

Own funds

Chapter 3

Own funds

3.1 Application and purpose

Application

3.1.1

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This chapter applies to:

(1) a *MIFIDPRU investment firm*; and

a *UK parent entity* that is required by ■ MIFIDPRU 2.5.7R to comply with ■ MIFIDPRU 3 on the basis of its *consolidated situation*.

3.1.2

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This chapter also applies to a *parent undertaking* that is subject to the *group capital test* in accordance with ■ MIFIDPRU 2.6.5R, but with the following modifications:

(1) the definitions in ■ MIFIDPRU 2.6.2R apply when calculating the *own funds instruments* of the *parent undertaking* for the purposes of the *group capital test*; and

(2) ■ MIFIDPRU 3.2.2R and ■ MIFIDPRU 3.2.3R do not apply, but ■ MIFIDPRU 3.7 applies instead.

3.1.3

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For the purposes of this chapter:

(1) any reference to the "*UK CRR*" is to the *UK CRR* in the form in which it stood on 1 January 2022, read together with any CRR rules (as defined in section 144A of the Act) made by the *PRA* that applied on that date;

(2) where a term is not italicised but is defined in the *UK CRR*, the definition in the *UK CRR* applies;

(3) where this chapter applies to a parent undertaking that is not a *firm*, reference to a "*MIFIDPRU investment firm*" or a "*firm*" includes a reference to that *parent undertaking*; and

(4) where this chapter applies on the basis of the *consolidated situation* of an entity under ■ MIFIDPRU 3.1.1R(2), a reference in this chapter to a "*firm*" is a reference to the hypothetical single *MIFIDPRU investment firm* created under the *consolidated situation*.

Purpose

- 3.1.4 **G** This chapter contains requirements for the calculation of a *MIFIDPRU investment firm's own funds*. These requirements are based on the provisions in Title I of Part Two of the *UK CRR*, but with the modifications set out in this chapter.

Supplementary provisions

- 3.1.5 **G**
- MIFIDPRU 3 Annex 7R (Additional provisions relating to own funds) and
 - MIFIDPRU 3 Annex 8R (Prudent valuation and additional valuation adjustments) contain supplementary provisions that are relevant to certain *rules* in this chapter or certain requirements in the *UK CRR* that are cross-applied by *rules* in this chapter. A *firm, UK parent entity or GCT parent undertaking* that is applying a relevant *rule* in this chapter should therefore also refer to those annexes.

3.2 Composition of own funds and initial capital

3.2.1 **R** The *own funds* of a *firm* are the sum of its:

- (1) *common equity tier 1 capital*;
- (2) *additional tier 1 capital*; and
- (3) *tier 2 capital*.

3.2.2 **R** A *firm* must, at all times, have *own funds* that satisfy all the following conditions:

- (1) the *firm's common equity tier 1 capital* must be equal to or greater than 56% of the *firm's own funds requirement* under ■ MIFIDPRU 4.3;
- (2) the sum of the *firm's common equity tier 1 capital* and *additional tier 1 capital* must be equal to or greater than 75% of the *firm's own funds requirement* under ■ MIFIDPRU 4.3; and
- (3) the *firm's own funds* must be equal to or greater than 100% of the *firm's own funds requirement* under ■ MIFIDPRU 4.3.

3.2.3 **R** A *firm's initial capital* must be made up of *own funds*.

3.2.4 **G** For the purposes of this chapter, the categorisation and the valuation of assets and off-balance sheet items should be carried out in accordance with the applicable accounting framework, unless a *rule* directs otherwise.

3.3 Common equity tier 1 capital

- 3.3.1** **R** (1) A *firm* must determine its *common equity tier 1 capital* in accordance with Chapter 2 of Title I of Part Two of the *UK CRR*, as modified by the *rules* in this section.
- (2) Any reference to the *UK CRR* in this section is to the *UK CRR* as applied by (1) and modified by the *rules* in this section.

- 3.3.1A** **R** Article 34 of the *UK CRR* (Additional valuation adjustments) applies only in relation to positions held in a *firm's trading book*.

- 3.3.1B** **G** (1) ■ MIFIDPRU 3 Annex 7R contains supplementary provisions that may be relevant when a *firm* is calculating its *common equity tier 1 capital* under ■ MIFIDPRU 3.3.1R.
- (2) ■ MIFIDPRU 3 Annex 8R contains supplementary provisions that apply when a *firm* is calculating any additional valuation adjustments under article 34 of the *UK CRR* (as applied by ■ MIFIDPRU 3.3.1AR).

Prior permission to include interim profits or year-end profits in common equity tier 1 capital

- 3.3.2** **R** To apply for permission to include interim or year-end profits in its *common equity tier 1 capital* before the *firm* has taken a formal decision confirming the final profit or loss for the year in accordance with article 26(2) of the *UK CRR*, a *firm* must complete the form in ■ MIFIDPRU 3 Annex 1R and submit it to the *FCA* using the *online notification and application system*.

Prior permission and notification of issuances of common equity tier 1 capital

- 3.3.3** **R** (1) To apply for permission to classify an issuance of capital instruments as *common equity tier 1 capital* in accordance with article 26(3) of the *UK CRR*, a *firm* must complete the form in ■ MIFIDPRU 3 Annex 2R and submit it to the *FCA* using the *online notification and application system*.
- (2) To notify the *FCA* in accordance with article 26(3) subparagraph two of the *UK CRR* about subsequent issuances of capital instruments for which it has already received the permission in (1), a *firm* must complete the form in ■ MIFIDPRU 3 Annex 3R and submit it to the *FCA* using the *online notification and application system*.

3.3.4

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- (1) Under article 26(3) of the *UK CRR*, a *firm* must normally obtain the *FCA's permission* before classifying an issuance of capital instruments as *common equity tier 1 capital*.
- (2) However, where a *firm* has already obtained permission from the *FCA* for a previous issuance of instruments that have been classified as *common equity tier 1 capital*, the *firm* is not required to obtain the *FCA's permission* for a subsequent issuance of the same form of instruments if:
 - (a) the provisions governing the subsequent issuance are substantially the same as the provisions governing the issuance for which the *firm* has already received permission; and
 - (b) the *firm* has notified the *FCA* of the subsequent issuance sufficiently far in advance of the classification of the relevant instruments as *common equity tier 1 capital*.
- (3) The *FCA* generally expects to receive a notification of a subsequent issuance of an existing form of *common equity tier 1 capital* instruments under article 26(3) of the *UK CRR* at least 20 *business days* before the *firm* intends to classify that issuance as *common equity tier 1 capital*.

Close correspondence between the value of a firm's covered bonds and the value of its assets

3.3.4A

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When determining whether there is a close correspondence between the value of a *firm's* covered bonds and the value of the *firm's* assets for the purposes of article 33(3)(c) of the *UK CRR*, the *Covered Bonds RTS* applies with the following modifications:

- (1) any reference to an "institution" is a reference to the *firm*; and
- (2) any reference to "Regulation (EU) No 575/2013" is a reference to the *UK CRR* as applied and modified by the *rules* in *MIFIDPRU*.

[Note: article 33(4) of the *UK CRR* and *BTS 523/2014*.]

Deductions from common equity tier 1 capital

3.3.5

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For the purposes of *MIFIDPRU*:

- (1) ■ *MIFIDPRU 3.3.6R* replaces article 36 of the *UK CRR*; and
- (2) any reference to article 36 of the *UK CRR* or any part of that article in the following is a reference to ■ *MIFIDPRU 3.3.6R* (or the equivalent part of it):
 - (a) another provision of the *UK CRR* that is incorporated by reference into *MIFIDPRU*; or
 - (b) any technical standard that applies to a *MIFIDPRU investment firm* under a provision of the *UK CRR* to which (a) applies.

3.3.6

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A *MIFIDPRU investment firm* must deduct the following from its common equity tier 1 items:

- (1) losses for the current financial year;
- (2) intangible assets;
- (3) deferred tax assets that rely on future profitability;
- (4) the value of any defined benefit pension fund assets on the balance sheet of the *firm* after deducting the amount of any associated deferred tax liability where that liability would be extinguished if the assets became impaired or were derecognised under the applicable accounting framework;
- (5) direct, indirect and synthetic holdings by the *firm* of its own *common equity tier 1 instruments*, including own *common equity tier 1 instruments* that the *firm* is under an actual or contingent obligation to purchase by virtue of an existing contractual obligation;
- (6) direct, indirect and synthetic holdings of the *common equity tier 1 instruments* of *financial sector entities* where those entities have a reciprocal cross holding with the *firm* that the *FCA* considers has been designed to inflate artificially the *own funds* of the *firm*;
- (7) direct, indirect and synthetic holdings by the *firm* of *common equity tier 1 instruments* of *financial sector entities* where the *firm* does not have a significant investment in those entities;
- (8) direct, indirect and synthetic holdings by the *firm* of the *common equity tier 1 instruments* of *financial sector entities* where the *firm* has a significant investment in those entities;
- (9) the amount of items required to be deducted from additional tier 1 items under article 56 of the *UK CRR* that exceeds the additional tier 1 items of the *firm*; and
- (10) any tax charge relating to common equity tier 1 items foreseeable at the moment of its calculation, except where the *firm* suitably adjusts the amount of common equity tier 1 items insofar as such tax charges reduce the amount up to which those items may be used to cover risks or losses.
- (11) where a *firm* is a *partnership* or a *limited liability partnership*, the amount by which the aggregate of any amounts withdrawn by its *partners* or members exceeds the profits of the *firm*, except to the extent that the amount:
 - (a) has already been deducted from the *firm's own funds* as a loss under (1);
 - (b) was repaid in accordance with ■ MIFIDPRU 3.3.16R(2) or ■ MIFIDPRU 3.3.17R(2); or
 - (c) is already reflected in a reduction of the *firm's own funds* that was permitted under articles 77 and 78 of the *UK CRR*, as applied in accordance with ■ MIFIDPRU 3.6 (General requirements for own funds instruments).

- 3.3.7** **R** (1) For the purposes of ■ MIFIDPRU 3.3.6R and ■ MIFIDPRU 3.3.15R, holdings in a *fund* are to be treated as holdings in a *non-financial sector entity*.
- (2) The requirement in (1) does not affect the meaning of the terms "*financial sector entity*" or "*non-financial sector entity*" when used in any other context in the *Handbook*.

Deferred tax assets that rely on future profitability

- 3.3.8** **R** A *firm* must deduct deferred tax assets that rely on future profitability from its common equity tier 1 items under ■ MIFIDPRU 3.3.6R(3) without applying:
- (1) article 39 of the *UK CRR* (tax overpayments, tax loss carry backs and deferred tax assets that do not rely on future profitability); or
- (2) article 48 of the *UK CRR* (threshold exemptions from deduction from common equity tier 1 items).

Defined benefit pension fund assets on the firm's balance sheet

- 3.3.9** **R** A *firm* must deduct defined benefit pension fund assets on its balance sheet from its common equity tier 1 items under ■ MIFIDPRU 3.3.6R(4) without applying article 41 of the *UK CRR* (deduction of defined benefit pension fund assets).

Holdings of common equity tier 1 instruments of financial sector entities

- 3.3.10** **R** (1) This *rule* applies to a *firm's* holdings of capital instruments that are not held in its *trading book*.
- (2) Subject to ■ MIFIDPRU 3.3.14R, a *firm* must deduct its direct, indirect and synthetic holdings of *common equity tier 1 instruments of financial sector entities* under ■ MIFIDPRU 3.3.6R(7) without applying article 46 of the *UK CRR* (deduction of holdings of *common equity tier 1 instruments* where an institution does not have a significant investment in a financial sector entity).
- 3.3.11** **R** The following provisions do not apply to *common equity tier 1 instruments* held in the *trading book* of a *firm*:
- (1) ■ MIFIDPRU 3.3.6R(7); and
- (2) article 46 of the *UK CRR*.
- 3.3.12** **R** Subject to ■ MIFIDPRU 3.3.14R, a *firm* must deduct its direct, indirect and synthetic holdings in the *common equity tier 1 instruments of financial sector entities* under ■ MIFIDPRU 3.3.6R(8) without applying article 48 of the *UK CRR* (threshold exemptions from deduction from common equity tier 1 items).

- 3.3.13 **R** Article 49 of the *UK CRR* (requirement for deduction where consolidation, supplementary supervision or institutional protection schemes are applied) does not apply for the purposes of this section.

Holdings of common equity tier 1 instruments issued by a financial sector entity within an investment firm group

- 3.3.14 **R** A *firm* is not required to deduct holdings of *common equity tier 1 instruments* issued by a *financial sector entity* from the *firm's* common equity tier 1 items in accordance with **■ MIFIDPRU 3.3.6R** if all of the following conditions are met:

- (1) the *financial sector entity* forms part of the same *investment firm group* as the *firm*;
- (2) there is no current or foreseen material, practical or legal impediment to the prompt transfer of capital or repayment of liabilities by the *financial sector entity*;
- (3) the *investment firm group* is subject to prudential consolidation under **■ MIFIDPRU 2.5**; and
- (4) the risk evaluation, measurement and control procedures of a *parent undertaking* included within the *consolidated situation* of the *UK parent entity* of the *investment firm group* include the *financial sector entity*.

Qualifying holdings outside the financial sector

- 3.3.15 **R**
- (1) A *firm* must deduct from its common equity tier 1 items any amounts in excess of the following limits:
 - (a) a *qualifying holding* in a *non-financial sector entity* which exceeds 15% of the *firm's own funds*; and
 - (b) the total of all the *qualifying holdings* of the *firm* in *non-financial sector entities* which exceeds 60% of the *firm's own funds*.
 - (2) When calculating any amounts in (1), the following must not be included:
 - (a) shares in *non-financial sector entities* where any of the following conditions is met:
 - (i) the shares are held temporarily during a financial assistance operation referred to in article 79 of the *UK CRR*;
 - (ii) the holding of the shares is an underwriting position held for five *business days* or fewer; or
 - (iii) the shares are held in the name of the *firm* on behalf of others; and
 - (b) shares which are not fixed financial assets under Directive 86/635/EEC UK law (as defined in article 4(1)(128B) of the *UK CRR*).

Common equity tier 1 instruments of partnerships

3.3.16

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A *partner's* account in relation to a *firm* that is a *partnership* satisfies the conditions in article 28(1)(e) (perpetual) and article 28(1)(f) (reduction or repayment) of the *UK CRR* if:

- (1) capital contributed by *partners* is paid into the account; and
- (2) under the terms of the partnership agreement an amount representing capital may be withdrawn from the account by a *partner* ("A"), otherwise than with prior *FCA* consent pursuant to ■ MIFIDPRU 3.6.2R or deemed consent under ■ MIFIDPRU 3.6.3R, only if:
 - (a) A ceases to be a *partner* and an equal amount is transferred to another *partner's* account by A's former *partners* or any *person* replacing A as their *partner*;
 - (b) any reduction in the capital credited to A's account is immediately offset by additional contributions of at least an equal aggregate amount to other *partner* accounts by one or more of A's *partners* (including any person becoming a *partner* of A at the time that the additional contribution is made);
 - (c) the *partnership* is wound up or dissolved; or
 - (d) the *firm* ceases to be *authorised* or no longer has a *Part 4A permission*.

