



General Prudential sourcebook

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(Valuation adjustments and reserves). It applies to a *BIPRU firm*.

- (2) When valuation adjustments or reserves give rise to losses of the current financial year, a *firm* must treat them in accordance with ■ GENPRU 2.2.85 R.
- (3) Valuation adjustments or reserves which exceed those made under the accounting framework to which a *firm* is subject must be treated in accordance with (2) if they give rise to losses and under ■ GENPRU 2.2.248 R (Net interim *trading book* profits) otherwise.

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

2.2.87 **R** Dividends must be deducted from reserves as soon as they are foreseeable

2.2.87A **G** Each *firm* must assess for itself when, in its particular circumstances, dividends are foreseeable. A dividend is foreseeable at the latest:

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

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

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

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

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

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

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

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

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

2.2.92

G

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

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

2.2.93

R

Eligible partnership capital means a partners' account:

- (1) into which capital contributed by the partners is paid; and
- (2) from which under the terms of the partnership agreement an amount representing capital may be withdrawn by a partner only if:
 - (a) he ceases to be a partner and an equal amount is transferred to another such account by his former partners or any *person* replacing him as their partner;
 - (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 IV permission*.

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

2.2.94

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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 IV permission*.

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

2.2.95

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A *BIPRU firm* that is a partnership or a *limited liability partnership* may not include *eligible partnership capital* or *eligible LLP members' capital* in its *tier one capital resources* unless (in addition to ■ GENPRU 2.2.62 R (General conditions relating to *tier one capital*)) it complies with ■ GENPRU 2.2.83R (2) (*Coupons* should not be cumulative

or mandatory). However ■ GENPRU 2.2.64R (3) (Redemption) is replaced by ■ GENPRU 2.2.93 R or ■ GENPRU 2.2.94 R.

2.2.96

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

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

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

2.2.97

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

2.2.98

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Without prejudice to ■ GENPRU 2.2.62 R (Tier one capital: General), the item other reserves (which forms part of the item profit and loss and other reserves) applies to a *BIPRU firm* that is a partnership or a *limited liability partnership* to the extent the reserves correspond to reserves that are eligible for inclusion as other reserves in the case of a *BIPRU firm* that is incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986.

2.2.99

G

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

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

2.2.100

R

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

Core tier one capital: Share premium account

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

Core tier one capital: externally verified interim net profits

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

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

Core tier one capital: valuation differences (insurer only)

- 2.2.104 **R** ■ GENPRU 2.2.104 R to ■ GENPRU 2.2.107 R only apply to an *insurer*.
- 2.2.105 **R** Valuation differences are all differences between the valuation of assets and liabilities as valued in *GENPRU* and the valuation that the *insurer* uses for its external financial reporting purposes, except valuation differences which are dealt with elsewhere in the *capital resources table*. The sum of these valuation differences must either be added to (if positive) or deducted from (if negative) an *insurer's capital resources* in accordance with the *capital resources table*.
- 2.2.106 **G** Additions to and deductions from *capital resources* will arise from the application of asset and liability valuation and admissibility rules (see ■ GENPRU 1.3 (Valuation), ■ GENPRU 2.2.251 R (Deductions from total capital: Inadmissible assets) and ■ GENPRU 2 Annex 7 (Admissible assets in insurance)). Downward adjustments include *discounting of technical provisions* for *general insurance business* (which is optional for financial reporting but not permitted for regulatory valuation - see ■ GENPRU 2.2.107 R) and derecognition of any *defined benefit asset* in respect of a *defined benefit occupational pension scheme* (see ■ GENPRU 1.3.9R (2) (General

requirements: Adjustments to accounting values)). Details of valuation differences relating to *technical provisions* and liability adjustments for *long-term insurance business* are set out in ■ INSPRU 1.2 (Mathematical reserves). In particular, contingent loans or other arrangements which are not valued as a liability under ■ INSPRU 1.2.79R (2) (Reinsurance) result in a positive valuation difference.

2.2.107

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

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

2.2.108

R

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

Other tier one capital: perpetual non-cumulative preference shares

2.2.109

R

A perpetual non-cumulative *preference share* may be included at stage B of the calculation in the *capital resources table* if (in addition to satisfying

all the other requirements in relation to *tier one capital*) it satisfies the following conditions:

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

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

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

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

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

Other tier one capital: innovative tier one capital: general

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

Other tier one capital: innovative tier one capital: redemption

2.2.114 R If a *tier one instrument*, other than a *PIBS*:

- (1) is redeemable; and

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

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

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

Other tier one capital: innovative tier one capital: loss absorption

2.2.116 **R** A *firm* may include a *capital instrument* that is not a *share* in its *innovative tier one capital resources* if (in addition to satisfying all the other requirements in relation to *tier one capital* and *innovative tier one capital*) it satisfies the condition in this *rule*. In addition a *firm* may not include any other capital in its *innovative tier one capital resources* unless it satisfies the condition in this *rule*. The condition in this *rule* is that the *firm's* obligations under the instrument either:

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

2.2.117 **G** The effect of **GENPRU 2.2.116 R** is that if a *potential tier one instrument* does constitute a liability, this should only be the case when the *firm* is able to pay that liability but chooses not to do so. As *tier one capital resources* should be undated, this will generally only be relevant on a solvent winding up of the *firm*. The holder should agree that the *firm* has no liability (including any contingent or prospective liability) to pay any amount

to the extent to which that liability would cause the *firm* to become insolvent if it made the payment or to the extent that its liabilities exceed its assets or would do if the payment were made. The terms of the *capital instrument* should be such that the *directors* can continue to trade in the best interests of the senior creditors even if this prejudices the interests of the holders of the instrument.

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

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

Other tier one capital: innovative tier one capital: coupons

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

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

2.2.121 **R** If:

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

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

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

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

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

2.2.124 **R**

- (1) ■ GENPRU 2.2.123 R - ■ GENPRU 2.2.137 R apply to capital of a *firm* if:
 - (a) either or both of the conditions in (2) are satisfied; and
 - (b) any of the *SPVs* referred to in (2) is a *subsidiary undertaking* of the *firm*.

(2) The conditions referred to in (1) are:

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

2.2.125 **R** A *BIPRU firm* may only count capital to which ■ GENPRU 2.2.124 R applies as *innovative tier one capital*.

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

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

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

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

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

- (1) it must comply with the conditions for qualification as *tier one capital*, as amended by ■ GENPRU 2.2.130 R, as if the *SPV* was itself a *firm* seeking to include that capital in its *tier one capital resources*;

- (2) its terms must include an obligation on the *firm* to substitute for the instrument issued by the *SPV* a *tier one instrument* issued by that *firm* that is not an *innovative tier one instrument* when the *capital resources* of the *firm* fall below, or are likely to fall below, its *capital resources requirement*;
- (3) the conversion ratio in respect of the substitution described in (2) must be fixed when the *SPV* issues the *capital instrument*; and
- (4) to the extent that investors have the benefit of an obligation by a *person* other than the *SPV*:
 - (a) that obligation must be one owed by a member of the *firm's group*; and
 - (b) the extent of that obligation must be no greater than would be permitted by *GENPRU* if that obligation formed part of the terms of a *capital instrument* issued by that member which complied with the *rules* in *GENPRU* relating to *innovative tier one capital*.

- 2.2.130 **R** For the purpose of ■ GENPRU 2.2.129 R and ■ GENPRU 2.2.132 R, ■ GENPRU 2.2.118 R (Requirement to obtain a legal opinion) does not apply.
- 2.2.131 **R** In relation to the obligation to substitute described in ■ GENPRU 2.2.129R (2), a *firm* must take all reasonable steps to ensure that it has at all times authorised and unissued *tier one instruments* that are not *innovative tier one instruments* (and the authority to issue them) sufficient to discharge its obligation to substitute.
- 2.2.132 **R** The capital which the *firm* seeks to include in its *capital resources* under ■ GENPRU 2.2.124R (3)(a) must satisfy the following conditions:
- (1) it meets the conditions for inclusion in *tier one capital* (subject to ■ GENPRU 2.2.130 R);
 - (2) its first call date (if any) must not arise before that on the instrument issued by the *SPV*; and
 - (3) its terms relating to repayment must be the same as those of the instrument issued by the *SPV*.
- 2.2.133 **R**
- (1) This rule deals with any transaction:
 - (a) under which an *SPV* directly or indirectly funds the subscription for capital issued by the *firm* as described in ■ GENPRU 2.2.124 R; or

(b) that is directly or indirectly funded by a transaction in (1)(a).

