2.1 Calculation of capital resources requirements

Application

2.1.1 This section applies to a BIPRU firm.

2.1.2 [deleted]

2.1.3 (1) This section applies to a firm in relation to the whole of its business, except where a particular provision provides for a narrower scope.

(2) [deleted]

2.1.4 The adequacy of a firm's capital resources needs to be assessed in relation to all the activities of the firm and the risks to which they give rise.

2.1.5 The requirements in this section apply to a firm on a solo basis.

Purpose

2.1.6 Principle 4 requires a firm to maintain adequate financial resources.

GENPRU 2 sets out provisions that deal specifically with the adequacy of that part of a firm's financial resources that consists of capital resources. The
adequacy of a firm’s capital resources needs to be assessed both by that firm and the appropriate regulator. Through its rules, the FCA sets minimum capital resources requirements for firms. It also reviews a firm’s own assessment of its capital needs, and the processes and systems by which that assessment is made, in order to see if the minimum capital resources requirements are appropriate (see GENPRU 1.2 (Adequacy of financial resources) and BIPRU 2.2 (Internal capital adequacy standards)).

2.1.7 This section sets capital resources requirements for a firm. GENPRU 2.2 (Capital resources) sets out how, for the purpose of meeting capital resources requirements, the amounts or values of capital, assets and liabilities are to be determined. More detailed rules relating to capital, assets and liabilities are set out in GENPRU 1.3 (Valuation) and, for a BIPRU firm, BIPRU.

2.1.8 (1) [deleted]

(2) This section also implements the third paragraph of article 95(2) of the UK CRR applying requirements that correspond to the provisions of the Capital Adequacy Directive and Banking Consolidation Directive concerning the level of capital resources which a BIPRU firm is required to hold. In particular it corresponds (in part) to article 75 of the Banking Consolidation Directive and Articles 5, 9, 10 and 18 of the Capital Adequacy Directive.

(3) [deleted]

2.1.8A Monitoring requirements

2.1.9 A firm must at all times monitor whether it is complying with the main BIPRU firm Pillar 1 rules and be able to demonstrate that it knows at all times whether it is complying with those rules.

2.1.10 For the purposes of GENPRU 2.1.9 R, a firm should have systems in place to enable it to be certain whether it has adequate capital resources to comply with the main BIPRU firm Pillar 1 rules at all times. This does not necessarily mean that a firm needs to measure the precise amount of its capital resources and its CRR on a daily basis. A firm should, however, be able to demonstrate the adequacy of its capital resources at any particular time if asked to do so by the FCA.

2.1.11 A firm must notify the FCA immediately of any breach, or expected breach, of the main BIPRU firm Pillar 1 rules.

Additional capital requirements

2.1.12 The FCA may impose a higher capital requirement than the minimum requirement set out in this section as part of the firm’s Part 4A permission (see GENPRU 1.2 (Adequacy of financial resources) and BIPRU 2.2 (Internal capital adequacy standards)).
Main requirement: BIPRU firms

2.1.40 R A BIPRU firm must maintain at all times capital resources equal to or in excess of the amount specified in the table in § GENPRU 2.1.45 R (Calculation of the variable capital requirement for a BIPRU firm).

2.1.41 R A BIPRU firm must maintain at all times capital resources equal to or in excess of the base capital resources requirement (see the table in § GENPRU 2.1.48 R).

2.1.42 R At the time that it first becomes a BIPRU firm, a firm must hold initial capital of not less than the base capital resources requirement applicable to that firm.

2.1.43 G The purpose of the base capital resources requirement for a BIPRU firm is to act as a minimum capital requirement or floor. It has been written as a separate requirement as there are restrictions in § GENPRU 2.2 (Capital resources) on the types of capital that a BIPRU firm may use to meet the base capital resources requirement which do not apply to some other parts of the capital requirement calculation. In order to preserve the base capital resources requirement's role as a floor rather than an additional requirement, § GENPRU 2.2.60 R allows a BIPRU firm to meet the base capital resources requirement with capital that is also used to meet the variable capital requirements in § GENPRU 2.1.40 R.

2.1.44 G The base capital resources requirement and the variable capital requirement in § GENPRU 2.1.40 R are together called the capital resources requirement (CRR) in the case of a BIPRU firm.

Calculation of the variable capital requirement for a BIPRU firm

2.1.45 R This table belongs to § GENPRU 2.1.40 R

<table>
<thead>
<tr>
<th>Firm category</th>
<th>Capital requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>BIPRU firm (including collective portfolio management investment firm)</td>
<td>the higher of (1) and (2):</td>
</tr>
<tr>
<td></td>
<td>(1) the sum of:</td>
</tr>
<tr>
<td></td>
<td>(a) the credit risk capital requirement; and</td>
</tr>
<tr>
<td></td>
<td>(b) the market risk capital requirement; and</td>
</tr>
<tr>
<td></td>
<td>(2) the fixed overheads requirement.</td>
</tr>
</tbody>
</table>
Adjustment of the variable capital requirement calculation for collective portfolio management investment firms

2.1.46 When a collective portfolio management investment firm calculates the credit risk capital requirement and the market risk capital requirement for the purpose of calculating the variable capital requirement under GENPRU 2.1.40 it must do so only in respect of designated investment business. For this purpose managing an AIF or managing a UK UCITS is excluded from designated investment business.

Calculation of the base capital resources requirement for a BIPRU firm

2.1.47 The amount of a BIPRU firm’s base capital resources requirement is set out in the table in GENPRU 2.1.48.

Table: Base capital resources requirement for a BIPRU firm

2.1.48 This table belongs to GENPRU 2.1.47.

<table>
<thead>
<tr>
<th>Firm category</th>
<th>Amount: Currency equivalent of</th>
</tr>
</thead>
<tbody>
<tr>
<td>BIPRU firm (but not a collective portfolio management investment firm)</td>
<td>€50,000</td>
</tr>
</tbody>
</table>

2.1.48A A collective portfolio management investment firm is required to maintain base own funds requirement of €125,000 (in line with IPRU-INV 11.3.1R(1)).

Definition of BIPRU firm

2.1.49 In summary, a BIPRU firm:

(1) does not provide the ancillary service of safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management, and is not authorised to do so;

(2) is not authorised to provide the following investment services:
   (a) to deal in any financial instruments for its own account;
   (b) to underwrite issues of financial instruments on a firm commitment basis;
   (c) to place financial instruments without a firm commitment basis; and
   (d) to operate a multilateral trading facility;

(3) is authorised to provide one or more of the following investment services:
   (a) the execution of investors’ orders for financial instruments; or
   (b) the management of individual portfolios of investments in financial instruments;

(4) may be authorised to provide one or more of the following investment services:
(a) reception and transmission of investors’ orders for financial instruments; or
(b) investment advice; and

(5) does not hold clients’ money and/or securities and is not authorised to do so (it should have a limitation or requirement prohibiting the holding of client money and its permission should not include safeguarding and administering investments).

**Calculation of the credit risk capital requirement (BIPRU firm only)**

2.1.51 R  
A BIPRU firm must calculate its credit risk capital requirement as the sum of:

(1) the credit risk capital component; and

(2) the counterparty risk capital component.

(3) [deleted]

**Calculation of the market risk capital requirement (BIPRU firm only)**

2.1.52 R  
(1) A BIPRU firm must calculate its market risk capital requirement as the sum of:

(a) the interest rate PRR (including the basic interest rate PRR for equity derivatives set out in BIPRU 7.3 (Equity PRR and basic interest rate PRR for equity derivatives));

(b) the equity PRR;

(c) the commodity PRR;

(d) the foreign currency PRR;

(e) the option PRR; and

(f) the collective investment undertaking PRR.

(2) Any amount calculated under BIPRU 7.1.9 R - BIPRU 7.1.13 R (Instruments for which no PRR treatment has been specified) must be allocated between the PRR charges in (1) in the most appropriate manner.

**Calculation of the fixed overheads requirement**

2.1.53 R  
A BIPRU firm must calculate a fixed overheads requirement, an amount that is equal to one quarter of the firm’s relevant fixed expenditure calculated in accordance with GENPRU 2.1.54 R.

2.1.54 R  
For the purpose of GENPRU 2.1.53 R, and subject to GENPRU 2.1.55 R to GENPRU 2.1.57 R, a BIPRU firm’s relevant fixed expenditure is the amount described as total expenditure in its most recent audited annual report and
accounts, less the following items (if they are included within such expenditure):

1. staff bonuses, except to the extent that they are guaranteed;
2. employees' and directors' shares in profits, except to the extent that they are guaranteed;
3. other appropriations of profits;
4. shared commission and fees payable which are directly related to commission and fees receivable, which are included within total revenue;
5. interest charges in respect of borrowings made to finance the acquisition of the firm's readily realisable investments;
6. interest paid to customers on client money;
7. interest paid to counterparties;
8. fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions;
9. foreign exchange losses; and
10. other variable expenditure.

2.1.55 The relevant fixed expenditure of a firm in the following circumstances is:

1. where its most recent audited annual report and accounts do not represent a twelve month period, an amount calculated in accordance with GENPRU 2.1.54 R, pro-rated so as to produce an equivalent annual amount; and
2. where it has not completed twelve months' trading, an amount based on forecast expenditure included in the budget for the first twelve months' trading, as submitted with its application for authorisation.

2.1.56 A firm must adjust its relevant fixed expenditure calculation so far as necessary if and to the extent that since the date covered by the most recent audited annual report and accounts or (if GENPRU 2.1.55R (2) applies) since the budget was prepared:

1. its level of fixed expenditure changes materially; or
2. its regulated activities comprised within its permission change.

2.1.57 If a firm has a material proportion of its expenditure incurred on its behalf by third parties and such expenditure is not fully recharged to that firm then the firm must adjust its relevant fixed expenditure calculation by adding back in the whole of the difference between the amount of the expenditure and the amount recharged.
For the purpose of GENPRU 2.1.57 R, the FCA would consider as material 10% of a firm's expenditure incurred on its behalf by third parties.

For the purpose of GENPRU 2.1.54 R to 2.1.57 R, fixed expenditure is expenditure which is inelastic relative to fluctuations in a firm's levels of business. Fixed expenditure is likely to include most salaries and staff costs, office rent, payment for the rent or lease of office equipment, and insurance premiums. It may be viewed as the amount of funds which a firm would require to enable it to cease business in an orderly manner, should the need arise. This is not an exhaustive list of such expenditure and a firm will itself need to identify (taking appropriate advice where necessary) which costs amount to fixed expenditure.

Calculation of base capital resources requirement for banks authorised before 1993

(1) This rule applies to a bank that meets the following conditions:

   (a) on 31 December 2006 it had the benefit of IPRU(BANK) rule 3.3.12 (Reduced minimum capital requirement for a bank that is a credit institution which immediately before 1 January 1993 was authorised under the Banking Act 1987);

   (b) the relevant amount (as referred to in IPRU(BANK) rule 3.3.12) applicable to it was below €5 million as at 31 December 2006; and

   (c) on 1 January 2007 it did not comply with the base capital resources requirement as set out in the table in GENPRU 2.1.48 R (€5 million requirement).

(2) Subject to (3), the applicable base capital resources requirement as at any time (the “relevant time”) is the higher of:

   (a) the relevant amount applicable to it under IPRU(BANK) rule 3.3.12 as at 31 December 2006 as adjusted under GENPRU 2.1.62 R; and

   (b) the highest amount of eligible capital resources which that bank has held between 1 January 2007 and the relevant time.

(3) This rule ceases to apply when:

   (a) that bank's eligible capital resources at any time since 1 January 2007 equal or exceed €5 million; or

   (b) a person (other than an existing controller) becomes the parent undertaking of that bank.

(4) If this rule ceases to apply under (3)(a) it continues not to apply if the bank's eligible capital resources later fall below €5 million.

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

(1) an existing controller of a bank means:
   (a) a person who has been a parent undertaking of that bank since 31 December 2006 or earlier; or
   (b) a person who became a parent undertaking of that bank after 31 December 2006 but who, when he became a parent undertaking of that bank, was a subsidiary undertaking of an existing controller of that bank;

(2) the relevant amount of capital as referred to in GENPRU 2.1.60R (2)(a) is adjusted by identifying the time as of which the amount of capital it was obliged to hold under IPRU(BANK) rule 3.3.12 as referred to in GENPRU 2.1.60R (2)(a) was fixed and then recalculating the capital resources it held at that time in accordance with the definition of eligible capital resources (as defined in (3)); and

(3) eligible capital resources mean capital resources eligible under GENPRU 2.2 (Capital resources) to be used to meet the base capital resources requirement.
2.2 Capital resources

Application

2.2.1 This section applies to a BIPRU firm.

Purpose

2.2.2 GENPRU 2.1 (Calculation of capital resources requirement) sets out minimum capital resources requirements for a firm. This section (GENPRU 2.2) sets out how, for the purpose of these requirements, capital resources are defined and measured.

2.2.4 This section also implements minimum standards for the composition of capital resources required to be held by a BIPRU firm. In particular pursuant to the third paragraph of article 95(2) of the UK CRR, it applies requirements that correspond to Articles 56 – 61, Articles 63 – 64, Article 66 and Articles 120 – 122 of the Banking Consolidation Directive and Articles 12 – 16, Article 17 (in part), Article 22(1)(c) (in part) and paragraphs 13 - 15 of Part B of Annex VII of the Capital Adequacy Directive.
### Contents guide

2.2.5 The table in GENPRU 2.2.6 sets out where the main topics in this section can be found.

### Table: Arrangement of GENPRU 2.2

2.2.6 This table belongs to GENPRU 2.2.5

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<td>GENPRU 2.2.7 G</td>
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<td>Principles underlying the definition of capital resources</td>
<td>GENPRU 2.2.8 G</td>
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<td>Which method of calculating capital resources applies to which type</td>
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<td>(certain types of capital resources cannot be used for certain</td>
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<td>Limits on the use of different forms of capital for <strong>BIPRU firms</strong></td>
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<td>GENPRU 2.2.51 to GENPRU 2.2.59 G</td>
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<td>societies only)</td>
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<td>Topic</td>
<td>Location of text</td>
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<tr>
<td>Core tier one capital: profit and loss account and other reserves: material applicable to all firms</td>
<td>GENPRU 2.2.85 R; GENPRU 2.2.87 R to GENPRU 2.2.89 G; GENPRU 2.2.91 G</td>
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<td>GENPRU 2.2.86 R; GENPRU 2.2.90 R; GENPRU 2.2.92 G</td>
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<td>Core tier one capital: provisions relating to partnerships and limited liability partnerships</td>
<td>GENPRU 2.2.93 R to GENPRU 2.2.100 R</td>
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<td>Core tier one capital: share premium account</td>
<td>GENPRU 2.2.101 R</td>
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<td>Core tier one capital: externally verified interim net profits</td>
<td>GENPRU 2.2.102 R to GENPRU 2.2.103 G</td>
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<td>Hybrid capital (excluding issues through SPVs) (BIPRU firm only)</td>
<td>GENPRU 2.2.115A R to GENPRU 2.2.119 G</td>
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<td>Hybrid capital (issues through SPVs) (BIPRU firm only)</td>
<td>GENPRU 2.2.123 R to GENPRU 2.2.137 R</td>
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<td>GENPRU 2.2.138 R to GENPRU 2.2.144 R</td>
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<td>Tier one capital: requirement to have sufficient unissued stock</td>
<td>GENPRU 2.2.145 R</td>
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<td>Deductions from tier one capital resources</td>
<td>GENPRU 2.2.155 R to GENPRU 2.2.156 G</td>
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<td>Tier two capital</td>
<td>GENPRU 2.2.11 G; GENPRU 2.2.157 G to GENPRU 2.2.197 G</td>
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<td>Deductions from tier one capital resources and tier two capital resources</td>
<td>GENPRU 2.2.208 R to GENPRU 2.1.216G; GENPRU 2.2.217 R to GENPRU 2.2.220 R; GENPRU 2.2.236 R to GENPRU 2.2.240 G</td>
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<tr>
<td>Tier three capital</td>
<td>GENPRU 2.2.12 G; GENPRU 2.2.241 R to GENPRU 2.2.249 R</td>
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<td>Step-ups (tier one capital and tier two capital)</td>
<td>GENPRU 2.2.146 R to GENPRU 2.2.154 G</td>
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<td>Redemption of tier one instruments</td>
<td>GENPRU 2.2.64R (3); GENPRU 2.2.70 R to GENPRU 2.2.79 G</td>
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<td>Purchases of tier one instruments: BIPRU firm only</td>
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<td>GENPRU 2.2.172 R to GENPRU 2.2.174 R; GENPRU 2.2.177 R to GENPRU 2.2.178 R (upper tier two instruments); GENPRU 2.2.194 R to GENPRU 2.2.197 G (lower tier two instruments)</td>
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<td>Non-standard capital instruments</td>
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<td>Public sector guarantees</td>
<td>GENPRU 2.2.276 R</td>
</tr>
</tbody>
</table>
### Simple capital issuers

2.2.7 Parts of this section are irrelevant to a BIPRU firm whose capital resources consist of straightforward capital instruments.

### Principles underlying the definition of capital resources

2.2.8 The FCA has divided its definition of capital into categories, or tiers, reflecting differences in the extent to which the capital instruments concerned meet the purpose and conform to the characteristics of capital listed in GENPRU 2.2.9 G. The FCA generally prefers a firm to hold higher quality capital that meets the characteristics of permanency and loss absorbency that are features of tier one capital. Capital instruments falling into core tier one capital can be included in a firm’s regulatory capital without limit. Typically, other forms of capital are either subject to limits (see the capital resources gearing rules) or, in the case of some specialist types of capital, may only be included with the express consent of the FCA (which takes the form of a waiver under section 138A of the Act). Details of the individual components of capital are set out in the capital resources table.

