

Chapter 2

Capital

2.2 Capital resources

Application

2.2.1 **R** This section applies to a *BIPRU firm*.

2.2.1A **R**

Purpose

2.2.2 **G** ■ 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 **G** This section also implements minimum EC standards for the composition of *capital resources* required to be held by a *BIPRU firm*. In particular it implements the third paragraph of article 95(2) of the *EU CRR*, applying Articles 56 – 61, Articles 63 – 64, Article 66 and Articles 120 – 122 of the *Banking Consolidation Directive* (2006/48/EC) 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* (2006/49/EC).

Contents guide

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

Table: Arrangement of GENPRU 2.2

2.2.6 **G** This table belongs to ■ GENPRU 2.2.5 G

Topic	Location of text
Application and purpose of the <i>rules</i> in this section	GENPRU 2.2.1 R to GENPRU 2.2.4 G
<i>BIPRU firms</i> that only have simple types of <i>capital resources</i> (<i>simple capital issuers</i>)	GENPRU 2.2.7 G
Principles underlying the definition of <i>capital resources</i>	GENPRU 2.2.8 G
Which method of calculating <i>capital resources</i> applies to which type of <i>firm</i>	GENPRU 2.2.17 R to GENPRU 2.2.19 R

Topic	Location of text
Purpose of the limits on the use of different forms of capital	GENPRU 2.2.24 G
Use of higher tier capital in lower tiers	GENPRU 2.2.25 R to GENPRU 2.2.28 R
Calculation of <i>capital resources</i> for <i>BIPRU firms</i>	GENPRU 2.2.20 G to GENPRU 2.2.21 G; GENPRU 2 Annex 4 to GENPRU 2 Annex 6
Limits on the use of different forms of capital for <i>BIPRU firms</i> (certain types of <i>capital resources</i> cannot be used for certain purposes)	GENPRU 2.2.44 R to GENPRU 2.2.45 R; GENPRU 2.2.47 R to GENPRU 2.2.48 R
Limits on the use of different forms of capital for <i>BIPRU firms</i> (<i>capital resources gearing rules</i>)	GENPRU 2.2.29 R to GENPRU 2.2.31 G; GENPRU 2.2.46 R; GENPRU 2.2.50 R
Example of how the <i>capital resources</i> calculation for <i>BIPRU firms</i> works	GENPRU 2.2.51 G to GENPRU 2.2.59 G
Capital used to meet the <i>base capital resources requirement</i> for <i>BIPRU firms</i>	GENPRU 2.2.60 R to GENPRU 2.2.61 G
Notification of issuance of <i>capital instruments</i> .	GENPRU 2.2.61A R to GENPRU 2.2.61H G
<i>Tier one capital instruments: general</i>	GENPRU 2.2.9 G to GENPRU 2.2.10 G; GENPRU 2.2.62 R to GENPRU 2.2.69 G; GENPRU 2.2.80 R to GENPRU 2.2.82 G
<i>Tier one capital: payment of coupons (BIPRU firm only)</i>	GENPRU 2.2.69A R to GENPRU 2.2.69F G
<i>Core tier one capital: permanent share capital</i>	GENPRU 2.2.83 R to GENPRU 2.2.84A G
General conditions for eligibility of <i>capital instruments</i> as <i>core tier one capital (BIPRU firm only)</i>	GENPRU 2.2.83A R to GENPRU 2.2.83D G; GENPRU 2.2.84A G
<i>Core tier one capital: exception to eligibility criteria (building societies only)</i>	GENPRU 2.2.83E R to GENPRU 2.2.83H G
<i>Core tier one capital: profit and loss account and other reserves: material applicable to all firms</i>	GENPRU 2.2.85 R; GENPRU 2.2.87 R to GENPRU 2.2.89 G; GENPRU 2.2.91 G
<i>Core tier one capital: profit and loss account and other reserves: material specific to BIPRU firms</i>	GENPRU 2.2.86 R; GENPRU 2.2.90 R; GENPRU 2.2.92 G
<i>Core tier one capital: provisions relating to partnerships and limited liability partnerships</i>	GENPRU 2.2.93 R to GENPRU 2.2.100 R
<i>Core tier one capital: share premium account</i>	GENPRU 2.2.101 R
<i>Core tier one capital: externally verified interim net profits</i>	GENPRU 2.2.102 R to GENPRU 2.2.103 G
<i>Hybrid capital (excluding issues through SPVs) (BIPRU firm only)</i>	GENPRU 2.2.115A R to GENPRU 2.2.119 G
<i>Hybrid capital (issues through SPVs) (BIPRU firm only)</i>	GENPRU 2.2.123 R to GENPRU 2.2.137 R
<i>Tier one capital: conversion ratio</i>	GENPRU 2.2.138 R to GENPRU 2.2.144 G

