

# Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries

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# Chapter 1

## Application and general provisions

## 1.1 Application

### Application

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1.1.1

**G**

This sourcebook applies to a *firm* with *Part 4A permission* to carry on:

- (1) *insurance distribution activity*;
- (2) *home finance mediation activity*;
- (3) *home financing*;
- (4) *home finance administration*; and
- (5) *insurance business*;

as specified in the beginning of each of the remaining chapters.



## 1.2 Actions for damages

1.2.1

**R**

A contravention of the *rules* in this sourcebook does not give rise to a right of action by a *private person* under section 138D of the *Act* (and each of those *rules* is specified under section 138D(3) of the *Act* as a provision giving rise to no such right of action).

## 1.3 Remuneration and property valuation requirements for MCD creditors

### Application

- 1.3.1 **R** ■ MIPRU 1.3 applies to an *MCD creditor*.

### Property valuation requirements

- 1.3.2 **R** For the valuation of residential immovable property to enter into an *MCD credit agreement*:
- (1) an *MCD creditor* must use reliable standards for the valuation where the valuation is carried out by the *MCD creditor*; or
  - (2) where the valuation is carried out by a third party, the *MCD creditor* must take reasonable steps to ensure that reliable standards are used.

[Note: article 19(1) of the *MCD*]

- 1.3.3 **G** For the purposes of ■ MIPRU 1.3.2 R:
- (1) reliable standards for the valuation of residential immovable property include internationally recognised valuation standards, in particular those developed by the International Valuation Standards Council (IVSC), the European Group of Valuers' Associations (EGoVA) or the Royal Institution of Chartered Surveyors (RICS), as well as the standards in ■ MIPRU 1.3.3AG or, where applicable, ■ MIPRU 4.2F.27 R to ■ MIPRU 4.2F.29 R.

[Note: recital 26 of the *MCD*]

- (2) the *MCD creditor* is not limited to on-site inspections where it is possible to demonstrate that any risks posed have been adequately assessed through the overall collateral management process.

- 1.3.3A **G** For the purposes of ■ MIPRU 1.3.3G(1), reliable standards for the valuation of residential immovable property also include the following standards:
- (1) the property must be valued by an independent valuer at or less than the market value. In the *UK* where rigorous criteria for the assessment of the mortgage lending value exist in statutory or



regulatory provisions property may instead be valued by an independent valuer at or less than the mortgage lending value;

- (2) market value means the estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value must be documented in a transparent and clear manner;
- (3) mortgage lending value means the value of the property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property. Speculative elements must not be taken into account in the assessment of the mortgage lending value. The mortgage lending value must be documented in a transparent and clear manner; and
- (4) the value of the collateral must be the market value or mortgage lending value reduced as appropriate to reflect the results of any required monitoring and to take account of any prior claims on the property.

### 1.3.4

**R** An *MCD creditor* must ensure that:

- (1) internal and external appraisers conducting property valuations are professionally competent and sufficiently independent from the credit underwriting process so they can provide an impartial and objective valuation; and
- (2) property valuations are documented in a *durable medium*.

[Note: article 19(2) of the *MCD*]



## Chapter 2

# Responsibility for insurance distribution and MCD credit intermediation activity

**2.1 Application and purpose**

**Application**

**2.1.1** **R** This chapter applies to a *firm* with *Part 4A permission* to carry on *insurance distribution activity* or *MCD credit intermediation activity*.

**Purpose**

**2.1.2** **G** The original purpose of this chapter was to implement in part the provisions of the *IDD* and the *MCD*.



## 2.2 Allocation of the responsibility for insurance distribution activity or MCD credit intermediation activity

### Responsibility for insurance distribution activity or MCD credit intermediation activity

**2.2.1** **R** A *firm*, other than a sole trader, must allocate the responsibility for the *firm's* insurance distribution activity or MCD credit intermediation activity to a director or senior manager.

[**Note:** article 3(1), eighth paragraph of the *IDD* and article 29(4)(a), first sentence, of the *MCD*.]

**2.2.1A** **G**

- (1) Where a *firm* allocates responsibility under **■ MIPRU 2.2.1R** it should ensure that the person to whom the allocation is made is of sufficient seniority and authority within the *firm* to take on that role.
- (2) The person could, for example, be:
  - (a) a *SMF manager* who holds the *executive director function* (SMF 3) or the *other overall responsibility function* (SMF 18); or
  - (b) a person who holds a significant management *FCA certification function*,

in relation to, as relevant, *insurance distribution* business or *MCD credit intermediation* business.