### Tier one capital

2.2.9 Tier one capital typically has the following characteristics:

1. it is able to absorb losses;
2. it is permanent or (in the case of a BIPRU firm) available when required;
3. it ranks for repayment upon winding up, administration or similar procedure after all other debts and liabilities; and
4. it has no fixed costs, that is, there is no inescapable obligation to pay dividends or interest.

2.2.10 The forms of capital that qualify for tier one capital are set out in the capital resources table and include, for example, share capital, reserves, partnership and sole trader capital, verified interim net profits and, for a mutual, the initial fund plus permanent members’ accounts. Tier one capital is divided into core tier one capital and hybrid capital. Hybrid capital is further divided into the different stages B1, B2 and C of the calculation in the capital resources table.

### Upper and lower tier two capital

2.2.11 Tier two capital includes forms of capital that do not meet the requirements for permanency and absence of fixed servicing costs that apply to tier one capital. Tier two capital includes, for example:

1. capital which is perpetual (that is, has no fixed term) but cumulative (that is, servicing costs cannot be waived at the issuer’s option, although they may be deferred – for example, cumulative preference capital).

<table>
<thead>
<tr>
<th>Topic</th>
<th>Location of text</th>
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<tbody>
<tr>
<td>Simple capital issuers</td>
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<td>The forms of capital that qualify for tier one capital are set out in the capital resources table and include, for example, share capital, reserves, partnership and sole trader capital, verified interim net profits and, for a mutual, the initial fund plus permanent members’ accounts. Tier one capital is divided into core tier one capital and hybrid capital. Hybrid capital is further divided into the different stages B1, B2 and C of the calculation in the capital resources table.</td>
<td></td>
</tr>
<tr>
<td>Upper and lower tier two capital</td>
<td>2.2.11 G</td>
</tr>
<tr>
<td>Tier two capital includes forms of capital that do not meet the requirements for permanency and absence of fixed servicing costs that apply to tier one capital. Tier two capital includes, for example:</td>
<td></td>
</tr>
<tr>
<td>(1) capital which is perpetual (that is, has no fixed term) but cumulative (that is, servicing costs cannot be waived at the issuer’s option, although they may be deferred – for example, cumulative preference capital).</td>
<td></td>
</tr>
</tbody>
</table>
shares); only perpetual capital instruments may be included in upper tier two capital;

(2) capital which is not perpetual (that is, it has a fixed term) or which may have fixed servicing costs that cannot generally be either waived or deferred (for example, most subordinated debt); such capital should normally be of a medium to long-term maturity (that is, an original maturity of at least five years); dated capital instruments are included in lower tier two capital;

(3) (for BIPRU firms) certain revaluation reserves such as reserves arising from the revaluation of land and buildings, including any net unrealised gains for the fair valuation of equities held in the available-for-sale financial assets category; and

(4) (for BIPRU firms) general/collective provisions.

Tier three capital

2.2.12 Tier three capital consists of forms of capital conforming least well to the characteristics of capital listed in § GENPRU 2.2.9 G: either subordinated debt of short maturity (upper tier three capital) or net trading book profits that have not been externally verified (lower tier three capital).

Non-standard capital instruments

2.2.13 There may be examples of capital instruments that, although based on a standard form, contain structural features that make the rules in this section difficult to apply. In such circumstances, a firm may seek individual guidance on the application of those rules to the capital instrument in question. See SUP 9 (Individual guidance) for the process to be followed when seeking individual guidance.

Deductions from capital

2.2.14 Deductions should be made at the relevant stage of the calculation of capital resources to reflect capital that may not be available to the firm or assets of uncertain value (for example, holdings of intangible assets and assets).

2.2.15 Deductions should also be made, in the case of certain BIPRU firms for illiquid assets (see § GENPRU 2.2.19 R).

2.2.16 A full list of deductions from capital resources is shown in the capital resources table applicable to the firm.
2.2.17 R A firm must calculate its capital resources in accordance with the version of the capital resources table applicable to the firm, subject to the capital resources gearing rules. The version of the capital resources table that applies to a firm is specified in the table in GENPRU 2.2.19 R.

2.2.18 R In the case of a BIPRU firm the capital resources table also sets out how the capital resources requirement is deducted from capital resources in order to decide whether its capital resources equal or exceed its capital resources requirement.

Table: Applicable capital resources calculation

<table>
<thead>
<tr>
<th>Type of firm</th>
<th>Location of rules</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>BIPRU firm without an investment firm consolidation waiver</td>
<td>GENPRU 2 Annex 4 (Deducts material holdings)</td>
<td>Applies to a BIPRU firm not using GENPRU 2 Annex 5 or GENPRU 2 Annex 6</td>
</tr>
<tr>
<td>BIPRU firm without an investment firm consolidation waiver</td>
<td>GENPRU 2 Annex 5 (Deducts illiquid assets)</td>
<td>A BIPRU firm must give one Month’s prior notice to the FCA before starting to use or stopping using this method</td>
</tr>
<tr>
<td>BIPRU firm with an investment firm consolidation waiver</td>
<td>GENPRU 2 Annex 6 (Deducts illiquid assets and material holdings)</td>
<td>A firm with an investment firm consolidation waiver must use this method. No other BIPRU firm may use it.</td>
</tr>
</tbody>
</table>

Calculation of capital resources: Which rules apply to BIPRU firms

2.2.20 G GENPRU 2.2.19 R sets out three different methods of calculating capital resources for BIPRU firms. The differences between the three methods relate to whether and how material holdings and illiquid assets are deducted when calculating capital resources. The method depends on whether a firm has an investment firm consolidation waiver. If a firm does have such a waiver, it should deduct illiquid assets, own group material holdings and certain contingent liabilities. If a firm does not have such a waiver, it should choose to deduct either material holdings or, subject to notifying the FCA, illiquid assets.

2.2.21 G A consequence of a firm deducting all of its illiquid assets under GENPRU 2 Annex 5 is that it is allowed a higher limit on short term subordinated debt under GENPRU 2.2.49 R.

Limits on the use of different forms of capital: General

2.2.24 G As the various components of capital differ in the degree of protection that they offer the firm and its customers and consumers, restrictions are placed on the extent to which certain types of capital are eligible for inclusion in a
firm’s capital resources. These rules are called the capital resources gearing rules.

Limits on the use of different forms of capital: Use of higher tier capital in lower tiers

2.2.25 R  A firm may include in a lower stage of capital, capital resources which are eligible for inclusion in a higher stage of capital if the capital resources gearing rules would prevent the use of that capital in that higher stage of capital. However:

(1) the capital resources gearing rules applicable to that lower stage of capital apply to higher stage of capital included in that lower stage of capital; and

(2) (subject to GENPRU 2.2.26 R and GENPRU 2.2.26A R) the rules in GENPRU governing the eligibility of capital in that lower stage of capital continue to apply.

2.2.26 R  An item of tier one capital which is included in a firm’s tier two capital resources under GENPRU 2.2.25 R is not subject to the requirement to obtain a legal opinion in GENPRU 2.2.159R (12).

2.2.26A R  A dated item of tier one capital which is included in a BIPRU firm’s tier two capital resources under GENPRU 2.2.25 R is not subject to the requirement to have no fixed maturity date in GENPRU 2.2.177R (1).

2.2.27 R  [deleted]

2.2.28 R  In the case of a BIPRU firm, the requirement to obtain a legal opinion in GENPRU 2.2.159R (12) does not apply to hybrid capital treated under GENPRU 2.2.25 R but the requirements to obtain a legal opinion in GENPRU 2.2.118 R continue to apply.

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

2.2.30A R  In relation to the tier one capital resources of a BIPRU firm, calculated at stage F of the calculation in the capital resources table (Total tier one capital after deductions):

(1) no more than 50% may be accounted for by hybrid capital;

(2) no more than 35% may be accounted for by hybrid capital included at stages B2 and C of the calculation in the capital resources table; and

(3) no more than 15% may be accounted for by hybrid capital included at stage C of the calculation in the capital resources table.
Limits on the use of different forms of capital: Limits relating to tier one capital: Purpose of the requirements

The purpose of the requirements in [GENPRU 2.2.30AR (1)] is to ensure that the firm’s tier one capital resources includes a minimum proportion of core tier one capital which provides the highest quality capital. Within the 50% limit on non-core tier one capital (1) [deleted]

(2) [GENPRU 2.2.30AR (2) and [GENPRU 2.2.30AR (3)] place further sub-limits on the amounts of hybrid capital included at stages B2 and C of the calculation in the capital resources table that a BIPRU firm may include in its tier one capital resources.

These limits are necessary to ensure that most of a firm’s tier one capital comprises items of capital of the highest quality.

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

Tier one capital and tier two capital are the only type of capital resources that a BIPRU firm may use for the purpose of meeting:

(1) the credit risk capital component;
(2) [deleted]
(3) the counterparty risk capital component; and
(4) the base capital resources requirement.

[GENPRU 2.2.44 R (and the capital resources gearing rules that relate to it)] also applies for the purposes of any other requirement in the Handbook for which it is necessary to calculate the capital resources of a BIPRU firm, except for the purposes described in [GENPRU 2.2.47 R and except as may otherwise be stated in the relevant part of the Handbook.

Limits on the use of different kinds of capital: Tier two limits (BIPRU firm only)

For the purpose of [GENPRU 2.2.44 R):

(1) the amount of the items which may be included in a BIPRU firm’s tier two capital resources must not exceed the amount calculated at stage F of the calculation in the capital resources table (Total tier one capital after deductions); and
(2) the amount of the items which may be included in a BIPRU firm's lower tier two capital resources must not exceed 50% of the amount calculated at stage F of the calculation in the capital resources table.

Limits on the use of different kinds of capital: Purposes for which tier three capital may be used (BIPRU firm only)

2.2.47 For the purposes of meeting:

(1) the market risk capital requirement; and

(2) [deleted]

(3) the fixed overheads requirement;

a BIPRU firm may only use the following parts of its capital resources:

(4) tier one capital to the extent that it is not required to meet the requirements in GENPRU 2.2.44 R (GENPRU 2.2.48 R explains how to calculate how much tier one capital is required to meet the requirements in GENPRU 2.2.44 R);

(5) tier two capital to the extent that it:

(a) comes within the limits in GENPRU 2.2.46 R (100% limit for tier two capital resources and 50% limit for lower tier two capital resources); and

(b) it is not required to meet the requirements in GENPRU 2.2.44 R;

(GENPRU 2.2.48 R explains how to calculate how much tier two capital is required to meet the requirements in GENPRU 2.2.44 R);

(6) tier two capital that cannot be used for the purposes in GENPRU 2.2.44 R because it falls outside the limits in GENPRU 2.2.46 R; and

(7) tier three capital.

2.2.48 The amount of tier one capital and tier two capital that is not used to meet the requirements in GENPRU 2.2.44 R as referred to in GENPRU 2.2.47 R (4) and (5)(5) is equal to the amount calculated at stage N of the calculation in the capital resources table (Total tier one capital plus tier two capital after deductions) less the parts of the capital resources requirement deducted immediately after stage N of the capital resources table (the parts of the capital resources requirements listed in GENPRU 2.2.44 R).

Limits on the use of different kinds of capital: Combined tier two and tier three limits (BIPRU firm only)

2.2.49 For the purpose of meeting the requirements in GENPRU 2.2.47 R (1) to GENPRU 2.2.47 R (3) and subject to GENPRU 2.2.50 R, a BIPRU firm must not include any item in either:

(1) its tier two capital resources falling within GENPRU 2.2.47 R (6) (excess tier two capital); or
(2) its upper tier three capital resources;

to the extent that the sum of (1) and (2) would exceed 250% of the amount resulting from the following calculation:

(3) calculate the amount at stage F of the calculation in the capital resources table (Total tier one capital after deductions); and

(4) deduct from (3) those parts of the firm’s tier one capital used to meet the requirements in ■ GENPRU 2.2.44R (1) and ■ (2) as established by ■ GENPRU 2.2.48 R.

In relation to a BIPRU firm which calculates its capital resources under ■ GENPRU 2 Annex 4 (Capital resources table for a BIPRU investment firm deducting material holdings), the figure of 200% replaces that of 250% in ■ GENPRU 2.2.49 R.

Example of how the capital resources calculation for BIPRU firms works

This table belongs to ■ GENPRU 2.2.51 G

<table>
<thead>
<tr>
<th>Description of the stage of the capital resources calculation</th>
<th>Stage in the capital resources table</th>
<th>Amount (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total tier one capital after deductions</td>
<td>Stage F</td>
<td>80</td>
</tr>
<tr>
<td>Total tier two capital</td>
<td>Stage K</td>
<td>80</td>
</tr>
<tr>
<td>Deductions</td>
<td>Stage M</td>
<td>(20)</td>
</tr>
<tr>
<td>Total tier one capital and tier two capital after deductions</td>
<td>Stage N</td>
<td>140</td>
</tr>
<tr>
<td>Upper tier three capital (this example assumes the firm has no lower tier three capital (trading book profits))</td>
<td>Stage Q</td>
<td>50</td>
</tr>
<tr>
<td>Total capital resources</td>
<td>Stage T</td>
<td>190</td>
</tr>
</tbody>
</table>

In the example in the table in ■ GENPRU 2.2.52 G the firm has total tier one capital after deductions of £80. Its tier two capital of £80 is therefore the maximum permitted under ■ GENPRU 2.2.46 R (Tier two limits), that is 100% of tier one capital.
The combined credit, operational and counterparty risk capital requirement is deducted after stage N of the capital resources table and the market risk requirement following stage T of the capital resources table. These calculations are shown in the table in GENPRU 2.2.56.

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

<table>
<thead>
<tr>
<th>Description of the stage of the capital resources calculation</th>
<th>Stage in the capital resources table</th>
<th>Amount (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total tier one capital and tier two capital after deductions</td>
<td>Stage N</td>
<td>140</td>
</tr>
<tr>
<td>Credit and counterparty risk requirement</td>
<td></td>
<td>(100)</td>
</tr>
<tr>
<td>Tier one capital and tier two capital available to meet market risk requirement</td>
<td>Stage Q</td>
<td>40</td>
</tr>
<tr>
<td>Tier three capital</td>
<td></td>
<td>50</td>
</tr>
<tr>
<td>Total capital available to meet market risk requirement</td>
<td></td>
<td>90</td>
</tr>
<tr>
<td>Market risk requirement</td>
<td></td>
<td>(90)</td>
</tr>
<tr>
<td>Market risk requirement met subject to meeting gearing limit set out in GENPRU 2.2.49 R – see GENPRU 2.2.57 G</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The gearing limit in GENPRU 2.2.49 R (Combined tier two and tier three limits) requires that the upper tier three capital used to meet the market risk requirement does not exceed 250% of the relevant tier one capital.

In this example it is assumed that the maximum possible amount of tier one capital is carried forward to meet the market risk requirement. There are other options as to the allocation of tier one capital and tier two capital to the credit and counterparty risk requirement.

In order to calculate the relevant tier one capital for the upper tier three gearing limit in accordance with GENPRU 2.2.49 R it is first necessary to allocate tier one capital and tier two capital to the individual credit and counterparty risk requirements. This allocation process underlies the calculation of the overall amount referred to in GENPRU 2.2.48 R. The calculation in GENPRU 2.2.49R (3) and GENPRU 2.2.49R (4) then focuses on the tier one element of this earlier calculation.

In this worked example, if it is assumed that the counterparty risk requirement has been met by tier one capital, the relevant tier one capital for gearing is £50. This is because the deductions of £20 and the credit risk requirement of £90 have been met by tier two capital in the first instance. However, the total sum of deductions and credit risk requirement exceed the tier two capital amount of £80 by £30. Hence the £80 of tier one capital has been reduced by £30 to leave £50.

In practical terms, the same result is achieved for the relevant tier one capital for gearing by taking the amount carried forward to meet market risk of £40
and adding back the £10 in respect of the counterparty risk requirement.

Again, there are other options as to the allocation to credit and counterparty risk of the constituent elements of Stage N of the capital resources table.

The outcome of these calculations can be summarised as follows:

1. The relevant tier one capital for the gearing calculation is £50;
2. 250% of the relevant tier one capital is £125; and
3. The upper tier three capital used to meet market risk is £50.

2.2.59

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

Capital used to meet the base capital resources requirement (BIPRU firm only)

2.2.60

A BIPRU firm may use the capital resources used to meet the base capital resources requirement to meet any other part of the capital resources requirement.

2.2.61

The explanation for 2.2.60 can be found in GENPRU 2.1.43 (Base capital resources requirement). In brief the reason is that the base capital resources requirement is not in practice meant to act as an additional capital resources requirement. It is meant to act as a floor to the capital resources requirement.

Notification of issuance of capital instruments

2.2.61A

This section applies to a firm intending to issue a capital instrument on or after 1 March 2012 for inclusion in its capital resources.

2.2.61B

A firm must notify the FCA in writing of its intention to issue a capital instrument which it intends to include within its capital resources at least one month before the intended date of issue, unless there are exceptional circumstances which make it impracticable to give such a period of notice, in which event the firm must give as much notice as is practicable in those circumstances. When giving notice, a firm must:

1. provide details of the amount of capital the firm is seeking to raise through the intended issue and whether the capital is intended to be issued to external investors or within its group;
2. identify the stage of the capital resources table the capital instrument is intended to fall within;
3. include confirmation from a senior manager of the firm responsible for authorising the intended issue that the capital instrument complies with the rules applicable to instruments included in the stage of the capital resources table identified in (2); and
4. provide 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 or not specifically contemplated by GENPRU 2.2.