Common equity tier 1 instruments of limited liability partnerships

3.3.17

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A member's account in relation to a *firm* that is a *limited liability partnership* will meet the conditions in article 28(1)(e) (perpetual) and article 28(1)(f) (reduction or repayment) of the *UK CRR* if:

- (1) capital contributed by the members is paid into the account; and
- (2) under the terms of the *limited liability partnership* agreement, an amount representing capital may be withdrawn from the account by a *partner* ("B"), otherwise than with prior *FCA* consent pursuant to ■ MIFIDPRU 3.6.2R or deemed consent under ■ MIFIDPRU 3.6.3R, only if:
 - (a) B ceases to be a member and an equal amount is transferred to another member account by B's former fellow members or any *person* replacing B as a member;
 - (b) any reduction in the capital credited to B's account is immediately offset by additional contributions of at least an equal aggregate amount to other member accounts by one or more of B's fellow members (including any person becoming a fellow member of B at the time that the additional contribution is made);
 - (c) the *limited liability partnership* is wound up or dissolved; or
 - (d) the *firm* ceases to be *authorised* or no longer has a *Part 4A permission*.

3.4 Additional Tier 1 capital

- 3.4.1** **R** (1) A *firm* must determine its *additional tier 1 capital* in accordance with Chapter 3 of Title I of Part Two of the *UK CRR*, as modified by the rules in this section.
- (2) Any reference to the *UK CRR* in this section is to the *UK CRR* as applied by (1) and modified by the *rules* in this section.
- 3.4.1A** **G** ■ MIFIDPRU 3 Annex 7R contains supplementary provisions relating to the calculation of a *firm's additional tier 1 capital* and to write-down and conversion requirements for *additional tier 1 instruments*.
- 3.4.2** **R** **Trigger events and write-down or conversion**
 The following provisions of the *UK CRR* do not apply in relation to the *additional tier 1 capital* of a *MIFIDPRU investment firm*:
- (1) article 54(1)(a); and
- (2) article 54(4)(a).
- 3.4.3** **R** (1) A *firm* must specify in the terms of an *additional tier 1 instrument* one or more trigger events for the purposes of article 52(1)(n) of the *UK CRR*.
- (2) The trigger events specified under (1) must include a trigger event that occurs where the *common equity tier 1 capital* of the *firm* falls below a level specified by the *firm* that is no lower than 64% of the *firm's own funds requirement*.
- (3) Article 54 of the *UK CRR* applies as if references to the trigger event in article 54(1)(a) of the *UK CRR* are references to the trigger event in (1).
- (4) The full principal amount of an *additional tier 1 instrument* must be written down or converted when a trigger event occurs.
- 3.4.4** **G** ■ MIFIDPRU 3.4.3R requires that the principal amount of an *additional tier 1 instrument* will convert into *common equity tier 1 capital* or will be written down if the *firm's common equity tier capital* falls below a specified level. This level must be set at no lower than 64% of the *firm's own funds requirement*. The *firm* may set the relevant trigger at a higher level (such as

70% of its *own funds requirement*) if it wishes. The *firm* may also specify additional trigger events alongside the required trigger event in ■ MIFIDPRU 3.4.3R(1).

Holdings of additional tier 1 instruments of financial sector entities

3.4.5

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- (1) This *rule* applies to a *firm's* holdings of capital instruments that are not held in its *trading book*.
- (2) A firm must deduct its direct, indirect and synthetic holdings in *additional tier 1 instruments of financial sector entities* under article 56(c) of the *UK CRR* without applying article 60 of the *UK CRR* (deduction of holdings of additional tier 1 instruments where an institution does not have a significant investment in a financial sector entity).
- (3) The requirement in article 56(c) of the *UK CRR* does not apply where ■ MIFIDPRU 3.4.7R applies.

3.4.6

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The following provisions do not apply to *additional tier 1 instruments* held in the trading book of a firm:

- (1) article 56(c) of the *UK CRR*; and
- (2) article 60 of the *UK CRR*.

Holdings of additional tier 1 instruments issued by a financial sector entity within an investment firm group

3.4.7

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A *firm* is not required to deduct holdings of *additional tier 1 instruments* issued by a *financial sector entity* from the *firm's* additional tier 1 items in accordance with article 56 of the *UK CRR* if all of the following conditions are met:

- (1) the *financial sector entity* forms part of the same *investment firm group* as the *firm*;
- (2) there is no current or foreseen material, practical or legal impediment to the prompt transfer of capital or repayment of liabilities by the *financial sector entity*;
- (3) the risk evaluation, measurement and control procedures of the *parent undertaking* include the *financial sector entity*; and
- (4) the *group capital test* under ■ MIFIDPRU 2.5 does not apply to the *investment firm group*.

3.5 Tier 2 capital

- 3.5.1** **R** (1) A *firm* must determine its *tier 2 capital* in accordance with Chapter 4 of Title I of Part Two of the *UK CRR*, as modified by the *rules* in this section.
- (2) Any reference to the *UK CRR* in this section is to the *UK CRR* as applied by (1) and modified by the *rules* in this section.

- 3.5.1A** **G** ■ MIFIDPRU 3 Annex 7R contains additional provisions relating to the calculation of a *firm's tier 2 capital*.

Holdings of tier 2 instruments of financial sector entities

- 3.5.2** **R** (1) This *rule* applies to a *firm's* holdings of capital instruments that are not held in its *trading book*.
- (2) A *firm* must deduct its direct, indirect and synthetic holdings in the *tier 2 instruments of financial sector entities* under article 66(c) of the *UK CRR* without applying article 70 of the *UK CRR* (deduction of tier 2 instruments where an institution does not have a significant investment in the relevant entity).
- (3) The requirement in article 66(c) of the *UK CRR* does not apply where ■ MIFIDPRU 3.5.4R applies.

- 3.5.3** **R** The following provisions do not apply to *tier 2 instruments* held in the *trading book* of the *firm*:
- (1) article 66(c) of the *UK CRR*; and
- (2) article 70 of the *UK CRR*.

Holdings of tier 2 instruments issued by a financial sector entity within an investment firm group

- 3.5.4** **R** A *firm* is not required to deduct holdings of *tier 2 instruments* issued by a *financial sector entity* from the *firm's tier 2 items* in accordance with article 66 of the *UK CRR* if all of the following conditions are met:
- (1) the *financial sector entity* forms part of the same *investment firm group* as the *firm*;

- (2) there is no current or foreseen material, practical or legal impediment to the prompt transfer of capital or repayment of liabilities by the *financial sector entity*;
- (3) the risk evaluation, measurement and control procedures of the parent undertaking include the financial sector entity; and
- (4) the group capital test under ■ MIFIDPRU 2.6 does not apply to the investment firm group.

3.6 General requirements for own funds instruments

- 3.6.1** **R** (1) A *firm* must comply with Chapter 6 of Title I of Part Two of the *UK CRR*, as modified by the *rules* in this section.
- (2) Any reference to the *UK CRR* in this section is to the *UK CRR* as applied by (1) and modified by the *rules* in this section.

- 3.6.1A** **G** ■ MIFIDPRU 3 Annex 7R contains additional provisions relating to the eligibility of instruments to be classified as *own funds* and to the reduction of *own funds*.

Reduction of own funds instruments

- 3.6.2** **R** To apply for permission for the purposes of articles 77 and 78 of the *UK CRR* to do any of the following, a *firm* must save in the circumstances set out in ■ MIFIDPRU 3.6.3R, complete the form in ■ MIFIDPRU 3 Annex 4R and submit it to the *FCA* using the *online notification and application system*:
- (1) reduce, redeem or repurchase any of its *common equity tier 1 instruments*;
 - (2) reduce, distribute or reclassify as another *own funds* item the share premium accounts related to any of its *own funds instruments*; or
 - (3) effect the call, redemption, repayment or repurchase of its *additional tier 1 instruments* or *tier 2 instruments* prior to the date of their contractual maturity;
- 3.6.3** **R** Permission under ■ MIFIDPRU 3.6.2R is deemed to have been granted if the following conditions are met:
- (1) either of the conditions in ■ MIFIDPRU 3.6.4R apply;
 - (2) at least 20 *business days* before the *day* on which the reduction, repurchase, call or redemption is proposed to occur, the *firm* has notified the *FCA* of:
 - (a) the proposed reduction, repurchase, call or redemption; and
 - (b) the basis on which the *firm* has concluded that either condition in (1) is satisfied;

3.6.4

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The conditions referred to in ■ MIFIDPRU 3.6.3R are that:

- (3) the notification in (2) is made using the form in ■ MIFIDPRU 3 Annex 5R and submitted using the *online notification and application system*; and
- (4) the *FCA* has not notified the *firm* of any objection to the proposal before the *day* on which the reduction, repurchase, call or redemption is proposed to occur.

- (1) before or at the same time as the reduction, repurchase, call or redemption, the *firm* replaces the relevant *own funds instruments* with *own funds instruments* of equal or higher quality on terms that are sustainable for the income capacity of the *firm*; or
- (2) the *firm* is redeeming *additional tier 1 instruments* or *tier 2 instruments* within five years of their date of issue and either:
 - (a) there is a change in the regulatory classification of the instruments that is likely to result in their exclusion from *own funds* or reclassification as a lower quality form of *own funds*, and both the following conditions are met:
 - (i) there are reasonable grounds to conclude that the change is sufficiently certain; and
 - (ii) the regulatory reclassification of the instruments was not reasonably foreseeable at the time of their issuance; or
 - (b) there is a change in the applicable tax treatment of those instruments which is material and was not reasonably foreseeable at the time of their issuance.

Notification of issuance of additional tier 1 and tier 2 instruments

3.6.5

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- (1) A *firm* must notify the *FCA* at least 20 *business days* before the intended issuance date of the *firm's* intention to issue:
 - (a) *additional tier 1 instruments*; or
 - (b) *tier 2 instruments*.
- (2) The notification requirement in (1) does not apply if:
 - (a) the *firm* has previously notified the *FCA* of an issuance of the same class of *additional tier 1 instruments* or *tier 2 instruments*; and
 - (b) the terms of the new instruments are identical in all material respects to the terms of the instruments in the issuance previously notified to the *FCA*.
- (3) The notification under (1) must:
 - be submitted to the *FCA* through the *online notification and application system* using the form in ■ MIFIDPRU 3 Annex 6R; and
 - (b) include the following:
 - (i) confirmation of whether the instruments are intended to be classified as *additional tier 1 instruments* or *tier 2 instruments*;

- (ii) confirmation of whether the instruments are intended to be issued to external investors or only to other members of the *firm's group* or connected parties;
- (iii) a copy of the term sheet and details of any features of the capital instrument which are novel, unusual or different from a capital instrument of a similar nature previously issued by the *firm* or widely available in the market;
- (iv) confirmation from a member of the *firm's senior management* or *governing body* who has oversight of the intended issuance that the instrument meets the conditions in ■ MIFIDPRU 3.4 or ■ MIFIDPRU 3.5 (as applicable, and including any conditions in the *UK CRR* applied by those sections) to be classified as *additional tier 1 instruments* or *tier 2 instruments*; and
- (v) a properly reasoned legal opinion from an appropriately qualified *individual*, confirming that the capital instruments meet the conditions in (iv).

3.6.6

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- (1) *MIFIDPRU investment firms* that were classified as *CRR firms* immediately before 1 January 2022 should refer to ■ MIFIDPRU TP 1 for transitional provisions relating to *own funds* permissions that were issued, and notifications that were made, before that date.

Those *firms* should also refer to ■ MIFIDPRU TP 7, which contains transitional provisions about capital instruments issued before 1 January 2022 and in respect of which the *firm* had not obtained *own funds* permissions or made notifications under the legal requirements in force at that time.

- (2) *MIFIDPRU investment firms* that were in existence immediately before 1 January 2022, but were not classified as *CRR firms*, should refer to ■ MIFIDPRU TP 7 for transitional provisions relating to *own funds* instruments issued before that date.

- (3) *Parent undertakings* should also refer to the following:

- (a) ■ MIFIDPRU TP 1, where they were subject to the *UK CRR* on an individual or a consolidated basis immediately before 1 January 2022 and had obtained permissions or made notifications under the *UK CRR* relating to *own funds* instruments issued before that date; or

- (b) ■ MIFIDPRU TP 7 in either of the following cases:

- (i) where they were not subject to the *UK CRR* on either an individual or a consolidated basis immediately before 1 January 2022, but wish to rely on transitional provisions relating to capital instruments issued before that date; or
- (ii) where they were subject to the *UK CRR* on an individual or a consolidated basis immediately before 1 January 2022, but wish to rely on transitional provisions relating to capital instruments issued before that date in respect of which the *parent undertaking* had not obtained *own funds* permissions or made notifications under the legal requirements in force at that time.

- 3.6.7** **G** Firms that are proposing to classify an issuance of capital instruments as *common equity tier 1 capital* should refer to the obligations and guidance in ■ MIFIDPRU 3.3.3R and ■ MIFIDPRU 3.3.4G. In particular, *firms* must obtain the FCA's prior permission for the first issuance of a class of instruments that is intended to comprise *common equity tier 1 capital*.
- 3.6.8** **R**
- (1) A *UK parent entity* must apply the modifications in (2) when either of the following apply on a *consolidated basis* in accordance with ■ MIFIDPRU 2.5.7R:
 - (a) ■ MIFIDPRU 3.3.2R to ■ MIFIDPRU 3.3.4G; and
 - (b) ■ MIFIDPRU 3.6.5R.
 - (2) The *Handbook* provisions in (1)(a) and (b) apply as if a reference to:
 - (a) a "*firm*" is a reference to the *UK parent entity*;
 - (b) "*capital instruments*" is a reference to capital instruments issued by the *UK parent entity*;
 - (c) "*additional tier 1 instruments*" and "*tier 2 instruments*" is a reference to these instruments issued by the *UK parent entity*; and
 - (d) "*common equity tier 1 capital*" is a reference to that type of capital as calculated on a *consolidated basis*.
- 3.6.9** **G** Submitting a notification in accordance with ■ MIFIDPRU 3.6.5R to ■ MIFIDPRU 3.6.8R does not guarantee that the relevant instruments meet the required conditions in ■ MIFIDPRU 3.4 or ■ MIFIDPRU 3.5 to qualify as *own funds*. The *firm* or *parent undertaking* must ensure that an instrument continues to meet the conditions to be counted as *own funds*, including if its terms are varied on a later date.