**2.2.1B** **R**

- (1) The *firm* must notify the *FCA* in a timely manner of the allocation in **■ MIPRU 2.2.1R** in accordance with (2).
- (2) Where the person allocated responsibility under **■ MIPRU 2.2.1R**, is:
  - (a) a *SMF manager*, then notification must be made in the following way:
    - (i) in Form A (Application to perform controlled functions) (see **■ SUP 10C Annex 3D** ), Form D (Notification: Changes to personal information/application details and conduct breaches/disciplinary action related to conduct) (see **■ SUP 10C Annex 6R**) or Form E (Internal transfer of a person performing a controlled function) (see **■ SUP 10C Annex 7D** ); and
    - (ii) included in (as relevant):
      - (A) a *statement of responsibilities*; or

(B) revised *statement of responsibilities* sent to the FCA as described in ■ SUP 10C.11.7D (Revised statements of responsibilities: Procedure); or

(b) a *Directory person*, the notification is included in the *Directory person* report (see ■ SUP 16 Annex 47AR (Directory persons report)); or

(c) a person other than a person in (a) and (b), then notification may be emailed to 'firm.queries@fca.org.uk' or made using a method as set out in ■ SUP 15.7.4R (Method of notification).

2.2.2 **R** [deleted]

2.2.3 **G** [deleted]

2.2.4 **G** Where a *firm* has appointed an *appointed representative* to carry on *insurance mediation activity* or *MCD credit intermediation activity* on its behalf, the *person* responsible for the *firm's insurance mediation activity* or *MCD credit intermediation activity* will also be responsible for the *insurance distribution activity* or *MCD credit intermediation activity* carried on by an *appointed representative*.

2.2.5 **G** The FCA will specify in the *Financial Services Register* the name of the *persons* to whom the responsibility for the *firm's insurance distribution activity* or *MCD credit intermediation activity* has been allocated. In the case of a *sole trader*, the FCA will specify in the *Financial Services Register* the name of the *sole trader* as the 'contact person' in the *firm*.

## Chapter 3

# Professional indemnity insurance

## 3.1 Application and purpose

### Application

#### 3.1.1

**R**

(1) [deleted]

(1A) Subject to the exceptions in (3) to (8), this chapter applies to a *firm* with *Part 4A permission* to carry on any of the following activities:

- (a) *insurance distribution activity*;
- (b) *home finance mediation activity*; and
- (c) *MCD article 3(1)(b) credit intermediation activity*.

(2) [deleted]

(3) In relation to *insurance distribution activity*, this chapter does not apply to a *firm* if another *authorised person* which has net tangible assets of more than £10 million provides a comparable guarantee; for this purpose:

- (a) if the *firm* is a member of a *group* in which there is an *authorised person* with net tangible assets of more than £10 million, the comparable guarantee must be from that *person*;
- (b) A 'comparable guarantee' means a written agreement on terms at least equal to those in a contract of professional indemnity insurance (see ■ MIPRU 3.2.4 R) to finance the claims that might arise as a result of a breach by the *firm* of its duties under the *regulatory system* or civil law.

(4) In relation to *home finance mediation activity*, this chapter does not apply to:

- (a) any *firm* which is an *MCD mortgage credit intermediary* exclusively advising on or arranging *second charge regulated mortgage contracts* (except for ■ MIPRU 3.2.9A R);
- (b) a *firm* that is subject to ■ MIPRU 3.2.9R; if:
  - (i) it has net tangible assets of more than £1 million; or
  - (ii) the comparable guarantee provisions of (3) apply (as if the *firm* was carrying on *insurance mediation activity*) but substituting £1 million for £10 million in (3)(a) and (b); or
- (c) a *firm* which carries on *home finance mediation activity* exclusively for *legacy CCA mortgage contracts*;

(5) This chapter does not apply to:

- (a) an *insurer*; or



- (b) a *managing agent*; or
- (c) a *firm* to which ■ IPRU-INV 13.1.5R(1) (Financial resource requirements for personal investment firms: requirement to hold professional indemnity insurance) applies.
- (d) [deleted]

(6) In relation to *home finance mediation activity* or *MCD article 3(1)(b) credit intermediation activity*, this chapter does not apply to an *authorised professional firm* which is not an *MCD credit intermediary*:

- (a) that is required by another *rule* to hold professional indemnity insurance (see *IPRU(INV) 2.3.1R*); and
- (b) whose *home finance mediation activity*, is incidental to its main business.

