89(3) of the *CRR*]

4 CONNECTED FUNDING OF A CAPITAL NATURE

- 4.1 This Chapter applies to every *firm* that is a *UK bank*.
- 4.2 A *firm* must not avoid the requirements of the *CRR* by structuring its investments as connected funding of a capital nature.
- 4.3 A *firm* must treat all connected funding of a capital nature as a holding of capital of the connected party and apply to it the treatment under the *CRR* and the PRA Rulebook applicable to such a holding, including any reporting or disclosure requirements in respect of such holding.
- 4.4 If the connected party is a *financial sector entity*, the *firm* must treat the connected funding of a capital nature as a holding of *Common Equity Tier 1 instruments*, *Additional Tier 1 instruments* or *Tier 2 instruments* of the connected party, as appropriate in light of the funding's characteristics when compared to the characteristics of each type of *own funds instruments*.
- 4.5 A *firm* must report to the *PRA* all connected funding of a capital nature at least 30 days in advance of entry into the relevant funding transaction and identify each relevant transaction with sufficient detail to allow the *PRA* to evaluate it.
- 4.6 A loan or other funding transaction is connected funding of a capital nature if it is made by the *firm* to a connected party and:
- (1) based on its terms and other factors of which the *firm* is aware, the connected party would be able to consider it from the point of view of its characteristics as capital as being similar to an *own funds instrument*; or
 - (2) the position of the *firm* from the point of view of maturity and repayment is inferior to that of the senior unsecured and unsubordinated creditors of the connected party.
- 4.7 A loan or other funding transaction is connected funding of a capital nature if it:
- (1) funds directly or indirectly a loan to a connected party that has the characteristics described in 4.6 or of a capital investment in a connected party; or
 - (2) has itself the characteristics described in 4.6.
- 4.8 A guarantee is connected funding of a capital nature if it is a guarantee by the *firm* of a loan or other funding transaction from a third party to a connected party of the *firm* and:
- (1) the loan or other funding transaction has the characteristics described in 4.6 or the characteristics described in 4.7; or

- (2) the rights that the *firm* would have against the connected party have the characteristics described in 4.6(2).
- 4.9 For the purposes of this Chapter and in relation to a *firm*, a connected party means another person (“P”) in respect of whom the *firm* has not been permitted to apply the individual consolidation method under Article 8 of the *CRR* and one of the following applies:
- (1) P is closely related to the *firm*;
 - (2) P is an associate of the *firm*; or
 - (3) the same persons significantly influence the *management body* of P and the *firm*.
- 4.10 For the purposes of 4.9(1), a *firm* and another person are closely related when:
- (1) the insolvency of one of them is likely to be associated with the insolvency or default of the others;
 - (2) it would be prudent when assessing the financial condition or creditworthiness of one to consider that of the other; or
 - (3) there is, or there is likely to be, a close relationship between the financial performance of the *firm* and that person.
- 4.11 For the purposes of 4.9(2), a person is an associate of a *firm* if it is:
- (1) in the same group as the *firm*;
 - (2) an appointed representative (in the sense of section 39 of *FSMA*) or tied agent (as described in Article 4(1)(25) of *MiFID*) of the *firm* or a member of the *firm*'s group; or
 - (3) any other person whose relationship with the *firm* or a member of the *firm*'s group might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties.

5 CONNECTED TRANSACTIONS

- 5.1 In determining whether an item of capital qualifies as a *Common Equity Tier 1 item*, an *Additional Tier 1 item* or a *Tier 2 item* a *firm* must take into account any connected transaction which, when taken together with the item of capital, would cause it not to display the characteristics of a *Common Equity Tier 1 item*, an *Additional Tier 1 item* or a *Tier 2 item*.
- 5.2 A *firm* must report to the *PRA* all connected transactions described in 5.1 at least 30 days in advance of entry into the relevant transaction and identify each relevant transaction with sufficient detail to allow the *PRA* to evaluate it.

6 OWN FUNDS INSTRUMENTS ISSUED UNDER NON-EEA LAW

- 6.1 A *firm* must demonstrate to the *PRA* that any *Additional tier 1 instruments* or *Tier 2 instruments* issued by it that are governed by the law of a *third country* are by their terms capable, as part of a resolution of the *firm*, of being written down or converted into *Common Equity Tier 1 instruments* of the *firm* to the same extent as an equivalent *own funds instrument* issued under the law of the United Kingdom.
- 6.2 A *firm* must include in the materials it provides to the *PRA* under 6.1 a properly reasoned independent legal opinion from an individual appropriately qualified in the relevant *third country*.

7 NOTIFICATION REGIME - ISSUANCE

- 7.1 A *firm* shall notify the *PRA* in writing of its intention, or the intention of another member of its *group* that is not a *firm* but is included in the supervision on a consolidated basis of the *firm*, to issue a capital instrument that it believes will qualify under the *CRR* as an *own funds instrument* at least thirty days before the intended date of issue. This rule does not apply to the capital instruments described in 7.3 below.
- 7.2 When giving notice under 7.1, the *firm* shall provide:
- (1) details of the amount and type of *own funds* the *firm* is seeking to raise through the intended issue and whether the capital instruments are intended to be issued to external investors or to other members of its *group*;
 - (2) a copy of the term sheet and details of any features of the capital instrument which are novel, unusual or different from a capital instrument of a similar nature previously issued by the *firm* or widely available in the market;
 - (3) confirmation from a member of the *firm's senior management* responsible for authorising the intended issue or, in the case of an issue by another *group* member, for the issue's inclusion in the *firm's* consolidated *own funds*, that the capital instrument meets the conditions for qualification as an *own funds instrument*; and
 - (4) a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the capital instrument meets the conditions for qualification as the relevant type of *own funds instrument*.
- 7.3 The *firm* does not have to give notice under 7.1 if the capital instrument is:
- (1) an ordinary share with voting rights and no new or unusual features; or
 - (2) a debt instrument issued under a debt securities programme under which the *firm* or *group* member has previously issued and the *firm* has notified the *PRA* in accordance with this Chapter prior to a previous issuance under the programme.
- 7.4 A *firm* shall notify the *PRA* in writing no later than the date of issue of its intention, or the intention of another member of its *group* that is not a *firm* but is included in the supervision on a consolidated basis of the *firm*, to issue a capital instrument described in 7.3.
- 7.5 When giving notice under 7.4, the *firm* shall provide:

(1) confirmation that the terms of the capital instrument have not changed since the previous issue by the *firm* of that type of capital instrument; and

(2) the items described in 7.2(1) and (3).

7.6 The *firm* shall notify the *PRA* in writing of any change to the intended date of issue, amount of issue, type of investors, type of *own funds instrument* or any other feature of the capital instrument to that previously notified to the *PRA* under 7.1 or 7.4.

8 NOTIFICATION REGIME - AMENDMENT

8.1 A *firm* shall notify the *PRA* in writing of its intention, or the intention of another member of its *group* that is not a *firm* but is included in the supervision on a consolidated basis of the *firm*, to amend or otherwise vary the terms of any *own funds instrument* included in its *own funds* or the *own funds* of its consolidated group at least thirty days before the intended date of such amendment or other variation.

9 NOTIFICATION REGIME – REDUCTION OF OWN FUNDS

9.1 A *firm* shall notify the *PRA* of its intention, or the intention of another member of its *group* that is not a *firm* but is included in the supervision on a consolidated basis of the *firm*, to carry out in respect of an *own funds instrument* any of the actions described in Article 77 of the *CRR*.

10 BUILDING SOCIETIES – CREDITOR HIERARCHY

10.1 This Chapter applies to every *firm* that is a *building society*.

10.2 A *firm* must ensure that any *Additional Tier 1 instrument* or *Tier 2 instrument* issued by it is contractually subordinated to its non-deferred shares.

11 TRANSITIONAL PROVISIONS FOR OWN FUNDS

11.1 The *Common Equity Tier 1 capital ratio* which *firms* must under Article 465(1)(a) of the *CRR* meet or exceed for the period from 1 January 2014 until 31 December 2014 shall be 4.0%.

[Note: Art 465(1)(a) of the CRR]

11.2 The *Tier 1 capital ratio* which *firms* must under Article 465(1)(b) of the *CRR* meet or exceed for the period from 1 January 2014 until 31 December 2014 shall be 5.5%.

[Note: Art 465(1)(b) of the CRR]

11.3 The applicable percentage for the purposes of Article 467(1) of the *CRR* shall be:

(1) 100% during the period from 1 January 2014 to 31 December 2014;

- (2) 100% during the period from 1 January 2015 to 31 December 2015;
- (3) 100% during the period from 1 January 2016 to 31 December 2016; and
- (4) 100% for the period from 1 January 2017 to 31 December 2017.

[Note: Art 467 of the CRR]

11.4 The applicable percentage for the purposes of Article 468(1) of the CRR shall be:

- (1) 0% during the period from 1 January 2015 to 31 December 2015;
- (2) 0% during the period from 1 January 2016 to 31 December 2016; and
- (3) 0% for the period from 1 January 2017 to 31 December 2017.

[Note: Art 468(1)-(3) of the CRR]

11.5 The applicable percentage for the purposes of Article 468(4) of the CRR shall be:

- (1) 100% for the period from 1 January 2014 to 31 December 2014;
- (2) 100% for the period from 1 January 2015 to 31 December 2015;
- (3) 100% for the period from 1 January 2016 to 31 December 2016; and
- (4) 100% for the period from 1 January 2017 to 31 December 2017.

[Note: Art 468(4), 478(1) of the CRR]

11.6 The applicable percentage for the purposes of Article 469(1)(a) of the CRR as it applies to the items referred to in points (a)-(b) and (d)-(h) of Article 36(1) shall be:

- (1) 100% during the period from 1 January 2014 to 31 December 2014;
- (2) 100% during the period from 1 January 2015 to 31 December 2015;
- (3) 100% during the period from 1 January 2016 to 31 December 2016; and
- (4) 100% for the period from 1 January 2017 to 31 December 2017.

[Note: Art 469(1)(a), 478(1) of the CRR]

11.7 The applicable percentage for the purposes of Article 469(1)(c) of the CRR as it applies to the items referred to in point (c) of Article 36(1) that existed prior to 1 January 2014 shall be:

- (1) 100% for the period from 1 January 2014 to 31 December 2014;
- (2) 100% for the period from 1 January 2015 to 31 December 2015;
- (3) 100% for the period from 1 January 2016 to 31 December 2016;

- (4) 100% for the period from 1 January 2017 to 31 December 2017;
- (5) 100% for the period from 1 January 2018 to 31 December 2018;
- (6) 100% for the period from 1 January 2019 to 31 December 2019;
- (7) 100% for the period from 1 January 2020 to 31 December 2020;
- (8) 100% for the period from 1 January 2021 to 31 December 2021;
- (9) 100% for the period from 1 January 2022 to 31 December 2022; and
- (10) 100% for the period from 1 January 2023 to 31 December 2023.

[Note: Art 469(1)(c), 478(2) of the CRR]

11.8 The applicable percentage for the purposes of Article 469(1)(c) of the *CRR* as it applies to the items referred to in point (c) of Article 36(1) that did not exist prior to 1 January 2014 and the items referred to in point (i) of Article 36(1) shall be:

- (1) 100% during the period from 1 January 2014 to 31 December 2014;
- (2) 100% during the period from 1 January 2015 to 31 December 2015;
- (3) 100% during the period from 1 January 2016 to 31 December 2016; and
- (4) 100% for the period from 1 January 2017 to 31 December 2017.

[Note: Art 469(1)(c), 478(1) of the CRR]

11.9 The applicable percentage for the purposes of Article 474(a) of the *CRR* shall be:

- (1) 20% during the period from 1 January 2014 to 31 December 2014;
- (2) 40% during the period from 1 January 2015 to 31 December 2015;
- (3) 60% during the period from 1 January 2016 to 31 December 2016; and
- (4) 80% for the period from 1 January 2017 to 31 December 2017.

[Note: Art 474(a), 478(1) of the CRR]

11.10 The applicable percentage for the purposes of Article 476(a) of the *CRR* shall be:

- (1) 20% during the period from 1 January 2014 to 31 December 2014;
- (2) 40% during the period from 1 January 2015 to 31 December 2015;
- (3) 60% during the period from 1 January 2016 to 31 December 2016; and
- (4) 80% for the period from 1 January 2017 to 31 December 2017.

[Note: Art 476(a), 478(1) of the CRR]

11.11 The applicable percentage for the purposes of Article 479(2) of the *CRR* shall be:

- (1) 0% for the period from 1 January 2014 to 31 December 2014;
- (2) 0% for the period from 1 January 2015 to 31 December 2015;
- (3) 0% for the period from 1 January 2016 to 31 December 2016; and
- (4) 0% for the period from 1 January 2017 to 31 December 2017.

[Note: Art 479 of the *CRR*]

11.12 The applicable factor for the purposes of Article 480(1) of the *CRR* as it applies to point (b) of Article 84(1) shall be:

- (1) 1 in the period from 1 January 2014 to 31 December 2014;
- (2) 1 in the period from 1 January 2015 to 31 December 2015;
- (3) 1 in the period from 1 January 2016 to 31 December 2016; and
- (4) 1 in the period from 1 January 2017 to 31 December 2017.

[Note: Art 480 of the *CRR*]

11.13 The applicable factor for the purposes of Article 480(1) of the *CRR* as it applies to point (b) of Article 85(1) and point (b) of Article 87(1) shall be:

- (1) 0.2 in the period from 1 January 2014 to 31 December 2014;
- (2) 0.4 in the period from 1 January 2015 to 31 December 2015;
- (3) 0.6 in the period from 1 January 2016 to 31 December 2016; and
- (4) 0.8 in the period from 1 January 2017 to 31 December 2017.

[Note: Art 480 of the *CRR*]

11.14 The applicable percentage for the purposes of Article 481(1) of the *CRR* shall be:

- (1) 0% for the period from 1 January 2014 to 31 December 2014;
- (2) 0% for the period from 1 January 2015 to 31 December 2015;
- (3) 0% for the period from 1 January 2016 to 31 December 2016; and
- (4) 0% for the period from 1 January 2017 to 31 December 2017.

[Note: Art 481 of the *CRR*]

11.15 The applicable percentage for the purposes of Article 486(2), (3) and (4) of the *CRR* shall be:

- (1) 80% for the period from 1 January 2014 to 31 December 2014;

- (2) 70% for the period from 1 January 2015 to 31 December 2015;
- (3) 60% for the period from 1 January 2016 to 31 December 2016;
- (4) 50% for the period from 1 January 2017 to 31 December 2017;
- (5) 40% for the period from 1 January 2018 to 31 December 2018;
- (6) 30% for the period from 1 January 2019 to 31 December 2019;
- (7) 20% for the period from 1 January 2020 to 31 December 2020; and
- (8) 10% for the period from 1 January 2021 to 31 December 2021.

[Note: Art 486 of the CRR]

12 BASE CAPITAL RESOURCES REQUIREMENT

- 12.1 A *CRR firm* must maintain at all times capital resources equal to or in excess of the base capital resources requirement set out in the table below:

<i>Firm category</i>	<i>Amount: Currency equivalent of</i>
<i>bank</i>	€5 million
<i>small specialist bank</i>	The higher of €1 million and £1 million
<i>building society</i>	The higher of €1 million and £1 million
<i>designated investment firm</i>	€730,000

Annex D

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

Part

BENCHMARKING OF INTERNAL APPROACHES

Chapter content

- 1 APPLICATION AND DEFINITIONS
- 2 SUPERVISORY BENCHMARKING OF INTERNAL APPROACHES FOR CALCULATING OWN FUNDS REQUIREMENTS

Links

1 APPLICATION AND DEFINITIONS

- 1.1 This Part applies to every *firm* that is a *CRR firm*.
- 1.2 Unless otherwise defined, any italicised expression used in this Part and in the *CRD* has the same meaning as in the *CRD*.

2 SUPERVISORY BENCHMARKING OF INTERNAL APPROACHES FOR CALCULATING OWN FUNDS REQUIREMENTS

- 2.1 Except for *operational risk*, a *firm* that is permitted to use *internal approaches* for the calculation of risk weighted exposure amounts or *own funds* requirements must report annually to the *PRA*:
- (1) the results of the calculations of their *internal approaches* for their exposures or positions that are included in the benchmark portfolios; and
 - (2) an explanation of the methodologies used to produce those calculations.
- 2.2 A *firm* shall submit the results of the calculations referred to in 2.1 above to the *PRA* and to *EBA* in accordance with the template set out in the Commission Regulation adopted under Article 78(8) of the *CRD*.

[Note: Art 78(1) and (2) of the *CRD*]

Annex E

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

Part

CREDIT RISK

Chapter content

- 1 APPLICATION AND DEFINITIONS
- 2 STANDARDISED APPROACH – TREATMENT OF EXPOSURES TO REGIONAL GOVERNMENTS
- 3 SECURITISATION – RECOGNITION OF SIGNIFICANT RISK TRANSFER
- 4 CRITERIA FOR CERTAIN EXPOSURES SECURED BY MORTGAGES ON COMMERCIAL IMMOVABLE PROPERTY
- 5 SETTLEMENT RISK

Links

1 APPLICATION AND DEFINITIONS

1.1 This Part applies to every *firm* that is a *CRR firm*.

1.2 In this Part, the following definitions shall apply:

exposure

means an asset or off-balance sheet item as defined for credit risk purposes by Article 5(1) of the *CRR*.

loss

means economic loss, including material discount effects, and material direct and indirect costs associated with collecting on the instrument as defined for credit risk purposes by Article 5(2) of the *CRR*.

1.3 Unless otherwise defined, any italicised expression used in this Part and in the *CRR* has the same meaning as in the *CRR*.

2 STANDARDISED APPROACH – TREATMENT OF EXPOSURES TO REGIONAL GOVERNMENTS

2.1 For the purposes of Article 115 of the *CRR*, a *firm* may treat *exposures* to the following regional governments as *exposures* to the *UK* central government:

- (1) The Scottish Parliament;
- (2) The National Assembly for Wales; and
- (3) The Northern Ireland Assembly.

[Note: Art 115 of the *CRR*]

3 SECURITISATION – RECOGNITION OF SIGNIFICANT RISK TRANSFER

3.1 A *firm* must notify the *PRA* that it is relying on the deemed transfer of significant credit risk under paragraph 2 of Article 243 of the *CRR* or paragraph 2 of Article 244 of the *CRR*, including when this is for the purposes of Article 337(5) of the *CRR*, no later than one month after the date of the transfer.

3.2 The notification in 3.1 must include sufficient information to allow the *PRA* to assess whether the possible reduction in risk weighted *exposure* amounts which would be achieved by the *securitisation* is justified by a commensurate transfer of credit risk to third parties.

4 CRITERIA FOR CERTAIN EXPOSURES SECURED BY MORTGAGES ON COMMERCIAL IMMOVABLE PROPERTY

- 4.1 For the purposes of Articles 124(2) and 126(2) of the *CRR* and in addition to the conditions set out therein, a *firm* may only treat *exposures* as fully and completely secured by mortgages on commercial immovable property located in the *UK* in accordance with Article 126 of the *CRR* where annual average *losses* stemming from lending secured by mortgages on commercial property located in the *UK* did not exceed 0.5% of risk-weighted exposure amounts over a representative period. A firm shall calculate the *loss* level referred to in this rule on the basis of the aggregate market data for commercial property lending published by the *PRA* in accordance with Article 101(3) of the *CRR*.
- 4.2 For the purposes of this rule, a representative period shall be a time horizon of sufficient length and which includes a mix of good and bad years.

[Note: Arts. 124(2) and 126(2) of the *CRR*]

5 SETTLEMENT RISK

- 5.1 In accordance with Article 380 of the *CRR*, where a system wide failure of a settlement system, a clearing system or a *CCP* occurs, the *own funds* requirements calculated as set out in Articles 378 and 379 of the *CRR* are waived until the situation is rectified. In this case, the failure of a counterparty to settle a trade shall not be deemed a default for purposes of credit risk.

[Note: Art. 380 of the *CRR*]

Annex F

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

Part

COUNTERPARTY CREDIT RISK

Chapter content

- 1 APPLICATION AND DEFINITIONS
- 2 HEDGING SETS
- 3 RECOGNITION OF NETTING: INTEREST RATE DERIVATIVES

Links

1 APPLICATION AND DEFINITIONS

1.1 This Part applies to every *firm* that is a *CRR firm*.

1.2 In this Part the following definitions shall apply:

CCR Mark-to-Market method

means the method set out in in Chapter Six, Section 3 of the *CRR*.

interest-rate contract

means an interest rate contract of a type listed in paragraph 1 of Annex II of the *CRR*.

1.3 Unless otherwise defined, any italicised expression used in this Part and in the *CRR* has the same meaning as in the *CRR*.

2 HEDGING SETS

2.1 For the purpose of Article 282(6) of the *CRR*, a *firm* must apply the *CCR Mark-to-Market method* to:

(a) *transactions* with a non-linear risk profile; or

(b) *payment legs* and *transactions* with debt instruments as underlying

for which it cannot determine the delta or modified duration, as the case may be, using an internal model approved by the *PRA* under Title IV of the *CRR* for the purposes of determining *own funds* requirements for *market risk*.

2.2 For the purposes of 2.1, a *transaction* means a transaction to which Chapter Six of the *CRR* applies.

3 RECOGNITION OF NETTING: INTEREST RATE DERIVATIVES

3.1 For the purpose of Article 298(4) of the *CRR*, a *firm* must use the original maturity of the *interest-rate contract*.

Annex G

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

Part

MARKET RISK

Chapter content

- 1 APPLICATION AND DEFINITIONS
- 2 USE OF INTERNAL MODELS: RISK CAPTURE
- 3 NETTING: CONVERTIBLE BONDS
- 4 INSTRUMENTS FOR WHICH NO TREATMENT SPECIFIED

Links

1 APPLICATION AND DEFINITIONS

1.1 This Part applies to every *firm* that is a *CRR firm*.

1.2 In this Part the following definitions shall apply:

convertible bond

means a *security* which gives the investor the right to convert the security into a *share* at an agreed price on an agreed basis.

equity

means a *share*.

security

has the meaning specified in Article 3(1) of the *Regulated Activities Order*.

share

means the investment specified in Article 76 of the *Regulated Activities Order*.

1.3 Unless otherwise defined, any italicised expression used in this Part and defined in the *CRR* has the same meaning as in the *CRR*.

2 USE OF INTERNAL MODELS: RISK CAPTURE

2.1 A *firm* which has a permission to use internal models in accordance with Title IV, Chapter 5 of the *CRR*:

- (a) must identify any material risks, or risks that when considered in aggregate are material, which are not captured by those models; and
- (b) must ensure that it holds *own funds* to cover those risk(s) in addition to those required to meet its *own funds* requirement calculated in accordance with Title IV, Chapter 5 of the *CRR*.

3 NETTING: CONVERTIBLE BONDS

3.1 For the purposes of Article 327(2) of the *CRR*, the netting of a *convertible bond* and an offsetting position in the instrument underlying is permitted. The *convertible bond shall* be:

- (a) treated as a position in the *equity* into which it converts; and

- (b) the *firm's own funds* requirement for the general and specific risk in its *equity* instruments shall be adjusted by making:
- (i) an addition equal to the current value of any loss which the *firm* would make if it did convert to *equity*; or
 - (ii) a deduction equal to the current value of any profit which the *firm* would make if it did convert to *equity* (subject to a maximum deduction equal to the *own funds* requirements on the notional position underlying the *convertible bond*).

4 INSTRUMENTS FOR WHICH NO TREATMENT SPECIFIED

- 4.1 Where a *firm* has a position in a *financial instrument* for which no treatment has been specified in the *CRR*, it must calculate its *own funds* requirement for that position by applying the most appropriate *rules* relating to positions that are specified in the *CRR*, if doing so is prudent and appropriate, and if the position is sufficiently similar to those covered by the relevant *rules*.
- 4.2 A *firm* must document its policies and procedures for calculating own funds for such positions in its *trading book policy statement*.
- 4.3 If there are no appropriate treatments the *firm* must calculate an *own funds* requirement of an appropriate percentage of the current value of the position. An appropriate percentage is either 100%, or a percentage that takes into account the characteristics of the position.
- 4.4 For the purposes of this rule, *trading book policy statement* means the statement of policies and procedures relating to the *trading book*.

Annex H

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

Part

GROUPS

Chapter content

- 1 APPLICATION AND DEFINITIONS
- 2 METHODS OF PRUDENTIAL CONSOLIDATION

Links

1 APPLICATION AND DEFINITIONS

1.1 This Part applies to every *firm* that is a *CRR firm*.

1.2 In this Part the following definitions shall apply:

Article 12(1) relationship

means a relationship where undertakings are linked by a relationship within the meaning of Article 12(1) of Directive 83/349 EEC.

Article 18(5) relationship

means a relationship where undertaking are linked by participations or capital ties other than those referred to in paragraphs (1) and (2) of Article 18 of the *CRR*.

Article 18(6) relationship

means a relationship of one of the following kinds:

- (a) where an *institution* exercises a significant influence over one or more *institutions* or *financial institutions*, but without holding a *participation* or other capital ties in these *institutions*; or
- (b) where two or more *institutions* or *financial institutions* are placed under single management other than pursuant to a contract or clauses of their memoranda or articles of association.

1.3 Unless otherwise defined:

- (1) any italicised expression used in this Part and in the *CRR* has the same meaning as in the *CRR*; and
- (2) any italicised expression used in this Part and in the *CRD* has the same meaning as in the *CRD*.

2 METHODS OF PRUDENTIAL CONSOLIDATION

2.1 (1) In carrying out the calculations in (Part One, Title II, Chapter 2 of the *CRR*) for the purposes of prudential consolidation, a *firm* must include the relevant proportion of an undertaking with whom it has an:

(a) *Article 12(1) relationship*; or

(b) *Article 18(6) relationship*.

(2) In 2.1(1), the relevant proportion is such proportion (if any) as stated in a requirement imposed on the *firm* in accordance with section 55M of *FSMA*.

[Note: Art 18(3) and (6) of the *CRR*]

- 2.2 In carrying out the calculations in Part One, Title II, Chapter 2 of the *CRR* for the purposes of prudential consolidation, a *firm* (for which the *PRA* is the *consolidating supervisor*) must include the proportion of the share of capital held of *participations* in *institutions* and *financial institutions* managed by an undertaking included in the consolidation together with one or more undertakings not included in the consolidation, where those undertakings' liability is limited to the share of capital they hold.

[Note: Art 18(4) of the *CRR*]

- 2.3 In carrying out the calculations in Part One, Title II, Chapter 2 of the *CRR* for the purposes of prudential consolidation, a *firm* must carry out a full consolidation of any undertaking with whom it has an *Article 18(5) relationship*.

[Note: Art 18(5) of the *CRR*]

Annex I

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

Part

LARGE EXPOSURES

Chapter content

- 1 APPLICATION AND DEFINITIONS
- 2 INTRA-GROUP EXPOSURES: NON-CORE LARGE EXPOSURES GROUP EXEMPTIONS
- 3 SOVEREIGN LARGE EXPOSURES EXEMPTION
- 4 CONDITIONS FOR THE NON-CORE LARGE EXPOSURES GROUP EXEMPTION AND THE SOVEREIGN LARGE EXPOSURES EXEMPTION

1 APPLICATION AND DEFINITIONS

1.1 This Part applies to every *firm* that is a *CRR firm*.

1.2 In this Part the following definitions shall apply:

core UK group

means all counterparties that:

- (a) are listed in a *firm's core UK group permission*;
- (b) in relation to a *firm*, satisfy the conditions in Article 113(6) of the *CRR*; and
- (c) in respect of which *exposures* are exempted, under Article 400(1)(f) of the *CRR*, from the application of Article 395(1) of the *CRR*.

core UK group eligible capital

means the sum of the following amounts for each member of the *core UK group* and the *firm* (the sub-group):

- (a) for the ultimate *parent undertaking* of the sub-group, the amount calculated in accordance with Article 6 of the *CRR* (or other applicable prudential requirements);
- (b) for any other member of the sub-group, the amount calculated in accordance with Article 6 of the *CRR* (or other applicable prudential requirements) less the book value of the sub-group's holdings of capital instruments in that member, to the extent not already deducted in calculations done in accordance with Article 6 of the *CRR* (or other applicable prudential requirements) for:
 - (i) the ultimate *parent undertaking* of the sub-group; or
 - (ii) any other member of the sub-group.

The deduction in (b) must be carried out separately for each type of capital instrument eligible as *own funds*.

core UK group permission

means a permission given by the *PRA* under Article 113(6) of the *CRR*.

exposure

has the meaning given to it in Article 389 of the *CRR*.

non-core large exposures group or NCLEG

means all counterparties that:

- (a) are listed in a *firm's NCLEG non-trading book permission* or *NCLEG trading book permission*; and
- (b) in relation to a *firm*, satisfy the conditions in 2.1 or 2.2.

NCLEG non-trading book exemption

means the exemption in 2.1.

NCLEG non-trading book permission

means a permission given by the *PRA* in respect of Article 400(2)(c) of the *CRR* to apply the *NCLEG non-trading book exemption*.

NCLEG trading book exemption

means the exemption in 2.2.

NCLEG trading book permission

means a permission given by the *PRA* in respect of Article 400(2)(c) of the *CRR* to apply the *NCLEG trading book exemption*.

sovereign large exposures exemption

means the exemption in 3.1.

sovereign large exposures permission

means a permission given by the *PRA* in respect of Article 400(2)(g) or (h) of the *CRR* to apply the *sovereign large exposures exemption*.

trading book exposure allocation

means the allocation in 2.2

1.3 Unless otherwise defined:

- (1) any italicised expression used in this Part and in the *CRR* has the same meaning as in the *CRR*; and
- (2) any italicised expression used in this Part and in the *CRD* has the same meaning as in the *CRD*.

2 INTRA-GROUP EXPOSURES: NON-CORE LARGE EXPOSURES GROUP EXEMPTIONS

NCLEG non-trading book exemption

2.1 (1) A *firm* with an *NCLEG non-trading book permission* may (in accordance with that permission) exempt, from the application of Article 395(1) of the *CRR*, *non-trading book exposures*, including participations or other kinds of holdings, incurred by the *firm* to members of its *NCLEG* that are:

- (a) its *parent undertaking*;
- (b) other *subsidiaries* of that *parent undertaking*; or
- (c) its own *subsidiaries*,

in so far as those undertakings are covered by the supervision on a *consolidated basis* to which the *firm* itself is subject, in accordance with the *CRR*, Directive 2002/87/EC or with equivalent standards in force in a third country.

(2) A *firm* may only use the *NCLEG non-trading book exemption* where:

(a) the total amount of *non-trading book exposures* (whether or not exempted from Article 395(1) of the *CRR*) from the *firm* to its *NCLEG* does not exceed 100% of the *firm's eligible capital*; or

(b) (if the *firm* has a *core UK group permission*) the total amount of *non-trading book exposures* (whether or not exempted from Article 395(1) of the *CRR*) from its *core UK group* (and the *firm*) to its *NCLEG* does not exceed 100% of the *core UK group eligible capital*.

A *firm* may calculate the total amount of such *exposures* after taking into account the effect of credit risk mitigation in accordance with Articles 399 to 403 of the *CRR*.

[Note: Art 400(2)(c) of the CRR]

NCLEG trading book exemption

2.2 (1) A *firm* with an *NCLEG trading book permission* may (in accordance with that permission) exempt, from the application of Article 395(1) of the *CRR*, *trading book exposures* up to its *trading book exposure allocation*, including *participations* or other kinds of holdings, incurred by the *firm* to members of its *NCLEG* that are:

- (a) its *parent undertaking*;
- (b) other *subsidiaries* of that *parent undertaking*; or
- (c) its own *subsidiaries*,

in so far as those undertakings are covered by the supervision on a *consolidated basis* to which the *firm* itself is subject, in accordance with the *CRR*, Directive 2002/87/EC or with equivalent standards in force in a third country;

(2) The *trading book exposure allocation* for a *firm* that does not have a *core UK group permission* is 100% of the *firm's eligible capital* less the total amount of *non-trading book exposures* (whether or not exempted from Article 395(1) of the *CRR*) from the *firm* to its *NCLEG*.

(3) The *trading book exposure allocation* for a *firm* (F) that has a *core UK group permission* is equal to RxTTBE where:

- (a) R is F's *trading book exposures* to its *NCLEG* divided by the total *trading book exposures* of the *core UK group* (and F) to F's *NCLEG*; and
- (b) TTBE is 100% of F's *core UK group eligible capital* less the total amount of *non-trading book exposures* (whether or not exempted from Article 395(1) of the *CRR*) from the *core UK group* (and F) to F's *NCLEG*.

(4) A firm may calculate its *trading book exposure allocation* after taking into account the effect of credit risk mitigation in accordance with Articles 399 to 403 of the *CRR*.

(5) A firm must allocate the *trading book exposures* it has to its *NCLEG* to its *trading book exposure allocation* in ascending order of specific-risk requirements in Part Three, Title IV, Chapter 2 and/or requirements in Article 299 and Part Three, Title V of the *CRR*.

[Note: Art 400(2)(c) of the *CRR*]

Notifications and reporting

2.3 (1) A firm with a *core UK group permission* and an *NCLEG trading book permission* or an *NCLEG non-trading book permission* must give the *PRA* written notice whenever the firm:

- (a) intends, or becomes aware that a member of its *core UK group* intends, for the total amount of *exposures* from the *core UK group* (and the firm) to a particular member of the firm's *NCLEG* to exceed 25% of its *core UK group eligible capital*;
- (b) becomes aware that the total amount of *exposures* from the *core UK group* (and the firm) to a particular member of the firm's *NCLEG* are likely to exceed, or have exceeded, 25% of its *core UK group eligible capital*;

(2) The written notice required under (1) must contain the following:

- (a) details of the size and the expected duration of the relevant *exposures*; and
- (b) an explanation of the reason for those *exposures*.

(3) A firm with a *core UK group permission* and an *NCLEG trading book permission* or an *NCLEG non-trading book permission* must submit FSA018 in accordance with SUP 16.12.

3 SOVEREIGN LARGE EXPOSURES EXEMPTION

3.1 (1) If a firm has a *sovereign large exposures permission*, the *exposures* specified in that permission are exempt from Article 395(1) of the *CRR* to the extent specified in that permission.

(2) For the purposes of the *sovereign large exposures permission*, and in relation to a firm, the *exposures* referred to in (1) are limited to the following:

- (a) asset items constituting claims on *central banks* in the form of required minimum reserves held at those *central banks* which are denominated in their national currencies; and
- (b) asset items constituting claims on central governments in the form of statutory liquidity requirements held in government securities which are denominated

and funded in their national currencies provided that, at the discretion of the *PRA*, the credit assessment of those central governments assigned by a *nominated ECAI* is investment grade.

[Note: Art 400(2)(g)-(h) of the *CRR*]

4 CONDITIONS FOR NON-CORE LARGE EXPOSURES GROUP EXEMPTIONS AND THE SOVEREIGN LARGE EXPOSURES EXEMPTION

4.1 A *firm* may only use the *NCLEG non-trading book exemption*, the *NCLEG trading book exemption* or the *sovereign large exposures exemption* where it can demonstrate to the *PRA* that the following conditions are met:

- (1) the specific nature of the *exposure*, the counterparty or the relationship between the *firm* and the counterparty eliminate or reduce the risk of the *exposure*; and
- (2) any remaining concentration risk can be addressed by other equally effective means such as the arrangements, processes and mechanisms provided for in Article 81 of *CRD*.

[Note: Art 400(3) of the *CRR*]

Annex J

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

Part

PUBLIC DISCLOSURE

Chapter content

- 1 APPLICATION AND DEFINITIONS
- 2 PUBLIC DISCLOSURE OF RETURN ON ASSETS

Links

1 APPLICATION AND DEFINITIONS

1.1 This Part applies to every *firm* that is a *CRR firm*.

1.2 In this Part the following definitions shall apply:

annual report and accounts

- (1) (in relation to a company incorporated in the *UK*) an annual report and annual accounts as those terms are defined in:
 - (a) section 262(1) of the Companies Act 1985, together with an auditor's report prepared in relation to those accounts under section 235 of the same Act where these provisions are applicable; or
 - (b) section 471 of the Companies Act 2006 together with an auditor's report prepared in relation to those accounts under sections 495 to 497 of the same Act;
- (2) (in relation to any other body) any similar or analogous documents which it is required to prepare whether by its constitution or by the law under which it is established.

2 PUBLIC DISCLOSURE OF RETURN ON ASSETS

2.1 A *firm* must disclose in its *annual report and accounts* among the key indicators their return on assets, calculated as their net profit divided by their total balance sheet.

[Note: Art 90 of the CRD]

Annex K

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

Part

WAIVERS TRANSITIONAL PROVISIONS

Chapter content

- 1 APPLICATION AND DEFINITIONS
- 2 WAIVERS TRANSITIONAL PROVISIONS
- 3 SCHEDULES

Links

1 APPLICATION AND DEFINITIONS

1.1 This Part applies to every *firm* that is a *CRR firm*.

1.2 In this Part the following definitions shall apply:

CRR permission

means a permission given to a *firm* by the *PRA* under any *CRR Article* listed in column B of the Tables in Schedules 1 and 2 in the exercise of the discretion afforded to it as a *competent authority*.

Waiver

means a direction waiving or modifying a rule given by the *PRA* under section 138A (waiver or modification of rules) *FSMA*.

1.3 Unless otherwise defined, any italicised expression used in this Part and in the *CRR* has the same meaning as in the *CRR*.

2 WAIVERS TRANSITIONAL PROVISIONS

- 2.1 (1) This rule applies where, immediately before 1 January 2014, a *waiver* given in relation to a rule listed in column A of the Tables in Schedules 1 and 2 and any condition relevant to the application of that waiver has effect.
- (2) Subject to paragraph (5), each *waiver* given in relation to a *PRA* rule listed in column A of the Tables in Schedules 1 and 2 is treated as a *CRR permission* given by the *PRA* to the *firm* under the *CRR Article* listed in the same row in column B of the Table.
- (3) Each *CRR permission* given in accordance with paragraph (2) shall continue to have effect until the expiry date specified in the *waiver*.
- (4) Where a *waiver* listed in Schedules 1 and 2 specifies that it applies to a *firm* on a consolidated basis in accordance with a relevant provision in *BIPRU* 8, the *CRR permission* shall apply to the *firm* on the basis of its *consolidated situation* in accordance with Article 11 of the *CRR*.
- (5) Paragraphs (1) to (4) only have effect in relation to a *waiver* listed in Schedule 1 where the *firm* has confirmed to the *PRA* that it materially complies with the requirements relevant to the *rules* listed in Column A of the Table, as waived or modified by the *waiver*, and any conditions relevant to the application of the *waiver* or the *firm* has a *remediation plan*.
- (6) Any condition relevant to the application of the waiver shall have effect on 1 January 2013 until the expiry date specified in the waiver.
- (7) A *waiver* listed in row 1 of the Table in Schedule 2 (individual consolidation method) only includes a deemed *waiver* under the *PRA's* prudential sourcebook for Banks, Building Societies and Investment Firms transitional provision 22.3R where a *firm* has confirmed to the *PRA* that the solo consolidation minimum standards are met with respect to the relevant *subsidiary undertaking*.

- 2.2 (1) This rule applies where, immediately before 1 January 2014, a *waiver* given in relation to a *rule* in the PRA's supervision manual listed in column A of the Table in Schedule 3 has effect.
- (2) Each *waiver* given in relation to a *rule in the PRA's supervision manual* listed in column A of the Table in Schedule 3 is to be treated as a *waiver* given by the PRA to the *firm* under the *SUP rule* listed in the same row in column B of the Table.