This rule does not apply to a firm which intends to issue a capital instrument listed in GENPRU 2.2.61E R.

### 2.2.61C

A firm must provide a further notification to the FCA in writing including all the information required in GENPRU 2.2.61BR (1) to (4) as soon as it proposes any change to the intended date of issue, amount of issue, type of investors, stage of capital, or any other feature of the capital instrument to that previously notified to the FCA.

### 2.2.61D

If a firm proposes to establish a debt securities program for the issue of capital instruments for inclusion within its capital resources, it must:

1. notify the FCA of the establishment of the program; and
2. provide the information required by GENPRU 2.2.61BR (1) to (4) at least one month before the first proposed drawdown. Any changes must be notified to the FCA in accordance with GENPRU 2.2.61C R.

### 2.2.61E

The capital instruments to which GENPRU 2.2.61B R does not apply are:

1. ordinary shares which:
   
   a. are the most deeply subordinated capital instrument issued by the firm;
   
   b. meet the criteria set out in GENPRU 2.2.83R (2) and (3) and, for a BIPRU firm, GENPRU 2.2.83A R; and
   
   c. are the same as ordinary shares previously issued by the firm;

2. debt instruments issued from a debt securities program, provided that program was notified to the FCA prior to its first drawdown, in accordance with GENPRU 2.2.61D R; and

3. capital instruments which are not materially different in terms of their characteristics and eligibility for inclusion in a particular tier of capital to capital instruments previously issued by the firm.

### 2.2.61F

A firm must notify the FCA in writing, no later than the date of issue, of its intention to issue a capital instrument listed in GENPRU 2.2.61E R which it intends to include within its capital resources. When giving notice, a firm must:

1. provide the information set out at GENPRU 2.2.61BR (1) to (3); and
2. confirm that the terms of the capital instrument have not changed since the previous issue by the firm of that type of capital instrument.
2.2.61G  ■ GENPRU 2.2.61B R provides that, in exceptional circumstances, a firm may provide less than one month’s notice of the intended issue. The FCA is unlikely to consider circumstances to be exceptional unless they are such that there is a risk of a firm’s capital resources falling below its capital resources requirement if a one-month notification period is observed. In such circumstances, a firm should notify the FCA as soon as it has resolved to issue further capital, and provide details of its circumstances and why it is not possible to provide one month’s notice of the intended issue.

2.2.61H  Details of the notification to be provided by a BIPRU firm in relation to capital instruments issued by another undertaking in its group for inclusion in its capital resources or the consolidated capital resources of its UK consolidation group or non-UK sub-group are set out in ■ BIPRU 8.6.1A R to ■ BIPRU 8.6.1F R.

Tier one capital: General

2.2.62  A firm may not include a capital instrument in its tier one capital resources unless it complies with the following conditions:

1. it is included in one of the categories in ■ GENPRU 2.2.63 R;
2. it complies with the conditions set out in ■ GENPRU 2.2.64 R;
3. it is not excluded under ■ GENPRU 2.2.65 R (Connected transactions); and
4. it is not excluded by any of the rules in ■ GENPRU 2.2.

2.2.63  The categories referred to in ■ GENPRU 2.2.62R (1) are:

1. permanent share capital;
2. eligible partnership capital;
3. eligible LLP members’ capital;
4. sole trader capital;
5. [deleted]
6. [deleted]
7. [deleted]
8. hybrid capital.

General conditions for eligibility as tier one capital

2.2.64  The conditions that an item of capital of a firm must comply with under ■ GENPRU 2.2.62R (2) are as follows:

1. it is issued by the firm;
(2) it is fully paid and the proceeds of issue are immediately and fully available to the firm;

(3) it:
   (a) cannot be redeemed at all or can only be redeemed on a winding up of the firm; or
   (b) complies with the conditions in GENPRU 2.2.70 R (Basic requirements for redeemability);

(4) the item of capital meets the following conditions in relation to any coupon:
   (a) the firm is under no obligation to pay a coupon; or
   (b) (if the firm is obliged to pay the coupon) the coupon is payable in the form of an item of capital that is:
      (i) core tier one capital

(5) any coupon is either:
   (a) non-cumulative; or
   (b) (if it is cumulative) it must, if deferred, be paid by the firm in the form of tier one capital complying with (4)(b);

(6) it is able to absorb losses to allow the firm to continue trading and:
   (a) [deleted]
   (b) it does not, through appropriate mechanisms, hinder the recapitalisation of the firm, and in particular it complies with:
      (i) GENPRU 2.2.80 R to GENPRU 2.2.81 R (Loss absorption);
      (ii) in the case of core tier one capital, GENPRU 2.2.83AR (9) to GENPRU 2.2.83AR (10) (General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only)); and
      (iii) in the case of hybrid capital, GENPRU 2.2.116 R to GENPRU 2.2.118 R (Other tier one capital: loss absorption);

(7) the amount of the item included must be net of any foreseeable tax charge at the moment of its calculation or must be suitably adjusted in so far as such tax charges reduce the amount up to which that item may be applied to cover risks or losses;

(8) it is available to the firm for unrestricted and immediate use to cover risks and losses as soon as these occur;

(9) it ranks for repayment upon winding up, administration or any other similar process:
(a) [deleted]

(b) lower than any items of capital that are

(i) eligible for inclusion within the firm's tier two capital resources; and

(ii) not eligible for inclusion within the firm's tier one capital resources; and

(10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9).

2.2.65 R

An item of capital does not qualify for inclusion as tier one capital if the issue of that item of capital by the firm is connected with one or more other transactions which, when taken together with the issue of that item, could result in that item of capital no longer displaying all of the characteristics set out in GENPRU 2.2.64R (1) to GENPRU 2.2.64R (9).

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

2.2.66 G

GENPRU 2.2.65 R is an example of the general principle in GEN 2.2.1 R (Purposive interpretation). Its purpose is to emphasise that an item of capital does not meet the conditions for inclusion in tier one capital if in isolation it does meet those requirements but it fails to meet those requirements when other transactions are taken into account. Examples of such connected transactions might include guarantees or any other side agreement provided to the holders of the capital instrument by the firm or a connected party or a related transaction designed, for example, to enhance their security or to achieve a tax benefit, but which may compromise the loss absorption capacity or permanence of the original capital item.

2.2.67 G

GENPRU 2.2.64R (2) is stricter than the Companies Act definition of fully paid, which only requires an undertaking to pay.

2.2.67A G

The purpose of GENPRU 2.2.64R (4) is to ensure that a firm retains flexibility over the payment of coupons and can preserve cash in times of financial stress. However, a firm may include, as part of the capital instrument terms, a right to make payments of a coupon mandatory if an item of capital becomes ineligible to form part of its capital resources (e.g. through a change in the relevant rules) and the firm has notified the FCA that the instrument is ineligible.

2.2.68 G

The FCA considers that dividend pushers diminish the quality of capital by breaching the principle of complete discretion over coupons set out in GENPRU 2.2.64R (4). A dividend pusher operates so that, in a given period of time, payments must be made on senior securities if payments have previously been made on junior securities or securities ranking pari passu. As such, dividend pushers may not be included in the terms of tier one capital, unless the firm has the option to fund the "pushed payment" in stock.

2.2.68A R

A BIPRU firm must not include a capital instrument in its tier one capital resources if:
(1) the capital instrument is affected by a dividend stopper; and

(2) the dividend stopper operates in a way that hinders recapitalisation.

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

An item of capital does not comply with GENPRU 2.2.64R (10) if it is marketed as a capital instrument that would only qualify for a lower level of capital or on the basis that investing in it is like investing in an instrument in a lower tier of capital. For example, an undated capital instrument should not be marketed as a dated capital instrument if the terms of the capital instrument include an option by the issuer to redeem the capital instrument at a specified date in the future.

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

A BIPRU firm must not make a payment of a coupon on an item of hybrid capital if the firm has no distributable reserves.

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

A BIPRU firm must not pay a coupon on an item of hybrid capital in the form of core tier one capital in accordance with GENPRU 2.2.64R (4)(b) unless:

(1) the firm meets its capital resources requirement; and

(2) such a substituted payment preserves the firm's financial resources.

The FCA considers that a BIPRU firm's financial resources are not preserved under GENPRU 2.2.69CR (2) unless, among other things, the conditions of the substituted payment are that:

(1) there is no decrease in the amount of the firm's core tier one capital;

(2) the deferred coupon is satisfied without delay using newly issued core tier one capital that has an aggregate fair value no more than the amount of the coupon;
(3) the firm is not obliged to find new investors for the newly issued instruments; and

(4) if the holder of the newly issued instruments subsequently sells the instruments and the sale proceeds are less than the value of the coupon, the firm is not obliged to issue further new instruments to cover the loss incurred by the holder of the instruments.

2.2.69E  A BIPRU firm must cancel the payment of a coupon if circumstances arise whereby the payment of the coupon by newly issued instruments, in accordance with GENPRU 2.2.64R (4)(b), does not comply with the requirements of GENPRU 2.2.69C R.

2.2.69F  (1) In relation to the cancellation or deferral of the payment of a coupon in accordance with GENPRU 2.2.64R (4) and GENPRU 2.2.64R (5), GENPRU 2.2.68A R, or GENPRU 2.2.69B R, the FCA expects that situations where a coupon may need to be cancelled or deferred will be resolved through analysis and discussion between the firm and the FCA. If the FCA and the firm do not agree on the cancellation or deferral of the payment of a coupon, then the FCA may consider using its powers under 55J of the Act to, on its own initiative, vary a firm’s Part 4A permission to require it to cancel or defer a coupon in accordance with the FCA’s view of the financial and solvency situation of the firm.

(2) In considering a firm’s financial and solvency situation, the FCA will normally take into account, among other things, the following:

(a) the firm’s financial and solvency position before and after the payment of the coupon, in particular whether that payment, or other foreseeable internal and external events or circumstances, may increase the risk of the firm breaching its capital resources requirement or the overall financial adequacy rule;

(b) an appropriately stressed capital plan, covering 3-5 years, which includes the effect of the proposed payment of the coupon; and

(c) an evaluation of the risks to which the firm is or might be exposed and whether the level of tier one capital ensures the coverage of those risks, including stress tests on the main risks showing potential loss under different scenarios.

(3) If the BIPRU firm is required to cancel or defer the payment of a coupon by the FCA, it may still be able to pay the coupon by way of newly issued core tier one capital in accordance with GENPRU 2.2.64R (4)(b) and GENPRU 2.2.69C R. The FCA may consider using its powers under 55J of the Act to, on its own initiative, vary a firm’s Part 4A permission to impose conditions on the use of such a mechanism or to require its cancellation, based on the factors outlined in this guidance.

Redemption of tier one instruments

2.2.70  A firm may not include a capital instrument in its tier one capital resources, unless its contractual terms are such that:

(3) the firm is not obliged to find new investors for the newly issued instruments; and

(4) if the holder of the newly issued instruments subsequently sells the instruments and the sale proceeds are less than the value of the coupon, the firm is not obliged to issue further new instruments to cover the loss incurred by the holder of the instruments.
(1) (if it is redeemable other than in circumstances set out in [GENPRU 2.2.64R (3)(a) (redemption on a winding up)]) it is redeemable only at the option of the firm or, in the case of a BIPRU firm, on the date of maturity;

(2) the firm cannot exercise that redemption right:
   (a) before the fifth anniversary of its date of issue; and
   (b) unless it has given notice to the FCA in accordance with [GENPRU 2.2.74 R];
   (c) unless at the time of exercise of that right it complies with the main BIPRU firm Pillar 1 rules and will continue to do so after redemption;

(3) (in the case of a BIPRU firm and if it is undated) if it provides for a moderate incentive for the BIPRU firm to redeem it, that incentive does not occur before the tenth anniversary of its date of issue; and

(4) (in the case of a BIPRU firm and if it is dated):
   (a) it has an original maturity date of at least 30 years after its date of issue; and
   (b) it does not provide an incentive to redeem on any date other than its maturity date.

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

A firm may include a term in a tier one instrument allowing the firm to redeem it before the date in [GENPRU 2.2.70R (2)(a) if the following conditions are satisfied:

(1) the other conditions in [GENPRU 2.2.70 R are met;

(2) the circumstance that entitles the firm to exercise that right is a change in the applicable tax treatment or regulatory classification of those instruments;

(3) the circumstance that entitles the firm to exercise that right was not reasonably foreseeable at the date of issue of the tier one instrument; and
(4) the firm’s right is conditional on it obtaining the FCA’s consent in the form of a waiver of GENPRU 2.2.72 R.

2.2.72 R A firm must not redeem a tier one instrument in accordance with a term included under GENPRU 2.2.71 R.

2.2.73 G The purpose of GENPRU 2.2.71 R to GENPRU 2.2.72 R is this. In general a tier one instrument should not be redeemable by the firm before its fifth anniversary. However there may be circumstances in which it would be reasonable for the firm to redeem it before then. GENPRU 2.2.71 R allows the firm to include a right to redeem the instrument before the fifth anniversary in certain circumstances. A tax call is an example of a term that may be allowed. GENPRU 2.2.71 R says that the terms of the tier one instrument should provide that the firm should not be able to exercise that right without the FCA’s consent. Any such consent will be given in the form of a waiver allowing early repayment. Thus although a firm may include a right to redeem early in the terms of a tier one instrument without the need to apply for a waiver the actual exercise of that right will require a waiver.

2.2.74 R A firm must not redeem any tier one instrument that it has included in its tier one capital resources unless it has notified the FCA of its intention at least one month before it becomes committed to do so. When giving notice, the firm must provide details of its position after such redemption in order to show how it will:

(1) meet its capital resources requirement;

(2) have sufficient financial resources to meet the overall financial adequacy rule; and

(3) in the case of a BIPRU firm, not otherwise suffer any undue effects to its financial or solvency conditions.

2.2.74A G The FCA considers that, in order to comply with GENPRU 2.2.74 R, the firm should, at a minimum, provide the FCA with the following information:

(1) a comprehensive explanation of the rationale for the redemption;

(2) the firm’s financial and solvency position before and after the redemption, in particular whether that redemption, or other foreseeable internal and external events or circumstances, may increase the risk of the firm breaching its capital resources requirement;

(3) an appropriately stressed capital plan covering 3-5 years, which includes the effect of the proposed redemption; and

(4) an evaluation of the risks to which the firm is or might be exposed and whether the level of tier one capital ensures the coverage of such risks including stress tests on the main risks showing potential loss under different scenarios.
If a BIPRU firm does not comply with its capital resources requirement or if the redemption of any dated tier one instrument would cause it to breach its capital resources requirement, it must suspend the redemption of its dated tier one instruments.

If a firm gives notice of the redemption or repayment of any tier one instrument, the firm must no longer include that instrument in its tier one capital resources.

### Meaning of redemption

1. This rule applies to a tier one instrument, tier two instrument or tier three instrument (instrument A) that under its terms is exchanged for or converted into another instrument or is subject to a similar process.

2. This rule also applies to instrument A if under its terms it is redeemed out of the proceeds of the issue of new securities.

3. If the instrument with which instrument A is replaced is included in the same stage of capital or a higher stage of capital as instrument A, instrument A is treated as not having been redeemed or repaid for the purposes of GENPRU 2.2.

4. (3) does not apply to:
   - GENPRU 2.2.114 R (Redeemable instrument likely to be repaid etc),
   - GENPRU 2.2.74 R (Notice of redemption of tier one instruments),
   - GENPRU 2.2.174 R (Notice of redemption of tier two instruments) or
   - GENPRU 2.2.245 R (so far as it relates to notice of redemption of tier three instruments).

5. (3) only applies if it would be reasonable (taking into account the economic substance) to treat the original instruments as continuing in issue on the same or a more favourable basis. The question of whether that basis is more or less favourable must be judged from the point of view of the adequacy of the firm's capital resources.

1. A share is not redeemable for the purposes of this section merely because the Companies Act 1985, the Companies (Northern Ireland) Order 1986 or the Companies Act 2006 allows the firm that issued it to purchase it.

2. A capital instrument is not redeemable for the purposes of this section merely because the firm that issued it has a right to purchase it similar to the right in (1).

This section generally uses the term repay and redeem interchangeably.
Purchases of tier one instruments: BIPRU firm only

2.2.79A  A BIPRU firm must not purchase a tier one instrument that it has included in its tier one capital resources unless:

1. the firm initiates the purchase;

2. [deleted]

3. the firm has given notice to the FCA in accordance with GENPRU 2.2.79G R; and

4. (in the case of hybrid capital) it is on or after the fifth anniversary of the date of issue of the instrument.

2.2.79B  In exceptional circumstances a BIPRU firm may apply for a waiver of GENPRU 2.2.79AR (4) under section 138A (Modification or waiver of rules) of the Act.

2.2.79C  GENPRU 2.2.79AR (4) does not apply if:

1. the firm replaces the capital instrument it intends to purchase with a capital instrument that is included in a higher stage of capital or the same stage of capital; and

2. the replacement capital instrument has already been issued.

2.2.79D  GENPRU 2.2.79AR (4) does not apply if:

1. the firm intends to hold the purchased instrument for a temporary period as market maker; and

2. the purchased instruments held by the firm do not exceed the lower of:

   a. 10% of the relevant issuance; or

   b. 3% of the firm's total issued hybrid capital.

2.2.79E  In the circumstances provided for in GENPRU 2.2.79D R, a firm would purchase the instrument and, instead of cancelling it, the firm would hold the instrument for a temporary period. In that case a firm should have in place adequate policies to take into account any relevant regulations and rules, which include those relating to market abuse.