(7) In relation to *home finance mediation activity* or *MCD article 3(1)(b) credit intermediation activity*, this chapter does not apply to an *MCD credit intermediary* if it holds a comparable guarantee (as specified in (4)(b)(ii)) against liability arising from professional negligence.

[Note: article 29(2) of the *MCD*]

- (8) In relation to *MCD article 3(1)(b) credit intermediation activity*, only ■ MIPRU 3.2.9A R applies.

[Note: article 29(2)(a) of the *MCD*]

3.1.2 G The definition of *insurance distribution activity* is any of several activities 'in relation to a *contract of insurance*' which includes a contract of reinsurance. This chapter, therefore, applies to a reinsurance intermediary in the same way as it applies to any other *insurance intermediary*.

### Purpose

3.1.3 G The purposes of this chapter are to:

- (1) reflect the *UK* provisions which implemented articles 10(4) and 10(5) of the *IDD* in so far as it required *insurance intermediaries* to hold professional indemnity insurance, or some other comparable guarantee, against any liability that might arise from professional negligence; and
- (2) meet the *statutory objectives* of consumer protection and protecting and enhancing the integrity of the *UK financial system* by ensuring that *firms* have adequate resources to protect themselves, and their *customers*, against losses arising from breaches in its duties under the *regulatory system* or civil law.

3.1.3A G

3.1.4 G Any breach in the duty of a *firm* or of its agents under the *regulatory system* or civil law can give rise to claims being made against the *firm*. Professional indemnity insurance has an important role to play in helping to finance such

claims. In so doing, this chapter amplifies *threshold condition 4* (Adequate resources). This *threshold condition* provides that a *firm* must have, on a continuing basis, resources that are, in the opinion of the *appropriate regulator*, adequate in relation to the *regulated activities* that the *firm* carries on.

**3.1.5** **G** Under *Principles 3* and *4* a *firm* is required to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems and to maintain adequate financial resources. Under *Principle 9* a *firm* is obliged to take reasonable care to ensure the suitability of its *advice on investments* and discretionary decisions for any *customer* who is entitled to rely upon its judgement.

**3.1.5A** **G**

**3.1.6** **G** Although financial resources and appropriate systems and controls can generally mitigate operational risk, professional indemnity insurance has a role in mitigating the risks a *firm* faces in its day to day operations, including those arising from not meeting the legally required standard of care when *advising on investments*. The purpose of this chapter is to ensure that a *firm* has in place the type, and level, of professional indemnity insurance necessary to mitigate these risks.



### 3.2 Professional indemnity insurance requirements

- 3.2.1 **R** A *firm* must take out and maintain professional indemnity insurance that is at least equal to the requirements of this section from:
- (1) an *insurance undertaking* authorised to transact professional indemnity insurance in the *UK*; or
  - (2) a *person* of equivalent status in:
    - (i) a *Zone A country*; or
    - (ii) the Channel Islands, Gibraltar, Bermuda or the Isle of Man.

[Note: articles 10(4) and 10(5) of the *IDD*]

- 3.2.2 **G** The minimum *limits of indemnity* for a *firm* whose *Part 4A permission* covers both *insurance distribution activity* and *home finance mediation activity* is the higher of the *limits of indemnity* for these activities. If the *firm* opts for a single comparable guarantee to finance the claims which might arise as a result of both activities, the requirements for *insurance distribution activity* apply.

- 3.2.3 **G** A non-*UK firm* (such as a captive insurance company outside the *UK*) will be able to provide professional indemnity insurance only if it is authorised to do so in one of the specified countries or territories.. The purpose of this provision is to balance the level of protection required for the *policyholder* against a reasonable level of flexibility for the *firm*.