- (2) Each *undertaking* that is a party to a transaction to which this *rule* applies (other than the *firm*) must be a *subsidiary undertaking* of the *firm*.
- (3) Each *SPV* that is a party to a transaction to which this *rule* applies must comply with ■ GENPRU 2.2.127 R.
- (4) Any capital to which (1) applies (other than the capital that is to be included in the *firm's capital resources*) must be in the form of capital that complies with ■ GENPRU 2.2.129R (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 2.2.124 R.
- (6) ■ GENPRU 2.2.132 R applies to the capital issued by the *firm* as referred to in ■ GENPRU 2.2.124 R. For these purposes references in ■ GENPRU 2.2.132 R to the instrument issued by the *SPV* are to the instrument referred to in (5).

2.2.134 **G** The purpose of ■ GENPRU 2.2.133 R is to deal with a capital-raising under which the capital raised by a special purpose vehicle is passed through a number of *undertakings* before it is invested in the *firm*. If the *capital resources* of the *firm* fall below, or are likely to fall below, its *capital resources requirement* the *firm* should replace the capital issued by that first special purpose vehicle with a *tier one instrument* directly issued by the *firm* itself that is not an *innovative tier one instrument*.

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

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

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

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

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

Tier one capital: Conversion ratio

2.2.138

R

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

2.2.139

R

In ■ GENPRU 2.2.138 R to ■ GENPRU 2.2.142 R:

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

2.2.140

R

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

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

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

(2) one unit of the original capital item.

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

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

2.2.143 **G**

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

2.2.144 **G**

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

Tier one capital: Requirement to have sufficient unissued stock

2.2.145

R

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

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

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

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

2.2.146

R

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

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

2.2.147

R

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

- 2.2.148** **G** The effect of ■ GENPRU 2.2.147 R is that for inclusion in *tier one capital resources*, *step-ups* in instruments should be moderate. A moderate *step-up* for these purposes is one which results in an increase over the initial rate that is no greater than the higher of the following two amounts:
- (1) 100 basis points, less the swap spread between the initial index basis and the stepped-up index basis; or
 - (2) 50% of the initial credit spread, less the swap spread between the initial index basis and the stepped-up index basis.
- 2.2.149** **G** If a *coupon* paid on an item of capital is initially set at a specified spread above an index (the initial index basis), and the *coupon* moves to being set relative to another index (the stepped up index basis), there will be an implied *step-up* (positive or negative) even if the specified spread does not change. This is because each index may itself include a spread relative to the risk free rate and this spread may differ between the two indexes. The deduction of the swap spread in ■ GENPRU 2.2.148G (1) and ■ (2) above adjusts for this difference.
- 2.2.150** **G** Where the *step-up* involves a conversion from fixed to floating (or vice versa), or a switch in basis index, the swap spread should be fixed at pricing date, reflecting the differential in pricing between indices at the time. The significance of deducting the swap spread can be seen by the following example:
- (1) the pricing date:
 - (a) 10 year gilts (G) = 5.5% (the initial index basis);
 - (b) 3 month LIBOR is the stepped up index basis and the 10 year mid swap rate (L) = 5.9%;
 - (c) initial fixed *coupon* rate = G + 200bp;
 - (d) swap spread = 0.4% (= 5.9% - 5.5%);
 - (e) initial fixed coupon rate = 7.5%;
 - (f) the swap spread shows that there is 40bps of spread in the stepped up index basis relative to the initial index basis; and
 - (g) the initial fixed coupon rate of 7.5% is equivalent to the mid swap rate + 160bp, or L + 200bp - the swap spread;
 - (2) pricing of *stepped-up* rate at year 10 with *step-up* of 100bp without deducting swap spread:
 - (a) *stepped-up* floating rate = L + 200 + 100bp *step-up* = 8.9%; and
 - (b) effective *step-up* from initial fixed rate of 140bp (= 8.9% - 7.5%); and
 - (3) pricing of *stepped-up* rate at year 10 with *step-up* of 100bp with deduction of the swap spread:
 - (a) *stepped-up* floating *coupon* rate = L + 200 less 40bp swap spread (difference between 5.5% and 5.9%) + 100bp *step-up* = 8.5%
 - (b) effective *step-up* from initial rate of 100bp (= 8.5% - 7.5%).

2.2.151

R

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

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

2.2.152

R

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

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

2.2.153

R

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

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

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

Deductions from tier one: Intangible assets

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

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

Tier two capital: General

2.2.157 **G** *Tier two capital resources* are split into upper and lower tiers. A major distinction between *upper* and *lower tier two capital* is that only perpetual instruments may be included in *upper tier two capital* whereas dated instruments, such as fixed term *preference shares* and dated subordinated debt, may be included in *lower tier two capital*.

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

General conditions for eligibility as tier two capital instruments

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

- (1) the claims of the creditors must rank behind those of all unsubordinated creditors;
- (2) the only events of default must be non-payment of any amount falling due under the terms of the *capital instrument* or the winding-up of the *firm* and any such event of default must not prejudice the subordination in (1);
- (3) to the fullest extent permitted under the laws of the relevant jurisdictions, the remedies available to the subordinated creditor in the event of non-payment or other breach of the terms of the

capital instrument must (subject to ■ GENPRU 2.2.161 R) be limited to petitioning for the winding-up of the *firm* or proving for the debt in the liquidation or administration;

- (4) any:
 - (a) remedy permitted by (3);
 - (b) remedy that cannot be excluded under the laws of the relevant jurisdictions as referred to in (3);
 - (c) remedy permitted by ■ GENPRU 2.2.161 R; and
 - (d) terms about repayment as referred to in (5);

must not prejudice the matters in (1) and (2) and in particular any damages permitted by (b) or (c) and repayment obligation must be subordinated in accordance with (1);
- (5) without prejudice to (1), the debt must not become due and payable before its stated final maturity date (if any) except on an event of default complying with (2) or as permitted by ■ GENPRU 2.2.172 R (Repayment at the option of the issuer) or ■ GENPRU 2.2.194R (2) (Repayment of *lower tier two capital* at the option of the holder) and any remedy described in (4)(a) to (c) must not prejudice this requirement;
- (6) the debt agreement or terms of the *capital instrument* are governed by the law of England and Wales, or of Scotland or of Northern Ireland;
- (7) to the fullest extent permitted under the laws of the relevant jurisdictions, creditors must waive their right to set off amounts they owe the *firm* against subordinated amounts included in the *firm's capital resources* owed to them by the *firm*;
- (8) the terms of the *capital instrument* must be set out in a written agreement that contains terms that provide for the conditions set out in (1) to (7);
- (9) the debt must be unsecured and fully paid up;
- (10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9) and, where it applies, ■ GENPRU 2.2.271 R (Other requirements: insurers carrying on with-profits business (Insurer only));
- (11) the amount of the item included must be net of any foreseeable tax charge at the moment of its calculation or must be suitably adjusted in so far as such tax charges reduce the amount up to which that item may be applied to cover risks or losses; and

(12) the *firm* has obtained a properly reasoned independent legal opinion from an appropriately qualified individual stating that the requirements in (1) to (7) and (insofar as it relates to whether the *capital instrument* is unsecured) (9) have been met.