2.2.79F  For the purposes of calculating its tier one capital resources, a firm must deduct the amount of any item of hybrid capital which it then holds.

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

(1) meet its *capital resources requirement*; and

(2) have sufficient financial resources to meet the *overall financial adequacy rule*.

2.2.79H The FCA considers that:

(1) in order to comply with GENPRU 2.2.79G R, the *firm* should, at a minimum, provide the *FCA* with the following information:

(a) a comprehensive explanation of the rationale for the purchase;

(b) the *firm’s* financial and solvency position before and after the purchase, in particular whether the purchase, or other foreseeable internal and external events or circumstances, may increase the risk of the *firm* breaching its *capital resources requirement* or the *overall financial adequacy rule*;

(c) an appropriately stressed capital plan covering 3-5 years, which includes the effect of the proposed purchase; and

(d) an evaluation of the risks to which the *firm* is or might be exposed and whether the level of *tier one capital* ensures the coverage of such risks including stress tests on the main risks showing potential loss under different scenarios; and

(2) the proposed purchase should not be on the basis that the *firm* reduces capital on the date of the purchase and then plans to raise new external capital during the following 3-5 years to replace the purchased capital.

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

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

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

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

2.2.80 **R** A firm may not include a share in its tier one capital resources unless (in addition to complying with the other relevant rules in GENPRU 2.2):

1. (in the case of a firm that is a company as defined in the Companies Act 2006 it is “called-up share capital” within the meaning given to that term in that Act; or
2. [deleted]
3. (in the case of any other firm) it is:
   a. in economic terms; and
   b. in its characteristics as capital (including loss absorbency, permanency, ranking for repayment and fixed costs); substantially the same as called-up share capital falling into (1).

2.2.81 **R** A firm may not include a capital instrument other than a share in its tier one capital resources unless it complies with GENPRU 2.2.80R (3).

2.2.82 **G** There are additional loss absorption requirements for hybrid capital in GENPRU 2.2.116AR to GENPRU 2.2.118 R (Other tier one capital: loss absorption) and for core tier one capital in GENPRU 2.2.83AR (9) to (10) (General conditions for eligibility of capital instruments as core tier one capital).

**Core tier one capital: permanent share capital**

2.2.83 **R** Permanent share capital means an item of capital which (in addition to satisfying GENPRU 2.2.64 R) meets the following conditions:

1. it is:
   a. an ordinary share; or
   b. a members' contribution; or
   c. part of the initial fund of a mutual; or
   d. [deleted]
2. any coupon on it is not cumulative, the firm is under no obligation to pay a coupon in any circumstances and the firm has the right to choose the amount of any coupon that it pays;
3. the terms upon which it is issued do not permit redemption and it is otherwise incapable of being redeemed to at least the same degree as an ordinary share issued by a company incorporated under the Companies Act 2006 (whether or not it is such a share); and
4. (in the case of a BIPRU firm) it meets the conditions set out in GENPRU 2.2.83A R (General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only)).
The conditions that a BIPRU firm’s permanent share capital must comply with under GENPRU 2.2.83AR (4) or that a BIPRU firm’s eligible partnership capital or eligible LLP members’ capital must comply with under GENPRU 2.2.95 R are as follows:

(1) it is undated;

(2) the terms upon which it is issued do not give the holder a preferential right to the payment of a coupon;

(3) the terms upon which it is issued do not indicate the amount of any coupon that may be payable nor impose an upper limit on the amount of any coupon that may be payable;

(4) the firm’s obligations under the instrument do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986 and the holder has no right to petition for the winding up or administration of the firm or for any similar procedure in relation to the firm arising from the non-payment of a coupon or any other sums payable under the instrument;

(5) there is no contractual or other obligation arising out of the terms upon which it is issued that requires the firm to repay capital to the holders other than on a liquidation of the firm;

(6) the terms upon which it is issued do not include a dividend pusher or a dividend stopper;

(7) the firm is under no obligation to issue core tier one capital or to make a payment in kind in lieu of making a coupon payment and non-payment of a coupon is not an event of default on the part of the firm;

(8) it is simple and the terms upon which it is issued are clearly defined;

(9) it is able to fully and unconditionally absorb losses on a non-discretionary basis as soon as they arise to allow the firm to continue trading, and it absorbs losses before all capital instruments that are not eligible for inclusion in stage A of the capital resources table and equally and proportionately with all capital instruments that are eligible for inclusion in stage A of the capital resources table;

(10) it ranks for repayment on winding up, administration or any other similar process lower than all other items of capital, and on a liquidation of the firm the holders have a claim on the residual assets remaining after satisfaction of all prior claims that is proportional to their holding and do not have a priority claim or a fixed claim for the nominal amount of their holding;

(11) the firm has not provided the holder with a direct or indirect financial contribution specifically to pay for the whole or a part of its subscription or purchase;
(12) a reasonable person would not think that the firm is likely to redeem or purchase it because of the description of its characteristics used in its marketing and in its contractual terms of issue; and

(13) its issue is not connected with one or more other transactions which, when taken together with its issue, could result in it no longer displaying all of the characteristics set out in GENPRU 2.2.83R (2), GENPRU 2.2.83AR (1) to (12) and (in the case of permanent share capital) GENPRU 2.2.83R (3).

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

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

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

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

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

(1) the capital instrument satisfies all other conditions for eligibility as core tier one capital set out in GENPRU 2.2.83 R to GENPRU 2.2.83AR;

(2) the coupon limit has been imposed by law or the constitutional documents of the firm;

(3) the objective of the limit is to protect the capital reserves of the firm;

(4) the firm continues to have the effective right to choose the amount of any coupon that it pays;

(5) all other capital instruments issued by the firm and included in stage A of the capital resources table:

(a) meet the conditions set out in GENPRU 2.2.83R (2), GENPRU 2.2.83R (3) and GENPRU 2.2.83AR (General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only)); and

(b) if subject to a coupon limit, are subject to the same coupon limit; and
(6) any preferential coupon on a capital instrument included in stage A of the capital resources table, arising as a result of the inclusion of a coupon limit on another capital instrument, must be restricted to a fixed multiple of the coupon payment on the capital instrument that is subject to the coupon limit. GENPRU 2.2.83AR (2) to (3) do not prevent a capital instrument from being included in stage A of the capital resources table if the only reason for those prohibitions not being met is that a preferential coupon arises, and is restricted, in the manner referred to in this paragraph (6).

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

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

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

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

(2) the preference so arising should be restricted so that it is not an unlimited preference.

Core tier one capital: additional information

[deleted]

2.2.84 G

2.2.84A G Under GENPRU 2.2.83AR (13) a tier one instrument does not meet the conditions for inclusion as core tier one capital if in isolation it does meet those requirements but fails to meet those requirements when other
transactions are taken into account. Examples of those transactions include guarantees, pledges of assets or other side agreements provided by the firm to the holder of a tier one instrument designed to enhance the legal or economic seniority of the tier one instrument.

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

2.2.85

(1) Negative amounts, including any interim net losses (but in the case of a BIPRU firm, only material interim net losses), must be deducted from profit and loss account and other reserves.

(2) For these purposes material interim net losses mean unaudited interim losses arising from a firm's trading book and non-trading book business which exceed 10% of the sum of its capital resources calculated at stage A (Core tier one capital) in the capital resources table.

(3) If interim losses as referred to in (2) exceed the 10% figure in (2) then a BIPRU firm must deduct the whole amount of those losses and not just the excess.

Core tier one capital: profit and loss account and other reserves: Losses arising from valuation adjustments (BIPRU firm only)

2.2.86

(1) This rule applies to trading book valuation adjustments or reserves referred to in GENPRU 1.3.29 R to GENPRU 1.3.35A G (Valuation adjustments and reserves). It applies to a BIPRU firm.

(2) When valuation adjustments or reserves give rise to losses of the current financial year, a firm must treat them in accordance with GENPRU 2.2.85 R.

(3) Valuation adjustments or reserves which exceed those made under the accounting framework to which a firm is subject must be treated in accordance with (2) if they give rise to losses and under GENPRU 2.2.248 R (Net interim trading book profits) otherwise.

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

2.2.87

Dividends must be deducted from reserves as soon as they are foreseeable.

2.2.87A

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

(1) in the case of an interim dividend, when it is declared by the directors; or

(2) in the case of a final dividend, when the directors approve the dividend to be proposed at the annual general meeting.
Core tier one capital: profit and loss account and other reserves: Capital contributions

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

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

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

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

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

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

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

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

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

2.2.93 R Eligible partnership capital means a partners' account:

(1) into which capital contributed by the partners is paid; and

(2) from which under the terms of the partnership agreement an amount representing capital may be withdrawn by a partner only if:

(a) he ceases to be a partner and an equal amount is transferred to another such account by his former partners or any person replacing him as their partner;

(b) the partnership is wound up or otherwise dissolved; or

(c) the BIPRU firm has ceased to be authorised or no longer has a Part 4A permission.

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

2.2.94 R Eligible LLP members' capital means a members' account:

(1) into which capital contributed by the members is paid; and
(2) from which under the terms of the limited liability partnership agreement an amount representing capital may be withdrawn by a member only if:

(a) he ceases to be a member and an equal amount is transferred to another such account by his former fellow members or any person replacing him as a member;

(b) the limited liability partnership is wound up or otherwise dissolved; or

(c) the BIPRU firm has ceased to be authorised or no longer has a Part 4A permission.

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

2.2.95 A BIPRU firm that is a partnership or a limited liability partnership may not include eligible partnership capital or eligible LLP members’ capital in its tier one capital resources unless (in addition to GENPRU 2.2.62 R (General conditions relating to tier one capital)) it complies with GENPRU 2.2.83R (2) (Coupons should not be cumulative or mandatory) and GENPRU 2.2.83A R to GENPRU 2.2.83C R (General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only). However, GENPRU 2.2.64R (3) (Redemption), GENPRU 2.2.83AR (5) (Capital repayment) and GENPRU 2.2.83AR (12) (Characteristics in contract) are replaced by GENPRU 2.2.93 R or GENPRU 2.2.94 R.

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

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

(2) a demonstration that the firm would have sufficient financial resources to meet any individual capital guidance and the firm’s latest assessment under the overall Pillar 2 rule immediately after the repayment; and

(3) a two to three year capital plan demonstrating that the firm would be able to meet the requirements in (1) and (2) at all times without needing further capital injections.

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

2.2.97 The items permanent share capital and share premium account (which form part of core tier one capital) do not apply to a BIPRU firm that is a partnership or a limited liability partnership.

2.2.98 Without prejudice to GENPRU 2.2.62 R (Tier one capital: General), the item other reserves (which forms part of the item profit and loss and other
reserves) applies to a BIPRU firm that is a partnership or a limited liability partnership to the extent the reserves correspond to reserves that are eligible for inclusion as other reserves in the case of a BIPRU firm that is incorporated under the Companies Act 2006.

2.2.99  
A BIPRU firm that is a partnership or a limited liability partnership should include profit and loss (taking into account interim losses or material interim net losses) in its core tier one capital.

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

2.2.100  
A BIPRU firm which is a partnership or limited liability partnership must deduct at stage E of the calculation in the capital resources table (Deductions from tier one capital) the amount by which the aggregate of the amounts withdrawn by its partners or members exceeds the profits of that firm. Amounts of eligible partnership capital or eligible LLP members' capital repaid in accordance with GENPRU 2.2.93 R or GENPRU 2.2.94 R are not included in this calculation.

Core tier one capital: Share premium account

2.2.101  
(1) A firm must include share premium account relating to the issue of a share forming part of its core tier one capital in its core tier one capital.

(2) A firm must include share premium account relating to the issue of a share forming part of another tier of capital in that other tier.

(3) A firm that is incorporated under the Companies Act 2006 may include its share premium account as core tier one capital notwithstanding (2) to the extent that the terms of issue of the share concerned provide that any premium is not repayable on redemption.

(4) Paragraph (3) applies to a firm that is not incorporated under the Companies Act 2006 if its share premium account is subject to substantially the same or greater restraints on use than a share premium account falling into (3).

Core tier one capital: externally verified interim net profits

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

2.2.103  
A firm may include interim profits before a formal decision has been taken only if these profits have been verified, in accordance with the relevant guidance issued by the Financial Reporting Council, by persons responsible for the auditing of the accounts.

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

2.2.108A  
A building society may include a deferred share at stage A of the calculation in the capital resources table if (in addition to satisfying all the other
requirements in relation to *tier one capital* it is *permanent share capital* and is otherwise equivalent to an ordinary *share* in terms of its capital qualities, taking into account the specific constitution of *building societies* under the *Building Societies Act 1986*.

The other main provisions relevant to inclusion of a *deferred share* in *tier one capital* are: ■ GENPRU 2.2.62 R (Tier one capital: General), ■ GENPRU 2.2.64 R (General conditions for eligibility as tier one capital), ■ GENPRU 2.2.65 R (Connected transactions) and ■ GENPRU 2.2.80 R (Loss absorption).

[deleted]

[deleted]

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

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

1. it cannot be redeemed in cash but can only be converted into *core tier one capital*;
2. it must be converted into *core tier one capital* by the *firm* during emergency situations;
3. the emergency situations referred to in (2):
   a. are clearly defined within the terms of the *capital instrument*, legally certain and transparent; and
   b. occur at the latest, and include, when the *BIPRU firm* does not meet its *capital resources requirement*;
4. the *FCA* may require its conversion into *core tier one capital* when the *FCA* considers it necessary;
5. it may be converted into *core tier one capital* by the *firm* or the holder of the instrument at any time; and
6. the maximum number of *capital instruments* which are *core tier one capital* into which it may be converted must:
   a. be determined at the date of its issue;
   b. be determined on the basis of the market value of those other instruments at the date of its issue;
   c. have an aggregate value equal to its par value; and
   d. not increase if the price of those other instruments decreases.
2.2.115B The intention of GENPRU 2.2.115A R is to ensure that capital instruments included in stage B1 of the calculation in the capital resources table have the same permanence as core tier one capital; the presence of a call option for these instruments may reduce their permanence.

2.2.115C (1) In respect of GENPRU 2.2.115AR (4), the FCA may require the firm to convert the instrument into core tier one capital based on its financial and solvency situation. The FCA will take into account, among other things, the factors identified at GENPRU 2.2.69FG (2), adjusted to take into account the effects of a conversion rather than payment of a coupon.

(2) Even if a firm meets its capital resources requirement, the FCA may consider the amount or composition of the firm's tier one capital as inadequate to cover the financial and solvency risks of the firm in which event the FCA may require the firm to convert the instrument into core tier one capital.

2.2.115D A BIPRU firm may include a capital instrument at stage B2 of the calculation in the capital resources table if (while satisfying all the other requirements in relation to tier one capital and hybrid capital) it cannot be included at stage B1 of that calculation as it does not satisfy the requirements of GENPRU 2.2.115A R.

2.2.115E (1) The other main provisions relevant to the eligibility of a capital instrument to be included at stages B1 and B2 of the calculation in the capital resources table are GENPRU 2.2.62 R (Tier one capital: General), GENPRU 2.2.64 R (General conditions for eligibility as tier one capital), GENPRU 2.2.65 R (Connected transactions), GENPRU 2.2.68A R (Dividend stoppers), GENPRU 2.2.70 R to GENPRU 2.2.75 R (Redemption of tier one instruments), GENPRU 2.2.80 R (Loss absorption) and GENPRU 2.2.116 R to GENPRU 2.2.118 R (Other tier one capital: loss absorption).

(2) The rule about hybrid capital included at stage C of the calculation in the capital resources table in GENPRU 2.2.115F R is also relevant. Capital instruments that would otherwise qualify for inclusion at stages B1 or B2 of the calculation in the capital resources table may only be eligible for inclusion at stage C of that calculation.

2.2.115F A BIPRU firm may include a capital instrument at stage C of the calculation in the capital resources table, and must not include it in stage B1 or B2 of that calculation, if (in addition to satisfying all the other requirements in relation to tier one capital and hybrid capital) it either:

(1) is dated; or

(2) provides an incentive for the firm to redeem it, as assessed at the date of its issue.

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

Other tier one capital: loss absorption

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

1. do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986; or

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

The effect of GENPRU 2.2.116 R and GENPRU 2.2.116A R is that if a potential tier one instrument does constitute a liability, this should only be the case when the firm is able to pay that liability but chooses not to do so. The holder should agree that the firm has no liability (including any contingent or prospective liability) to pay any amount to the extent to which that liability would cause the firm to become insolvent if it made the payment or to the extent that its liabilities exceed its assets or would do if the payment were made. The terms of the capital instrument should be such that the directors can continue to trade in the best interests of the senior creditors even if this prejudices the interests of the holders of the instrument.

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

1. is clearly defined and legally certain;

2. is disclosed and transparent to the market;

3. makes the recapitalisation of the firm more likely by adequately reducing the potential future outflows to a holder of the capital instrument at certain trigger points;
(4) enables the firm, at and after the trigger points, to operate the mechanism; and

(5) when initiated, operates in one of the following ways:

(a) the principal of the instrument is written down permanently; or

(b) the principal of the instrument is written down temporarily. During the write-down period any coupon payable on the instrument must be cancelled and any related dividend stoppers and pushers must operate in a way that does not hinder recapitalisation; or

(c) the instrument is converted into core tier one capital. The maximum number of capital instruments which are core tier one capital into which it must be converted must:

(i) be determined at the date of its issue;

(ii) be determined on the basis of the market value of those other instruments at the date of its issue;

(iii) have an aggregate value no more than 150% of its par value; and

(iv) not increase if the share price decreases; or

(d) an alternative process applies which has the same or greater effect on the likelihood of recapitalisation as (a), (b), and (c).