#### Terms to be incorporated in the insurance

- 3.2.4 **R** The contract of professional indemnity insurance must incorporate terms which make provision for:
- (1) cover in respect of claims for which a *firm* may be liable as a result of the conduct of itself, its *employees* and its *appointed representatives* (acting within the scope of their appointment);
  - (2) the minimum *limits of indemnity* per year set out in this section;
  - (3) an excess as set out in this section;
  - (4) appropriate cover in respect of legal defence costs;

(5) continuous cover in respect of claims arising from work carried out from the date on which the *firm* was given *Part 4A permission* for the *insurance distribution activity* or *home finance mediation activity* concerned; and

(6) cover in respect of *Ombudsman* awards made against the *firm*.

3.2.5 **G** A *firm* is responsible for the conduct of all of its *employees*. The *firm's employees* include, but are not limited to, its *partners, directors*, individuals that are self-employed or operating under a contract hire agreement and any other individual that is employed in connection with its business.

3.2.6 **G** A *firm* is responsible for the conduct of all of its *appointed representatives*.

**Minimum limits of indemnity: insurance intermediary**

3.2.7 **R** If the *firm* is an *insurance intermediary*, then the minimum *limits of indemnity* per year are:

(1) for a single claim, €1,300,380; and

(2) in aggregate, the higher of:

(a) €1,924,560; and

(b) an amount equivalent to 10% of annual income (this amount being subject to a maximum of £30 million).

[Note: articles 10(4) and 10(5) of the *IDD*]

3.2.7A **G** [deleted]

3.2.8 **R** If a *policy* is denominated in any currency other than euros, a *firm* must take reasonable steps to ensure that the *limits of indemnity* are, when the *policy* is effected and at *renewal*, at least equivalent to those required.

**Minimum limits of indemnity: home finance intermediary that is not an MCD credit intermediary**

3.2.9 **R** If the *firm* is a *home finance intermediary* that is not subject to **MIPRU 3.2.9A R**, then the minimum *limit of indemnity* is the higher of 10% of *annual income* up to £1 million, and:

- (1) for a single claim, £100,000; or
- (2) in aggregate, £500,000.

**Minimum limits of indemnity: MCD credit intermediaries**

3.2.9A

**R**

If the *firm* is:

- (1) an *MCD article 3(1)(b) credit intermediary* who is not also an *MCD article 3(1)(b) creditor* carrying out direct sales only; or
- (2) a *home finance intermediary* that is:
  - (a) an *MCD mortgage adviser*; or
  - (b) an *MCD mortgage arranger*,  
who is not also an *MCD mortgage lender* carrying out direct sales only;

then the minimum *limit of indemnity* is that specified in ■ MIPRU 3.2.9BR.

[Note: article 29(2) of the *MCD*]

3.2.9B

**R**

The minimum monetary amount of the professional indemnity insurance or comparable guarantee is:

EUR 460 000 for each individual claim;

in aggregate EUR 750 000 per calendar year for all claims.

[Note: article 1 of the Commission Delegated Regulation (EU) No 1125/2014.]

**Excess**

3.2.10

**R**

In this chapter, "*client assets*" includes a *document* only if it has value, or is capable of having value, in itself (such as a bearer instrument).

3.2.11

**R**

For a *firm* which does not hold *client money* or other *client assets*, the excess must not be more than the higher of:

- (1) £2,500; and
- (2) 1.5% of *annual income*.

3.2.12

**R**

For a *firm* which holds *client money* or other *client assets*, the excess must not be more than the higher of:

- (1) £5,000; and
- (2) 3% of *annual income*.

**Policies covering more than one firm**

3.2.13

**R**

If a *policy* provides cover to more than one *firm*, then:

- (1) the *limits of indemnity* must be calculated on the combined *annual income* of all the *firms* named in the *policy*; and
- (2) each *firm* named in the *policy* must have the benefit of the relevant minimum *limits of indemnity*.