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

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

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

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

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

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

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

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

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

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

- 2.2.165** **G** For the purposes of ■ GENPRU 2.2.159R (5) the debt agreement or terms of the instrument should not contain any clause which might require early repayment of the debt (e.g. cross default clauses, negative pledges and restrictive covenants). A cross default clause is a clause which says that the loan goes into default if any of the borrower's other loans go into default. It is intended to prevent one creditor being repaid before other creditors, e.g. obtaining full repayment through the courts. A negative pledge is a clause which puts the loan into default if the borrower gives any further charge over its assets. A restrictive covenant is a term of contract that directly, or indirectly, could lead to early repayment of the debt. Some covenants, e.g. relating to the provision of management information or ownership restrictions, are likely to comply with ■ GENPRU 2.2.159R (3) as long as monetary redress is ruled out, or any payments are covered by the subordination clauses.
- 2.2.166** **G** ■ GENPRU 2.2.159R (3) allows a *capital instrument* to form part of the *tier two capital resources* even though the laws of the relevant jurisdiction do not allow remedies to be limited in the way described there. For example it is not possible to limit certain remedies in the case of an issue in the United States that is SEC-registered and subject to the provisions of the Trust Indenture Act.
- 2.2.167** **G** The purpose of ■ GENPRU 2.2.159R (7) is to ensure that all of the *firm's* assets are available to *consumers* ahead of subordinated creditors. The waiver should apply both before and during liquidation or administration.
- 2.2.168** **G** The *guidance* in ■ GENPRU 2.2.119 G (Employee may give legal opinion) also applies for the purpose of ■ GENPRU 2.2.159R (12) and ■ GENPRU 2.2.163 R.

Tier two capital instruments: Connected transactions

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

Amendment of tier two instruments

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

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

Redemption of tier two instruments

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

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

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

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

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

Tier two capital: step-ups

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

Upper tier two capital: General

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

- (1) perpetual cumulative *preference shares*;

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

2.2.177

R

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

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

2.2.178

R

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

2.2.179

G

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

Upper tier two capital: Loss absorption

2.2.180

R

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

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

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

Upper tier two capital: Legal opinions

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

Upper tier two capital: Guidance

- 2.2.182 **G** ■ GENPRU 2.2.180 R is an example of the general principle in ■ GENPRU 2.2.177R (3).
- 2.2.183 **G** The *guidance* in ■ GENPRU 2.2.117 G (There should be no liability to the extent that the *firm* would become insolvent, etc) also applies for the purpose of ■ GENPRU 2.2.180 R.
- 2.2.184 **G** The *guidance* in ■ GENPRU 2.2.119 G (Employee may give legal opinion) also applies for the purpose of ■ GENPRU 2.2.181 R.

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

- 2.2.185 **R**
- (1) This *rule* applies to a *BIPRU firm*.
 - (2) A *BIPRU firm* must, in relation to equities held in the available-for-sale financial assets category:
 - (a) deduct any net losses at stage E of the calculation in the *capital resources table* (Deductions from tier one capital); and
 - (b) include any net gains (after deduction of deferred tax) in revaluation reserves at stage G of the calculation in the *capital resources table* (Upper tier two capital).

- (3) A *BIPRU firm* must include any net gains, after deduction of deferred tax, on revaluation reserves of investment properties at stage G of the calculation in the *capital resources table*. A *firm* must include any losses on such revaluation reserves in profit and loss account and other reserves.
- (4) A *BIPRU firm* must include any net gains, after deduction of deferred tax, on revaluation reserves of land and buildings at stage G of the calculation in the *capital resources table*. A *firm* must include any losses on such revaluation reserves in profit and loss account and other reserves.
- (5) (2) only applies to a *firm* to the extent that the category of asset referred to in that paragraph exists under the accounting framework that applies to the *firm* as referred to in ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied).
- (6) (3) and (4) apply to a *firm* whatever the accounting treatment of those items is under the accounting framework that applies to the *firm* as referred to in ■ GENPRU 1.3.4 R.

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

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

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

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

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

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

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

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

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

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

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

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

Lower tier two capital

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

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

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

- 2.2.196 **R** (1) For the purposes of calculating the amount of a *lower tier two instrument* which may be included in a *firm's capital resources*:
- (a) in the case of an instrument with a fixed maturity date, in the final five years to maturity; and
 - (b) in the case of an instrument with or without a fixed maturity date but where five years' or more notice of redemption or repayment has been given, in the final five years to the date of redemption or repayment;
- the principal amount must be amortised on a straight line basis.
- (2) If a *firm* gives notice of the redemption or repayment of a *lower tier two instrument* and (1) does not apply, the *firm* must no longer include it in its *lower tier two capital resources*.

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

The effect of swaps on debt capital

- 2.2.198 **R** ■ GENPRU 2.2.198 R to ■ GENPRU 2.2.201 R apply to a *tier one instrument*, *tier two instrument* or *tier three instrument* of a *firm* that is treated as a liability under the accounting framework to which it is subject as referred to in ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied) (a "debt instrument").
- 2.2.199 **R** A *firm* must recognise for the purpose of this section any effect that changes in exchange rates or interest rates have on a debt instrument (as defined in ■ GENPRU 2.2.198 R) under the accounting framework to which the *firm* is subject as referred to in ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied).
- 2.2.200 **R** A *firm* must recognise, in accordance with ■ GENPRU 2.2.201 R, the effect of a *foreign currency* hedge on a debt instrument (as defined in ■ GENPRU 2.2.198 R) denominated in a *foreign currency* or of an interest rate hedge on a fixed rate *coupon* debt instrument if:
- (1) the accounting framework to which the *firm* is subject as referred to in ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied) provides for a fair value hedge accounting relationship between a liability and its related hedge;
 - (2) such a relationship exists under that accounting framework between that debt instrument and that hedge;
 - (3) (if the debt instrument is a *tier one instrument*) the *firm's* obligations under that hedge comply with the conditions in

■ GENPRU 2.2.64 R to ■ GENPRU 2.2.65 R (General conditions for eligibility as tier one capital);

(4) (if the debt instrument is a *tier two instrument* or an *upper tier three instrument*) the *firm's* obligations under that hedge comply with the conditions in ■ GENPRU 2.2.159 R to ■ GENPRU 2.2.169 R (General conditions for eligibility as tier two capital instruments) as modified, in the case of an *upper tier three instrument*, by ■ GENPRU 2.2.244 R (Application of *tier two capital rules* to *tier three capital debt*) except as follows:

- (a) ■ GENPRU 2.2.159R (9) only applies to the extent that it requires that hedge to be unsecured; and
- (b) ■ GENPRU 2.2.159R (12) (legal opinion) does not apply.

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

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

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

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

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

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

2.2.205 **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

2.2.206

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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:

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

2.2.207

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The following are not included as *qualifying holdings*:

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

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

2.2.208

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

2.2.209

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A *material holding* is:

- (1) a *BIPRU firm's* holdings of *shares* and any other interest in the capital of an individual *credit institution* or *financial institution* (held in the *non-trading book* or the *trading book* or both) exceeding 10% of the *share* capital of the issuer, and, where this is the case, any holdings of subordinated debt of the same issuer are also included as a *material holding*; the full amount of the holding is a *material holding*; or

- (2) a *BIPRU firm's* holdings of *shares*, any other interest in the capital and subordinated debt in an individual *credit institution* or *financial institution* (held in the *non-trading book* or the *trading book* or both) not deducted under (1) if the total amount of such holdings exceeds 10% of that *firm's capital resources* at stage N (Total tier one capital plus tier two capital after deductions) of the calculation in the *capital resources table* (calculated before deduction of its *material holdings*); only the excess amount is a *material holding*; or
- (3) a *bank* or *building society's* aggregate holdings in the *non-trading book* of *shares*, any other interest in the capital, and subordinated debt in all *credit institutions* or *financial institutions* not deducted under (1) or (2) if the total amount of such *holdings* exceeds 10% of that *firm's capital resources* at stage N of the calculation in the *capital resources table* (calculated before deduction of its *material holdings*); only the excess amount is a *material holding*; or
- (4) a *material insurance holding*.

2.2.210 **G** For the purpose of the definition of a *material holding*, *share* capital includes *preference shares*. *Share* premium should be taken into account when determining the amount of *share* capital.

2.2.211 **R** When calculating the size of its *material holdings* a *firm* must only include an actual holding (that is, a long cash position). A *firm* must not net such holdings with a short position.