3.7 Composition of capital for parent undertakings subject to the group capital test

- 3.7.1** **R** This section applies to a *parent undertaking* in accordance with **■ MIFIDPRU 3.1.2R**.
- 3.7.2** **R** A *parent undertaking* must, at all times, have *own funds instruments* that satisfy the following conditions:
- (1) the *parent undertaking's common equity tier 1 capital* must be at least equal to:
 - (a) the sum of the book value of the *parent undertaking's holdings of the common equity tier 1 capital of the relevant financial undertakings* under **■ MIFIDPRU 2.6.5R**; plus
 - (b) the total amount of all the *parent undertaking's contingent liabilities in favour of the relevant financial undertakings* under **■ MIFIDPRU 2.6.5R**;
 - (2) the sum of *common equity tier 1 capital* and *additional tier 1 capital* of the *parent undertaking* must be at least equal to the sum of:
 - (a) the amounts in (1)(a) and (1)(b); plus
 - (b) the sum of the book value of the *parent undertaking's holdings in the additional tier 1 capital of the relevant financial undertakings* under **■ MIFIDPRU 2.6.5R**; and
 - (3) the sum of the *parent undertaking's own funds instruments* must be at least equal to the total requirement under **■ MIFIDPRU 2.6.5R**.
- 3.7.3** **G** As explained in **■ MIFIDPRU 2.6.6G**, the *group capital test* effectively applies to each intermediate parent undertaking, as well as to the ultimate *parent undertaking* of the *investment firm group*.
- 3.7.4** **R**
- (1) Subject to (2), a *parent undertaking* must comply with:
 - (a) **■ MIFIDPRU 3.3.2R** to **■ MIFIDPRU 3.3.4G** when issuing *own funds instruments* which are intended to qualify as *common equity tier 1 capital*;
 - (b) **■ MIFIDPRU 3.6.5R** when issuing *own funds instruments* which are intended to qualify as *additional tier 1 instruments* or *tier 2 instruments*.

3.7.5

R

(12) Where the *Handbook* provisions in (1)(a) and (b) apply, they apply as if a reference to:

- (a) a "*firm*" is a reference to the *parent undertaking*;
- (b) "*capital instruments*" is a reference to capital instruments issued by the *parent undertaking*;
- (c) "*additional tier 1 instruments*" and "*tier 2 instruments*" is a reference to these instruments issued by the *parent undertaking*; and
- (d) "*common equity tier 1 capital*" is a reference to this type of capital as held by the *parent undertaking*.

(1) This *rule* applies where a *responsible UK parent* applies the approach in ■ MIFIDPRU 2.6.7R(2)(a) in relation to an *undertaking* established in a *third country*.

(2) Where this *rule* applies, a *responsible UK parent* must comply with ■ MIFIDPRU 3.7.4R in relation to any issuance of own funds instruments by the *undertaking* established in a *third country*.

Application under MIFIDPRU 3.3.2R - permission to include interim or year-end profits as CET1

[Editor's note: The form can be found at this address: [https://www.handbook.fca.org.uk/form/mifidpru/MIFIDPRU 3 Annex 1R Application under MIFIDPRU 3.3.2R for permission to include interim or year-end profits as common equity tier 1 \(CET1\) capital before the firm.pdf](https://www.handbook.fca.org.uk/form/mifidpru/MIFIDPRU%203%20Annex%201R%20Application%20under%20MIFIDPRU%203.3.2R%20for%20permission%20to%20include%20interim%20or%20year-end%20profits%20as%20common%20equity%20tier%201%20(CET1)%20capital%20before%20the%20firm.pdf)

Application under MIFIDPRU 3.3.3R(1) - permission to classify capital instruments as CET1

[Editor's note: The form can be found at this address: https://www.handbook.fca.org.uk/form/mifidpru/MIFIDPRU_3Annex2R_27.09.2022.pdf

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Notification under MIFIDPRU 3.3.3R(2) - issuance of additional capital instruments that have already been approved as CET1 instruments

[Editor's note: The form can be found at this address: [https://www.handbook.fca.org.uk/form/MIFIDPRU 3 Annex 3R Notification under MIFIDPRU 3.3.3R\(2\) of issuance of additional capital instruments that have already been approved as CET1 instruments.pdf](https://www.handbook.fca.org.uk/form/MIFIDPRU%203%20Annex%203R%20Notification%20under%20MIFIDPRU%203.3.3R(2)%20of%20issuance%20of%20additional%20capital%20instruments%20that%20have%20already%20been%20approved%20as%20CET1%20instruments.pdf)

Application under MIFIDPRU 3.6.2R - permission to reduce own funds instruments when neither condition in MIFIDPRU 3.6.4R applies

[Editor's note: The form can be found at this address: [https://www.handbook.fca.org.uk/form/MIFIDPRU 3 Annex 4R](https://www.handbook.fca.org.uk/form/MIFIDPRU%203%20Annex%204R) Application under MIFIDPRU 3.6.2R for permission to reduce own funds instruments where neither condition in MIFIDPRU 3.6.4R applies.pdf

Notification under MIFIDPRU 3.6.3R - intended reduction in own funds instruments where a condition in MIFIDPRU 3.6.4R applies

[Editor's note: The form can be found at this address: [https://www.handbook.fca.org.uk/form/MIFIDPRU 3 Annex 5R Notification under MIFIDPRU 3.6.3R of the intended reduction in own funds instruments where a condition in MIFIDPRU 3.6.4R applies.pdf](https://www.handbook.fca.org.uk/form/MIFIDPRU%203%20Annex%205R%20Notification%20under%20MIFIDPRU%203.6.3R%20of%20the%20intended%20reduction%20in%20own%20funds%20instruments%20where%20a%20condition%20in%20MIFIDPRU%203.6.4R%20applies.pdf)

Notification under MIFIDPRU 3.6.5R of issuance of additional tier 1 or tier 2 instruments

[Editor's note: The form can be found at this address: [https://www.handbook.fca.org.uk/form/MIFIDPRU 3 Annex 6R Notification under MIFIDPRU 3.6.5R of the intended issuance of AT1 or T2 instruments.pdf](https://www.handbook.fca.org.uk/form/MIFIDPRU%203%20Annex%206R%20Notification%20under%20MIFIDPRU%203.6.5R%20of%20the%20intended%20issuance%20of%20AT1%20or%20T2%20instruments.pdf)

Additional provisions relating to own funds

Additional provisions relating to own funds

Application and purpose

- | | | |
|-----|---|--|
| 7.1 | R | <p>This annex applies to any of the following entities when that entity is determining its <i>own funds</i> under MIFIDPRU 3:</p> <ol style="list-style-type: none"> (1) a <i>MIFIDPRU investment firm</i>; (2) a <i>UK parent entity</i>; and (3) a <i>GCT parent undertaking</i>. |
| 7.2 | G | <p>This annex contains additional <i>rules</i> and <i>guidance</i> that supplement the requirements in MIFIDPRU 3 and <i>UK CRR</i> (as applied by MIFIDPRU 3) relating to the calculation of <i>own funds</i>.</p> |
| 7.3 | R | <p>Any reference in this annex to the <i>UK CRR</i> is to the <i>UK CRR</i> as applied and modified by MIFIDPRU 3.</p> |

Definition of cooperative societies and similar undertakings

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| 7.4 | R | <p>For the purposes of article 27(1)(a)(ii) of the <i>UK CRR</i>, a <i>firm</i> is a <i>cooperative society</i> where the following conditions are met:</p> <ol style="list-style-type: none"> (1) the <i>firm</i> is a registered society within the meaning of the Co-operative and Community Benefit Societies Act 2014, or a society registered or treated as registered under the Cooperative and Community Benefit Societies Act (Northern Ireland) 1969; (2) with respect to <i>common equity tier 1 capital</i>, the <i>firm</i> is able to issue, under the applicable law of the <i>United Kingdom</i> (or any part of it) or the <i>firm's</i> statutes, at the level of the legal entity, only capital instruments referred to in article 29 of the <i>UK CRR</i>; (3) where, under the applicable law of the <i>United Kingdom</i> (or any part of it), the holders of the <i>firm's common equity tier 1 instruments</i> (whether they are members or non-members of the <i>firm</i>) have the ability to resign and return the capital instrument to the <i>firm</i>, this must be subject to any applicable restrictions under the following: <ol style="list-style-type: none"> (a) the law of the <i>United Kingdom</i> (or any part of it); (b) the statutes of the <i>firm</i>; (c) any provision of the <i>UK CRR</i> that is applied by MIFIDPRU; and (d) any provision of the <i>Handbook</i>. |
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[Note: article 4 of BTS 241/2014]

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| 7.5 | R | <p>For the purposes of article 27(1)(a)(iv) of the <i>UK CRR</i>, a <i>firm</i> is a <i>similar institution</i> where the following conditions are met:</p> |
|-----|---|---|

- (1) with respect to *common equity tier 1 capital*, the *firm* is able to issue, under the applicable law of the *United Kingdom* (or any part of it) or the *firm's* statutes, at the level of the legal entity, only capital instruments referred to in article 29 of the *UK CRR*; and
- (2) at least one of the following applies:
- (a) where the holders of the *firm's* *common equity tier 1 instruments* (whether they are members or non-members of the *firm*) have the ability to resign under the applicable law of the *United Kingdom* (or any part of it) and have the right to put the capital instrument back to the *firm*, this must be subject to any applicable restrictions under the following:
- (i) the law of the *United Kingdom* (or any part of it);
- (ii) the statutes of the *firm*;
- (iii) any provision of the *UK CRR* that is applied by *MIFIDPRU*; and
- (iv) any provision of the *Handbook*;
- (b) the sum of capital, reserves and interim or year-end profits is not allowed, under the applicable law of the *United Kingdom* (or any part of it), to be distributed to holders of the *common equity tier 1 instruments* of the *firm*, except where:
- (i) the *common equity tier instruments* grant the holders, on a going concern basis, a right to a part of the profits and reserves that is proportionate to their contribution to the capital and reserves of the *firm* or is otherwise determined in ac

			(ii)	<p>cordance with an alternative arrangement, and in either case, this is permitted under applicable law;</p> <p>the <i>common equity tier 1 instruments</i> grant the holders, in the case of the insolvency or liquidation of the <i>firm</i>, the right to reserves that need not be proportionate to the contribution to capital and reserves, provided that the conditions in article 29(4) and article 29(5) of the <i>UK CRR</i> are met;</p> <p>or</p>
			(iii)	<p>the total amount or a partial amount of the sum of capital and reserves is owned by members of the <i>firm</i> who do not, in the ordinary course of business, benefit from direct distribution of the reserves, in particular through the payment of dividends.</p>
7.6	R			<p>[Note: article 7 of BTS 241/2014.]</p> <p>MIFIDPRU 3 Annex 7.4R(3) and MIFIDPRU 3 Annex 7.5(2)(a) do not prevent the <i>firm</i> from issuing, whether under the law of the <i>United Kingdom</i> (or any part of it) or of a <i>third country</i>, <i>common equity tier 1 instruments</i> to members or non-members that comply with article 29 of the <i>UK CRR</i> and do not grant a right to return the capital instrument to the firm.</p> <p>[Note: article 4(4) and article 7(4)(a) of BTS 241/2014.]</p>
Distributions constituting disproportionate drags on capital or preferential distributions				
7.7	R	(1)		<p>This <i>rule</i> applies for the purpose of determining whether a distribution on an instrument intended to qualify as a <i>common equity tier 1 capital instrument</i> constitutes a disproportionate drag</p>

- on capital under article 28(1)(h)(iii) and 28(3) of the *UK CRR*.
- (2) References in this *rule* to the “dividend multiple” are to the dividend multiple referred to in article 28(3) of the *UK CRR*.
- (3) Distributions on an instrument will not constitute a disproportionate drag on capital for the purposes of (1) where:
- (a) the dividend multiple is a multiple of the distribution paid on the voting instruments and is not a predetermined fixed amount;
 - (b) the dividend multiple is set contractually or under the statutes of the *firm*;
 - (c) the dividend multiple is not revisable;
 - (d) the same dividend multiple applies to all instruments with a dividend multiple;
 - (e) the amount of distribution on one instrument with a dividend multiple does not represent more than 125% of the amount of the distribution on one voting *common equity tier 1 instrument*, as determined in accordance with the formula in (6);
 - (f) the total amount of the distributions paid on all *common equity tier 1 instruments* during a one-year period does not exceed 105% of the amount that would have been paid if instruments with fewer or no voting rights received the same distributions as voting instruments, as determined in accordance with the formula in (7).
- (4) Where the conditions in (3)(a) to (3)(e) are not met, all outstanding instruments with a dividend multiple shall be deemed to cause a disproportionate drag on capital for the purposes of (1).
- (5) Where the condition in (3)(f) is not met, only the amount of the instruments with a dividend multiple that exceeds the threshold in that provision shall be deemed to cause a disproportionate drag on capital for the purposes of (1).
- (6) The formula referred to in (3)(e) is:
- $$I \leq 1.25 \times k$$
- where:
- k = the amount of the distribution on one instrument without a dividend multiple; and
- I = the amount of the distribution on one instrument with a dividend multiple.

		(7)	<p>The formula referred to in (3)(f) applies on a one-year basis and is as follows:</p> $kX + lY \leq (1.05) \times k \times (X + Y)$ <p><i>k</i> =the amount of the distribution on one instrument without a dividend multiple;</p> <p><i>l</i> =the amount of the distribution on one instrument with a dividend multiple;</p> <p><i>X</i> =the number of voting instruments; and</p> <p><i>Y</i> =the number of non-voting instruments.</p> <p>[Note: article 7a of BTS 241/2014.]</p>
7.8	R		<p>A distribution on a <i>common equity tier 1 instrument</i> referred to in article 28 of the <i>UK CRR</i> shall be deemed to be a preferential distribution under article 28(1)(h)(i) of the <i>UK CRR</i> relative to other <i>common equity tier 1 instruments</i> where there are differentiated levels of distributions, unless the conditions in MIFIDPRU 3 Annex 7.7R are met.</p> <p>[Note: article 7b(1) of BTS 241/2014.]</p>
7.9	R	(1)	<p>This rule applies where:</p> <p>(a) a <i>common equity tier 1 instrument</i> has been issued by a firm that is a <i>cooperative society</i> or a <i>similar institution</i>;</p> <p>(b) the instrument in (a) has fewer or no voting rights when compared to a <i>common equity tier 1 instrument</i> of the firm with full voting rights;</p> <p>(c) the distribution on the instrument in (a) is a multiple of the distribution on the voting instruments; and</p> <p>(d) the distribution in (c) is set contractually or under statute.</p>
		(2)	<p>Where this rule applies, a distribution on the instrument in (1)(a) is deemed not to be preferential relative to the <i>common equity tier 1 instrument</i> in (1)(b) for the purposes of article 28(1)(h)(i) of the <i>UK CRR</i> where:</p> <p>(a) the dividend multiple is a multiple of the distribution paid on the voting instruments and not a predetermined fixed amount;</p> <p>(b) the dividend multiple is set contractually or under the statutes of the firm;</p> <p>(c) the dividend multiple is not revisable;</p> <p>(d) the same dividend multiple applies to all instruments with a dividend multiple;</p> <p>(e) the amount of the distribution on one instrument with a dividend multiple does not represent more than 125% of the</p>