**Additional capital**

3.2.14

**R**

If a *firm* seeks to have an excess which is higher than the relevant limit, it must hold additional capital as calculated in accordance with the appropriate table below:

Table: Calculation of additional capital for firm not holding client money or other client assets (£000's)

Income MoreUp than to	Excess obtained up to and including:													
	2.5	5	10	15	20	25	30	40	50	75	100	150	200+	
0 100	0	5	9	12	14	17	19	23	26	33	39	50	59	
100 200	0	7	12	16	19	22	25	30	34	43	51	64	75	
200 300	0	7	12	16	20	24	27	32	37	47	56	71	84	
300 400	0	0	12	16	21	24	28	34	39	50	60	77	91	
400 500	0	0	11	16	21	24	28	34	40	53	63	81	96	
500 600	0	0	10	16	20	24	28	35	41	54	65	84	100	
600 700	0	0	0	15	20	24	28	35	41	55	67	87	104	
700 800	0	0	0	14	19	24	28	35	42	56	68	89	107	
800 900	0	0	0	13	18	23	27	35	42	56	69	91	109	
900 1000	0	0	0	0	17	22	27	34	41	57	70	92	111	
1000 1500	0	0	0	0	0	21	26	34	41	57	71	97	118	
1500 2000	0	0	0	0	0	0	0	30	38	56	71	98	121	
2000 2500	0	0	0	0	0	0	0	24	33	53	69	99	126	
2500 3000	0	0	0	0	0	0	0	0	28	50	68	101	130	
3000 3500	0	0	0	0	0	0	0	0	0	47	67	101	132	
3500 4000	0	0	0	0	0	0	0	0	0	43	65	101	133	
4000 4500	0	0	0	0	0	0	0	0	0	39	62	101	134	
4500 5000	0	0	0	0	0	0	0	0	0	0	58	99	134	
5000 6000	0	0	0	0	0	0	0	0	0	0	54	97	133	
6000 7000	0	0	0	0	0	0	0	0	0	0	0	91	131	
7000 8000	0	0	0	0	0	0	0	0	0	0	0	84	126	
8000 9000	0	0	0	0	0	0	0	0	0	0	0	75	120	
9000 10000	0	0	0	0	0	0	0	0	0	0	0	0	113	
10000 100000	0	0	0	0	0	0	0	0	0	0	0	0	0	
100000 n/a	0	0	0	0	0	0	0	0	0	0	0	0	0	

Table: Calculation of additional capital for firm holding client money or other client assets (£000's)

Income		Excess obtained up to and including:											
More than	Up to	5	10	15	20	25	30	40	50	75	100	150	200+
0	100	0	4	7	9	12	14	18	21	28	34	45	54
100	200	0	7	11	14	17	20	25	29	38	46	59	70
200	300	0	7	11	14	17	20	25	30	40	49	64	77
300	400	0	0	9	13	16	19	25	30	40	50	67	81
400	500	0	0	0	11	14	18	24	29	40	51	68	83
500	600	0	0	0	8	12	15	22	28	40	51	69	85
600	700	0	0	0	0	9	13	20	26	39	50	69	86
700	800	0	0	0	0	6	10	17	24	38	49	69	87
800	900	0	0	0	0	0	7	15	22	36	48	69	87
900	1,000	0	0	0	0	0	0	12	19	34	47	68	87
1,000	1,500	0	0	0	0	0	0	0	16	32	45	67	86
1,500	2,000	0	0	0	0	0	0	0	0	18	34	59	81
2,000	2,500	0	0	0	0	0	0	0	0	0	19	48	71
2,500	3,000	0	0	0	0	0	0	0	0	0	6	37	64
3,000	3,500	0	0	0	0	0	0	0	0	0	0	26	55
3,500	4,000	0	0	0	0	0	0	0	0	0	0	14	45
4,000	4,500	0	0	0	0	0	0	0	0	0	0	1	33
4,500	5,000	0	0	0	0	0	0	0	0	0	0	0	21
5,000	6,000	0	0	0	0	0	0	0	0	0	0	0	8
6,000	7,000	0	0	0	0	0	0	0	0	0	0	0	0
7,000	8,000	0	0	0	0	0	0	0	0	0	0	0	0
8,000	9,000	0	0	0	0	0	0	0	0	0	0	0	0
9,000	10,000	0	0	0	0	0	0	0	0	0	0	0	0
10,000	100,000	0	0	0	0	0	0	0	0	0	0	0	0
100,000	n/a	0	0	0	0	0	0	0	0	0	0	0	0

3.2.15 **R** The *rule* on the items which are eligible to contribute to the capital resources of a *firm* applies (see ■ MIPRU 4.4.2 R).