2.2.212 **R** A *material insurance holding* means the holdings of a *BIPRU firm* of items of the type set out in ■ GENPRU 2.2.213 R in any:

- (1) *insurance undertaking*; or
- (2) *insurance holding company*;

that fulfils one of the following conditions:

- (3) it is a *subsidiary undertaking* of that *firm*; or
- (4) that *firm* holds a *participation* in it.

2.2.213 **R** An item falls into this provision for the purpose of ■ GENPRU 2.2.212 R if it is:

- (1) an *ownership share*; or
- (2) subordinated debt or another item of capital that falls into Article 16(3) of the *First Non-Life Directive* or, as applicable, Article 27(3) of the *Consolidated Life Directive*.

- 2.2.214 **R** The amount to be deducted with respect to each *material insurance holding* is the higher of:
- (1) the book value of the *material insurance holding*; and
 - (2) the *solo capital resources requirement* for the *insurance undertaking* or *insurance holding company* in question calculated in accordance with Part 3 of ■ GENPRU 3 Annex 1 (Method 3 of the capital adequacy calculations for financial conglomerates).
- 2.2.215 **R** For the purpose of the definition of a *material holding*, holdings must be valued using the valuation method which the holder uses for its external financial reporting purposes.
- 2.2.216 **G**
- (1) This paragraph gives *guidance* on how the calculation under ■ GENPRU 2.2.214R (1) should be carried out where an *insurance undertaking* is accounted for using the embedded value method.
 - (2) On acquisition, any "goodwill" element (that is, the difference between the acquisition value according to the embedded value method and the actual investment) should be deducted from *tier one capital resources*.
 - (3) The embedded value should be deducted from the total of *tier one capital resources* and *tier two capital resources*.
 - (4) Post-acquisition, where the embedded value of the *undertaking* increases, the increase should be added to reserves, while the new embedded value is deducted from total *capital resources*.
 - (5) This means that the net impact on the level of total *capital resources* is zero, although *tier two capital resources* headroom will increase with any increase in *tier one capital resources* reserves.
 - (6) Embedded value is the value of the *undertaking* taking into account the present value of the expected future inflows from existing life assurance business.
- 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 2 (Capital resources table for a bank) and ■ GENPRU 2 Annex 3 (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*.

- (3) The following investments in *subsidiary undertakings* and *participations* should be deducted at this stage:
- (a) those not deducted in Part 1 of stage M because of the operation of the thresholds in ■ GENPRU 2.2.205 R (on qualifying holdings) and ■ GENPRU 2.2.209 R (on material holdings); and
 - (b) those which do not meet the definition of *qualifying holding* or *material holding*.
- (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.

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

- 2.2.217 **R** ■ GENPRU 2.2.217 R to ■ GENPRU 2.2.220 R apply to a *BIPRU firm*.
- 2.2.218 **R** A *BIPRU firm* must deduct at stage M of the calculation in the *capital resources table* (Deductions from the totals of tier one and two) any *reciprocal cross-holdings*. However a *BIPRU firm* must not deduct such holdings to the extent that they fall to be deducted at Part 1 of stage M of the calculation in the *capital resources table* (Deductions for *material holdings*, *qualifying holdings* and certain other items).
- 2.2.219 **R** A *reciprocal cross-holding* means a holding of the *BIPRU firm* of *shares*, any other interest in the capital, and subordinated debt, whether in the *trading* or *non-trading* book, in:
- (1) a *credit institution*; or
 - (2) a *financial institution*;
- that satisfies the following conditions:
- (3) the holding is the subject of an agreement or arrangement between the *BIPRU firm* and either the issuer of the instrument in question or a member of a *group* to which the issuer belongs;
 - (4) under the terms of the agreement or arrangement described in (3) the issuer invests in the *BIPRU firm* or in a member of the *group* to which that *BIPRU firm* belongs; and
 - (5) the effect of that agreement or arrangement on the capital position of the *BIPRU firm*, the issuer, or any member of a *group* to which either belongs, under any relevant rules is significantly more beneficial than it is in economic terms, taking into account the agreement or arrangement as a whole.

2.2.220 **R** For the purpose of ■ GENPRU 2.2.219 R, a relevant rule means a *rule* in GENPRU, BIPRU or INSPRU or any other capital adequacy or solvency requirements of the FSA or any other regulator, territory or country.

Deductions from tiers one and two: Connected lending of a capital nature (bank only)

2.2.221 **R** ■ GENPRU 2.2.221 R to ■ GENPRU 2.2.235 G only apply to a *bank*.

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

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

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

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

2.2.225 **R** For the purpose of ■ GENPRU 2.2.224 R, in relation to a *person* ("P") to which a *bank* has an *exposure* when P is acting on his own behalf and also an *exposure* to P when P acts in his capacity as a trustee, custodian or general partner of an investment trust, unit trust, venture capital or other investment fund, pension fund or similar fund (a "fund") the *bank* may choose to treat this latter *exposure* as an *exposure* to the fund, unless such treatment would be misleading.

2.2.226 **G** ■ BIPRU 10.3.13 G (*Guidance* on ■ BIPRU 10.3.12 R) applies to ■ GENPRU 2.2.225 R as it applies to ■ BIPRU 10.3.12 R (Exposures to trustees for concentration risk purposes).

2.2.227 **R** A loan is *connected lending of a capital nature* if:

- (1) it is made by the *bank* to a connected party; and
- (2) it falls into ■ GENPRU 2.2.228 R.

- 2.2.228 **R** A loan falls into this *rule* for the purposes of ■ GENPRU 2.2.227R (2) if, whether through contractual, structural, reputational or other factors:
- (1) based on the terms of the loan and the other knowledge available to the *bank*, the borrower would be able to consider it from the point of view of its characteristics as capital as being similar to *share* capital or subordinated debt; or
 - (2) the position of the lender from the point of view of maturity and repayment is inferior to that of the senior unsecured and unsubordinated creditors of the borrower.
- 2.2.229 **R** A loan is also *connected lending of a capital nature* if:
- (1) it funds directly or indirectly a loan to a connected party of the *bank* falling into ■ GENPRU 2.2.228 R or an investment in the capital of a connected party of the *bank*; and
 - (2) it falls into ■ GENPRU 2.2.228 R.
- 2.2.230 **G** It is likely that a loan is not *connected lending of a capital nature* if:
- (1) it is secured by collateral that is eligible for the purposes of *credit risk mitigation* under the *standardised approach* to credit risk as set out in ■ BIPRU 5.4 (Financial collateral) and ■ BIPRU 5.5 (Other funded credit risk mitigation); or
 - (2) it is repayable on demand (and should be treated as such for accounting purposes by the borrower and lender) and the *bank* can demonstrate that there are no potential obstacles to exercising the right to repay, whether contractual or otherwise.
- 2.2.231 **R** A guarantee is *connected lending of a capital nature* if it is a guarantee by the *bank* of a loan from a third party to a connected party of the *bank* and:
- (1) the loan meets the requirements of ■ GENPRU 2.2.228 R; or
 - (2) the rights that the *bank* would have against the borrower with respect to the guarantee meet the requirements of ■ GENPRU 2.2.228R (2).
- 2.2.232 **R** A guarantee is also *connected lending of a capital nature* if it is a guarantee by the *bank* of a loan falling into ■ GENPRU 2.2.229R (1); and
- (1) the loan meets the conditions in ■ GENPRU 2.2.228 R; or
 - (2) the guarantee meets the conditions in ■ GENPRU 2.2.231R (2).
- 2.2.233 **R** The amount of a guarantee that constitutes *connected lending of a capital nature* that a *firm* must deduct is the amount guaranteed.

2.2.234 **G** A loan may initially fall outside the definition of *connected lending of a capital nature* but later fall into it. For example, if the initial lending to a connected party is subsequently downstreamed to another connected party the relationship between the *bank* and the ultimate borrower may be such that, looking at the arrangements as a whole, the *undertaking* to which the *bank* lends is able to regard the loan to it as being capable of absorbing losses.

2.2.235 **G** Lending to a connected party will not normally be *connected lending of a capital nature* where that party:

- (1) is acting as a vehicle to pass funding to an unconnected party; and
- (2) has no other creditors whose claims could be senior to those of the lender.