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

(1) be clearly defined within the instrument and legally certain;

(2) be disclosed and transparent to the market; and

(3) be prudent and timely, and include trigger points which occur:

(a) before a breach of the firm’s capital resources requirement and both:

(i) when the firm’s losses lead to a significant reduction of the firm’s retained earnings or other reserves which causes a significant deterioration of the firm’s financial and solvency conditions; and

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

(b) when the firm is in breach of its capital resources requirement.

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

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

2.2.118

(1) [deleted]

(2) A BIPRU firm may not include a capital instrument at stage B1, B2 or C of the calculation in the capital resources table unless it has obtained a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the criteria in GENPRU 2.2.62 R (Tier one capital: General), GENPRU 2.2.64R (1) to GENPRU 2.2.64R (9) (General conditions for eligibility as tier one capital) and GENPRU 2.2.80 R to GENPRU 2.2.81 R (Loss absorption) are met.

2.2.118A

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

2.2.119

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

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

2.2.123

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

2.2.124

(1) GENPRU 2.2.123 R - GENPRU 2.2.137 R apply to capital of a firm if:

(a) either or both of the conditions in (2) are satisfied; and

(b) any of the SPVs referred to in (2) is a subsidiary undertaking of the firm.

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

(a) that capital is issued to an SPV; or

(b) the subscription for the capital issued by the firm is funded directly or indirectly by an SPV.

(3) A BIPRU firm may not include capital coming within this rule in its capital resources unless the requirements in the following rules are satisfied:

(a) (if (2)(a) applies and (2)(b) does not) GENPRU 2.2.127 R, GENPRU 2.2.129 R and GENPRU 2.2.132 R; or

(b) (in any other case) GENPRU 2.2.133 R.

2.2.125

A BIPRU firm may only count capital to which GENPRU 2.2.124 R applies at stage C of the calculation in the capital resources table.
For the purpose of § GENPRU 2.2, an SPV is, in relation to a BIPRU firm, any undertaking whose main activity is to raise funds for that firm or for a group to which that BIPRU firm belongs.

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

1. it is controlled by the firm and may not operate independently of the firm;
2. the rights of investors in the SPV who do not belong to the group of the BIPRU firm in question are not such as to affect the ability of the firm to control the SPV;
3. all or virtually all of its exposures (calculated by reference to the amount) consist of exposures to the firm or to that firm’s group; and
4. it is incorporated under, and governed by, the laws and jurisdiction of England and Wales, Scotland or Northern Ireland.

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

§ GENPRU 2.2.127R (4) does not apply if the firm has conducted a properly reasoned analysis confirming that any potential risks, including legal and operational risks, associated with cross-border issues, which undermine the quality of the capital for the issuer, that arise from an SPV not being incorporated under or governed by the laws and jurisdiction of England and Wales, Scotland or Northern Ireland, are adequately mitigated.

The analysis must be set out in writing and dated before the date of issue of the capital instrument and the firm must be able to show that the analysis has been fully considered as part of its decision to proceed with the issue. The analysis must be conducted by a person or persons appropriately qualified to assess the relevant risks and that person may be an independent adviser or an employee of the firm who is not part of the business unit responsible for the transaction (including the drafting of the issue documentation).
The SPV referred to in RGENPRU 2.2.124R (2)(a) must fund its subscription for the capital issued by the firm by the issue of capital that satisfies the following conditions:

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

(2) (a) its terms must include an obligation on the firm that, in the event of a collapse of the SPV structure, and if the mechanism contained within the instrument under RGENPRU 2.2.117A R is a conversion, the firm must substitute the capital instrument issued by the SPV with core tier one capital issued by the firm; and

(b) there must be no obstacle to the firm’s issue of new securities;

(3) the conversion ratio in respect of the substitution described in (2) must be fixed when the SPV issues the capital instrument;

(4) to the extent that investors have the benefit of an obligation by a person other than the SPV:

(a) that obligation must be one owed by a member of the firm’s group; and

(b) the extent of that obligation must be no greater than would be permitted by GENPRU if that obligation formed part of the terms of a capital instrument issued by that member which complied with the rules in GENPRU relating to tier one capital included at stage C of the calculation in the capital resources table; and

(5) if the SPV structure collapses, the holder of it has no better a claim against the firm than a holder of the same type of instrument directly issued by the firm.

For the purpose of RGENPRU 2.2.129 R and RGENPRU 2.2.132 R, RGENPRU 2.2.118 R (Requirement to obtain a legal opinion) does not apply.

In relation to the obligation to substitute described in RGENPRU 2.2.129R (2), a firm must take all reasonable steps to ensure that it has at all times authorised and unissued capital instruments which are core tier one capital (and the authority to issue them) sufficient to discharge its obligation to substitute.

RGENPRU 2.2.129R (2) and RGENPRU 2.2.131 R allow a firm to replace the capital issued by the SPV with capital instrument which are core tier one capital.

The capital which the firm seeks to include in its capital resources under RGENPRU 2.2.124R (3)(a) must satisfy the following conditions:

(1) it meets the conditions for inclusion in tier one capital (subject to RGENPRU 2.2.130 R); and

(2) its first call date (if any) must not arise before that on the instrument issued by the SPV; and
(3) its terms relating to repayment must be the same as those of the instrument issued by the SPV.

(1) This rule deals with any transaction:
(a) under which an SPV directly or indirectly funds the subscription for capital issued by the firm as described in GENPRU 2.2.124 R; or
(b) that is directly or indirectly funded by a transaction in (1)(a).

(2) Each undertaking that is a party to a transaction to which this rule applies (other than the firm) must be a subsidiary undertaking of the firm.

(3) Each SPV that is a party to a transaction to which this rule applies must comply with GENPRU 2.2.127 R.

(4) Any capital to which (1) applies (other than the capital that is to be included in the firm’s capital resources) must be in the form of capital that complies with GENPRU 2.2.129R (1) and GENPRU 2.2.129R (4), whether or not issued by an SPV.

(5) The obligations in GENPRU 2.2.129R (2) and GENPRU 2.2.129R (3) only apply to capital issued by an SPV at the end of the chain of transactions beginning with the issue of capital by the firm referred to in GENPRU 2.2.124 R.

(6) GENPRU 2.2.132 R applies to the capital issued by the firm as referred to in GENPRU 2.2.124 R. For these purposes references in GENPRU 2.2.132 R to the instrument issued by the SPV are to the instrument referred to in (5).

The purpose of GENPRU 2.2.133 R is to deal with a capital-raising under which the capital raised by a special purpose vehicle is passed through a number of undertakings before it is invested in the firm. If the capital resources of the firm fall below, or are likely to fall below, its capital resources requirement the firm should replace the capital issued by that first special purpose vehicle with a tier one instrument directly issued by the firm which complies with GENPRU 2.2.129R (2).

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

The FCA is likely to consider as unusual a transaction which involves the raising by the firm of tier one capital through a subsidiary undertaking of that firm that is not an SPV. The FCA would expect a firm to request individual guidance in such circumstances.
A firm must ensure that, in relation to a transaction falling within GENPRU 2.2.124 R:

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

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

**Tier one capital: Conversion ratio**

1. This rule applies to a potential tier one instrument if:
   a. it is redeemable by the firm (ignoring GENPRU 2.2.77 R (Meaning of redemption));
   b. it provides that if the issuer does not exercise that right or does not do so in specified circumstances the issuer must or may have to redeem it in whole or in part through the issue of shares eligible for inclusion in the firm’s tier one capital resources or the instrument converts or may convert into such shares; and
   c. GENPRU 2.2.77 R means that the obligation in (1)(b) is treated as not being inconsistent with GENPRU 2.2.70R (1) (Tier one capital should not be redeemable at the option of the holder).

2. A firm must not include a potential tier one instrument to which this rule applies in its tier one capital resources if:
   a. the conversion ratio as at the date of redemption may be greater than the conversion ratio as at the time of issue by more than 150%; or
   b. the market price of the conversion instruments issued in relation to one unit of the original capital item (plus any cash element of the redemption) may be greater than the issue price of that original capital item.

3. All determinations under this rule are made as at the date of issue of the original capital item.

In GENPRU 2.2.138 R to GENPRU 2.2.142 R:

1. the original capital item means the capital item that is being redeemed; and

2. the conversion instrument means the tier one capital to be issued on its redemption.

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

1. the number of units of the conversion instrument that the firm must issue to satisfy its redemption obligation (so far as it is to be satisfied
by the issue of conversion instruments) in respect of one unit of the
original capital item; to

(2) one unit of the original capital item.

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

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

2.2.143 G (1) The significance of the limitations on conversion in
GENPRU 2.2.138R (2) can be seen in the example in this paragraph.

(2) A firm issues innovative notes with a par value of £100 each. The
terms of the instrument provide that if the instrument is not called at
par at the first call date the notes convert into a variable number of
ordinary shares.

(3) If the market price of the ordinary shares is 400 pence per share on
the day of issue of the innovative notes then the maximum number
of ordinary shares (M) that a single £100 par value innovative note
can be converted into is calculated as follows:

(a) M = Par value of innovative instrument * 150% / market value of
ordinary share;

(b) M = £100 * 1.5/ £4 = 37.5 shares.

(4) The practical effect is that conversion will result in the holder of an
innovative capital note receiving ordinary shares equal to the par
value of that note only when the market price of the ordinary shares
remains above half the market price of the shares at the date of issue
of the notes.

(5) If the market price of the ordinary shares fell by half to 200 pence,
the maximum permitted number of shares (37.5) would have to be
issued in order to give an investor in the innovative note ordinary
shares with a market value equal to £100. If the market price of the
ordinary shares fell below 200 pence, the issue of the maximum
permitted number of ordinary shares would have a market value
below £100.

2.2.144 G (1) In addition to the maximum conversion ratio of 150%
GENPRU 2.2.138R (2)(b) does not permit a firm to issue shares that
would have a market value that exceeds the issue price of the
instrument being redeemed.
(2) In the example in GENPRU 2.2.143 G, if the market value of the ordinary shares was 250 pence at the conversion date, the maximum number of ordinary shares that may be issued to satisfy the redemption of one of the £100 par value innovative notes would be 40 (= £100 / £2.5).

**Tier one capital: Requirement to have sufficient unissued stock**

2.2.145 R

(1) This rule applies to a potential tier one instrument of a firm where either:

(a) the redemption proceeds; or

(b) any coupon on that capital item;

can be satisfied by the issue of another capital instrument.

(2) A firm may only include an item of capital to which this rule applies in its tier one capital resources if the firm has authorised and unissued capital instruments of the kind in question (and the authority to issue them):

(a) that are sufficient to satisfy all such payments then due; and

(b) are of such amount as is prudent in respect of such payments that could become due in the future.

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

2.2.146 R

(1) Where a rule in this section says that a particular treatment applies to an item of capital that is subject to a step-up of a specified amount, the question of whether that rule is satisfied must be judged by reference to the cumulative amount of all step-ups since the issue of that item of capital rather than just by reference to a particular step-up.

(2) Where a step-up arises through a change from paying a coupon on a debt instrument to paying a dividend on a share issued in settlement of the coupon, any net cost to the firm arising from the different tax treatment of the dividend compared to the tax treatment of interest may be ignored for the purpose of assessing the effect of that step-up.

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

2.2.147 R

(1) A firm may not include in its tier one capital resources a tier one instrument that is or may be subject to a step-up that does not meet the definition of moderate in the press release of the Basle Committee on Banking Supervision of 27th October 1998 called "Instruments eligible for inclusion in Tier 1 capital".

(2) For the purpose of (1) the words in that press release “than, at national supervisory discretion, either” are replaced by “than the higher of the following two amounts”.

(3) The calculations required by this rule and GENPRU 2.2.151 R must be carried out as at the date of issue of the relevant instrument.
(4) A BIPRU firm may not include a capital instrument in its tier one capital resources if it is redeemable and subject to more than one step-up.

2.2.148 The effect of GENPRU 2.2.147 R is that for inclusion in tier one capital resources, step-ups in instruments should be moderate. A moderate step-up for these purposes is one which results in an increase over the initial rate that is no greater than the higher of the following two amounts:

(1) 100 basis points, less the swap spread between the initial index basis and the stepped-up index basis; or

(2) 50% of the initial credit spread, less the swap spread between the initial index basis and the stepped-up index basis.

2.2.149 If a coupon paid on an item of capital is initially set at a specified spread above an index (the initial index basis), and the coupon moves to being set relative to another index (the stepped up index basis), there will be an implied step-up (positive or negative) even if the specified spread does not change. This is because each index may itself include a spread relative to the risk free rate and this spread may differ between the two indexes. The deduction of the swap spread in GENPRU 2.2.148G (1) and (2) above adjusts for this difference.

2.2.150 Where the step-up involves a conversion from fixed to floating (or vice versa), or a switch in basis index, the swap spread should be fixed at pricing date, reflecting the differential in pricing between indices at the time. The significance of deducting the swap spread can be seen by the following example:

(1) the pricing date:
   (a) 10 year gilts (G) = 5.5% (the initial index basis);
   (b) 3 month LIBOR is the stepped up index basis and the 10 year mid swap rate (L) = 5.9%;
   (c) initial fixed coupon rate = G + 200bp;
   (d) swap spread = 0.4% (= 5.9% - 5.5%);
   (e) initial fixed coupon rate = 7.5%;
   (f) the swap spread shows that there is 40bps of spread in the stepped up index basis relative to the initial index basis; and
   (g) the initial fixed coupon rate of 7.5% is equivalent to the mid swap rate + 160bp, or L + 200bp – the swap spread;

(2) pricing of stepped-up rate at year 10 with step-up of 100bp without deducting swap spread:
   (a) stepped-up floating rate = L + 200 + 100bp step-up = 8.9%; and
   (b) effective step-up from initial fixed rate of 140bp (= 8.9% - 7.5%); and

(3) pricing of stepped-up rate at year 10 with step-up of 100bp with deduction of the swap spread:
(a) stepped-up floating coupon rate = L + 200 less 40bp swap spread (difference between 5.5% and 5.9%) + 100bp step-up = 8.5%

(b) effective step-up from initial rate of 100bp (= 8.5% - 7.5%).

2.2.151

(1) Subject to (2), if a tier two instrument is or may be subject to a step-up that does not meet the definition of moderate in the press release of the Basle Committee on Banking Supervision referred to in GENPRU 2.2.147R (1) as adjusted under GENPRU 2.2.147R (2), the first date that a step-up can take effect is deemed to be its final maturity date if that date is before its actual maturity date.

(2) If a tier two instrument:

(a) is or may be subject to a step-up during the period beginning on the fifth anniversary of the date of issue of that item and ending immediately before the tenth anniversary of the date of issue; and

(b) the step-up or possible step-up is one which may result in an increase over the initial rate that is greater than 50 basis points, less the swap spread between the initial index basis and the stepped-up index basis (all these terms must be interpreted in accordance with GENPRU 2.2.147 R);

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

2.2.152

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

(1) the instrument is fungible with other instruments (the “existing stock”) that are included in the firm’s tier one capital resources (in the case of GENPRU 2.2.147 R) or tier two capital resources (in the case of GENPRU 2.2.151 R);

(2) (if there has been no more than one previous issue of the existing stock) the existing stock complied with those limits on its date of issue;

(3) (if there has been more than one previous issue of the existing stock) the first such issue of the existing stock complied with those limits on its date of issue; and

(4) the result of the step-up on the instrument to which this rule applies is that the coupon on that instrument and the coupon on the existing stock is the same.

2.2.153

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

(2) A firm must not include in its tier two capital resources a capital instrument that is or may become subject to a step-up if that step-up
Debt instruments containing embedded options, e.g. issues containing options for the interest rate after the step-up to be at a margin over the higher of two (or more) reference rates, or for the interest rate in the previous period to act as a floor, may affect the funding costs of the borrower and imply a step-up. In such circumstances, a firm may wish to seek individual guidance on the application of the rules relating to step-ups to the capital instrument in question. See SUP 9 (Individual guidance) for the process to be followed when seeking individual guidance.

### Deductions from tier one: Intangible assets

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

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

Intangible assets include goodwill as defined in accordance with the requirements referred to in GENPRU 1.3.4 R (General requirements: accounting principles to be applied) applicable to the firm.

### Tier two capital: General

Tier two capital resources are split into upper and lower tiers. A major distinction between upper and lower tier two capital is that, except as provided by GENPRU 2.2.26A R for BIPRU firms, only perpetual instruments may be included in upper tier two capital whereas dated instruments, such as fixed term preference shares and dated subordinated debt, may be included in lower tier two capital.

