Chapter 15

Prudential requirements

15.1 Application and purpose

General application

15.1.1 R Subject to FPCOB 15.1.2R, this chapter applies to *firms* with a *Part 4A permission* for *regulated funeral plan* activities.

15.1.2 R This chapter does not apply to a *PRA-authorised person*.

Purpose

15.1.3 G

(1) The purpose of FPCOB 15 is to set out the detailed prudential obligations that apply to *regulated funeral plan activity*.

(2) Adequate financial resources are necessary for the effective management of prudential risks. The *rules* in this chapter therefore impose requirements relating to the financial resources of a *firm* to which this chapter applies.

(3) The *rules* concern the adequacy of the financial resources that a *firm* needs to hold in order to be able to meet its liabilities as they fall due (the *general solvency requirement*). These resources include both capital and liquidity resources.

(4) The *rules* also place a *core capital resources* requirement on a *firm* to which this chapter applies. This *core capital resources requirement* varies depending on the nature of the activities undertaken by the *firm*.

15.2 General solvency requirement

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

15.2.2 **G** The liabilities referred to in the *general solvency requirement* include:

(1) a *firm's* contingent and prospective liabilities;

(2) liabilities that arise both in scenarios where the *firm* is a going concern and where the *firm* ceases to be a going concern; and

(3) claims that could be made against a *firm* which ought to be paid in accordance with fair treatment of *customers*, even if such claims could not be legally enforced.

15.2.3 **G** The liabilities referred to in the *general solvency requirement* exclude liabilities that might arise from transactions that a *firm* has not entered into and which it could avoid. This could include, for example, taking realistic management actions such as ceasing to transact new business after a suitable period of time has elapsed.

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

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

15.2.6 **G** As part of its day-to-day supervision of a *firm*, the *FCA* may review whether the amount and quality of capital and liquidity resources that a *firm* holds to comply with its *general solvency requirement* is sufficient.

15.2.7 G Where necessary, the *FCA* may consider the use of its powers under section 166 of the *Act* (Reports by skilled persons) to assist with the review referred to in FPCOB 15.2.6.

15.2.8 G

(1) Following such a review, the *FCA* may conclude that a *firm* should hold an additional amount or quality of capital or liquidity resources to comply with the *general solvency requirement*.

(2) Where this is the case, the *FCA* will normally specify an amount or quality of capital or liquidity resources that the *firm* should hold by:

   (a) issuing *individual capital guidance*;

   (b) issuing *individual liquidity guidance*; or

   (c) imposing a *requirement* on the *firm*.

(3) The amounts in (2) will typically represent the *FCA's* assessment of the *firm's general solvency requirement*. However, in some cases, it may be specified on a different basis (such as by reference to a specific component of the *general solvency requirement* or to a particular risk or harm).

(4) The *FCA* may choose to conduct reviews of the *regulated funeral plans activities* sector, or aspects of it. In such cases, the *FCA* may subsequently choose to issue *guidance* on a sectoral basis or to impose additional *requirements* on all, or only a subset of, the entities included within that review. The *guidance* or *requirement* may relate to:

   (a) additional amounts or quality of capital or liquidity resources that such *firms* must hold; or

   (b) other actions that such *firms* must undertake.

15.2.9 G The *FCA* will determine whether a *requirement* or *guidance* is more appropriate. Where the FCA chooses to issue guidance, this will normally explain how the *FCA* will approach supervising the *general solvency requirement* in relation to the *firm*. The *FCA* expects that the *firm* would normally confirm to the *FCA* that the *firm* will hold the amounts specified in that *guidance* going forward (and will therefore hold the relevant capital and or liquidity resources to comply with the *general solvency requirement*), unless the *firm* subsequently determines that higher amounts are required.

15.2.10 G Where the *FCA* considers that it is appropriate to apply a *requirement* in connection with the *general solvency requirement*, it may invite a *firm* to make a voluntary application under section 55L(5) of the *Act* to impose a *requirement* on the *firm* to hold the level of capital or liquidity resources that the *FCA* has assessed as being required by the *firm* in order to meet the *general solvency requirement*.

15.2.11 G *Guidance* on the *general solvency requirement* issued by the *FCA* will apply until the *FCA* issues revised *guidance* (or varies or removes the *requirement* relating to the *general solvency requirement*) in relation to the *firm*.