SCHEDULES

Schedule 1

Internal model waivers

	CRR Permission	Column A PRA/FCA Rule (rule waiver or modification)	Column B CRR Reference
1	Internal Ratings Based (IRB) permission for credit risk	<ul style="list-style-type: none"> - <i>BIPRU 4</i> applies to a <i>firm</i> with an <i>IRB permission</i> - Rules waived or modified: <ul style="list-style-type: none"> (a) <i>GENPRU 2.1.51R</i> (b) <i>BIPRU 3.1.1R</i> 	<ul style="list-style-type: none"> - Part Three, Title II, Chapter 3 - Art. 143 - Art. 178.1(b) (where a <i>firm</i> is authorised by its <i>IRB waiver</i> to use a 180 days definition of default for exposures secured by residential real estate in the retail exposure class, as well as for exposures to public sector entities)
2	Eligibility of physical collateral under the IRB Approach	<ul style="list-style-type: none"> - <i>BIPRU 4.10.16R</i> (Where authorised by the <i>firm's IRB permission</i>) 	Art. 199.6
3	Master netting agreement internal models approach	<ul style="list-style-type: none"> - <i>BIPRU 5.6.1R</i> in accordance with <i>BIPRU 5.6.12R</i> 	Art. 221
4	Supervisory formula method for securitisation transactions	<ul style="list-style-type: none"> - <i>BIPRU 9.12.3R</i> - <i>BIPRU 9.12.5R</i> - <i>BIPRU 9.12.21R</i> (Where authorised by the <i>firm's IRB permission</i>) 	Art. 259.1(b) Art. 262
5	ABCP internal assessment approach	<ul style="list-style-type: none"> - <i>BIPRU 9.12.20R</i> (Where authorised by the <i>firm's IRB permission</i>) 	Art. 259.3
6	Exceptional treatment for liquidity facilities where pre-securitisation RWEA cannot be calculated	<ul style="list-style-type: none"> - <i>BIPRU 9.11.10R</i> as modified in accordance with <i>BIPRU 9.12.28G</i> (Where authorised by the <i>firm's IRB permission</i>) 	Art. 263.2
7	Advanced Measurement Approach (AMA) permission	<ul style="list-style-type: none"> - <i>BIPRU 6.5</i> applies to a <i>firm</i> with an <i>AMA permission</i> 	<ul style="list-style-type: none"> - Art. 312.2 - Part Three, Title III,

		- <i>Rule waived or modified: BIPRU 6.2.1R</i>	Chapter 4
8	Combined use of different approaches for operational risk – AMA and standardised approach or basic indicator approach	- <i>BIPRU 6.2.9R (in accordance with BIPRU 6.2.10G and the firm's AMA permission)</i>	Art. 314, par. 2 and 3
9	Permission to use internal models to calculate own funds requirements for market risk (Value at Risk)	- <i>BIPRU 7.10 applies to a firm with a VaR model permission</i> - <i>Standard market risk PRR rules as specified and waived or modified by the firm's VaR model permission waiver</i> - <i>GENPRU 2.1.52R</i>	- Art. 363 - Part Three; Title IV; Chapter 5; Sections 2, 3 and 4
10	Permission to use internal models to calculate own fund requirements for the correlation trading portfolio	- <i>BIPRU 7.10.55T R to BIPRU 7.10.55ZA R</i> (Where the <i>firm</i> is authorised to use the <i>all price risk measure</i> in its <i>VaR model permission waiver</i>)	Art. 377

Schedule 2

Other Waivers and Requirements

	CRR Permission	Column A PRA/FCA Rule (rule waiver or modification)	Column B CRR Reference
1	Individual consolidation method	- <i>BIPRU 2.1.7R</i> (<i>Solo consolidation waivers</i>)	Art. 9
2	Application of requirements of Part Five (exposures to transferred credit risk) on a consolidated basis	- <i>BIPRU 9.15.16A R</i>	Art. 14.3
3	Entities excluded from the scope of prudential consolidation	- <i>BIPRU 8.5.9R</i> - <i>BIPRU 8.5.10R</i>	Art. 19.2
4	Permission to revert to the use of a less sophisticated approach for credit risk	- <i>BIPRU 4.2.23R</i> (as modified in accordance with <i>BIPRU 4.2.25G</i>) - <i>BIPRU 4.2.24R</i> (as modified in accordance with <i>BIPRU 4.2.25G</i>)	Art. 149
5	Traditional securitisation – recognition of significant risk transfer	- <i>BIPRU 9.4.11R</i> - <i>BIPRU 9.4.12R</i> (subject to conditions in <i>BIPRU 9.4.15D</i>)	Art. 243 par. 2, 3, 4 and 5
6	Synthetic securitisation – recognition of significant risk transfer	- <i>BIPRU 9.5.1R</i> (6) and(7) (subject to conditions in <i>BIPRU 9.5.1B D</i>)	Art. 244, par. 2, 3, 4 and 5
7	Securitisations of revolving exposures with early amortisation provisions – similar transactions	- <i>BIPRU 9.13.11R</i> - <i>BIPRU 9.13.13R</i> - <i>BIPRU 9.13.14R</i> - <i>BIPRU 9.13.15R</i> - <i>BIPRU 9.13.16R</i> - <i>BIPRU 9.13.17R</i> (subject to conditions in <i>BIPRU 9.13.18G</i>)	Art. 256.7
8	Permission to revert to the use of a less sophisticated approach for operational risk	- <i>BIPRU 6.2.5R</i> (as modified in accordance with <i>BIPRU 6.2.6G</i>) - <i>BIPRU 6.2.7R</i> (as modified in accordance with <i>BIPRU 6.2.8G</i>)	Art. 313
9	Combined use of different approaches for operational risk	- <i>BIPRU 6.2.12R</i> (as modified in accordance with <i>BIPRU 6.2.13G</i>)	Art. 314.4

	– standardised approach and basic indicator approach		
10	Waiver of the 3 year average for calculating the own funds requirement under the basic indicator approach for operational risk	- <i>BIPRU 6.3.2R</i> (as modified in accordance with <i>BIPRU 6.3.9G</i>)	Art. 315
11	Waiver of the 3 year average for calculating the own funds requirement under the standardised approach for operational risk	- <i>BIPRU 6.4.5R</i> (as modified in accordance with <i>BIPRU 6.4.8G</i>)	Art. 317.4
12	Own funds requirements for position risk for options and warrants on: (a) interest rates; (b) debt instruments; (c) equities; (d) equity indices; (e) financial futures; (f) swaps; and (g) foreign currencies	- <i>BIPRU 7.9</i> applies to a <i>firm</i> with a <i>CAD1 model waiver</i> . - <i>Rules waived or modified:</i> (a) <i>GENPRU 2.1.52R</i> (b) <i>BIPRU 7.6.1R</i>	Art. 329
13	Own funds requirements for commodities risk for options and warrants on: (a) commodities; and (b) commodities derivatives	- <i>BIPRU 7.9</i> applies to a <i>firm</i> with a <i>CAD1 model waiver</i> . - <i>Rules waived or modified:</i> (a) <i>GENPRU 2.1.52R</i> (b) <i>BIPRU 7.4.1R</i>	Art. 358.3
14	Interest rate risk on derivative instruments	- <i>CAD1 model waiver</i> for the use of an interest rate pre-processing model in accordance with <i>BIPRU 7.9.44G</i> - <i>Rule waived: GENPRU 2.1.52R</i>	Art. 331 Art. 340
15	Waiver of 100% large exposure limit where the €150 million limit applies	- <i>BIPRU 10.6.32R</i> – As waived in accordance with <i>BIPRU 10.6.33G</i> - <i>SUP 15.3.11R</i>	- Art. 396 in relation to the 100% large exposure limit set out in Art. 395(1)
16	Waiver of large exposure limits in relation to intra-group exposures: core group waivers	- <i>BIPRU 3.2.25R(2)</i> - <i>BIPRU 10.8A</i>	Art. 113.6 Art. 400.1(f)
17	Waiver of large exposure limits in relation to intra-group exposures: non-core group waivers	- <i>BIPRU 10.9A</i>	- Art. 400.2(c) as implemented by rule 2 at Annex I of the PRA Rulebook CRR Firms

			Instrument 2013
18	Waiver of large exposure limits in relation to sovereign exposures	- BIPRU 10.6.34R as waived in accordance with BIPRU 10.6.37G	- Art. 400.2(g) and (h) as implemented by rule 3 at Annex I of the PRA Rulebook CRR Firms Instrument 2013

Schedule 3**Waivers in Supervision Manual (SUP) 16**

Column A SUP 16 rule as in force until 31 December 2013	Column B SUP 16 rule as in force from 1 January 2014
SUP 16.12.11R	SUP 16.12.11B R
SUP 16.12.12. R	SUP 16.12.12A R
SUP 16.12.15 R	SUP 16.12.15B R
SUP 16.12.16 R	SUP 16.12.16A R
SUP 16.12.22A R	SUP 16.12.22C R
SUP 16.12.25A R	SUP 16.12.25C R
SUP 16.12.26 R	SUP 16.12.26A R

Annex L

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

Part

INTERPRETATION

Chapter content

- 1 APPLICATION**
- 2 INTERPRETATIVE PROVISIONS**

Links

1 APPLICATION

- 1.1 This Part applies to a *firm*.

2 INTERPRETATIVE PROVISIONS

Purposive interpretation

- 2.1 Every provision in the *PRA* Rulebook must be interpreted in the light of its purpose.

Use of defined expressions

- 2.2 In the *PRA* Rulebook, save as otherwise indicated in a Part of the *PRA* Rulebook, an expression in italics defined:

- (1) in the *PRA* Rulebook Glossary has the meaning given in that glossary;
- (2) for the purposes of *FSMA* has the meaning given in that Act;
- (3) in the Interpretation Act 1978 has the meaning given in that Act.

Application of the Interpretation Act 1978

- 2.3 Save as otherwise indicated, the Interpretation Act 1978 applies to the *PRA* Rulebook.

Cross-references in the *PRA* Rulebook

- 2.4 A reference in the *PRA* Rulebook to another provision in the *PRA* Rulebook is a reference to that provision as amended from time to time.

Activities covered by rules

- 2.5 In the *PRA* Rulebook, a rule made by the *PRA* under section 137G of *FSMA* applies to a *firm* with respect to the carrying on of any activities, except to the extent that a contrary intention appears.

Continuity of authorised partnerships and unincorporated associations

- 2.6 If a *firm* is dissolved, but its authorisation continues to have effect under section 32 (Partnerships and unincorporated associations) of *FSMA* in relation to any partnership or unincorporated association that succeeds to the business of the dissolved *firm*, the successor partnership or unincorporated association is to be regarded as the same *firm* for the purposes of the *PRA* Rulebook unless the context otherwise requires.

Annex M

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

Part

PERMISSIONS

Chapter content

- 1 APPLICATION AND DEFINITIONS**
- 2 FORM AND MANNER OF APPLICATION FOR A CRR PERMISSION**
- 3 NOTIFICATION OF ALTERED CIRCUMSTANCES**

Links

1 APPLICATION AND DEFINITIONS

1.1 This Part applies to every firm that is a *CRR firm*.

1.2 In this Part the following definitions shall apply:

CRR permission

means a permission given to a *firm* by the *PRA* under powers conferred on the *PRA* by the *CRR*.

1.3 Unless otherwise defined, any italicised expression used in this Part and in the *CRR* has the same meaning as in the *CRR*.

2 FORM AND MANNER OF APPLICATION FOR A CRR PERMISSION

2.1 The *PRA* directs that a *firm* wishing to apply for a *CRR permission* must make a written application to the *PRA*.

2.2 The application must be accompanied by such information and documents as are necessary to demonstrate how the firm complies with the conditions contained in the relevant *CRR* Article.

3 NOTIFICATION OF ALTERED CIRCUMSTANCES

3.1 A *firm* that has applied for or has been granted a *CRR permission* must notify the *PRA* immediately if it becomes aware of any matter which could affect the continuing relevance or appropriateness of the application, the *CRR permission* or any condition to which the *CRR permission* is subject.

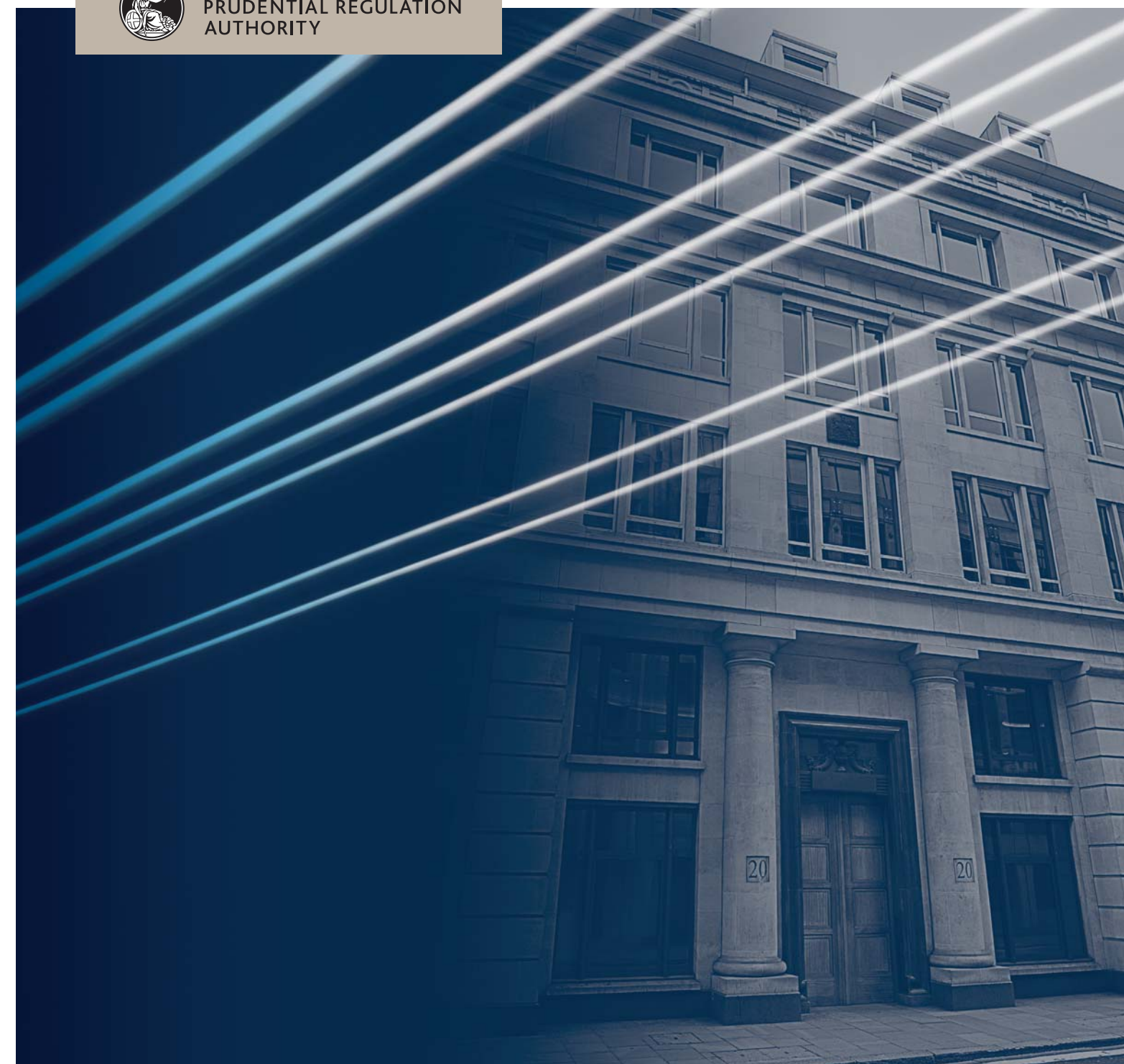
Supervisory Statement | SS5/13

The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)

December 2013



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS5/13

The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)

December 2013

1 Introduction

1.1 This supervisory statement is aimed at firms to which CRD IV⁽¹⁾ applies.

1.2 The purpose of this supervisory statement is to set out the expectations that the Prudential Regulation Authority (PRA) has in relation to the Internal Capital Adequacy Assessment Process (ICAAP) and the requirements set out in the PRA Rulebook in the Internal Capital Adequacy Assessment rules.

1.3 It provides further detail in relation to the high-level expectations outlined in *The PRA's approach to banking supervision*.⁽²⁾

1.4 The PRA will review a firm's ICAAP as part of its Supervisory Review and Evaluation Process (SREP), and this supervisory statement also sets out some of the factors that the PRA will take into consideration during the SREP.

1.5 In addition, this supervisory statement sets out the PRA's expectations with regard to firms' coverage and treatment of interest rate risk arising in the non-trading book, group risk and operational risk.

2 Expectations of firms undertaking an ICAAP

2.1 A firm must carry out an ICAAP in accordance with the PRA's ICAAP rules. These include requirements on the firm to undertake a regular assessment of the amounts, types and distribution of capital that it considers adequate to cover the level and nature of the risks to which it is or might be exposed. This assessment should cover the major sources of risks to the firm's ability to meet its liabilities as they fall due and incorporate stress testing and scenario analysis. The ICAAP should be documented and updated annually by the firm 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.

2.2 The PRA expects firms in the first instance to take responsibility for ensuring that the capital they have is adequate, with the ICAAP being an integral part of meeting this expectation. The PRA expects the ICAAP to be the responsibility of a firm's governing body, that it is reviewed and signed off by the governing body, and that it is used as an integral part of the firm's management process and decision-making culture. The processes and systems used to produce the ICAAP should ensure that the assessment of the adequacy of a firm's financial resources is reported to its governing body and senior management as often as is necessary.

2.3 The ICAAP, and internal processes and systems supporting it, should be proportionate to the nature, scale and complexity of the activities of a firm, as set out in Internal Capital Adequacy Assessment 3.3 in the PRA's Rulebook. Where a firm has identified risks as not being material, it should be able to provide evidence of the assessment process that determined this and discuss why that conclusion has been reached.

2.4 Liquidity risk should also be assessed, including in relation to potential losses arising from the liquidation of assets and increases in the cost of funding during periods of stress. The requirements in relation to liquidity risk may be found in BIPRU 12.

2.5 As outlined in the supervisory statement on stress testing, the PRA expects firms to develop a framework for stress testing, scenario analysis and capital management that captures the full range of risks to which they are exposed and enables these risks to be assessed against a range of plausible yet severe scenarios. The ICAAP should outline how stress testing supports capital planning for the firm.

2.6 Where a firm uses a model to aid its assessment of the level of adequate capital, it should be appropriately conservative and should contribute to prudent risk management and measurement. The firm should expect the PRA to investigate the structure, parameterisation and governance of the model, and the PRA will seek reassurance that the firm understands the attributes, outputs and limitations of the model, and that it has the appropriate skills and expertise to operate, maintain and develop the model.

3 The SREP

3.1 The SREP is a process by which the PRA will, taking into account the nature, scale and complexity of a firm's activities:

- review the arrangements, strategies, processes and mechanisms implemented by a firm to comply with its regulatory requirements laid down in PRA rules and the CRR;
- evaluate the risks to which the firm is or might be exposed;
- assess the risks that the firm poses to the financial system; and
- evaluate the further risks revealed by stress testing.

3.2 As part of its SREP, the PRA will review the firm's ICAAP and have regard to the risks outlined in the overall Pillar 2 rule in Internal Capital Adequacy Assessment 3.1, the governance arrangements of the firm, its corporate culture and values, and the ability of members of the management body to perform their duties. The degree of involvement of the governing body

(1) The Capital Requirements Directive (2013/36/EU) (CRD) and the Capital Requirements Regulation (575/2013) (CRR), jointly 'CRD IV'.

(2) www.bankofengland.co.uk/pr/Pages/supervision/approach/default.aspx.

of the firm will be taken into account by the PRA when assessing the ICAAP, as will the appropriateness of the internal processes and systems for supporting and producing the ICAAP.

3.3 When the PRA reviews an ICAAP as part of the SREP, it does so in order to determine whether all of the material risks have been identified and that the amount and quality of capital identified by the firm is sufficient to cover the nature and level of the risks to which it is or might be exposed.

3.4 The SREP will also consider:

- (a) the results of stress tests carried out in accordance with the CRR by firms that use the Internal Ratings-Based (IRB) approach or internal models for market risk capital requirements;
- (b) the exposure to and management of concentration risk by firms, including their compliance with the requirements set out in Part Four of the CRR and Chapter 6 of the ICAAP rules;
- (c) the robustness, suitability and manner of application of policies and procedures implemented by firms for the management of the residual risk associated with the use of credit risk mitigation techniques;
- (d) the extent to which the capital held by a firm in respect of assets which it has securitised is adequate, having regard to the economic substance of the transaction, including the degree of risk transfer achieved;
- (e) the exposure to and management of liquidity risk by firms, including the development of alternative scenario analyses, the management of risk mitigants (including the level, composition and quality of liquidity buffers), and effective contingency plans;
- (f) the impact of diversification effects and how such effects are factored into firms' risk measurement system;
- (g) the geographical location of firms' exposures;
- (h) the exposure of firms to the risk of excessive leverage; and
- (i) whether a firm has provided implicit support to a securitisation.

3.5 The PRA will also assess as part of the SREP the risks that the firm poses to the financial system.

3.6 The PRA may need to request further information and meet with the governing body and other representatives of a firm in order to evaluate fully the comprehensiveness of the

ICAAP. The management of the firm, including the governing body, should therefore be prepared to discuss all aspects of the ICAAP, covering both quantitative and qualitative components. Additionally, the PRA will consider the business model of the firm and the advocated rationale for the model, as well as the firm's expectations regarding the future market and economic environment and how they might affect its business model.

3.7 The SREP will generally be the same across all types of firms, but will be proportionate given the nature, scale and complexity of a firm's activities. There may also be a different emphasis depending on the type of firm or its potential risk to the financial system. For example, banks and building societies may be more exposed to credit concentration risk and interest rate risk in the non-trading book, with investment firms being more likely to be exposed to market risk; these potentially different areas of emphasis will be reflected in the conduct of the SREP, where applicable, for relevant firms.

3.8 On the basis of the SREP, the PRA will determine whether the arrangements implemented by a firm and the capital held by it provide sound management and adequate coverage of its risks. If necessary, the PRA will require the firm to take appropriate actions or steps at an early stage to address any future potential failure to meet its prudential regulatory requirements.

4 The setting of Individual Capital Guidance (ICG) and the Capital Planning Buffer (CPB)

ICG

4.1 Following the SREP, including both a review of the ICAAP and any further interactions with a firm, the PRA will normally give the firm Individual Capital Guidance (ICG), advising the firm of the amount and quality of capital that the PRA considers the firm should hold to meet the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1.

4.2 The PRA will give ICG on a consolidated basis to firms which must comply with the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1 on a consolidated basis. The PRA may decide not to give ICG on an individual basis to members of a group where firms are able to demonstrate that capital has been adequately allocated among subsidiaries and that there are no impediments to the transfer of capital within the group. This does not absolve individual firms or members of the group of their obligation to comply with the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1, which applies to all firms on an individual basis whether or not it also applies to the firm on a consolidated basis.

4.3 Where the PRA gives ICG to a firm it will generally specify an amount of capital (Pillar 2A) that the firm should hold at all times in addition to the capital it must hold to comply with

the CRR (Pillar 1). It will usually do so stating that the firm should hold capital of an amount at least equal to a specified percentage of that firm's capital requirement under the CRR, plus one or more static add-ons in relation to specific risks in accordance with the overall Pillar 2 rule in Internal Capital Adequacy Assessment 3.1. The PRA expects firms to meet Pillar 2A with at least 56% Common Equity Tier 1 (CET1) capital and no more than 44% in AT1 by 1 January 2015.

4.4 It is for firms to ensure that they comply with the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1. However, if a firm holds the level of capital recommended as its ICG that does not necessarily mean that it is complying with the overall financial adequacy rule. Deviation by a firm from the terms of the ICG given to it by the PRA does not automatically mean that the firm is in breach of the overall financial adequacy rule or that the PRA will consider that the firm is failing or is likely to fail to satisfy the Threshold Conditions (TCs). However, firms should expect the PRA to investigate whether any firm is failing or likely to fail to satisfy the TCs, with a view to taking further action as necessary.

4.5 The PRA does not expect a firm to meet the CRD IV buffers with any CET1 capital maintained to meet its ICG. If a firm agrees with its ICG, the PRA will expect the firm to apply for a requirement under Section 55M(5) of the Financial Services and Markets Act 2000 (FSMA) preventing the firm from meeting any of the CRD IV buffers that apply to it with any CET1 capital maintained to meet its ICG. The firm will normally be invited to apply for such a requirement at the same time as it is advised of its ICG. If the firm does not apply for such a requirement the PRA will consider using its powers under Section 55M(3) to impose one of its own initiative.

4.6 Where a firm is subject to the Basel 1 floor the PRA does not expect a firm to meet the CRD IV buffers with any CET1 maintained by the firm to meet the Basel 1 floor and will use its powers under Section 55M to prevent a firm from doing so. Where applicable to a firm, global and other systemically important institution buffers will also be set by the PRA using its powers under Section 55M of FSMA.

CPB

4.7 Following the SREP, the PRA may also notify the firm of an amount and quality of capital that it should hold as a Capital Planning Buffer (CPB), over and above the level of capital recommended as its ICG, and will generally do so at the same time as advising the firm of its ICG. The CPB, based on a firm-specific supervisory assessment, should be of sufficient amount and adequate quality to allow the firm to continue to meet the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1. This should be the case even in adverse circumstances, after allowing for realistic management actions that a firm could and would take in a

stress scenario. Use of the CPB is not of itself a breach of capital requirements or the TCs. The automatic distribution constraints associated with the CRD IV buffers do not apply to the CPB.

4.8 The PRA may set a firm's CPB either as an amount of capital which it should hold from the time of the PRA's notification following the firm's SREP or, in exceptional cases, as a forward-looking target that a firm should build up over time. More information on setting the CPB is outlined in the supervisory statement on stress testing. Where the general stress and scenario testing rule, as part of the ICAAP rules, applies to a firm on consolidated basis the PRA may notify the firm that it should hold a group CPB.

4.9 Where the amount or quality of capital which the PRA considers a firm should hold to meet the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1 or as a CPB is different from that identified by the firm through its ICAAP, the PRA usually expects to discuss the difference with the firm and may consider the use of its powers under Section 166 of FSMA to assist in such circumstances.

4.10 If a firm considers that the ICG or the CPB advised to it by the PRA is inappropriate to its circumstances it should notify the PRA of this, consistent with Principle 11 (Relations with regulators). If, after discussion, the PRA and the firm do not agree on an adequate level of capital, the PRA may consider using its powers under Section 55M of FSMA to impose a requirement on the firm to hold capital in accordance with the PRA's view of the capital necessary to comply with the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1. In deciding whether it should use its powers under Section 55M of FSMA, the PRA will take into account the amount and quality of the capital that the firm should hold for its CPB.

5 Failure to meet ICG and use of the CPB

5.1 The PRA expects every firm to hold at least the level of capital advised to it via its ICG at all times. If a firm's capital has fallen or is expected to fall below that level it should inform the PRA as soon as practicable (even if the firm has not accepted the ICG given by the PRA), explaining why this has happened or is expected to happen. The firm will also be expected to discuss the actions that it intends to take to increase its capital and/or reduce its risks (and therefore capital requirements), and any potential modification that it considers should be made to the ICG.

5.2 Where this has happened, the PRA may ask a firm for alternative and more detailed proposals or further assessments of capital adequacy and risks faced by the firm. The PRA will seek to agree with the firm appropriate timescales and the scope for any such additional work.

5.3 Where a firm has a CPB in place, it should only use that buffer to absorb losses or meet increased capital requirements if certain adverse circumstances materialise. These should be circumstances beyond the firm's normal and direct control, whether relating to a deteriorating external environment or periods of stress such as macroeconomic downturns or financial/market shocks, or firm-specific circumstances.

5.4 Consistent with Principle 11, a firm should notify the PRA as early as possible in advance where it has identified that it would need to use its CPB (even if the firm has not accepted the PRA's assessment of the amount or quality of the capital required for the CPB). The firm's notification should state as a minimum:

- what adverse circumstances are likely to force the firm to draw down its CPB;
- how the CPB will be used up in line with the firm's capital planning projections; and
- what plan is in place for the eventual restoration of the CPB.

5.5 Following discussions with the firm, the PRA may put in place additional reporting arrangements to monitor the firm's use of its CPB in accordance with the plan agreed to restore that buffer. The PRA may also identify specific trigger points as the CPB is being used up by the firm, which may lead to additional supervisory actions.

5.6 Where a firm's CPB is being drawn down due to circumstances other than those arising from a deteriorating external environment or periods of stress (eg macroeconomic downturns or financial/market shocks), or firm-specific circumstances (eg poor planning), the PRA may ask the firm for more detailed plans to restore its CPB. In light of the relevant circumstances, the PRA may consider taking other remedial actions, which may include using its powers under Section 55M of FSMA to require the firm to take specified action to restore its CPB within an appropriate timeframe.

5.7 Where a firm has started to use its CPB in circumstances where it was not possible to notify the PRA in advance, it should notify the PRA and provide information about the cause, the current and projected usage of the buffer, and its eventual restoration as soon as practicable afterwards.

6 Interest rate risk in the non-trading book

6.1 Firms must have appropriate systems and processes, proportionate to the nature, scale and complexity of their business, to evaluate and manage interest rate risk in the non-trading book. Examples of interest rate risk in the non-trading book include:

- the mismatch of repricing of assets and liabilities and off balance sheet short and long-term positions (termed 'repricing risk');

- hedging exposure to one interest rate with exposure to a rate which reprices under slightly different conditions ('basis risk');
- the uncertainties of occurrence of transactions, eg where actual transactions do not equal those that were expected in the future ('pipeline risk'); and
- consumers redeeming fixed rate products when market rates change ('optionality risk').

6.2 The systems and processes should allow the firm to include:

- the ability to measure the exposure and sensitivity of the firm's activities, if material, to repricing risk, yield curve risk, basis risk and risks arising from embedded optionality (eg pipeline risk, prepayment risk) as well as changes in assumptions (eg those about customer behaviour);
- consideration as to whether a purely static analysis of the impact on its current portfolio of a given shock or shocks should be supplemented by a more dynamic simulation approach; and
- scenarios in which different interest rate paths are computed and in which some of the assumptions (eg about behaviour, contribution to risk and balance sheet size and composition) are themselves functions of interest rate level.

6.3 Under Internal Capital Adequacy Assessment 13.1, a firm is required to make a written record of its assessments made under those rules. A firm's record of its approach to evaluating and managing interest rate risk as it affects the firm's non-trading activities should cover the following issues:

- the internal definition of the boundary between 'banking book' and 'trading activities';
- the definition of economic value and its consistency with the method used to value assets and liabilities (eg discounted cash flows);
- the size and the form of the different shocks to be used for internal calculations;
- the use of a dynamic and/or static approach in the application of interest rate shocks;
- the treatment of commonly called 'pipeline transactions' (including any related hedging);
- the aggregation of multi-currency interest rate exposures;
- the inclusion (or not) of non-interest bearing assets and liabilities (including capital and reserves);
- the treatment of current and savings accounts (ie the maturity attached to exposures without a contractual maturity);
- the treatment of fixed rate assets (liabilities) where customers still have a right to repay (withdraw) early;
- the extent to which sensitivities to small shocks can be scaled up on a linear basis without material loss of accuracy

(ie covering both convexity generally and the non-linearity of pay-off associated with explicit option products);

- the degree of granularity employed (for example offsets within a time bucket); and
- whether all future cash flows or only principal balances are included.

6.4 In accordance with Internal Capital Adequacy Assessment 9.2, a firm should apply a 200 basis point shock in both directions to each major currency exposure. The PRA will periodically review whether the level of the shock is appropriate in light of changing circumstances, in particular the general level of interest rates (for instance, during periods of very low interest rates) and their volatility. The level of shock required may also be changed in accordance with EBA guidelines. A firm's internal systems should, therefore, be flexible enough to compute its sensitivity to any standardised shock that is prescribed. If a 200 basis point shock would imply negative interest rates, or if such a shock would otherwise be considered inappropriate, the PRA will consider adjusting the requirements accordingly.

6.5 Alongside the requirement to monitor and evaluate the potential impact of changes in interest rates on economic value, the PRA expects firms to monitor the potential impact on earnings volatility. This should be assessed on an appropriate timeframe of three to five years, and factor in the firm's forward-looking view of product volumes, based on its proposed business model, and the projected path of interest rates.

7 Group risk

7.1 Under SYSC 12.1.8R a firm is required to have adequate, sound and appropriate risk management processes and internal control mechanisms for the purpose of assessing and managing its own exposure to group risk, including sound administrative and accounting procedures.

8 Operational risk

8.1 In meeting the general standard referred to in Internal Capital Adequacy Assessment 10.1, a firm that undertakes market-related activities should be able to demonstrate to the PRA:

- in the case of a firm calculating its capital requirement for operational risk using the basic indicator approach or standardised approach, that it has considered; or
- in the case of a firm with an Advanced Measurement Approach (AMA) permission, compliance with

the Committee of European Banking Supervisors' *Guidelines on the management of operational risk in market-related activities*,⁽¹⁾ published in October 2010.

8.2 In meeting the general standards referred to in Internal Capital Adequacy Assessment 10.1, a firm with an AMA approval should be able to demonstrate to the appropriate regulator that it has considered and complies with Section III of the European Banking Authority's *Guidelines on the Advanced Measurement Approach (AMA) — Extensions and Changes*,⁽²⁾ published in January 2012.

8.3 The matters dealt with in a business continuity plan should include:

- (a) resource requirements such as people, systems and other assets, and arrangements for obtaining these resources;
- (b) the recovery priorities for the firm's operations;
- (c) communication arrangements for internal and external concerned parties (including the PRA, clients and the press);
- (d) escalation and invocation plans that outline the processes for implementing the business continuity plans, together with relevant contact information;
- (e) processes to validate the integrity of information affected by the disruption; and
- (f) regular testing of the business continuity plan in an appropriate and proportionate manner.

(1) www.eba.europa.eu/regulation-and-policy/operational-risk/guidelines-on-the-management-of-operational-risk-in-market-related-activities.

(2) www.eba.europa.eu/-/guidelines-on-ama-extensions-and-chang-1.

Supervisory Statement | SS6/13

Stress testing, scenario analysis and capital planning

December 2013



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Supervisory Statement | SS6/13

Stress testing, scenario analysis and capital planning

December 2013

1 Introduction

1.1 This supervisory statement is aimed at firms to which CRD IV applies.

1.2 This statement sets out the Prudential Regulation Authority's (PRA's) expectations of firms in relation to stress testing, scenario analysis and capital planning, and the requirements set out in the PRA Rulebook in Chapter 12 of the Internal Capital Adequacy Assessment rules.

1.3 It provides further detail on the high-level expectations outlined in *The PRA's approach to banking supervision*.

1.4 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.

1.5 Scenario analysis typically refers to a wider range of parameters being varied at the same time. Scenario analyses often examine the impact of adverse events on the firm's financial position, for example, simultaneous movements in a number of risk categories affecting all of a firm's business operations, such as business volumes, investment values and interest rate movements.

2 Expectations of firms

2.1 There are three broad purposes of stress testing and scenario analysis. First, it can be used as a means of quantifying how much capital might be absorbed if an adverse event or events occurred. This might be a proportionate approach to risk management for an unsophisticated business. Second, 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. Third, it can be used to explore the sensitivities in longer-term business plans and how capital needs might change over time.

2.2 The general stress test and scenario analysis rule in Internal Capital Adequacy Assessment 12.1 requires a firm to carry out stress tests and scenario analyses as part of its obligations under the overall Pillar 2 rule in Internal Capital Adequacy Assessment 3.1. Both stress tests and scenario analyses are undertaken by a firm to further and better its understanding of the vulnerabilities that it faces under adverse conditions. They are based on the analysis of the impact of a range of events of varying nature, severity and duration. These events can be financial, operational or legal, or relate to any other risk that might have an economic impact on the firm.

3 Overall approach

3.1 As part of its obligation under the general stress and scenario testing rule in Internal Capital Adequacy Assessment 12.1, a firm should undertake a broad range of

stress tests which reflect a variety of perspectives, including sensitivity analysis, scenario analysis and stress testing on individual portfolios as well as at a firm-wide level.

3.2 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 the overall Pillar 2 rule in Internal Capital Adequacy Assessment 3.1 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 amend and/or add some stress tests and scenario analyses in order to reflect that concentration.

3.3 The firm should document its stress testing and scenario analysis policies and procedures, as well as the results of its tests in accordance with Internal Capital Adequacy Assessment 13.1. These results should be included within the firm's ICAAP document.

Governance

3.4 The PRA expects a firm's senior management and governing body to be actively involved and engaged in all relevant stages of the firm's stress testing and scenario analysis programme. This would include establishing an appropriate stress testing programme, reviewing the programme's implementation (including the design of scenarios) and challenging, approving and taking action based on the results of the stress tests. The PRA expects firms to assign adequate resources, including IT systems, to stress testing and scenario analysis, taking into account the stress testing techniques employed, so as to be able to accommodate different and changing stress tests at an appropriate level of granularity.

Scenarios

3.5 In identifying scenarios, and assessing their impact, the PRA expects a firm to take into account, where material, how changes in circumstances might impact upon:

- the nature, scale and mix of its future activities; and
- 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).

3.6 Firms should develop a range of firm-wide scenarios including some based on macroeconomic and financial market shocks for the purposes of their own stress testing. These scenarios should be developed so as to be relevant to the circumstances of the firm, including its business model, and the market(s) in which it operates. When the PRA publishes

macroeconomic scenarios, firms are expected to consider their severity to inform the design of their own stress-testing frameworks. In addition, the PRA may also ask a firm to apply specific scenarios directly in its ICAAP submission. More information on ICAAP expectations is outlined in the supervisory statement on the ICAAP and the SREP.

3.7 The calibration of the stress and scenario analyses should be reconciled to a clear statement setting out the premise upon which the firm's internal capital assessment under the overall Pillar 2 rule in Internal Capital Adequacy Assessment 3.1 is based.

3.8 In identifying adverse circumstances and events in accordance with Internal Capital Adequacy Assessment 12.1, a firm should consider the results of any reverse stress-testing conducted in accordance with SYSC 20. Reverse stress-testing may be expected to provide useful information about the firm's vulnerabilities and variations around the most likely scenarios for the purpose of meeting the firm's obligations under Internal Capital Adequacy Assessment 12.1. In addition, such a comparison may help a firm to assess the sensitivity of its financial position to different stress calibrations.
Impact on resources

3.9 In carrying out the stress tests and scenario analyses required by the general stress and scenario testing rule in Internal Capital Adequacy Assessment 12.1, the PRA expects a firm to also consider any impact of the adverse circumstances on its capital resources. In determining whether it would have adequate financial resources in the event of each identified realistic adverse scenario, the firm should:

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

3.10 In identifying an appropriate range of adverse circumstances and events in accordance with Internal Capital Adequacy Assessment Rules 12.1, a firm will need to consider:

- (a) the nature, scale and complexity of its business and of the risks that it bears;
- (b) its risk appetite, including in light of the adverse conditions through which it expects to remain a going concern;
- (c) the cycles it is most exposed to and whether these are general economic cycles or specific to particular markets, sectors or industries; and
- (d) for the purposes of Internal Capital Adequacy Assessment 12.1, the amplitude and duration of the

relevant cycle which should include a severe downturn scenario based on forward-looking hypothetical events, calibrated against the most adverse movements in individual risk drivers experienced over a long historical period.

Time horizon

3.11 Both stress testing and scenario analysis are forward-looking analysis techniques, which seek to anticipate possible losses that might occur if an identified economic downturn or a risk event crystallises.

3.12 In making the estimate required by Internal Capital Adequacy Assessment 12.1(3), a firm should project both its capital resources and its required capital resources over a time horizon of three to five years, taking account of its business plan and the impact of relevant adverse scenarios. In making the estimate, the firm should consider both the capital resources required to meet its capital requirements under the CRR and the capital resources needed to meet the overall financial adequacy rule. The firm should make these projections in a manner consistent with its risk management processes and systems as set out in Internal Capital Adequacy Assessment 3.1.

3.13 When deciding the planning horizon over which to conduct their analysis, firms should consider how long it might take to recover from any loss. The time horizon over which stress tests and scenario analyses should be carried out will depend on, among other things, the maturity and liquidity of the positions stressed. For example, for the market risk arising from the holding of investments, this will depend upon the extent to which there is a regular, open and transparent market in those assets, which would allow fluctuations in the values of the investments to be more readily and quickly identified.

3.14 In projecting its financial position over the relevant time horizon, the firm should:

- (a) reflect how its business plan would 'flex' in response to the adverse events being considered, taking into account factors such as changing consumer demand and changes to new business assumptions;
- (b) consider the potential impact on its stress testing of dynamic feedback effects and second-order effects of the major sources of risk identified in accordance with the overall Pillar 2 rule in Internal Capital Adequacy Assessment 3.1;
- (c) estimate the effects on the firm's financial position of the adverse event without adjusting for management actions;
- (d) separately, identify any realistic management actions that the firm could and would take to mitigate the adverse effects of the stress scenario; and

- (e) estimate the effects of the stress scenario on the firm's financial position after taking account of realistic management actions.

Management actions

3.15 The PRA expects firms to identify any realistic management actions intended to maintain or restore capital adequacy. These could include ceasing to transact new business after a suitable period has elapsed, balance sheet shrinkage, restricting distribution of profits or raising additional capital. A firm should reflect management actions in its projections only where it could and would take such actions, taking account of factors such as market conditions in the stress scenario and any effects upon the firm's reputation with its counterparties and investors. The combined effect on capital and retained earnings should be estimated.

3.16 In order to assess whether prospective management actions in a stress scenario would be realistic, and to determine which actions the firm could and would take, the PRA expects a firm to take into account any preconditions that might affect the value of management actions as risk mitigants. It should then analyse the difference between the estimates of its financial position over the time horizon, both gross and net of management actions, in sufficient detail to understand the implications of taking different management actions at different times, particularly where they represent a significant divergence from the firm's business plan.

3.17 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 risks covered by the stress or scenario test actually materialise. Such measures might be a contingency plan or more concrete risk mitigation steps.

4 PRA review: the SREP

4.1 The PRA will review the firm's records referred to in Internal Capital Adequacy Assessment 13.1 as part of its SREP to enable it to judge whether a firm will be able to continue to meet its CRR and the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1 throughout the time horizon used for the capital planning exercise.

4.2 If a firm's stress testing management plan shows that the firm's projected capital resources are less than those required to continue to meet its ICG or less than those needed to continue to meet the overall financial adequacy rule over the appropriate time horizon, the PRA may require the firm to set out additional countervailing measures and off-setting actions to reduce such differences or to restore the firm's capital adequacy after the stress event.