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

### General conditions for eligibility as tier two capital instruments

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

1. the claims of the creditors must rank behind those of all unsubordinated creditors;
2. the only events of default must be non-payment of any amount falling due under the terms of the capital instrument or the winding-up of the firm and any such event of default must not prejudice the subordination in (1);
(3) to the fullest extent permitted under the laws of the relevant jurisdictions, the remedies available to the subordinated creditor in the event of non-payment or other breach of the terms of the capital instrument must (subject to GENPRU 2.2.161 R) be limited to petitioning for the winding-up of the firm or proving for the debt in the liquidation or administration;

(4) any:
   (a) remedy permitted by (3);  
   (b) remedy that cannot be excluded under the laws of the relevant jurisdictions as referred to in (3);  
   (c) remedy permitted by GENPRU 2.2.161 R; and  
   (d) terms about repayment as referred to in (5);  
   must not prejudice the matters in (1) and (2) and in particular any damages permitted by (b) or (c) and repayment obligation must be subordinated in accordance with (1);

(5) without prejudice to (1), the debt must not become due and payable before its stated final maturity date (if any) except on an event of default complying with (2) or as permitted by GENPRU 2.2.172 R (Repayment at the option of the issuer) or GENPRU 2.2.194R (Repayment of lower tier two capital at the option of the holder) and any remedy described in (4)(a) to (c) must not prejudice this requirement;

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

(7) to the fullest extent permitted under the laws of the relevant jurisdictions, creditors must waive their right to set off amounts they owe the firm against subordinated amounts included in the firm's capital resources owed to them by the firm;

(8) the terms of the capital instrument must be set out in a written agreement that contains terms that provide for the conditions set out in (1) to (7);

(9) the debt must be unsecured and fully paid up;

(10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9);

(11) the amount of the item included must be net of any foreseeable tax charge at the moment of its calculation or must be suitably adjusted in so far as such tax charges reduce the amount up to which that item may be applied to cover risks or losses; and

(12) the firm has obtained a properly reasoned independent legal opinion from an appropriately qualified individual stating that the requirements in (1) to (7) and (insofar as it relates to whether the capital instrument is unsecured) (9) have been met.
A holder of a non-deferred share of a building society must be treated as a senior unsecured creditor of that building society for the purpose of GENPRU 2.2.159 R.

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

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

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

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

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

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

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

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

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

For the purposes of GENPRU 2.2.159R (5) the debt agreement or terms of the instrument should not contain any clause which might require early repayment of the debt (e.g. cross default clauses, negative pledges and restrictive covenants). A cross default clause is a clause which says that the loan goes into default if any of the borrower’s other loans go into default. It is intended to prevent one creditor being repaid before other creditors, e.g. obtaining full repayment through the courts. A negative pledge is a clause which puts the loan into default if the borrower gives any further charge over its assets. A restrictive covenant is a term of contract that directly, or
indirectly, could lead to early repayment of the debt. Some covenants, e.g. relating to the provision of management information or ownership restrictions, are likely to comply with GENPRU 2.2.159R (3) as long as monetary redress is ruled out, or any payments are covered by the subordination clauses.

2.2.166 GENPRU 2.2.159R (3) allows a capital instrument to form part of the tier two capital resources even though the laws of the relevant jurisdiction do not allow remedies to be limited in the way described there. For example it is not possible to limit certain remedies in the case of an issue in the United States that is SEC-registered and subject to the provisions of the Trust Indenture Act.

2.2.167 The purpose of GENPRU 2.2.159R (7) is to ensure that all of the firm’s assets are available to consumers ahead of subordinated creditors. The waiver should apply both before and during liquidation or administration.

2.2.168 The guidance in GENPRU 2.2.119 G (Employee may give legal opinion) also applies for the purpose of GENPRU 2.2.159R (12) and GENPRU 2.2.163 R.

Tier two capital instruments: Connected transactions

2.2.169 An item of capital does not comply with GENPRU 2.2.159 R (General conditions for eligibility as tier two capital instruments) or GENPRU 2.2.177 R (Upper tier two capital: General) if the issue of that item of capital by the firm is connected with one or more other transactions which, when taken together with the issue of that item, could result in that item of capital no longer displaying all of the characteristics set out in whichever of those rules apply.

2.2.170 GENPRU 2.2.66 G (Guidance on GENPRU 2.2.65 R) applies to GENPRU 2.2.169 R in the same way as it does to GENPRU 2.2.65 R (The equivalent of GENPRU 2.2.169 R in relation to tier one capital).

Amendment of tier two instruments

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

(1) at least one Month before the amendment is due to take effect, the firm has given the FCA notice in writing of the proposed amendment and the FCA has not objected; and

(2) that notice includes confirmation that the legal opinions referred to in GENPRU 2.2.159R (12) and, if applicable, GENPRU 2.2.163 R (General conditions for eligibility as tier two capital instruments: Alternative governing laws) and GENPRU 2.2.181 R (Legal opinions for upper tier two instruments), continue in full force and effect in relation to the terms of the debt and documents after any proposed amendment.
Redemption of tier two instruments

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

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

In relation to a tier two instrument, a firm must notify the:

(1) [deleted]

(2) [deleted]

FCA one month before it becomes committed to the proposed repayment (unless that firm intends to repay an instrument on its final maturity date). When giving notice, the firm must provide details of its position after such repayment in order to show how it will:

(3) meet its capital resources requirement; and

(4) have sufficient financial resources to meet the overall financial adequacy rule.

Tier two capital: step-ups

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

Upper tier two capital: General

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

(1) perpetual cumulative preference shares;

(2) perpetual subordinated debt; and

(3) other instruments that have the same economic characteristics as (1) or (2).

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

(1) it must have no fixed maturity date;
(2) the terms of the instrument must provide for the firm to have the option to defer any coupon on the debt, except that the firm need not have that right in the case of a coupon payable in the form of an item of capital that is included in the same stage of capital or a higher stage of capital as that first item of capital;

(3) the terms of the instrument must provide for the loss-absorption capacity of the capital instrument and unpaid coupons, whilst enabling the firm to continue its business;

(4) it meets the conditions in GENPRU 2.2.169 R (Connected transactions) and GENPRU 2.2.180 R (Loss absorption); and

(5) the terms of the instrument are such that either the instrument or debt is not redeemable or repayable or it is repayable or redeemable only at the option of the firm.

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

2.2.179 (1) The purpose of GENPRU 2.2.177R (2) is to ensure that a firm which issues an item of capital with a coupon retains flexibility over the payments of such coupon and can preserve cash in times of financial stress. However, a firm may include, as part of the capital instrument terms, a right to make payments of a coupon mandatory if an item of capital becomes ineligible to form part of its capital resources (for example, through a change in the relevant rules) and the firm has notified the FCA that the instrument is ineligible.

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

(3) GENPRU 2.2.26A R provides an exception, in the case of a BIPRU firm, to the rule that instruments must have no fixed maturity date to be eligible for upper tier two capital resources.

Upper tier two capital: Loss absorption

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

(1) do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986; or

(2) do constitute such a liability but the terms of the instrument are such that:

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

   (i) the firm is, or is likely to become, unable to pay its debts; or

   (ii) its liabilities exceed its assets;
(b) a person (including but not limited to a holder of the instrument) is not able to petition for the winding up or administration of the firm or for any similar procedure in relation to the firm on the grounds that the firm is or may become unable to pay any such liability; and

(c) the firm is not obliged to take into account such a liability for the purposes of deciding whether or not the firm is, or may become, insolvent for the purposes of section 214 of the Insolvency Act 1986 (wrongful trading).

Upper tier two capital: Legal opinions

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

Upper tier two capital: Guidance

2.2.182 G □ GENPRU 2.2.180 R is an example of the general principle in □ GENPRU 2.2.177R (3).

2.2.183 G The guidance in □ GENPRU 2.2.117 G (There should be no liability to the extent that the firm would become insolvent, etc) also applies for the purpose of □ GENPRU 2.2.180 R.

2.2.184 G The guidance in □ GENPRU 2.2.119 G (Employee may give legal opinion) also applies for the purpose of □ GENPRU 2.2.181 R.

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

2.2.185 R (1) This rule applies to a BIPRU firm.

(2) A BIPRU firm must, in relation to equities held in the available-for-sale financial assets category:

(a) deduct any net losses at stage E of the calculation in the capital resources table (Deductions from tier one capital); and

(b) include any net gains (after deduction of deferred tax) in revaluation reserves at stage G of the calculation in the capital resources table (Upper tier two capital).

(3) A BIPRU firm must include any net gains, after deduction of deferred tax, on revaluation reserves of investment properties at stage G of the calculation in the capital resources table. A firm must include any losses on such revaluation reserves in profit and loss account and other reserves.

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

(6) (3) and (4) apply to a firm whatever the accounting treatment of those items is under the accounting framework that applies to the firm as referred to in GENPRU 1.3.4 R.

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

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

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

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

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

1. the market risk capital requirement multiplied by a factor of 12.5; and
2. the sum of risk weighted assets under the standardised approach for credit risk.

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

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

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

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

2.2.192 R

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

2.2.193 R

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

Lower tier two capital

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

(1) it has an original maturity of at least five years; or

(2) it is redeemable on notice from the holder, but the period of notice of repayment required to be given by the holder is five years or more.

2.2.195 G

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

2.2.196 R

(1) For the purposes of calculating the amount of a lower tier two instrument which may be included in a firm’s capital resources:

(a) in the case of an instrument with a fixed maturity date, in the final five years to maturity; and

(b) in the case of an instrument with or without a fixed maturity date but where five years’ or more notice of redemption or repayment has been given, in the final five years to the date of redemption or repayment;

the principal amount must be amortised on a straight line basis.

(2) If a firm gives notice of the redemption or repayment of a lower tier two instrument and (1) does not apply, the firm must no longer include it in its lower tier two capital resources.

2.2.197 G

If a firm wishes to include in lower tier two capital resources an instrument with or without a fixed maturity date but where less than five years’ notice of redemption or repayment has been given, it should seek individual guidance from the FCA.
The effect of swaps on debt capital

2.2.198 R
GENPRU 2.2.198 R to GENPRU 2.2.201 R apply to a tier one instrument, tier two instrument or tier three instrument of a firm that is treated as a liability under the accounting framework to which it is subject as referred to in GENPRU 1.3.4 R (General requirements: accounting principles to be applied) (a "debt instrument").

2.2.199 R
A firm must recognise for the purpose of this section any effect that changes in exchange rates or interest rates have on a debt instrument (as defined in GENPRU 2.2.198 R) under the accounting framework to which the firm is subject as referred to in GENPRU 1.3.4 R (General requirements: accounting principles to be applied).

2.2.200 R
A firm must recognise, in accordance with GENPRU 2.2.201 R, the effect of a foreign currency hedge on a debt instrument (as defined in GENPRU 2.2.198 R) denominated in a foreign currency or of an interest rate hedge on a fixed rate coupon debt instrument if:

1. the accounting framework to which the firm is subject as referred to in GENPRU 1.3.4 R (General requirements: accounting principles to be applied) provides for a fair value hedge accounting relationship between a liability and its related hedge;

2. such a relationship exists under that accounting framework between that debt instrument and that hedge;

3. (if the debt instrument is a tier one instrument) the firm's obligations under that hedge comply with the conditions in GENPRU 2.2.64 R to GENPRU 2.2.65 R (General conditions for eligibility as tier one capital);

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

(a) GENPRU 2.2.159R (9) only applies to the extent that it requires that hedge to be unsecured; and

(b) GENPRU 2.2.159R (12) (legal opinion) does not apply.

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

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

2.2.202 R
GENPRU 2.2.202 R to GENPRU 2.2.207 R only apply to a bank or building society.
A qualifying holding is a direct or indirect holding of a bank or building society in a non-financial undertaking which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking.

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

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

The amount of qualifying holdings that a bank or building society must deduct in the calculation in the capital resources table is:

1. (if the firm has one or more qualifying holdings that exceeds 15% of its relevant capital resources) the sum of such excesses; and
2. to the extent not already deducted in (1), the amount by which the sum of each of that firm's qualifying holdings exceeds 60% of its relevant capital resources.

The relevant capital resources of a firm mean for the purposes of this rule the sum of the amount of capital resources calculated at stages L (Total tier one capital plus tier two capital) and Q (Total tier three capital) of the calculation in the capital resources table as adjusted in accordance with the following:

1. the firm must not take into account the items referred to in any of the following:
   a. GENPRU 2.2.190 R to GENPRU 2.2.193 R (surplus provisions); or
   b. GENPRU 2.2.236 R (expected loss amounts and other negative amounts); or
   c. GENPRU 2.2.237 R (securitisation positions);

2. the firm must make the deductions to be made at stage S of the calculation in the capital resources table (Deductions from total capital); and

3. the firm need not deduct any excess trading book position under (2).

The following are not included as qualifying holdings:

1. shares that are not held as investments; or
(2) shares that are held temporarily during the normal course of underwriting; or

(3) shares held in a firm’s name on behalf of others.

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

(1) Subject to (2) and (3), a material holding is:

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

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

(c) a bank or building society’s aggregate holdings in the non-trading book of shares, any other interest in the capital, and subordinated debt in all credit institutions or financial institutions not deducted under (a) or (b) if the total amount of such holdings exceeds 10% of that firm’s capital resources at stage N of the calculation in the capital resources table (calculated before deduction of its material holdings); only the excess amount is a material holding; or

(d) a material insurance holding.

(2) If a BIPRU firm holds shares in the capital of Business Growth Fund plc or another financial institution which makes venture capital investments (in this section and its related annexes, a "Venture Capital Investor") and the following conditions are met:

(a) the sole business of the Venture Capital Investor is the making of venture capital investments together with the performance of ancillary activities in relation to the administration of the venture capital investments;

(b) none of the venture capital investments made by the Venture Capital Investor is an investment (direct or indirect) in:

(i) a credit institution; or

(ii) a financial institution the principal activity of which is to perform any activity other than the acquisition of holdings in other undertakings;
(c) the relevant proportion of the Venture Capital Investor is included in the firm’s UK consolidation group in accordance with BIPRU 8.5; and

(d) the firm assigns a risk weight to its exposure to the Venture Capital Investor as if it were an equity exposure to which the simple risk weight approach is applied as set out in BIPRU 4.7.9 R to BIPRU 4.7.12 R (and in calculating its capital resources requirement the firm must assign a risk weight to that exposure in accordance with those rules and notwithstanding that those rules would not otherwise apply to that calculation);

the Venture Capital Investor may be ignored for the purposes of determining whether there is a material holding.

(3) If a BIPRU firm holds shares in the capital of a subsidiary undertaking which is a financial institution solely by reason of its principal activity being the acquiring of holdings and which in turn holds (directly or indirectly) shares in the capital of a Venture Capital Investor (in this section and its related annexes, a “Venture Capital Holding Company”) and the following conditions are met:

(a) the Venture Capital Investor meets the conditions in (2)(a) and (b);

(b) the Venture Capital Holding Company is included in the firm’s UK consolidation group in accordance with BIPRU 8.5;

(c) the proportion of the value of the Venture Capital Holding Company attributable to investment in Venture Capital Investors and the proportion of the value of the Venture Capital Holding Company attributable to investment in other investments can be identified and valued on a regular basis; and

(d) the firm assigns a risk weight to its exposure to the proportion of the Venture Capital Holding Company that represents the value of its investment in Venture Capital Investors as if it were an equity exposure to which the simple risk weight approach is applied as set out in BIPRU 4.7.9 R to BIPRU 4.7.12 R (and in calculating its capital resources requirement the firm must assign a risk weight to that exposure in accordance with those rules and notwithstanding that those rules would not otherwise apply to that calculation);

the proportion of the firm’s investment in the Venture Capital Holding Company that represents the value of its investment in Venture Capital Investors may be ignored for the purposes of determining whether there is a material holding. The proportion of the firm’s investment in the Venture Capital Holding Company that represents the value of other investments is a material holding.

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

2.2.211 When calculating the size of its material holdings a firm must only include an actual holding (that is, a long cash position). A firm must not net such holdings with a short position.
2.2.212 A *material insurance holding* means the holdings of a *BIPRU firm* of items of the type set out in §GENPRU 2.2.213 in any:

1. *insurance undertaking*; or

2. *insurance holding company*;

that fulfils one of the following conditions:

3. it is a *subsidiary undertaking* of that *firm*; or

4. that *firm* holds a *participation* in it.

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

1. an *ownership share*; or

2. an item of "basic own funds" as defined in the PRA Rulebook: Glossary.

2.2.214 The amount to be deducted with respect to each *material insurance holding* is the higher of:

1. the book value of the *material insurance holding*; and

2. the *solo capital resources requirement* for the *insurance undertaking* or *insurance holding company* in question calculated in accordance with:

   a. for an *insurer* that is a *Solvency II firm*, the PRA Rulebook: Solvency II Firms; and

   b. for an *insurer* other than in (a), the PRA Rulebook: Non-Solvency II Firms.

2.2.215 For the purpose of the definition of a *material holding*, holdings must be valued using the valuation method which the holder uses for its external financial reporting purposes.

2.2.216 (1) This paragraph gives *guidance* on how the calculation under §GENPRU 2.2.214R (1) should be carried out where an *insurance undertaking* is accounted for using the embedded value method.

(2) On acquisition, any "goodwill" element (that is, the difference between the acquisition value according to the embedded value method and the actual investment) should be deducted from *tier one capital resources*.

(3) The embedded value should be deducted from the total of *tier one capital resources* and *tier two capital resources*.

(4) Post-acquisition, where the embedded value of the *undertaking* increases, the increase should be added to reserves, while the new embedded value is deducted from total *capital resources*. 
(5) This means that the net impact on the level of total capital resources is zero, although tier two capital resources headroom will increase with any increase in tier one capital resources reserves.

(6) Embedded value is the value of the undertaking taking into account the present value of the expected future inflows from existing life assurance business.

(1) This paragraph gives guidance as to the amount to be deducted at Part 2 of stage M (Deductions from the totals of tier one and two) of GENPRU 2 Annex 2 (Capital resources table for a bank) and GENPRU 2 Annex 3 (Capital resources table for a building society) in respect of investments in subsidiary undertakings and participations (excluding any amount which is already deducted as material holdings or qualifying holdings).

