

## Chapter 2

# Level of application of requirements

## 2.6 The group capital test

**2.6.1** **R** This section applies to an *investment firm group* that has been granted permission by the *FCA* to apply the *group capital test* under **■** MIFIDPRU 2.4.17R.

### Group capital test: requirements

**2.6.2** **R** For the purposes of **■** MIFIDPRU 2.6:

- (1) 'own funds instruments' means own funds as defined in **■** MIFIDPRU 3, without applying the deductions referred to in **■** MIFIDPRU 3.3.6R(8), article 56(d), and article 66(d) of the *UK CRR*;
- (2) the terms '*investment firm*', '*financial institution*', '*ancillary services undertaking*', '*tied agent*' and '*relevant financial undertaking*' include undertakings established in *third countries* that would satisfy the definitions of those terms if they were established in the *UK*.

**2.6.3** **G** The definition of 'own funds instruments' for the purpose of **■** MIFIDPRU 2.6.2R ensures that significant investments in *common equity tier 1 instruments*, *additional tier 1 instruments* and *tier 2 instruments* of financial sector entities in the *investment firm group* do not need to be deducted by a *parent undertaking* when applying the *group capital test*. This is to avoid 'double counting' of those investments.

**2.6.4** **G** **■** MIFIDPRU 3.7 contains *rules* and *guidance* on the composition of capital for *parent undertakings* subject to the *group capital test*.

**2.6.5** **R** Where the *FCA* has granted an application under **■** MIFIDPRU 2.4.17R, a *UK parent entity* and any other *GCT parent undertakings* in the *investment firm group* must hold own funds instruments sufficient to cover the sum of the following:

- (1) the sum of the full book value of their holdings, subordinated claims and instruments referred to in **■** MIFIDPRU 3.3.6R(8), article 56(d), and article 66(d) of the *UK CRR* in *relevant financial undertakings* in the *investment firm group*; and
- (2) the total amount of their contingent liabilities in favour of *relevant financial undertakings* in the *investment firm group*.

2.6.6

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- (1) Each *GCT parent undertaking* in the *investment firm group* must satisfy the *group capital test*. The *group capital test* can therefore apply at each level within the group structure. This mitigates the risk of leverage or capital gearing being introduced at levels underneath the *UK parent entity*.
- (2) The requirement in ■ MIFIDPRU 2.6.5R only applies to *GCT parent undertakings*. However, ■ MIFIDPRU 2.6.7R imposes obligations on *GCT parent undertakings* in relation to their *subsidiaries* that are:
  - (a) *parent undertakings* established in a *third country*; or
  - (b) *parent undertakings* incorporated in, or with their principal place of business in, the *UK* that are not *GCT parent undertakings*.
- (3) This prevents leverage and capital gearing being introduced into the *investment firm group* through:
  - (a) *intermediate parent undertakings* established in a *third country*; or  
 intermediate *parent undertakings* in the *UK* to which the *group capital test* does not directly apply.

2.6.7

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- (1) This *rule* applies where:
  - (a) an *investment firm group* has been granted permission to apply the group capital test under ■ MIFIDPRU 2.4.17R; and
  - (b) a *parent undertaking* in that *investment firm group* is a *relevant financial undertaking* and either:
    - (i) is established in a *third country*; or
    - (ii) is incorporated in, or has its principal place of business in, the *UK* and is not a *GCT parent undertaking*.
- (2) Where this *rule* applies, the *responsible UK parent* must either:
  - (a) ensure that the *undertaking* in (1)(b) holds own funds instruments sufficient to cover the sum of the amounts in ■ MIFIDPRU 2.6.5R(1) and ■ (2) as they would apply to that *undertaking*; or
  - (b) hold own funds instruments sufficient to cover the sum of the amounts in ■ MIFIDPRU 2.6.5R(1) and ■ (2) that:
    - (i) apply to the *responsible UK parent* itself; and
    - (ii) would apply to the *undertaking* in (1)(b).

2.6.8

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- (1) The effect of ■ MIFIDPRU 2.6.7R is shown through the example below of a hypothetical *investment firm group* that contains the following *undertakings*:
  - a *UK parent entity* ("A");
  - an intermediate *investment holding company* ("B"), that is incorporated in the *UK* and is a direct *subsidiary* of A;
  - an *undertaking* established in a *third country* ("C") that would be an *investment holding company* if it were established in the *UK* and that is a direct *subsidiary* of B;

an *undertaking* established in a *third country* ("D") that would be a *MIFIDPRU investment firm* if it were established in the *UK* and that is a *direct subsidiary* of C;

a *MIFIDPRU investment firm* ("E") that is a *direct subsidiary* of D;

a *tied agent* ("F") that is established in the *UK* and that is a *direct subsidiary* of B;

an *undertaking* established in a *third country* ("G") that would be a *financial institution* if it were established in the *UK* and that is a *direct subsidiary* of C;

an intermediate holding company ("H") that is incorporated in the *UK* and is a *direct subsidiary* of A; and

an *authorised payment institution* ("I") that is incorporated in the *UK* and is a *direct subsidiary* of H.

(2) The *group capital test*:

- (a) applies directly to A and B because they are both *GCT parent undertakings*;
- (b) applies only indirectly to C and D, through the obligations imposed on the *responsible UK parent*, because C and D are *parent undertakings* established in a *third country*;
- (c) applies only indirectly to H, through the obligations imposed on A in its capacity as the *responsible UK parent*, because H is not a *GCT parent undertaking*; and
- (d) does not apply to E, F, G or I because they are not *parent undertakings*.

