

Chapter 2

Capital

2.1 Calculation of capital resources requirements

Application

- 2.1.1 **R** This section applies to a BIPRU firm.
- 2.1.1A **R**
- 2.1.2 **G** The scope of application of this section is not restricted to *firms* that are subject to the relevant *EU* Directives.
- 2.1.3 **R** (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 **G** 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 **G** The requirements in this section apply to a *firm* on a solo basis.

Purpose

- 2.1.6 **G** *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 **G** 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 G (1) [deleted]
- (2) This section also implements the third paragraph of article 95(2) of the *EU CRR* applying 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 implements (in part) article 75 of the *Banking Consolidation Directive* and Articles 5, 9, 10 and 18 of the *Capital Adequacy Directive*.
- (3) [deleted]

2.1.8A G

Monitoring requirements

2.1.9 R 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 G 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 R 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 G 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

FCA

Firm category	Capital requirement
<i>BIPRU firm</i> (including <i>collective portfolio management investment firm</i>)	the higher of (1) and (2):
	(1) the sum of:
	(a) the <i>credit risk capital requirement</i> ; and (b) the <i>market risk capital requirement</i> ; and
	(2) the <i>fixed overheads requirement</i> .

Adjustment of the variable capital requirement calculation for collective portfolio management investment firms

2.1.46 **R** 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 R it must do so only in respect of *designated investment business*. For this purpose *managing an AIF* or *managing a UCITS* is excluded from *designated investment business*.

Calculation of the base capital resources requirement for a BIPRU firm

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

Table: Base capital resources requirement for a BIPRU firm

2.1.48 **R** This table belongs to ■ GENPRU 2.1.47 R

Firm category	Amount: Currency equivalent of
<i>BIPRU firm</i> (but not a <i>collective portfolio management investment firm</i>)	€50,000

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

Definition of BIPRU firm

- 2.1.49 **G** The Capital Adequacy Directive sets out various categories of *investment firms* subject to differing levels of initial capital. For the purpose of the third paragraph of article 95(2) of the *EU CRR*, a *BIPRU firm* falls into the category in article 5(3) of the Capital Adequacy Directive. 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 **R** 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 **R** 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 **R** 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.

2.1.58 **G** 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.

2.1.59 **G** 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

2.1.60 **R**

- (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 2.1.62R (2); 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.

2.1.61 G 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 R 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*.