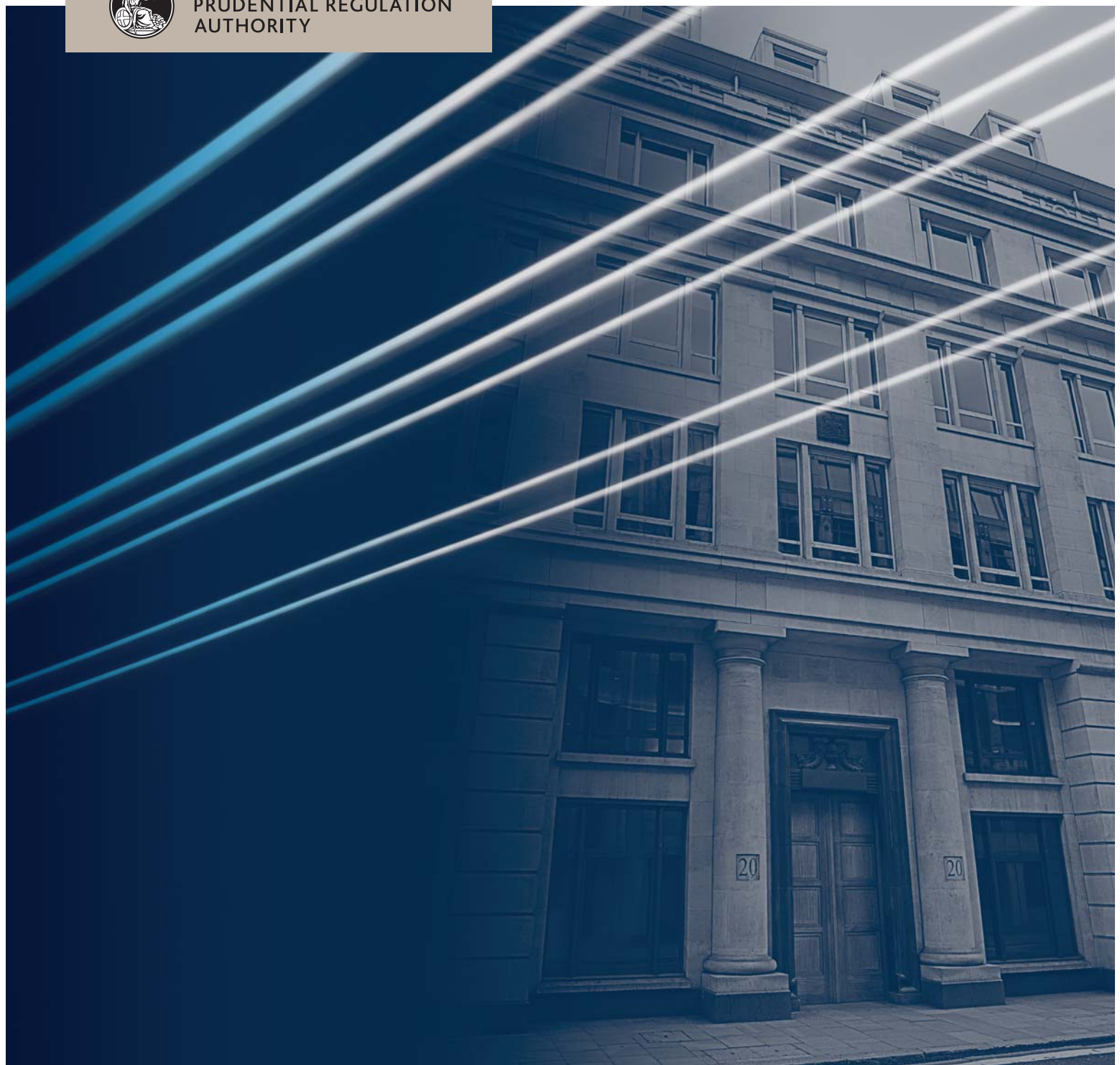
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CRD IV and capital

December 2013



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Supervisory Statement | SS7/13

CRD IV and capital

December 2013

1 Introduction

1.1 This statement is aimed at firms to which CRD IV applies.

1.2 It sets out the Prudential Regulation Authority's (PRA's) expectations on the quality of regulatory capital resources that firms are required to hold, under CRD and the CRR. This statement complements the requirements set out in Part 2 of the CRR, in the Capital rules of the PRA Rulebook and the high-level expectations on capital as outlined in *The PRA's approach to banking supervision*.⁽¹⁾

2 Quality and composition of capital

2.1 As set out in *The PRA's approach to banking supervision*, the PRA expects the most significant part of a firm's capital to be ordinary shares and reserves. These are the highest-quality form of capital, as they allow firms to absorb losses unambiguously on a going concern basis.

2.2 When assessing firms, the PRA will be mindful of the fact that quality of capital is not purely about whether a firm meets each sub-tier of the capital rules. For example, even if two firms have identical Common Equity Tier 1 (CET1) positions, the PRA may view the quality of their capital differently due to the nature of the items underlying their CET1 position.

2.3 As set out in *The PRA's approach to banking supervision*, the PRA also expects firms to comply with the clearly stated internationally agreed criteria around the definition of capital, in spirit as well as to the letter, when structuring capital instruments. This includes an expectation that firms ensure their marketing of proposed capital instruments does not undermine their compliance with the spirit of these criteria. The PRA expects firms to refrain from innovation to structure new capital instruments if these may be ineffective (or less effective) in absorbing losses. For example, the PRA would expect firms to refrain from complex structures, including transactions involving several legs or side agreements, where the same prudential aim can be achieved more simply.

3 Additional Tier 1 Triggers

3.1 CRR requires AT1 instruments to contain a trigger of at least 5.125% CET1, but allows firms to select a higher trigger. It also recognises that the terms of an AT1 instrument may provide for a write-down that is either temporary or permanent, and that the amount converted or written down may be limited to that necessary to restore the firm's CET1 ratio to 5.125% or may be greater.

3.2 Depending on the circumstances, an instrument with a trigger of 5.125% CET1 may not convert in time to prevent the

failure of a firm. A temporary write-down may make it more difficult for the firm to re-establish its capital position following a stress. Also, conversion or write-down that only restores the firm's CET1 ratio to 5.125% may leave the firm close to a second trigger event. Firms will wish to consider these factors when deciding how to exercise the choices available to them under CRR. The PRA expects to discuss with firms their analysis on features of draft capital instruments that they submit for our review.

4 Preference

4.1 Where possible, the PRA expects firms to meet their CET1 requirements entirely with voting common shares and associated reserves. The PRA strongly discourages firms from including non-voting shares in CET1, particularly if such shares have higher dividends than common shares. The main reason for the PRA's concern is that it is imperative that the composition of a firm's CET1 is as straightforward and transparent as possible. There should also be no doubt that a firm's CET1 only includes the highest quality capital. The inclusion of instruments other than voting common shares in CET1 could lead to concerns that such instruments may not have the same capital quality.

5 Subordination, remedies, events of default and set-off

5.1 Under CRR, all regulatory capital must be capable of absorbing losses either on a going or gone concern basis. Therefore, all capital instruments as a minimum must be subordinated to all senior creditors, including depositors. In particular, building societies must ensure that any capital instruments issued by them are subordinated to retail depositors (as per the rule in Capital 10.2).

5.2 It is also important that subordination is not made less effective by granting additional rights to holders of subordinated instruments for example in respect of events of default, remedies and rights of set-off. The PRA expects events of default to be restricted to non-payment of any amount falling due under the terms of the instrument or on the winding-up of the firm. This ensures that the subordinated creditor cannot force early repayment while the issuer may still be technically solvent. This is important so as not to hinder the efforts of the authorities in the context of recovery or resolution actions in relation to the issuer.

5.3 In the event that default occurs, the PRA expects remedies to be restricted, to the fullest extent permitted under the laws of the relevant jurisdictions, to petitioning for the winding-up of the firm or proving for the debt in liquidation or

(1) www.bankofengland.co.uk/pr/Pages/supervision/approach/default.aspx.

administration. Limiting remedies in this way prevents holders of subordinated instruments using other remedies to receive payment, potentially ahead of senior creditors. The expectations set out for restrictions on remedies are not intended to capture remedies for breaches of contract that do not relate to payment obligations, ie remedies that are not available for failure to pay any amount of principal, interest, expenses or in respect of any other payment obligation. Further, any damages or repayment obligation (arising, for example, because remedies could not be limited under applicable law) must be subordinated in accordance with the normal ranking of the instrument in insolvency.

5.4 Also, to the fullest extent permitted under the laws of the relevant jurisdictions, the PRA expects subordinated creditors to waive any rights to set off amounts they owe the issuer against subordinated amounts owed to them by the issuer. Waiving rights of set-off helps to maintain the creditor hierarchy so that subordinated creditors are not treated in the same way as senior creditors.

6 Regulatory capital and subordinated swaps

6.1 CRR requires that the full amount of regulatory capital is subordinated. If a firm chooses to hedge the valuation volatility associated with a capital instrument that it has issued under fair value hedge accounting, then to maintain consistency with the CRR capital regime the PRA expects the hedging instrument also to be subordinated. For example, if the value of a subordinated debt instrument falls from 100 to 90, then the hedge must also be subordinated in order to continue to count 100 of subordinated debt as regulatory capital. If the hedge is not subordinated, then only 90 of subordinated debt would be eligible to count as regulatory capital. This is because the ten contributed by the swap would not be subordinated and therefore would not meet the minimum eligibility criteria specified in CRR.

7 Significant insurance holdings

7.1 As announced in the PRA statement on 29 June 2013 and reiterated in CP5/13, the PRA requires firms to follow the default position in CRR Article 49(1). Firms are therefore required to deduct holdings of own funds instruments issued by an insurer in which the firm has a significant investment.

7.2 For the purposes of valuation, the PRA considers that the embedded value method is not appropriate for determining the value of firms' significant insurance holdings. This is because the embedded value method could have the effect of inflating banks' CET1 as it takes into account the present value of the expected future inflows from existing life assurance business.

8 Connected funding of a capital nature (CFCN)

8.1 Chapter 4 of the PRA's Definition of Capital rules states that firms must treat all CFCN as a holding of capital of the connected party and apply to it the treatment under the CRR applicable to such a holding. The CFCN rule applies on an ongoing basis. Therefore where a loan initially falls outside the definition of CFCN but later falls into it, the appropriate capital treatment should be applied immediately and the PRA should be notified. 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 whole, the entity to which the bank lends is able to regard the loan as being capable of absorbing losses.

8.2 Banks should take account of contractual, structural, reputational or other factors when determining whether a transaction is a CFCN.

8.3 Lending to a connected party will not normally be considered CFCN where that party is acting as a vehicle to pass funding to an unconnected party and has no other creditors whose claims could be senior to those of the lender.

8.4 Additionally, for connected parties within the same consolidation group, it is likely that a loan is not CFCN if:

- (a) it is secured by collateral that is eligible for the purposes of credit risk mitigation under the standardised approach to credit risk; or
- (b) it is repayable on demand (and is 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.

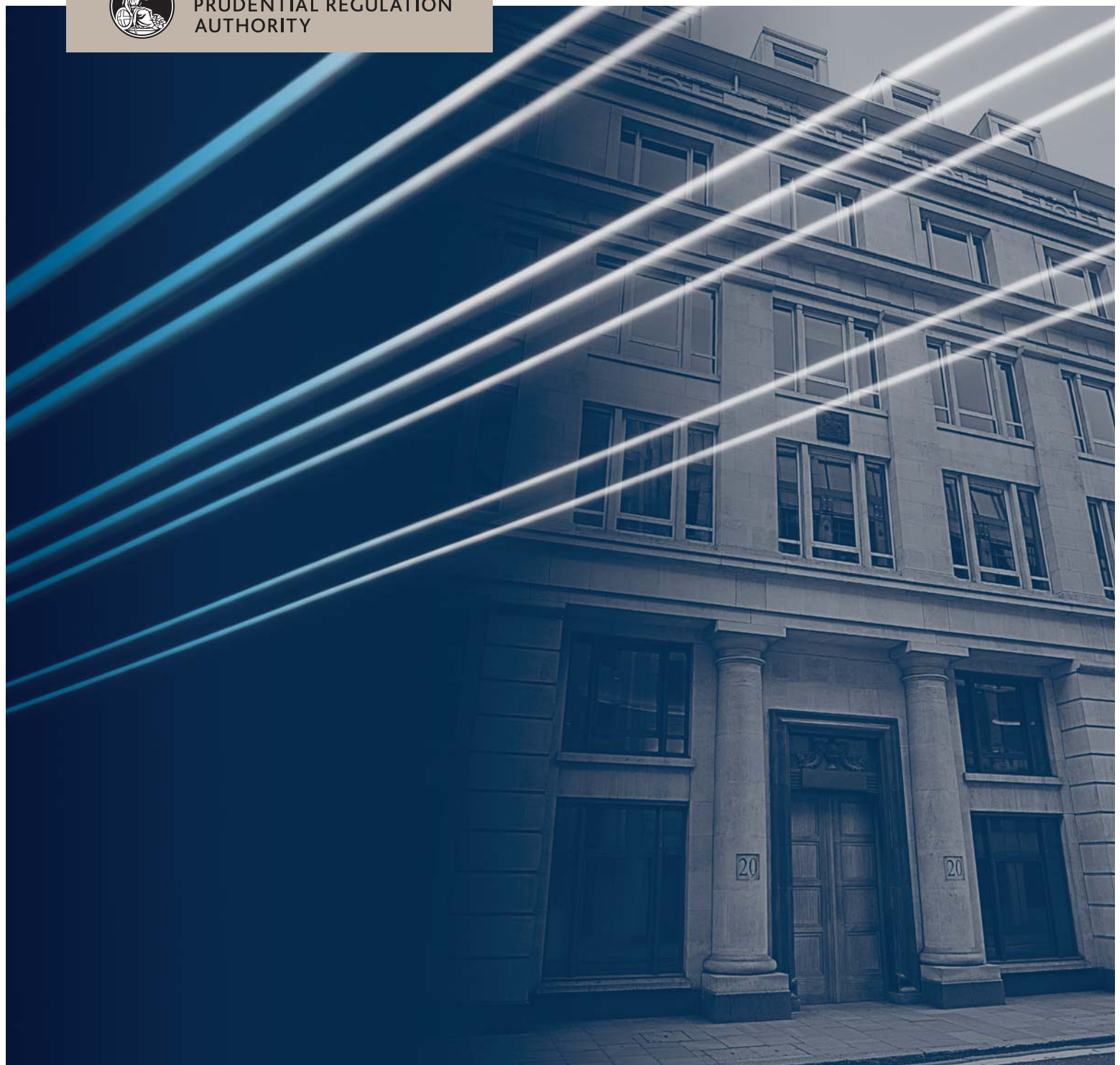
Supervisory Statement | SS8/13

The Basel I floor

December 2013



BANK OF ENGLAND
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BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS8/13

The Basel I floor

December 2013

1 Introduction

1.1 This statement is aimed at firms to which CRD IV applies.

1.2 This statement sets out the Prudential Regulation Authority's (PRA's) expectations regarding the application of the Basel I floor. This statement complements the requirements set out in the CRR and replaces the requirements in BIPRU TP 2⁽¹⁾ which set out how the capital floor provisions were to be applied.

2 Calculation of capital requirements

2.1 Firms should apply the requirements in CRR Article 500(1) to their portfolio as it changes over time. For example, if a firm is calculating its capital requirements as at 31 December 2014 it will have two calculations. The first is carried out in accordance with CRR Article 92 (disregarding Article 500) and the second takes 80% of the requirements of IPRU⁽²⁾ as it stood on 31 December 2006. Both calculations are applied to the firm's figures as at 31 December 2014, and the firm's capital requirement is the greater of these two calculations. Firms should take into account the impact of expected loss, credit risk adjustments and other similar adjustments as defined in CRR Article 159 in these calculations.

2.2 This section provides an illustrative example.⁽³⁾ In this example:

- (a) the own funds required by Article 92 (disregarding Article 500) would be £5.4 million, and the sum of credit risk and similar adjustments are £0.25 million less than expected losses; and
- (b) under IPRU, the firm's capital resources requirement would be £8.0 million and this would be met in part by general credit risk adjustments of £0.5 million.

2.3 Expected losses need to be taken into account. In these calculations both capital requirements will be compared against the CRR definition of capital, which includes the expected loss adjustment. Therefore, expected loss needs to be factored in by amending the IPRU capital resources requirement. For these purposes, if expected losses, less value adjustments and provisions are positive, then the absolute value of that amount should be deducted from the IPRU capital resources requirement. If the result is negative then that amount should be added to the IPRU capital resources requirement. In this example the result is positive, and so a capital requirement of £5.65 million (which is 80% multiplied by £8.0 million, less £0.5 million less £0.25 million) should be used for the second calculation.

2.4 As the CRR Article 92 calculation of £5.4 million is still less than the floor-adjusted IPRU capital resources requirement of £5.65 million, the effect of CRR Article 500 is that the firm is subject to the (higher) IPRU-based capital requirement. If the Article 92 calculation had been greater than £5.65 million, the effect of Article 500 is that the firm would have been subject to the Article 92 requirement at that time. (See Article 500(1).)

3 Permission to apply floor based on non-modelled CRR approaches

3.1 The PRA expects that it will only grant permission to apply a floor based on non-modelled CRR approaches⁽⁴⁾ in place of the Basel I floor in accordance with CRR Article 500(2) in the following circumstances:

- (a) the firm has first used an advanced approach on 1 January 2010 or later; and
- (b) the firm does not have access to systems and data that would allow it to calculate capital requirements based on IPRU without incurring materially greater costs than if it were to use non-modelled CRR approaches for the floor instead; and
- (c) the firm can demonstrate, based on the latest available information at the time it applies for permission, that its floored capital requirements based on non-modelled CRR approaches are not materially less than those based on IPRU (see: CRR Article 500(2)).

4 Permission to disapply floor

4.1 The PRA does not expect that it will waive the application of the Basel I floor in accordance with CRR Article 500(5).

(1) Prudential sourcebook for Banks, Building Societies and Investment Firms: <http://fshandbook.info/FS/html/PRA/BIPRU/TP/2>.
(2) 'The Interim Prudential Sourcebook', comprising IPRU(BANK), IPRU(BSOC), IPRU(FSOC), IPRU(INS) and IPRU(INV), which formed part of the FSA Handbook.
(3) This example assumes that a firm does not have permission under CRR Article 500(2) to apply the floor based on non-modelled CRR approaches.
(4) CP10/22 section 3.10.

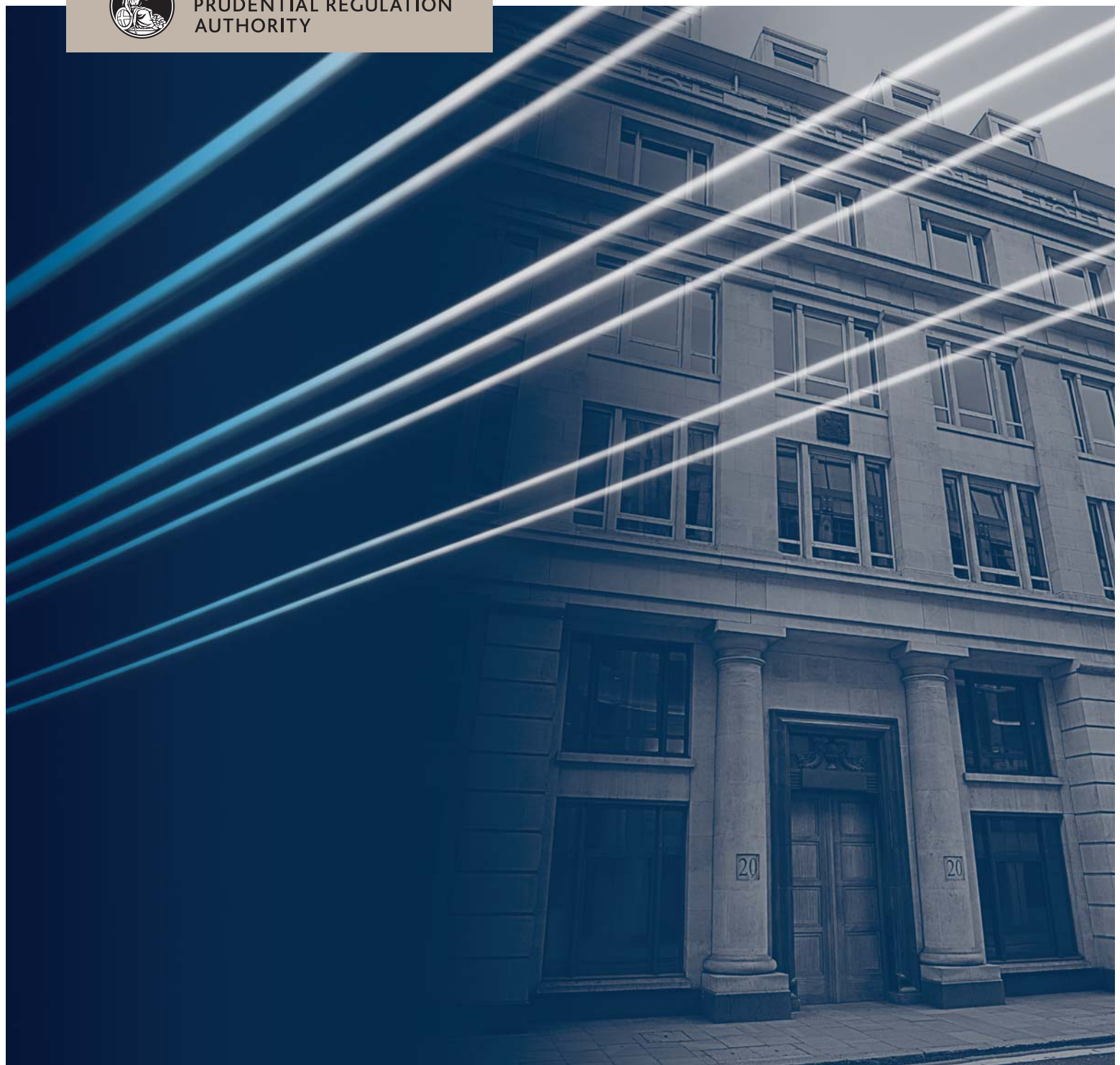
Supervisory Statement | SS9/13

Securitisation

December 2013



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Supervisory Statement | SS9/13

Securitisation

December 2013

1 Introduction

1.1 This statement is aimed at firms to which CRD IV applies.

1.2 This statement sets out the Prudential Regulation Authority's (PRA's) expectations of firms in respect of securitisation in the following sections:

- (2) 'High-level Significant Risk Transfer considerations' — general expectations of firms seeking to obtain significant risk transfer (SRT) through securitisation;
- (3) 'Significant Risk Transfer notifications and permissions' — process for notifying the PRA of SRT transactions and for obtaining permission to undertake own assessments of SRT;
- (4) 'Regulatory capital calculation methodology and SRT' — methodologies firms use to calculate post-securitisation risk weights in SRT transactions;
- (5) 'Implicit Support and SRT' — the PRA's approach to implicit support;
- (6) 'High cost credit protection and other SRT considerations' — factors likely to affect the assessment of SRT transactions; and
- (7) 'Mapping of External Credit Assessment Institutions (ECAIs) credit assessments to credit quality steps' — the PRA's view of interim mapping of rating agency grades to credit quality steps for the purposes of securitisation positions under the Ratings Based Approach to securitisation.

1.3 The statement supplements the rules in the Benchmarking of Internal Approaches and Credit Risk Part of the PRA Rulebook.

2 High-level Significant Risk Transfer considerations

2.1 The CRR requires any reduction in capital requirements achieved through securitisation to be justified by a commensurate transfer of risk to third parties. Where the PRA determines that the reduction in risk-weighted exposure amounts (RWEA), which would be achieved through a particular securitisation transaction, is not justified by a commensurate transfer of risk then SRT shall not be considered to have been achieved by that transaction.

2.2 SRT is an ongoing requirement. Accordingly, the PRA expects firms to ensure that any reduction in capital requirements achieved through securitisation continues to be

matched by a commensurate transfer of risk throughout the life of the transaction. The PRA expects firms to take a substance over form approach to assessing SRT. Firms should be able to demonstrate that the capital relief post-transaction adequately captures the economic substance of the entire transaction, and is commensurate to the retained risks.

2.3 One indication of whether or not risk transfer is commensurate is whether the RWEA post-securitisation is commensurate with the RWEA that would apply if the firm acquired the securitised exposures from a third party. The PRA expects firms purchasing risk transfer products to give adequate consideration to all relevant factors when assessing SRT, including the size of premiums paid.

2.4 When risk transfer transactions are structured as a group of linked transactions rather than a single transaction, the PRA expects the aggregate effect of linked transactions to comply with the CRR. The PRA expects firms to ensure that analysis of risk transfer incorporates all linked transactions, particularly if certain transactions within a group of linked transactions are undertaken at off-market rates.

2.5 The PRA expects the instruments used to transfer credit risk not to contain provisions which materially limit the amount of risk transferred. For example, should losses or defaults on the securitised exposures occur — ie deterioration in the credit quality of the underlying pool — the PRA expects the originator's net cost of protection or the yield payable to investors should not increase as a result.

2.6 In order to ensure their continuing appropriateness, the PRA expects firms to update the opinions of qualified legal counsel, required by CRR, as necessary to ensure their continuing validity. For example, an opinion may need to be updated if relevant statutory provisions are amended, or where a new decision or judgment of a court has a bearing on the continuing validity of counsel's opinion.

2.7 The PRA expects relevant senior management of a firm to be appropriately engaged in the execution of securitisation transactions that lead to a reduction in RWEA, where the firm is providing or purchasing structured trades.

2.8 The PRA does not operate a pre-approval process for securitisation transactions. The PRA nevertheless expects a firm to discuss with its supervisor at an early stage securitisation transactions that are material or have complex features. Where a firm claims a regulatory capital reduction from securitisation transactions in its disclosures to the market, the PRA expects such disclosures to include caveats making clear the risk of full or partial re-characterisation where this risk is material in the light of the PRA's stated policy.

2.9 Although this supervisory statement sets out the PRA's expectations regarding securitisation, these expectations are also relevant for other similar credit protection arrangements.

2.10 The PRA will seek to ensure that the securitisation framework is not used to undermine or arbitrage other parts of the prudential framework. In relation to other similar credit protection arrangements, including those subject to credit risk mitigation or trading book rules, the impact of certain features (eg significant premiums or call options) may cast doubt on the extent of risk transferred and the resulting capital assessment.⁽¹⁾ Features which result in inadequate capital requirements compared to the risks a firm is running may result in the credit protection not being recognised or the firm being subject to extra capital charges in their Individual Capital Guidance (ICG) in the form of Pillar 2 add-ons. Credit protection arrangements in general are subject to the same overarching principles as those in the securitisation framework.

2.11 Where a firm achieves SRT for a particular transaction, the PRA expects it to continue to monitor risks related to the transaction to which it may still be exposed. The PRA expects firms to consider the capital planning implications of securitised assets returning onto their balance sheets. The CRR requires firms to conduct regular stress testing of their securitisation activities and off balance sheet exposures. The PRA expects those stress tests to consider the firm-wide impact of stressed market conditions on those activities and exposures and the implications for other sources of risk, for example, credit risk, concentration risk, counterparty risk, market risk, liquidity risk and reputational risk. The PRA expects a firm's stress testing of securitisation activities to take into account existing securitisations and pipeline transactions. The PRA expects a firm to have in place procedures to assess and respond to the results of that stress testing and would expect them to be taken into account under Pillar 2.

(CRR Articles 243, 244 and 337)

3 Significant Risk Transfer notifications and permissions

Requirements for originators to use securitisation risk weights

3.1 The CRR provides three options for firms to demonstrate how they transfer significant credit risk for any given securitisation transaction:

- (1) the originator does not retain more than 50% of the risk weighted exposure amounts of mezzanine securitisation positions, where these are:
 - (i) positions to which a risk weight lower than 1,250% applies; and

- (ii) more junior than the most senior position in the securitisation and more junior than any position in the securitisation rated Credit Quality Step 1 or 2.

- (2) where there is no mezzanine position, the originator does not hold more than 20% of the exposure values of securitisation positions that are subject to a deduction or 1,250% risk weight and where the originator can demonstrate that the exposure value of such securitisation positions exceeds a reasoned estimate of the expected loss on the securitised exposures by a substantial margin; and
- (3) the competent authority may grant permission to an originator to make its own assessment if it is satisfied that the originator can meet certain requirements.

SRT under options (1) and (2)

3.2 Credit Risk 3.1 in the PRA Rulebook requires a firm to notify the PRA of each transaction on which it seeks capital relief under options 1 and 2.

3.3 Where the PRA considers that the possible reduction in RWEA achieved via the securitisation is not justified by a commensurate transfer of risk to third parties, then the PRA will find SRT has not been achieved. Consequently, firms will not be able to recognise any reduction in RWEA from the transaction.

(CRR Articles 243, 244 and 337)

SRT option 3

3.4 The PRA intends to grant permission for an originator to make its own assessment of SRT only where it is satisfied that:

- in every relevant case, the reduction in capital requirements achieved would be justified by a commensurate transfer of risk to third parties;
- the firm has in place appropriately risk-sensitive policies and methodologies to assess the transfer of risk; and
- such transfer of risk to third parties is also recognised for the purposes of the firm's internal risk management and internal capital allocation.

3.5 Where the PRA grants permission for multiple transactions, that permission will cover a defined scope of potential transactions. The permission will enable a firm (within certain limits) to carry out these transactions without notifying the PRA in each individual instance.

(1) Article 194(2) of the CRR requires firms to, 'take all appropriate steps to ensure the effectiveness of the credit protection arrangement and to address the risks related to that arrangement'.

(CRR Articles 243, 244 and 337)

Deduction or 1,250% risk weighting

3.6 A firm seeking to achieve capital relief by deducting or applying a 1,250% risk weight to all retained positions where permitted under CRR Article 243 or 244 would not need to make a notification under Credit Risk 3. In such cases, a firm should consider whether the characteristics of the transaction are such that the PRA would reasonably expect prior notice of it.

(CRR Articles 243, 244)

SRT notifications

Process for submitting notifications

3.7 When informing the PRA of a transaction in accordance with Credit Risk 3.1, the information should be sent simultaneously via email to the SRT notifications inbox (SRT@bankofengland.co.uk) and to the firm's usual supervisory contact.

Information to be provided

3.8 A firm's notification should include sufficient information to enable the PRA to assess whether the possible reduction in RWEA which would be achieved by the securitisation is justified by a commensurate transfer of credit risk to third parties. The PRA expects such information to include at least the following:

- (a) details of the securitisation positions, including rating, exposure value and RWEA broken down by securitisation positions sold and retained;
- (b) a copy of the SRT policy applied to the transaction, including details of the methodology and any models used to assess risk transfer;
- (c) a statement of how all relevant risks are incorporated into the SRT assessment and how the full economic substance of the transaction is taken into consideration;
- (d) the SRT calculation, setting out why the firm believes the capital relief proposed is commensurate with the credit risk transferred to third parties;
- (e) details of reliance on external credit assessment institutions (ECAIs) in the SRT assessment;
- (f) a description of the risks being retained;
- (g) key transaction documentation and any relevant supporting documents (eg a summary of the transaction);
- (h) copies of investor and internal presentations on the transaction;

- (i) details of the underlying assets (including asset class, geography, tenor, rating, spread, collateral, exposure size);
- (j) details of the transaction structure;
- (k) details of any termination options (eg call options);
- (l) details of the cash flow between parties involved in the transaction;
- (m) details of the ratings and pricing of bonds issued in the transaction;
- (n) details of any connected parties involved in the transaction;
- (o) details of the rationale for the transaction;
- (p) details of the CRR rules the firm is relying on; and
- (q) details of the governance process for the transaction, including details of any committees involved in approving the transaction.

Communicating PRA decisions on notified transactions

3.9 Following review of sufficient information provided by the firm, the PRA will inform the firm of its view on commensurate risk transfer. The PRA's review will focus on the proportion of credit risk transferred — including any transaction features which undermine effective risk transfer — compared to the proportion by which RWEA is reduced as a result of the transaction. Where the PRA judges the reduction in RWEA not to be justified by a commensurate transfer of credit risk to third parties, it will inform the firm that SRT has not been achieved by this transaction. Otherwise the PRA will inform the firm that it does not object to the transaction.

3.10 The PRA does not intend to pre-approve transactions. Instead, the PRA will provide a view on whether it considers commensurate risk transfer to have been achieved at a point in time, which may be provided after a transaction has closed. The PRA may reassess its judgement of the achievement of commensurate risk transfer if the level of credit risk transfer in a transaction changes materially.

Permissions for own assessment of SRT

3.11 Firms may apply for permission to consider SRT to have been achieved without needing to rely on option (1) or (2). The scope of such permission may be defined to cover a number of transactions or an individual transaction.

(CRR Articles 243 and, 244 and 337)

Multiple transaction permissions

3.12 Where a firm applies for such permission, the PRA expects the scope to be defined according to a range of characteristics, including the type of asset class and the structural features of the transaction. The characteristics that the PRA expects a firm to consider when defining the scope of a permission application include:

- (a) asset class (eg residential or commercial mortgages, credit card receivables, leasing, loans to corporates or small and medium-sized enterprises, consumer loans, trade receivables, securitisations, Private Finance Initiative, insurance, covered bonds, other assets);
- (b) further asset class distinction (eg geography and asset quality); and
- (c) structural features (eg distinguishing between securitisation and re-securitisation, traditional and synthetic securitisation and non-revolving structures and revolving structures).

3.13 It is likely to be more straightforward for the PRA to assess applications for relatively narrowly scoped permissions than those covering a wide range of assets and/or with complex structural features.

PRA areas of review and information to be submitted by firms

3.14 In order to assess a firm's ability to use its own policies and methodologies for assessing SRT, the PRA's permission application reviews will focus on the following factors:

- the firm's understanding of the risk of potential transactions within the scope of the permission, including for potential underlying assets, securitisation structures and other relevant factors that affect the economic substance of risk transfer;
- the firm's governance around SRT assessment (including sign-off procedures) and systems and controls relating to risk-transfer assessment and determination of SRT;
- SRT calculation policies and methodologies, including models used;
- the firm's historical experience with relevant securitisation origination; and
- the use of third-party risk assessments (eg external ECAI ratings) and the relationship with internal assessments.

3.15 The information the PRA expects a firm to provide in a permission application includes the following:

- (a) details of the firm's governance processes for SRT, including details of any relevant committees and the seniority and expertise of key persons involved in sign-off;
- (b) a copy of the firm's SRT policy, including details of the SRT calculation policies, methodologies and any models used to assess risk transfer (this should set out how the firm ensures it only takes capital relief in proportion to the amount of risk transferred on any given transaction);
- (c) a statement of how all relevant risks are incorporated in the SRT calculations and how the full economic substance of transactions is taken into consideration;
- (d) details of the firm's systems and controls regarding risk transfer in securitisations;
- (e) a copy of the firm's capital allocation strategy;
- (f) details of any securitised assets that have come back on the firm's balance sheet and the reason why; and
- (g) details of reliance on ECAs in determining SRT.

Limits attached to multiple transaction permissions

Materiality

3.16 The PRA will apply two materiality limits to the proportion of RWEA reduction that can be taken under any permission covering multiple transactions:

- (a) transaction level limit — any transaction that would in principle be within the scope of the permission, but that resulted in an RWEA reduction exceeding 1% of the firm's credit risk related RWEAs, as at the date of the firm's most recent regulatory return, will fall outside the scope of a multiple transaction permission and will require a separate permission or require notification (if the transaction would satisfy option 1 or 2); and
- (b) aggregate limit — once the aggregate RWEA reduction on all SRT transactions executed within the scope of a permission exceeds 5% of the firm's credit risk-related RWEAs as at the date of the firm's most recent regulatory return, no additional transactions may be executed within scope of the permission. In such circumstances, a firm should take one of the following actions:
 - (i) apply to renew the multiple transaction permission;
 - (ii) apply for a new permission covering the specific transactions exceeding the RWEA limit; or

- (iii) notify the PRA of the transaction, following the SRT notification procedure (if the transactions would satisfy option 1 or 2).

Length of permission

3.17 Multiple transaction permissions will be granted for a period of one year. The PRA's review of permission renewal will focus on changes to the firm's SRT policies and methodologies since the previous review.

Individual transaction permissions

3.18 Permissions relating to individual transactions need not be granted prior to the execution of a transaction. The PRA does not intend to specify the timeframe in which a firm should submit an individual transaction permission application, but firms should note that capital relief from a specific transaction will not be available until a firm has obtained permission covering the SRT assessment and capital treatment (unless the transaction is being notified under option 1 or 2, or falls within scope of a multiple transaction permission).

3.19 The information the PRA expects to receive in an individual transaction permission includes the items set out in paragraph 3.8 points d to p, and paragraph 3.15 points a to c.

Limits attached to individual transaction permissions

3.20 The PRA may grant an individual permission for the full duration of a transaction, or may impose a shorter time limit on the permission. Where a firm seeks to take capital relief on a transaction beyond the expiry date of the relevant permission, the permission will require renewal prior to expiry.

3.21 As SRT should be met on a continuing basis, permissions will typically include a requirement to notify the PRA of changes in circumstances from those under which the permission was granted. Any reduction in credit risk transfer subsequent to the permission being granted will require the firm to make a commensurate reduction in the extent of RWEA reduction that is recognised. If a firm does not effect a commensurate reduction in the RWEA relief in such circumstances, the PRA may revoke the relevant permission.

(CRR Articles 243, 244 and 337)

4 Regulatory capital calculation methodology and SRT

4.1 Originators must transfer a significant amount of credit risk associated with securitised exposures to third parties to be able to apply the securitisation risk weights set out in Chapter 5 of the CRR, and any associated reduction in capital requirements must be matched by a commensurate transfer of risk to third parties.

4.2 As part of the notification and permissions process, the PRA expects a firm to inform it of the methodology the firm intends to use to calculate securitisation capital requirements. The PRA will generally be more sceptical of the achievement of commensurate risk transfer for transactions where the regulatory capital calculation used produces very low capital requirements. Where the method used to calculate regulatory capital requirements post-securitisation results in a particularly significant reduction in capital requirements, the PRA will apply a high degree of scrutiny in its assessment of whether commensurate risk transfer is achieved.

(CRR Articles 243, 244 and 337)

5 Implicit support and SRT

5.1 The PRA will monitor the support provided by a firm to its securitisation transactions, and will consider this carefully in the assessment of commensurate risk transfer. As part of firms' ongoing consideration of risk transfer, the PRA expects them to consider the support they have provided to securitisation transactions.

5.2 If a firm is found to have provided support to a securitisation, the expectation that the firm will provide future support to its securitisations is increased. The PRA will take account of this increased expectation in future assessments of commensurate risk transfer for that firm.

5.3 The PRA expects securitisation documentation to make clear, where applicable, that repurchase of securitisation positions by the originator beyond its contractual obligations is not mandatory and may only be made at fair market value.

5.4 Where a firm provides support which it is entitled, but not obliged, to provide under the contractual documentation of the securitisation, the PRA will consider the following factors in assessing if that support has been appropriately reflected in the assessment of SRT:

- (a) whether the fact that the firm may provide such support was expressly set out in the contractual and marketing documents for the securitisation;
- (b) whether the nature of the support that the firm may give is precisely described in the documentation;
- (c) whether the maximum degree of support that could be provided could be ascertained at the time of the securitisation by the firm and by a person whose only information came from the marketing documents for the securitisation;
- (d) whether the assessment of whether SRT was achieved and the amount of that risk transferred was made on the basis

that the firm would provide support to the maximum degree possible; and

- (e) whether the firm's own funds and own funds requirements were appropriately adjusted at the time of the securitisation on the basis that the firm provided support to the maximum degree possible.

5.5 If a firm fails to comply with CRR Article 248(1), the PRA may require it to disclose publicly that it has provided non-contractual support to its transaction.

(CRR Articles 243, 244, 248 and 337 and CRD4 Article 98)

6 High-cost credit protection and other SRT considerations

6.1 Some transactions transfer little or no economic risk from the protection buyer to the protection seller, but may nevertheless result in a reduction in regulatory capital requirements. An example of such a transaction-type is one in which protection is purchased on a junior tranche and a high premium is paid for that protection.

6.2 Generally, the amount of premium paid will not materially affect the assessment of whether SRT is achieved. This is because either:

- the protection payment payable upon default from protection seller to protection buyer is significantly larger than the overall premium payable to the protection seller; or
- the payment of premium leads to an immediate incurred cost.

6.3 However, there comes a point at which the premium payable for protection can reduce significantly the economic risk that is transferred from the protection buyer to protection seller. A premium payable of 100% of the protection amount could leave the protection buyer in a position over the life of the transaction that was no better than if protection had not been purchased.

6.4 The PRA expects originators seeking to apply the securitisation risk weights to synthetic securitisations to take into account all relevant factors to assess the extent of risk transferred. As well as the size and timing of amounts payable to the protection seller, the circumstances in which those amounts are payable can undermine the effectiveness of risk transfer. The PRA expects firms seeking capital relief through synthetic securitisations to incorporate premiums in their assessment of SRT. In particular, the following transaction features may have a significant impact on the extent of risk transfer:

- premium which is guaranteed in all or almost all circumstances, eg premium which is payable upfront or deferred;
- those that could result in the amount of premium payable for protection being significantly greater than the spread income on the assets in the portfolio or similar to the size of the hedged position; and
- those under which the protection buyer retains the expected loss through higher transaction costs to the counterparty, in the form of premium or otherwise.

6.5 Originators should have regard to the statement on high cost credit protection issued by the Basel Committee on Banking Supervision (www.bis.org/publ/bcbs_n16.htm).