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

2.2.236 **R** A BIPRU firm calculating *risk weighted exposure amounts* under the *IRB approach* must deduct:

- (1) any negative amounts arising from the calculation in BIPRU 4.3.8R (Treatment of expected loss amounts); and
- (2) any *expected loss* amounts calculated in accordance with BIPRU 4.7.12R (*Expected loss* amounts under the simple risk weight approach to calculating *risk weighted exposure amounts* for exposures belonging to the *equity exposure IRB exposure class*) or BIPRU 4.7.17R (*Expected loss* amounts under the *PD/LGD approach*).

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

2.2.237 **R** A BIPRU firm calculating *risk weighted exposure amounts* under the *IRB approach* or the *standardised approach* to credit risk must deduct from its *capital resources* the exposure amount of *securitisation positions* which receive a *risk weight* of 1250% under BIPRU 9 (Securitisation), unless the *firm* includes the *securitisation positions* in its calculation of *risk weighted exposure amounts* (see BIPRU 9.10 (Reduction in risk-weighted exposure amounts)).

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

2.2.238 **R** ■ GENPRU 2.2.238 R to ■ GENPRU 2.2.241 R apply to a BIPRU firm and relate to the deductions in respect of:

- (1) *material holdings*;
- (2) *expected loss* amounts and other negative amounts referred to in ■ GENPRU 2.2.236 R; and

- (3) *securitisation positions* referred to in ■ GENPRU 2.2.237 R.
- 2.2.239 **R** (1) The treatment in the *capital resources table* of the deductions in ■ GENPRU 2.2.238 R only has effect for the purpose of the *capital resources gearing rules*.
- (2) In other cases (3) and (4) apply.
- (3) A *BIPRU firm* making the deductions described in ■ GENPRU 2.2.238 R must deduct 50% of the total amount of those deductions at stage E (Deductions from tier one capital) and 50% at stage J (Deductions from tier two capital) of the calculation in the *capital resources table* after the application of the *capital resources gearing rules*.
- (4) To the extent that half of the total of:
- (a) *material holdings*;
- (b) *expected loss* amounts and other negative amounts; and
- (c) *securitisation positions*;
- exceeds the amount calculated at stage I (Total tier two capital) of that calculation, a *firm* must deduct that excess from the amount calculated at stage F (Total tier one capital after deductions) of the *capital resources table*.
- 2.2.240 **G** The alternative calculation in ■ GENPRU 2.2.239R (3) to ■ (4) is only relevant to BIPRU 11 (Pillar 3 disclosures) and certain reporting requirements under *SUP*. However the deduction of *material holdings* at Part 2 of stage E of the *capital resources table* in the case of a *BIPRU investment firm* with an *investment firm consolidation waiver* has effect for all purposes.
- Tier three capital: upper tier three capital resources (BIPRU firm only).....**
- 2.2.241 **R** ■ GENPRU 2.2.241 R to ■ GENPRU 2.2.245 R only apply to a *BIPRU firm*.
- 2.2.242 **R** A *BIPRU firm* may include subordinated debt in its *upper tier three capital resources* only if:
- (1) it has an original maturity of at least two years or is subject to at least two years' notice of repayment; and
- (2) payment of interest or principal is permitted only if, after that payment, the *firm's capital resources* would be not less than its *capital resources requirement*.
- 2.2.243 **R** A *BIPRU firm* which includes subordinated debt in its *tier three capital resources* must notify the *FSA* one month in advance of all payments of either interest or principal made when the *firm's capital resources* are less than 120% of its *capital resources requirement*.

2.2.244 **R** The *rules* in the table in ■ GENPRU 2.2.245 R apply to short term subordinated debt that a *BIPRU firm* includes in its *tier three capital resources* in the same way that they apply to a *firm's tier two capital resources* with the adjustments in that table.

2.2.245 **R** Table: Application of tier two capital rules to tier three debt

This table belongs to ■ GENPRU 2.2.244 R

<i>Tier two capital rule</i>	<i>Adjustment</i>
GENPRU 2.2.159 R (General conditions for eligibility as tier two capital)	<p>The references in GENPRU 2.2.159R (5) (Capital must not become repayable prior to stated maturity date except in specified circumstances) to repayment at the option of the holder are replaced by a reference to GENPRU 2.2.242R (1) (<i>Upper tier three capital</i> should have maturity or notice period of at least two years)</p> <p>The reference in GENPRU 2.2.159R (10) (Description of <i>tier two capital</i> in marketing documents) to GENPRU 2.2.271 R (Other requirements: insurers carrying on with-profits business (Insurer only)) does not apply</p>
GENPRU 2.2.160 R (Holder of a non-deferred share of a <i>building society</i> to be treated as a senior creditor)	
GENPRU 2.2.161 R (Additional remedies)	
GENPRU 2.2.163 R (Legal opinion where debt subject to a law of a country outside the <i>United Kingdom</i>)	
GENPRU 2.2.169 R (Ineligibility as <i>tier two capital</i> owing to connected transactions)	The reference to GENPRU 2.2.177 R (General eligibility conditions for <i>upper tier two capital</i>) does not apply
GENPRU 2.2.171 R (Amendments to terms of the <i>capital instrument</i>)	
GENPRU 2.2.172 R to GENPRU 2.2.173 R (Redeemability at the option of the issuer)	
GENPRU 2.2.174 R (Notification of redemption)	

Tier two capital rule

Adjustment

References in the *rules* in the first column to the fifth anniversary are amended so as to refer to the second anniversary.

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

- 2.2.246 **R** ■ GENPRU 2.2.246 R to ■ GENPRU 2.2.249 R only apply to a *BIPRU firm*.
- 2.2.247 **R** A *BIPRU firm's* net interim *trading book* profits mean its net *trading book* profits adjusted as follows:
- (1) they are net of any foreseeable charges or dividends and less net losses on its other business; and
 - (2) a *firm* must not take into account items that have already been included in the calculation of *capital resources* as part of the calculation of the following items:
 - (a) interim net profits (see stage (A) of the *capital resources table*); or
 - (b) interim net losses or material interim net losses (see stage (A) of the *capital resources table*); or
 - (c) profit and loss and other reserves (see stage (A) of the *capital resources table*).
- 2.2.248 **R** *Trading book* profits and losses, other than those losses to which ■ GENPRU 2.2.86R (2) (Valuation adjustment and reserves) refers, originating from valuation adjustments or reserves as referred to in ■ GENPRU 1.3.29 R to ■ GENPRU 1.3.35 G (Valuation adjustments or reserves) must be included in the calculation of net interim *trading book* profits and be added to or deducted from *tier three capital resources*.
- 2.2.249 **R** *Trading book* valuation adjustments or reserves as referred to in ■ GENPRU 1.3.29 R to ■ GENPRU 1.3.35 G which exceed those made under the accounting framework to which a *firm* is subject must be treated in accordance with ■ GENPRU 2.2.248 R if not required to be treated under ■ GENPRU 2.2.86R (2).
- Deductions from total capital: Inadmissible assets (insurers only)**
- 2.2.250 **R** ■ GENPRU 2.2.250 R to ■ GENPRU 2.2.253 G only apply to an *insurer*.
- 2.2.251 **R** For the purposes of the *capital resources table*, an *insurer* which is not a *pure reinsurer* must deduct from total *capital resources* the value of any asset which is not an *admissible asset* as listed in ■ GENPRU 2 Annex 7 (Admissible assets in insurance), unless the asset is held to cover *property-linked liabilities* or *index-linked liabilities* under ■ INSPRU 3.1.57 R or ■ INSPRU 3.1.58 R (Covering linked liabilities).

2.2.252 **G** ■ GENPRU 2.2.251 R does not apply to intangible assets which should be deducted from *tier one capital resources* under ■ GENPRU 2.2.155 R (Deductions from tier one: Intangible assets).