(2) The effect of those rules is to achieve the deduction of all investments in subsidiary undertakings and participations for banks and building societies by ensuring that amounts not already deducted under other rules are accounted for at this stage of the calculation of capital resources, except where the investment has been made in:

(a) a Venture Capital Investor and the conditions in GENPRU 2.2.209R (2) are met; or

(b) a Venture Capital Holding Company and the conditions in GENPRU 2.2.209R (3) are met;

(3) The following investments in subsidiary undertakings and participations should be deducted at this stage:

(a) those not deducted in Part 1 of stage M because of the operation of the thresholds in GENPRU 2.2.205 R (on qualifying holdings) and GENPRU 2.2.209 R (on material holdings); and

(b) those which do not meet the definition of qualifying holding or material holding, but excluding investments in Venture Capital Investors which are ignored in accordance with GENPRU 2.2.209R (2) and investments in Venture Capital Holding Companies which are ignored in accordance with GENPRU 2.2.209R (3), for the purposes of determining whether there is a material holding.

(4) For example, an investment in an undertaking which is not a qualifying holding under GENPRU 2.2.204R (2) (on the definition of a non-financial undertaking), that is whose exclusive or main activities are a direct extension of banking or concern services ancillary to banking, such as leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity, should be deducted at this stage.

Deductions from tiers one and two: Reciprocal cross holdings (BIPRU firm only)
2.2.218 R A BIPRU firm must deduct at stage M of the calculation in the capital resources table (Deductions from the totals of tier one and two) any reciprocal cross-holdings. However a BIPRU firm must not deduct such holdings to the extent that they fall to be deducted at Part 1 of stage M of the calculation in the capital resources table (Deductions for material holdings, qualifying holdings and certain other items).

2.2.219 R A reciprocal cross-holding means a holding of the BIPRU firm of shares, any other interest in the capital, and subordinated debt, whether in the trading or non-trading book, in:

(1) a credit institution; or

(2) a financial institution;

that satisfies the following conditions:

(3) the holding is the subject of an agreement or arrangement between the BIPRU firm and either the issuer of the instrument in question or a member of a group to which the issuer belongs;

(4) under the terms of the agreement or arrangement described in (3) the issuer invests in the BIPRU firm or in a member of the group to which that BIPRU firm belongs; and

(5) the effect of that agreement or arrangement on the capital position of the BIPRU firm, the issuer, or any member of a group to which either belongs, under any relevant rules is significantly more beneficial than it is in economic terms, taking into account the agreement or arrangement as a whole.

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

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

2.2.221 R

(1) 2.2.221 R to 2.2.235 G only apply to a bank.

(2) If a firm has elected to ignore an investment in a Venture Capital Investor or a Venture Capital Holding Company in accordance with 2.209R (2) or (3), for the purposes of determining whether there is a material holding, 2.221 R to 2.233 R do not apply to any lending by the firm to that Venture Capital Investor or Venture Capital Holding Company, provided that any lending to the Venture Capital Holding Company is made to and deployed by the firm solely in connection with the Venture Capital Investor.

2.2.222 R Connected lending of a capital nature means all lending within 2.227 R or 2.229 R and guarantees within 2.231 R or 2.233 R.
A bank must not deduct any item as connected lending of a capital nature to the extent that it falls to be deducted at Part 1 of stage M of the calculation in the capital resources table (Deductions for material holdings, qualifying holdings and certain other items) or as a reciprocal cross-holding.

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

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

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

A loan is connected lending of a capital nature if:

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

A loan falls into this rule for the purposes of GENPRU 2.2.227 R (2) if, whether through contractual, structural, reputational or other factors:

1. based on the terms of the loan and the other knowledge available to the bank, the borrower would be able to consider it from the point of view of its characteristics as capital as being similar to share capital or subordinated debt; or
2. the position of the lender from the point of view of maturity and repayment is inferior to that of the senior unsecured and unsubordinated creditors of the borrower.
A loan is also connected lending of a capital nature if:

1. it funds directly or indirectly a loan to a connected party of the bank falling into GENPRU 2.2.228 R or an investment in the capital of a connected party of the bank; and

2. it falls into GENPRU 2.2.228 R.

It is likely that a loan is not connected lending of a capital nature if:

1. it is secured by collateral that is eligible for the purposes of credit risk mitigation under the standardised approach to credit risk as set out in BIPRU 5.4 (Financial collateral) and BIPRU 5.5 (Other funded credit risk mitigation); or

2. it is repayable on demand (and should be treated as such for accounting purposes by the borrower and lender) and the bank can demonstrate that there are no potential obstacles to exercising the right to repay, whether contractual or otherwise.

A guarantee is connected lending of a capital nature if it is a guarantee by the bank of a loan from a third party to a connected party of the bank and:

1. the loan meets the requirements of GENPRU 2.2.228 R; or

2. the rights that the bank would have against the borrower with respect to the guarantee meet the requirements of GENPRU 2.2.228R (2).

A guarantee is also connected lending of a capital nature if it is a guarantee by the bank of a loan falling into GENPRU 2.2.229R (1); and

1. the loan meets the conditions in GENPRU 2.2.228 R; or

2. the guarantee meets the conditions in GENPRU 2.2.231R (2).

The amount of a guarantee that constitutes connected lending of a capital nature that a firm must deduct is the amount guaranteed.

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

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

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

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

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

1. any negative amounts arising from the calculation in BIPRU 4.3.8 R (Treatment of expected loss amounts); and

2. any expected loss amounts calculated in accordance with BIPRU 4.7.12 R (Expected loss amounts under the simple risk weight approach to calculating risk weighted exposure amounts for exposures belonging to the equity exposure IRB exposure class) or BIPRU 4.7.17 R (Expected loss amounts under the PD/LGD approach).

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

2.2.237 A BIPRU firm calculating risk weighted exposure amounts under the IRB approach or the standardised approach to credit risk must deduct from its capital resources the following:

1. the exposure amount of securitisation positions which receive a risk weight of 1250% under BIPRU 9 (Securitisation), unless the firm includes the securitisation positions in its calculation of risk weighted exposure amounts (see BIPRU 9.10 (Reduction in risk-weighted exposure amounts)); and

2. the exposure amount of securitisation positions in the trading book that would receive a risk weight of 1250% if they were in the firm's non-trading book.

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

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

1. material holdings;

2. expected loss amounts and other negative amounts referred to in GENPRU 2.2.236 R; and

3. securitisation positions referred to in GENPRU 2.2.237 R.

2.2.239 (1) The treatment in the capital resources table of the deductions in GENPRU 2.2.238 R only has effect for the purpose of the capital resources gearing rules.

(2) In other cases (3) and (4) apply.
(3) A BIPRU firm making the deductions described in GENPRU 2.2.238 R must deduct 50% of the total amount of those deductions at stage E (Deductions from tier one capital) and 50% at stage J (Deductions from tier two capital) of the calculation in the capital resources table after the application of the capital resources gearing rules.

(4) To the extent that half of the total of:
   (a) material holdings;
   (b) expected loss amounts and other negative amounts; and
   (c) securitisation positions;
exceeds the amount calculated at stage I (Total tier two capital) of that calculation, a firm must deduct that excess from the amount calculated at stage F (Total tier one capital after deductions) of the capital resources table.

2.2.240 The alternative calculation in GENPRU 2.2.239R (3) to (4) is only relevant to BIPRU 11 (Pillar 3 disclosures) and certain reporting requirements under SUP. However the deduction of material holdings at Part 2 of stage E of the capital resources table in the case of a BIPRU firm with an investment firm consolidation waiver has effect for all purposes.

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

2.2.241 GENPRU 2.2.241 R to GENPRU 2.2.245 R only apply to a BIPRU firm.

2.2.242 A BIPRU firm may include subordinated debt in its upper tier three capital resources only if:
   (1) it has an original maturity of at least two years or is subject to at least two years’ notice of repayment; and
   (2) payment of interest or principal is permitted only if, after that payment, the firm’s capital resources would be not less than its capital resources requirement.

2.2.243 A BIPRU firm which includes subordinated debt in its tier three capital resources must notify the FCA one month in advance of all payments of either interest or principal made when the firm’s capital resources are less than 120% of its capital resources requirement.

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

2.2.245 Table: Application of tier two capital rules to tier three debt
   This table belongs to GENPRU 2.2.244 R
Tier two capital rule

| GENPRU 2.2.159 R (General conditions for eligibility as tier two capital) | The references in GENPRU 2.2.159R (5) (Capital must not become repayable prior to stated maturity date except in specified circumstances) to repayment at the option of the holder are replaced by a reference to GENPRU 2.2.242R (1) (Upper tier three capital should have maturity or notice period of at least two years) The reference in GENPRU 2.2.159R (10) (Description of tier two capital in marketing documents) to GENPRU 2.2.265R |
| GENPRU 2.2.161 R (Additional remedies) | |
| GENPRU 2.2.163 R (Legal opinion where debt subject to a law of a country outside the United Kingdom) | |
| GENPRU 2.2.168 R (Ineligibility as tier two capital owing to connected transactions) | The reference to GENPRU 2.2.177 R (General eligibility conditions for upper tier two capital) does not apply |
| GENPRU 2.2.171 R (Amendments to terms of the capital instrument) | |
| GENPRU 2.2.172 R to GENPRU 2.2.173 R (Redeemability at the option of the issuer) | |
| GENPRU 2.2.174 R (Notification of redemption) | |
| References in the rules in the first column to the fifth anniversary are amended so as to refer to the second anniversary. | |

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

2.2.246 R ■ GENPRU 2.2.246 R to ■ GENPRU 2.2.249 R only apply to a BIPRU firm.

2.2.247 R A BIPRU firm’s net interim trading book profits mean its net trading book profits adjusted as follows:

(1) they are net of any foreseeable charges or dividends and less net losses on its other business; and

(2) a firm must not take into account items that have already been included in the calculation of capital resources as part of the calculation of the following items:

(a) interim net profits (see stage (A) of the capital resources table); or

(b) interim net losses or material interim net losses (see stage (A) of the capital resources table); or

(c) profit and loss and other reserves (see stage (A) of the capital resources table).
2.2.248 R Trading book profits and losses, other than those losses to which
GENPRU 2.2.86R (2) (Valuation adjustment and reserves) refers, originating
from valuation adjustments or reserves as referred to in GENPRU 1.3.29 R to
GENPRU 1.3.35A G (Valuation adjustments or reserves) must be included in
the calculation of net interim trading book profits and be added to or
deducted from tier three capital resources.

2.2.249 R Trading book valuation adjustments or reserves as referred to in
GENPRU 1.3.29 R to GENPRU 1.3.35A G which exceed those made under the
accounting framework to which a firm is subject must be treated in
accordance with GENPRU 2.2.248 R if not required to be treated under
GENPRU 2.2.86R (2).

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

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

2.2.260 R Illiquid assets means illiquid assets including

(1) tangible fixed assets (except land and buildings if they are used by a
firm as security for loans, but this exclusion is only up to the value of
the principal outstanding on the loans); or

(2) any holdings in the capital resources of credit institutions or financial
institutions, except to the extent that:
   (a) they have already been deducted as a material holding; or
   (b) they are shares which are included in a firm's trading book and
      included in the calculation of the firm's market risk capital
      requirement; or

(3) holdings of other securities which are not readily realisable securities;
   or

(4) deficiencies of net assets in subsidiary undertakings; or

(5) deposits which are not repayable within 90 days (except for payments
    in connection with margined futures or options contracts); or

(6) loans and other amounts owed to a firm except where they are due
to be repaid within 90 days; or

(7) physical stocks except for positions in physical commodities which are
    included in the calculation of a firm's commodity PRR.

2.2.261 G If a loan or other amount owing to a firm was originally due to be paid
more than 90 days from the date of the making of the loan or the incurring
of the payment obligation, as the case may be, it may be treated as liquid
for the purposes of GENPRU 2.2.260R (6) where through the passage of time
the remaining time to the contractual repayment date falls below 90 days.
If a loan or other amount is due to be paid within 90 days (whether measured by reference to original or remaining maturity), a firm should consider whether it can reasonably expect the amount owing to be paid within that period. If the firm cannot reasonably expect it to be paid within that period the firm should treat it as illiquid.

Deductions from total capital: Excess trading book position (bank or building society only)

2.2.263 R 
GENPRU 2.2.263 R to GENPRU 2.2.265 R only apply to a bank or building society.

2.2.264 R 
(1) The excess trading book position is the excess of:
   (a) a bank or building society’s aggregate net long (including notional) trading book positions in shares, subordinated debt or any other interest in the capital of credit institutions or financial institutions;
   over;
   (b) 25% of that firm’s capital resources calculated at stage T (Total capital after deductions) of the capital resources table (calculated before deduction of the excess trading book position).

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

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

2.2.270 R [deleted]

2.2.270A G [deleted]

2.2.271 R [deleted]

2.2.272 G [deleted]

2.2.274 G [deleted]

Public sector guarantees

2.2.276 R A BIPRU firm may not include a guarantee from a state or public authority in its capital resources.
Capital resources table for an insurer
Capital resources table for a bank
Capital resources table for a building society
Capital resources table for a BIPRU firm deducting material holdings

<table>
<thead>
<tr>
<th>Type of capital</th>
<th>Related text</th>
<th>Stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core tier one capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Permanent share capital</td>
<td>GENPRU 2.2.83 R</td>
<td>(A)</td>
</tr>
<tr>
<td>Profit and loss account and other reserves (taking into account material interim net losses)</td>
<td>GENPRU 2.2.85 R to 2.2.90</td>
<td></td>
</tr>
<tr>
<td>Eligible partnership capital</td>
<td>GENPRU 2.2.93 R; GENPRU 2.2.95 R</td>
<td></td>
</tr>
<tr>
<td>Eligible LLP members' capital</td>
<td>GENPRU 2.2.94 R; GENPRU 2.2.95 R</td>
<td></td>
</tr>
<tr>
<td>Sole trader capital</td>
<td>None</td>
<td></td>
</tr>
<tr>
<td>Share premium account</td>
<td>GENPRU 2.2.101 R</td>
<td></td>
</tr>
<tr>
<td>Externally verified interim net profits</td>
<td>GENPRU 2.2.102 R</td>
<td></td>
</tr>
<tr>
<td>Hybrid capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stage B1</td>
<td>GENPRU 2.2.115A R to GENPRU 2.2.117B R</td>
<td>(B1)</td>
</tr>
<tr>
<td>Stage B2</td>
<td>GENPRU 2.2.115D R to GENPRU 2.2.117B R</td>
<td>(B2)</td>
</tr>
<tr>
<td>Stage C</td>
<td>GENPRU 2.2.115F R to GENPRU 2.2.117B R</td>
<td>(C)</td>
</tr>
<tr>
<td>Total tier one capital before deductions = A + B1 + B2 + C</td>
<td></td>
<td>(D)</td>
</tr>
<tr>
<td>Deductions from tier one capital</td>
<td></td>
<td>(E)</td>
</tr>
<tr>
<td>Investments in own shares</td>
<td>None</td>
<td></td>
</tr>
<tr>
<td>Intangible assets</td>
<td>GENPRU 2.2.155 R</td>
<td></td>
</tr>
<tr>
<td>Excess of drawings over profits for partnerships, limited liability partnerships and sole traders</td>
<td>GENPRU 2.2.100 R; there is no related text for sole traders</td>
<td></td>
</tr>
<tr>
<td>Net losses on equities held in the available-for-sale financial asset category</td>
<td>GENPRU 2.2.185 R</td>
<td></td>
</tr>
<tr>
<td>(For certain limited purposes only certain additional deductions are made here)</td>
<td>GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)</td>
<td></td>
</tr>
<tr>
<td>Total tier one capital after deductions = D-E</td>
<td></td>
<td>(F)</td>
</tr>
<tr>
<td>Upper tier two capital</td>
<td></td>
<td>(G)</td>
</tr>
<tr>
<td>Perpetual cumulative preference shares</td>
<td>GENPRU 2.2.159 R to GENPRU 2.2.181 R</td>
<td></td>
</tr>
<tr>
<td>Perpetual subordinated debt</td>
<td>See previous entry</td>
<td></td>
</tr>
</tbody>
</table>
The capital resources calculation for an investment firm deducting material holdings

<table>
<thead>
<tr>
<th>Type of capital</th>
<th>Related text</th>
<th>Stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Perpetual subordinated securities</td>
<td>See previous entry</td>
<td></td>
</tr>
<tr>
<td>Revaluation reserves</td>
<td>GENPRU 2.2.185 R</td>
<td></td>
</tr>
<tr>
<td>General/collective provisions</td>
<td>GENPRU 2.2.187 R to GENPRU 2.2.189 R</td>
<td></td>
</tr>
<tr>
<td>Surplus provisions</td>
<td>GENPRU 2.2.190 R to GENPRU 2.2.193 R</td>
<td></td>
</tr>
<tr>
<td><strong>Lower tier two capital</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed term preference shares</td>
<td>GENPRU 2.2.159 R to GENPRU 2.2.174 R; GENPRU 2.2.194 R to GENPRU 2.2.196 R</td>
<td>(H)</td>
</tr>
<tr>
<td>Long term subordinated debt</td>
<td>See previous entry</td>
<td></td>
</tr>
<tr>
<td>Fixed term subordinated securities</td>
<td>See previous entry</td>
<td></td>
</tr>
<tr>
<td><strong>Total tier two capital</strong></td>
<td></td>
<td>(I)</td>
</tr>
<tr>
<td><strong>Deductions from tier two capital</strong></td>
<td></td>
<td>(J)</td>
</tr>
<tr>
<td>(For certain limited purposes only certain additional deductions are made here)</td>
<td>GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)</td>
<td></td>
</tr>
<tr>
<td><strong>Total tier two capital after deductions</strong> = I - J</td>
<td></td>
<td>(K)</td>
</tr>
<tr>
<td><strong>Total tier one capital plus tier two capital</strong> = F + K</td>
<td></td>
<td>(L)</td>
</tr>
<tr>
<td><strong>Deductions from the totals of tier one and two</strong></td>
<td></td>
<td>(M)</td>
</tr>
<tr>
<td>Material holdings</td>
<td>GENPRU 2.2.208 R to GENPRU 2.2.215 R</td>
<td></td>
</tr>
<tr>
<td>Expected loss amounts and other negative amounts</td>
<td>GENPRU 2.2.236 R</td>
<td>(Part 1 of stage M)</td>
</tr>
<tr>
<td>Securitisation positions</td>
<td>GENPRU 2.2.237 R</td>
<td>(Part 2 of stage M)</td>
</tr>
<tr>
<td>Reciprocal cross-holdings</td>
<td>GENPRU 2.2.217 R to GENPRU 2.2.220 R</td>
<td></td>
</tr>
<tr>
<td><strong>Total tier one capital plus tier two capital after deductions</strong> = L-M</td>
<td></td>
<td>(N)</td>
</tr>
</tbody>
</table>

In calculating whether a firm's capital resources exceed its capital resources requirement:
(1) the credit risk capital component and the counterparty risk capital component; or
(2) the base capital resources requirement; as the case may be, must be deducted here.