6.6 The CRR requires maturity to be assessed in considering SRT. When assessing the effective maturity of synthetic securitisations, the PRA expects firms to consider whether the transaction contains an option to terminate the protection at the discretion of the protection buyer. The PRA will consider the following to be examples of features which generally indicate a positive incentive for the protection buyer to call a transaction, or at least to constitute grounds for discussion with the PRA prior to the conclusion of the transaction:

- the transaction contains terms, such as payments at maturity or payments upon early termination or significant premiums, which may reduce risk transfer;
- the transaction includes a requirement for the protection buyer to incur additional costs or obligations if they do not exercise their option to terminate the protection; and
- there are pre-agreed mechanisms, for example 'at-market unwinds', where the protection seller and protection buyer agree that the transaction can be terminated in the future at a 'market' value and specifies aspects of how the value is calculated.

(CRR Articles 243, 244 and 337)

7 Mapping of ECAI credit assessments to credit quality steps

7.1 The CRR requires the European Banking Authority (EBA) to produce implementing technical standards (ITS) mapping the credit assessments of ECAs to the credit quality steps specified in the CRR for the purposes of calculating risk-weighted exposure amounts under the ratings-based approach.

7.2 EBA is required to submit those draft ITS to the European Commission by 1 July 2014. Prior to adoption of the EBA's ITS,

the PRA would expect firms to continue to use the PRA mapping of ECAI credit assessments to credit quality steps, as set out in **Tables 1–4** below. These tables will be superseded by the EBA's mapping once that mapping has been adopted by the Commission.

Table 1 Long-term mapping: standardised approach

Credit quality step	Risk weights	Fitch	Moody's	S&P	DBRS
1	20%	AAA to AA-	Aaa to Aa3	AAA to AA-	AAA to AAL
2	50%	A+ to A-	A1 to A3	A+ to A-	AH to AL
3	100%	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	BBBH to BBBL
4	350%	BB+ to BB-	Ba1 to Ba3	BB+ to BB-	BBH to BBL
5	1,250%	B+ and below	B1 and below	B+ and below	BH and below

Table 2 Long-term mapping: IRB approach

Credit quality step	Risk weights			Credit assessments			
	Most senior tranche	Base	Non-granular pool	Fitch	Moody's	S&P	DBRS
1	7%	12%	20%	AAA	Aaa	AAA	AAA
2	8%	15%	25%	AA	Aa	AA	AA1
3	10%	18%	35%	A+	A1	A+	AH
4	12%	20%	35%	A	A2	A	A
5	20%	35%	35%	A-	A3	A-	AL
6	35%	50%	50%	BBB+	Baa1	BBB+	BBBH
7	60%	75%	75%	BBB	Baa2	BBB	BBB
8	100%	100%	100%	BBB-	Baa3	BBB-	BBBL
9	250%	250%	250%	BB+	Ba1	BB+	BBH
10	425%	425%	425%	BB	Ba2	BB	BB
11	650%	650%	650%	BB-	Ba3	BB-	BBL
Below 11	1,250%	1,250%	1,250%	Below BB-	Below Ba3	Below BB-	Below BBL

Table 3 Short-term mapping: standardised approach

Credit quality step	Risk weights	Fitch	Moody's	S&P	DBRS
1	20%	F1+, F1	P-1	A-1+, A-1	R-1 (high), R-1 (middle), R-1 (low)
2	50%	F2	P-2	A-2	R-2 (high), R-2 (middle), R-2 (low)
3	100%	F3	P-3	A-3	R-3
All other credit assessments	1,250%	Below F3	NP	All short-term ratings below A3	All short-term ratings below R-3

Table 4 Short-term mapping: IRB approach

Credit quality step	Risk weights			Credit assessments			
	Most senior tranche	Base	Non-granular pool	Fitch	Moody's	S&P	DBRS
1	7%	12%	20%	F1+, F1	P-1	A-1+, A-1	R-1 (high), R-1 (middle), R-1 (low)
2	12%	20%	35%	F2	P-2	A-2	R-2 (high), R-2 (middle), R-2 (low)
3	60%	75%	75%	F3	P-3	A-3	R-3
All other credit assessments	1,250%	1,250%	1,250%	Below F3	All short-term ratings below A3, P3 and F3	All short-term ratings below A3	All short-term ratings below R-3

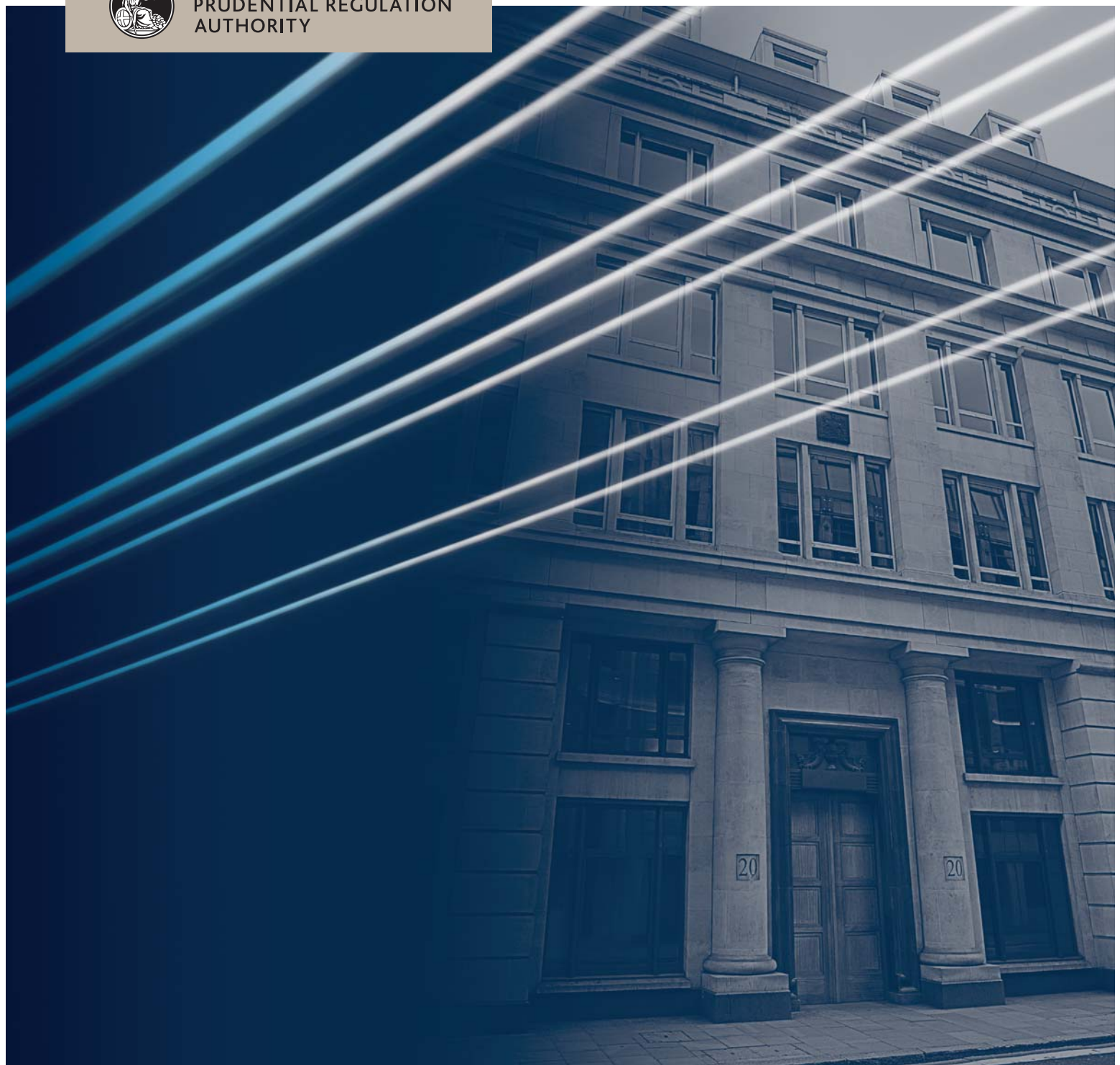
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Standardised approach

December 2013



BANK OF ENGLAND
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Supervisory Statement | SS10/13

Standardised approach

December 2013

1 Introduction

1.1 This statement is aimed at firms to which CRD IV applies.

1.2 The purpose of this statement is to set out the Prudential Regulation Authority's (PRA's) expectations in respect of certain aspects of a firm's implementation of the standardised approach to credit risk.

2 Exposures to institutions

2.1 The PRA confirms that, in relation to the concessionary treatment set out in CRR Article 119(5), there are no financial institutions currently authorised and supervised by it — other than those to which the CRR applies directly — that are subject to prudential requirements that the PRA considers to be comparable in terms of robustness to those applied to institutions under the CRR.

(CRR Article 119(5))

3 Third country equivalence

3.1 CRR articles 107(3), 114(7), 115(4), 116(5) and 132(3) each include a third country equivalence provision which allows a certain credit risk treatment to be applied where a non-EEA jurisdiction ('third country') applies prudential and supervisory requirements at least equivalent to those applied in the European Union. The Commission is empowered under each of these provisions to make a decision as to which countries apply equivalent arrangements. Prior to the end of 2013, the PRA will set out the approach to be taken during 2014 in the absence of an equivalent determination by the European Commission.

(CRR Articles 107(3), 107(4), 114(7), 115(4), 116(5) and 132(3))

4 Retail exposures

4.1 Where an exposure is denominated in a currency other than the Euro, the PRA expects firms to use appropriate and consistent exchange rates to determine compliance with relevant CRR thresholds. Accordingly, the PRA expects a firm to calculate the Euro equivalent value of the exposure for the purposes of establishing compliance with the aggregate monetary limit of €1 million for retail exposures using a set of exchange rates the firm considers to be appropriate. The PRA expects a firm's choice of exchange rate to have no obvious bias and to be derived on the basis of a consistent approach.

(CRR Article 23(c))

5 Exposures fully and completely secured by mortgages on residential property

Ijara mortgages

5.1 The PRA considers an Ijara mortgage to be an example of an exposure to a tenant under a property leasing transaction concerning residential property under which the firm is the lessor and the tenant has an option to purchase.

5.2 Accordingly, the PRA expects exposures to Ijara mortgages to be subject to all of the requirements applicable to exposures secured by mortgages on residential property including in respect of periodic property revaluation.

(CRR Articles 124 and 125)

Buy-to-let mortgages

5.3 The United Kingdom has a well-developed and long-established residential property market. For example, in 1987, the amount outstanding of total Sterling net secured lending to individuals and housing associations (not seasonally adjusted) was £166 billion; in 2012, such lending stood at £1.3 trillion.⁽¹⁾

5.4 The write-off rate for UK residential mortgages in 2012, calculated using Bank of England data, was 0.05%.⁽²⁾ Pending the availability of annual loss rates collected on a uniform basis through COREP, the PRA considers this write-off rate to be a suitable proxy for the loss rates referred to in CRR Articles 125(3) and 199(3).⁽³⁾

5.5 The write-off rates for the seventeen years prior to 2012 are set out below:

• 2011	0.06%;
• 2010	0.08%;
• 2009	0.13%;
• 2008	0.07%;
• 2007	0.03%;
• 2006	0.03%;
• 2005	0.01%;
• 2004	0.00%;
• 2003	0.02%;
• 2002	0.01%;
• 2001	0.03%;
• 2000	0.04%;
• 1999	0.07%;
• 1998	0.08%;

(1) These data may be found in Bank of England data series LPQVTXH.

(2) The write-off rate was calculated using seasonally unadjusted data extracts from Bank of England series RPATBVX and RPATFHD.

(3) The data have been gathered on the basis of the Bank's reporting form WO which collects data in respect of both complete and partial write-offs as well as write-ons.

- 1997 0.15%;
- 1996 0.11%; and
- 1995 0.12%.

(CRR Articles 125(3) and 199(3))

6 Exposures in default

6.1 When determining the portion of a past due item that is secured, the PRA expects the secured portion of an exposure covered by a mortgage indemnity product that is eligible for credit risk mitigation purposes under Chapter 4 of the CRR potentially to be capable of qualifying as an eligible guarantee.

(CRR Article 129(2))

7 Items associated with particularly high risk

7.1 When determining whether exposures in the form of units or shares in a collective investment undertaking (CIU) are associated with particularly high risk, the PRA expects the following features would be likely to give rise to such risk:

- (a) an absence of external credit assessment of the CIU from an external credit assessment institution (ECAI) recognised under the provisions of Article 132(2) of the CRR, and where the CIU has specific features (such as high levels of leverage or lack of transparency) that prevent it from meeting the eligibility criteria set out in Article 132(3) of the CRR; and
- (b) a substantial element of the CIU's property is made up of items that would be subject to a risk weight of more than 100%, or the mandate of a CIU would permit it to invest in a substantial amount of such items.

7.2 The PRA would expect a firm's assessment of whether types of exposure referred to in Article 128(3) of the CRR are associated with particularly high risk to include consideration of exposures arising out of a venture capital business — whether the firm itself carries on the venture capital business or not — to be associated with particularly high risk. The PRA considers 'venture capital business' to include the business of carrying on any of the following:

- (a) managing investments which are, arranging (bringing about) transactions in, or making arrangements with a view to transactions in, venture capital investments;
- (b) managing investments in relation to portfolios, or establishing, operating or winding up collective investment schemes, where the portfolios or collective investment schemes (apart from funds awaiting investment) invest only in venture capital investments;

(c) any custody activities provided in connection with the activities in (a) or (b); and

(d) any related ancillary activities.

(CRR Article 128)

8 Mapping of ECAI credit assessments

8.1 Until such time as the European Commission adopts implementing technical standards drafted by the Joint Committee of the European Supervisory Agencies specifying for all ECAIs the relevant credit assessments of the ECAI that correspond to the credit quality steps set out in the CRR, the PRA expects firms to continue to use **Table 1** for the purposes of mapping the credit assessments of the specified ECAIs to credit quality steps.

Table 1 Mapping of ECAIs' credit assessments to credit quality steps for the purposes of the standardised approach**Long-term mapping**

Credit quality step	Fitch's s assessment	Moody's assessments	S&P's assessments	DBRS assessments	Corporate	Institution (includes banks)		Sovereign	
						Sovereign method	Credit assessment method		
							Maturity > three months		Maturity three months or less
1	AAA to AA-	Aaa to Aa3	AAA to AA-	AAA to AAL	20%	20%	20%	20%	0%
2	A+ to A-	A1 to A3	A+ to A-	AH to AL	50%	50%	50%	20%	20%
3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-	BBBH to BBBL	100%	100%	50%	20%	50%
4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-	BBH to BBL	100%	100%	100%	50%	100%
5	B+ to B-	B1 to B3	B+ to B-	BH to BL	150%	100%	100%	50%	100%
6	CCC+ and below	Caa1 and below	CCC+ and below	CCCH and below	150%	150%	150%	150%	150%

Short-term mapping

Credit quality step	Fitch	Moody's	S&P	DBRS	Risk weights
1	F1+, F1	P-1	A-1+, A-1	R-1 (high), R-1 (middle), R-1 (low)	20%
2	F2	P-2	A-2	R-2 (high), R-2 (middle), R-2 (low)	50%
3	F3	P-3	A-3	R-3	100%
4	Below F3	NP	B-1, B-2, B-3, C	R-4, R-5	150%
5					150%
6					150%

Collective investment undertakings (CIUs)

Credit quality step	Risk weights	Fitch	Moody's	S&P	S&P
1	20%	AAA to AA-	Aaa to Aa3	Principal stability funds ratings AAA-m to AA-m	Fund credit quality ratings AAAf to AA-f
2	50%	A+ to A-	A1 to A3	A+m to A-m	A+f to A-f
3	100%	BBB+ to BBB-	Baa1 to Baa3	BBB+m to BBB-m	BBB+f to BBB-f
4	100%	BB+ to BB-	Ba1 to Ba3	BB+m to BB-m	BB+f to BB-f
5	150%	B+ to B-	B1 to B3	B+m to B-m	B+f to B-f
6	150%	CCC+ and below	Caa1 and below	CCC+ m and below	CCC+f and below

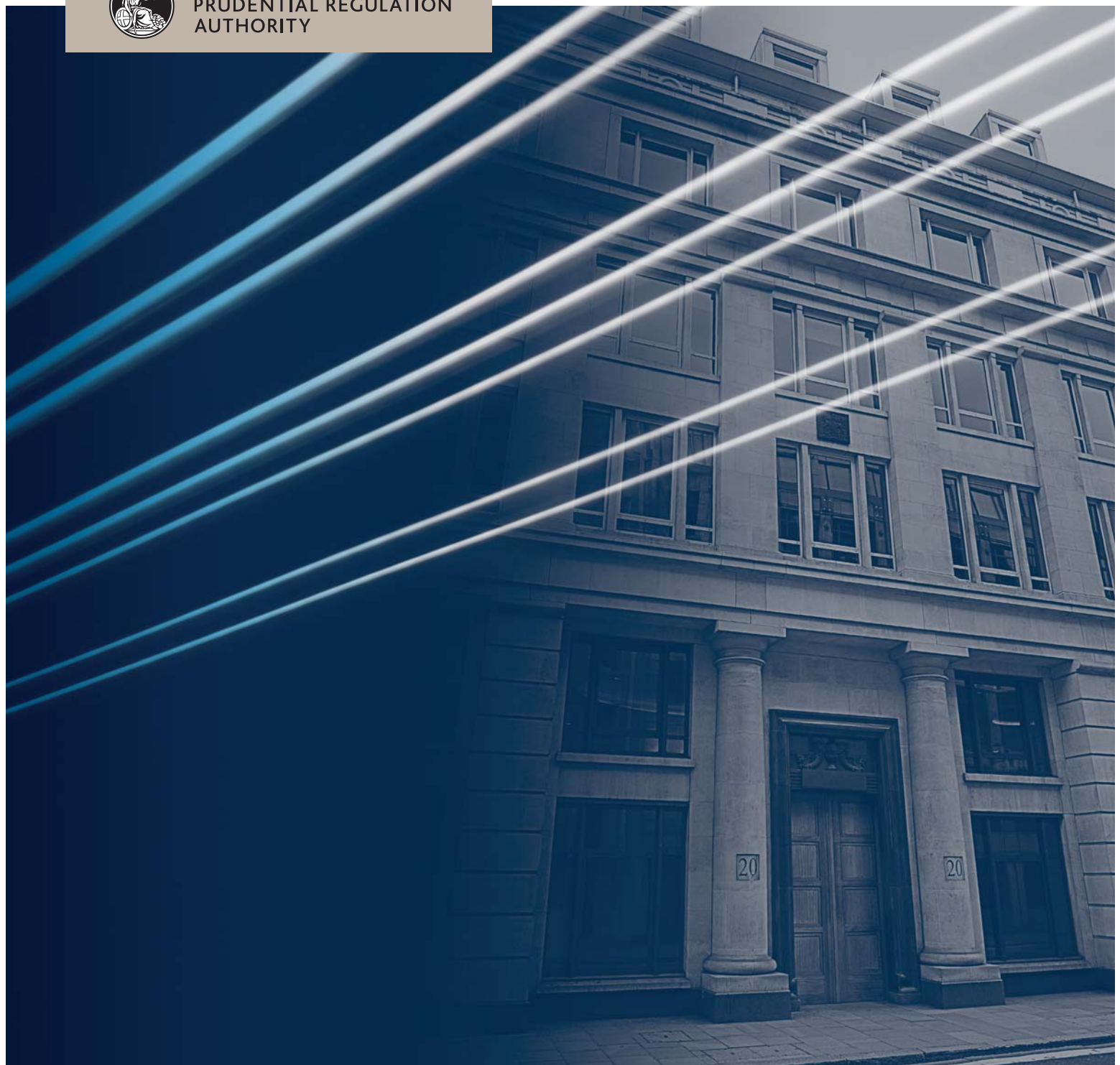
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Internal Ratings Based approaches

December 2013



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Internal Ratings Based approaches

December 2013

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1 Introduction

1.1 This supervisory statement is aimed at firms to which CRD IV applies.

1.2 Article 143(1) of the CRR requires the Prudential Regulation Authority (PRA) to grant permission to use the Internal Ratings Based (IRB) approach where it is satisfied that the requirements of Title II Chapter 3 of the CRR are met. The purpose of this supervisory statement is to provide explanation, where appropriate, of the PRA's expectations when assessing whether firms meet those requirements, including in respect of the conservatism applied.

1.3 Responsibility for ensuring that internal models are appropriately conservative and are CRR compliant rests with firms themselves. The PRA stated in *The PRA's approach to banking supervision* that 'if a firm is to use an internal model in calculating its regulatory capital requirements, the PRA will expect the model to be appropriately conservative'.

1.4 Firms should be aware that where approval to use the IRB approach is subject to a joint decision under CRR Article 20, the expectations set out in this supervisory statement will be subject to discussion between the PRA and other EEA regulators regarding the joint decision.

1.5 Some parts of this supervisory statement will require revision in due course as a result of the development by the EBA of binding technical standards required by the CRR. The PRA expects to amend or delete these parts of this supervisory statement when those technical standards enter into force.

1.6 The PRA expects that this document will be revised on a periodic basis.

2 Application of requirements to EEA groups applying the IRB approach on a unified basis

2.1 The CRR provides that where the IRB approach is used on a unified basis by an EEA group, the PRA is required to permit certain IRB requirements to be met on a collective basis by members of that group. The PRA considers that where a firm is reliant upon a rating system or data provided by another member of its group it will not meet the condition that it is using the IRB approach on a unified basis unless:

- (a) the firm only does so to the extent that it is appropriate, given the nature and scale of the firm's business and portfolios and the firm's position within the group;

- (b) the integrity of the firm's systems and controls is not adversely affected;
- (c) the outsourcing of these functions meets the requirements of SYSC;⁽¹⁾ and
- (d) the abilities of the PRA and the lead regulator of the group to carry out their responsibilities under the CRR are not adversely affected.

(CRR Article 20(6))

2.2 Prior to reliance being placed by a firm on a rating system, or data provided by another member of the group, the PRA expects the proposed arrangements to have been explicitly considered, and found to be appropriate, by the governing body of the firm.

2.3 If a firm uses a rating system or data provided by another group member, the PRA expects the firm's governing body to delegate those functions formally to the persons or bodies that are to carry them out.

(CRR Article 20(6))

3 Third country equivalence

3.1 CRR Article 107(3) allows exposures to third country investment firms, third country credit institutions and/or third country clearing houses and exchanges to be treated as exposures to an institution only if the third country applies prudential and supervisory requirements to that entity that are at least equivalent to those applied in the Union. The definition of 'large financial sector entity' in CRR Article 142(1)(4) depends in part on whether the third country in question applies prudential and supervisory requirements to that entity that are at least equivalent to those applied in the Union.

3.2 Prior to the end of 2013, the PRA will set out the approach to be taken during 2014 in the absence of an equivalence determination by the European Commission.

(1) Senior Management Arrangements, Systems and Controls, as contained in the PRA Handbook.

4 Materiality of non-compliance

4.1 Where a firm seeks to demonstrate to the PRA that the effect of its non-compliance with the requirements of CRR Title II Chapter 3 is immaterial under CRR Article 146(b), the PRA expects it to have taken into account all instances of non-compliance with the requirements of the IRB approach and to have demonstrated that the overall effect of non-compliance is immaterial.

(CRR Article 146(b))

5 Corporate governance

5.1 Where a firm's rating systems are used on a unified basis pursuant to CRR Article 20(6), the PRA considers that the governance requirements in CRR Article 189 can be met only if the subsidiary undertakings have delegated to the governing body or designated committee of the EEA parent institution, EEA parent financial holding company or EEA parent mixed financial holding company responsibility for approval of all material aspects of rating and estimation processes.

5.2 The PRA expects an appropriate individual in a Significant Influence Function (SIF) role to provide to the PRA on an annual basis written attestation that:

- (i) the firm's internal approaches for which it has received a permission comply with the CRR requirements and any applicable PRA IRB supervisory statements; and
- (ii) where a model rating system has been found not to be compliant, a credible plan for a return to compliance is in place and being completed.

5.3 Firms should agree with the PRA the appropriate SIF for providing this attestation. The PRA would not expect to agree more than two SIFs to cover all the firm's IRB models. In agreeing which SIF (or SIFs) may provide the annual attestation, the PRA will consider the firm's arrangements for approving rating and estimation processes under CRR Article 189.

(CRR Article 189, 20(6) and CRD Article 3(1)(7))

6 Permanent partial use

Policy for identifying exposures

6.1 The PRA expects a firm that is seeking to apply the Standardised Approach on a permanent basis to certain exposures to have a well-documented policy, explaining the

basis on which exposures would be selected for permanent exemption from the IRB approach. This policy should be provided to the PRA when the firm applies for permission to use the IRB approach and maintained thereafter. Where a firm also wishes to undertake sequential implementation, the PRA expects the firm's roll-out plan to provide for the continuing application of that policy on a consistent basis over time.

(CRR Article 143(1), 148(1) and CRR Article 150(1))

Exposures to sovereigns and institutions

6.2 The PRA may permit the exemption of exposures to sovereigns and institutions under CRR Articles 150(1)(a) and 150(1)(b) respectively, only if the number of material counterparties is limited and it would be unduly burdensome to implement a rating system for such counterparties.

6.3 The PRA considers that the 'limited number of material counterparties' test is unlikely to be met if for the UK group total exposures to 'higher-risk' sovereigns and institutions exceed either £1 billion or 5% of total assets (other than in the case of temporary fluctuations above these levels). For these purposes, 'higher-risk' sovereigns and institutions are considered to be those that are unrated or carry ratings of BBB+ (or equivalent) or lower. In determining whether to grant this exemption, the PRA will also consider whether a firm incurs exposures to 'higher-risk' counterparties which are below the levels set out below, but are outside the scope of its core activities.

6.4 In respect of the 'unduly burdensome' condition, the PRA considers that an adequate, but not perfect, proxy for the likely level of expertise available to a firm is whether its group has a trading book. Accordingly, if a firm's group does not have a trading book, the PRA is likely to accept the argument that it would be unduly burdensome to implement a rating system.

(CRR Article 150(1)(a) and 150(1)(b))

Non-significant business units and immaterial exposures classes and types

6.5 Where a firm wishes permanently to apply the standardised approach to certain business units on the grounds that they are non-significant, and/or certain exposure classes or types of exposures on the grounds that they are immaterial in terms of size and perceived risk profile, the PRA expects to permit this exemption only to the extent that the risk-weighted exposure amounts calculated under paragraphs (a) and (f) of CRR Article 92(3) that are based on the standardised approach (insofar as they are attributable to the exposures to which the standardised approach is permanently applied) — would be no more than 15% of the risk-weighted exposure amounts calculated under

paragraphs (a) and (f) of CRR Article 92, based on whichever of the standardised approach and the IRB approach would apply to the exposures at the time the calculation was made.

6.6 The following points set out the level at which the PRA would expect the 15% test to be applied for firms that are members of a group:

- (a) if a firm were part of a group subject to consolidated supervision in the EEA and for which the PRA was the lead regulator, the calculations in part (a) would be carried out with respect to the wider group;
- (b) if a firm were part of a group subject to consolidated supervision in the EEA and for which the PRA was not the lead regulator the calculation set out in part (a) would not apply but the requirements of the lead regulator related to materiality would need to be met in respect of the wider group;
- (c) if the firm were part of a subgroup subject to consolidated supervision in the EEA, and part of a wider third-country group subject to equivalent supervision by a regulatory authority outside of the EEA, the calculation set out in part (a) would not apply but the requirements of the lead regulator related to materiality would need to be met in respect of both the subgroup and the wider group; and
- (d) if the firm is part of a subgroup subject to consolidated supervision in the EEA, and is part of a wider third-country group that is not subject to equivalent supervision by a regulatory authority outside of the EEA, then the calculation in part (a) would apply in respect of the wider group if supervision by analogy (as referred to in CRR) is applied and in respect of the subgroup if other alternative supervisory techniques are applied.

6.7 Whether a third-country group is subject to equivalent supervision, whether it is subject to supervision by analogy, as referred to in the CRR, or whether other alternative supervisory techniques apply, is decided in accordance with CRD Article 126.

(CRR Article 150(1)(c) and CRD Article 126)

Identification of connected counterparties

6.8 Where a firm wished permanently to apply the standardised approach to exposures to connected counterparties in accordance with CRR Article 150(1)(e), the PRA will normally grant permission to do so only if the firm has a policy that identifies connected counterparty exposures that would be permanently exempted from the IRB approach and also identifies connected counterparty exposures (if any) that would not be permanently exempted. The PRA expects a firm

to use the IRB approach either for all of its intra-group exposures or for none of them.

(CRR Article 150(1)(e))

7 Sequential implementation following significant acquisition

7.1 In the event that a firm with an IRB permission acquires a significant new business, it should discuss with the PRA whether sequential roll-out of the firm's IRB approach to these exposures would be appropriate. In addition, the PRA would expect to review any existing time period and conditions for sequential roll-out and determine whether these remain appropriate.

(CRR Article 148)

8 Classification of retail exposures

8.1 CRR Article 154(4)(d) specifies that for an exposure to be treated as a Qualified Revolving Retail Exposure (QRRE), it needs to exhibit relatively low volatility of loss rates. The PRA expects firms to assess the volatility of loss rates for the qualifying revolving retail exposure portfolio relative to the volatilities of loss rates of other relevant types of retail exposures for these purposes. Low volatility should be demonstrated by reference to data on the mean and standard deviation of loss rates over a time period that can be regarded as representative of the long-run performance of the portfolios concerned.

8.2 CRR Article 154(4)(e) specifies that for an exposure to be treated as a QRRE this treatment should be consistent with the underlying risk characteristics of the subportfolio. The PRA considers that a subportfolio consisting of credit card or overdraft obligations will usually meet this condition and that it is unlikely that any other type of retail exposure would do so. If a firm wishes to apply the treatment in CRR Article 154(4) to product types other than credit card or overdraft obligations the PRA expects it to discuss this with the PRA before doing so.

(CRR Article 154(4))

9 Documentation

9.1 The PRA expects a firm to ensure that all documentation relating to its rating systems (including any documentation referenced in this supervisory statement or required by the CRR requirements that relate to the IRB approach) is stored, arranged and indexed in such a way that it could make them all, or any subset thereof, available to the PRA immediately on demand or within a short time thereafter.

10 Overall requirements for estimation

High-level expectations for estimation

10.1 In order to be able to determine that the requirements in CRR Article 144(1) have been met, the PRA would typically have the high level expectations set out in this subsection.

10.2 The PRA expects the information that a firm produces or uses for the purpose of the IRB approach to be reliable and take proper account of the different users of the information produced (customers, shareholders, regulators and other market participants).

10.3 The PRA expects firms to establish quantified and documented targets and standards, against which it should test the accuracy of data used in its rating systems. Such tests should cover:

- (a) a report and accounts reconciliation, including whether every exposure has a Probability of Default (PD), Loss Given Default (LGD) and, if applicable, conversion factor (CF) for reporting purposes;
- (b) whether the firm's risk control environment has key risk indicators for the purpose of monitoring and ensuring data accuracy;
- (c) whether the firm has an adequate business and information technology infrastructure with fully documented processes;
- (d) whether the firm has clear and documented standards on ownership of data (including inputs and manipulation) and timeliness of current data (daily, monthly, real time); and
- (e) whether the firm has a comprehensive quantitative audit programme.

10.4 The PRA expects that in respect of data inputs, the testing for accuracy of data, including the reconciliation referred to above, should be sufficiently detailed so that, together with other available evidence, it provides reasonable assurance that data input into the rating system is accurate, complete and appropriate. The PRA considers that input data would not meet the required standard if it gave rise to a serious risk of material misstatement in the capital requirement, either immediately or subsequently.

10.5 In respect of data outputs, as part of the reconciliation referred to above, the PRA expects a firm to be able to identify and explain material differences between the outputs produced under accounting standards and those produced under the requirements of the IRB approach, including in relation to areas that address similar concepts in different

ways (for example expected loss (EL) and accounting provisions).

10.6 The PRA expects a firm to have clear and documented standards and policies about the use of data in practice (including information technology standards) which should in particular cover the firm's approach to the following:

- (a) data access and security;
- (b) data integrity, including the accuracy, completeness, appropriateness and testing of data; and
- (c) data availability.

(CRR Article 144(1)(a))

Ratings systems: policies

10.7 In order for the PRA to be satisfied that a firm documents its ratings systems appropriately in accordance with CRR Article 144(1)(e) the PRA expects a firm to be able to demonstrate that it has an appropriate policy in respect of its ratings systems in relation to:

- (a) any deficiencies caused by its not being sensitive to movements in fundamental risk drivers or for any other reason;
- (b) the periodic review and action in the light of such review;
- (c) providing appropriate internal guidance to staff to ensure consistency in the use of the rating system, including the assignment of exposures or facilities to pools or grades;
- (d) dealing with potential weaknesses of the rating system;
- (e) identifying appropriate and inappropriate uses of the rating system and acting on that identification;
- (f) novel or narrow rating approaches; and
- (g) ensuring the appropriate level of stability over time of the rating system.

(CRR Article 144(1)(a) and 144(1)(e))

Collection of data

10.8 In order to be satisfied that the requirements in CRR Article 179(1) are met, the PRA expects a firm to collect data on what it considers to be the main drivers of the risk parameters of PD, LGD, CF and EL, for each group of obligors or facilities, to document the identification of the main drivers of risk parameters, and to be able to demonstrate that the process of identification is reasonable and appropriate.

10.9 In its processes for identifying the main drivers of risk parameters, the PRA expects that a firm should set out its

reasons for concluding that the data sources chosen provide in themselves sufficient discriminative power and accuracy, and why additional potential data sources do not provide relevant and reliable information that would be expected materially to improve the discriminative power and accuracy of its estimates of the risk parameter in question. The PRA would not expect this process necessarily to require an intensive analysis of all factors.

(CRR Article 179(1)(a), 179(1)(d) and CRR Article 179(1)(e))

Data quality

10.10 In order to demonstrate that rating systems provide for meaningful assessment, the PRA expects that a firm's documentation relating to data include clear identification of responsibility for data quality. The PRA expects a firm to set standards for data quality, aim to improve them over time and measure its performance against those standards. Furthermore, the PRA expects a firm to ensure that its data are of sufficiently high quality to support the firm's risk management processes and the calculation of its capital requirements.

(CRR Article 144(1)(a))

Use of models and mechanical methods to produce estimates of parameters

10.11 Further detail of standards that the PRA would expect firms to meet when it assesses compliance with CRR Article 174 are set out in the sections on PD, LGD and Exposure at Default (EAD).

10.12 In assessing whether the external data used by a firm to build models are representative of its actual obligors or exposures, the PRA expects a firm to consider whether the data are appropriate to its own experience and whether adjustments are necessary.

(CRR Article 174 and 174(c))

Calculation of long-run averages of PD, LGD and EAD

10.13 In order to estimate PDs that are long-run averages of one year default rates for obligor grades or pools, the PRA expects firms to estimate expected default rates for the grade/pool over a representative mix of good and bad economic periods, rather than simply taking the historic average of default rates actually incurred by the firm over a period of years. The PRA expects that a long-run estimate would be changed when there is reason to believe that the existing long-run estimate is no longer accurate, but that it would not be automatically updated to incorporate the experience of additional years, as these may not be representative of the long-run average.

(CRR Article 180)

10.14 In order to be able to demonstrate compliance with CRR Article 144(1)(1), the PRA expects a firm to take into account the following factors in understanding differences between their historic default rates and their PD estimates, and in adjusting the calibration of their estimates as appropriate:

- (a) the rating philosophy of the system and the economic conditions in the period over which the defaults have been observed;
- (b) the number of defaults, as a low number is less likely to be representative of a long-run average. Moreover, where the number of internal defaults is low, there is likely to be a greater need to base PDs on external default data as opposed to purely internal data;
- (c) the potential for under-recording of actual defaults; and
- (d) the level of conservatism applied.

10.15 The PRA expects that a firm that is not able to produce a long-run estimate, as described above, to consider what action it would be appropriate for it to take to comply with CRR Article 180(1)(a). In some circumstances, it may be appropriate for firms to amend their rating system so that the PD used as an input into the IRB capital requirement is an appropriately conservative estimate of the actual default rate expected over the next year. However, such an approach is not likely to be appropriate where default rates are dependent on the performance of volatile collateral.

(CRR Article 179(1)(f) and 180(1)(a))

10.16 In accordance with CRR Article 181(1)(b) and CRR Article 182(1)(b), where the estimates appropriate for an economic downturn are more conservative than the long-run average, we would expect the estimate for each of these parameters to represent the LGD or CF expected, weighted by the number of defaults, over the downturn period. Where this was not the case we would expect the estimate to be used to be the expected LGD or CF, weighted by the number of defaults, over a representative mix of good and bad economic periods.

(CRR Article 179, 181 and 182)

Assignment to grades or pools

10.17 In order to demonstrate that a rating system provided for a meaningful differentiation of risk and accurate and consistent quantitative estimates of risk the PRA expects that a firm would have regard to the sensitivity of the rating to movements in fundamental risk drivers, in assigning exposures to grades or pools within a rating system.

(CRR Article 171)

11 Definition of default

Identification of obligors

11.1 The PRA expects that if a firm ordinarily assigns exposures in the corporate, institution or central government and central bank exposure classes to a member of a group substantially on the basis of membership of that group and a common group rating, and the firm does so in the case of a particular obligor group, the firm should consider whether members of that group should be treated as a single obligor for the purpose of the definition of default set out in CRR Article 178(1).

11.2 The PRA would not expect a firm to treat an obligor as part of a single obligor under the preceding paragraph if the firm rated its exposures on a stand alone basis or if its rating was notched. (For these purposes a rating is notched if it takes into account individual risk factors, or otherwise reflects risk factors that are not applied on a common group basis.) Accordingly, if a group has two members which are separately rated, the PRA would not expect that the default of one would necessarily imply the default of the other.

Days past due

11.3 Under CRR Article 178(2)(d) the PRA is empowered to replace 90 days with 180 days in the days past due component of the definition of default for exposures secured by residential or SME commercial real estate in the retail exposure class, as well as exposures to public sector entities (PSEs).

11.4 We would expect to replace 90 days with 180 days in the days past due component of the definition of default for exposures secured by residential real estate in the retail exposure class, and/or for exposures to PSEs, where this was requested by the firm. Where this occurred, it would be specified in a firm's IRB permission.

Unlikelihood to pay: distressed restructuring

11.5 The PRA expects that a credit obligation be considered a distressed restructuring if an independent third party, with expertise in the relevant area, would not be prepared to provide financing on substantially the same terms and conditions.

(See CRR Article 178(2)(d))

Return to performing status

11.6 In order to be satisfied that a firm complies with the documentation requirements set out in CRR Article 175(3) the PRA expects that a firm should have a clear and documented policy for determining whether an exposure that has been in default should subsequently be returned to performing status.

(CRR Article 175(3))

12 Probability of default in IRB approaches

Rating philosophy

12.1 'Rating philosophy' describes the point at which a rating system sits on the spectrum between the stylised extremes of a point in time (PiT) rating system and a through the cycle (TTC) rating system. Points (a) and (b) explain these concepts further:

- (a) PiT: firms seek explicitly to estimate default risk over a fixed period, typically one year. Under such an approach the increase in default risk in a downturn results in a general tendency for migration to lower grades. When combined with the fixed estimate of the long-run default rate for the grade, the result is a higher capital requirement. Where data are sufficient, grade level default rates tend to be stable and relatively close to the PD estimates; and
- (b) TTC: firms seek to remove cyclical volatility from the estimation of default risk, by assessing borrowers' performance across the economic cycle. TTC ratings do not react to changes in the cycle, so there is no consequent volatility in capital requirements. Actual default rates in each grade diverge from the PD estimate for the grade, with actual default rates relatively higher at weak points in the cycle and relatively lower at strong points.

12.2 Most rating systems sit between these two extremes. Rating philosophy is determined by the cyclical nature of the drivers/criteria used in the rating assessment, and should not be confused with the requirement for grade level PDs to be 'long run'. The calibration of even the most PiT rating system needs to be targeted at the long-run default rates for its grades; the use of long-run default rates does not convert such a system into one producing TTC ratings or PDs.

12.3 Firms should understand where their rating systems lie on the PiT/TTC spectrum to enable them to estimate how changes in economic conditions will affect their IRB capital requirements. The PRA also expects firms to be able to compare the actual default rates incurred against the default rate expected over the same period given the economic conditions pertaining, as implied by their PD estimate.

Variable scalar approaches

Use of variable scalar approaches

12.4 We use the term 'variable scalar' to describe approaches in which the outputs of an underlying, relatively PiT, rating system are transformed to produce final PD estimates used for regulatory capital requirements that are relatively non-cyclical. Typically this involves basing the resulting requirement on the long-run default rate of the portfolio or segments thereof.

12.5 CRR Article 169(3) allows the use of direct estimates of PDs, though such a measure could be assessed over a variety of different time horizons which CRR does not specify. Accordingly, the PRA considers it acceptable in principle to use methodologies of this type in lieu of estimation of long-run averages for the grade/pool/score of the underlying rating system where conditions set out below are met. Meeting these conditions would require firms using the variable scalar approach to have a deep understanding of how and why their default rates varied over time.