15.2.12 G If a *firm* subsequently determines, as a result of its own assessment, that it needs to hold a higher level or quality of capital or liquidity resources to satisfy the *general solvency requirement*, it must hold that higher level. This is because the *FCA's* assessment (or a *requirement* applied to the *firm* by the *FCA*) reflects an assessment carried out at that point in time and does not relieve the *firm* of its obligation to ensure that it is meeting the *general solvency requirement* at all times.

15.2.13 G A *firm's* business model or operating model may undergo a significant change, with the result that the *firm* considers that the amount or quality of capital or liquidity resources specified in the *guidance* issued by, or the requirement applied by, the *FCA* exceeds the amount or quality of capital or liquidity resources that the *firm* requires to comply with the *general solvency requirement*. In this case, the *firm*:

(a) should undertake its own assessment of the amounts that the *firm* now requires to comply with the *general solvency requirement* or, where applicable, to address the risks in relation to which the *requirement* was imposed; and

(b) having undertaken the determination in (a), may contact the *FCA* to request a review of the existing *guidance* or *requirement*.

15.2.14 G The *FCA* will not give *individual capital guidance* or *individual liquidity guidance* to the effect that the amount of capital advised in that *guidance* is lower than the amount of capital which a *firm* should hold to meet its *core capital resources requirement*.

15.3 Core capital resources requirement

15.3.1 R A *firm* must at all times maintain *capital resources* equal to or in excess of its *core capital resources requirement*.

15.4 Capital resources: relevant accounting principles

15.4.1 R A *firm* must recognise an asset or liability, and measure its amount, in accordance with the relevant accounting principles applicable to it for the purpose of preparing its *annual financial statements*.

15.5 Core capital resources requirement for funeral plan provision activities

15.5.1 R Subject to FPCOB 15.7.1R, for a *firm* with a *Part 4A permission* to carry on *regulated funeral plan provision activities* to which FPCOB 15.6.1R does not apply, the *core capital resources requirement* is the higher of:

(1) £20,000;

(2) 2.5% of the *firm's annual income*; or

(3) the sum of:

(a) the number of undrawn *funeral plan contracts* backed by *trust arrangements*, multiplied by the median of the amounts that would be payable to the *firm* under each *trust arrangement* if a funeral were required on the day following the end of the *firm's* previous period for submitting its funeral plan financials return in accordance with SUP 16.12, multiplied by 0.5%; and

(b) the number of undrawn *funeral plan contracts* backed by a *whole of life insurance policy*, multiplied by the median of the amounts payable to the *firm* under each *whole of life insurance policy* if a funeral were required on the day following the end of the *firm's* previous period for submitting its Funeral plan financials return in accordance with SUP 16.12, multiplied by 0.5%.

15.5.2 R The calculation in FPCOB 15.5.1R(3) does not include any undrawn *legacy funeral plan contracts* held by the *firm*.

15.6 Core capital resources requirement for a firm that only undertakes funeral plan distribution activity

15.6.1 R Subject to FPCOB 15.7.1R, for a *firm* with a *Part 4A permission* to carry on *funeral plan distribution activity* that does not also carry on any other *regulated funeral plan activity*, the *core capital resources requirement*, is the higher of:

£10,000; or

2.5% of the *firm's annual income*.

15.7 Core capital resources requirement for a firm carrying on other regulated activity

15.7.1 R Where a *firm* to which this chapter applies also has a *Part 4A permission* to carry on other *regulated activities*, the capital resources requirement is the higher of:

(1) the *core capital resources requirement* in FPCOB 15.5.1R or FPCOB 15.6.1R; and

(2) a capital resources requirement (however described) applied to the *firm* by any other *rule* or *requirement*.

15.8 Calculation of annual income

Annual income

15.8.1 R A *firm's annual income* refers to all income received or receivable, whether arising from the *firm's permitted activities* or not, as reported in its most recent audited *annual financial statements*.

Annual income: periods of less than 12 months

15.8.2 R If the *firm's* most recent *annual financial statement* does not cover a 12-*month* period, the *annual income* is taken to be the amount in the statement converted, proportionally, to a 12-*month* period.

Annual income: no financial statements

15.8.3 R If the *firm* does not have *annual financial statements*, the *annual income* is to be taken from the forecast or other appropriate accounts which the *firm* has submitted to the *FCA* in accordance with its reporting obligations in SUP 16.12.