## Chapter 4

# Capital resources

## 4.1 Application and purpose

### Application

**4.1.1** **R** This chapter applies to a *firm* with *Part 4A permission* to carry on any of the following activities, unless an exemption in this section applies:

- (1) *insurance distribution activity*;
- (2) *home finance mediation activity*;
- (3) *home financing*;
- (4) *home finance administration*.

**4.1.2** **G** [deleted]

**4.1.3** **G** The definition of *insurance distribution activity* refers to several activities 'in relation to a *contract of insurance*' which includes a contract of reinsurance. This chapter, therefore, applies to a reinsurance intermediary in the same way as it applies to any other *insurance intermediary*.

### Application: banks, designated investment firms, building societies, insurers and friendly societies

**4.1.4** **R** This chapter does not apply to:

- (1) a *bank*; or
- (1A) a *designated investment firm*; or
- (2) a *building society*; or
- (3) a solo consolidated *subsidiary of a bank or a building society*; or
- (4) an *insurer*; or
- (5) a *friendly society*.

**4.1.5** **G** The capital resources of the *firms* above are calculated in accordance with the appropriate prudential sourcebook.

**Application: firms carrying on designated investment business only**

**4.1.6** **R** This chapter does not apply to a *firm* whose *Part 4A permission* is limited to *regulated activities* which are *designated investment business*.

**4.1.7** **G** A *firm* which carries on *designated investment business*, and no other *regulated activity*, may disregard this chapter. For example, a *firm* with *permission* limited to *dealing in investments as agent* in relation to *securities* is only carrying on *designated investment business* and may be subject to the Prudential sourcebook for MiFID Investment Firms (*MIFIDPRU*) or the Interim Prudential sourcebook for Investment Businesses (*IPRU(INV)*), as appropriate. However, if its *permission* is varied to enable it to arrange motor insurance as well, this activity is not *designated investment business* so the *firm* will be subject to the higher of the requirements in this chapter and those sourcebooks (see **■** MIPRU 4.2.5 R).

**Application: professional firms**

- 4.1.10** **R**
- (1) This chapter does not apply to an *authorised professional firm*:
    - (a) whose main business is the practice of its profession; and
    - (b) whose *regulated activities* covered by this chapter are incidental to its main business.
  - (2) A *firm's* main business is the practice of its profession if the proportion of income it derives from professional fees is, during its annual accounting period, at least 50% of the *firm's* total income (a temporary variation of not more than 5% may be disregarded for this purpose).
  - (3) Professional fees are fees, commissions and other receipts receivable in respect of legal, accountancy, actuarial, conveyancing and surveying services provided to clients but excluding any items receivable in respect of *regulated activities*.

**Application: social housing firms**

**4.1.13** **G** There are special provisions for a *social housing firm* when it is carrying on *home financing* or *home finance administration* (see **■** MIPRU 4.2.7 R).

**Application: MCD firms**

**4.1.13A** **R** This chapter does not apply to a *firm* which only carries on one or more of the following:

- (1) *home finance mediation activity* exclusively for *second charge regulated mortgage contracts*; or
- (1A) *home finance mediation activity* exclusively for *legacy CCA mortgage contracts*; or
- (2) *home financing* exclusively for *second charge regulated mortgage contracts*; or

(3) *home finance administration* exclusively for *second charge regulated mortgage contracts*; or

(4) *home finance administration* exclusively for *legacy CCA mortgage contracts*.

**4.1.13B** **R** For a *firm* that carries on a combination of *home finance mediation activity*, *home financing* and *home finance administration*, this chapter will only apply to the extent its activities relate to *specified investments* other than *second charge regulated mortgage contracts*.

### Purpose

**4.1.14** **G** This chapter:

- (1) sets out that a *firm* must meet, on a continuing basis, a basic solvency requirement and a minimum *capital resources requirement* (see ■ COND 2.4 (Appropriate resources)); and
- (2) amplifies *Principle 4* which requires a *firm* to maintain adequate financial resources by setting out capital requirements for a *firm* according to the *regulated activity* or *regulated activities* it carries on.

**4.1.15** **G** Capital has an important role to play in protecting consumers and complements the roles played by professional indemnity insurance and *client money* protection (see the *client money rules*). Capital provides a form of protection for situations not covered by a *firm's* professional indemnity insurance and it provides the funds for the *firm's* PII excess, which it has to pay out of its own finances (see ■ MIPRU 3.2.11 R and ■ MIPRU 3.2.12 R for the relationship between the *firm's* capital and its excess).