2.2.253 **G** The list of *admissible assets* has been drawn with the aim of excluding assets:

- (1) for which a sufficiently objective and verifiable basis of valuation does not exist; or
- (2) whose realisability cannot be relied upon with sufficient confidence; or
- (3) whose nature presents an unacceptable custody risk; or
- (4) the holding of which may give rise to significant liabilities or onerous duties.

Deductions from total capital: Adjustments for related undertakings

2.2.254 **R** ■ GENPRU 2.2.254 R to ■ GENPRU 2.2.258 G only apply to an *insurer*.

2.2.255 **R** An *insurer* must deduct from its *capital resources* the value of its investments in each of its *related undertakings* that is an *ancillary services undertaking*.

2.2.256 **R** In relation to each of its *related undertakings* that is a *regulated related undertaking* (other than an *insurance undertaking*) an *insurer* must add to (if positive), at stage J in the *capital resources table* (Positive adjustments for related undertakings), or deduct from (if negative), at stage L in the *capital resources table* (Deductions from total capital), its *capital resources* the value of its *shares* in that *undertaking* calculated in accordance with ■ GENPRU 1.3.47 R (Shares in and debts due from related undertakings).

2.2.257 **G** For the purposes of ■ GENPRU 2.2.255 R, investments must be valued at their accounting book value in accordance with ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied).

2.2.258 **G** *Related undertakings* which are also *insurance undertakings* are not included in ■ GENPRU 2.2.256 R because an *insurer* that is a *participating insurance undertaking* is subject to the requirements of ■ INSPRU 6.1 (Group Risk: Insurance Groups).

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

2.2.259 **R** ■ GENPRU 2.2.259 R to ■ GENPRU 2.2.262 G only apply to a *BIPRU investment firm*.

- 2.2.260 **R** *Illiquid assets* means illiquid assets including
- (1) tangible fixed assets (except land and buildings if they are used by a *firm* as security for loans, but this exclusion is only up to the value of the principal outstanding on the loans); or
 - (2) any holdings in the *capital resources* of *credit institutions* or *financial institutions*, except to the extent that:
 - (a) they have already been deducted as a *material holding*; or
 - (b) they are *shares* which are included in a *firm's trading book* and included in the calculation of the *firm's market risk capital requirement*; or
 - (3) holdings of other *securities* which are not *readily realisable securities*; or
 - (4) deficiencies of net assets in *subsidiary undertakings*; or
 - (5) deposits which are not repayable within 90 days (except for payments in connection with margined *futures* or *options* contracts); or
 - (6) loans and other amounts owed to a *firm* except where they are due to be repaid within 90 days; or
 - (7) physical stocks except for *positions* in *physical commodities* which are included in the calculation of a *firm's commodity PRR*.
- 2.2.261 **G** If a loan or other amount owing to a *firm* was originally due to be paid more than 90 days from the date of the making of the loan or the incurring of the payment obligation, as the case may be, it may be treated as liquid for the purposes of **R** GENPRU 2.2.260R (6) where through the passage of time the remaining time to the contractual repayment date falls below 90 days.
- 2.2.262 **G** If a loan or other amount is due to be paid within 90 days (whether measured by reference to original or remaining maturity), a *firm* should consider whether it can reasonably expect the amount owing to be paid within that period. If the *firm* cannot reasonably expect it to be paid within that period the *firm* should treat it as illiquid.
- Deductions from total capital: Excess trading book position (bank or building society only)**
- 2.2.263 **R** **R** GENPRU 2.2.263 R to **R** GENPRU 2.2.265 R only apply to a *bank* or *building society*.
- 2.2.264 **R** (1) The *excess trading book position* is the excess of:
- (a) a *bank* or *building society's* aggregate net long (including notional) *trading book positions* in *shares*, subordinated debt

or any other interest in the capital of *credit institutions* or *financial institutions*;

over;

(b) 25% of that *firm's capital resources* calculated at stage T (Total capital after deductions) of the *capital resources table* (calculated before deduction of the *excess trading book position*).

(2) Only the excess amount calculated under (1) must be deducted.

2.2.265 **R** The *standard market risk PRR rules* apply for establishing what is a *net position* and the amount and value of that *position* for the purposes of ■ GENPRU 2.2.264 R, ignoring *rules* which would otherwise exclude such *positions* from ■ BIPRU 7.2 (Interest rate PRR) or ■ BIPRU 7.3 (Equity PRR and basic interest rate PRR for equity derivatives) on the basis that they are to be deducted from a *bank* or *building society's capital resources*, or for any other reason.

Other capital resources: Unpaid share capital or initial funds and calls for supplementary contributions (Insurer only)

2.2.266 **G** ■ GENPRU 2.2.266 G to ■ GENPRU 2.2.269 G only apply to an *insurer*.

2.2.267 **G** Unpaid *share capital* or, in the case of a *mutual*, *unpaid initial funds* and calls for supplementary contributions are excluded from the *capital resources* of a *firm* except to the extent allowed in a *waiver* under section 148 of the *Act* (Modification or waiver of rules).

2.2.268 **G** Subject to a *waiver*, under the *Insurance Directives* a maximum of one half of unpaid *share capital* or, in the case of a *mutual*, one half of the *unpaid initial fund* may be included in an *insurer's capital resources*, once the paid-up part amounts to 25% of that *share capital* or fund, up to 50% of total *capital resources*.

2.2.269 **G** In the case of a *mutual* carrying on *general insurance business* and subject to a *waiver*, calls for supplementary contributions within the *financial year* may only be included in a *firm's capital resources* up to a maximum of 50% of the difference between the maximum contributions and the contributions actually called in, subject to a limit of 50% of total *capital resources*. In the case of a *mutual* carrying on *long-term insurance business*, the *Consolidated Life Directive* does not permit calls for supplementary contributions to be included in a *firm's capital resources*.

Other requirements: insurers carrying on with-profits business (Insurer only)

2.2.270 **R** ■ GENPRU 2.2.270 R to ■ GENPRU 2.2.275 G only apply to an *insurer*.

2.2.271 **R** An *insurer* carrying on *with-profits insurance business* must, in addition to the other requirements in respect of *capital resources* elsewhere in

■ GENPRU 2.2, meet the following conditions before a *capital instrument* can be included in that *insurer's capital resources*:

- (1) the *insurer* must manage the *with-profits fund* so that discretionary benefits under a *with-profits insurance contract* are calculated and paid disregarding, insofar as is necessary for its *customers* to be treated fairly, any liability the *firm* may have to make payments under the *capital instrument*;
- (2) the intention to manage the *with-profits fund* on the basis set out in (1) must be disclosed in the *firm's Principles and Practices of Financial Management*; and
- (3) no amounts, whether interest, principal, or other amounts, must be payable by the *firm* under the *capital instrument* if the *firm's* assets would then be insufficient to enable it to declare and pay under a *with-profits insurance contract* discretionary benefits that are consistent with the *firm's* obligations under *Principle 6* (Customers' interests).

2.2.272 G The purpose of ■ GENPRU 2.2.271 R is to achieve practical subordination of *capital instruments* if they are to qualify as *capital resources* to the liabilities an *insurer* has to *with-profits policyholders*, including liabilities which arise from the regulatory duty to treat *customers* fairly in setting discretionary benefits. (*Principle 6* (Customers' interests) requires a *firm* to pay due regard to the interests of its customers and treat them fairly.) It is not sufficient for a *capital instrument* to be subordinated to such liabilities only on winding up of the *firm* because such liabilities to *policyholders* may have been reduced by the inappropriate use of management discretion to enable funds to be applied in repaying subordinated *capital instruments* before winding up proceedings commence.

2.2.273 G ■ GENPRU 2.2.271 R is an additional requirement to all other *rules* in this section concerning the eligibility of a *capital instrument* to count as a component of an *insurer's capital resources*. Subordinated debt instruments will be the main type of *capital instrument* to which this *rule* is relevant, including both *upper tier two* (undated) and *lower tier two* (dated) subordinated debt instruments. Subordinated debt instruments which are issued by a *related undertaking* are not intended to be covered by this *rule* and may be included in *group capital resources* as appropriate if the other eligibility criteria are met.