Topic	Location of text
<i>Tier one capital</i> : requirement to have sufficient unissued stock	GENPRU 2.2.145 R
Deductions from <i>tier one capital resources</i>	GENPRU 2.2.155 R to GENPRU 2.2.156 G
<i>Tier two capital</i>	GENPRU 2.2.11 G; GENPRU 2.2.157 G to GENPRU 2.2.197 G
Deductions from <i>tier one capital resources</i> and <i>tier two capital resources</i>	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
<i>Tier three capital</i>	GENPRU 2.2.12 G; GENPRU 2.2.241 R to GENPRU 2.2.249 R
Deductions from total <i>capital resources</i>	GENPRU 2.2.14 G to GENPRU 2.2.16 G; GENPRU 2.2.259 R to GENPRU 2.2.62 R
The effect of swaps	GENPRU 2.2.198 R to GENPRU 2.2.201 R
<i>Step-ups (tier one capital and tier two capital)</i>	GENPRU 2.2.146 R to GENPRU 2.2.154 G
Redemption of <i>tier one instruments</i>	GENPRU 2.2.64R (3); GENPRU 2.2.70 R to GENPRU 2.2.79 G
Purchases of <i>tier one instruments</i> : <i>BIPRU firm</i> only	GENPRU 2.2.79A R to GENPRU 2.2.79H G; GENPRU 2.2.79L G
Redemption of <i>tier two instruments</i>	GENPRU 2.2.172 R to GENPRU 2.2.174 R; GENPRU 2.2.177 R to GENPRU 2.2.178 R (<i>upper tier two instruments</i>); GENPRU 2.2.194 R to GENPRU 2.2.197 G (<i>lower tier two instruments</i>)
Non-standard capital instruments	GENPRU 2.2.13 G
Standard form documentation for subordinated debt	GENPRU 2.2.164 G
Public sector guarantees	GENPRU 2.2.276 R

Simple capital issuers

2.2.7 **G** 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 **G** 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

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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.

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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

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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 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

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

2.2.16 **G** A full list of deductions from *capital resources* is shown in the *capital resources table* applicable to the *firm*.

Which method of calculating capital resources applies to which type of 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

2.2.19 **R** This table belongs to ■ GENPRU 2.2.17 R

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

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

2.2.31 **G** 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.

2.2.42 **R** [deleted]

2.2.43 **G** [deleted]

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

2.2.44 **R** *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*.

2.2.45 **R** ■ 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)

2.2.46 **R** 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 **R** 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 **R** 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 2.2.47R (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 **R** For the purpose of meeting the requirements in ■ GENPRU 2.2.47R (1) to ■ GENPRU 2.2.47R (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 2.2.47R (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.

2.2.50 **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

2.2.51 **G** ■ GENPRU 2.2.52 G to ■ GENPRU 2.2.59 G illustrate how to calculate a *BIPRU firm's capital resources* and how the *capital resources gearing rules* work. In this example the *BIPRU firm* has a combined credit, operational and counterparty risk requirement of £100 (of which £10 is due to counterparty risk) and a market risk requirement of £90, making a total capital requirement of £190. Its *capital resources* are as set out in the table in ■ GENPRU 2.2.52 G.

Table: Example of the calculation of the capital resources of a BIPRU firm

2.2.52 **G** This table belongs to ■ GENPRU 2.2.51 G

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

2.2.53 **G** [deleted]

2.2.54 **G** 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*.

2.2.55 **G** 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 G.

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

2.2.56 **G** This table belongs to ■ GENPRU 2.2.55 G

Description of the stage of the capital resources calculation	Stage in the <i>capital resources table</i>	Amount (£)
Total <i>tier one capital</i> and <i>tier two capital</i> after deductions	Stage N	140
Credit and counterparty risk requirement		(100)
<i>Tier one capital</i> and <i>tier two capital</i> available to meet market risk requirement		40
<i>Tier three capital</i>	Stage Q	50
Total capital available to meet market risk requirement		90
Market risk requirement		(90)
Market risk requirement met subject to meeting gearing limit set		

Description of the stage of the capital resources calculation	Stage in the <i>capital resources table</i>	Amount (£)
out in GENPRU 2.2.49 R – see GENPRU 2.2.57 G		

2.2.57 **G** 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*.