15.8.4 R If a *firm* is a *principal*, its *annual income* includes amounts due to its *appointed representative* in respect of activities for which the *firm* has accepted responsibility.

15.8.5 R If a *firm* is a *network*, it should include the relevant income due to all of its *appointed representatives* in its *annual income*.

15.9 Calculation of core capital resources

The calculation of a firm's core capital resources

15.9.1 R A *firm* must calculate its *capital resources* for the *core capital resources requirement* from the items that are eligible to contribute to a *firm's capital resources*, as set out in items 1 to 6 in the table in FPCOB 15.9.3R.

15.9.2 R In arriving at its calculation of its capital resources for the *core capital resources requirement* a *firm* must deduct the items set out in items 1 to 5 in the table in FPCOB 15.9.5R.

15.9.3 R The items that are eligible to contribute to the *capital resources* of a *firm* are set out in the following table:

	Item	Additional explanation
1	*Share* capital	This must be fully paid and may include: (1) ordinary *share* capital; or (2) preference *share* capital (excluding preference *shares* redeemable by shareholders within 2 years).

	Item	Additional explanation
2	Capital other than *share capital* (for example, the capital of a *sole trader*, *partnership* or *limited liability partnership*)	(1) The capital of a *sole trader* is the net balance on the *firm's* capital account and current account. (2) The capital of a *partnership* is the capital made up of the *partners*': (a) Capital account, which is the account: (i) into which capital contributed by the *partners* is paid; and (ii) from which, under the terms of the *partnership* agreement, into which capital contributed by the *partners* is paid; and from which an amount representing capital may be withdrawn by a *partner* only if: (A) the person ceases to be a *partner* and an equal amount is transferred to another such account by their former *partners* or any person replacing them as their *partner*, or (B) the *partnership* is otherwise dissolved or wound up; and (b) Current accounts according to the most recent financial statement. For the purpose of the calculation of capital resources in respect of a *defined benefit occupational pension scheme*: (1) a *firm* must derecognise any *defined benefit asset*; (2) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*, provided that the election is applied consistently in respect of any one *financial year*.
3	Reserves (Note)	These are (subject to the Note) the audited accumulated profits retained by the *firm* (after deduction of tax, dividends and proprietors' or *partners*' drawings) and other reserves created by appropriations of share premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a *parent undertaking*. For the purposes of calculating capital resources, a *firm* must make the following adjustments to its reserves, where appropriate: (1) a *firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on debt instruments held, or formerly held, in the available-for-sale financial assets category; (2) a *firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost; (3) in respect of a *defined benefit occupational pension scheme*: (a) a *firm* must derecognise any *defined benefit asset*; (b) a *firm* may substitute for a *defined benefit liability* the *firm's reduction amount*, provided that the election is applied consistently in respect of any one *financial year*.

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	Item	Additional explanation
4	Interim net profits (Note)	If a *firm* seeks to include interim net profits in the calculation of its capital resources, the profits must (subject to the Note), be verified by the *firm's* external auditor, net of tax, anticipated dividends or proprietors' drawings and other appropriations.
5	Revaluation reserves	[*Editor's note*: Deliberately left blank.]
6	Subordinated loans/debt	Subordinated loans/debt must be included in capital on the basis of the provisions in this chapter that apply to subordinated loans/debts.
Note: Reserves		
Reserves must be audited, and interim net profits, general and collective provisions must be verified by the *firm's* external auditor unless the *firm* is exempt from the provisions of Part 16 of the Companies Act 2006 (section 477 (Small companies: conditions for exemption from audit)) relating to the audit of accounts.		

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

15.9.5 R In arriving at its calculation of its capital resources for the *core capital resources requirement* a *firm* must deduct the items set out in the following table:

Item	Additional explanation
1	*Investments* in own *shares*
2	*Investments* in *subsidiaries* (Note 1)
3	Intangible assets (Note 2)
4	Interim net losses (Note 3)
5	Excess of drawings over profits for a *sole trader* or a *partnership* (Note 3)
Notes:	1. *Investments* in subsidiaries are the full balance sheet value.
	2. Intangible assets are the full balance sheet value.
	3. The interim net losses in row 4, and the excess of drawings in row 5, are in relation to the accounting period following the date as at which the *capital resources* are being computed.