- amount of the distribution on one voting *common equity tier 1 instrument*, as determined in accordance with the formula in (5); and
- (f) the total amount of distributions paid on all *common equity tier 1 instruments* during a one-year period does not exceed 105% of the amount that would have been paid if instruments with fewer or no voting rights received the same distributions as the voting instruments, as determined in accordance with the formula in (6).
- (3) Where any of the conditions in (2)(a) to (2)(e) are not met, all outstanding instruments with a dividend multiple shall be disqualified from the *common equity tier 1 capital* of the firm.
- (4) Where the condition in (2)(f) is not met, only the amount of the instruments with a dividend multiple that exceeds the threshold defined in that provision shall be disqualified from the *common equity tier 1 capital* of the firm.
- (5) Subject to (7), the formula referred to in (2)(e) is:
 $I \leq 1.25 \times k$
 where:
 k = the amount of the distribution on one instrument without a dividend multiple; and
 I = the amount of the distribution on one instrument with a dividend multiple.
- (6) Subject to (7), the formula referred to in (2)(f) applies on a one-year basis and is as follows:
 $kX + IY \leq (1.05) \times k \times (X + Y)$
 k = the amount of the distribution on one instrument without a dividend multiple;
 I = the amount of the distribution on one instrument with a dividend multiple;
 X = the number of voting instruments; and
 Y = the number of non-voting instruments.
- (7) Where the distributions on *common equity tier 1 instruments* (whether for voting or non-voting instruments) are expressed with reference to the purchase price of the instrument at issuance, the formulae in (5) and (6) shall be adapted as follows for those instruments:
- (a) I shall represent the amount of the distribution on one instrument without a dividend multiple divided by the purchase price at issuance of that instrument; and

			(b)	<i>k</i> shall represent the amount of the distribution on one instrument with a dividend multiple divided by the purchase price at issuance of that instrument.
		(8)		The one-year period referred to in (6) shall be deemed to end on the date of the last financial statements of the <i>firm</i> .
				[Note: article 7b(2) to 7b(5) of BTS 241/2014.]
7.10	R	(1)		This rule applies where:
			(a)	a <i>common equity tier 1 instrument</i> has been issued by a firm that is a <i>cooperative society</i> or a <i>similar institution</i> ;
			(b)	the instrument in (a) has fewer or no voting rights when compared to a <i>common equity tier 1 instrument</i> of the <i>firm</i> with full voting rights; and
			(c)	the distribution on the instrument in (a) is not a multiple of the distribution on the voting instruments.
		(2)		Where this <i>rule</i> applies, a distribution on the instrument in (1)(a) shall be deemed not to be preferential relative to the <i>common equity tier 1 instrument</i> in (1)(b) for the purposes of article 28(1)(h)(i) of the <i>UK CRR</i> where:
			(a)	either of the conditions in (3) is met; and
			(b)	both of the conditions in (5) are met.
		(3)		The relevant conditions in (2)(a) are that either:
			(a)	both of the following points are satisfied:
				(i) the instrument with fewer or no voting rights can only be subscribed and held by the holders of voting instruments; and
				(ii) the number of the voting rights of any single holder is limited, as specified in (4); or
			(b)	the distributions on the voting instruments issued by the <i>firm</i> are subject to a cap set out under the applicable law of the

- United Kingdom (or any part of it), or of a third country.*
- (4) For the purposes of (3)(a)(ii), the voting rights of any single holder shall be deemed to be limited in the following cases:
- (a) where each holder only receives one voting right irrespective of the number of voting instruments for any holder;
 - (b) where the number of voting rights is capped irrespective of the number of voting instruments held by any holder; or
 - (c) where the number of voting instruments any holder may hold is limited under the statutes of the *firm* or under the applicable law of the *United Kingdom* (or any part of it), or of a *third country*.
- (5) The relevant conditions in (2)(b) are that:
- (a) the average of the distributions on voting instruments of the *firm* during the preceding 5 years is low in relation to other comparable instruments; and
 - (b) the payout ratio as calculated under MIFIDPRU 3 Annex 7.12R is under 30%.
- (6) A *firm* must assess compliance with the conditions in (3) and (5) and notify the *FCA* of the results of that assessment in the following situations:
- (a) every time the *firm* takes a decision on the amount of distributions on *common equity tier 1 instruments*; and
 - (b) every time the *firm* issues a new class of *common equity tier 1 instruments* with fewer or no voting rights when compared with *common equity tier 1 instruments* of the *firm* with full voting rights.
- (7) A *firm* must make the notification in (6) by completing the form in MIFIDPRU 1 Annex 6R and submitting it to the *FCA* using the *online notification and application system*.
- (8) Where neither of the conditions in (3) are met, the distributions on all outstanding non-voting instruments are deemed to be preferential unless they meet the conditions in MIFIDPRU 3 Annex 7.9R(2).
- (9) Where the condition in (5)(a) is not met, the distributions on all outstanding non-voting instruments shall be deemed to be preferential unless

			they meet the conditions in MIFIDPRU 3 Annex 7.9R(2).
		(10)	Where the condition in (5)(b) is not met, only the amount of the non-voting instruments for which distributions exceed the threshold specified in that provision shall be deemed to entail preferential distributions.
			[Note: article 7b(6) to 7b(14) of BTS 241/2014.]
7.11	G		A <i>firm</i> may apply under section 138A of the Act for a waiver of the requirements in MIFIDPRU 3 Annex 7.10R(3)(a)(i) or MIFIDPRU 3 Annex 7.10R(5)(b) where:
		(1)	the <i>firm</i> is in breach of, or due to a rapidly deteriorating financial condition, is likely in the near future to be in breach of, the requirements in MIFIDPRU (other than those in MIFIDPRU 3 Annex 7.10R(3)(a)(i) or MIFIDPRU 3 Annex 7.10R(5)(b));
		(2)	the FCA has required the <i>firm</i> to increase its <i>common equity tier 1 capital</i> within a specified period; and
		(3)	the <i>firm</i> considers that it will not be able to rectify or avoid the breach of MIFIDPRU within that specified period unless the relevant requirement in MIFIDPRU 3 Annex 7.10R(3)(a)(i) or MIFIDPRU 3 Annex 7.10R(5)(b) is waived.
			[Note: article 7b(15) of BTS 241/2014.]
7.12	R	(1)	A <i>firm</i> must calculate the payout ratio under MIFIDPRU 3 Annex 7.10R(5)(b) using the following formula: R= D/P where: R =the payout ratio; D =the sum of the distributions related to total <i>common equity tier 1 instruments</i> over the previous 5 yearly periods; and P =the sum of profits related to the previous 5 yearly periods.
		(2)	For the purposes of paragraph (1), profits shall be:
		(a)	in the case of a period for which the <i>firm</i> submitted <i>data item</i> FSA030 (Income Statement), the amount of profit after taxation reported in cell 25A of that <i>data item</i> ;
		(b)	in the case of a period for which the <i>firm</i> submitted <i>data item</i> FSA002 (Income Statement), the amount of net profit reported in cell 46B of that <i>data item</i> ; and
		(c)	in the case of a period for which the <i>firm</i> submitted FIN-REP return F02.00 (Statement of profit or loss), whether under IFRS or GAAP, the amount of

profit after tax reported in row 670.

[Note: article 7c of BTS 241/2014.]

7.13 R For the purposes of article 28 of the *UK CRR*, a distribution on a *common equity tier 1 instrument* shall be deemed to be preferential relative to other *common equity tier 1 instruments* regarding the order of distribution payments where at least one of the following conditions is met:

- (1) distributions are decided at different times;
- (2) distributions are paid at different times;
- (3) there is an obligation on the firm to pay the distributions on one type of *common equity tier 1 instruments* before paying the distributions on another type of *common equity tier 1 instruments*; or
- (4) a distribution is paid on some *common equity tier 1 instruments* but not on others, unless the condition in MIFIDPRU 3 Annex 7.10R3(a) is satisfied.

[Note: article 7d of BTS 241/2014.]

Deduction of foreseeable dividends from interim or year-end profits to be recognised as CET1 items

- 7.14 R
- (1) This *rule* applies for the purpose of determining the amount of any foreseeable dividend that must be deducted by a *MIFIDPRU investment firm* from its interim or year-end profits under article 26(2)(b) of the *UK CRR*.
 - (2) Where the *firm's management body* has formally taken a decision or proposed a decision to the *firm's relevant body* regarding the amount of dividends to be distributed, that amount must be deducted from the corresponding interim or year-end profits.
 - (3) Before the *firm's management body* has formally taken a decision or proposed a decision to the *firm's relevant body* on the distribution of dividends, the amount of foreseeable dividends to be deducted by the *firm* from the interim or year-end profits must equal the amount of interim or year-end profits multiplied by the dividend payout ratio (as calculated in accordance with MIFIDPRU 3 Annex 7.16R).
 - (4) Where the *firm* pays an interim dividend, the residual amount of interim profit which is to be added to the *firm's common equity tier 1 items* must be reduced (taking into account the requirement in (3)), by the amount of any foreseeable dividend which can be expected to be paid out from that residual interim profit with the final dividends for the full business year.
 - (5) This *rule* is subject to MIFIDPRU 3 Annex 7.15R.

[Note: article 2 of BTS 241/2014.]

7.15 R (1) Where a foreseeable dividend is to be paid in a form that does not reduce the common equity tier 1 items of the *firm* (such as through a scrip dividend), the amount of that dividend does not need to be deducted from a *firm's* interim or

			<p>year-end profits for the purposes of article 26(2) of the <i>UK CRR</i>.</p> <p>(2) Where a <i>firm</i> is subject to a regulatory restriction on the amount of any dividend it can pay, the amount of any foreseeable dividend to be deducted must be determined taking into account that restriction.</p> <p>[Note: article 2(9) and 2(10) of BTS 241/2014.]</p>
7.16	R	(1)	This <i>rule</i> applies for the purposes of determining the dividend payout ratio referred to in MIFIDPRU 3 Annex 7.14R(3).
		(2)	Subject to (3), the dividend payout ratio must be determined on the basis of the dividend policy approved for the relevant period by the <i>firm's management body or relevant body</i> .
		(3)	Where the <i>firm's</i> dividend policy in (2) contains a payout range instead of a fixed value, the upper end of the range must be used when determining the dividend payout ratio.
		(4)	Where the <i>firm</i> does not have an approved dividend policy, the dividend payout ratio is the higher of the following:
		(a)	the average dividend payout ratio over the three years prior to the year under consideration; or
		(b)	the dividend payout ratio of the year preceding the year under consideration.
		(5)	The dividend payout ratio in (4)(a) and (4)(b) must be calculated using the following formula: R=D/N where: R =the dividend payout ratio for the relevant period; D =the sum of distributions made by the <i>firm</i> during the relevant period; and N =the net income of the <i>firm</i> during the relevant period.
			[Note: article 2(4) to 2(6) of BTS 241/2014.]
7.17	G	(1)	The <i>FCA</i> may require a <i>firm</i> to use the alternative calculation of the dividend payout ratio in MIFIDPRU 3 Annex 7.16R(4) where, even though the <i>firm</i> has an approved dividend policy, the <i>FCA</i> considers that:
		(a)	the <i>firm</i> would not apply the dividend policy in practice; or
		(b)	the policy is not a prudent basis on which to determine the amount to be deducted from interim or year-end profits for the purposes of MIFIDPRU 3 Annex 7.14R.

		(2)	In the circumstances in (1), the <i>FCA</i> will normally invite the <i>firm</i> to apply for the imposition of a <i>requirement</i> on the <i>firm</i> under section 55L(5) of the <i>Act</i> to apply the alternative calculation. Alternatively, the <i>FCA</i> may seek to impose such a <i>requirement</i> on its own initiative under section 55L(3) of the <i>Act</i> .
7.18	G		<p>[Note: article 2(7) of BTS 241/2014.]</p> <p>A <i>firm</i> may apply to the <i>FCA</i> under section 138A of the <i>Act</i> for a modification of MIFIDPRU 3 Annex 7.16R(4) to exclude exceptional dividends where the <i>firm</i> has paid those dividends during the period for which the dividend payout ratio is being determined. The <i>FCA</i> will consider whether including those dividends in the calculation would be unduly onerous or would otherwise fail to achieve the purpose of that <i>rule</i>. This is likely to depend on whether the <i>firm</i> can demonstrate that the dividends are genuinely exceptional in nature.</p> <p>[Note: article 2(8) of BTS 241/2014.]</p>
Deduction of foreseeable charges from interim or year-end profits to be recognised as CET1 items			
7.19	R	(1)	This <i>rule</i> applies for the purpose of determining the amount and timing of any foreseeable charge that must be deducted by a <i>MIFIDPRU investment firm</i> from its interim or year-end profits under article 26(2)(b) of the <i>UK CRR</i> .
		(2)	The amount of foreseeable charges to be deducted must include the following: <ul style="list-style-type: none"> (a) any taxes; (b) any amounts resulting from obligations or circumstances that may arise during the related reporting period where: <ul style="list-style-type: none"> (i) those amounts are likely to reduce the profits of the <i>firm</i>; and (ii) the <i>firm</i> has not made all necessary value adjustments or provisions, including AVAs under article 34 of the <i>UK CRR</i>, to cover such amounts.
		(3)	Where the <i>firm</i> has not already taken a foreseeable charge into account in the profit and loss account, the charge must be assigned to the interim period during which it was incurred.
		(4)	For the purposes of (3), where a charge was incurred during more than one interim period, the <i>firm</i> must allocate the amount so that each interim period bears a reasonable amount of the relevant charge.

- (5) A charge that occurs from a material or non-recurrent event must be allocated in full without delay to the interim period during which the event arises.

[Note: article 3 of BTS 241/2014.]