2.2.58 **G** 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 **G** 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 **R** 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 **G** The explanation for **■ GENPRU 2.2.60 R** can be found in **■ GENPRU 2.1.43 G** (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 **R** 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 **R** 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 **R** 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 **R** 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 **R** 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 **R** 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 **G** **■ 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 **G** 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-EEA sub-group* are set out in **■ BIPRU 8.6.1A R** to **■ BIPRU 8.6.1F R**.

Tier one capital: General

2.2.62 **R** 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 **R** 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 **R** 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 (Purposeful 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.
- 2.2.68B **G** 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).
- 2.2.69 **G** 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)**.....
- 2.2.69A **R** A *BIPRU firm* must not make a payment of a *coupon* on an item of *hybrid capital* if the *firm* has no distributable reserves.
- 2.2.69B **R** 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*.

- 2.2.69C** **R** 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.
- 2.2.69D** **G** 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** **R** 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** **G**
- (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

R

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

- (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.

2.2.70A

G

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.

2.2.71

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.

2.2.74B **R** 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*.

2.2.75 **R** 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

2.2.77 **R**

- (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*.

2.2.78 **R**

- (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).

2.2.79 **G** This section generally uses the term *repay* and *redeem* interchangeably.

Purchases of tier one instruments: BIPRU firm only

- 2.2.79A** **R** 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** **G** 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** **R** **■ 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** **R** **■ 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** **G** 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** **R** 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** **R** A *BIPRU firm* must not purchase a *tier one instrument* in accordance with **■ GENPRU 2.2.79A R** 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 **G** 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 **R** 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 **R** 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 **R** 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 **G** 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)).

General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only)

2.2.83A

R

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 2.2.83A R 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 2.2.83A R;
- (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 2.2.83A R (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

2.2.84 **G** [deleted]

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 **R** (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.

2.2.85A **R**

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

2.2.86 **R**

- (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 **R**

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

2.2.87A **G**

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 **R** 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 **G** 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 **R** 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 **R** 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 **G** 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 **R** 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 **R**
- (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 **R** 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 **G** 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 **R** 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.
- 2.2.108B **G** 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).

2.2.111 **R** [deleted]

2.2.112 **G** [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)

2.2.115A **R** 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 **G** 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 **G** (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 **R** 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 **G** (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 **R** 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.

2.2.115G **G** 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

2.2.116A **R** 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).

2.2.117 G 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.

2.2.117A R 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 **R** 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 **G**

- (1) The effects of the mechanisms described in **GENPRU 2.2.117A R** 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 **R**

- (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 **G** 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 **G** For the purpose of ■ GENPRU 2.2.118R, 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 **R** ■ GENPRU 2.2.123 R to ■ GENPRU 2.2.137 R apply to a *BIPRU firm*.

2.2.124 **R**

- (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 **R** 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*.

2.2.126 **R** 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.

2.2.127 **R** 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.

- 2.2.128** **G** 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*.
- 2.2.128A** **R** ■ 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.
- 2.2.128B** **R** 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).
- 2.2.129** **R** The *SPV* referred to in ■ GENPRU 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 ■ GENPRU 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 ■ GENPRU 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*.
- 2.2.130** **R** For the purpose of ■ GENPRU 2.2.129 R and ■ GENPRU 2.2.132 R, ■ GENPRU 2.2.118 R (Requirement to obtain a legal opinion) does not apply.
- 2.2.131** **R** In relation to the obligation to substitute described in ■ GENPRU 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.
- 2.2.131A** **G** ■ GENPRU 2.2.129R (2) and ■ GENPRU 2.2.131 R allow a *firm* to replace the capital issued by the *SPV* with *capital instrument* which are *core tier one capital*.
- 2.2.132** **R** The capital which the *firm* seeks to include in its *capital resources* under ■ GENPRU 2.2.124R (3)(a) must satisfy the following conditions:
- (1) it meets the conditions for inclusion in *tier one capital* (subject to ■ GENPRU 2.2.130 R);
- (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*.
- 2.2.133** **R**
- (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).

2.2.134 **G** 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).

2.2.135 **R** 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*.

2.2.136 **G** 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.

2.2.137 **R** 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

2.2.138 **R**

- (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.

2.2.139

R

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.