**Upper tier three**

| Short term subordinated debt                         | GENPRU 2.2.241 R to GENPRU 2.2.245 R              | (O)   |

**Lower tier three**

| Net interim trading book profit and loss             | GENPRU 2.2.246 R to GENPRU 2.2.249 R              | (P)   |

**Total tier three capital = O + P**                   |                                                   | (Q)   |

**Total capital before deductions = N + Q**            |                                                   | (R)   |

**Deductions from total capital**                      |                                                   | (S)   |
The capital resources calculation for an investment firm deducting material holdings

<table>
<thead>
<tr>
<th>Type of capital</th>
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<tbody>
<tr>
<td>Free deliveries</td>
<td>BIPRU 14.4</td>
<td></td>
</tr>
</tbody>
</table>

**Total capital after deductions \((R - S)\)**

In calculating whether a firm’s capital resources exceed its capital resources requirement, the market risk capital requirement and the fixed overheads requirement must be deducted here.

Note (1): Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.

Note (2): If the amount calculated at:
(a) stage N less the deductions in respect of the capital resources requirement made immediately following stage N; or
(b) stage T less the deductions in respect of the capital resources requirement made immediately following stages N and T;

is a negative number the firm’s capital resources are less than its capital resources requirement.
## Capital resources table for a BIPRU firm deducting illiquid assets

### The capital resources calculation for an investment firm that deducts illiquid assets

<table>
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</tr>
<tr>
<td>Stage B2</td>
<td>GENPRU 2.2.115D R to GENPRU 2.2.117B R</td>
<td>(B2)</td>
</tr>
<tr>
<td>Stage C</td>
<td>GENPRU 2.2.115F R to GENPRU 2.2.117B R</td>
<td>(C)</td>
</tr>
<tr>
<td><strong>Total tier one capital before deductions</strong></td>
<td>= A + B1 + B2 + C</td>
<td>(D)</td>
</tr>
<tr>
<td><strong>Deductions from tier one capital</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments in own shares</td>
<td>None</td>
<td>(E)</td>
</tr>
<tr>
<td>Intangible assets</td>
<td>GENPRU 2.2.155 R</td>
<td></td>
</tr>
<tr>
<td>Excess of drawings over profits for partnerships, limited liability partnerships and sole traders</td>
<td>GENPRU 2.2.100 R; there is no related text for sole traders</td>
<td></td>
</tr>
<tr>
<td>Net losses on equities held in the available-for-sale financial asset category</td>
<td>GENPRU 2.2.185 R</td>
<td></td>
</tr>
<tr>
<td>(For certain limited purposes only certain additional deductions are made here)</td>
<td>GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)</td>
<td></td>
</tr>
<tr>
<td><strong>Total tier one capital after deductions</strong></td>
<td>= D-E</td>
<td>(F)</td>
</tr>
<tr>
<td><strong>Upper tier two capital</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Perpetual cumulative preference shares</td>
<td>GENPRU 2.2.159 R to GENPRU 2.2.181 R</td>
<td>(G)</td>
</tr>
<tr>
<td>Perpetual subordinated debt</td>
<td>See previous entry</td>
<td></td>
</tr>
</tbody>
</table>
The capital resources calculation for an investment firm that deducts illiquid assets

<table>
<thead>
<tr>
<th>Type of capital</th>
<th>Related text</th>
<th>Stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Perpetual subordinated securities</td>
<td>See previous entry</td>
<td></td>
</tr>
<tr>
<td>Revaluation reserves</td>
<td>GENPRU 2.2.185 R</td>
<td></td>
</tr>
<tr>
<td>General/collectional provisions</td>
<td>GENPRU 2.2.187 R to GENPRU 2.2.189 R</td>
<td></td>
</tr>
<tr>
<td>Surplus provisions</td>
<td>GENPRU 2.2.190 R to GENPRU 2.2.193 R</td>
<td></td>
</tr>
<tr>
<td><strong>Lower tier two capital</strong></td>
<td></td>
<td>(H)</td>
</tr>
<tr>
<td>Fixed term preference shares</td>
<td>GENPRU 2.2.159 R to GENPRU 2.2.174 R; GENPRU 2.2.194 R to GENPRU 2.2.196 R</td>
<td></td>
</tr>
<tr>
<td>Long term subordinated debt</td>
<td>See previous entry</td>
<td></td>
</tr>
<tr>
<td>Fixed term subordinated securities</td>
<td>See previous entry</td>
<td></td>
</tr>
<tr>
<td><strong>Total tier two capital</strong> = G+H</td>
<td></td>
<td>(I)</td>
</tr>
<tr>
<td><strong>Deductions from tier two capital</strong></td>
<td></td>
<td>(J)</td>
</tr>
<tr>
<td>(For certain limited purposes only certain additional deductions are made here)</td>
<td>GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)</td>
<td></td>
</tr>
<tr>
<td><strong>Total tier two capital after deductions</strong></td>
<td>I - J</td>
<td>(K)</td>
</tr>
<tr>
<td><strong>Total tier one capital plus tier two capital</strong> = F+K</td>
<td>(L)</td>
<td></td>
</tr>
<tr>
<td><strong>Deductions from the totals of tier one and two</strong></td>
<td>GENPRU 2.2.236 R (Part 1 of stage M)</td>
<td>(M)</td>
</tr>
<tr>
<td>Expected loss amounts and other negative amounts</td>
<td>GENPRU 2.2.237 R (Part 2 of stage M)</td>
<td></td>
</tr>
<tr>
<td>Securitisation positions</td>
<td>GENPRU 2.2.217 R to GENPRU 2.2.220 R</td>
<td></td>
</tr>
<tr>
<td>Reciprocal cross-holdings</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total tier one capital plus tier two capital after deductions</strong></td>
<td>L-M</td>
<td>(N)</td>
</tr>
<tr>
<td>In calculating whether a firm's capital resources exceed its capital resources requirement:</td>
<td>(1) the credit risk capital component and the counterparty risk capital component; or (2) the base capital resources requirement; as the case may be, must be deducted here.</td>
<td></td>
</tr>
<tr>
<td><strong>Upper tier three</strong></td>
<td></td>
<td>(O)</td>
</tr>
<tr>
<td>Short term subordinated debt</td>
<td>GENPRU 2.2.241 R to GENPRU 2.2.245 R</td>
<td></td>
</tr>
<tr>
<td><strong>Lower tier three</strong></td>
<td></td>
<td>(P)</td>
</tr>
<tr>
<td>Net interim trading book profit and loss</td>
<td>GENPRU 2.2.246 R to GENPRU 2.2.249 R</td>
<td></td>
</tr>
<tr>
<td><strong>Total tier three capital</strong> = O+P</td>
<td></td>
<td>(Q)</td>
</tr>
<tr>
<td><strong>Total capital before deductions</strong></td>
<td>N+Q</td>
<td>(R)</td>
</tr>
<tr>
<td><strong>Deductions from total capital</strong></td>
<td></td>
<td>(S)</td>
</tr>
</tbody>
</table>
### The capital resources calculation for an investment firm that deducts illiquid assets

<table>
<thead>
<tr>
<th>Type of capital</th>
<th>Related text</th>
<th>Stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illiquid assets</td>
<td>GENPRU 2.2.259 R to GENPRU 2.2.260 R</td>
<td></td>
</tr>
<tr>
<td>Free deliveries</td>
<td>BIPRU 14.4</td>
<td></td>
</tr>
</tbody>
</table>

Total capital after deductions = R-S (T)

In calculating whether a firm’s capital resources exceed its capital resources requirement, the market risk capital requirement and the fixed overheads requirement must be deducted here.

Note (1): Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.

Note (2): If the amount calculated at:
(a) stage N less the deductions in respect of the capital resources requirement made immediately following stage N; or
(b) stage T less the deductions in respect of the capital resources requirement made immediately following stages N and T;

is a negative number the firm’s capital resources are less than its capital resources requirement.
# Capital resources table for a BIPRU firm with a waiver from consolidated supervision

<table>
<thead>
<tr>
<th>Type of capital</th>
<th>Related text</th>
<th>Stage</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Core tier one capital</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Permanent share capital</td>
<td>GENPRU 2.2.83 R</td>
<td>(A)</td>
</tr>
<tr>
<td>Profit and loss account and other reserves</td>
<td>GENPRU 2.2.85 R to 2.2.90</td>
<td></td>
</tr>
<tr>
<td>(taking into account material interim net</td>
<td></td>
<td></td>
</tr>
<tr>
<td>losses)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Eligible partnership capital</td>
<td>GENPRU 2.2.93 R; GENPRU 2.2.95 R</td>
<td></td>
</tr>
<tr>
<td>Eligible LLP members’ capital</td>
<td>GENPRU 2.2.94 R; GENPRU 2.2.95 R</td>
<td></td>
</tr>
<tr>
<td>Sole trader capital</td>
<td>None</td>
<td></td>
</tr>
<tr>
<td>share premium account</td>
<td>GENPRU 2.2.101 R</td>
<td></td>
</tr>
<tr>
<td>Externally verified interim net profits</td>
<td>GENPRU 2.2.102 R</td>
<td></td>
</tr>
<tr>
<td><strong>Hybrid capital</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stage B1</td>
<td>GENPRU 2.2.115A R to GENPRU 2.2.117B R</td>
<td>(B1)</td>
</tr>
<tr>
<td>Stage B2</td>
<td>GENPRU 2.2.115D R to GENPRU 2.2.117B R</td>
<td>(B2)</td>
</tr>
<tr>
<td>Stage C</td>
<td>GENPRU 2.2.115F R to GENPRU 2.2.117B R</td>
<td>(C)</td>
</tr>
<tr>
<td><strong>Total tier one capital before deductions</strong></td>
<td>A + B1 + B2 + C</td>
<td>(D)</td>
</tr>
<tr>
<td><strong>Deductions from tier one capital</strong></td>
<td></td>
<td>(E)</td>
</tr>
<tr>
<td>Investments in own shares</td>
<td>None</td>
<td>(Part 1 of stage E)</td>
</tr>
<tr>
<td>Intangible assets</td>
<td>GENPRU 2.2.155 R</td>
<td></td>
</tr>
<tr>
<td>Excess of drawings over profits for</td>
<td>GENPRU 2.2.100 R; there is no related text for</td>
<td></td>
</tr>
<tr>
<td>partnerships, limited liability partnerships</td>
<td>sole traders</td>
<td></td>
</tr>
<tr>
<td>and sole traders</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net losses on equities held in the available</td>
<td>GENPRU 2.2.185 R</td>
<td></td>
</tr>
<tr>
<td>for-sale financial asset category</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(For certain limited purposes only certain</td>
<td>GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)</td>
<td>(Part 2 of stage E)</td>
</tr>
<tr>
<td>additional deductions are made here. This</td>
<td></td>
<td></td>
</tr>
<tr>
<td>line does not include material holdings.)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Material holdings falling into Note (4)</td>
<td>Note (4) of Part 2 of this table; GENPRU 2.2.208</td>
<td></td>
</tr>
<tr>
<td></td>
<td>R to GENPRU 2.2.215 R</td>
<td>(Part 2 of stage E)</td>
</tr>
</tbody>
</table>
### Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision

<table>
<thead>
<tr>
<th>Type of capital</th>
<th>Related text</th>
<th>Stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>(For certain limited purposes only certain additional deductions of material holdings are made here)</td>
<td>Note (5) of Part 2 of this table; GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)</td>
<td>(Part 3 of stage E)</td>
</tr>
</tbody>
</table>

**Total tier one capital after deductions = D-E**

**Upper tier two capital**

- Perpetual cumulative preference shares: GENPRU 2.2.159 R to GENPRU 2.2.181 R
- Perpetual subordinated debt: See previous entry
- Perpetual subordinated securities: See previous entry
- Revaluation reserves: GENPRU 2.2.185 R
- General/collective provisions: GENPRU 2.2.187 R to GENPRU 2.2.189 R
- Surplus provisions: GENPRU 2.2.190 R to GENPRU 2.2.193 R

**Lower tier two capital**

- Fixed term preference shares: GENPRU 2.2.159 R to GENPRU 2.2.174 R; GENPRU 2.2.194 R to GENPRU 2.2.196 R
- Long term subordinated debt: See previous entry
- Fixed term subordinated securities: See previous entry

**Total tier two capital = G+H**

**Deductions from tier two capital**

(For certain limited purposes only certain additional deductions are made here) | Note (5) of Part 2 of this table; GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4) | (Part 1 of stage M) |

**Total tier two capital after deductions = I - J**

**Total tier one capital plus tier two capital = (L)**

**Deductions from the totals of tier one and two**

- Material holdings falling into Note (5) | Note (5) of Part 2 of this table; GENPRU 2.2.208 R to GENPRU 2.2.215 R | (Part 1 of stage M) |
- Contingent liabilities | Note (6) of Part 2 of this table |
- Expected loss amounts and other negative amounts | GENPRU 2.2.236 R |
- Securitisation positions | GENPRU 2.2.237 R |
- Reciprocal cross-holdings | GENPRU 2.2.217 R to GENPRU 2.2.220 R | (Part 2 of stage M) |

**Total tier one capital plus tier two capital after deductions = L-M**

In calculating whether a firm's capital resources exceed its capital resources requirement:

1. the credit risk capital component and the counterparty risk capital component; or
2 Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision

<table>
<thead>
<tr>
<th>Type of capital</th>
<th>Related text</th>
<th>Stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>(2)the base capital resources requirement; as the case may be, must be deducted here.</td>
<td>(O)</td>
<td></td>
</tr>
<tr>
<td>Upper tier three</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short term subordinated debt</td>
<td>GENPRU 2.2.241 R to GENPRU 2.2.245 R</td>
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<tr>
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</tr>
<tr>
<td>Net interim trading book profit and loss</td>
<td>GENPRU 2.2.246 R to GENPRU 2.2.249 R</td>
<td>(P)</td>
</tr>
<tr>
<td>Total tier three capital = O + P</td>
<td></td>
<td>(Q)</td>
</tr>
<tr>
<td>Total capital before deductions = N + Q</td>
<td></td>
<td>(R)</td>
</tr>
<tr>
<td>Deductions from total capital</td>
<td></td>
<td>(S)</td>
</tr>
<tr>
<td>Illiquid assets</td>
<td>GENPRU 2.2.259 R to GENPRU 2.2.260 R</td>
<td></td>
</tr>
<tr>
<td>Free deliveries</td>
<td>BIPRU 14.4</td>
<td></td>
</tr>
<tr>
<td>Total capital after deductions = R - S</td>
<td></td>
<td>(T)</td>
</tr>
</tbody>
</table>

In calculating whether a firm's capital resources exceed its capital resources requirement, the market risk capital requirement, and the fixed overheads requirement must be deducted here.

Note (1): Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.

Note (2): If the amount calculated at:
(a) stage N less the deductions in respect of the capital resources requirement made immediately following stage N; or
(b) stage T less the deductions in respect of the capital resources requirement made immediately following stages N and T;

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

Note (4): The material holdings that must be deducted at part 2 of stage E are material holdings issued by undertakings which would have been members of the firm's UK consolidation group or non-UK sub-group if the firm did not have an investment firm consolidation waiver if:

(1) in relation to a BIPRU firm, the holding forms part of the undertaking's tier one capital resources; or
(2) (subject to (3)) in relation to any other undertaking, the holding would form part of the undertaking's tier one capital resources if:
   (a) that undertaking were a BIPRU firm with a Part 4A permission; and
   (b) it had carried on all its business in the United Kingdom and had obtained whatever permissions for doing so are required under the Act; or
(3) in relation to any undertaking not falling within (1) and for which the methodology in (2) does not give an answer, the holding would form part of its tier one capital resources if the undertaking...
Part 2 of the capital resources calculation for an investment firm with a waiver from consolidated supervision

| Note (5): The material holdings that must be deducted by a firm at part 3 of stage E and at stage J or at Part 1 of stage M are material holdings issued by undertakings which would have been members of that firm's UK consolidation group or non-UK sub-group if the firm did not have an investment firm consolidation waiver and which do not fall into Note (4). |
| Note (6): The contingent liabilities that must be deducted by a firm at Part 1 of stage M are any contingent liabilities which the firm has in favour of BIPRU firms, financial institutions, asset management companies and ancillary services undertakings which would have been members of the firm's UK consolidation group or non-UK sub-group if the firm did not have an investment firm consolidation waiver. |

*ing were a BIPRU firm of the same category as the firm carrying out the calculation under this Annex.*
Admissible assets in insurance
Guidance on applications for waivers relating to Implicit items