- (a) firms meet the following four principles which address the considerable conceptual and technical challenges to be overcome in order to carry out variable scalar adjustments in an appropriate way:

Principle 1: both the initial calculations of and subsequent changes to the scalar should be able to take account of changes in default risk that are not purely related to the changes in the cycle;

Principle 2: a firm should be able accurately to measure the long-run default risk of its portfolio; this must include an assumption that there are no changes in the business written;

Principle 3: a firm should use a data series of appropriate length in order to provide a reasonable estimate of the long-run default rate referred to in paragraph 10.13; and

Principle 4: a firm should be able to demonstrate the appropriateness of the scaling factor being used across a portfolio.

- (b) stress testing includes a stress test covering the downturn scenarios outlined by the PRA, based on the PDs of the underlying PiT rating system, in addition to the stress test based on the parameters used in the Pillar 1 capital calculation (ie the portfolio level average long-run default rates); and
- (c) firms are able to understand and articulate upfront how the scaling factor would vary over time in order to achieve the intended effect.

12.6 The PRA will not permit firms using a variable scalar approach to revert to using a PiT approach during more benign economic conditions.

12.7 Principle 1 is the most important and challenging to achieve as it requires an ability to be able to distinguish movements not related to the economic cycle, from changes purely related to the economic cycle, and not to average these away. This is because a variable scalar approach removes the

ability of a rating system to take account automatically of changes in risk through migration between its grades.

12.8 Accordingly, the PRA expects firms using a variable scalar approach to adopt a PD that is the long-run default rate expected over a representative mix of good and bad economic periods, assuming that the current lending conditions including borrower mix and attitudes and the firm's lending policies remain unchanged. If the relevant lending conditions or policies change, then we would expect the long-run default rate to change.

(CRR Article 180(1)(a), 180(1)(b) and 180(2)(a))

Variable scalar considerations for retail portfolios

12.9 The PRA considers that until more promising account level arrears data is collected, enabling firms to better explain the movement in their arrears rate over time, the likelihood of firms being able to develop a compliant variable scalar approach for non-mortgage retail portfolios is low. This is because of the difficulty that firms have in distinguishing between movements in default rates that result from cyclical factors and those that result from non-cyclical reasons for these portfolios. In practice therefore the rest of this section applies to residential mortgage portfolios.

12.10 For the purposes of this subsection 'non-mortgage retail portfolios' refers to non-mortgage lending to individuals (eg credit cards, unsecured personal loans, auto-finance) but does not include portfolios of exposures to small and medium-sized entities (SMEs in the retail exposure class).

12.11 The PRA considers that one variable scalar approach, potentially compliant with the four principles set out above, could involve:

- (a) segmenting a portfolio by its underlying drivers of default risk; and
- (b) estimating separate long-run default rates for each of these segmented pools.

Segmentation

12.12 A firm that applied a segmentation approach properly could satisfy both Principle 1 and Principle 4. The choice of the basis of segmentation and the calibration of the estimated long-run default rate for the segments would both be of critical importance.

12.13 The PRA expects segmentation to be done on the basis of the main drivers of both willingness and ability to pay. In the context of residential mortgages, an example of the former is the amount of equity in the property and an example of the latter is the ratio of debt to income of the borrower. The PRA expects firms to:

- incorporate an appropriate number of drivers of risk within the segmentation to maximise the accuracy of the system;
- provide detailed explanations supporting their choices of drivers, including an explanation of the drivers they have considered but chosen not to use; and
- ensure that the drivers reflect their risk processes and lending policy, and are not be chosen using only statistical criteria (ie a judgemental assessment of the drivers chosen is applied).

(CRR Article 179(1)(d))

12.14 To the extent that the basis of segmentation is not sufficient completely to explain movements in non-cyclical default risk, the long-run default rate for that segment will not be stable (eg a change in the mix of the portfolio within the segment could change the long-run default rate). In such cases, we expect firms to make a conservative compensating adjustment to the calibration of the long-run average PD for the affected segments and to be able to demonstrate that the amount of judgement required to make such adjustments is not excessive. Where judgement is used, considerable conservatism may be required. The PRA expects conservatism applied for this reason not to be removed as the cycle changes.

Long-run default rate

12.15 The PRA expects firms to review and amend as necessary the long-run default rate to be applied to each segment on a regular (at least an annual) basis. When reviewing the long-run default rate to be applied to each segment, the PRA expects firms to consider the extent to which:

- realised default rates are changing due to cyclical factors and the scaling factors needs to be changed;
- new information suggests that both the PiT PDs and the long-run PDs should be changed; and
- new information suggests that the basis of segmentation should be amended.

12.16 The PRA expects that over time the actual default rates incurred in each segment would form the basis of PD estimates for the segments. However at the outset the key calibration issue is likely to be the setting of the initial long-run default rate for each segment, as this will underpin the PD of the entire portfolio for some years to come. The PRA expects firms to apply conservatism in this area and this is something on which the PRA is likely to focus on in particular in PRA model reviews.

Governance

12.17 The PRA expects firms to put in place a governance process to provide a judgemental overlay to assess their choices of segments, PD estimates and scalars, both initially and on a continuing basis. Moreover, where the basis of their estimation is a formulaic approach, we would consider that the act of either accepting or adjusting the estimate suggested by the formula would represent the exercise of judgement.

12.18 The PRA expects firms to consider what use they can make of industry information. However, we would expect firms to seek to measure the absolute level of and changes to their own default risk, rather than changes in default risk relative to the industry. Given the potential for conditions to change across in the market as a whole, the PRA expects a firm should not to draw undue comfort from the observation that its default risk is changing in the same way as the industry as a whole. Doing so would not allow them to meet Principle 1.

12.19 The PRA expects firms to be able to demonstrate that they have adequate information and processes in order to underpin the decisions outlined above on choice of segmentation, source of data, and adequacy of conservatism in the calibration, and that this information is reflected in the reports and information being used to support the variable scalar governance process. Given that, for retail business, these decisions would be likely to affect only the regulatory capital requirements of the firm and not the day-to-day running of its business, we will be looking for a high level of reassurance and commitment from firms' senior management to maintain an adequate governance process.

Data considerations

12.20 The PRA expects firms to consider the following issues when seeking to apply a variable scalar approach for UK mortgages:

- in respect of Principle 2, the commonly used Council for Mortgage Lenders database was based on arrears data and not defaults during a period, and the use of these data without further analysis and adjustment can undermine the accuracy of any calculations; and
- in respect of Principle 3, the historical data time period chosen for use in the calculations will vary the long-run PDs, and thus capital requirements, when there is no change in the underlying risk.

12.21 The PRA expects firms that are including mortgage arrears data as a proxy for default data to:

- carry out sensitivity analysis identifying the circumstances in which the assumption that arrears may be used as a proxy for default would produce inaccuracy in long-run PD estimates;

- (b) set a standard for what might constitute a potentially significant level of inaccuracy, and demonstrate why in practice the use of this proxy would not result in any significant inaccuracy;
- (c) establish a process for assessing the on-going potential for inaccuracy, including thresholds beyond which the level of inaccuracy may no longer be insignificant; and
- (d) consider the use of conservative adjustments to address the potential inaccuracy.

12.22 When using historical mortgage data as a key input into variable scalar models the PRA expects firms to:

- (a) carry out sensitivity analysis identifying the implications of using different cut-off dates for the start of the reference data set; and
- (b) justify the appropriateness of their choice of cut-off date.

Retail exposures: obligor level definition of default

12.23 Where a firm has not chosen to apply the definition of default at the level of an individual credit facility in accordance with CRR Article 178(1), the PRA expects it to ensure that the PD associated with unsecured exposures is not understated as a result of the presence of any collateralised exposures.

12.24 The PRA expects the PD of a residential mortgage would typically be lower than the PD of an unsecured loan to the same borrower.

(CRR Article 178(1))

Retail exposures: facility level definition of default

12.25 Where a firm chooses to apply the definition of default at the level of an individual credit facility in accordance with CRR Article 178(1) and a customer has defaulted on a facility, then default on that facility is likely to influence the PD assigned to that customer on other facilities. The PRA expects firms to take this into account in its estimates of PD.

(CRR Article 178(1))

Multi-country mid-market corporate PD models

12.26 In order to ensure that a rating system provides a meaningful differentiation of risk and accurate and consistent quantitative estimates of risk, the PRA would expect firms to develop country-specific mid-market PD models. Where firms develop multi-country mid-market PD models, we would expect firms to be able to demonstrate that the model rank orders risk and predicts default rates for each country where it is to be used for regulatory capital calculation.

12.27 The PRA expects firms to have challenging standards in place to meaningfully assess whether a model rank orders risk

and accurately predict default rates. These standards should specify the number of defaults that are needed for a meaningful assessment to be done.

12.28 We would expect firms to assess the model's ability to predict default rates using a time series of data (ie not only based on one year of default data).

12.29 In our view a model is not likely to be compliant where the firm cannot demonstrate that it rank orders risk and predicts default rates for each country regardless of any apparent conservatism in the model.

Use of external ratings agency grades

12.30 We would expect firms using a rating agency grades as the primary driver in their IRB models to be able to demonstrate (and document) compliance with the following criteria:

- (a) the firm has its own internal rating scale;
- (b) the firm has a system and processes in place that allow it continuously to collect and analyse all relevant information, and the 'other relevant information' considered by the firm in accordance with CRR Article 171(2) reflects the information collected and analysed by the firm when extending credit to new or existing obligors;
- (c) the 'other relevant information' considered by the firm is included in an IRB model in a transparent and objective way and is subject to challenge. We would expect the firm to be able to demonstrate what information was used and why, and, how it was included; and if no additional information is included, to be able to document what information was discarded and why;
- (d) the development of final grades includes the following steps:
 - (i) the firm takes into account all available information (eg external agency grades and any 'other relevant information') prior to allocating obligors to internal grades. The firm does not automatically assign obligors to grades based on the rating agency grade;
 - (ii) any overrides are applied to these grades; and
 - (iii) the firm has a system and processes in place that allows it to continuously collect and analyse final rating overrides.
- (e) the grades to which obligors are assigned is reassessed at least annually. The firm is able to demonstrate how

the grades are reassessed on a more frequent than annual basis when new relevant information becomes available; and

- (f) firms can demonstrate that a modelling approach is being applied, both in terms of the choice of the rating agency grade as the primary driver and, where information is found materially and consistently to add to the accuracy or predictive power of the internal rating grade, that they have incorporated this information as an additional driver. The PRA expects this work to be analytical (rather than entirely subjective) and could form part of the annual independent review of the model.

12.31 In the PRA's view, if a firm does not have any additional information to add to the external ratings for the significant part of its portfolio then the PRA expects it will not meet the requirements for using an IRB approach.

Low default portfolios

12.32 The PRA expects a firm to estimate PD for a rating system in accordance with this section where a firm's internal experience of defaults for that rating system was 20 or fewer, and reliable estimates of PD cannot be derived from external sources of default data including the use of market price related data. In PD estimation for all exposures covered by that rating system, the PRA expects firms to:

- (a) use a statistical technique to derive the distribution of defaults implied by the firm's experience, estimating PDs (the 'statistical PD') from the upper bound of a confidence interval set by the firm in order to produce conservative estimates of PDs in accordance with CRR Article 179(f);
- (b) use a statistical technique to derive the distribution of default which takes account, as a minimum, of the following modelling issues:
- (i) the number of defaults and number of obligor years in the sample;
 - (ii) the number of years from which the sample was drawn;
 - (iii) the interdependence between default events for individual obligors;
 - (iv) the interdependence between default rates for different years; and
 - (v) the choice of the statistical estimators and the associated distributions and confidence intervals.
- (c) further adjust the statistical PD to the extent necessary to take account of the following:

- (i) any likely differences between the observed default rates over the period covered by the firm's default experience and the long-run PD for each grade required by CRR Articles 180(1)(a) and 180(2)(a); and
- (ii) any other information that indicates (taking into account the robustness and cogency of that information) that the statistical PD is likely to be an inaccurate estimate of PD.

12.33 The PRA expects firms to take into account only defaults that occurred during periods that are relevant to the validation under the CRR of the model or other rating system in question when determining whether there are 20 defaults or fewer.

Supervisory slotting criteria for specialised lending

12.34 The PRA expects firms to assign exposures to the risk-weight category for specialised lending exposures based on the criteria set out in the tables in Appendix A. Draft EBA regulatory technical standards due to be developed by 31 December 2014 will specify these assignments.

13 Loss Given Default in IRB approaches

Negative LGDs

13.1 The PRA expects firms to ensure that no LGD estimate is less than zero.

Low LGDs

13.2 The PRA does not expect firms to be using zero LGD estimates in cases other than where they had cash collateral supporting the exposures.

13.3 The PRA expects firms to justify any low LGD estimates using analysis on volatility of sources of recovery, notably on collateral, and cures (as outlined below). This includes:

- (a) recognising that the impact of collateral volatility on low LGDs is asymmetric as surpluses over amounts owed need to be returned to borrowers and that this effect may be more pronounced when estimating downturn rather than normal period LGDs; and
- (b) recognising the costs and discount rate associated with realisations and the requirements of CRR Article 181(1)(e).

13.4 In order to ensure that the impact of collateral volatility is taken into account, the PRA expects firms' LGD framework to include non-zero LGD floors which are not solely related to administration costs.

(CRR Article 179(1)(f))

Treatment of cures

13.5 Where firms wish to include cures in their LGD estimates, the PRA expects them to do so on a cautious basis with reference to both their current experience and how this is expected to change in downturn conditions. In particular, this involves being able to articulate clearly both the precise course of events that will allow such cures to take place and any consequences of such actions for other elements of their risk quantification. For example:

- (a) Where cures are driven by the firm's own policies, we would expect firms to consider whether this is likely to result in longer realisation periods and larger forced sale discounts for those exposures that do not cure, and higher default rates on the book as a whole, relative to those that might be expected to result from a less accommodating attitude. To the extent feasible, the PRA expects cure assumptions in a downturn to be supported by relevant historical data.
- (b) The PRA expects firms to be aware of and properly account for the link between cures and subsequent defaults. In particular, an earlier cure definition is, other things being equal, likely to result in a higher level of subsequent defaults.

(CRR Article 5(2))

Incomplete workouts

13.6 In order to ensure that estimates of LGDs take into account the most up to date experience, we would expect firms to take account of data in respect of relevant incomplete workouts (ie defaulted exposures for which the recovery process is still in progress, with the result that the final realised losses in respect of those exposures are not yet certain).

(CRR Article 179(1)(c))

LGD — sovereign floor

13.7 To ensure that sovereign LGD models are sufficiently conservative in view of the estimation error that may arise from the lack of data on losses to sovereigns, the PRA expects firms to apply a 45% LGD floor to each unsecured exposure in the sovereign asset class.

(CRR Articles 144(1) and 179(1)(a))

LGD — UK retail mortgage property sales reference point(2)

13.8 The PRA believes that an average reduction in property sales prices of 40% from their peak price, prior to the market downturn, forms an appropriate reference point when assessing downturn LGD for UK mortgage portfolios. This reduction captures both a fall in the value of the property due

to house price deflation as well as a distressed forced sale discount.

13.9 Where firms adjust assumed house price values within their LGD models to take account of current market conditions (for example with reference to appropriate house price indices) we recognise that realised falls in market values may be captured automatically. Firms adopting such approaches may remove observed house price falls from their downturn house price adjustment so as not to double count. The PRA expects all firms wishing to apply such an approach to seek the consent of the PRA and to be able to demonstrate that the following criteria are met:

- (a) the adjustment applied to the market value decline element of a firm's LGD model is explicitly derived from the decrease in indexed property prices (ie the process is formulaic, not judgemental);
- (b) the output from the adjusted model has been assessed against the 40% peak-to-trough property sales prices decrease reference point (after inclusion of a forced sale discount);
- (c) a minimum 5% market value decline applies at all times in the LGD model; and
- (d) the firm has set a level for reassessment of the property market price decline from its peak. For example, if a firm had initially assumed a peak-to-trough market decline of 15%, then it will have set a level of market value decline where this assumption will be reassessed.

CRR Article 181(1)(b))

Downturn LGDs

13.10 In order to ensure that their LGD estimates are oriented towards downturn conditions, the PRA expects firms to have a process through which they:

- (a) identify appropriate downturn conditions for each IRB exposure class within each jurisdiction;
- (b) identify adverse dependencies, if any, between default rates and recovery rates; and
- (c) incorporate adverse dependencies, if identified, between default rates and recovery rates in the firm's estimates of LGD in a manner that meets the requirements relating to an economic downturn.

(CRR Article 181(1)(b))

Discounting cash flows

13.11 In order to ensure that their LGD estimates incorporate material discount effects, the PRA expects firms' methods for

discounting cash flows to take account of the uncertainties associated with the receipt of recoveries with respect to a defaulted exposure, for example by adjusting cash flows to certainty equivalents or by using a discount rate that embodies an appropriate risk premium; or by a combination of the two.

13.12 If a firm intends to use a discount rate that does not take full account of the uncertainty in recoveries, we would expect it to be able to explain how it has otherwise taken into account that uncertainty for the purposes of calculating LGDs. This can be addressed by adjusting cash flows to certainty equivalents or by using a discount rate that embodies an appropriate risk premium for defaulted assets; or by a combination of the two.

13.13 In addition to the above measures the PRA expects firms to ensure that no discount rate used to estimate LGD is less than 9%.

(CRR Article 5(2))

Wholesale LGD

13.14 The PRA expects firms using AIRB approaches to have done the following in respect of wholesale LGD estimates:

- (a) applied LGD estimates at transaction level;
- (b) ensured that all LGD estimates (both downturn and non-downturn) are cautious, conservative and justifiable, given the paucity of observations. In accordance with CRR Article 179(1)(a), estimates must be derived using both historical experience and empirical evidence, and not be based purely on judgemental consideration. We expect the justification as to why the firm thinks the estimates are conservative to be documented;
- (c) identified and explained at a granular level how each estimate has been derived. This should include an explanation of how internal data, external data, expert judgement or a combination of these has been used to produce the estimate;
- (d) clearly documented the process for determining and reviewing estimates, and the parties involved in the process in cases where expert judgement was used;
- (e) demonstrated an understanding of the impact of the economic cycle on collateral values and be able to use that understanding in deriving their downturn LGD estimates;
- (f) demonstrated sufficient understanding of any external benchmarks used and identified the extent of their relevance and suitability to the extent that the firm can satisfy itself that they are fit for purpose;

- (g) evidenced that they are aware of any weaknesses in their estimation process and have set standards, for example related to accuracy, that their estimates are designed to meet;
- (h) demonstrated that they have sought and utilised relevant and appropriate external data, including through identifying all relevant drivers of LGD and how these will be affected by a downturn;
- (i) ensured, in most cases, estimates incorporate effective discrimination on the basis of at least security type and geography. In cases where these drivers are not incorporated into LGD estimates then we would expect the firm to be able to demonstrate why they are not relevant;
- (j) have put in place an on-going data collection framework to collect all relevant internal loss and exposure data required for estimating LGD and a framework to start using these data as soon as any meaningful information becomes available; and
- (k) ensured it can articulate the data the firm intends to use from any industry-wide data collection exercises in which it is participating, and how the data will be used.

(CRR Section 6)

13.15 We have developed a framework for assessing the conservatism of firms' wholesale LGD models for which there are a low number of defaults. The framework is set out in Appendix C and does not apply to sovereign LGD estimates which are floored at 45%. We are in the process of using this framework to assess the calibration of firms' material.

LGD models for low-default portfolios

13.16 In the following cases, the PRA expects firms to determine the effect of applying the framework set out in Appendix C to models which include LGD values that are based on fewer than 20 'relevant' data points (as defined in Appendix C):

- (a) the model is identified for review by the PRA; or
- (b) the firm submits a request for approval for a material change to its LGD model.

13.17 In such cases firms should contact their supervisor to obtain the relevant data templates that should be populated and submitted to the PRA.

Unexpected loss (UL) on defaulted assets⁽¹⁾

13.18 The CRR is unclear in how UL should be calculated for defaulted assets. This was also the case for the BCD. The answer to transposition group question 655 on the calculation of UL for defaulted assets under the BCD referred to two approaches:

- (a) the independent calculation approach; and
- (b) subtraction of the best estimate of expected loss from post-default LGD.

13.19 The PRA considers that both of the approaches set out in the CRD transposition group answer are acceptable in principle.

13.20 Where an independent calculation approach is adopted for the calculation of unexpected loss on defaulted assets the PRA expects firms to ensure that estimates are at least equal, at a portfolio level, to a 100% risk-weight, ie 8% capital requirement on the amount outstanding net of provisions.⁽²⁾

(CRR Article 181(1)(h))

Unsecured LGDs where the borrowers' assets are substantially used as collateral

13.21 The extent to which a borrower's assets are already given as collateral will affect the recoveries available to unsecured creditors. If the degree to which assets are pledged is substantial this will be a material driver of LGDs on such exposures. Although potentially present in all transactions, the PRA expects firms to be particularly aware of this driver in situations in which borrowing on a secured basis is the normal form of financing, leaving relatively few assets available for the unsecured debt. Specialist lending (including property), hedge funds, some SME/mid-market lending are examples of such cases.

13.22 The PRA expects firms to take into account the effect of assets being substantially used as collateral for other obligations estimating LGDs for borrowers for which this is the case. The PRA expects firms not to use unadjusted data sets that ignore this impact, and note that it is an estimate for downturn conditions that is normally required. In the absence of relevant data to estimate this effect, conservative LGDs — potentially of 100% — are expected to be used.

(CRR Articles 171(2), 179(1)(a))

14 Own estimates of exposure at default (EAD) in IRB approaches

Estimation of EAD in place of conversion factors

14.1 The PRA considers that a firm may provide own estimates of EAD in place of the own estimates of CFs that it is permitted or required to provide under CRR Article 151.

14.2 In this supervisory statement references to EAD refer to both direct estimates of EAD and CFs unless specified otherwise.

(CRR Article 151)

General expectations for estimating EAD

14.3 The PRA expects that EAD estimates should not be less than current drawings (including interest accrued to date). Consequently, the PRA expects CF estimates not to be less than zero.

14.4 The EAD required for IRB purposes is the exposure(s) expected to be outstanding under a borrower's current facilities should it go into default in the next year, assuming that economic downturn conditions occur in the next year and a firm's policies and practices for controlling exposures remain unchanged other than changes that result from the economic downturn conditions.

14.5 In order to achieve sufficient coverage of the EAD, the PRA expects firms to take into account all facility types that may result in an exposure when an obligor defaults, including uncommitted facilities.

14.6 To the extent that a firm makes available multiple facilities, the PRA expects firms to be able to demonstrate:

- (a) how they deal with the fact that exposures on one facility may become exposures under another on which the losses are ultimately incurred; and
- (b) the impact of its approach on its capital requirements.

14.7 The PRA expects firms using own estimates of EAD to have done the following in respect of EAD estimates:

- (a) applied EAD estimates at the level of the individual facility;
- (b) where there is a paucity of observations, ensured that all EAD estimates are cautious, conservative and justifiable. In accordance with Article 179(1)(a), estimates must be derived using both historical experience and empirical evidence, and must not be based purely on judgemental consideration. The PRA would expect the justification as to why the firm thinks the estimates are conservative to be documented;

(1) <http://ec.europa.eu/yqol/index.cfm?fuseaction=question.show&questionID=655>.

(2) Independent calculation approaches are an alternative to measuring the UL on defaulted assets as being the difference between downturn LGD and best estimate LGD. See link in footnote (1) above for further information.

- (c) identified and explained at a granular level how each estimate has been derived. This should include an explanation of how internal data, any external data, expert judgement or a combination of these has been used to produce the estimate.
- (d) ensured that where expert judgement has been used there is clear documentation of the process for arriving at and reviewing the estimates, and identifying the parties involved;
- (e) demonstrated an understanding of the impact of the economic cycle on exposure values and be able to use that understanding in deriving downturn EAD estimates;
- (f) demonstrated sufficient understanding of any external benchmarks used and identified the extent of their relevance and suitability to the extent that the firm can satisfy itself that they are fit for purpose;
- (g) evidenced that they are aware of any weaknesses in their estimation process and have set standards that their estimates are designed to meet (eg related to accuracy);
- (h) ensured, in most cases, that estimates incorporate effective discrimination on the basis of at least product features and customer type. In cases where these drivers are not incorporated into EAD estimates then the PRA expects the firm to be able to demonstrate why they are not relevant;
- (i) have an on-going data collection framework in place to collect all relevant internal exposure data required for estimating EAD and a framework to start using this data as soon as any meaningful information becomes available;
- (j) made use of the data they are collecting to identify all relevant drivers of EAD and to understand how these drivers will be affected by a downturn; and
- (k) identified dependencies between default rates and conversion factors for various products and markets when estimating downturn EADs. Firms are expected to consider how they expect their own policies regarding exposure management to evolve in a downturn.

14.8 The PRA has developed a framework for assessing the conservatism of firms' wholesale EAD models for which there are a low number of defaults. The PRA is in the process of using this framework to assess the calibration of firms' material EAD models for low-default portfolios.

14.9 In the following cases, the PRA expects firms to determine the effect of applying the framework set out in

Appendix C to models which include EAD values that are based on fewer than 20 'relevant' data points (as defined in Appendix C):

- (a) the model is identified for review by the PRA; or
- (b) the firm submits a request for approval for a material change to its EAD model.

14.10 In such cases firms should contact their supervisor to obtain the relevant data templates that should be populated and submitted to the PRA.

(CRR Articles 4(56), 166, Section 6)

Time horizon

14.11 The PRA expects firms to use a time horizon of one year for EAD estimates, unless they can demonstrate that another period would be more conservative.

14.12 EAD estimates can be undertaken on the basis that default occurs at any time during the time horizon (the 'cohort approach'), or at the end of the time horizon (the 'fixed-horizon approach'). The PRA considers that either approach is acceptable in principle.

14.13 The PRA expects the time horizon for additional drawings to be the same as the time horizon for defaults. In effect this means that EAD estimation need cover only additional drawings that might take place in the next year, such that:

- (a) no capital requirement need be held against facilities, or proportions of facilities that cannot be drawn down within the next year; and
- (b) where facilities can be drawn down within the next year, firms may in principle reduce their estimates to the extent that they can demonstrate that they are able and willing, based on a combination of empirical evidence, current policies, and documentary protection to prevent further drawings.

(CRR Article 182)

Direct estimates of EAD

14.14 There are a range of approaches that focus on the total amount that will be drawn down at the time of default and directly estimate EAD. Typically, but not in all cases, these will estimate EAD as a percentage of Total Limit. These approaches can be described collectively as 'momentum' approaches.

14.15 A 'momentum' approach can be used either:

- (a) by using the drawings/limit percentage to formulaically derive a conversion factor on the undrawn portion of the limit; or
- (b) by using the higher of percentage of the limit and the current balance as the EAD.

14.16 The PRA considers that the use of momentum approaches in both of the ways outlined above is acceptable in principle as an alternative to direct estimation of conversion factors.

(CRR Article 4(56))

Distortions to conversion factor estimates caused by low undrawn limits

14.17 In cases where firms estimate CFs directly, using a reference data set that includes a significant number of high CFs as a result of very low undrawn limits at the observation date, the PRA expects firms to:

- (a) investigate the distribution of realised CFs in the reference data set;
- (b) base the estimated CF on an appropriate point along that distribution that results in the choice of a CF appropriate for the exposures to which it is being applied and consistent with the requirement in CRR Article 179 for estimates to include a margin of conservatism related to errors; and
- (c) be cognisant that while the median of the distribution might be a starting point, they should not assume without analysis that the median represents a reasonable unbiased estimate. The PRA expects firms to consider whether the pattern of distribution in realised CFs means that some further segmentation is needed (eg treating facilities that are close to full utilisations differently).

(CRR Article 182(1)(a))

Identification of exposures for which an EAD must be estimated

14.18 The PRA expects firms to treat a facility as an exposure from the earliest date at which a customer is able to make drawings under it.

14.19 Where the facility is of the type that it is customary not to advise the borrower of its availability, the PRA expects an EAD/CF to be applied from the time that the existence of the facility is recorded on the firm's systems in a way that would allow the borrower to make a drawing.

14.20 If the availability of a facility is subject to a further credit assessment by the firm, an EAD/CF may not be required. However, the PRA expects this to be the case only if the subsequent credit assessment were of substantially equivalent rigour to that of the initial credit approval, and if this includes a re-rating or a confirmation of the rating of the borrower.

14.21 Firms are not expected to include in their EAD/CF estimates the probability of increases in limits between observation and default date. If the reference data set included the impact of such increases, the PRA expects firms to be able to adjust their estimates accordingly with the aim of assessing what the exposure would have been at default if the limit had not been increased.

14.22 The PRA expects firms to investigate the incidence of exposures existing at default that arise from products or relationships that are not intended to result in a credit exposure and, consequently, have no credit limit established against them and are not reflected in their estimates of EAD. Unless such exposures are immaterial, the PRA expects firms to apply a Pillar 1 capital charge on a portfolio basis to such exposures.

14.23 The PRA expects firms to investigate how their EAD estimates are impacted by exposures that are in excess of limits at either the observation date (if in the reference data set) or at the current reporting date (for the existing book to which estimates need to be applied). Unless a momentum approach is being used exposures in excess of limit should be excluded from the reference data set (as the undrawn limit is negative and nonsensical answers would result from their inclusion). The PRA expects firms to ensure that their EAD estimation includes the risk of further drawings on accounts that are in excess of their limits.

(CRR Article 4(56))

Accrued interest

14.24 Exposures include not only principal amounts borrowed under facilities but also interest accrued which will fluctuate between payment dates. In order to ensure proper coverage of interest, the PRA expects firms to take the following approach:

- (a) accrued interest to date should be included in current exposure for performing exposures;
- (b) firms may choose whether estimated increases in accrued interest up to the time of default should be included in LGD or EAD;
- (c) in the estimation of EAD increases in accrued interest may be offset against reductions in other outstandings;

- (d) estimation of changes in accrued interest needs to take account of changes in the contractual interest rate over the time horizon up to default, and in a way consistent with the scenario envisaged in the calculation of the downturn/default weighted average;
- (e) inclusion of estimates of future post-default interest is not necessary in either EAD or LGD; and
- (f) firms' accounting policies will determine the extent to which interest accrued to date is reflected in current exposure as opposed to LGD for defaulted exposures.

(CRR Article 166(1))

Netting

14.25 The PRA considers that there is scope within the CRR for firms to recognise on-balance sheet netting (including in respect of cross-currency balances) through EAD as an alternative to LGD in those cases where the general conditions for on-balance sheet netting set out in the CRR Article 205 are met.

14.26 As regards the CF on undrawn limits, this may be applied on the basis of the net limit provided the conditions in the CRR for the use of net limits are met. However, firms are reminded that the purpose of the measure is to estimate the amount that would be outstanding in the event of a default. This implies that their ability in practice to constrain the drawdown of credit balances will be particularly tested. Moreover the PRA expects the appropriate conversion factor to be higher as a percentage of a net limit than of a gross limit.

14.27 The lower the net limit as a percentage of gross limits or exposures, the greater will be the need on the part of the firm to ensure that it is restricting exposures below net limits in practice and that it will be able to continue to do so should borrowers encounter difficulties. The application of a zero net limit is acceptable in principle, but there is a consequently a very high obligation on the firm to ensure that breaches of this are not tolerated.

(CRR Article 166(3))

Underwriting commitments

14.28 Estimation of CFs on underwritten facilities in the course of primary market syndication may take account of anticipated sell down to other parties.

14.29 Firms are reminded that since the basis of EAD estimation is that default by the borrower is expected to take place in a one-year time horizon, and quite possibly in downturn conditions, the PRA expects any reduction in their CF in anticipation of syndication to take account of this scenario.

(CRR Article 4(56))

15 Maturity for exposures to corporates, institutions or central governments and central banks

15.1 The PRA expects all firms that have not received permission to use own estimates of LGDs and conversion factors to use the maturity approach set out in CRR Article 162(2) to 162(3) for these exposures. This will be reflected in their permissions to use the IRB approach.

(CRR Article 166)

16 Stress tests used in assessment of capital adequacy

16.1 In order to be satisfied that the credit risk stress test undertaken by a firm pursuant to CRR Article 177(2) is meaningful and considers the effects of severe, but plausible, recession scenarios the PRA would expect that the stress test would be based on an economic cycle that is consistent with the supervisory statement on the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP) — SS5/13.

(CRR Article 177(2))

17 Validation

17.1 The PRA expects a firm to have a validation process that includes the following:

- (a) standards of objectivity, accuracy, stability and conservatism that it designs its ratings systems to meet and processes that establish whether its rating systems meet those standards;
- (b) standards of accuracy of calibration (ie whether outcomes are consistent with estimates) and discriminative power (ie the ability to rank-order risk) that it designs its rating systems to meet and processes that establish whether its rating systems meet those standards;
- (c) policies and standards that specify the actions to be taken when a rating system fails to meet its specified standards of accuracy and discriminative power.
- (d) a mix of developmental evidence, benchmarking and process verification and policies on how this mixture varies between different rating systems;
- (e) use of both quantitative and qualitative techniques;

- (f) policies on how validation procedures are expected to vary over time; and
- (g) ensuring independent input into and review of its rating systems.

(CRR Article 188)

17.2 In the paragraph above:

- (a) developmental evidence means evidence that substantiates whether the logic and quality of a rating system (including the quantification process) adequately discriminates between different levels of, and delivers accurate estimates of PD, EL, LGD and CFs (as applicable); and
- (b) process verification means the process of establishing whether the methods used in a rating system to discriminate between different levels of risk and to quantify PD, EL, LGD and CFs are being used, monitored and updated in the way intended in the design of the rating system.

(CRR Article 188)

17.3 The PRA expects a firm to be able to explain the performance of its rating systems against its chosen measure (or measures) of discriminative power. In making this comparison a firm should rely primarily on actual historic default experience where this is available. In particular, the PRA expects a firm be able to explain the extent of any potential inaccuracy in these measures, caused in particular by small sample size and the potential for divergence in the future, whether caused by changing economic conditions or other factors. Firms' assessment of discriminative power should include appropriate use of external benchmarks where available.

17.4 The PRA will take into consideration the sophistication of the measure of discrimination chosen when assessing the adequacy of a rating system's performance.

17.5 In the case of a portfolio for which there is insufficient default experience to provide any confidence in statistical measures of discriminative power, the PRA expects a firm to use other methods. For example, analysis of whether the firm's rating systems and an external measurement approach, eg external ratings, rank common obligors in broadly similar ways. Where such an approach is used we would expect a firm to ensure it does not systematically adjust its individual ratings with the objective of making them closer to the external ratings as this would be counter to the philosophy of an internal rating approach. The PRA expects a firm to be able

to explain the methodology it uses and the rationale for its use.

18 Income-producing real estate portfolios

CRR compliance

18.1 The PRA considers income-producing real estate (IPRE) to be a particularly difficult asset class for which to build effective rating systems that are compliant with the CRR's requirements for the IRB approach.

18.2 As with all asset classes, firms should assess whether their IPRE model is CRR compliant and not whether it is the nearest they can get to compliance given the constraints imposed on their model development (eg lack of data or resource constraints).

18.3 Where material non-compliance is identified and cannot be remediated in a timely fashion, firms should adopt a compliant approach for calculating regulatory capital. In most cases this is likely to be the slotting approach.

(CRR Article 144(1))

Drivers of risk

18.4 The PRA expects firms to be able to demonstrate that the model drivers selected offer sufficient discriminatory power and to justify why other potential data sources are not expected to materially improve the discriminatory power and accuracy of estimates.

18.5 The PRA expects that an IPRE rating system will only be compliant if a firm is able to demonstrate the following in respect of its treatment of cash flows (except where the firm can demonstrate that this is not an appropriate risk driver):

- (a) the difference in deal ratings when tenant ratings are altered is intuitive;
- (b) the transformation of ratings into non-rent payment probability is intuitive;⁽¹⁾
- (c) selection of parameter values and/or distributions, and their impact on deal ratings, is well supported and intuitive;
- (d) impact on the deal rating is intuitive for such features as: type of building, geographical location and building quality; and

(1) Even where tenants are rated by the firm the PD will not usually represent a direct read across to probability of non-payment due to, for example, model philosophy issues. Addressing this is likely to be a key area since many firms struggle with defining what divergence is expected between observed default rate and PD in different economic conditions in the mid-corporate space.

- (e) where data are missing or unavailable the treatment is conservative.

18.6 The PRA expects that an IPRE rating system will only be compliant if a firm is able to demonstrate the following in respect of its treatment of interest rate risk (IRR):

- (a) IRR is included as a relevant risk driver (unless the portfolio is exclusively hedged);
- (b) the way in which interest rate risk is included in the deal rating is intuitive with respect to model philosophy;⁽¹⁾ and
- (c) the model rates deals where IRR is hedged by the firm differently from deals where IRR is unhedged and the magnitude of the difference in these ratings is intuitive.

18.7 The PRA expects that an IPRE rating system will only be compliant if a firm is able to demonstrate the following in respect of its treatment of refinance risk:

- (a) refinance risk is included as a relevant risk driver (unless the portfolio contains only amortising loans);
- (b) the model rates interest only and amortising deals differently in the final year and that the magnitude of the difference in these ratings is intuitive;
- (c) given the time horizon associated with IRB estimates (ie twelve months) the refinance risk could have a zero weight until the deal enters its final year for point in time models;⁽²⁾ and
- (d) the firm is able to report by borrowers that have previously had a distressed restructuring unlikelihood to pay indicator (even if they are now performing) by number, EAD and risk-weighted assets (RWA).

Calibration

18.8 The PRA expect that firms will not be compliant with the calibration requirements relating to use of a long-run default rate unless it can demonstrate that:

- (a) the internal data series is the longest relevant and accurate data series, on a CRR compliant definition of default, that is available;
- (b) the determination of long-run default rate includes reference to an appropriate source of downturn data;⁽³⁾
- (c) the relevance of any external data used is analysed, and the relationship between internal default data and the external data used is considered over a multi-year period; and

- (d) where uncertainty is introduced due to, for example, the quality of internal data or shortcomings in the relevance of external data a conservative adjustment to the estimates should be made.

18.9 The PRA expects that a firm will only be compliant with the calibration requirements relating to model philosophy if it can demonstrate that:

- (a) model philosophy is clearly articulated and justified;⁽⁴⁾ and
- (b) in addition to encapsulating this information in a coherent way in the calibration, the impact of capturing risks such as IRR and refinance risk is clearly documented.

Low default portfolios

18.10 Where the rating system is classed as a low default portfolio in accordance with this supervisory statement firms should be able to demonstrate that the framework applied adequately considers:

- (a) economic environment of data used;
- (b) changes in portfolio composition over time;
- (c) parameter choices; and
- (d) model philosophy.

Constructed theoretically

18.11 Under CRR Article 144(1) all models, including those constructed from a theoretical basis without reference to any empirical default data (such as Monte Carlo cash flow simulation models) must meet the IRB requirements that are set out in CRR Title II Chapter 3.

18.12 The PRA considers that to meet these requirements it will be necessary for firms to demonstrate that a firm has a good understanding of PD models that are constructed theoretically and that the parameter estimates reflect a one-year PD. In addition, even if empirical data were not used to determine the PD estimate it should, where available, be used to back-test the estimates.

18.13 The PRA expects that, as most models of this type will be able to produce one-year estimates of PD that correspond

(1) For example a 'point in time' rating should consider the current interest rate and likely change over a one-year time horizon, whereas a 'through the cycle' model needs to consider the interest rate risk averaged over an economic cycle.
 (2) In these cases the risk should be captured in stress testing and Pillar 2.
 (3) This may require the use of external data.
 (4) Justification should include analysis of the performance of assets, and the corresponding ratings assigned, over a change in economic conditions (ie as long a period as possible).

closely to 'point in time' estimates, firms should conduct robust back-testing as such estimates by comparing them with realised default rates. Firms would need to demonstrate that the results of such back-testing meets pre-defined and stringent standards in order for the PRA to be satisfied that the IRB requirements are met.

18.14 Because assumptions in the model build process are likely materially to impact the resulting PDs, the PRA expects these choices to be clearly justified in the model documentation and to have been subject to independent review. In order to be satisfied that a firm is complying with CRR Article 176(1)(d) the PRA expects a firm to support justification for all assumptions with analysis of the sensitivity of the model outputs to changes in the assumptions.

18.15 Where the firm has fewer than 20 defaults in its internal data set, the PRA expects it to be necessary for the firm to perform a statistical low default portfolio calibration, as set out in this Supervisory Statement.

Validation

18.16 The PRA expects that a firm will be compliant with the validation requirements only where it can demonstrate in respect of discriminatory power that:

- (a) appropriate minimum standards that the rating system is expected to reach are defined together with reasoning behind the adoption of such standards and that the factors considered when determining the tests are clearly documented;
- (b) an objective rank ordering metric, measured using an appropriate time horizon (eg using ratings one year prior to default) or cohort approach), such as Gini or Accuracy Ratio of 50% is achieved over time;
- (c) where there are sufficient defaults from different time periods the discriminatory power is shown to have reached the appropriate minimum standard over an extended time period (ie longest period possible including most recent data); and
- (d) any concentrations in ratings from the model are demonstrated to be appropriate.

18.17 The PRA expects that a firm will be compliant with the validation requirements only where it can demonstrate in respect of the calibration that:

- (a) observed default rate versus PD is considered at grade level and across a range of economic environments (ie as long as period as possible);
- (b) where the PD does not relate to a pure point in time estimate either the PD or the observed default rate is

transformed such that comparison between the two is meaningful. This transformation should be consistent with the model philosophy and calibration technique applied; and

- (c) pre-defined tolerances for the degree of divergence, and the associated actions for what should happen when they are not met, are set.