2.2.140

R

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) $M = \text{Par value of innovative instrument} * 150\% / \text{market value of ordinary share};$
 - (b) $M = £100 * 1.5 / £4 = 37.5 \text{ shares}.$
- (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 **G** 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 **G** 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

G

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

R

- (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 **R** 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 **R**

- (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* can arise earlier than the fifth anniversary of the date of issue of that item of capital.

2.2.154 **G** 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

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

2.2.156 **G** 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.

2.2.156A **G** 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

2.2.157 **G** *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*.

2.2.158 **G** *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

2.2.159 **R** 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 (2) (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.

2.2.160 R 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

2.2.161 R 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).

2.2.162 G 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

2.2.163 **R** ■ 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

2.2.164 **G** 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

2.2.165 **G** 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 **G** ■ 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 **G** 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 **G** 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 **R** 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 **G** ■ 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 **R** 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

- 2.2.172 **R** A *tier two instrument* may be redeemable 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.
- 2.2.173 **R** ■ 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).
- 2.2.174 **R** 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

- 2.2.175 **G** 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

- 2.2.176 **G** 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).

- 2.2.177 **R** 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 **R** 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 **G** (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

2.2.180 **R** 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 **G** 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 **R** 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 **R** 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 **R** 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 **R** 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 **R** 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

2.2.194 **R** 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*.

2.2.203 **R** 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*.

2.2.204 **R** 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*.

2.2.205 **R** 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*.

2.2.206 **R** 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).

2.2.207 **R** 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)

2.2.208 **R** ■ GENPRU 2.2.208 R to ■ GENPRU 2.2.216 G only apply to a *BIPRU firm*.

- 2.2.209 **R**
- (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 **G** 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 **R** 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 **R** A *material insurance holding* means the holdings of a *BIPRU firm* of items of the type set out in ■ GENPRU 2.2.213 R 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 **R** An item falls into this provision for the purpose of ■ GENPRU 2.2.212 R 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 **R** 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** **R** 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** **G**
- (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.
- 2.2.216A** **G**
- (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)

2.2.217 **R** ■ GENPRU 2.2.217 R to ■ GENPRU 2.2.220 R apply to a *BIPRU firm*.

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 ■ GENPRU 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) ■ GENPRU 2.2.221 R to ■ GENPRU 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 ■ GENPRU 2.2.209R (2) or ■ (3), for the purposes of determining whether there is a *material holding*, ■ GENPRU 2.2.221 R to ■ GENPRU 2.2.233 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 ■ GENPRU 2.2.227 R or ■ GENPRU 2.2.229 R and guarantees within ■ GENPRU 2.2.231 R or ■ GENPRU 2.2.233 R.
- 2.2.223 **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*.
- 2.2.224 **R** 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*.
- 2.2.225 **R** 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.
- 2.2.226 **G** ■ BIPRU 10.3.13 G (*Guidance on exposures to trustees*) applies to ■ GENPRU 2.2.225 R .
- 2.2.227 **R** 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.

- 2.2.228** **R** A loan falls into this *rule* for the purposes of **■ GENPRU 2.2.227R (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.
- 2.2.229** **R** 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**.
- 2.2.230** **G** 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.
- 2.2.231** **R** 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)**.
- 2.2.232** **R** 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)**.
- 2.2.233** **R** The amount of a guarantee that constitutes *connected lending of a capital nature* that a *firm* must deduct is the amount guaranteed.

2.2.234 **G** 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.

2.2.235 **G** 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 **R** 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 **R** 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 **R** **■ 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 **R**
- (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 **G** 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 **R** ■ GENPRU 2.2.241 R to ■ GENPRU 2.2.245 R only apply to a *BIPRU firm*.

2.2.242 **R** 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 **R** 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 **R** 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 **R** Table: Application of tier two capital rules to tier three debt

This table belongs to ■ GENPRU 2.2.244 R

<i>Tier two capital rule</i>	<i>Adjustment</i>
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) (<i>Upper tier three capital</i> should have maturity or notice period of at least two years) The reference in GENPRU 2.2.159R (10) (Description of <i>tier two capital</i> 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 <i>United Kingdom</i>)	
GENPRU 2.2.169 R (Ineligibility as <i>tier two capital</i> owing to connected transactions)	The reference to GENPRU 2.2.177 R (General eligibility conditions for <i>upper tier two capital</i>) does not apply
GENPRU 2.2.171 R (Amendments to terms of the <i>capital instrument</i>)	
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 <i>rules</i> 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.

2.2.262 **G** 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*.