2.2.274 G ■ GENPRU 2.2.64R (10) and ■ GENPRU 2.2.159R (10) contain provisions concerning the marketing of a *capital instrument*. In relation to a *firm* to which ■ GENPRU 2.2.271 R applies, in order to comply with ■ GENPRU 2.2.64R (10) and ■ GENPRU 2.2.159R (10), it should draw to the attention of subscribers the risk that payments may be deferred or cancelled in order to operate the *with-profits fund* so as to give priority to the payment of discretionary benefits to *with-profits policyholders*.

2.2.275 G (1) *Upper tier two instruments* should meet the requirements of ■ GENPRU 2.2.177R (3) which goes beyond the requirement in ■ GENPRU 2.2.271R (3) since it requires a *firm* to have the option to defer payments in all circumstances, not just if necessary to treat *customers* fairly. However, for *lower tier two instruments*, ■ GENPRU 2.2.271R (3) represents an additional requirement since a failure to pay

amounts of interest or principal on a due date must not constitute an event of default under ■ GENPRU 2.2.159R (2) for *firms* carrying on *with-profits insurance business*.

- (2) For *firms* which are *realistic basis life firms* compliance with ■ GENPRU 2.2.271R (3) would usually be achieved if the *capital instrument* provides that no amounts will be payable under it unless the *firm's capital resources* exceed its *capital resources requirement*. However, such *firms* should ensure that the terms of the *capital instrument* refer to *FSA capital resources requirements* in force from time to time, including the current realistic reserving requirements and are not restricted to former minimum capital requirements based only on the *Insurance Directives'* required minimum margin of solvency. For *firms* which are not *realistic basis life firms*, compliance with ■ GENPRU 2.2.271R (3) will probably require specific reference to be made to treating *customers* fairly in the terms of the *capital instrument*.

Public sector guarantees

2.2.276

R

A *BIPRU firm* may not include a guarantee from a state or public authority in its *capital resources*.

2.3 Application of GENPRU 2 to Lloyd's

Application of GENPRU 2.1

- 2.3.1 **R** ■ GENPRU 2.1 applies to the *Society* in accordance with ■ INSPRU 8.1.2 R.
- 2.3.2 **R** ■ GENPRU 2.1.38 R to ■ GENPRU 2.2.39 G apply to *managing agents* in accordance with ■ INSPRU 8.1.4 R.
- 2.3.3 **G** ■ GENPRU 2.1.13 R requires the *Society* to ensure, in relation to each *member's insurance business*, that *capital resources* equal to or in excess of the *member's capital resources* requirement (*CRR*) are maintained. ■ GENPRU 2.1 sets out the overall framework of the *CRR*. INSPRU 1.1 sets out the calculation of the components of the *general insurance capital requirement* and the *long-term insurance capital requirement*.
- 2.3.4 **G** *Managing agents* are required to calculate the *ECR* for the purposes of carrying out *syndicate ICAs* under ■ INSPRU 7.1. As *with-profits insurance business* is not carried on through any *syndicate*, the calculation of the *with-profits insurance capital component* will not be applicable. INSPRU 1.3 is not applied to Lloyd's.

Calculation of the MCR

- 2.3.5 **R** For the purposes of ■ GENPRU 2.1.24 R, the *Society* must calculate the *MCR* in respect of the *general insurance business* of each *member* as the higher of:
- (1) the *member's share* of the *base capital resources requirement* in respect of *general insurance business* for the *members* in aggregate; and
 - (2) the *general insurance capital requirement* for the *members*, calculated according to ■ GENPRU 2.3.11 R.
- 2.3.6 **R** For the purposes of ■ GENPRU 2.3.5R (1), the *Society* must determine the *member's share* by apportioning the *base capital resources requirement* in respect of *general insurance business* for the *members* in aggregate between *members* in proportion to the result for each *member* of ■ GENPRU 2.3.11 R.

- 2.3.7 **R** For the purposes of ■ GENPRU 2.1.25 R, the *Society* must calculate the MCR in respect of the *long-term insurance business* of each *member* as the higher of:
- (1) the *member's* share of the *base capital resources requirement* in respect of *long-term insurance business* for the *members* in aggregate; and
 - (2) the sum of, for each *member*:
 - (a) the *long-term insurance capital requirement*; and
 - (b) the *resilience capital requirement*.
- 2.3.8 **R** For the purposes of ■ GENPRU 2.3.7R (1), the *Society* must determine the *member's* share by applying to the aggregate long-term business *base capital resources requirement* the ratio of the result for the *member* of ■ GENPRU 2.3.7R (2) to the aggregate of the results of ■ GENPRU 2.3.7R (2) for all *members*.
- Calculation of the base capital resources requirement**.....
- 2.3.9 **R** The amount of the *base capital resources requirement* for the *members* in aggregate is:
- (1) for *general insurance business*, €3.2 million; and
 - (2) for *long-term insurance business*, €3.2 million.
- Calculation of the general insurance capital requirement**.....
- 2.3.10 **R** For the purposes of ■ GENPRU 2.1.34 R, the *Society* must calculate the *general insurance capital requirement* for the *members* in aggregate as the higher of:
- (1) the aggregate for all *members* of the higher of, for each *member*, the result of the *premiums amount* and the *claims amount*; and
 - (2) the *brought forward amount*.
- 2.3.11 **R** The *Society* must determine the *general insurance capital requirement* for each *member* by apportioning the result of ■ GENPRU 2.3.10 R between *members* on a fair and reasonable basis, provided that the *general insurance capital requirement* for a *member* must not be less than the higher of the result of the *premiums amount* and the *claims amount* for that *member*.
- 2.3.12 **G** The *Society* should calculate the *premiums amount* and the *claims amount* for each *member* on the basis of the *member's* own *general insurance business*, including *insurance business* that attaches to the reinsuring *member* for the purposes of GENPRU following an *approved reinsurance to close* (see ■ INSPRU 8.2.16 R).

2.3.13 **R** The *Society* must calculate the *general insurance capital requirement* it would have to determine under ■ GENPRU 2.1.34 R if it were an *insurer* carrying on all the *general insurance business* carried on by its *members*, but eliminating *inter-syndicate reinsurance* (the *Society GICR*).

2.3.14 **G** For the purpose of ■ GENPRU 2.3.13 R the *Society* may make appropriate approximations, taking reasonable care to avoid underestimating the *Society GICR*.

2.3.15 **R** The *Society* must determine each *member's* share of the *Society GICR* by allocating the *Society GICR* between the *members* in proportion to the result for each *member* of ■ GENPRU 2.3.11 R.

Application of GENPRU 2.2

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

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

2.3.17 **G** ■ GENPRU 2.1 sets out minimum *capital resources requirements* for a *firm* and for Lloyd's *members*. ■ GENPRU 2.2 sets out how, for the purpose of these requirements, *capital resources* are defined and measured. ■ GENPRU 2.2 applies:

- (1) to *managing agents* for their calculation of the *capital resources* managed by them in respect of each *syndicate* they manage (by reference, where there is a change in the underlying capital provision, to each open *syndicate* year); and
- (2) to the *Society* for its calculation of:
 - (a) each *member's capital resources*; and
 - (b) its own *capital resources*.

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

2.3.19 **R** ■ GENPRU 2.2.32 R to ■ GENPRU 2.2.41 R (Limits on the use of different forms of capital) do apply to the *Society* with respect to:

- (1) the *capital resources* requirements for the *members* in aggregate; and
- (2) the aggregate *capital resources* supporting the *insurance business* of all the *members*.

2.3.20 **R** ■ GENPRU 2.2.74 R does not apply to the *Society* or to *managing agents*.

- 2.3.21 **R** In this section (■ GENPRU 2.3), "the aggregate *capital resources* supporting the *insurance business* of all the *members*" are:
- (1) the aggregate of all the *members' capital resources* calculated under ■ GENPRU 2.3.25 R; and
 - (2) the *Society's capital resources* excluding callable contributions.