18.18 The PRA also expects that firms will be compliant with the validation requirements only where it can demonstrate that:

- (a) appropriate stability metrics are considered across a range of economic environments (ie longest period possible including most recent data);
- (b) the tolerances for the degree of divergence, and associated actions for what should happen when they are not met, is pre-defined; and
- (c) subsections of portfolios by characteristics affecting risk profile, and therefore potentially model performance, are investigated. Such subsections could include:
 - (i) loan type (amortising/interest only); (ii) degree of hedging;
 - (ii) building type; and
 - (iii) other factors such as non-special purpose vehicle (SPV) lending in a predominately SPV lending book or *vice versa*.

(CRR Article 188)

Other requirements

18.19 The PRA expects that a firm would only be able to comply with certain other CRR requirements where it can demonstrate that:

- (a) in relation to CRR Article 144(1)(e), where more than one model was used, the rationale and the associated boundary issues were clearly articulated and justified. The PRA expects the criteria for assigning an asset to a rating model are objective and clear;
- (b) in relation to CRR Article 173(1)(c), the firm has a process in place to ensure valuations of the property are appropriate and up to date;
- (c) in relation to CRR Article 171(2), the firm makes reference to information available from the Investment Property Databank where relevant. Where this data is utilised at a broad level when more granular data is available this is fully justified with appropriate analysis;

- (d) in relation to CRR Article 173(1)(b), the rating histories demonstrate that deals are re-rated every time material information becomes available;⁽¹⁾
 - (e) in relation to CRR Article 189(3), management information covering all aspects required by the CRR is produced and reviewed regularly by senior management and the tolerances for the degree of divergence, and associated actions for what should happen when they are not met, are pre-defined; and
 - (f) in relation to CRR Article 177(2), the impact on PDs and RWAs in a firm's credit risk stress test is consistent with model philosophy (although ratings should be affected by events such as tenant defaults even if they are TTC) and impairment projections are justified with reference to past internal data.
- (a) Rating system development (eg changes to the ratings philosophy of a material rating system).
 - (b) Extension of rating systems or development of new rating systems for new products and where partial use provisions were employed to migrate standardised portfolios to IRB.
 - (c) Mergers and acquisitions — a firm with IRB model approval may acquire rating systems which are not IRB compliant, or firms may have legacy capital models that they wish to amalgamate.
 - (d) Upgrades to IRB approaches — for example, from Foundation to Advanced IRB.
 - (e) A change resulting in a change in credit risk capital requirements for the UK consolidation group that is greater than 1%. In assessing changes to credit risk capital requirements firms should take into account changes in expected loss and treatment of securitisation positions as well as changes arising from RWAs.
 - (f) A recalibration that results in a reduction in portfolio level credit risk capital requirements greater than 5%. If a recalibration has an impact below 5% at the portfolio level but above 1% at the group level then such a recalibration would count as a significant reduction by virtue of (e) above. 'Portfolio level' should be interpreted as the portion of the group's overall exposures covered by the ratings system that the firm is proposing to modify. In assessing changes to credit risk capital requirements firms should take into account changes in expected loss and treatment of securitisation positions as well as changes arising from RWAs.
 - (g) A significant change to the outputs of the ratings system resulting from a series of changes that in isolation may not be significant but cumulatively have a significant effect.

19 Notification and approval of changes to approved models

Changes to approved models

19.1 This section sets out the PRA's expectations in respect of the notifications and changes to approved models. For clarification, the term 'approved model' refers to all aspects of the IRB rating system that were in place at the time that the model was approved and implemented. This would include any judgemental overlays or conservatism that were put in place or processes for manually overriding the model outputs, updating house price indices or ongoing recalibrations for point in time PD models.

19.2 Where a firm intends to make changes to an approved model these must be pre-notified to the PRA if they are significant and post-notified otherwise. Firms may nominate certain models for exclusion from these notification requirements on the grounds of immateriality. In addition, in certain circumstances temporary adjustments may be made to capital requirements outside of this framework. Further details are set out below.

Pre-notification of significant changes

19.3 Model changes may necessitate a modification to the IRB approval originally granted. For the avoidance of doubt, any change that requires a revision to the IRB permission and/or joint decision must be pre-notified.

19.4 In addition, firms must notify the PRA of significant changes to IRB models prior to these changes being implemented. A firm's IRB permission offers some broad guidelines around the factors that constitute significant change.

19.5 In addition to these broad guidelines, the following are examples of factors which constitute significant change (please note that this is not an exhaustive list):

19.6 In relation to paragraph 19.5(e) and 19.5(f) above, in the context of a CRR Article 20 joint decision, it should be open for the PRA and other EEA regulators to agree to the parameter for defining a significant change, so that there is consensus on how these cases are dealt with within the CRR Article 20 framework. Where the PRA is the consolidated supervisor, it will attempt to agree the thresholds for significance with other EEA regulators.

(1) For example where the deal enters its final year (and refinancing risk becomes relevant) or a tenant defaults, is replaced or has their rating changed.

19.7 Firms should implement a formal internal policy which governs the IRB changes that require pre and post-notification, or are de minimis and require no notification.

19.8 An IRB permission may specify that one or more rating systems is to be rolled out within a time window and may specify that the PRA will review the rating system prior to rollout. Where the PRA has not indicated in the permission that it will review the ratings system prior to rollout, firms should nonetheless follow the above approach in determining whether pre-notification of a model change is necessary.

Process for pre-notifying a change

19.9 Firms should follow the process outlined below to pre-notify a change:

Step 1. Submit the information set out in the pro-forma in Appendix B.

Step 2. The firm should advise its PRA supervisor about future proposed changes as far in advance as possible. Formal pre-notification to the PRA of specific changes in more detail may follow. Such advance notice might take the form of a periodic report setting out the firm's current thinking on future changes, in aggregate across the group.

Advance notice is particularly important in the case of firms with an IRB permission that is subject to joint decision under CRR Article 20, where the PRA may need to revise the joint decision in consultation with other EEA regulators, or more generally where a proposed change impacts on overseas jurisdictions where it may be appropriate to consult with other regulators. The common decision by the PRA and other regulators must be reached within six months.

Step 3. Conduct a self-assessment of the change against the relevant CRR requirements and guidance in this supervisory statement, noting any areas of CRR non-compliance with details of how these gaps will be closed.

Step 4. If the change affects a rating system, then, in addition to the information provided in the pro-forma in Appendix B, the firm should also comment on the following areas:

- (i) the way in which the rating system complies with the use test;
- (ii) what the internal governance arrangements and sign-off procedures were for the rating system;
- (iii) what validation work has been performed on the ratings system or is planned; and

- (iv) how the firm's Pillar 1 stress-testing practices, including the impact on the quantitative results of stress testing, have been affected by the change.

Step 5. Send the material from Steps 1, 2, 3 and 4 to its PRA supervisor. The material needs to be sent sufficiently far in advance of the proposed change to allow the PRA time to review it prior to implementation. If the PRA chooses to review the change, it may ask for additional information and, if necessary, meetings or on-site visits. The PRA is content for firms to provide internal documentation for this purpose, provided this addresses clearly and sufficiently the process requirements set out above.

Process for post-notifying a change

19.10 Where a change to an approved model may be notified to the PRA after it has occurred, firms should prepare and submit the following information:

- (a) the information set out in the pro-forma in Appendix B;
- (b) confirmation that the change has been reviewed through the firm's internal governance processes; and
- (c) confirmation that a self-assessment of the change against the relevant CRR requirements and guidance in this supervisory statement has been completed and has not identified any areas of CRR non-compliance.

19.11 After the post-notification, the PRA may request additional information to assist in any review that the PRA may undertake.

Immaterial models

19.12 The PRA will normally permit firms to nominate a number of models, which in total account for no more than 1% of the credit risk capital requirement of the UK consolidation group, for which neither pre-notification nor post-notification is ordinarily necessary.

Fees

19.13 There will be some circumstances where a fee may be applied, for example, where a firm is upgrading from FIRB to AIRB, or a special project fee in the case of a merger or acquisition.

Self-assessment

19.14 The self-assessment process described above need only be an assessment against the CRR requirements and guidance in this supervisory statement that are relevant to the change in question. While it is the firm's responsibility to decide on the method of conducting the self-assessment, this should be sufficiently rigorous to allow the firm to identify areas of non-compliance.

19.15 A high-level 'gap analysis' or a process that places reliance on the firm's governance process or on the firm's developmental process to deliver a compliant approach is unlikely to form an adequate self-assessment, at least in the early years of IRB operation.

Temporary adjustments to approved models

19.16 Firms should address identified model issues in a timely fashion with suitable model changes, and ensure that such changes are implemented in accordance with the model changes process outlined above. The PRA recognises, however, that there are instances where it is prudent and correct for firms to adjust the capital requirements produced by their models on a temporary basis. The PRA does not expect any such adjustment to be in place for a period longer than six months and firms should take any action required to remove an adjustment (including notifying the PRA of a model change where appropriate) within that period.

19.17 Firms should meet the following criteria in respect of any temporary adjustments to approved models:

- (a) The framework must be applied at a portfolio level. For this a 'portfolio' is defined as the group of assets covered by the IRB model the adjustment is being made for. If adjustments are being made to more than one model (eg PD and LGD) which cover overlapping assets (eg a global LGD model and regional PD models), then a portfolio(s) must be defined as the subset of assets covered by the same models (eg in the example above the assets covered by the regional PD model would be classified as a single portfolio).
- (b) Irrespective of what model component the adjustment is for (eg PD, LGD or EAD) the RWA and EL adjustments are made as a portfolio level add-on to the requirements produced by the approved models (ie the underlying models must not be recalibrated or changed to give the desired capital outcome).
- (c) Firms' PD, LGD and EAD models remain in place until the correct level of approval has been obtained for any changes. These models continue to be monitored as required by the CRR.
- (d) Only adjustments that increase RWA and EL are made and there should be no netting of adjustments across portfolios (eg if there are two data issues, in separate portfolios, one which increases RWA by £200 million and one that decreased RWA by £100 million, only the adjustment increase of £200 million is applied). Where netting of impacts is proposed, this is applied in the relevant portfolio (ie where a model covers a number of portfolios, netting can only be done at a portfolio level).
- (e) A list of all model adjustments is included in the firm's model monitoring information presented to senior management, containing the following information as a minimum:
 - (i) the portfolio and model component affected;
 - (ii) a description of the issue and why it requires the adjustment;
 - (iii) the date when the issue was first identified;
 - (iv) what action is being taken to address the issue and the timeline for this action; and
 - (v) the increase to RWA and EL as a result of the adjustment.
- (f) Firms may make adjustments across model components (eg PD, LGD and EAD), however if the PRA judges that a firm is not applying the netting across components appropriately, or with the correct degree of conservatism, then it will require that netting is permitted only within a model component (eg if the adjustment to PD increases capital and to LGD decreases capital, the firm would only apply the increased capital that results from the PD adjustment).

19.18 Firms should include any EL and RWA adjustments in their regulatory returns. In respect of the FSA004 return, uplifts should be made by adjusting the total figures within the relevant IRB asset classes. In respect of the FSA045 return the total RWA and EL figures for each of the PD grades should be increased proportionally.

20 Appendix A: Slotting criteria

Table 1 Supervisory rating grades for project finance exposures

	Strong	Good	Satisfactory	Weak
Financial strength				
Market conditions.	Few competing suppliers or substantial and durable advantage in location, cost, or technology. Demand is strong and growing.	Few competing suppliers or better than average location, cost, or technology but this situation may not last. Demand is strong and stable.	Project has no advantage in location, cost, or technology. Demand is adequate and stable.	Project has worse than average location, cost, or technology. Demand is weak and declining.
Financial ratios (eg debt service coverage ratio (DSCR), loan life coverage ratio (LLCR), project life coverage ratio (PLCR), and debt-to-equity ratio).	Strong financial ratios considering the level of project risk; very robust economic assumptions.	Strong to acceptable financial ratios considering the level of project risk; robust project economic assumptions.	Standard financial ratios considering the level of project risk.	Aggressive financial ratios considering the level of project risk.
Stress analysis.	The project can meet its financial obligations under sustained, severely stressed economic or sectoral conditions.	The project can meet its financial obligations under normal stressed economic or sectoral conditions. The project is only likely to default under severe economic conditions.	The project is vulnerable to stresses that are not uncommon through an economic cycle, and may default in a normal downturn.	The project is likely to default unless conditions improve soon.
Financial structure				
Duration of the credit compared to the duration of the project.	Useful life of the project significantly exceeds tenor of the loan.	Useful life of the project exceeds tenor of the loan.	Useful life of the project exceeds tenor of the loan.	Useful life of the project may not exceed tenor of the loan.
Amortisation schedule.	Amortising debt.	Amortising debt.	Amortising debt repayments with limited bullet payment.	Bullet repayment or amortising debt repayments with high bullet repayment.
Political and legal environment				
Political risk, including transfer risk, considering project type and mitigants.	Very low exposure; strong mitigation instruments, if needed.	Low exposure; satisfactory mitigation instruments, if needed.	Moderate exposure; fair mitigation instruments.	High exposure; no or weak mitigation instruments.
Force majeure risk (war, civil unrest, etc).	Low exposure.	Acceptable exposure.	Standard protection.	Significant risks, not fully mitigated.
Government support and project's importance for the country over the long term.	Project of strategic importance for the country (preferably export-oriented). Strong support from Government.	Project considered important for the country. Good level of support from Government.	Project may not be strategic but brings unquestionable benefits for the country. Support from Government may not be explicit.	Project not key to the country. No or weak support from Government.
Stability of legal and regulatory environment (risk of change in law).	Favourable and stable regulatory environment over the long term.	Favourable and stable regulatory environment over the medium term.	Regulatory changes can be predicted with a fair level of certainty.	Current or future regulatory issues may affect the project.
Acquisition of all necessary supports and approvals for such relief from local content laws.	Strong	Satisfactory	Fair	Weak
Enforceability of contracts, collateral and security.	Contracts, collateral and security are enforceable.	Contracts, collateral and security are enforceable.	Contracts, collateral and security are considered enforceable even if certain non-key issues may exist.	There are unresolved key issues in respect if actual enforcement of contracts, collateral and security.

	Strong	Good	Satisfactory	Weak
Transaction characteristics				
Design and technology risk.	Fully proven technology and design.	Fully proven technology and design.	Proven technology and design — start-up issues are mitigated by a strong completion package.	Unproven technology and design; technology issues exist and/or complex design.
Construction risk				
Permitting and siting.	All permits have been obtained.	Some permits are still outstanding but their receipt is considered very likely.	Some permits are still outstanding but the permitting process is well defined and they are considered routine.	Key permits still need to be obtained and are not considered routine. Significant conditions may be attached.
Type of construction contract.	Fixed-price date-certain turnkey construction EPC (engineering and procurement contract).	Fixed-price date-certain turnkey construction EPC.	Fixed-price date-certain turnkey construction contract with one or several contractors.	No or partial fixed-price turnkey contract and/or interfacing issues with multiple contractors.
Completion guarantees.	Substantial liquidated damages supported by financial substance and/or strong completion guarantee from sponsors with excellent financial standing.	Significant liquidated damages supported by financial substance and/or completion guarantee from sponsors with good financial standing.	Adequate liquidated damages supported by financial substance and/or completion guarantee from sponsors with good financial standing.	Inadequate liquidated damages or not supported by financial substance or weak completion guarantees.
Track record and financial strength of contractor in constructing similar projects.	Strong.	Good.	Satisfactory.	Weak.
Operating risk				
Scope and nature of operations and maintenance (O&M) contracts.	Strong long-term O&M contract, preferably with contractual performance incentives, and/or O&M reserve accounts.	Long-term O&M contract, and/or O&M reserve accounts.	Limited O&M contract or O&M reserve account.	No O&M contract: risk of high operational cost overruns beyond mitigants.
Operator's expertise, track record, and financial strength.	Very strong, or committed technical assistance of the sponsors.	Strong.	Acceptable.	Limited/weak, or local operator dependent on local authorities.
Off-take risk				
(a) If there is a take-or-pay or fixed-price off-take contract:	Excellent creditworthiness of off-taker; strong termination clauses; tenor of contract comfortably exceeds the maturity of the debt.	Good creditworthiness of off-taker; strong termination clauses; tenor of contract exceeds the maturity of the debt.	Acceptable financial standing of off-taker; normal termination clauses; tenor of contract generally matches the maturity of the debt.	Weak off-taker; weak termination clauses; tenor of contract does not exceed the maturity of the debt.
(b) If there is no take-or-pay or fixed-price off-take contract:	Project produces essential services or a commodity sold widely on a world market; output can readily be absorbed at projected prices even at lower than historic market growth rates.	Project produces essential services or a commodity sold widely on a regional market that will absorb it at projected prices at historical growth rates.	Commodity is sold on a limited market that may absorb it only at lower than projected prices.	Project output is demanded by only one or a few buyers or is not generally sold on an organised market.
Supply risk				
Price, volume and transportation risk of feed-stocks; supplier's track record and financial strength.	Long-term supply contract with supplier of excellent financial standing.	Long-term supply contract with supplier of good financial standing.	Long-term supply contract with supplier of good financial standing — a degree of price risk may remain.	Short-term supply contract or long-term supply contract with financially weak supplier — a degree of price risk definitely remains.
Reserve risks (eg natural resource development).	Independently audited, proven and developed reserves well in excess of requirements over lifetime of the project.	Independently audited, proven and developed reserves in excess of requirements over lifetime of the project.	Proven reserves can supply the project adequately through the maturity of the debt.	Project relies to some extent on potential and undeveloped reserves.
Strength of sponsor				
Sponsor track record, financial strength, and country/sector experience.	Strong sponsor with excellent track record and high financial standing.	Good sponsor with satisfactory track record and good financial standing.	Adequate sponsor with adequate track record and good financial standing.	Weak sponsor with no or questionable track record and/or financial weaknesses.
Sponsor support, as evidenced by equity, ownership clause and incentive to inject additional cash if necessary.	Strong. Project is highly strategic for the sponsor (core business — long-term strategy).	Good. Project is strategic for the sponsor (core business — long-term strategy).	Acceptable. Project is considered important for the sponsor (core business).	Limited. Project is not key to sponsor's long-term strategy or core business.

	Strong	Good	Satisfactory	Weak
Security package				
Assignment of contracts and accounts.	Fully comprehensive.	Comprehensive.	Acceptable.	Weak.
Pledge of assets, taking into account quality, value and liquidity of assets.	First perfected security interest in all project assets, contracts, permits and accounts necessary to run the project.	Perfected security interest in all project assets, contracts, permits and accounts necessary to run the project.	Acceptable security interest in all project assets, contracts, permits and accounts necessary to run the project.	Little security or collateral for lenders; weak negative pledge clause.
Lender's control over cash flow (eg cash sweeps, independent escrow accounts).	Strong.	Satisfactory.	Fair.	Weak.
Strength of the covenant package (mandatory prepayments, payment deferrals, payment cascade, dividend restrictions...).	Covenant package is strong for this type of project. Project may issue no additional debt.	Covenant package is satisfactory for this type of project. Project may issue extremely limited additional debt.	Covenant package is fair for this type of project. Project may issue limited additional debt.	Covenant package is Insufficient for this type of project. Project may issue unlimited additional debt.
Reserve funds (debt service, O&M, renewal and replacement, unforeseen events, etc).	Longer than average coverage period, all reserve funds fully funded in cash or letters of credit from highly rated bank.	Average coverage period, all reserve funds fully funded.	Average coverage period, all reserve funds fully funded.	Shorter than average coverage period, reserve funds funded from operating cash flows.

Table 2 Supervisory rating grades for income-producing real estate expo

	Strong	Good	Satisfactory	Weak
Financial strength				
Market conditions.	The supply and demand for the project's type and location are currently in equilibrium. The number of competitive properties coming to market is equal or lower than forecasted demand.	The supply and demand for the project's type and location are currently in equilibrium. The number of competitive properties coming to market is roughly equal to forecasted demand.	Market conditions are roughly in equilibrium. Competitive properties are coming on the market and others are in the planning stages. The project's design and capabilities may not be state of the art compared to new projects.	Market conditions are weak. It is uncertain when conditions will improve and return to equilibrium. The project is losing tenants at lease expiration. New lease terms are less favourable compared to those expiring.
Financial ratios and advance rate.	The property's debt service coverage ratio (DSCR) is considered strong (DSCR is not relevant for the construction phase) and its loan to value ratio (LTV) is considered low given its property type. Where a secondary market exists, the transaction is underwritten to market standards.	The DSCR (not relevant for development real estate) and LTV are satisfactory. Where a secondary market exists, the transaction is underwritten to market standards.	The property's DSCR has deteriorated and its value has fallen, increasing its LTV.	The property's DSCR has deteriorated significantly and its LTV is well above underwriting standards for new loans.
Stress analysis.	The property's resources, contingencies and liability structure allow it to meet its financial obligations during a period of severe financial stress (eg interest rates, economic growth).	The property can meet its financial obligations under a sustained period of financial stress (eg interest rates, economic growth). The property is likely to default only under severe economic conditions.	During an economic downturn, the property would suffer a decline in revenue that would limit its ability to fund capital expenditures and significantly increase the risk of default.	The property's financial condition is strained and is likely to default unless conditions improve in the near term.
Cash-flow predictability				
(a) For complete and stabilised property.	The property's leases are long-term with creditworthy tenants and their maturity dates are scattered. The property has a track record of tenant retention upon lease expiration. Its vacancy rate is low. Expenses (maintenance, insurance, security, and property taxes) are predictable.	Most of the property's leases are long-term, with tenants that range in creditworthiness. The property experiences a normal level of tenant turnover upon lease expiration. Its vacancy rate is low. Expenses are predictable.	Most of the property's leases are medium rather than long-term with tenants that range in creditworthiness. The property experiences a moderate level of tenant turnover upon lease expiration. Its vacancy rate is moderate. Expenses are relatively predictable but vary in relation to revenue.	The property's leases are of various terms with tenants that range in creditworthiness. The property experiences a very high level of tenant turnover upon lease expiration. Its vacancy rate is high. Significant expenses are incurred preparing space for new tenants.
(b) For complete but not stabilised property.	Leasing activity meets or exceeds projections. The project should achieve stabilisation in the near future.	Leasing activity meets or exceeds projections. The project should achieve stabilisation in the near future.	Most leasing activity is within projections; however, stabilisation will not occur for some time.	Market rents do not meet expectations. Despite achieving target occupancy rate, cash flow coverage is tight due to disappointing revenue.
(c) For construction phase.	The property is entirely pre-leased through the tenor of the loan or pre-sold to an investment grade tenant or buyer, or the bank has a binding commitment for take-out financing from an investment-grade lender.	The property is entirely pre-leased or pre-sold to a creditworthy tenant or buyer, or the bank has a binding commitment for permanent financing from a creditworthy lender.	Leasing activity is within projections but the building may not be pre-leased and there may not exist a take-out financing. The bank may be the permanent lender.	The property is deteriorating due to cost overruns, market deterioration, tenant cancellations or other factors. There may be a dispute with the party providing the permanent financing.

	Strong	Good	Satisfactory	Weak
Asset characteristics				
Location.	Property is located in highly desirable location that is convenient to services that tenants desire.	Property is located in desirable location that is convenient to services that tenants desire.	The property location lacks a competitive advantage.	The property's location, configuration, design and maintenance have contributed to the property's difficulties.
Design and condition.	Property is favoured due to its design, configuration, and maintenance, and is highly competitive with new properties.	Property is appropriate in terms of its design, configuration and maintenance. The property's design and capabilities are competitive with new properties.	Property is adequate in terms of its configuration, design and maintenance.	Weaknesses exist in the property's configuration, design or maintenance.
Property is under construction.	Construction budget is conservative and technical hazards are limited. Contractors are highly qualified.	Construction budget is conservative and technical hazards are limited. Contractors are highly qualified.	Construction budget is adequate and contractors are ordinarily qualified.	Project is over budget or unrealistic given its technical hazards. Contractors may be under qualified.
Strength of sponsor/developer				
Financial capacity and willingness to support the property.	The sponsor/developer made a substantial cash contribution to the construction or purchase of the property. The sponsor/developer has substantial resources and limited direct and contingent liabilities. The sponsor/developer's properties are diversified geographically and by property type.	The sponsor/developer made a material cash contribution to the construction or purchase of the property. The sponsor/developer's financial condition allows it to support the property in the event of a cash flow shortfall. The sponsor/developer's properties are located in several geographic regions.	The sponsor/developer's contribution may be immaterial or non-cash. The sponsor/developer is average to below average in financial resources.	The sponsor/developer lacks capacity or willingness to support the property.
Reputation and track record with similar properties.	Experienced management and high sponsors' quality. Strong reputation and lengthy and successful record with similar properties.	Appropriate management and sponsors' quality. The sponsor or management has a successful record with similar properties.	Moderate management and sponsors' quality. Management or sponsor track record does not raise serious concerns.	Ineffective management and substandard sponsors' quality. Management and sponsor difficulties have contributed to difficulties in managing properties in the past.
Relationships with relevant real estate actors.	Strong relationships with leading actors such as leasing agents.	Proven relationships with leading actors such as leasing agents.	Adequate relationships with leasing agents and other parties providing important real estate services.	Poor relationships with leasing agents and/or other parties providing important real estate services.
Security package				
Nature of lien.	Perfected first lien. ^(a)	Perfected first lien. ^(a)	Perfected first lien. ^(a)	Ability of lender to foreclose is constrained.
Assignment of rents (for projects leased to long-term tenants).	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to remit rents directly to the lender, such as a current rent roll and copies of the project's leases.	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to the tenants to remit rents directly to the lender, such as current rent roll and copies of the project's leases.	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to the tenants to remit rents directly to the lender, such as current rent roll and copies of the project's leases.	The lender has not obtained an assignment of the leases or has not maintained the information necessary to readily provide notice to the building's tenants.
Quality of the insurance coverage.	Appropriate.	Appropriate.	Appropriate.	Substandard.

(a) Lenders in some markets extensively use loan structures that include junior liens. Junior liens may be indicative of this level of risk if the total LTV inclusive of all senior positions does not exceed a typical first loan LTV.

Table 3 Supervisory rating grades for object finance exposures

	Strong	Good	Satisfactory	Weak
Financial strength				
Market conditions.	Demand is strong and growing, strong entry barriers, low sensitivity to changes in technology and economic outlook.	Demand is strong and stable. Some entry barriers, some sensitivity to changes in technology and economic outlook.	Demand is adequate and stable, limited entry barriers, significant sensitivity to changes in technology and economic outlook.	Demand is weak and declining, vulnerable to changes in technology and economic outlook, highly uncertain environment.
Financial ratios (debt service coverage ratio and loan to value ratio)	Strong financial ratios considering the type of asset. Very robust economic assumptions.	Strong/acceptable financial ratios considering the type of asset. Robust project economic assumptions.	Standard financial ratios for the asset type.	Aggressive financial ratios considering the type of asset.
Stress analysis.	Stable long-term revenues, capable of withstanding severely stressed conditions through an economic cycle.	Satisfactory short-term revenues. Loan can withstand some financial adversity. Default is only likely under severe economic conditions.	Uncertain short-term revenues. Cash flows are vulnerable to stresses that are not uncommon through an economic cycle. The loan may default in a normal downturn.	Revenues subject to strong uncertainties; even in normal economic conditions the asset may default, unless conditions improve.
Market liquidity.	Market is structured on a worldwide basis; assets are highly liquid.	Market is worldwide or regional; assets are relatively liquid.	Market is regional with limited prospects in the short term, implying lower liquidity.	Local market and/or poor visibility. Low or no liquidity, particularly on niche markets.

	Strong	Good	Satisfactory	Weak
Political and legal environment				
Political risk, including transfer risk.	Very low; strong mitigation instruments, if needed.	Low; satisfactory mitigation instruments, if needed.	Moderate; fair mitigation instruments.	High; no or weak mitigation instruments.
Legal and regulatory risks.	Jurisdiction is favourable to repossession and enforcement of contracts.	Jurisdiction is favourable to repossession and enforcement of contracts.	Jurisdiction is generally favourable to repossession and enforcement of contracts, even if repossession might be long and/or difficult.	Poor or unstable legal and regulatory environment. Jurisdiction may make repossession and enforcement of contracts lengthy or impossible.
Transaction characteristics				
Financing term compared to the economic life of the asset.	Full payout profile/minimum balloon. No grace period.	Balloon more significant, but still at satisfactory levels.	Important balloon with potentially grace periods.	Repayment in fine or high balloon.
Operating risk				
Permits/licensing.	All permits have been obtained; asset meets current and foreseeable safety regulations.	All permits obtained or in the process of being obtained; asset meets current and foreseeable safety regulations.	Most permits obtained or in process of being obtained, outstanding ones considered routine, asset meets current safety regulations.	Problems in obtaining all required permits, part of the planned configuration and/or planned operations might need to be revised.
Scope and nature of O&M contracts.	Strong long-term O&M contract, preferably with contractual performance incentives, and/or O&M reserve accounts (if needed).	Long-term O&M contract, and/or O&M reserve accounts (if needed).	Limited O&M contract or O&M reserve account (if needed).	No O&M contract: risk of high operational cost overruns beyond mitigants.
Operator's financial strength, track record in managing the asset type and capability to remarket asset when it comes off-lease.	Excellent track record and strong remarketing capability.	Satisfactory track record and remarketing capability.	Weak or short track record and uncertain remarketing capability.	No or unknown track record and inability to remarket the asset.
Asset characteristics				
Configuration, size, design and maintenance (ie age, size for a plane) compared to other assets on the same market.	Strong advantage in design and maintenance. Configuration is standard such that the object meets a liquid market.	Above average design and maintenance. Standard configuration, maybe with very limited exceptions — such that the object meets a liquid market.	Average design and maintenance. Configuration is somewhat specific, and thus might cause a narrower market for the object.	Below average design and maintenance. Asset is near the end of its economic life. Configuration is very specific; the market for the object is very narrow.
Resale value.	Current resale value is well above debt value.	Resale value is moderately above debt value.	Resale value is slightly above debt value.	Resale value is below debt value.
Sensitivity of the asset value and liquidity to economic cycles.	Asset value and liquidity are relatively insensitive to economic cycles.	Asset value and liquidity are sensitive to economic cycles.	Asset value and liquidity are quite sensitive to economic cycles.	Asset value and liquidity are highly sensitive to economic cycles.
Strength of sponsor				
Operator's financial strength, track record in managing the asset type and capability to remarket asset when it comes off-lease	Excellent track record and strong remarketing capability.	Satisfactory track record and remarketing capability.	Weak or short track record and uncertain remarketing capability.	No or unknown track record and inability to remarket the asset.
Sponsors' track record and financial strength.	Sponsors with excellent track record and high financial standing.	Sponsors with good track record and good financial standing.	Sponsors with adequate track record and good financial standing.	Sponsors with no or questionable track record and/or financial weaknesses.
Security package				
Asset control.	Legal documentation provides the lender effective control (eg a first perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it.	Legal documentation provides the lender effective control (eg a perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it.	Legal documentation provides the lender effective control (eg a perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it.	The contract provides little security to the lender and leaves room to some risk of losing control on the asset.
Rights and means at the lender's disposal to monitor the location and condition of the asset.	The lender is able to monitor the location and condition of the asset, at any time and place (regular reports, possibility to lead inspections).	The lender is able to monitor the location and condition of the asset, almost at any time and place.	The lender is able to monitor the location and condition of the asset, almost at any time and place.	The lender is able to monitor the location and condition of the asset are limited.
Insurance against damages.	Strong insurance coverage including collateral damages with top quality insurance companies.	Satisfactory insurance coverage (not including collateral damages) with good quality insurance companies.	Fair insurance coverage (not including collateral damages) with acceptable quality insurance companies.	Weak insurance coverage (not including collateral damages) or with weak quality insurance companies.

Table 4 Supervisory rating grades for commodities finance exposures

	Strong	Good	Satisfactory	Weak
Financial strength				
Degree of over-collateralisation of trade.	Strong.	Good.	Satisfactory.	Weak.
Political and legal environment				
Country risk.	No country risk.	Limited exposure to country risk (in particular, offshore location of reserves in an emerging country).	Exposure to country risk (in particular, offshore location of reserves in an emerging country).	Strong exposure to country risk (in particular, inland reserves in an emerging country).
Mitigation of country risks.	Very strong mitigation: Strong offshore Mechanisms. Strategic commodity. 1st class buyer.	Strong mitigation: Offshore mechanisms. Strategic commodity. Strong buyer.	Acceptable mitigation: Offshore mechanisms. Less strategic commodity. Acceptable buyer.	Only partial mitigation: No offshore mechanisms. Non-strategic commodity. Weak buyer.
Asset characteristics				
Liquidity and susceptibility to damage.	Commodity is quoted and can be hedged through futures or OTC instruments. Commodity is not susceptible to damage.	Commodity is quoted and can be hedged through OTC instruments. Commodity is not susceptible to damage.	Commodity is not quoted but is liquid. There is uncertainty about the possibility of hedging. Commodity is not susceptible to damage.	Commodity is not quoted. Liquidity is limited given the size and depth of the market. No appropriate hedging instruments. Commodity is susceptible to damage.
Strength of sponsor				
Financial strength of trader.	Very strong, relative to trading philosophy and risks.	Strong.	Adequate.	Weak.
Track record, including ability to manage the logistic process.	Extensive experience with the type of transaction in question. Strong record of operating success and cost efficiency.	Sufficient experience with the type of transaction in question. Above average record of operating success and cost efficiency.	Limited experience with the type of transaction in question. Average record of operating success and cost efficiency.	Limited or uncertain track record in general. Volatile costs and profits.
Trading controls and hedging policies.	Strong standards for counterparty selection, hedging, and monitoring.	Adequate standards for counterparty selection, hedging, and monitoring.	Past deals have experienced no or minor problems.	Trader has experienced significant losses on past deals.
Quality of financial disclosure.	Excellent.	Good.	Satisfactory.	Financial disclosure contains some uncertainties or is insufficient.
Security package				
Asset control.	First perfected security interest provides the lender legal control of the assets at any time if needed.	First perfected security interest provides the lender legal control of the assets at any time if needed.	At some point in the process, there is a rupture in the control of the assets by the lender. The rupture is mitigated by knowledge of the trade process or a third party undertaking as the case may be.	Contract leaves room for some risk of losing control over the assets. Recovery could be jeopardised.
Insurance against damages.	Strong insurance coverage including collateral damages with top quality insurance companies.	Satisfactory insurance coverage (not including collateral damages) with good quality insurance companies.	Fair insurance coverage (not including collateral damages) with acceptable quality insurance companies.	Weak insurance coverage (not including collateral damages) or with weak quality insurance companies.

21 Appendix B: Model change pro-forma required when pre or post-notifying changes to a ratings system

Firm:	
Date notification sent to PRA:	
Pre or post change notification:	
Rating system:	Name: Asset type: PD/LGD/EAD
Brief description of change(s):	
Portfolio information: <i>[Credit risk capital information on the ratings system that the firm is proposing to change — this information should be prior to the application of the proposed change.]</i>	EAD £xxx (date) RWA £xxx (date) EL £xxx (date)
Group information: <i>[Credit risk capital information for UK consolidation group.]</i>	EAD £xxx (date) RWA £xxx (date) EL £xxx (date)
Materiality of change:	RWA impact £xxx RWA % change % EL impact £xxx EL % change %
Reason change is pre/post notified: <i>[Explain here why the change is classed as pre or post notified.]</i>	
Relevant committee approval: <i>[Committee responsible for approval of change.]</i>	Name: Date of approval:
Proposed implementation date: <i>[Date from which changes are intended to affect capital calculations, subject to approval received in the case of material pre-notified changes.]</i>	
Attach supporting documentation here: <i>[Including the following where available: development document(s); validation document(s); materials presented to approval committee; approval committee minutes; other supplementary materials.]</i>	

22 Appendix C: Wholesale LGD and EAD framework

22.1 The following framework should be used to assess wholesale LGD models in the circumstances set out in paragraph 13.15 of this supervisory statement:

- (a) For unsecured recoveries, if a firm has fewer than 20 relevant default observations of recoveries in a specific country for an individual type of exposure, then the maximum recovery a firm can assume must be equivalent to that which would give a 45% LGD for senior unsecured exposures, 75% for subordinated exposures and 11.25% for covered bonds.
- (b) If a firm is taking account of non-financial collateral which is not eligible under the foundation approach, where they do not have 20 or more relevant data points of recovery values for that type of collateral or do not have a reliable time series of market price data for the collateral in a specific country, then the LGD for the exposure to which the collateral is applied must be floored at 45%.
- (c) If a firm is taking account of non-financial collateral, which is eligible under the foundation approach, where they do not have 20 or more relevant data points of recovery values for that type of collateral or do not have a reliable time series of market price data for that collateral in a specific country, then the LGD for the exposure to which the collateral is applied must be floored at 35%.

22.2 Firms should note the following when applying the framework to LGD models:

- (a) The 20 or more relevant data points can include internal or external data, however the PRA expects firms to ensure that each data point is independent, representative and an accurate record of the recovery for that exposure or collateral type in that specific country.
- (b) We would anticipate firms being able to use market price data within the framework where they have less than 20 defaults only in exceptional circumstances. As a minimum, firms would need to demonstrate that the market price data being used is representative of their collateral and that it is over a long enough time period to ensure that an appropriate downturn and forced sale haircut can be estimated.
- (c) The framework does not affect the use of financial collateral.
- (d) The framework does not affect the use of unfunded credit protection.

- (e) Where a model takes account of multiple collateral types, if this only includes collateral that is eligible under the foundation approach then LGDs must be floored at 35%, and if any collateral type is not eligible under the foundation approach then LGDs must be floored at 45%.
- (f) The effect of this framework is to floor bank and non-bank financial institution (NBFIs) exposures at foundation values unless sufficient country-specific recovery data is available. This floor should be applied where the exposures are to types of banks and NBFIs that are not sufficiently represented in the available historic data (eg if the historic recovery data only relates to small banks then the floor will affect large banks).
- (g) When applying the framework the PRA expects firms to assess whether the 11.25% LGD floor for covered bonds is sufficient given the quality of the underlying assets.

22.3 Firms should select the most appropriate of the following three options when using the framework to assess wholesale EAD models in the circumstances set out in paragraph 14.8 of this supervisory statement:

- (a) Rank-order the off balance sheet product types (separately for lending and trade finance) according to their drawdown risk. The EAD parameter for a product with 20 or more default observations can then be applied to low-default products with a lower drawdown risk; or
- (b) For product types where the firm has the defaults needed to estimate the EAD for committed credit lines (or an estimate derived from the option above) but less than 20 defaults for uncommitted credit lines, use 50% of the committed credit line conversion factor as an estimate of the uncommitted credit line conversion factor; or
- (c) Apply the foundation parameters.

22.4 Firms should note the following when applying the framework to EAD models:

- (a) Firms may select more than one option when applying the framework providing that they can demonstrate that their chosen combination is appropriate, reflecting their particular mix of products and risks, and is not selected in order to minimise their capital requirements.
- (b) As we believe that the EAD experienced by firms is dependent on their own credit management processes we would expect only internal data to be used to estimate EAD. However, where firms can convincingly

demonstrate to the PRA's satisfaction that the credit process are consistent across countries then we would accept that data sourced from these countries could be combined to estimate the EAD for each product (ie the 20 default data points do not have to be country specific for the purposes of estimating EAD).

- (c) Firms using the option in paragraph 22.3(a) above should be able to demonstrate that a sufficiently robust approach has been taken to rank-ordering their product types by drawdown risk. This approach must be fully documented and assessed by an independent reviewer.

Supervisory Statement | SS12/13

Counterparty credit risk

December 2013



BANK OF ENGLAND
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Supervisory Statement | SS12/13

Counterparty credit risk

December 2013

1 Introduction

1.1 This supervisory statement is aimed at firms to which CRD IV applies. This statement:

- clarifies the Prudential regulation Authority's (PRA's) expectations as to the inclusion of securities financing transactions in the calculation of the credit valuation adjustment capital charge;
- clarifies the identification of qualifying central counterparties;
- sets out the factors which the PRA expects such firms to take into account when applying for certain permissions related to the counterparty credit risk regulatory framework; and
- sets out the PRA's approach to post approval changes to counterparty credit risk advanced model approaches.

1.2 This statement should be considered in addition to the requirements in CRR Articles 162 and 382; the Counterparty Credit Risk rules of the PRA Rulebook and the high-level expectations outlined in *The PRA's Approach to Banking Supervision*.⁽¹⁾

2 Factors which the PRA expects firms to take into account when applying to certain permissions related to the counterparty credit risk regulatory framework

Use of 'Internal CVA model' for the calculation of the maturity factor 'M'

2.1 This section sets out the PRA's expectations for granting a firm permission to use its own one-sided credit valuation adjustment internal models (an 'Internal CVA model') for the purpose of estimating the Maturity factor 'M', as proposed under CRR Article 162(2), paragraph (h).

2.2 The Maturity factor 'M' is intended to increase own funds requirements to reflect higher risks associated with medium and long-term over the counter (OTC) derivative portfolios where the exposure profile of contracts extends beyond one year. The adjustment is only applicable to firms using the Internal Model Method (IMM) for the calculation of exposure values.