Prohibition on direct or indirect funding of own funds instruments

- 7.20 R (1) This *rule* applies for the purpose of determining when an instrument has been funded indirectly by a *firm* for the purposes of any of the following provisions of the *UK CRR*:
- (a) article 28(1)(b);
 - (b) article 52(1)(c); or
 - (c) article 63(c).
- (2) Funding will be indirect funding for the purposes of (1) when it is not direct funding as defined in (3).
- (3) Direct funding is either of the following:
- (a) a situation where a *firm* has granted a loan or other funding in any form to an investor that is used to purchase the *firm's* capital instruments; or
 - (b) funding granted by the *firm* for purposes other than those in (a) to any natural or legal person in the following situations, where the conditions in (4) are not met:
 - (i) the person has a qualifying holding (as defined in article 4(1)(36) of the *UK CRR*) in the *firm*; or
 - (ii) the person is deemed to be a related party within the meaning of the definitions in paragraph 9 of International Accounting Standard 24 on Related Party Disclosures, as applied by *UK-adopted international accounting standards* on 1 January 2022.
- (4) The conditions in (3)(b) are:

			(a)	the transaction is realised at similar conditions to other transactions with third parties; and
			(b)	the natural or legal <i>person</i> does not have to rely on the distributions or on the sale of the capital instruments held to support the payment of interest or the repayment of the funding granted by the <i>firm</i> .
				[Note: article 8 of BTS 241/2014.]
7.21	R	(1)		The following are non-exhaustive examples of indirect funding for the purposes of the provisions of the <i>UK CRR</i> listed in MIFIDPRU 3 Annex 7.20R(1) where the condition in (2) is also satisfied:
			(a)	funding of an investor's purchase, at issuance or thereafter, of a <i>firm's</i> capital instruments by entities over which the <i>firm</i> has direct or indirect control, or by entities included in any of the following:
				(i) the scope of accounting or prudential consolidation of the <i>firm</i> ; or
				(ii) the scope of supplementary supervision of the <i>firm</i> under <i>Directive 2002/87/EC UK law</i> ;
			(b)	funding of an investor's purchase, at issuance or thereafter, of a <i>firm's</i> capital instruments by external entities that are protected by a guarantee or by the use of a credit derivative or are secured in some other way so that the credit risk is transferred to the <i>firm</i> or to any entities on which the <i>firm</i> has a direct or indirect control or any entities included in any of the following:
				(i) the scope of accounting or prudential consolidation of the <i>firm</i> ; or
				(ii) the scope of supplementary supervision of the <i>firm</i> under <i>Directive 2002/87/EC UK law</i> ;

			(c)	funding of a borrower that passes the funding on to the ultimate investor for the purchase, at issuance or thereafter, of a <i>firm's</i> capital instruments.
		(2)		The relevant condition is that the investor or, where applicable, the external entity is not included in any of the following:
			(a)	the scope of accounting or prudential consolidation of the <i>firm</i> ; or
			(b)	the scope of supplementary supervision of the <i>firm</i> under <i>Directive 2002/87/EC UK law</i> .
7.22	R			[Note: article 9(1) and 9(2) of BTS 241/2014.] When establishing whether the purchase of a capital instrument involves direct or indirect funding for the purposes of MIFIDPRU 3 Annex 7.20R, the amount to be considered must be net of any individually assessed impairment allowance made.
7.23	R			[Note: article 9(3) of BTS 241/2014.] To prevent a loan or other form of funding or guarantee being classified as direct or indirect funding for the purposes of MIFIDPRU 3 Annex 7.20R, the <i>firm</i> must:
		(1)		where the loan, funding or guarantee is granted to any natural or legal person referred to in MIFIDPRU 3 Annex 7.20R(3)(b)(i) or (ii), ensure on an ongoing basis that the loan, funding or guarantee has not been provided for the purpose of subscribing directly or indirectly for the <i>firm's</i> capital instruments; and
		(2)		where the loan, funding or guarantee has been granted to other types of parties, use the <i>firm's</i> best efforts to avoid providing the loan, funding or guarantee for the purpose of subscribing directly or indirectly for the <i>firm's</i> capital instruments.
7.24	R			[Note: article 9(4) of BTS 241/2014.]
		(1)		This <i>rule</i> applies to a <i>firm</i> that is:
			(a)	a <i>cooperative society</i> ; or
			(b)	a <i>similar institution</i> .
		(2)		Where a <i>firm</i> in (1) has an obligation under the law of the <i>United Kingdom</i> (or any part of it) or the statutes of the <i>firm</i> for a customer to subscribe for capital instruments in the <i>firm</i> in order to receive a loan, that loan shall not be considered as direct or indirect funding for the purposes of MIFIDPRU 3 Annex 7.20R where the following conditions are met:
			(a)	the value of the subscription amount is not material;
			(b)	the purpose of the loan is not the purchase of capital instruments in the <i>firm</i> ; and

		(c)	subscription for one or more capital instruments of the <i>firm</i> is necessary for the customer to become a member of the <i>firm</i> .
			[Note: article 9(5) of BTS 241/2014.]
Requirements relating to the reduction of own funds instruments			
7.25	R		For the purposes of MIFIDPRU 3.6.4R(1), terms will be sustainable for the income capacity of the <i>firm</i> where:
		(1)	the profitability of the <i>firm</i> will continue to be sound and will not see any negative change in the foreseeable future after the replacement of the original <i>own funds instruments</i> with <i>own funds instruments</i> of equal or higher quality; and
		(2)	the assessment of profitability in the foreseeable future in (1) takes into account the <i>firm's</i> profitability in stressed situations.
			[Note: article 27 of BTS 241/2014.]
7.26	R		Where the prior permission of the <i>FCA</i> is required for the redemption, repurchase or reduction of <i>own funds instruments</i> under article 77 of the <i>UK CRR</i> , a <i>firm</i> must not announce the redemption, repurchase or reduction to holders of the relevant <i>own funds instruments</i> until it has obtained that permission.
			[Note: article 28(1) of BTS 241/2014.]
7.27	R	(1)	A <i>firm</i> must deduct from the corresponding elements of its <i>own funds</i> any amounts of its <i>own funds instruments</i> to be reduced, redeemed or repurchased as soon as the following conditions are met:
		(a)	where required, the <i>firm</i> has obtained permission from the <i>FCA</i> under article 78 of the <i>UK CRR</i> ; and
		(b)	the reduction, redemption or repurchase is expected to take place with sufficient certainty.
		(2)	For the purposes of (1)(b), a situation in which sufficient certainty will exist includes, but is not limited to, where the <i>firm</i> has publicly announced its intention to redeem, reduce or repurchase an <i>own funds instrument</i> .
			[Note: article 28(2) of BTS 241/2014.]
7.28	R	(1)	This <i>rule</i> applies for the purposes of limitations on redemption applied by any of the following under article 29(2)(b) of the <i>UK CRR</i> or article 78(3) of the <i>UK CRR</i> :
		(a)	a <i>cooperative society</i> ; or
		(b)	a <i>similar institution</i> .
		(2)	A <i>firm</i> may issue <i>common equity tier 1 instruments</i> with a possibility to redeem only where permitted by the applicable law of the <i>United Kingdom</i> (or any part of it) or of a <i>third country</i> .
		(3)	The ability of a <i>firm</i> to limit the redemption of a capital instrument under article 29(2)(b) or article 78(3) of the <i>UK CRR</i> includes:

- (a) the right to defer the redemption; and
 - (b) the right to limit the amount to be redeemed.
- (4) There is no specific limit on the period of time for which a *firm* may defer the redemption of a capital instrument or may limit the amount to be redeemed under (3), but the *firm* must comply with the requirement in (5).
- (5) The extent of the limitations on redemption included in the provisions governing the instruments must be determined by the *firm* on the basis of its prudential situation at any time, having regard in particular to the following non-exhaustive factors:
- (a) the overall financial, liquidity and solvency situation of the *firm*;
 - (b) the amount of the *firm's common equity tier 1 capital, tier 1 capital* and total own funds compared to the *firm's own funds requirement*.
- (6) A *firm* must:
- (a) document any decision to limit the redemption of a capital instrument under this *rule*; and
 - (b) notify the *FCA* of the decision by completing the form in MIFIDPRU 1 Annex 6R and submitting it via the *online notification and application system*, explaining the reasons for the limitation and how the factors in (5) apply.

[**Note:** article 10 and article 11(3) and 11(4) of BTS 241/2014.]

Gains on a sale

7.29

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- (1) This *rule* applies for the purpose of defining the concept of a gain on sale under article 32(1)(a) of the *UK CRR*.
- (2) A gain on sale is any recognised gain on sale for the *firm* that:
 - (a) is recorded as an increase in any element of *own funds*; and
 - (b) is associated with future margin income arising from a sale of securitised assets when they are removed from the *firm's* balance sheet in the context of a securitised transaction.
- (3) The recognised gain on sale must be determined as the difference between the following, as determined by applying the relevant accounting framework:

- (a) the net value of the assets received (including any new asset obtained) less any other asset given or any new liability assumed; and
 - (b) the carrying amount of the securitised assets or of the part derecognised.
- (4) The recognised gain on sale which is associated with the future margin income is the expected future express spread, which is determined as the finance charge collections and other fee income received in respect of the securitised exposures net of costs and expenses.

[Note: article 12 of BTS 241/2014.]

Deductions from own funds

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- (1) Subject to (3), for the purpose of calculating its *common equity tier 1* capital during the year, and irrespective of whether the *firm* closes its financial accounts at the end of each interim period, the *firm* must determine its profit and loss accounts and deduct any resulting losses from common equity tier 1 items under MIFIDPRU 3.3.6R(1) as they arise.
- (2) For the purpose of determining a *firm's* profit or loss accounts under (1), a *firm* must:
- (a) determine its income and expenses under the same process and on the basis of the same accounting standards as those used for the year-end financial report;
 - (b) prudently estimate income and expenses and assign them to the interim period in which they are incurred so that each interim period bears a reasonable amount of the anticipated annual income and expenses; and
 - (c) consider material or non-recurrent events in full and without delay in the interim period during which they arise.
- (3) Where losses for the current financial year have already reduced the *firm's* common equity tier 1 items as a result of an interim or a year-end financial report, a deduction is not required.
- (4) For the purposes of this *rule*, a "financial report" means that the profit and losses have been determined after a closing of the interim or the annual accounts in accordance with the applicable accounting framework.
- (5) This *rule* applies in the same manner to gains and losses included in accumulated other comprehensive income.

[Note: article 13 of BTS 241/2014.]

7.31	R	<p>(1) This <i>rule</i> applies for the purposes of determining the deduction of deferred tax assets that rely on future profitability under MIFIDPRU 3.3.6R(3).</p> <p>(2) The offsetting between deferred tax assets and associated deferred tax liabilities must be done separately for each taxable entity.</p> <p>(3) Associated deferred tax liabilities must be limited to those that arise from the tax law of the same jurisdiction as the deferred tax assets.</p> <p>(4) For the calculation of deferred tax assets and liabilities at consolidated level, a taxable entity includes any number of entities which are members of the same tax group, fiscal consolidation, fiscal unity or consolidated tax return under any applicable law of the <i>United Kingdom</i> or of a <i>third country</i>.</p> <p>(5) The amount of associated deferred tax liabilities which are eligible for offsetting deferred tax assets that rely on future profitability is equal to the difference between the following:</p> <ul style="list-style-type: none"> (a) the amount of deferred tax liabilities as recognised under the applicable accounting framework; (b) the amount of associated deferred tax liabilities arising from intangible assets and from defined benefit pension fund assets.
[Note: article 14 of BTS 241/2014.]		
7.32	R	<p>(1) This <i>rule</i> defines an <i>intermediate entity</i> for the purposes of MIFIDPRU 3 Annex 7.33R to MIFIDPRU 3 Annex 7.40R.</p> <p>(2) An <i>intermediate entity</i> is any of the following entities, where that entity holds capital instruments of a <i>financial sector entity</i>:</p> <ul style="list-style-type: none"> (a) a collective investment undertaking; (b) a pension fund other than a defined benefit pension fund; (c) a defined benefit pension fund, where the <i>firm</i> is supporting the investment risk and where the defined benefit pension fund is not independent from its sponsoring institution in accordance with (4); (d) an entity that is directly or indirectly under the control or under significant influence of one of the following: <ul style="list-style-type: none"> (i) the <i>firm</i> or its <i>subsidiaries</i>; (ii) the <i>parent undertaking</i> of the <i>firm</i> or the

			<i>subsidiaries of that parent undertaking;</i>
	(iii)		the parent <i>financial holding company</i> of the <i>firm</i> or the <i>subsidiaries</i> of that parent <i>financial holding company</i> ;
	(iv)		the parent <i>investment holding company</i> of the <i>firm</i> or the <i>subsidiaries</i> of that parent <i>investment holding company</i> ;
	(v)		the parent <i>mixed-activity holding company</i> of the <i>firm</i> or the <i>subsidiaries</i> of the parent <i>mixed activity holding company</i> ; or
	(vi)		the parent <i>mixed financial holding company</i> of the <i>firm</i> or the <i>subsidiaries</i> of the parent <i>mixed financial holding company</i> ;
	(e)		a special purpose entity;
	(f)		an entity whose activity is to hold <i>financial instruments</i> of <i>financial sector entities</i> ; and
	(g)		an entity that is used for the purpose of circumventing the rules relating to the deduction of indirect and synthetic holdings.
(3)		Except where (2)(g) applies, the following are not <i>intermediate entities</i> :	
	(a)		<i>mixed-activity holding companies</i> ;
	(b)		<i>institutions</i> ;
	(c)		<i>MIFIDPRU investment firms</i> ;

- (d) *insurance undertakings;*
 - (e) *reinsurance undertakings;*
 - (f) *financial sector entities* (other than those in (a) to (e)) that are supervised and required to deduct the following from their regulatory capital:
 - (i) direct and indirect holdings of their own capital instruments; and
 - (ii) holdings of capital instruments of *financial sector entities*.
- (4) For the purposes of (2)(c), a defined benefit pension fund will be deemed to be independent from its sponsoring institution where the following conditions are met:
- (a) the defined benefit pension fund is legally separate from the sponsoring institution and its governance is independent;
 - (b) either:
 - (i) the statutes, the instruments of incorporation and the internal rules of the specific pension fund, as applicable, have been approved by an independent regulator; or
 - (ii) the rules governing the incorporation and functioning of the defined benefit pension fund, as applicable, are established in the applicable law of the relevant country;
 - (c) the trustees or administrators of the defined pension fund have an obligation under applicable national law to:

- (i) act impartially in the best interests of the scheme beneficiaries instead of those of the sponsor;
 - (ii) manage assets of the defined pension fund prudently; and
 - (iii) conform to the restrictions set out in the statutes, the instruments of incorporation and the internal rules of the specific pension fund, as applicable, or statutory or regulatory framework described in point (b); and
 - (d) the statutes or the instruments of incorporation or the rules governing the incorporation and functioning of the defined benefit pension fund referred to in point (b) include restrictions on investments that the defined pension scheme can make in own funds instruments issued by the sponsoring institution.
- (5) Where a defined benefit pension fund referred to in (2)(c) holds own funds instruments of the sponsoring institution, the sponsoring institution must:
- (a) treat that holding as an indirect holding of its own *common equity tier 1 instruments*, *own additional tier 1 instruments* or *own tier 2 instruments*, as applicable; and
 - (b) determine the amount to be deducted from its common equity tier 1 items, additional tier 1 items or tier 2 items (as applicable) in accordance with MIFIDPRU 3 Annex 7.34R and MIFIDPRU 3 Annex 7.39R.

[Note: article 15a of BTS 241/2014.]