(3) In this example, B is a *responsible UK parent* because:

- (a) B has two *subsidiaries* (a *direct subsidiary*, C, and an *indirect subsidiary*, D) that are both *parent undertakings* established in a *third country* and that would be *relevant financial undertakings* if they were established in the *UK*; and
- (b) B does not have a subsidiary in the *UK* that is the *parent undertaking* of C or D. (Although F is a *UK subsidiary* of B, F is not a *parent undertaking*.) This means that there is no intermediate *parent undertaking* in the *UK* between B and either of C or D.

(4) A is not a *responsible UK parent* in relation to C and D. This is because A has a *subsidiary*, B, that is a *parent undertaking* of C and D and that is incorporated in the *UK*. B is therefore an intermediate *parent undertaking* in the *UK* between A on the one hand and C and D on the other.

(5) B is a *responsible UK parent* in relation to C and D. Note that B is the *responsible UK parent* of both C and D, even though D is only an *indirect subsidiary* of B. This is because there is no *parent undertaking* between C and D that is established in the *UK* and the definition of a *subsidiary* includes *subsidiaries of subsidiaries*.

(6) Under ■ MIFIDPRU 2.6.7R(2), B therefore has the choice of whether to:

- (a) ensure that both C and D comply with the requirements of the *group capital test* as it would apply to them if they were established in the *UK*; or
  - (b) hold own funds instruments that are sufficient to cover the sum of the requirements of the *group capital test* that apply to B and would apply to C and D if they were established in the *UK*.
- (7) If B chooses the approach in (6)(a), B must:
- (a) hold sufficient own funds instruments to cover the sum of B's holdings in, and contingent liabilities in favour of, C and F;
  - (b) ensure that C holds sufficient own funds instruments to cover the sum of C's holdings in, and contingent liabilities in favour of, D and G; and
  - (c) ensure that D holds sufficient own funds instruments to cover the sum of D's holdings in, and contingent liabilities in favour of, E.
- (8) If B chooses the approach in (6)(b), B must hold sufficient own funds instruments to cover the sum of:
- (a) B's holdings in, and contingent liabilities in favour of, C and F;
  - (b) C's holdings in, and contingent liabilities in favour of, D and G; and
  - (c) D's holdings in, and contingent liabilities in favour of, E.
- (9) A is, however, a *responsible UK parent* in relation to H. This is because A is a *GCT parent undertaking* that is the *parent undertaking* of H. H is a *relevant financial undertaking* (being a holding company, and therefore a *financial institution*) and a *parent undertaking*. H is not a *GCT parent undertaking* because H is not an *authorised person* and does not have a *MIFIDPRU investment firm* as a *subsidiary*. There is also no intermediate *GCT parent undertaking* between A and H.
- (10) In a similar way to B above, A therefore has a choice under ■ MIFIDPRU 2.6.7R(2) of whether to:
- (a) ensure that H complies with the requirements of the *group capital test* as if it applied directly to H; or
  - (b) hold own funds instruments that are sufficient to cover the sum of the requirements of the *group capital test* that apply to A and would apply to H.
- (11) If A chooses the approach in (10)(a), A must:
- (a) hold sufficient own funds instruments to cover the sum of A's holdings in, and contingent liabilities in favour of, B and H; and
  - (b) ensure that H holds sufficient own funds instruments to cover the sum of H's holdings in, and contingent liabilities in favour of, I.
- (12) If A chooses the approach in (10)(b), A must hold sufficient own funds instruments to cover the sum of:
- (a) A's holdings in, and contingent liabilities in favour of, B and H; and
  - (b) H's holdings in, and contingent liabilities in favour of, I.

**2.6.9** **R** A UK parent entity must have systems in place to monitor and control the sources of capital and funding of all *relevant financial undertakings* within the *investment firm group*.

**Group capital test: reporting requirements**

**2.6.10** **R** (1) Where the FCA has granted an application under ■ MIFIDPRU 2.4.17R, a UK parent entity and any other GCT parent undertakings in the investment firm group must comply with the reporting requirements in (2).

Each GCT parent undertaking in (1) must:

- (a) report in accordance with ■ MIFIDPRU 9 how that GCT parent undertaking meets the group capital test; and
- (b) if the GCT parent undertaking is a responsible UK parent, also report in accordance with ■ MIFIDPRU 9 how:
  - (i) the undertaking in ■ MIFIDPRU 2.6.7R(1)(b) holds the required amount of own funds instruments referenced in ■ MIFIDPRU 2.6.7R(2)(a); or
  - (ii) the GCT parent undertaking holds at least the amount of own funds instruments to cover the amount applicable to the undertaking in ■ MIFIDPRU 2.6.7R(1)(b), as referenced in ■ MIFIDPRU 2.6.7R(2)(b).

**2.6.11** **R** An investment firm group may designate:

- (1) a parent undertaking in the UK that is part of the investment firm group; or
- (2) a MIFIDPRU investment firm that is part of the investment firm group and that is not a parent undertaking;

to submit reports to the FCA under ■ MIFIDPRU 2.6.10R on behalf of the GCT parent undertakings in the investment firm group.

**Inclusion of holding companies in supervision of compliance with the group capital test**

**2.6.12** **G** UK investment holding companies and UK mixed financial holding companies are included in the FCA's supervision of compliance with the group capital test where they are GCT parent undertakings.