Calculation of capital resources

- 2.3.22 **R** The *capital resources table* applies with the modifications that:
- (1) *Core tier one capital* includes *Lloyd's members' contributions* in accordance with ■ GENPRU 2.3.34 R, subject, in the case of letters of credit, guarantees and verifiable sums arising out of life assurance policies, to compliance with ■ GENPRU 1.5.8 G to ■ GENPRU 1.5.12 R; and
 - (2) the *Society* may also recognise and value *callable contributions*, pursuant to ■ GENPRU 2.3.24 R.

- 2.3.23 **G** *Lloyd's member's contributions* are *admissible assets* under ■ GENPRU 2.3.34 R and include letters of credit, guarantees and verifiable sums arising out of life assurance policies held as *funds at Lloyd's*. Assets that may be valued as part of *capital resources* under *PRU* are not necessarily, however, permitted investments for *members* under the terms of any *Lloyd's trust deed*.

- 2.3.24 **R** In calculating its *capital resources*, the *Society* may, subject to ■ GENPRU 1.5.13 R to ■ GENPRU 1.5.14 R, recognise and value *callable contributions*.

- 2.3.25 **R** The *Society* must calculate each *member's capital resources* as the sum of:
- (1) a *member's* proportionate share of the *capital resources* held at *syndicate* level for each *syndicate* in which the *member* participates; and
 - (2) the value of a *member's funds at Lloyd's* after deducting liabilities in compliance with ■ GENPRU 1.5.18 R.

- 2.3.26 **R** In order to comply with ■ GENPRU 2.1.13 R the *Society* must ensure at all times that:
- (1) each *member's capital resources requirement* is covered by:
 - (a) that *member's capital resources*, calculated according to ■ GENPRU 2.3.25 R; and

(b) to the extent that (a) is insufficient, by the *Society's own capital resources*; and

(2) the *Society GICR* is covered by the aggregate *capital resources* supporting the *insurance business* of all the *members*.

2.3.27 **R** For the purposes of ■ GENPRU 2.3.26R (1)(b), the *Society* must maintain at all times *capital resources* sufficient to meet the aggregate of, for each *member*, the amount, if any, by which the *member's capital resources* fall short of the *member's capital resources requirement*.

2.3.28 **R** The *Society* must calculate each *member's* share of the amount of *capital resources* required to comply with ■ GENPRU 2.2.33 R as the higher of:

(1) 1/3 of the *long-term insurance capital requirement* for the *members* in aggregate; and

(2) the *base capital resources requirement*;

allocated between the *members* in proportion to the result for each *member* of ■ GENPRU 2.3.7R (2).

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

(1) 1/3 of the *general insurance capital requirement* for the *members* in aggregate;

(2) 1/3 of the *Society GICR*; and

(3) the *base capital resources requirement*;

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

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

(1) 1/3 of the *general insurance capital requirement* for the *members* in aggregate;

(2) 1/3 of the *Society GICR*; and

(3) the *base capital resources requirement*;

allocated between the *members* in proportion to the result for each *member* of ■ GENPRU 2.3.11 R.

Characteristics of tier one capital

- 2.3.31 **R** A Lloyd's member's contribution may be included in tier one capital resources to the extent that:
- (1) the proceeds are immediately and fully available in respect of the member's insurance business at Lloyd's;
 - (2) (except in relation to letters of credit), it complies with ■ GENPRU 2.2.64R (3) or cannot be repaid to a member until all of the member's liabilities in respect of its insurance business at Lloyd's have been extinguished, covered or reinsured by an approved reinsurance to close;
 - (3) it otherwise complies with ■ GENPRU 2.2.64R (5) to ■ GENPRU 2.2.64R (10).

Adjustments for related undertakings

- 2.3.32 **R** ■ GENPRU 2.2.256 R (Adjustment for regulated related undertakings other than insurance undertakings) applies to the Society with the modification that the Society must also value its insurance undertakings in accordance with ■ GENPRU 2.2.256 R.
- 2.3.33 **R** If a related undertaking is an insurance undertaking which has a deficit in the capital resources available to cover its capital resources requirement, the Society must make provision for:
- (1) its proportionate share of that deficit; or
 - (2) in the case of a subsidiary undertaking, the whole of that deficit.

Modification of GENPRU 2 Annex 7R for Lloyd's

- 2.3.34 **R** In the case of members, Lloyd's members' contributions are included in ■ GENPRU 2 Annex 7 and include:
- (1) letters of credit;
 - (2) guarantees; and
 - (3) verifiable sums arising out of life assurance policies;
- held as funds at Lloyd's.

- 2.3.35 **G** The effect of ■ GENPRU 2.3.34 R is that Lloyd's members' contributions, including letters of credit, guarantees and life assurance policies, are admissible assets.

The capital resources calculation for a bank		
Type of capital	Related text	Stage
<i>Expected loss amounts and other negative amounts</i>	GENPRU 2.2.236 R	
<i>Securitisation positions</i>	GENPRU 2.2.237 R	
<i>Reciprocal cross-holdings</i>	GENPRU 2.2.217 R to GENPRU 2.2.220 R	
Investments in <i>subsidiary undertakings and participations</i> excluding any amount which is already deducted as <i>material holdings</i> or <i>qualifying holdings</i>	GENPRU 2.2.216A G	(Part 2 of stage M)
<i>Connected lending of a capital nature</i>	GENPRU 2.2.221 R to GENPRU 2.2.233 R	
Total tier one capital plus tier two capital after deductions = L-M		(N)
<p>In calculating whether a <i>bank's capital resources</i> exceed its <i>capital resources requirement</i>:</p> <p>(1) the <i>credit risk capital component</i>, the <i>operational risk capital requirement</i> and the <i>counterparty risk capital component</i>; or</p> <p>(2) the <i>base capital resources requirement</i>; as the case may be, must be deducted here.</p>		
Upper tier three		(O)
Short term subordinated debt	GENPRU 2.2.241 R to GENPRU 2.2.245 R	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	GENPRU 2.2.246 R to GENPRU 2.2.249 R	
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)
Deductions from total capital		(S)
<i>Excess trading book position</i>	GENPRU 2.2.263 R to GENPRU 2.2.265 R	
<i>Free deliveries</i>	BIPRU 14.4	
Total capital after deductions (R - S)		(T)
<p>In calculating whether a <i>bank's capital resources</i> exceed its <i>capital resources requirement</i>, the <i>market risk capital requirement</i> and</p>		

The capital resources calculation for a bank

Type of capital	Related text	Stage
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the <i>concentration risk capital component</i> must be deducted here.		
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Note (1): Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.

Note (2): If the amount calculated at:

- (a) stage N less the deductions in respect of the *capital resources requirement* made immediately following stage N; or
- (b) stage T less the deductions in respect of the *capital resources requirement* made immediately following stages N and T;

is a negative number the *bank's capital resources* are less than its *capital resources requirement*.

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

Capital resources table for a building society

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

The capital resources calculation for a building society

2

Type of capital	Related text	Stage
General/collective provisions	GENPRU 2.2.187 R to GENPRU 2.2.189 R	
Surplus provisions	GENPRU 2.2.190 R to GENPRU 2.2.193 R	
Lower tier two capital		(H)
Long term subordinated debt	GENPRU 2.2.159 R to GENPRU 2.2.174 R; GENPRU 2.2.194 R to GENPRU 2.2.196 R	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)	
Total tier two capital after deductions = I - J		(K)
Total tier one capital plus tier two capital = F+K		(L)
Deductions from the totals of tier one and two		(M)
<i>Qualifying holdings</i>	GENPRU 2.2.202 R to GENPRU 2.2.207 R	
<i>Material holdings</i>	GENPRU 2.2.208 R to GENPRU 2.2.215 R	(Part 1 of stage M)
<i>Expected loss amounts and other negative amounts</i>	GENPRU 2.2.236 R	
<i>Securitisation positions</i>	GENPRU 2.2.237 R	
<i>Reciprocal cross-holdings</i>	GENPRU 2.2.217 R to GENPRU 2.2.220 R	(Part 2 of stage M)
<i>Investments in subsidiary undertakings and participations excluding any amount which is already deducted as material holdings or qualifying holdings</i>	GENPRU 2.2.216A G	
Total tier one capital plus tier two capital after deductions = L-M		(N)