Personal assets

15.9.6 R In relation to a sole trader's *firm* or a *firm* which is a *partnership*, the *sole trader* or a *partner* in the *firm* may use personal assets to meet the *core capital resources requirement*, to the extent necessary to make up any shortfall in meeting that requirement, unless:

(1) those assets are needed to meet other liabilities arising from:

(a) personal activities; or

(b) another business activity not regulated by the *FCA*; or

(2) the *firm* holds *client money* or other *client* assets in relation to *regulated activities* other than *regulated funeral plan activity*.

15.9.7 G A *sole trader* or a *partner* may use any personal assets, including property, to meet the capital requirements of this chapter, but only to the extent necessary to make up a shortfall.

Subordinated loans

15.9.8 R A subordinated loan/debt must not form part of the *capital resources* for the *core capital resources requirement* of the *firm* unless it meets the following conditions:

(1) it has an original maturity of:

(a) at least 5 years; or

(b) it is subject to 5 years' notice of repayment;

(2) the claims of the subordinated creditors must rank behind those of all unsubordinated creditors;

(3) the only events of default must be non-payment of any interest or principal under the debt agreement or the winding up of the *firm*;

(4) the remedies available to the subordinated creditor in the event of non-payment or other default in respect of the subordinated loan/debt must be limited to petitioning for the winding up of the *firm* or proving the debt and claiming in the liquidation of the *firm*;

(5) the subordinated loan/debt must not become due and payable before its stated final maturity date, except on an event of default complying with (3);

(6) the agreement and the debt are governed by the law of England and Wales, or of Scotland or of Northern Ireland;

(7) to the fullest extent permitted under the rules of the relevant jurisdiction, creditors must waive their right to set off amounts they owe the *firm* against subordinated amounts owed to them by the *firm*;

(8) the terms of the subordinated loan/debt must be set out in a written agreement that contains terms that provide for the conditions set out in this *rule*; and

(9) the loan/debt must be unsecured and fully paid up.

15.9.9 R When calculating its *capital resources*, the *firm* must exclude any amount by which the aggregate amount of its subordinated loans/debts exceeds the amount calculated as follows:

A - B

where:

Ais equal to the sum of items 1 to 6 (inclusive) in the table of items in FPCOB 15.9.3R, which are eligible to contribute to a *firm's capital resources*.

Bis equal to the sum of items 1 to 5 (inclusive) in the table of items in FPCOB 15.9.5R which must be deducted in arriving at *firm's capital resources*.

15.10 Systems, strategies, processes and reviews

Purpose

15.10.1 G In addition to adequate financial resources, adequate systems and controls are necessary for the effective management of prudential risks. The rules in this section therefore impose *requirements* relating to such systems and controls.

15.10.2 G This section also has *rules* requiring a *firm* to identify, assess and document:

(1) risks to it being able to meet its liabilities as the fall due;

(2) how it intends to mitigate these risks; and

(3) the amount and nature of financial resources that the *firms* consider necessary to address any remaining risks.

15.10.3 G The *FCA* may review this assessment as part of its own assessment of the adequacy of a *firm's* financial resources.

Systems, strategies, processes

15.10.4 R A *firm* must use sound, effective and comprehensive systems, strategies and processes to assess and maintain on an ongoing basis the amounts, types and distribution of financial resources that it considers adequate to cover:

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

(2) the risk that the *firm* might not be able to meet its *core capital resources requirement* and *general solvency requirement* in the future.

Documentation of risk assessments

15.10.5 R A *firm* must make a written record of the assessments required under FPCOB 15.10.4R. In particular, it must make a written record of:

(1) the major sources of risk identified in accordance with FPCOB 15.10.4R; and

(2) how it intends to deal with those risks.

15.10.6 R A *firm* must retain the records of its assessments referred to in FPCOB 15.10.5R for at least 3 years.

15.10.7 G The *FCA* may review the written record of the assessment as set out under FPCOB 15.10.5R as part of its own assessment of the adequacy of a *firm's* financial resources as part of its day-to-day supervision of *firms*.

15.11 Action for damages

15.11.1 R A contravention of the *rules* in FPCOB 15 does not give rise to a right of action by a *private person* under section 138D of the *Act* and each of those *rules* is specified under section 138D(3) of the *Act* as a provision giving rise to no such right of action.