**4.1.16** **G** More generally, having adequate capital gives the *firm* a degree of resilience and some indication to consumers of creditworthiness, substance and the commitment of its owners. It reduces the possibility of a shortfall of funds and provides a cushion against disruption if the *firm* ceases to trade.

**4.1.17** **G** There is a greater risk to consumers, and a greater adverse impact on market confidence, if a *firm* holding *client money* or other *client* assets fails. For this reason, the capital resources *rules* in this chapter clearly distinguish between *firms* holding *client* assets and those that do not.

### Purpose: social housing firms

**4.1.18** **G** *Social housing firms* undertake small amounts of home finance business even though their main business consists of activities other than *regulated activities*. Their *home financing* is only done as an adjunct to their primary purpose (usually the provision of housing) and is substantially different in character to that done by commercial lenders. Furthermore, they are *subsidiaries* of local authorities or registered social landlords which are already subject to separate regulation. The FCA does not consider that it would be proportionate to the risks involved with such business to impose significant capital requirements for these *firms*. The capital resources requirement for *social housing firms* therefore simply provides that, where

their *Part 4A permission* is limited to *home financing* and *home finance administration*, their net tangible assets must be greater than zero.

## 4.1.19

G

A registered social landlord is a non-profit organisation which provides and manages homes for rent and sale for people who might not otherwise be able to rent or buy on the open market. It can be a housing association, a housing society or a non-profit making housing company. The Homes and Communities Agency and the Tenant Services Authority were set up by Parliament in 2008 and cooperate in providing financial assistance for social housing.

## 4.2 Capital resources requirements

4.2.-1 **G**

### General solvency requirement

4.2.1 **R** A *firm* must at all times ensure that it is able to meet its liabilities as they fall due.

4.2.1A **G** Specific liquidity requirements for a *firm* carrying on any *home financing* or *home finance administration* connected to *regulated mortgage contracts* are set out in ■ MIPRU 4.2D.

### General capital resource requirement

4.2.2 **R** A *firm* must at all times maintain capital resources equal to or in excess of its relevant capital resources requirement.

### Capital resources: relevant accounting principles

4.2.3 **R** A *firm* must recognise an asset or liability, and measure its amount, in accordance with the relevant accounting principles applicable to it for the purpose of preparing its annual financial statements unless a *rule* requires otherwise.

### Capital resources: client assets

4.2.4 **R** In this chapter, "*client assets*" includes a *document* only if it has value, or is capable of having value, in itself (such as a bearer instrument)

### Capital resources requirement: firms carrying on regulated activities including designated investment business

4.2.5 **R** The capital resources requirement for a *firm* (other than a *credit union*) carrying on *regulated activities*, including *designated investment business* and to which *IPRU(INV)* does not apply, is the higher of:

- (1) the requirement which is applied by this chapter according to the activity or activities of the *firm* (treating the relevant *rules* as applying to the *firm* by disregarding its *designated investment business*); and

(2) the financial resources requirement which is applied by the Prudential sourcebook for MiFID Investment Firms (*MIFIDPRU*).

**4.2.5A** **G** The capital resources requirement for a *firm* (other than a *credit union*) carrying on *regulated activities*, including *designated investment business*, which is also subject to the Interim Prudential sourcebook for investment businesses is the amount calculated in IPRU(INV) 13.13.3R.

**Capital resources requirement: social housing firms**

**4.2.7** **R** The capital resources requirement for a *social housing firm* whose *Part 4A permission* is limited to carrying on the *regulated activities* of:

- (1) *home financing*; or
- (2) *home finance administration* (or both);

is that the *firm's* net tangible assets must be greater than zero.

**4.2.8** **G** If a *social housing firm* is carrying on *home financing* or *home finance administration* (and no other *regulated activity*), its net tangible assets must be greater than zero. However, if it carries on *insurance distribution activity* or *home finance mediation activity*, there is no special provision and the capital resources requirement for *firms* carrying on *designated investment business*, *insurance distribution activity* or *home finance mediation activity* only applies to it as appropriate.