2.3 Subject to permission being granted by the PRA, as the relevant competent authority, firms may replace the formula for the Maturity factor 'M', as set out in CRR Article 162(2), paragraph (g), with the 'effective credit duration' derived from the firm's Internal CVA model.

2.4 Internal CVA models are complex by nature and modelling practices vary significantly across the industry. The PRA considers the creation of an acceptable model resulting in an appropriate credit duration to be challenging. Accordingly, the

PRA expects firms to demonstrate a strong case for permission to be granted.

2.5 A firm that wishes to make an application under CRR Article 162(2), paragraph (h) should provide a satisfactory justification for the use of an internal CVA model for estimating the maturity factor 'M'. The PRA does not consider the reduction of the own funds requirements for counterparty credit risk to be a reasonable justification. The PRA will also require highly conservative modelling assumptions within a firm's Internal CVA model for the purpose of CRR Article 162(2), paragraph (h).

2.6 To apply for the CRR Article 162(2), paragraph (h) permission, firms should contact the PRA.

Permission to set the maturity factor 'M' to 1 for the Counterparty Credit Risk default charge

2.7 This section sets out the PRA's expectations for granting a permission to firms with the permission to use the Internal Model Method (IMM) and the permission to use an internal Value-at-Risk (VaR) model for specific risk associated with traded debt instruments to set to 1 the Maturity factor 'M' defined in CRR Article 162.

2.8 CRR Article 162(2), paragraph (i) allows a firm using the IMM to set the Maturity factor 'M' to 1 provided the firm's internal VaR model for specific risk associated with traded debt instruments reflects the effect of rating migration. This is subject to the PRA's permission.

2.9 Internal VaR models for specific risk associated with traded debt instruments are not designed to capture the effects of rating migrations. The risk captured by these models is based on a ten-day time horizon which does not appropriately reflect the dynamics of rating migrations, which occur on an irregular and infrequent basis. This deficiency was one of the main reasons for the introduction of a separate risk measure for the capture of both default and migration risk, based on a one-year time horizon (the 'IRC' model, CRR Article 372). Since the challenges of appropriately capturing credit rating migrations in an internal VaR model are significant, the PRA expects firms to demonstrate a strong case for the granting of the permission set out in CRR Article 162(2), paragraph (i).

2.10 A firm that wishes to make an application under CRR Article 162(2), paragraph (i) should provide a satisfactory justification for the use of its internal VaR to capture the risks associated with rating migration. The reduction of the own funds requirements for counterparty credit risk is not considered by the PRA to be a reasonable justification. The PRA expects highly conservative modelling assumptions for the capture of rating migrations within a firm's internal VaR

(1) www.bankofengland.co.uk/pr/Pages/supervision/approach/default.aspx.

model for the purpose of satisfying the requirements of CRR Article 162(2), paragraph (i).

2.11 To apply for the permission proposed under CRR 162(2), paragraph (i), firms should contact the PRA.

3 Inclusion of securities financing transactions in the scope of the CVA capital charge

3.1 This section sets out the PRA's determination of when risk exposures arising from securities financing transactions (SFTs) should be deemed material and be included in the scope of the own funds requirements for credit valuation adjustment (CVA) in accordance with CRR Article 382(2).

3.2 SFTs are not defined in the regulation. The PRA considers that, for these purposes, SFTs should include:

- repurchase transactions; and
- securities or commodities lending or borrowing transactions.

3.3 SFTs generally need not be included within the scope of a firm's CVA charge since they are typically accounted for based on their substance as secured lending arrangements. However, firms can be exposed to CVA risk as a result of SFT transactions. For example, the transfer of an asset and its forward sale (which underpin the legal form of the SFT) would be recognised as a derivative in the event of a subsequent deterioration in the creditworthiness of the counterparty to the SFT. The PRA considers that this CVA risk may be material where the following three conditions are met:

- the SFT's counterparty has demonstrated a recent deterioration of its creditworthiness;
- a severe deterioration of the SFT's counterparty's creditworthiness would lead to a previous transfer being accounted for as a sale and therefore the recognition of a derivative that would be included in the scope of the CVA charge; and
- the SFT transactions do not benefit from adequate credit risk mitigation. An example would be where the SFTs are not included in a master netting agreement that has the effect of reducing exposure to credit risk.

3.4 Where these conditions are met, firms must include SFT transactions in the scope of own funds requirements for CVA risk. The PRA may review firms' methodology for determining the inclusion of these SFT transactions in the scope of own funds requirements for CVA risks.

4 Calculating own fund requirements for exposures to Central counterparties: identifying qualifying central counterparties

4.1 During the transitional period, the following will be qualifying central counterparties (QCCPs):

- all CCPs listed on the Bank of England's register of Recognised Clearing Houses (RCHs); and
- those third country CCPs that currently provide clearing services to UK credit institutions, or their subsidiaries.

4.2 The Bank of England's register of RCHs is available on the following link:
www.bankofengland.co.uk/financialstability/Pages/fmis/supervised_sys/rch.aspx.

4.3 The transitional period will expire on 15 June 2014, unless extended by the European Commission.

4.4 Following the authorisation or recognition of CCPs a link will be provided to the relevant register on the Bank of England website and to the European Securities and Markets Authority website. Authorised or recognised CCPs on the registers will be considered to be QCCPs.

4.5 The PRA will notify UK institutions if a QCCP no longer meets the requirement to calculate its hypothetical capital (KCCP) or ceases to be a QCCP.

5 Annual SIF attestation of counterparty credit risk internal models

5.1 The PRA expects an appropriate individual in a Significant Influence Function role to provide to the PRA on an annual basis written attestation that:

- the firm's internal approaches for which it has received a permission comply with the requirements in Part 3 Title II of the CRR, and any applicable PRA counterparty credit risk supervisory statements; and
- where a model has been found not to be compliant, a credible plan for a return to compliance is in place and being completed.

5.2 Firms should agree the appropriate SIF for providing this attestation with the PRA, noting that the PRA would not expect to agree more than two SIFs to cover all the firm's counterparty credit risk internal models as described in Part Three Title II of the CRR.

6 Counterparty credit risk advanced model approaches: process for post approval changes

6.1 This section describes the PRA's approach for post-approval changes to Counterparty Credit Risk Internal Model Method (IMM) as defined in Section 6 of Title II, Chapter 6 of the CRR and Internal Models approach for Master netting agreements ('Repo VaR') as defined in Article 221 of the CRR, including extensions of the scope of approval, and roll out of portfolios according to the roll-out plan; it suggests the documentation the PRA would seek to support the proposed change and provides an overview of the PRA's response to these advised changes.

6.2 The framework for post-approval model changes outlined here forms one integral element of the wider regime for calculating counterparty credit risk using advanced methods but does not encompass the entirety of the regime. To run this regime effectively, the PRA will deal with firm-driven actions (such as model changes) and also undertake other work (such as reviews and thematic work).

6.3 The PRA regard the post-approval regime as critical to maintaining confidence in the high standards which firms have been set during their initial CRR permission applications. An effective post-approval framework, which is the objective of the proposals in this paper, will provide this assurance while firms' models are adjusted over time, without imposing a disproportionate burden on firms and on the PRA.

6.4 The PRA will ask for prior information only for the most material changes (defined in paragraph 10) to their IMM or Repo VaR model, as described in paragraph 13. The PRA envisage that this will typically result in only a few pre-notifications on average per year per firm, even from the largest firms. For details about the changes, the PRA will rely to the extent it can on information generated internally by the firms. This should foster a pragmatic, 'no surprises', and proportionate regime.

6.5 Other changes need be reported in summary form only and after implementation. The arrangements allow for firms to agree *de minimis* thresholds below which no report needs to be made at all.

6.6 The PRA will review in due course, with input from the industry, how the process is operating.

Defining materiality

6.7 Firms must notify the PRA of significant changes to IMM or Repo VaR models prior to these changes being implemented for capital purposes. The permission will offer some broad guidelines around factors which constitute significant change:

these will be published in due course. The starting point is the assumption that firms will proactively advise supervisors of significant events or issues affecting the operation of the advanced model with the onus on the firm to judge what is significant.

6.8 The PRA's approach to assessing the significance of issues will be based on the materiality of changes, which in turn will be governed by the substance of the change as relevant to the firm rather than measurement against a predefined set of parameters. Once notified, the firm supervisor will evaluate the proposed change on a case by case basis. It is expected that both the firm and its respective supervisor will in the course of time reach a common understanding of the type of change that warrants consultation and approval.

6.9 Changes to a firm's model can be categorised as low or high impact depending on the level of materiality. This spectrum at one end denotes simple, minor changes which do not warrant prior consultation with the PRA. The other end is characterised by significant, high-impact changes which will need to be reported in advance and require PRA approval. These boundaries will encompass a middle range of changes that will be reported but which may or may not warrant PRA review.

Examples of change

6.10 Changes may involve several aspects of the advanced model framework. The following are examples of changes the PRA deems to be significant and therefore requiring prior approval by the PRA (please note that this is not an exhaustive list):

- (a) Development of new models to cover products currently not in the scope of the permission, eg equity derivatives, interest rate derivatives.
- (b) A model change resulting in a change in Counterparty Credit Risk (CCR) capital requirements for the UK consolidation group greater than 5% in both directions (that is, either increase or decrease of capital) or a change in gross EAD (for clarity the EAD should be calculated gross of netting, margin and collateral) of 5% in both directions. While the PRA would be open to suggestions from firms as to their preferred level for this threshold, or the basis on which it is calculated, the final parameter would need to be agreed between the firm and the PRA. As a benchmark the PRA intend that a change in CCR capital requirements of 5% should be considered significant or a change in gross EAD of 5% should be considered significant.
- (c) A model previously deemed immaterial becomes material if it will calculate EAD greater than 5% of gross EAD or contribute more than 5% of CCR related capital requirement.

- (d) Changes to the calculation system. This could include:
- (i) Structural changes to the system used to generate exposure profiles.
 - (ii) Re-development/optimisation of existing routines which could lead to significant changes in the output of the model.

6.11 The following are examples of changes the PRA deem to be less significant and therefore require post-notification to the PRA (please note that this is not an exhaustive list):

- (e) Extension of current models to new product types (product types currently not in the scope of the permission) eg swaps, caps, swaptions, etc.
- (f) Changes to currently approved models. This may be related to:
 - (i) Introduction of new risk factors (eg introduction of a new market risk factor in the simulation engine such as new currencies, new interest rate curves. It is not expected that this will cover increases in the granularity of particular risk factor curves).
 - (ii) Changes to the evolution process of existing risk factors.
 - (iii) Calibration methodology.
 - (iv) Changes to the pricing functions used.
- (g) Changes to the models due to changes in the composition of the portfolios and products traded (eg changes due to merger and/or acquisitions).
- (h) A significant change to the outputs of the model resulting from a series of changes that in isolation may not be significant but cumulatively have a significant effect.

6.12 Firms may agree more detailed materiality thresholds with the PRA, if they wish.

Parallel running and the experience requirement

6.13 Depending on the materiality of changes, the requirements with regards to parallel running as defined under Article 289(2) of the CRR may change. The PRA does not intend to apply any formal requirement for parallel running to changes of IMM and Repo VaR systems. The PRA would, however, expect firms themselves to include parallel running to the extent they deem necessary as part of their normal general project management disciplines when introducing new or enhanced risk management tools.

6.14 It is expected that firms will demonstrate that the model is appropriate through backtesting. Firms are expected to backtest the advanced model and the relevant components that input into the calculation of EAD using historical data movements in market risk factors considering a number of distinct time horizons out to at least one year. The backtesting

should cover a range of observation periods representing a wide range of market conditions.

Change of governance process

6.15 This section describes the process firms will be required to follow when pre-notifying or post-notifying a model change.

Pre-notifying a change

- **Step 1.** The firm should advise the PRA about future proposed changes as far in advance as possible. In addition to this, during IMM reviews the firm will be expected to advise the PRA of its current thinking on future changes, across the group. The firm should expect that a decision by the PRA regarding pre-approval of a change can take up to six months.
- **Step 2.** The firm should submit a short description of the change.
- **Step 3.** The firm should conduct a self-assessment of the change against the relevant CRR rules, noting any areas of non-compliance with details of how and when these gaps will be closed and set out which CRR rules are not considered relevant.
- **Step 4.** If the change is recognized to be significant as per paragraph 10 prepare and submit the material set out in Appendix B.
- **Step 5.** Send the material from Steps 2, 3 and 4 to the PRA. The material needs to be sent sufficiently far in advance of the proposed change to allow time to review it prior to implementation. If the PRA chooses to review the change, it may ask for additional information and if necessary meetings or on-site visits. The PRA is content for firms to provide internal documentation for this purpose provided this addresses clearly and sufficiently the process requirements set out above.

Post-notifying a change

6.16 Where the change belongs to category (e), (f), (g), (h) in paragraph 10 the firm can notify the PRA after it has occurred. The firm will need to provide the following:

- (a) a short description of the change, including the date on which the change was implemented;
- (b) confirmation that the change has been reviewed through the firm's internal governance processes; and
- (c) confirmation that a self-assessment of the change against the CRR rules has been completed and has not identified any areas of non-compliance.

6.17 After the post-notification, the PRA might request additional information, including internal documentation consistent with the relevant parts of Appendix C.

6.18 The PRA is also prepared to respond constructively to proposals from firms on a cumulative de minimis figure for immaterial models, changes to which will not require post-notification. The PRA envisage this total figure being in the region of a 5% increase or decrease in the CCR related capital requirement or EAD of the model for the UK consolidation group. Accordingly, a firm may nominate a number of models, each of which account for no more than a 5% change in the CCR related capital requirement or EAD and which in total account for no more than a 5% change in CCR related capital or EAD, for which neither pre-notification nor post-notification is ordinarily necessary.

Fees

6.19 There will be some circumstances where a fee will be applied — for example, when a firm is extensively changing the scope of its model approval or following a merger or acquisition that impacts the materiality of business in scope of an advanced approach permission.

Self-assessment

6.20 The self-assessment process described in paragraph 13, Step 3 needs only be an assessment against CRR rules that are relevant to the change in question. While it is the firm's responsibility to decide on the method of conducting the self-assessment, the PRA expects the self-assessment to be sufficiently rigorous to allow the firm to identify areas of non-compliance. In the case where areas of non-compliance have been identified the PRA expects firms to provide a detailed process for becoming compliant in the areas identified.

6.21 It is important to highlight that a high-level 'gap analysis' or a process that places reliance on the firm's governance process or on the firm's developmental process to deliver a compliant approach is unlikely to form an adequate self-assessment.

PRA response

6.22 To pre-notified changes: Following pre-notification, the PRA will make a prompt initial assessment of the material and determine whether a full review is needed or not. If a full review is not judged necessary, then the firm may make the change as planned. If a full review is judged necessary, then the firm will be informed, any on-site review work executed and a decision reached. In very limited circumstances, to be agreed on a case by case basis, the PRA may be prepared to allow firms to implement the proposed change in the interim, subject to an additional element of conservatism being applied.

6.23 Decision options for pre-notified changes are: 'approve', 'approve with hard ongoing conditions' and 'reject'. Firms will be given the opportunity to address issues prior to a formal decision being issued.

6.24 To post-notified changes: The PRA may take no action, or may select a change or portfolio for subsequent review as part of the review process.

6.25 Our relationship with other EEA regulators will be governed by Articles 115, 116 and, if necessary, by Articles 112 and 113 of the CRD as well as by the associated technical standards. The PRA will maintain a reciprocal agreement between EEA regulators to keep each other informed of significant changes as advised by the respective local sites. Involvement with other non-EEA regulators will be achieved via continued collaboration.

6.26 Updating the Direction: In the spirit of accuracy and transparency, any revisions to the permission decision should be reflected in the permission document and published as a subsequent version of the original. Generally, changes to the scope will warrant a change to the permission and require formal action. However, not every model change will warrant an update, even if it is a significant change. Following review of a significant change, there may follow a recommendation to add conditions.

Pillar 2

6.27 Depending on the magnitude of the effect on the firm's capital position, the change may also trigger a review of the firm's capital position under Pillar 2, possibly requiring submission of a fresh ICAAP.

6.28 The firm should not rely on the PRA to ensure that a notified change is compliant and should not assume that the lack of an immediate response to a submission positively indicates that the change is compliant: responsibility for compliance rests with the firm.

Summary

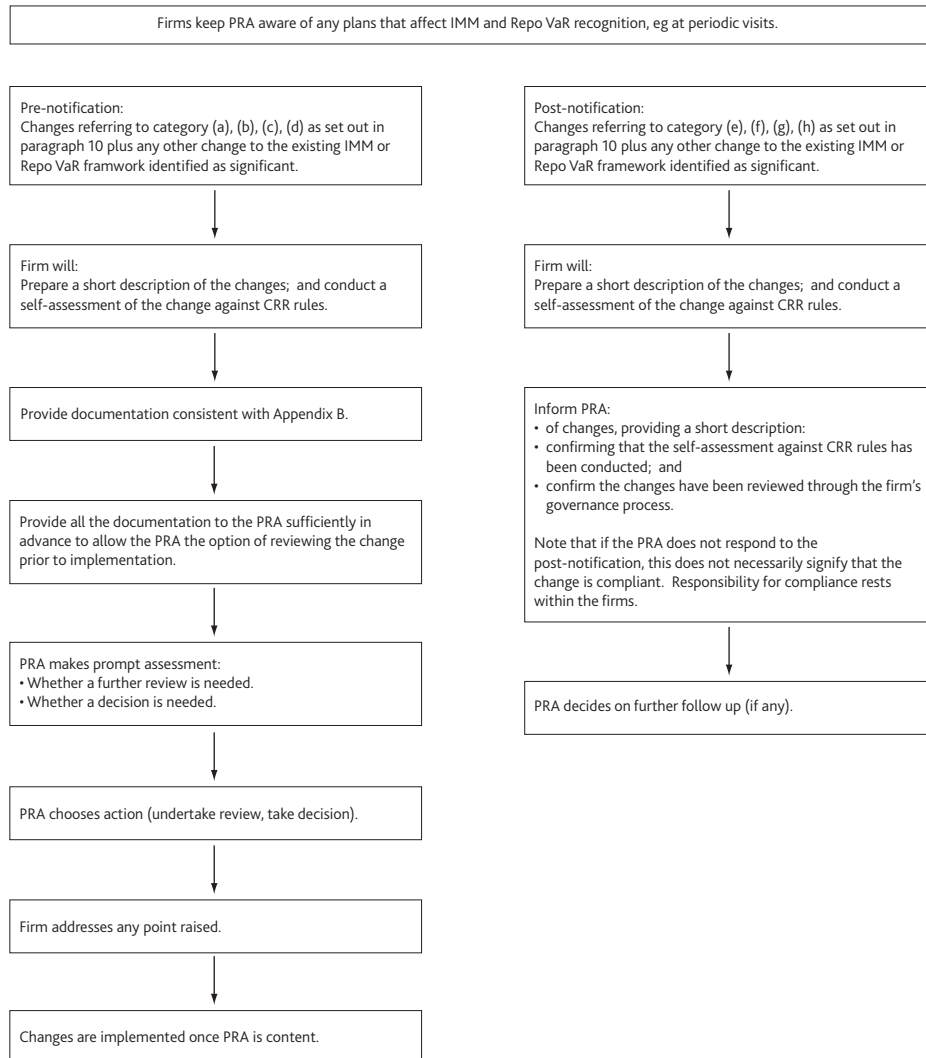
6.29 The PRA observe that the assessment of significant changes cannot be a mechanistic approach given the individual characteristics of each firm. The PRA recognises that there will be a process of learning and refinement on both sides in terms of reaching an understanding of what is considered to be significant.

6.30 A diagram covering the key steps is attached as Appendix A.

Appendix A

IMM and Repo VaR Post-Approval Model

Changes Process



Appendix B

Documentation required for material changes

As detailed under paragraph 14 (step 4) if the changes to the IMM or Repo VaR model are recognised to be material, further documentation will be required for review from the PRA. The following list represents a minimum requirement which needs to be met when applying for material changes. The PRA may ask for further information and/or documentation on a case by case basis. This section is divided in two main categories:

- Changes to models.
- Changes to the counterparty risk system.

Changes to models (new model being introduced or changes to existing models)

The following is the minimum information that should be provided for changes to models.

- CRR self-assessment. This should include an assessment against any requirement relevant to the changes made and sign-off from a Significant Influence Function attesting that the model is fit for purpose and meets regulatory requirements.
- Distribution of risk for an appropriate parallel run period for the transactions covered by the model changes according to the following categories (each table should include number of trades, Positive MtM, EAD, PFE, regulatory capital using the old model, regulatory capital using the new model):
 - (i) Product (if more than one) for number of trades; positive MtM; and exposure and capital measures calculated gross of netting;
 - (ii) Counterparty Credit Rating (ie Probability of Default rating);
 - (iii) Industry;
 - (iv) Country/Geographic region.
- Independent validation report relevant to the changes to models.
- Backtesting results for an appropriate parallel run period.
- Sign off minutes for model approval from the relevant committees.

The following information should be provided if documentation previously submitted has changed as a result of the changes to models.

- Technical documentation outlining the methodology used to model and calibrate risk factors. This documentation should also include the methodology used to estimate the relationship between risk factors, eg correlation.

- Technical documentation for the methodology used to price the product(s) modelled.
- Technical documentation for the modelling of collateral if modelled jointly with exposures.
- Technical documentation outlining the implementation of netting/margining rules for the new model.
- Updated policy for:
 - (i) Backtesting
 - (ii) Stress Testing
 - (iii) Wrong Way Risk
 - (iv) Collateral management
 - (v) Validation policy

Changes to the counterparty risk system

If changes to the system occur in conjunction with material changes to models the latter would require a separate submission of documents as outlined in the section 'Changes to models (new model being introduced or changes to existing models)'. The following is the minimum information that should be provided for changes to the counterparty risk system.

- CRR self-assessment. This should include an assessment against any requirement relevant to the changes made and sign-off from a Significant Influence Function attesting that the model is fit for purpose and meets regulatory requirements.
- Distribution of risk: distribution of risk, over an appropriate parallel run period, for the transactions covered by changes according to the following categories (each table should include number of trades, positive MtM, EAD, PFE, regulatory capital prior to and after changes being applied):
 - (i) Product (if more than one) for number of trades; positive MtM; and exposure and capital measures calculated gross of netting;
 - (ii) Counterparty Credit Rating (ie Probability of Default rating);
 - (iii) Industry;
 - (iv) Country/Geographic Region.
- Operational requirements (in the form of internal documentation or policies as relevant):
 - (i) Description of the Control Unit in charge of design of model (including organizational chart);
 - (ii) Description of the Control Unit in charge of implementation into production system (including organisational chart);
 - (iii) Description of the Control Unit in charge of initial and ongoing validation of Counterparty Risk Exposure Model (including organizational chart);

- (iv) Data integrity assessment and policy around data quality;
 - (v) Sample reports of the output of the model (as used and seen by model users);
 - (vi) Impact on trading limits (ie change in credit policy with regards to allocation/management of credit limits).
- Backtesting analysis and results for an appropriate parallel running period.

The following information should be provided if documentation previously submitted has changed as a result of the changes to the counterparty risk system.

- Updated policy for:
 - (i) Stress Testing
 - (ii) Wrong Way Risk
 - (iii) Backtesting
 - (iv) Collateral
 - (v) Validation (covering both initial and ongoing validation).

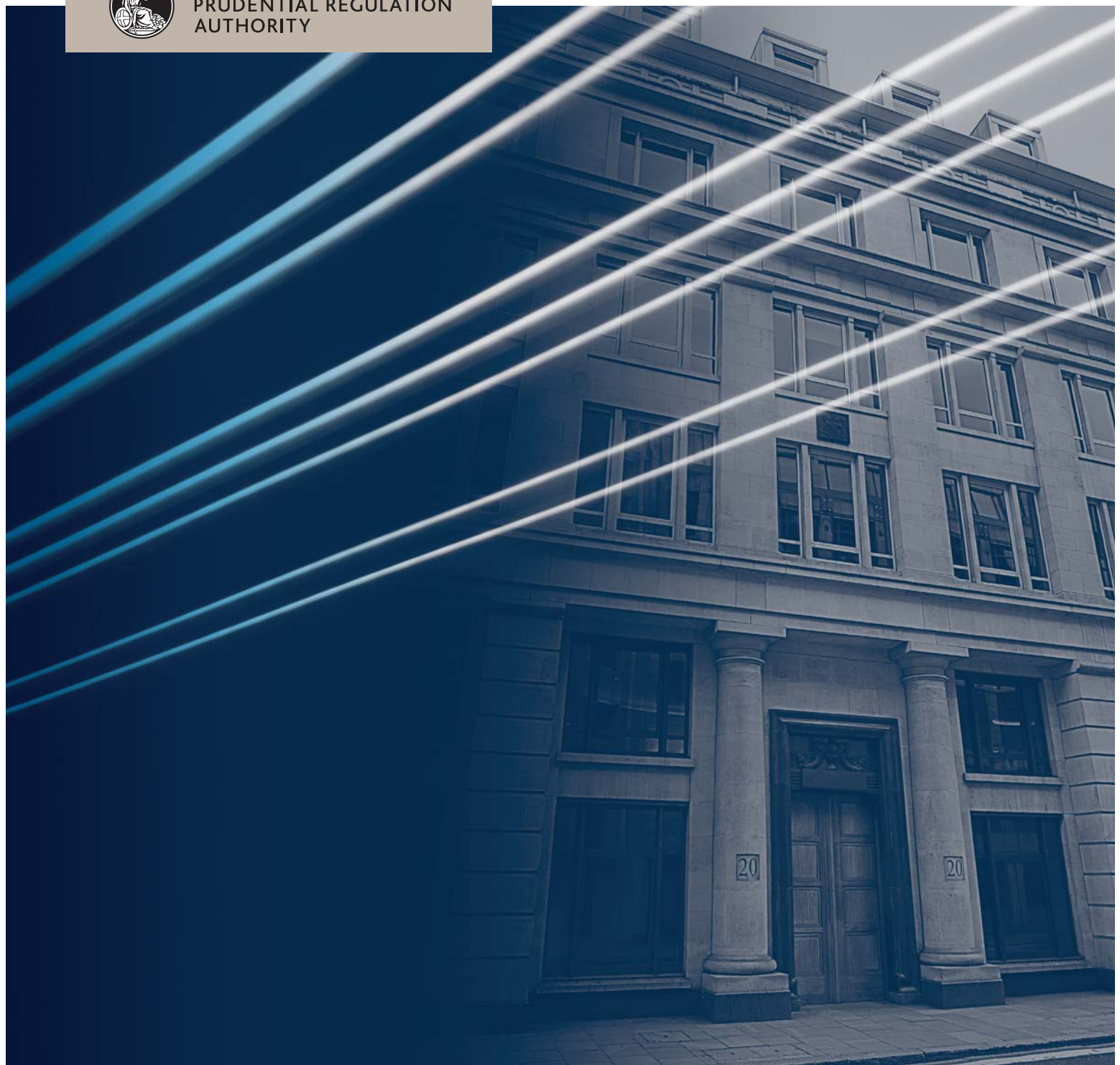
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Market risk

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Market risk

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1 Introduction

1.1 This supervisory statement is aimed at firms to which CRD IV applies.

1.2 It sets out the Prudential Regulation Authority's (PRA's) expectations of firms in relation to market risk and should be considered in addition to requirements set out in CRD IV Articles 325–377, the market risk rules of the PRA Rulebook and the high-level expectations outlined in *The PRA's approach to banking supervision*.⁽¹⁾

1.3 This statement details the PRA's expectations with regard to the following:

- Material deficiencies in risk capture by an institution's internal approach.
- Standardised approach for options.
- Netting a convertible with its underlying instrument.
- Offsetting derivative instruments.
- Exclusion of backtesting exceptions when determining multiplication factor addends.
- Derivation of notional positions for standardised approaches.
- Qualifying debt instruments.
- Expectations relating to internal models.
- Value-at-Risk (VaR) and stressed VaR (sVaR) calculation.
- Requirement to have an internal incremental risk charge (IRC) model.
- Annual SIF attestation of market risk internal models.

2 Material deficiencies in risk capture by an institution's internal approach

2.1 This section sets out the PRA's requirements for the calculation of additional own funds for the purposes of implementing CRD Article 101, which applies where a firm has permission to calculate own funds requirements for one or more categories of market risk under CRR Part 3 Title IV Chapter 5. It requires firms to identify any risks which are not adequately captured by those models and to hold additional own funds against those risks. The methodology for the identification of those risks and the calculation of those additional own funds for VaR and sVaR models is referred to as the 'RNIV framework'.

2.2 Firms are responsible for identifying these additional risks, and this should be seen as an opportunity for risk managers and management to better understand the shortcomings of the firm's models. Following this initial assessment, the PRA will engage with the firm to provide challenge and so ensure an appropriate outcome.

Scope of the Risks not in VaR (RNIV) framework

2.3 The RNIV framework is intended to ensure that own funds are held to meet all risks which are not captured, or not captured adequately, by the firm's VaR and sVaR models. These include, but are not limited to missing and/or illiquid risk factors such as cross-risks, basis risks, higher-order risks, and calibration parameters. The RNIV framework is also intended to cover event risks that could adversely affect the relevant business.

Identification and measurement framework

2.4 The PRA expects firms to systematically identify and measure all non-captured or poorly captured risks. This analysis should be updated at least quarterly, or more frequently at the request of the PRA. The measurement of these risks should capture the losses that could arise due to the risk factor(s) of all products that are within the scope of the relevant internal model permission, but are not adequately captured by the relevant internal models.

Identification of risk factors

2.5 The PRA expects firms to, on a quarterly basis, identify and assess individual risk factors covered by the RNIV framework. The PRA will review the results of this exercise and may require that firms identify additional risk factors as being eligible for measurement.

Measurement of risk factors

2.6 Where sufficient data is available, and where it is appropriate to do so, the PRA expects firms to calculate a VaR and sVaR metric for each risk factor within scope of the framework. The stressed period for the RNIV sVaR should be consistent with that used for sVaR. No offsetting or diversification may be recognised across risk factors included in the RNIV framework. The multipliers used for VaR and sVaR should be applied to generate an own funds requirement.

2.7 If it is not appropriate to calculate a VaR and sVaR metric for a risk factor, a firm should instead measure the size of the risk based on a stress test. The confidence level and capital horizon of the stress test should be commensurate with the liquidity of the risk, and should be at least as conservative as comparable risk factors under the internal model approach. The capital charge should be at least equal to the losses arising from the stress test.

3 Standardised approach for options

3.1 Firms that need to use own estimates of delta for the purposes of the standardised approach for options, should provide the PRA with confirmation that they meet the minimum standards set out below for each type of option for

(1) www.bankofengland.co.uk/pr/Pages/supervision/approach/default.aspx.

which they calculate delta. Firms should only provide this confirmation if they meet the minimum standards. Where a firm meets the minimum standards, they will be permitted to use own estimates of delta for the relevant option.

3.2 If a firm is unable to provide assurance with regard to a particular option type which is currently within its permissions, a capital add-on may be applied and a rectification plan agreed. If a firm is unable to comply with the rectification plan within the mandated time frame, further supervisory measures may be taken. This may include variation of permissions so that they are no longer allowed to trade those particular types of option for which they do not meet the minimum standards.

Minimum standards

3.3 The level of sophistication of the pricing models, which are used to calculate own estimates of delta for use in the standardised approach for options, should be proportionate to the complexity and risk of each option and the overall risk of the firm's options trading business. In general, it is considered that the risk of sold options will be higher than the risk of the same options when bought.

3.4 Delta should be recalculated at least daily. Firms should also recalculate delta promptly following significant movements in the market parameters used as inputs to calculate delta.

3.5 The pricing model used to calculate delta should be:

- based on appropriate assumptions which have been assessed and challenged by suitably qualified parties independent of the development process;
- independently tested, including validation of the mathematics, assumptions, and software implementation; and
- developed or approved independently of the trading desk.

3.6 A firm should use generally accepted industry standard pricing models for the calculation of own deltas where these are available, such as for relatively simple options.

3.7 The IT systems used to calculate delta should be sufficient to ensure that delta can be calculated accurately and reliably.

3.8 Firms should have adequate systems and controls in place when using pricing models to calculate deltas. This should include the following documented policies and procedures:

- clearly defined responsibilities of the various areas involved in the calculation;
- frequency of independent testing of the accuracy of the model used to calculate delta; and
- guidelines for the use of unobservable inputs, where relevant.

3.9 A firm should ensure its risk management functions are aware of weaknesses of the model used to calculate deltas. Where weaknesses are identified, the firm should ensure that estimates of delta result in prudent capital requirements being held. The outcome should be prudent across the whole portfolio of options and underlying positions at a given time.

4 Netting a convertible with its underlying instrument

4.1 For the purposes of CRR Article 327(2), the netting of a convertible bond and an offsetting position in the instrument underlying it is permitted. The convertible bond should be:

- treated as a position in the equity into which it converts; and
- the firm's equity own funds requirement should be adjusted by making:
 - (i) an addition equal to the current value of any loss which the firm would make if it did convert to equity; or
 - (ii) a deduction equal to the current value of any profit which the firm would make if it did convert to equity (subject to a maximum deduction equal to the own funds requirements on the notional position underlying the convertible).

5 Offsetting derivative instruments

5.1 CRR Article 331(2) states conditions that should be met before firms not using interest rate pre-processing models can fully offset interest rate risk on derivative instruments. One of the conditions is that the reference rate (for floating rate positions) or coupon (for fixed rate positions) should be 'closely matched'. The PRA would normally consider a difference of less than 15 basis points as indicative of the reference rate or coupon being 'closely matched' for the purposes of this rule.

6 Exclusion of overshootings when determining multiplication factor addends

6.1 The PRA's starting assumption will be that all overshootings should be taken into account for the purpose of the calculation of addends. If a firm believes that an overshooting should not count for that purpose, then it should seek a variation of its VaR model permission in order to exclude that particular overshooting. The PRA will then decide whether to agree to such a variation.

6.2 One example of when a firm's overshooting might properly be disregarded is when it has arisen as a result of a risk that is not captured in its VaR model, but against which capital resources are already held.

7 Derivation of notional positions for standardised approaches

Futures and forwards on a basket or index of debt securities

7.1 These should be converted into forwards on single debt securities as follows:

- (1) futures or forwards on a single currency basket or index of debt securities should be treated as either:
 - (a) a series of forwards, one for each of the constituent debt securities in the basket or index, of an amount which is a proportionate part of the total underlying the contract according to the weighting of the relevant debt security in the basket; or
 - (b) a single forward on a notional debt security; and
- (2) futures or forwards on multiple currency baskets or indices of debt securities should be treated as either:
 - (a) a series of forwards (using the method described in 1(a)); or
 - (b) a series of forwards, each one on a notional debt security to represent one of the currencies in the basket or index, of an amount which is a proportionate part of the total underlying the contract according to the weighting of the relevant currency in the basket.

7.2 Notional debt securities derived through this treatment should be assigned a specific risk position risk adjustment and a general market risk position risk adjustment equal to the highest that would apply to the debt securities in the basket or index.

7.3 The debt security with the highest specific risk position risk adjustment within the basket might not be the same as the one with the highest general market risk position risk adjustment. A firm should select the highest percentages even where they relate to different debt securities in the basket or index, and regardless of the proportion of those debt securities in the basket or index.

Bonds where the coupons and principal are paid in different currencies

7.4 Where a debt security pays coupons in one currency, but will be redeemed in a different currency, it should be treated as:

- (i) a debt security denominated in the coupon's currency; and
- (ii) a foreign currency forward to capture the fact that the debt security's principal will be repaid in a different currency from that in which it pays coupons, specifically:
 - (a) a notional forward sale of the coupon currency and purchase of the redemption currency, in the case of a long position in the debt security; or

- (b) a notional forward purchase of the coupon currency and sale of the redemption currency, in the case of a short position in the debt security.

Interest rate risk on other futures, forwards and swaps

7.5 Other futures, forwards, and swaps where a treatment is not specified in Article 328 should be treated as positions in zero specific risk securities, each of which:

- (i) has a zero coupon;
- (ii) has a maturity equal to that of the relevant contract; and
- (iii) is long or short according to the following table:

Instrument	Notional positions	
Foreign currency forward or future	A long position denominated in the currency purchased	and a short position denominated in the currency sold.
Gold forward	A long position if the forward or future involves an actual (or notional) sale of gold	or A short position if the forward or future involves an actual or notional purchase of gold.
Equity forward	A long position if the contract involves an actual (or notional) sale of the underlying equity	or A short position if the contract or future involves an actual (or notional) purchase of the underlying equity.

Deferred start interest rate swaps or foreign currency swaps

7.6 Interest rate swaps or foreign currency swaps with a deferred start should be treated as the two notional positions (one long, one short). The paying leg should be treated as a short position in a zero specific risk security with a coupon equal to the fixed rate of the swap. The receiving leg should be treated as a long position in a zero specific risk security, which also has a coupon equal to the fixed rate of the swap.

7.7 The maturities of the notional positions are shown in the following table:

	Paying leg	Receiving leg
Receiving fixed and paying floating	The maturity equals the start date of the swap.	The maturity equals the maturity of the swap.
Paying fixed and receiving floating	The maturity equals the maturity of the swap.	The maturity equals the start date of the swap.

Swaps where only one leg is an interest rate leg

7.8 For the purposes of interest rate risk, a firm should treat a swap (such as an equity swap) with only one interest rate leg as a notional position in a zero-specific-risk security:

- (a) with a coupon equal to that on the interest rate leg;
- (b) with a maturity equal to the date that the interest rate will be reset; and
- (c) which is a long position if the firm is receiving interest payments and short if making interest payments.

Foreign exchange forwards, futures and CFDs

7.9 A firm should treat a foreign currency forward, future, or Contracts for Difference (CFDs) as two notional currency positions as follows:

- (a) a long notional position in the currency which the firm has contracted to buy; and
- (b) a short notional position in the currency which the firm has contracted to sell.

7.10 The notional positions should have a value equal to either:

- (a) the contracted amount of each currency to be exchanged in the case of a forward, future, or CFD held in the non-trading book; or
- (b) the present value of the amount of each currency to be exchanged in the case of a forward, future, or CFD held in the trading book.

Foreign currency swaps

7.11 A firm should treat a foreign currency swap as:

- (a) a long notional position in the currency in which the firm has contracted to receive interest and principal; and
- (b) a short notional position in the currency in which the firm has contracted to pay interest and principal.

7.12 The notional positions should have a value equal to either:

- (a) the nominal amount of each currency underlying the swap if it is held in the non-trading book; or
- (b) the present value amount of all cash flows in the relevant currency in the case of a swap held in the trading book.

Futures, forwards, and CFDs on a single commodity

7.13 Where a forward, future or CFD settles according to:

- (1) the difference between the price set on trade date and that prevailing at contract expiry, then the notional position should:
 - (a) equal the total quantity underlying the contract; and
 - (b) have a maturity equal to the expiry date of the contract; and
- (2) the difference between the price set on trade date and the average of prices prevailing over a certain period up to contract expiry, then a notional position should be derived for each of the reference dates used in the averaging period to calculate the average price, which:
 - (a) equals a fractional share of the total quantity underlying the contract; and
 - (b) has a maturity equal to the relevant reference date.

Buying or selling a single commodity at an average of spot prices prevailing in the future

7.14 Commitments to buy or sell at the average spot price of the commodity prevailing over some period between trade date and maturity should be treated as a combination of:

- (1) a position equal to the full amount underlying the contract with a maturity equal to the maturity date of the contract, which should be:
 - (a) long, where the firm will buy at the average price; or
 - (b) short, where the firm will sell at the average price; and
- (2) a series of notional positions, one for each of the reference dates where the contract price remains unfixed, each of which should:
 - (a) be long if the position under (1) is short, or short if the position under (1) is long;
 - (b) equal to a fractional share of the total quantity underlying the contract; and
 - (c) have a maturity date of the relevant reference date.

8 Qualifying debt instruments

8.1 CRR Article 336(4)(a) states that positions listed on a stock exchange in a third country, where the exchange is recognised by the competent authorities, qualify for the specific risk own funds requirements in the second row of the table in CRR Article 336.

8.2 For the purposes of this rule, the PRA recognise the following stock exchanges in third countries:

- Australian Securities Exchange Limited.
- Bermuda Stock Exchange.
- Bolsa Mexicana de Valores.
- Bourse de Montreal Inc.
- Channel Islands Stock Exchange.
- Chicago Board of Trade.
- Chicago Board Options Exchange.
- Chicago Board of Trade (CBOT).
- Chicago Stock Exchange.
- Dubai Financial Market.
- EUREX (Zurich).
- Euronext Amsterdam Commodities Market.
- Hong Kong Exchanges and Clearing Limited.
- ICE Futures US, Inc.
- Indonesia Stock Exchange.
- Johannesburg Stock Exchange.
- Kansas City Board of Trade.
- Korea Exchange.
- Kuala Lumpur Stock Exchange.
- Minneapolis Grain Exchange.
- NASDAQ OMX PHLX.
- National Association of Securities Dealers Automated Quotations (NASDAQ).

- National Stock Exchange India.
- New York Stock Exchange.
- New York Mercantile Exchange Inc (NYMEX Inc.).
- New Zealand Exchange.
- NYSE Liffe US.
- NYSE MKT.
- Osaka Securities Exchange.
- Shanghai Stock Exchange.
- Singapore Exchange.
- SIX Swiss Exchange AG.
- South African Futures Exchange.
- Stock Exchange of Mumbai.
- Stock Exchange of Thailand.
- Taiwan Stock Exchange.
- The Chicago Mercantile Exchange (CME).
- Tokyo Financial Exchange.
- Tokyo Stock Exchange.
- Toronto Stock Exchange.