7.33	R	(1)	The following financial products are synthetic holdings of capital instruments for the purposes of MIFIDPRU 3.3.6R(5), (7) and (8):
			(a) derivative instruments that have capital instruments of a <i>financial sector entity</i> as their underlying or have the <i>financial sector entity</i> as their reference entity;
			(b) guarantees or credit protection provided to a third party in respect of the third party's investments in a capital instrument of a <i>financial sector entity</i> .
		(2)	The financial products in (1) include the following:
			(a) investments in total return swaps on a capital instrument of a <i>financial sector entity</i> ;
			(b) call options purchased by the firm on a capital instrument of a <i>financial sector entity</i> ;
			(c) put options sold by the firm on a capital instrument of a <i>financial sector entity</i> or any other actual or contingent contractual obligation of the firm to purchase its own funds instruments; and
			(d) investments in forward purchase agreements on a capital instrument of a <i>financial sector entity</i> .
			[Note: article 15b of BTS 241/2014.]
7.34	R	(1)	The amount of indirect holdings that a <i>firm</i> must deduct from its common equity tier 1 items under MIFIDPRU 3.3.6R(5), (7) or (8) must be calculated in one of the following ways:
			(a) according to the default approach set out in MIFIDPRU 3 Annex 7.35R; or
			(b) subject to (3), with the prior permission of the FCA, the structure-based approach in MIFIDPRU 3 Annex 7.36R.
		(2)	To obtain the permission in (1)(b), a <i>firm</i> must:
			(a) complete the application form in MIFIDPRU 1 Annex 5R and submit to the FCA using the <i>online notification and application system</i> ; and
			(b) demonstrate to the satisfaction of the FCA that it would be impractical or excessively complex to apply the default ap-

			proach in MIFIDPRU 3 Annex 7.35R.
		(3)	A <i>firm</i> must not use the structure-based approach to calculate deductions in relation to investments in the <i>intermediate entities</i> in MIFIDPRU 3 Annex 7.32R(2)(d) and (e).
			[Note: article 15c of BTS 241/2014.]
7.35	R	(1)	This <i>rule</i> contains the default approach for the deduction of indirect holdings under MIFIDPRU 3 Annex 7.34R(1)(a).
		(2)	A <i>firm</i> must calculate the amount of indirect holdings of <i>common equity tier 1 instruments</i> to be deducted as follows:
		(a)	where the exposures of all investors to the <i>intermediate entity</i> rank <i>pari passu</i> , the amount shall be equal to the percentage of funding multiplied by the amount of <i>common equity tier 1 instruments</i> of the <i>financial sector entity</i> held by the <i>intermediate entity</i> ;
		(b)	where the exposures of all investors to the <i>intermediate entity</i> do not rank <i>pari passu</i> , the amount shall be equal to the percentage of funding multiplied by the lower of the following amounts:
		(i)	the amount of <i>common equity tier 1 instruments</i> of the <i>financial sector entity</i> held by the <i>intermediate entity</i> ;
		(ii)	the <i>firm's</i> exposure to the <i>intermediate entity</i> together with all other funding provided to the <i>intermediate entity</i> that rank <i>pari passu</i> with the <i>firm's</i> exposure.
		(3)	A <i>firm</i> must use the calculation method in (2)(b) for each tranche of funding that ranks <i>pari passu</i> with the funding provided by the <i>firm</i> .
		(4)	The percentage of funding in (2) is calculated as the <i>firm's</i> exposure to the <i>intermediate entity</i> divided by the sum of the <i>firm's</i> exposure to the <i>intermediate entity</i> and all other exposures to the

			<p><i>intermediate entity</i> that rank pari passu with the <i>firm's</i> exposure.</p>
		(5)	A <i>firm</i> must carry out the calculation in (2) separately for each holding in a <i>financial sector entity</i> held by each <i>intermediate entity</i> .
		(6)	Where a <i>firm</i> holds investments in <i>common equity tier 1 instruments</i> of a <i>financial sector entity</i> indirectly through several <i>intermediate entities</i> , the <i>firm</i> must determine the percentage of funding in (2) by dividing the amount in (a) below by the amount in (b):
			(a) the result of the multiplication of amounts of funding provided by the <i>firm</i> to <i>intermediate entities</i> by the amounts of funding provided by these <i>intermediate entities</i> to subsequent <i>intermediate entities</i> and by amounts of funding provided by these subsequent <i>intermediate entities</i> to the <i>financial sector entity</i> ;
			(b) the result of the multiplication of amounts of capital instruments or other instruments as relevant, issued by each <i>intermediate entity</i> .
		(7)	The percentage of funding referred to in (6) must be calculated separately for each holding in a <i>financial sector entity</i> held by <i>intermediate entities</i> and for each tranche of funding that ranks pari passu with the funding provided by the <i>firm</i> and the subsequent <i>intermediate entities</i> .
			[Note: article 15d of BTS 241/2014.]
7.36	R	(1)	This <i>rule</i> contains the structure-based approach for the deduction of indirect holdings under MIFIDPRU 3 Annex 7.34R(1)(b).
		(2)	The amount to be deducted from <i>common equity tier 1</i> items referred to in MIFIDPRU 3.3.6R(5) shall be equal to the percentage of funding, as defined in MIFIDPRU 3 Annex 7.35R(4), multiplied by the amount of <i>common equity tier 1 instruments</i> of the <i>firm</i> held by the <i>intermediate entity</i> .
		(3)	The amount to be deducted from common equity tier 1 items referred to in MIFIDPRU 3.3.6R(7) and (8) shall be equal to the percentage of funding, as defined in MIFIDPRU 3 Annex 7.35R(4), multiplied by the aggregate amount of <i>common equity tier 1 instruments</i> of <i>financial sector entities</i> held by the <i>intermediate entity</i> .
		(4)	(For the purposes of (2) and (3), a <i>firm</i> must calculate separately for each <i>intermediate entity</i> the aggregate amount of <i>common equity tier 1 instruments</i> of the <i>firm</i> that the <i>intermediate entity</i> holds and the aggregate amount of <i>common equity tier 1 instruments</i> of other <i>financial sector entities</i> that the <i>intermediate entity</i> holds.

- (5) The *firm* must treat the amount of holdings in *common equity tier 1 instruments* of *financial sector entities* calculated in accordance with (3) as a significant investment referred to in article 43 of the *UK CRR* and must deduct the amount in accordance with MIFIDPRU 3.3.6R(8).
- (6) Where investments in *common equity tier 1 instruments* are held indirectly through subsequent or several *intermediate entities*, MIFIDPRU 3 Annex 7.35R(6) and (7) apply.
- (7) Where a *firm* is not able to identify the aggregate amounts that the *intermediate entity* holds in *common equity tier 1 instruments* of the *firm* or in *common equity tier 1 instruments* of *financial sector entities*, the *firm* must estimate the amounts it cannot identify by using the maximum amounts that the *intermediate entity* is able to hold on the basis of its investment mandates.
- (8) Subject to (9), where the *firm* is not able to determine, on the basis of the investment mandate, the maximum amount that the *intermediate entity* holds in *common equity tier 1 instruments* of the institution or in *common equity tier 1 instruments* of *financial sector entities*, the *firm* must treat the amount of funding that it holds in the *intermediate entity* as an investment in its own *common equity tier 1 instruments* and must deduct them in accordance with MIFIDPRU 3.3.6R(5).
- (9) By way of derogation from (8), the *firm* must treat the amount of funding that it holds in the *intermediate entity* as a non-significant investment and must deduct that investment in accordance with MIFIDPRU 3.3.6R(7), where all of the following conditions are met:
- (a) the amounts of funding are less than 0.25% of the *firm's common equity tier 1 capital*;
 - (b) the amounts of funding are less than £10 million;
 - (c) the *firm* cannot reasonably determine the amounts of its own *common equity tier 1 instruments* that the *intermediate entity* holds.
- (10) Where funding to the *intermediate entity* is in the form of units or shares of a CIU, the *firm* may rely on the third parties referred to in article 132(5) of the *UK CRR*, and under the conditions set by that article, to calculate and report the aggregate amounts referred to in (7).

[Note: article 15e of BTS 241/2014.]

7.37

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- (1) The amount of synthetic holdings to be deducted from common equity tier 1 items under MIFIDPRU 3.3.6R(5), (7) and (8) is determined as follows:

			(a)	for holdings in the <i>trading book</i> :
			(i)	for options, the delta equivalent amount of the relevant instruments calculated in accordance with Title IV of Part III of the <i>UK CRR</i> ; and
			(ii)	for any other synthetic holdings, the nominal or notional amount, as applicable; and
			(b)	for holdings that are not in the <i>trading book</i> :
			(i)	for call options, the current market value; and
			(ii)	for any other synthetic holdings, the nominal or notional amount, as applicable.
		(2)	A <i>firm</i> must deduct the synthetic holdings in (1) from the date of signature of the contract between the <i>firm</i> and the counterparty.	
			[Note: article 15g of BTS 241/2014.]	
7.38	R	(1)	For the purposes of MIFIDPRU 3.3.6R(8), in order to assess whether a <i>firm</i> owns more than 10% of the <i>common equity tier 1 instruments</i> issued by a <i>financial sector entity</i> in accordance with article 43(a) of the <i>UK CRR</i> , a <i>firm</i> must add together:	
			(a)	its gross long positions in direct holdings in the <i>financial sector entity</i> ; and
			(b)	its indirect holdings in the <i>financial sector entity</i> , as calculated in accordance with MIFIDPRU 3 Annex 7.32R(2)(d) to (g).
		(2)	A <i>firm</i> must take into account any indirect or synthetic holdings when assessing whether the conditions in article 43(b) or (c) of the <i>UK CRR</i> are met.	
7.39	R	(1)	The methodology in MIFIDPRU 3 Annex 7.32R to MIFIDPRU 3 Annex 7.38R also applies with the modifications in (2) for the purposes of the requirements relating to:	

			(a)	the deductions of holdings in <i>additional tier 1 instruments</i> in article 56(a), (c) and (d) of the <i>UK CRR</i> ; and
			(b)	the deductions of holdings in <i>tier 2 instruments</i> in article 66(a), (c) and (d) of the <i>UK CRR</i> .
		(2)	When applying MIFIDPRU 3 Annex 7.32R to MIFIDPRU 3 Annex 7.38R:	
			(a)	for the purpose in (1)(a), references to “common equity tier 1” are references to “additional tier 1”; and
			(b)	for the purpose in (1)(b), references to “common equity tier 1” are references to “tier 2”.
		[Note: article 15h of BTS 241/2014.]		
7.40	R	(1)	Subject to (2) and (3), where an <i>intermediate entity</i> holds <i>common equity tier 1 instruments</i> , <i>additional tier 1 instruments</i> or <i>tier 2 instruments</i> of <i>financial sector entities</i> :	
			(a)	the <i>common equity tier 1 instruments</i> must be deducted first;
			(b)	the <i>additional tier 1 instruments</i> must be deducted second; and
			(c)	the <i>tier 2 instruments</i> must be deducted last.
		(2)	Where the intermediate entity holds <i>own funds instruments</i> of the <i>firm</i> , when applying (1), the <i>firm</i> must deduct the holdings of the <i>firm’s own funds instruments</i> first.	
		(3)	Where a <i>firm</i> holds capital instruments of <i>financial sector entities</i> indirectly, the amount to be deducted from the <i>firm’s own funds</i> is limited to the lower of the following amounts:	
			(a)	the total funding provided by the <i>firm</i> to the <i>intermediate entity</i> ; or
			(b)	the amount of <i>own funds instruments</i> held by the <i>intermediate entity</i> in the <i>financial sector entity</i> .
		[Note: article 15i of BTS 241/2014.]		
7.41	R	(1)	This <i>rule</i> applies for the purposes of the deduction of foreseeable tax charges under MIFIDPRU 3.3.6R(10) and article 56(f) of the <i>UK CRR</i> .	
		(2)	A <i>firm</i> may proceed on the basis that foreseeable tax charges have already been taken into account, and therefore no further deduction is required, where:	
			(a)	the <i>firm</i> applies an accounting framework and accounting policies that provide for the full recognition of current and de

- ferred tax liabilities related to transactions and other events recognised in the balance sheet or the profit and loss account; and
- (b) all other necessary deductions have been made under applicable accounting standards or other adjustments.
- (3) Where the *firm* is calculating its *common equity tier 1 capital* on the basis of financial statements made in accordance with *UK-adopted international accounting standards*, the conditions in (2) are deemed to be met.
- (4) Where the *firm* does not meet, and has not been deemed to meet, the conditions in (2), it must decrease its common equity tier 1 items by the estimated amount of current and deferred tax charges not yet recognised in:
- (a) the balance sheet profit and loss account related to transactions; and
- (b) other events in the balance sheet profit and loss account.
- (5) The estimated amount of current and deferred tax charges in (4) must be determined using an approach equivalent to the one provided by *UK-adopted international accounting standards*.
- (6) The estimated amount of deferred tax charges in (4) may not be netted against deferred tax assets that are not recognised in the financial statements.

[Note: article 16 of BTS 241/2014.]

Deduction of holdings of capital instruments issued by financial institutions

7.42 R

Subject to MIFIDPRU 3 Annex 7.43R, for the purposes of article 36(3) of the *UK CRR*, a *firm* must deduct its holdings of capital instruments of *financial institutions* as follows:

- (1) the *firm* must deduct from its common equity tier 1 items any instruments of the *financial institution* that meet the following conditions:
- (a) the instruments qualify as capital under the company law applicable to the *financial institution*; and
- (b) where the *financial institution* is subject to solvency requirements, the instruments are included in the highest quality tier of regulatory own funds without any limits; or
- (c) where the *financial institution* is not subject to solvency requirements, the instruments:
- (i) are perpetual;

- (2) the *firm* must deduct its holdings of subordinated capital instruments of the *financial institution* on the following basis:
- (a) where the subordinated instruments absorb losses on a going-concern basis (including where the issuer has the discretion to cancel coupon payments), the *firm* must:
 - (i) absorb the first and proportionately greatest share of losses as they occur;
 - (ii) rank below all other claims in the event of insolvency and liquidation; and
 - (iii) have no preferential or pre-determined distributions;
 - (b) the *firm* must deduct all other subordinated instruments not included in (a) on the following basis:
 - (i) deduct them from the *firm's* additional tier 1 items; and
 - (ii) if the value of the subordinated instruments exceeds the value of the *firm's* additional tier 1 capital, deduct the excess amount from the *firm's* common equity tier 1 items;
 - (i) the *firm* must first deduct them from the *firm's* tier 2 items; and
 - (ii) if the value of the subordinated instruments exceeds the value of the *firm's* tier 2

				capital, the firm must deduct the excess amount from the <i>firm's</i> additional tier 1 items; and
			(iii)	if the additional tier 1 items are not sufficient, the firm must deduct the remaining excess amount from the <i>firm's</i> common equity tier 1 items;
		(3)		the <i>firm</i> must deduct its holdings of any other instruments of the <i>financial institution</i> from the <i>firm's</i> common equity tier 1 items where:
			(a)	the instruments are included in the <i>financial institution's</i> own funds under the prudential framework applicable to the <i>financial institution</i> ; and
			(b)	the instruments do not meet the conditions to be deducted under (a) or (b).
				[Note: article 36(3) of the UK CRR and article 17(1) of BTS 241/2014.]
7.43	R	(1)		In the cases set out in (2):
			(a)	the deductions in MIFIDPRU 3 Annex 7.42R do not apply; and
			(b)	a <i>firm</i> must instead apply the deductions in MIFIDPRU 3 and the UK CRR (as applied by MIFIDPRU 3) for holdings of capital instruments based on the approach that would apply to the same component of capital for which those instruments would qualify if they were issued by the <i>firm</i> itself.
		(2)		The relevant cases are where the <i>financial institution</i> is:
			(a)	a UK AIFM;
			(b)	a management company;
			(c)	an authorised payment institution;
			(d)	an authorised electronic money institution; or
			(e)	an entity that is authorised and supervised by an overseas regulator, provided that the <i>firm</i> applying the deduction is able to

			apply the approach in (1)(b) in relation to that entity.
		[Note: article 17(2) and 17(3) of BTS 241/2014.]	
7.44	R	(1)	This rule applies to a firm's holdings of capital instruments in a <i>third country insurance undertaking</i> or a <i>third country reinsurance undertaking</i> where either of the following conditions are met:
		(a)	the <i>third country insurance undertaking</i> or <i>third country reinsurance undertaking</i> is subject to a solvency regime that:
		(i)	before <i>IP completion day</i> , had been assessed as non-equivalent to that laid down in Title I, Chapter VI of the <i>Solvency II Directive</i> according to the procedure set out in article 227 of that directive; and
		(ii)	has not subsequently been subject to a determination of equivalence by HM Treasury under article 379A of the <i>Solvency II Delegated Regulation (EU) 2015/35</i> or by the PRA under regulation 19 of the <i>Solvency 2 Regulations 2015</i> ; or
		(b)	the <i>third country insurance undertaking</i> or <i>third country reinsurance undertaking</i> is subject to a solvency regime that has not been assessed for equivalence:
		(i)	before <i>IP completion day</i> , in accordance with the procedure in (a)(i); and

