

Chapter 3

Own funds



3.3 Common equity tier 1 capital

- 3.3.1

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(1) A *firm* must determine its *common equity tier 1 capital* in accordance with Chapter 2 of Title I of Part Two of the *UK CRR*, as modified by the *rules* in this section.

(2) Any reference to the *UK CRR* in this section is to the *UK CRR* as applied by (1) and modified by the *rules* in this section.

- 3.3.1A

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

- 3.3.1B

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(1) ■ MIFIDPRU 3 Annex 7R contains supplementary provisions that may be relevant when a *firm* is calculating its *common equity tier 1 capital* under ■ MIFIDPRU 3.3.1R.

(2) ■ MIFIDPRU 3 Annex 8R contains supplementary provisions that apply when a *firm* is calculating any additional valuation adjustments under article 34 of the *UK CRR* (as applied by ■ MIFIDPRU 3.3.1AR).

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

- 3.3.2

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

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

- 3.3.3

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

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

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

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

3.3.4A

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

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

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

Deductions from common equity tier 1 capital

3.3.5

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For the purposes of *MIFIDPRU*:

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

3.3.6

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

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

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

Deferred tax assets that rely on future profitability

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

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

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

Holdings of common equity tier 1 instruments of financial sector entities

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

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

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

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

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

Qualifying holdings outside the financial sector

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

Common equity tier 1 instruments of partnerships

3.3.16

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

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

Common equity tier 1 instruments of limited liability partnerships

3.3.17

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

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