9 Expectations relating to internal models

9.1 CRR Article 363 states that permission for an institution to use internal models to calculate capital is subject to competent authorities verifying compliance with:

- the general requirements;
- requirements particular to specific risk modelling; and
- requirements for an internal model for incremental default and migration risk.

9.2 The standards that the PRA expects to be met to consider that an institution is compliant with these requirements are set out below.

High-level standards

9.3 A firm should be able to demonstrate that it meets the risk management standards set out in CRR Article 368 on a legal entity and business line basis where appropriate. This is particularly important for a subsidiary undertaking in a group subject to matrix management, where the business lines cut across legal entity boundaries.

Categories of position

9.4 A VaR model permission will generally set out the broad classes of position within each risk category within its scope. It may also specify how individual products within one of those broad classes may be brought into or taken out of scope of the VaR model permission. These broad classes of permission are as follows:

- (1) Linear products, which comprise securities with linear pay-offs (such as bonds and equities), and derivative products which have linear pay-offs in the underlying risk factor (such as interest rate swaps, forward-rate agreements, and total return swaps).

- (2) European, American and Bermudan put and call options (including caps, floors, and swaptions) and investments with these features.
- (3) Asian options, digital options, single barrier options, double barrier options, look back options, forward starting options, compound options and investments with these features.
- (4) All other option based products (such as basket options, quantos, outperformance options, timing options, and correlation-based products) and investments with these features.

Data standards

9.5 The PRA expects a firm to ensure that the data series used by its VaR model is reliable. Where a reliable data series is not available, proxies or any other reasonable value-at-risk measurement may be used when the firm can demonstrate that the requirements of CRR Article 367(2)(e) are met. A firm should be able to demonstrate that the technique is appropriate and does not materially understate the modelled risks.

9.6 Data may be deemed insufficient if, for example, it contains missing data points, or data points which contain stale data. With regard to less-liquid risk factors or positions, the PRA expects the firm make a conservative assessment of those risks, using a combination of prudent valuation techniques and alternative VaR estimation techniques to ensure there is a sufficient cushion against risk over the close out period, which takes account of the illiquidity of the risk factor or position.

9.7 A firm is expected to update data sets to ensure standards of reliability are maintained in accordance with the frequency set out in its VaR model permission, or more frequently if volatility in market prices or rates necessitates more frequent updating. This is in order to ensure a prudent calculation of the VaR measure.

Aggregating VaR measures

9.8 In determining whether it is appropriate for an institution to use empirical correlations within risk categories and across risk categories within a model, the PRA expects certain features to be observed in assessing whether such an approach is sound and implemented with integrity. In general, the PRA expects a firm to determine the aggregate VaR measure by adding the relevant VaR measure for each category, unless the firm's permission provides for a different method of aggregating VaR measures which is empirically sound.

9.9 The PRA does not expect a firm to use the square root of the sum of the squares approach when aggregating measures across risk categories or within risk categories unless the

assumption of zero correlation between these categories is empirically justified. If correlations between risk categories are not empirically justified, the VaR measures for each category should simply be added in order to determine its aggregate VaR measure. However, to the extent that a firm's VaR model permission provides for a different way of aggregating VaR measures:

- (1) that method applies instead; and
- (2) if the correlations between risk categories used for that purpose cease to be empirically justified then the firm must notify the appropriate regulator at once.

Testing prior to model validation

9.10 A firm is expected to provide evidence of its ability to comply with the requirements for a VaR model permission. In general, it will be required to demonstrate this by having a back-testing programme in place and should provide three months of back-testing history.

9.11 A period of initial monitoring or live testing is required before a VaR model can be recognised. This will be agreed on a firm by firm basis.

9.12 In assessing the firm's VaR model and risk management, the results of internal model validation procedures used by the firm to assess the VaR model will be taken into account.

Backtesting

9.13 For clarity, the back-testing requirements of CRR Article 366 should be implemented as follows:

- If the day on which a loss is made is day n , the value-at-risk measure for that day will be calculated on day $n-1$, or overnight between day $n-1$ and day n . Profit and loss figures are produced on day $n+1$, and back-testing also takes place on day $n+1$. The firm's supervisor should be notified of any overshootings by close of business on day $n+2$.
- Any overshooting initially counts for the purpose of the calculation of the plus factor even if subsequently the PRA agrees to exclude it. Thus, where the firm experiences an overshooting and already has four or more overshootings for the previous 250 business days, changes to the multiplication factor arising from changes to the plus factor become effective at day $n+3$.

9.14 A longer time period generally improves the power of back-testing. However a longer time period may not be desirable if the VaR model or market conditions have changed to the extent that historical data is no longer relevant.

9.15 The PRA will review, as part of a firm's VaR model permission application, the processes and documentation relating to the derivation of profit and loss used for

backtesting. A firm's documentation should clearly set out the basis for cleaning profit and loss. To the extent that certain profit and loss elements are not updated every day (for example certain reserve calculations) the documentation should clearly set out how such elements are included in the profit and loss series.

Planned changes to the VaR model

9.16 In accordance with CRR Article 363(3), the PRA expects a firm to provide and discuss with the PRA details of any significant planned changes to the VaR model before those changes are implemented. These details must include detailed information about the nature of the change, including an estimate of the impact on VaR numbers and the incremental risk charge.

Bias from overlapping intervals for ten-day VaR and sVaR

9.17 The use of overlapping intervals of ten-day holding periods for the purposes of CRR Article 365 introduces an autocorrelation into the data that would not exist should truly independent ten-day periods be used. This may give rise to an underestimation of the volatility and the VaR at the 99% confidence level. To obtain clarity on the materiality of the bias, a firm should measure the bias arising from the use of overlapping intervals for ten-day VaR and sVaR when compared to using independent intervals. A report on the analysis, including a proposal for a multiplier on VaR and sVaR to adjust for the bias, should be submitted to the PRA for review and approval.

10 Stressed VaR calculation

10.1 CRR Article 365 requires firms that use an internal model for calculating their own funds requirement to calculate at least weekly an sVaR of their current portfolio. When the PRA considers a firm's application to use an sVaR internal model, the PRA would expect the following features to be present prior to permission being granted as indicative that the conditions for granting permission have been met.

Quantile estimator

10.2 The firm should calculate the sVaR measure to be greater than or equal to the average of the second and third worst loss in a twelve-month time series comprising of 250 observations. The PRA expects as a minimum that a corresponding linear weighting scheme should be applied if the firm use a larger number of observations.

Meaning of 'period of significant financial stress relevant to the institution's portfolio'

10.3 The firm should ensure that the sVaR period chosen is equivalent to the period that would maximise VaR given the firm's portfolio. There is an expectation that a stressed period should be identified at each legal entity level at which capital

is reported. Therefore, group-level sVaR measures should be based on a period that maximises the group-level VaR, whereas entity-level sVaR should be based on a period that maximises VaR for that entity.

Antithetic data

10.4 The PRA expects firms to consider whether the use of antithetic data in the calculation of the sVaR measure is appropriate to the firm's portfolio. A justification for using or not using antithetic data should be provided to the PRA.

Absolute and relative shifts

10.5 The PRA expects firms to explain the rationale for the choice of absolute or relative shifts for both VaR and sVaR methodologies. In particular, statistical processes driving the risk factor changes need to be evidenced for both VaR and sVaR.

10.6 The following information is expected to be submitted quarterly:

- analysis to support the equivalence of the firm's current approach to a VaR-maximising approach on an ongoing basis;
- the rationale behind the selection of key major risk factors used to find the period of significant financial stress;
- summary of ongoing internal monitoring of stressed period selection with respect to current portfolio;
- analysis to support capital equivalence of up-scaled one-day VaR and sVaR measures to corresponding full ten-day VaR and sVaR measures;
- graphed history of sVaR/VaR ratio;
- analysis to demonstrate accuracy of partial revaluation approaches specifically for sVaR purposes (for firms using revaluation ladders or spot/vol-matrices). This should include a review of the ladders/matrices or spot/vol-matrices, ensuring that they are extended to include wider shocks to risk factors that incur in stress scenarios; and
- minutes of Risk Committee meeting or other form of evidence to reflect governance and senior management oversight of stressed VaR methodology.

11 Requirement to have an internal IRC model

11.1 CRR Article 372 requires firms that use an internal model for calculating own funds requirements for specific risk of traded debt instruments to also have an internal incremental default and migration risk (IRC) model in place. This model should capture the default and migration risk of its trading book positions that are incremental to the risks captured by its VaR model.

11.2 When the PRA considers a firm's application to use an IRC internal model, the PRA expects that the following matters would be included as demonstrating compliance with the standards set in CRR Article 372.

Basis risks for migration

11.3 The PRA expects the IRC model to capitalise pre-default basis risk. In this respect, the model should reflect that in periods of stress the basis could widen substantially. Firms should disclose to the PRA their material basis risks that are incremental to those already captured in existing market risk capital measures (VaR-based and others). This must take actual close-out periods during periods of illiquidity into account.

Price/spread change model

11.4 The price/spread change model used to capture the profit and loss impact of migration should calibrate spread changes to long-term averages of differences between spreads for relevant ratings. These should either be conditioned on actual rating events, or using the entire history of spreads regardless of migration. Point-in-time estimates are not considered acceptable, unless they can be shown to be as conservative as using long-term averages.

Dependence of the recovery rate on the economic cycle

11.5 To achieve a soundness standard comparable to those under the IRB approach, LGD estimates should reflect the economic cycle. The PRA therefore expects firms to incorporate dependence of the recovery rate on the economic cycle into the IRC model. Should the firm use a conservative parameterisation to comply with the IRB standard of the use of downturn estimates, evidence of this will be required to be submitted in quarterly reporting to the PRA, bearing in mind that for trading portfolios, which contain long and short positions, downturn estimates would not in all cases be a conservative choice.

12 Annual SIF attestation of market risk internal models

12.1 The PRA expects an appropriate individual in a significant influence function (SIF) role to provide to the PRA on an annual basis written attestation that:

- (i) the firm's internal approaches for which it has received a permission comply with the requirements in Part 3 Title IV of the CRR, and any applicable PRA market risk supervisory statements; and
- (ii) where a model has been found not to be compliant, a credible plan for a return to compliance is in place and being completed.

12.2 Firms should agree the appropriate SIF for providing this attestation with the PRA, noting that the PRA would not expect to agree more than 2 SIFs to cover all the firm's market risk internal models as described in Part 3 Title IV of the CRR.

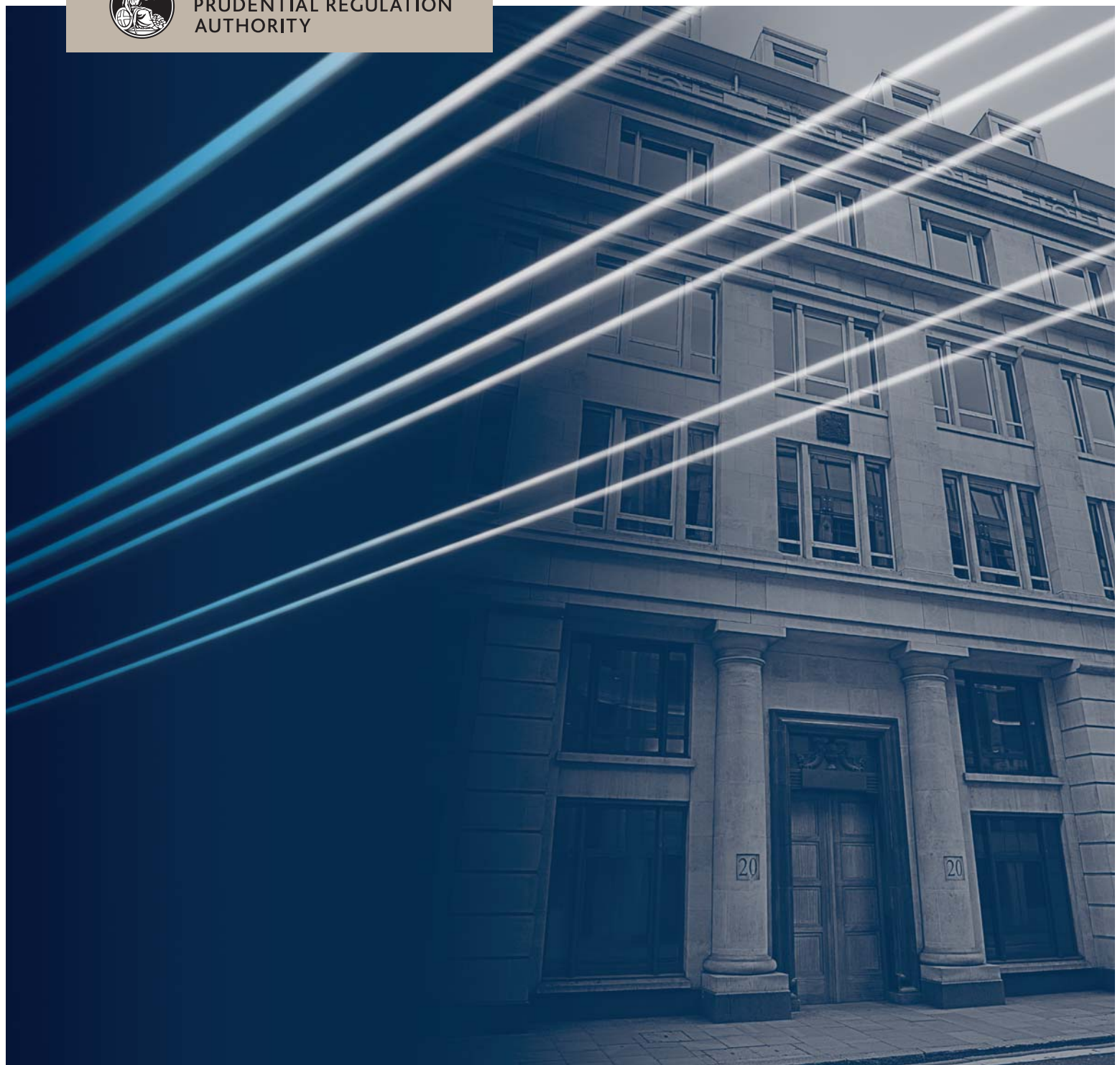
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Operational risk

December 2013



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Supervisory Statement | SS14/13

Operational risk

December 2013

1 Introduction

1.1 This supervisory statement is aimed at firms to which CRD IV applies.

1.2 This statement sets out the Prudential Regulation Authority's (PRA's) expectations on the extent to which the Advanced Measurement Approach (AMA) should capture the firms' operational risks where the firm has, or is about to, implement AMA. This is relevant where the AMA is applied across only part of a firm's operations and is used in conjunction with either the Basic Indicator Approach (BIA), or the Standardised Approach (TSA). This statement also sets out the PRA's expectation of SIF attestation of the firm's compliance with AMA standards.

1.3 This statement should be read in conjunction with CRR Article 314(3) and the high-level expectations outlined in *The PRA's approach to banking supervision*.⁽¹⁾

2 The PRA's expectations in relation to AMA

2.1 A firm may use an AMA in combination with either the BIA or TSA provided it obtains permission from the PRA.

2.2 In granting such permission, the PRA is required by CRR Article 314(3) to impose the following conditions when the AMA is used in combination with BIA or TSA:

- (a) on the date of first implementation of an AMA, a 'significant' part of the institution's operational risk are captured by that Approach; and
- (b) the institution to commit to apply the AMA across a 'material' part of its operations within a time schedule approved by the PRA.

2.3 For the purposes of these conditions, the PRA considers that:

- a 'significant' part of operational risk is approximately 50% or more; and
- a 'material' part of its operations is around 85% (or more).

3 Annual Significant Influence Function (SIF) attestation of Operational Risk Advanced Measurement Approach

3.1 The PRA expects an appropriate individual in a SIF role to provide to the PRA, on an annual basis, written attestation that:

- (a) the firm's AMA (for which it has received a permission) comply with the requirements in Part 3 Title III of the CRR, and any applicable PRA operational risk supervisory statements; and
- (b) where the firm's AMA has been found not to be compliant, a credible plan for a return to compliance is in place and being completed.

3.2 Firms should agree with the PRA the appropriate SIF for providing this attestation, noting that the PRA would not expect to agree more than 2 SIFs to cover the firm's operational risk AMA as described in Part 3 Title III of the CRR.

(1) www.bankofengland.co.uk/pr/Pages/supervision/approach/default.aspx.

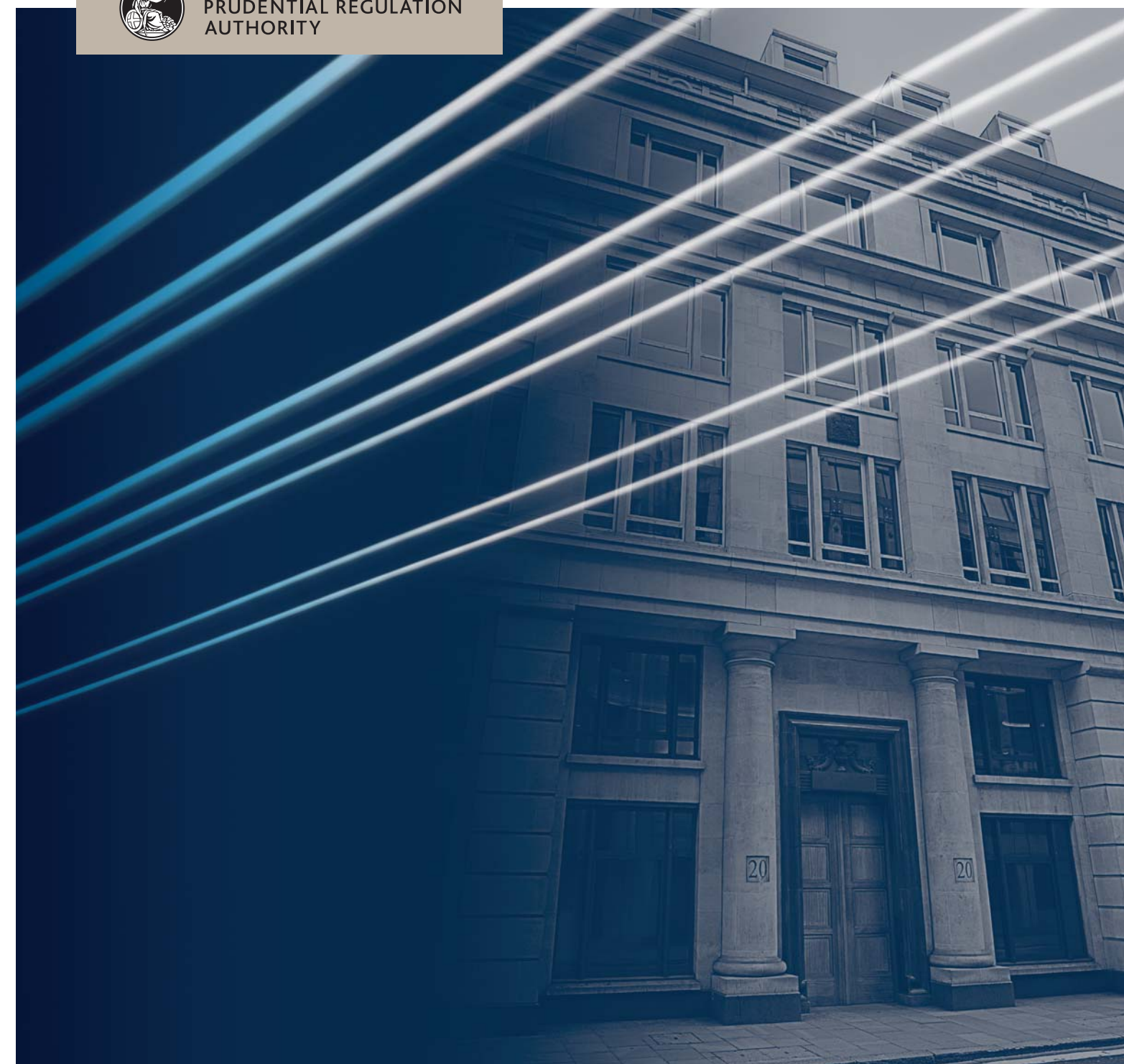
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Groups

December 2013



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Groups

December 2013

1 Introduction

1.1 This supervisory statement is aimed at firms to which CRD IV applies at a consolidated level and who are part of a group.

1.2 This statement sets out the Prudential Regulation Authority's (PRA's) expectations about applications relating to:

- (a) its approach to consolidation, in particular individual consolidation (CRR Article 9) and the method of consolidation for entities falling within CRR Article 18(5); and
- (b) excluding certain entities from consolidation (CRR Article 19(2)).

1.3 This statement should be read in conjunction with the CRR articles listed, the requirements in the Groups Part of the PRA Rulebook and the high-level expectations outlined in *The PRA's approach to banking supervision*.⁽¹⁾

2 Approach to consolidation

Application process

2.1 Where a parent institution wishes to apply for individual consolidation, it will be expected to make a formal application to the PRA. The PRA expects the application to demonstrate how the conditions set out in CRR Article 9 and 396(2) are met.

2.2 The PRA will assess individual consolidation applications against CRR Article 9 and 396(2) on a case by case basis. Where the conditions in CRR Article 9 and 396(2) are met, the PRA will assess whether it is still appropriate to permit the treatment, if doing so risks conflict with its statutory objectives. The PRA will apply a high level of scrutiny to applications under CRR Article 9 as per the PRA's previous solo consolidation regime.

2.3 Where a parent institution does not wish to fully consolidate its undertakings subject to CRR Article 18(5), it will be expected to make a formal application to the PRA. The application should seek to demonstrate how fully consolidating those undertakings is disproportionate to the risk carried by the firm.

Application of criteria

2.4 CRR Article 9(2) requires parent institutions to demonstrate fully to the PRA, as competent authority, that there are no material practical or legal impediments to the prompt transfer of own funds or repayment of liabilities when due by the subsidiary to its parent undertaking.

2.5 When making this assessment, the PRA will consider whether any minority interest may represent an impediment

of any kind to the prompt transfer of own funds or repayment of liabilities from subsidiary undertaking to parent. The PRA expects that the parent institution should demonstrate that any minority interest in a subsidiary institution will not result in the potential blocking or delay of prompt transfer of own funds or repayment of liabilities.

2.6 It is possible for a firm to meet the condition in CRR Article 7(1)(d) but not meet the condition in CRR Article 9(2).

2.7 The PRA will consider the non-exhaustive list below when determining whether the conditions in CRR Article 9(2) are met:

- (a) the speed with which funds can be transferred or liabilities repaid to the firm and the simplicity of the method for the transfer or repayment;
- (b) whether there are any interests other than those of the firm in the subsidiary undertaking and what impact those other interests may have on the firm's control over the subsidiary undertaking and on the ability of the firm to require a transfer of funds or repayment of liabilities. As part of the PRA's overall assessment, it would consider one of the indicators to achieving prompt transfer as being ownership of 75% or more of the subsidiary undertaking;⁽²⁾
- (c) whether the prompt transfer of funds or repayment of liabilities to the firm might harm the reputation of the firm or its subsidiary undertakings;
- (d) whether there are any tax disadvantages for the firm or the subsidiary undertaking as a result of the transfer of funds or repayment of liabilities;
- (e) whether there are any exchange controls that may have an impact on the transfer of funds or repayment of liabilities;
- (f) whether there are assets in the subsidiary undertaking available either to be transferred or liquidated for the purposes of the transfer of funds or repayment of liabilities;
- (g) whether any regulatory requirements affect the ability of the subsidiary undertaking to transfer funds or repay liabilities promptly;
- (h) whether the purpose of the subsidiary undertaking prejudices the prompt transfer of funds or repayment of liabilities;

(1) www.bankofengland.co.uk/pr/Pages/supervision/approach/default.aspx.

(2) 75% or more shareholders can pass a special resolution.

- (i) whether the legal structure of the subsidiary undertaking prejudices the prompt transfer of funds or repayment of liabilities;
- (j) whether the contractual relationships of the subsidiary undertaking with the firm and other third parties prejudices the prompt transfer of funds or repayment of liabilities;
- (k) whether past and proposed flows of funds between the subsidiary undertaking and the firm demonstrate the ability to make prompt transfer of funds or repayment of liabilities; and
- (l) whether the degree of solo consolidation by the firm undermines the PRA's ability to assess the soundness of the firm as a legal entity.

3 CRR Article 19(2) — entities excluded from the scope of prudential consolidation

Application process

3.1 Where a firm wishes to exclude entities from the scope of prudential consolidation, it will be expected to make a formal application to the PRA. This application should seek to articulate how one of the conditions set out in CRR Article 19(2) (a), (b) or (c) is met.

3.2 The PRA will assess applications to exclude entities from the scope of prudential consolidation under CRR Article 19(2) on a case by case basis. The PRA will only grant this treatment with respect to undertakings where one of the conditions in CRR Article 19(2) is met. Even where a CRR Article 19(2) condition is met, the PRA will make its own judgment whether to permit this treatment.

Application of criteria

3.3 CRR Article 19(2) allows the consolidating supervisor to decide that an institution, financial institution or ancillary services undertaking, which is a subsidiary or in which a participation is held, need not be included in the consolidation in the following cases:

- (a) where the undertaking concerned is situated in a third country where there are legal impediments to the transfer of necessary information; or
- (b) where the undertaking concerned is of negligible interest only with respect to the objectives of monitoring credit institutions.

3.4 If several undertakings meet the criterion in (b) above, and are collectively of non-negligible interest with respect of the specified objectives, the PRA may not agree to exclude them all from the consolidation.

3.5 The PRA may ask a firm to provide information about the undertakings excluded from consolidation.

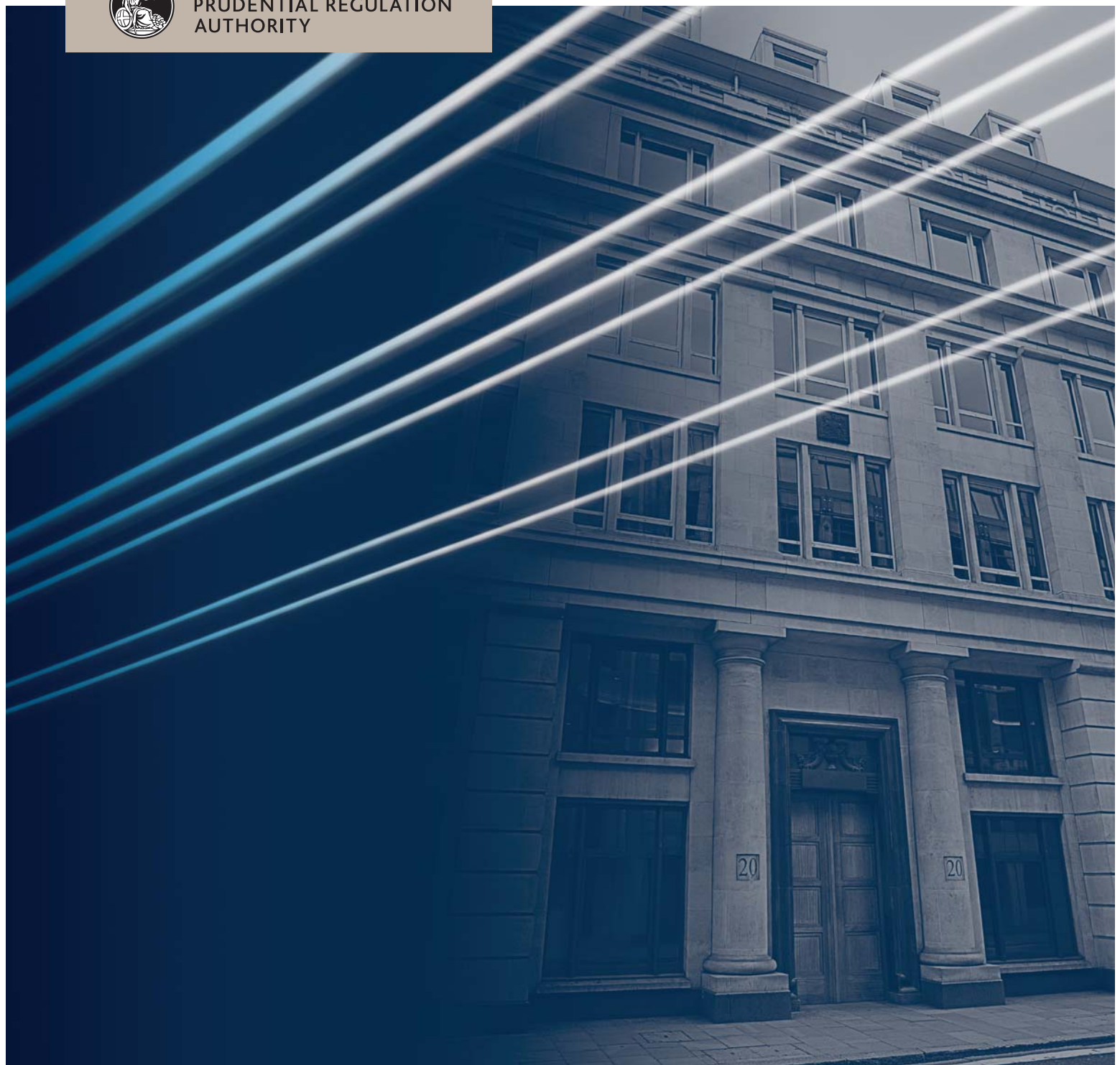
Supervisory Statement | SS16/13

Large exposures

December 2013



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Supervisory Statement | SS16/13

Large exposures

December 2013

1 Introduction

1.1 This supervisory statement is aimed at firms to which CRD IV applies.

1.2 This statement outlines the Prudential Regulation Authority's (PRA's) expectations in relation to large exposures requirements within the CRR. It covers:

- Applications to include undertakings within a core UK group (CRR Article 113(6)) and non-core large exposure group (CRR 400(2)(c)).
- Sovereign large exposures exemptions (CRR Article 400(2)(g or h)) and exposures to trustees.

1.3 This statement should be read in conjunction with the specified CRR articles, the requirements in the Large Exposures Part of the PRA Rulebook and the high-level expectations outlined in *The PRA's approach to banking supervision*.⁽¹⁾

2 CRR Article 113(6): core UK group applications

2.1 CRR Article 113(6) permits a firm, subject to conditions, to apply a 0% risk weight for exposures to certain entities within its consolidation group. CRR Article 400(1)(f) then requires that exposures that would be assigned a 0% risk weight under CRR Article 113(6) are fully exempted from the large exposures limit stipulated in CRR Article 395(1).

Application process

2.2 Firms wishing to apply a 0% risk weight to relevant exposures should make a formal application to the PRA, through which they should seek to demonstrate how the conditions set out in CRR Article 113(6)(a)–(e) are met.

2.3 The PRA will assess individual applications against CRR Article 113(6) on a case-by-case basis. The PRA will only approve applications where the conditions stipulated in CRR Article 113(6) are met.

2.4 Firms should note that the PRA will still make a wider judgement whether it is appropriate to grant this treatment even where the conditions in CRR Article 113(6) are met.

2.5 It is the PRA's intention to continue to apply a high level of scrutiny to applications under CRR Article 113(6).

Application of criteria

2.6 In relation to CRR Article 113(6)(d), the PRA will consider the condition to have been satisfied if:

- the relevant counterparty is incorporated in the United Kingdom; or

- it is an undertaking of a type that falls within the scope of the Council Regulation of 29 May 2000 on insolvency proceedings (Regulation 1346/2000/EC); and
- it is established in the United Kingdom other than by incorporation; and
- the firm can demonstrate that the counterparty's centre of main interests is situated in the United Kingdom.

2.7 In relation to CRR Article 113(6)(e), the PRA will consider the following non-exhaustive list of factors when assessing whether this condition has been met:

- the speed with which funds can be transferred or liabilities repaid to the firm and the simplicity of the method for the transfer or repayment. As part of our overall assessment, we would consider one of the indicators to achieving prompt transfer as being ownership of 100% of the subsidiary undertaking;
- whether there are any interests other than those of the firm in the undertaking, and what impact those other interests may have on the firm's control over the undertaking and the ability of the firm to require a transfer of funds or repayment of liabilities;
- whether there are any tax disadvantages for the firm or the undertaking as a result of the transfer of funds or repayment of liabilities;
- whether the purpose of the undertaking prejudices the prompt transfer of funds or repayment of liabilities;
- whether the legal structure of the undertaking prejudices the prompt transfer of funds or repayment of liabilities;
- whether the contractual relationships of the undertaking with the firm and other third parties prejudices the prompt transfer of funds or repayment of liabilities; and
- whether past and proposed flows of funds between the undertaking and the firm demonstrate the ability to make prompt transfer of funds or repayment of liabilities.

2.8 When demonstrating how CRR Article 113(6)(e) is met, the PRA considers that in the case of a counterparty which is not a firm, the formal application should include a legally binding agreement between the firm and the counterparty. This agreement will be to promptly, on demand by the firm, increase the firm's eligible capital by an amount required to ensure that the firm complies with the provisions contained in CRR Part Two (Own funds) and any other requirements relating to eligible capital or concentration risk imposed on a firm by or under the regulatory system.

(1) www.bankofengland.co.uk/pr/Pages/supervision/approach/default.aspx.

2.9 For the purpose of demonstrating compliance with CRR Article 113(6)(e), the PRA considers that the agreement to increase the firm's eligible capital may be limited to eligible capital available to the undertaking. It may reasonably exclude such amount of eligible capital that, if transferred to the firm, would cause the undertaking to become balance sheet insolvent, in the manner contemplated in section 123(2) of the Insolvency Act 1986.

2.10 The PRA does not expect a firm to which this section applies to use any member of its core UK group (which is not a firm) to route lending, or to have exposures to any third party in excess of the limits stipulated in Article 395(1).

3 CRR Article 400(2)(c) — non-core large exposures group exemptions (trading book and non-trading book)

3.1 CRR 400(2)(c) permits the PRA to fully or partially exempt exposures incurred by a firm to certain intra-group undertakings from the large exposures limit stipulated in CRR Article 395(1). The PRA will consider exempting non-trading book and trading book exposures to intra-group undertakings that meet specified conditions (set out in the large exposures rules). Guidance in respect of these conditions is outlined below. Firms should note however that under CRR Article 400(2)(c) intra-group exposures that do not meet the criteria in Article 400(2)(c) are to be treated as exposures to a third party.

3.2 The PRA expects that members of a non-core large exposures group meet the conditions set out in CRR Article 113(6) except for the condition to be established in the United Kingdom — CRR Article 113(6)(d).

Non-core large exposures group non-trading book exemption

3.3 The PRA's rules fully exempt from the large exposures limit any non-trading book exposures from a firm to members of its non-core large exposures group, provided that the total such exposures are no greater than 100% of the firm's eligible capital. If the firm has a core UK group permission then the same can apply provided that the total such exposures are no greater than 100% of the core UK group's eligible capital.

Non-core large exposures group trading book exemption

3.4 A firm can also apply for a non-core large exposures group trading book exemption. The calculation of how much trading book exposures are exempt depends on whether the firm has a core UK group permission and the size of non-trading book exposures of the firm (or the firm and its core UK group) to the non-core large exposures group. The PRA rules provide for the calculation of this exemption as follows:

- If a firm does not have a core UK group permission, its trading book exposure allocation (amount of trading book exposures it can exempt under the non-core large exposures group trading book exemption) is the difference between the size of the firm's eligible capital and the amount of non-trading book exposures it has to the members of the non-core large exposures group.
- If a firm has a core UK group permission, its trading book exposure allocation is the product of:
 - (i) its proportion of the core UK group's trading book exposures to the non-core large exposures group; and
 - (ii) the difference between the core UK group's total eligible capital and the core UK group's total non-trading book exposures to the non-core large exposures group.

3.5 Any trading book exposures of a firm to its non-core large exposures group above the firm's trading book exposure allocation will be subject to the CRR large exposures regime (Part Four). This includes the ability to have trading book exposures that exceed the 25% limit provided the conditions in CRR Article 395 are met, including the additional own funds requirement in CRR Article 395(5)(b).

3.6 In addition to outlining how to calculate the size of the trading book exemption at any point in time, the PRA rules also specify that firms must allocate exposures to its trading book exposure allocation in order of ascending risk requirements. Therefore, a firm should first allocate the trading book exposures with the lowest risk requirements to its trading book exposure allocation. Once no further trading book exposures can be allocated within the firm's trading book exposure allocation, any remaining trading book exposures are subject to the CRR large exposure regime.

3.7 The PRA has judged that this approach represents the most appropriate way to retain our current intra-group large exposures policy under the CRR. Although there is a degree of additional complexity in calculating the amount of intra-group exposures that can be exempted under our rules the PRA judges that the policy outcome will be broadly similar to that under the current regime. The impact of this approach on the total own funds requirement for excess intra-group trading book exposures will depend on specific firm circumstances.

Application process

3.8 In its review of a firm's non-core large exposures exemption application, the PRA expects to assess:

- compliance with the conditions set out in the large exposures rules; and
- how the counterparties to be included in the non-core large exposures group meet the conditions for the core UK group except CRR Article 113(6)(d).

3.9 Firms should note that the PRA will still make a wider judgement whether it is appropriate to grant this treatment even where the above conditions are met.

4 CRR Article 400(2)(g) and (h) — sovereign large exposures exemption

4.1 CRR Article 400(2)(g) and (h) allows the PRA to exempt exposures which constitute claims on central banks in the form of minimum reserves held at central banks and denominated in their national currencies, and claims on central governments in the form of statutory liquidity requirements held in government securities, which are denominated and funded in their national currencies.

Application process

4.2 A firm seeking a sovereign large exposures exemption should demonstrate in the application to the PRA how the conditions in the large exposures rules are met.

4.3 The PRA will assess individual sovereign large exposures exemption applications against the conditions set out in the large exposures rules.

4.4 Firms should note that the PRA will still make a wider judgement whether it is appropriate to grant this treatment even where the conditions set out in the large exposures rules are met.

Application of criteria

4.5 It is the PRA's intention to continue to apply a high level of scrutiny to applications in respect of CRR Article 400(2)(g) or (h).

4.6 As part of the process of applying for a sovereign large exposure exemption, the PRA will set out the amount of the exposures that may be exempted. In general, the PRA expects the likelihood of the firm's liabilities (that fund the particular exempt exposure) falling alongside a fall in that exposure in an event of default to form one of the key considerations in determining the total amount of such exempt exposures.

4.7 The PRA will expect the firm to demonstrate that, taking into account the aggregate of all exposures exempted under other sovereign large exposure exemptions granted to the firm, the exemption being sought would not result in an undue risk to the safety and soundness of the firm.

5 Exposures to trustees

5.1 This section clarifies the PRA's expectations on firms when considering exposures to counterparties which act as a trustee, custodian or general partner of an investment trust, unit trust, venture capital or other investment fund, pension fund or a similar fund.

5.2 If a firm has an exposure to a person ('A') when A is acting on his own behalf, and also an exposure to A when A acts in his capacity as trustee, custodian or general partner of an investment trust, unit trust, venture capital or other investment fund, pension fund or a similar fund (a 'fund'), the firm may treat the latter exposure as if it was to the fund. This treatment may be adopted unless such a treatment would be misleading.

5.3 When considering whether the treatment described is misleading, factors a firm should consider include:

- the degree of independence of control of the fund, including the relation of the fund's board and senior management to the firm or to other funds or to both;
- the terms on which the counterparty, when acting as trustee, is able to satisfy its obligation to the firm out of the fund of which it is trustee;
- whether the beneficial owners of the fund are connected to the firm, or related to other funds managed within the firm's group, or both; and
- for a counterparty that is connected to the firm itself, whether the exposure arises from a transaction entered into on an arm's length basis.

5.4 When a firm decides whether a transaction is at arm's length, the PRA expects the following factors to be taken into account:

- the extent to which the person to whom the firm has an exposure ('A') can influence the firm's operations, through for example the exercise of voting rights;
- the management role of A where A is also a director of the firm; and
- whether the exposure would be subject to the firm's usual monitoring and recovery procedures if repayment difficulties emerged.

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Credit risk mitigation

December 2013



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Supervisory Statement | SS17/13

Credit risk mitigation

December 2013

1 Introduction

1.1 This supervisory statement is aimed at firms to which CRD IV applies.

1.2 The purpose of this statement is to provide clarification to firms of the Prudential Regulation Authority's (PRA's) expectations in respect of the recognition of credit risk mitigation in the calculation of certain risk-weighted exposure amounts.

2 Eligibility of protection providers under all approaches

2.1 The PRA does not consider there to be any financial institution of the type identified in Article 119(5) of the CRR. Accordingly, the PRA has no list of such providers to publish.

(CRR Articles 119(5) and 202)

3 Recognised exchanges

3.1 To qualify as a recognised exchange under the CRR, an exchange must be a MIFID regulated market.

3.2 Prior to the end of 2013, the PRA will set out the approach to be taken prior to the adoption of the ESMA implementing technical standard specifying the list of recognised exchanges.

(CRR Articles 4(1)(72), 197(4) and (8), 198(1) and 224(1))

4 Conditions for applying a 0% volatility adjustment under the Financial Collateral Comprehensive Method

4.1 For the purposes of repurchase transactions and securities lending or borrowing transactions, the PRA does not consider there to be any core market participants other than those entities listed in Article 227(3) of the CRR.

(CRR Article 227)