- (ii) on or after *IP completion day*, in accordance with either of the procedures in (a)(ii).
- (2) Where this *rule* applies, a *firm* must deduct holdings in the capital instruments of the *third country insurance undertaking* or *third country reinsurance undertaking* in (1) as follows:
- (a) all instruments qualifying as capital under the company law applicable to the *third country insurance undertaking* or *third country reinsurance undertaking* that issued them, and which are included in the highest quality tier of regulatory own funds without any limits under the *third country* regime, must be deducted from the *firm's* common equity tier 1 items;
- (b) for subordinated instruments absorbing losses on a going-concern basis (including where the issuer has discretion to cancel coupon payments):
- (i) the amount must first be deducted from the *firm's additional tier 1* items; and
- (ii) where the amount of the subordinated instruments exceeds the amount of the *firm's additional tier 1 capital*, the excess amount must be deducted from the *firm's* common equity tier 1 items;
- (c) for any subordinated instruments other than those in (b):
- (i) the amount must first be deducted from the *firm's* tier 2 items;
- (ii) where the amount of those subor-

minated instruments exceeds the amount of the *firm's tier 2 capital*, the excess amount must be deducted from the *firm's additional tier 1 items*; and

(iii)

where the excess amount exceeds the amount of the *firm's additional tier 1 capital*, the remaining excess amount must be deducted from the *firm's common equity tier 1 items*;

(d)

any holdings of other instruments of the *third country insurance undertaking* or *third country reinsurance undertaking* must be deducted from the *firm's common equity tier 1 items* where:

(i)

the *third country insurance undertaking* or *third country reinsurance undertaking* is subject to prudential solvency requirements;

(ii)

the instruments are included in the *third country insurance undertaking* or *third country reinsurance undertaking's* own funds under the applicable solvency regime; and

(iii)

the instruments do not meet the conditions to be

			deducted under (a) to (c).
		[Note: article 18(1) of BTS 241/2014.]	
7.45	R	(1)	<p>This <i>rule</i> applies to a <i>firm's</i> holdings of capital instruments in a <i>third country insurance undertaking</i> or a <i>third country reinsurance undertaking</i> where the <i>third country</i> solvency regime, including requirements on own funds, applicable to the <i>third country insurance undertaking</i> or <i>third country reinsurance undertaking</i> meets either of the following conditions:</p> <p>(a) before <i>IP completion day</i>, it has been assessed as equivalent to the requirements laid down in Title I, Chapter VI of the <i>Solvency II Directive</i>, according to the procedure set out in article 227 of that directive, and that assessment has not been revoked by HM Treasury on or after <i>IP completion day</i>; or</p> <p>(b) on or after <i>IP completion day</i>, it has been assessed as equivalent to the requirements laid down in the law of the <i>United Kingdom</i> that implemented Title I, Chapter VI of the <i>Solvency II Directive</i>, according to the procedure set out in article 379A of the <i>Solvency II Delegated Regulation (EU) 2015/35</i>, or has been assessed as equivalent by the <i>PRA</i> according to the procedure in regulation 19 of the <i>Solvency 2 Regulations 2015</i>.</p>
		(2)	<p>Where this <i>rule</i> applies, a <i>firm</i> must:</p> <p>(a) treat the relevant holdings of capital instruments as holdings of the capital instruments of insurance undertakings or reinsurance undertakings (as each is defined in section 417(1) of the Act); and</p> <p>(b) apply the deductions in article 44(b), article 58(b) and article 68(b) of the UK CRR, as applicable, to the holdings in (a).</p>
		[Note: article 18(2) and (3) of BTS 241/2014.]	
7.46	R		<p>A <i>firm</i> must deduct holdings of capital instruments of undertakings falling within article 4(1)(27)(k) of the UK CRR as follows:</p> <p>(1) a <i>firm</i> must deduct instruments meeting the following conditions from the <i>firm's common equity tier 1 capital</i>:</p> <p>(a) the instruments qualify as capital under the company law applicable to the <i>undertaking</i> that issued them; and</p>

- (b) the instruments are included in the highest quality tier of regulatory own funds of the *undertaking* that issued them without any limits;
- (2) a *firm* must deduct any subordinated instruments that absorb losses on a going-concern basis (including where the issuer has discretion to cancel coupon payments) on the following basis:
- (a) first, the instruments must be deducted from the *firm's* additional tier 1 items; and
- (b) if the amount of the subordinated instruments exceeds the amount of the *firm's additional tier 1 capital*, the excess amount must be deducted from the *firm's* common equity tier 1 items;
- (3) a *firm* must deduct any subordinated instruments other than those in (2) on the following basis:
- (a) first, the instruments must be deducted from the *firm's* tier 2 items;
- (b) if the amount of the subordinated instruments exceeds the amount of the *firm's tier 2 capital*, the excess amount must be deducted from the *firm's* additional tier 1 items; and
- (c) if the excess amount exceeds the *firm's additional tier 1 capital*, the remaining excess amount must be deducted from the *firm's* common equity tier 1 items; and
- (4) a *firm* must deduct any other holdings of instruments issued by the *undertaking* from the *firm's common equity tier 1 capital* where the instruments:
- (a) are included in the *undertaking's* own funds under the solvency regime applicable to that *undertaking*; and
- (b) do not fall within (1) to (3) above.

[Note: article 19 of BTS 241/2014.]

Conversion and write-down of additional tier 1 instruments

- 7.47 R (1) This *rule* applies for the purposes of:
- (a) any write-down of the principal amount of an *additional tier 1 instrument* under article 52(1)(n) of the *UK CRR*; and

- (b) any subsequent write-up of the principal amount of an *additional tier 1 instrument* for the purposes of article 52(2)(c) of the *UK CRR*.
- (2) The write-down of the principal amount of an *additional tier 1 instrument* of a *firm* must apply on a pro rata basis to all holders of *additional tier 1 instruments* that include a similar write-down mechanism and an identical trigger level.
- (3) For a write-down to be considered temporary, all of the following conditions must be met:
- (a) any distributions payable after a write-down must be based on the reduced amount of the principal;
- (b) any write-up must be based on profits after the *firm* has taken a formal decision confirming the final profits;
- (c) any write-up of the instrument or payment of coupons on the reduced amount of the principal must be operated at the full discretion of the *firm*, subject to the constraints arising from (d) to (f) below, and there must be no obligation for the *firm* to operate or accelerate a write-up under specific circumstances;
- (d) a write-up must be operated on a pro rata basis among similar *additional tier 1 instruments* of the *firm* that have been subject to a write-down;
- (e) the maximum amount to be attributed to the sum of the write-up of the *additional tier 1 instruments*, together with the payment of coupons on the reduced amount of the principal of *additional tier 1 instruments*, must be calculated according to the following formula, which must be applied at the time that the write-up operates: $M = P \times A/T$ where: M = the maximum amount to be attributed to the write-up, together with the payment of coupons on the reduced amount of principal; P = the profit of the *firm*; A = the sum of the nominal value (before write-down) of all *additional tier instruments* of the *firm* that have been subject to a write-down; and T = the tier 1 capital of the firm;

			(f)	the sum of any write-up amounts and payments of coupons on the reduced amount of the principal of the <i>additional tier 1 instruments</i> must be treated as a payment that reduces the <i>common equity tier 1 capital</i> of the <i>firm</i> .
			[Note: article 21 of BTS 241/2014.]	
7.48	R	(1)	This <i>rule</i> applies for the purposes of specifying the procedures and timing for determining that a trigger event has occurred in relation to an <i>additional tier 1 instrument</i> under article 52(1)(n) of the <i>UK CRR</i> .	
		(2)	Where a <i>firm</i> establishes that its <i>common equity tier 1 capital</i> has fallen below the level of the trigger event of an <i>additional tier 1 instrument</i> :	
			(a)	the <i>management body</i> or any other <i>relevant body</i> of the <i>firm</i> must, without delay, determine that a trigger event has occurred; and
			(b)	the <i>firm</i> is under an irrevocable obligation to write-down or convert the <i>additional tier 1 instrument</i> .
		(3)	The amount to be written down or converted must be determined as soon as possible and in any case, within a maximum period of one <i>month</i> from the time that the <i>firm</i> has determined that a trigger event had occurred under (2).	
		(4)	If the terms of the <i>additional tier 1 instrument</i> require an independent review of the amount to be written down or converted, the <i>management body</i> or other <i>relevant body</i> of a <i>firm</i> must ensure that the review:	
			(a)	is commenced immediately;
			(b)	is completed as soon as possible; and
			(c)	does not create impediments to the <i>firm</i> writing-down or converting the <i>additional tier 1 instrument</i> or to meeting the requirement in (3).
			[Note: article 22(1), (2) and (4) of BTS 241/2014.]	
7.49	G		In appropriate cases, the <i>FCA</i> may exercise its powers under:	
		(1)	section 55L of the <i>Act</i> to impose a <i>requirement</i> on a <i>firm</i> to determine the required write-down or conversion amount more quickly than the one- <i>month</i> period in MIFIDPRU 3 Annex 7.48R(3); or	
		(2)	section 166 of the <i>Act</i> to require the <i>firm</i> to commission an independent review of the amount to be written down or converted for the purposes of MIFIDPRU 3 Annex 7.48R.	
			[Note: article 22(3) and (4) of BTS 241/2014.]	

7.50	R		<p>For the purposes of article 52(1)(o) of the <i>UK CRR</i>, features that could hinder the recapitalisation of a <i>firm</i> include provisions that require the <i>firm</i> to compensate existing holders of capital instruments where a new capital instrument is issued.</p> <p>[Note: article 23 of BTS 241/2014.]</p>
		Incentives to redeem	
7.51	R	(1)	<p>For the purposes of article 52(1)(g) and article 63(h) of the <i>UK CRR</i>, an incentive to redeem means any feature that provides, at the date of issuance of a capital instrument, an expectation that the capital instrument is likely to be redeemed.</p>
		(2)	<p>An incentive to redeem under (1) includes:</p>
		(a)	a call option combined with an increase in the credit spread of the instrument if the call is not exercised;
		(b)	a call option combined with a requirement or an investor option to convert the instrument into a <i>common equity tier 1 instrument</i> where the call is not exercised;
		(c)	a call option combined with a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate minus the swap rate;
		(d)	a call option combined with an increase of the redemption amount in the future;
		(e)	a remarketing option combined with an increase in the credit spread of the instrument or a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate minus the swap rate where the instrument is not remarketed; and
		(f)	a marketing of the instrument in a way which suggests to investors that the instrument will be called.
			[Note: article 20 of BTS 241/2014.]
		Use of special purpose vehicles for indirect issuance of own funds	
7.52	R	(1)	This <i>rule</i> applies for the purposes of article 52(1)(p) and article 63(n) of the <i>UK CRR</i> .
		(2)	<p>Where the <i>firm</i> issues a capital instrument that is subscribed for by a special purpose entity, the capital instrument must not be recognised by the <i>firm</i> as capital of a higher quality than the lowest quality of:</p>
		(a)	the capital issued to the special purpose entity; and

- (b) the capital issued to third parties by the special purpose entity.
- (3) Where another entity (“A”) within the same *consolidated situation* as the *firm* issues a capital instrument that is subscribed for by a special purpose entity, the capital instrument must not be recognised by A as capital of a higher quality than the lowest quality of:
- (a) the capital issued to the special purpose entity; and
- (b) the capital issued to third parties by the special purpose entity.
- (4) The requirement in (2) also applies on an equivalent basis to a *UK parent entity* for the purposes of determining its consolidated *own funds*, with the reference to the “*firm*” being read as a reference to the *UK parent entity*.
- (5) The rights of the holders of instruments issued by a special purpose entity in (2), (3) or (4) must be no more favourable than if the instrument was issued directly by the *firm*, A or the *UK parent entity*, as applicable.

[Note: article 24 of BTS 241/2014.]

Distributions on own funds instruments

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- (1) This *rule* contains the definition of a broad market index for the purpose of article 73(5) of the *UK CRR*.
- (2) An interest rate index is a broad market index if it fulfils all of the following conditions:
- (a) it is used to set interbank lending rates in one or more currencies;
- (b) it is used as a reference rate for floating rate debt issued by the *firm* in the same currency, where applicable;
- (c) it is calculated as an average rate by a body independent of the *institutions* or *MIFIDPRU investment firms* that are contributing to the index (a “panel”);
- (d) each of the rates set under the index is based on quotes submitted by a panel of *institutions* or *MIFIDPRU investment firms* active in that interbank market; and
- (e) the composition of the panel referred to in point (c) ensures a sufficient level of representativeness of *institutions* or *MIFIDPRU investment firms* present in the *United Kingdom*.

- (3) For the purposes of (2)(e), a sufficient level of representativeness will be deemed to exist in either of the following cases:
- (a) where the panel in (2)(c) includes at least six different contributors before any discount of quotes is applied for the purposes of setting the rate; or
 - (b) where both of the following conditions are met:
 - (i) the panel in (2)(c) includes at least four different contributors before any discount of quotes is applied for the purposes of setting the rate; and
 - (ii) the contributors to the panel in (2)(c) represent at least 60% of the related market.
- (4) The related market referred to in (3)(b)(ii) is calculated by dividing the amount in (a) by the amount in (b):
- (a) the sum of the assets and liabilities of the effective contributors to the panel in the domestic currency;
 - (b) the sum of assets and liabilities in the domestic currency of *credit institutions* in the United Kingdom, including branches established in the *United Kingdom*, and money market funds in the *United Kingdom*.
- (5) A stock index is deemed to be a broad market index where it is appropriately diversified in accordance with article 344 of the *UK CRR*.

[Note: article 24a of BTS 241/2014.]

Indirect holdings arising from index holdings

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- (1) This rule applies for the purpose of determining whether an estimate is sufficiently conservative for the purposes of article 76(2) of the *UK CRR*.
- (2) An estimate is sufficiently conservative where either of the following conditions are met:
 - (a) the investment mandate of the index specifies that a capital instrument of a *financial sector entity* that is part of the index

cannot exceed a maximum percentage of that index and the *firm* uses that percentage as an estimate of the value of the holdings that must be deducted from:

- (i) its *common equity tier 1 capital, additional tier 1 capital or tier 2 capital* (as applicable) in accordance with MIFIDPRU 3 Annex 7.43R(1)(b); or
- (ii) its *common equity tier 1 capital* where the *firm* cannot determine the precise nature of the holding; or

(b) if the *firm* is unable to determine the maximum percentage referred to in (a) and the index includes capital instruments of *financial sector entities* (as evidenced by its investment mandate or other relevant information), the *firm* deducts the full amount of the index holdings from:

- (i) its *common equity tier 1 capital, additional tier 1 capital or tier 2 capital* (as applicable) in accordance with MIFIDPRU 3 Annex 7.43R(1)(b); or
- (ii) its *common equity tier 1 capital* where the *firm* cannot determine the precise nature of the holding.

(3) For the purposes of (2):

(a) an indirect holding arising from an index holding consists of the proportion of the index invested in the *common equity tier 1 instruments, additional*

				<p><i>tier 1 instruments and tier 2 instruments of financial sector entities included in the index; and</i></p> <p>(b) an index includes, but is not limited to, index funds, equity or bond indices or any other scheme where the underlying instrument is a capital instrument issued by a <i>financial sector entity</i>.</p>
				[Note: article 25 of BTS 241/2014.]
7.55	G	(1)		Under article 76(3) of the <i>UK CRR</i> , a <i>firm</i> may apply for permission to use the conservative estimate approach in article 76(2) of the <i>UK CRR</i> (as supplemented by MIFIDPRU 3 Annex 7.54R) where the <i>firm</i> has demonstrated that it would be operationally burdensome to monitor its underlying exposure to the items referred to in articles 76(2)(a) and (b) of the <i>UK CRR</i> .
		(2)		For these purposes, “operationally burdensome” means situations in which the look-through approach to capital holdings in <i>financial sector entities</i> on an ongoing basis would be unjustified. When considering whether a situation is operationally burdensome, the <i>FCA</i> will take into account whether the <i>firm’s</i> index holding:
			(a)	is immaterial when compared with the <i>firm’s own funds</i> ; and
			(b)	has a short holding period or is highly liquid in nature.
				[Note: article 26 of BTS 241/2014.]
				Temporary waiver of deduction from own funds
7.56	G	(1)		In accordance with article 79 of the <i>UK CRR</i> (as applied by MIFIDPRU 3.6.1R), the <i>FCA</i> may waive the requirement for a <i>firm</i> to deduct holdings of capital instruments or subordinated loans that the <i>firm</i> has granted that qualify as <i>common equity tier 1 instruments, additional tier 1 instruments or tier 1 instruments of a financial sector entity</i> where:
			(a)	the <i>firm</i> will hold the capital instruments or subordinated loans only temporarily; and
			(b)	the <i>FCA</i> considers that the holdings are for the purposes of a financial assistance operational designed to reorganise and save the <i>financial sector entity</i> .
		(2)		A <i>firm</i> that wishes to apply for a waiver for the purposes of article 79 of the <i>UK CRR</i> should apply for a waiver of MIFIDPRU 3.6.1R (insofar as it applies that article) under section 138A of the Act.
		(3)		When considering an application for a waiver under (2), the <i>FCA</i> considers that the conditions for a waiver will be unlikely to be met where:

- (a) the duration of the waiver exceeds the timeframe envisaged under the financial assistance operation plan or exceeds five years;
- (b) the waiver is not limited to new holdings of instruments in the *financial sector entity*;
- (c) the financial assistance operation has not been discussed with and, where necessary, approved by the *FCA*; or
- (d) the financial assistance operation does not clearly state phases, timing and objectives and does not specify the interaction between the *firm's* temporary holdings and the broader financial assistance operation.

[Note: article 79 of the UK CRR and article 33 of BTS 241/2014.]

Own funds instruments issued by special purpose entities

- 7.57 G (1) Under article 83(1) of the *UK CRR* (as applied by MIFIDPRU 2.5.10R(1)), a *UK parent entity* may include *additional tier 1 instruments, tier 2 instruments* issued by a special purpose entity, and their related share premium accounts, in qualifying *own funds* under Title II of Part Two only where the conditions in article 83(1) are met.
- (2) Under article 83(1)(d) of the *UK CRR*, one of the conditions is that the only asset of the special purpose entity is its investment in the *own funds* of the *parent undertaking* or a *subsidiary* of that *parent undertaking* that is included within the same prudential consolidation group.
- (3) Article 83 of the *UK CRR* permits the *FCA* to waive the condition in article 83(1)(d) where the assets of the relevant special purpose entity (other than its investment in the *own funds* of the *parent undertaking* or *subsidiary*) are minimal and insignificant for that entity.
- (4) The *FCA* expects that a firm that wishes to obtain the waiver in (3) will make an application under section 138A of the *Act* to waive the application of MIFIDPRU 2.5.10R(1), insofar as it applies the condition in article 83(1)(d) of the *UK CRR*. When considering any such application, the *FCA* will normally consider, among other factors, whether the assets of the special purpose entity (other than the investments in the *own funds* of the *parent undertaking* or *subsidiary* within the same prudential consolidation group):
- (a) are limited to cash assets dedicated to the payment of coupons and redemption of the *own funds instruments* that are due; and

			(b)	are no higher than 0.5% of the average total assets of the special purpose entity over the last three years.
		(5)		The <i>FCA</i> considers that it may be appropriate to grant a <i>firm</i> a waiver when a special purpose entity has a higher percentage of assets than that specified in (4)(b) provided that:
			(a)	the higher percentage is necessary exclusively to cover the running costs of the special purpose entity; and
			(b)	the corresponding nominal amount of those assets does not exceed £500,000.
				[Note: article 83(1) of the UK CRR and article 34 of BTS 241/2014.]
7.58	R	(1)		For the purpose of the sub-consolidation calculation required under articles 84(2), 85(2) and 87(2) of the UK CRR, the qualifying minority interests of a <i>subsidiary</i> referred to in article 81 of the UK CRR (“X”) that is itself a <i>parent undertaking</i> of an entity referred to in article 81(1) of the UK CRR must be calculated in accordance with the remainder of this <i>rule</i> .
		(2)		Where X complies with either of the following on the basis of its <i>consolidated situation</i> , the treatment in (3) applies:
			(a)	MIFIDPRU 4 and 5 ; or
			(b)	Part Three of the UK CRR.
		(3)		The relevant treatment in (2) is as follows:
			(a)	the <i>common equity tier 1 capital</i> of X on a <i>consolidated basis</i> (as referred to in article 84(1)(a) of the UK CRR) shall be taken to include the eligible minority interests that arise from X’s own <i>subsidiaries</i> calculated under article 84 of the UK CRR and MIFIDPRU 3 Annex 7R;
			(b)	for the purpose of the sub-consolidation calculation, the amount of <i>common equity tier 1 capital</i> required under article 84(1)(a)(i) of the UK CRR is the amount required to meet X’s <i>common equity tier 1 capital</i> requirements at the level of its <i>consolidated situation</i> calculated in accordance with article 84(1)(a) of the UK CRR:
			(c)	for the purpose of the sub-consolidation calculation, the specific own funds requirements in article 84(1)(a)(i) of the UK CRR are:

(i) any amount in excess of X's *own funds requirement* that X is required to hold to meet its *own funds threshold requirement*; or

(ii) any amount specified by the PRA under regulation 34 of the Capital Requirements Regulations 2013 in relation to X;

(d) the amount of consolidated *common equity tier 1 capital* required under article 84(1)(a)(ii) of the *UK CRR* is the contribution of X on the basis of its *consolidated situation* to the common equity tier 1 own funds requirements of the *firm* for which the eligible minority interests are calculated on a consolidated basis ("Y");

(e) for the purpose of calculating the contribution of X under (d):

(i) all intra-group transactions between *undertakings* included in the scope of prudential consolidation of Y must be eliminated; and

(ii) X must not include capital requirements arising from its *subsidiaries* that are not included in the scope of prudential consolidation of Y.

(4) Where a *UK parent entity* has an intermediate *subsidiary* that meets the following conditions, the treatment in (5) applies:

(a) the intermediate *subsidiary* is not referred to in article 81(1) of the *UK CRR*; and

- (b) the intermediate subsidiary has *subsidiaries* that are referred to in article 81(1) of the *UK CRR*.
- (5) Where (4) applies, the *UK parent entity*:
- (a) may include in its *common equity tier 1 capital* the amount of minority interests arising from those *subsidiaries* calculated in accordance with article 84(1) of the *UK CRR*; but
- (b) must not include in its *common equity tier 1 capital* any minority interests arising from a *subsidiary* that is not referred to in article 81(1) of the *UK CRR*.
- (6) This *rule* applies on an equivalent basis to the calculation of:
- (a) qualifying *tier 1 instruments* under article 85 of the *UK CRR*, in which case references to “common equity tier 1” in this *rule* are references to “tier 1”; and
- (b) qualifying own funds under article 87 of the *UK CRR*, in which case references to “common equity tier 1” in this *rule* are references to “own funds”.

Prudent valuation and additional valuation adjustments

Application and purpose			
8.1	R	(1)	This annex applies for the purposes of calculating additional valuation adjustments under article 34 of the <i>UK CRR</i> (as applied by MIFIDPRU 3.3.1AR).
		(2)	Any reference to the <i>UK CRR</i> in this annex is to the <i>UK CRR</i> as applied and modified by MIFIDPRU 3.3.1R.
8.2	G	(1)	Under article 34 of the <i>UK CRR</i> , a <i>firm</i> must apply the requirements of article 105 of the <i>UK CRR</i> to the <i>firm's</i> assets measured at fair value when calculating the amount of its <i>own funds</i> .
		(2)	Under MIFIDPRU 3.3.1AR, a <i>firm</i> is only required to apply article 34 of the <i>UK CRR</i> to positions held within its <i>trading book</i> .
Sources of market data			
8.3	R	(1)	Where a <i>firm</i> calculates an AVA based on market data, it must consider the same range of market data as the data used in the independent price verification process referred to in article 105(8) of the <i>UK CRR</i> , subject to the adjustments in this <i>rule</i> .
		(2)	A <i>firm</i> must consider the full range of available and reliable market data sources to determine a prudent value, including each of the following to the extent relevant: <ol style="list-style-type: none"> (a) exchange prices in a liquid market; (b) trades in the <i>financial instrument</i> or a very similar instrument, either from the <i>firm's</i> own records or, where available, trades from across the market; (c) tradable quotes from brokers and other market participants; (d) consensus service data; (e) indicative broker quotes; and (f) counterparty collateral valuations.
[Note: article 3 of BTS 2016/101.]			
Determination of AVAs			
8.4	R	(1)	A <i>firm</i> must calculate the value of assets for which the <i>firm</i> must determine AVAs in accordance with this <i>rule</i> .

(2) The value in (1) is the sum of the absolute value of fair-valued assets and liabilities, as stated in the *firm's* financial statements in accordance with the applicable accounting framework, modified as follows:

(a) exactly matching offsetting fair-valued and liabilities must be excluded; and

(b) where a change in the accounting valuation of fair-valued assets and liabilities would:

(i) only be partially reflected in *common equity tier 1 capital*, the value of those assets or liabilities must only be included in proportion to the impact of the relevant valuation change on *common equity tier 1 capital*; or

(ii) have no impact on *common equity tier 1 capital*, the value of those assets or liabilities must be excluded.

[Note: article 4 of BTS 2016/101.]

8.5 R A *firm's* total AVAs are 0.1% of the sum of the assets calculated under MIFIDPRU 3 Annex 8.4R(1).

[Note: articles 5 and 6 of BTS 2016/101.]

Documentation, systems and controls

8.6 R A *firm* must appropriately document its prudent valuation methodology and its policies on the following:

- (1) the range of methodologies for quantifying AVAs for each valuation position;
- (2) the hierarchy of methodologies for each asset class, product, or *valuation position*;
- (3) the hierarchy of market data sources used in the AVA methodology;
- (4) the required characteristics of market data to justify a zero AVA for each asset class, product, or *valuation position*; and
- (5) the fair-valued assets and liabilities for which a change in accounting valuation has a partial or no impact on *common equity tier 1 capital* according to MIFIDPRU 3 Annex 8.4R(2)(b).

		[Note: article 18(1) of BTS 2016/101.]
8.7	R	The <i>firm</i> must ensure that the documentation and policies in MIFID-PRU 3 Annex 8.6R are: <ol style="list-style-type: none"> (1) reviewed at least annually; and (2) approved by the firm's senior management following each review. [Note: article 18(3) of BTS 2016/101.]
8.8	R	A <i>firm</i> must: <ol style="list-style-type: none"> (1) maintain records to allow the calculation of AVAs at <i>valuation exposure</i> level to be analysed; and (2) ensure that the senior management of the <i>firm</i> are provided with information from the AVA calculation process to permit them to understand the level of valuation uncertainty on the <i>firm's</i> portfolio of fair-valued positions. [Note: article 18(3) of BTS 2016/101.]
Systems and controls requirements		
8.9	R	A <i>firm</i> must ensure that AVAs are authorised and subsequently monitored by an independent control function. [Note: article 19(1) of BTS 2016/101.]
8.10	R	(1) A <i>firm</i> must have: <ol style="list-style-type: none"> (a) effective controls related to the governance of all fair-valued positions; and (b) adequate resources to implement the controls in (a) and ensure robust valuation processes even during a stressed period. (2) The controls and processes in (1) must include the following: <ol style="list-style-type: none"> (a) a review of the performance of the <i>firm's</i> valuation model at least annually; (b) approval by senior management of all significant changes to valuation policies; (c) a clear statement of the <i>firm's</i> risk appetite for exposure to positions subject to valuation uncertainty, which must be monitored at an aggregate <i>firm-wide</i> level; (d) independence in the valuation process between risk-taking and internal control functions; and (e) a comprehensive internal audit process relating to valuation processes and controls. [Note: article 19(2) of BTS 2016/101.]
8.11	R	(1) A <i>firm</i> must:

- (a) have effective and consistently applied controls relating to the valuation process for all fair-valued positions; and
- (b) ensure that the controls in (a) are subject to regular internal audit review.
- (2) The controls in (1) must include the following:
- (a) a precisely defined *firm-wide* product inventory, ensuring that every *valuation position* is uniquely mapped to a product definition;
- (b) valuation methodologies for each product in the inventory covering:
- (i) the choice and calibration of model;
 - (ii) fair value adjustments;
 - (iii) independent price verification;
 - (iv) AVAs;
 - (v) the methodologies applicable to the product; and
 - (vi) the measurement of valuation uncertainty.
- (c) a validation process ensuring that, for each product, both the risk-taking and relevant control functions approve the product-level methodologies described in point (b) and certify that they reflect the actual practice for every *valuation position* mapped to the product;
- (d) defined thresholds based on observed market data for determining when valuation models are no longer sufficiently robust;
- (e) a formal independent price verification process based on prices independent from the relevant trading desk;
- (f) a new product approval process referencing the product inventory and involving all internal stakeholders relevant to risk measurement, risk control, financial reporting and the assignment and verification of valu

(g)

ations of *financial instruments*;
and

a new deal review process to ensure that pricing data from new trades are used to assess whether valuations of similar valuation exposures remain appropriately prudent.

[Note: article 19(3) of BTS 2016/101.]