**Capital resources requirement: application according to regulated activities**

**4.2.9** **R** Unless any of the *rules* on capital resources for *firms* carrying on *designated investment business*, for *credit unions* or for *social housing firms* apply, the capital resources requirement for a *firm* varies according to the *regulated activity* or activities it carries on.

**4.2.10** **R** Table: Application of capital resources requirements

	Regulated activities	Provisions
1.	(a) <i>insurance distribution activity</i> ; or  (b) <i>home finance mediation activity</i> (or both); and no other <i>regulated activity</i> .	MIPRU 4.2.11 R
2.	(a) <i>home financing</i> not connected to <i>regulated mortgage contracts</i> ; or  (b) <i>home financing</i> and <i>home finance administration</i> (not connected to <i>regulated mortgage contracts</i> ); and no other <i>regulated activity</i> .	MIPRU 4.2.12 R to MIPRU 4.2.17 E

	Regulated activities	Provisions
3.	<i>home finance administration; and no other regulated activity.</i>	MIPRU 4.2.18 R to MIPRU 4.2.19 R
4.	<i>insurance distribution activity; and</i> (a) <i>home financing; or</i> (b) <i>home finance administration (or both).</i>	MIPRU 4.2.20 R
5.	<i>home finance mediation activity; and</i> (a) <i>home financing, or</i> (b) <i>home finance administration (or both).</i>	MIPRU 4.2.21 R
7.	a) <i>home financing connected to regulated mortgage contracts; or</i>  (b) <i>home financing and home finance administration connected to regulated mortgage contracts; and no other regulated activity.</i>	[deleted] MIPRU 4.2.23 R
8.	any combination of <i>regulated activities</i> not within rows 1 to 7.	MIPRU 4.2.22 R

4.2.10A

G

■ MIPRU 4.2.12 R to ■ MIPRU 4.2.23 R have the effect that a *firm* carrying on any *home financing* or *home finance administration* which is connected to *regulated mortgage contracts* will be subject to different capital requirements to a *firm* that carries on those activities without connection to *regulated mortgage contracts*. To identify which of the *rules* in ■ MIPRU 4.2.12 R to ■ MIPRU 4.2.23 R is applicable, a *firm* should consider which *regulated activities* it performs as part of its *home financing* and *home finance administration* activities and determine whether any of those *regulated activities* (no matter what proportion) are connected to *regulated mortgage contracts*.

**Capital resources requirement: insurance distribution activity or home finance mediation activity only**

4.2.11

R

- (1) If a *firm* carrying on *insurance distribution activity* or *home finance mediation activity* (and no other *regulated activity*) does not hold *client money* or other *client assets* in relation to these activities, its capital resources requirement is the higher of:
- (a) £5,000; and
  - (b) 2.5% of the *annual income* from its *insurance distribution activity* or *home finance mediation activity* (or both).



(2) If a *firm* carrying on *insurance distribution activity* or *home finance mediation activity* (and no other *regulated activity*) holds *client money* or other *client assets* in relation to these activities, its capital resources requirement is the higher of:

- (a) £10,000; and
- (b) 5% of the *annual income* from its *insurance distribution activity* or *home finance mediation activity* (or both).

### Capital resources requirement: home financing and home finance administration not connected to regulated mortgage contracts

4.2.12

R

(1) The capital resources requirement for a *firm* carrying on only *home financing*, which is not connected to *regulated mortgage contracts*, or *home financing and home finance administration* which is not connected to *regulated mortgage contracts* (and no other *regulated activity*) is the higher of:

- (a) £100,000; and
- (b) 1% of:
  - (i) its total assets plus total undrawn commitments and unreleased amounts under the *home reversion plan*; less:
  - (ii) excluded loans or amounts plus intangible assets (see Note 1 in the table in ■ MIPRU 4.4.4 R).

(2) Undrawn commitments and unreleased amounts means the total of those amounts which a *customer* has the right to draw down or to receive from the *firm* but which have not yet been drawn down or received, excluding those under an agreement:

- (a) which has an original maturity of up to one year; or
- (b) which can be unconditionally cancelled at any time by the lender or provider.

4.2.13

G

When considering what is an undrawn commitment or unreleased amount, the *appropriate regulator* takes into account an amount which a *customer* has the right to draw down or to receive under a *home finance transaction*, but which has not yet been drawn down or received, whether the commitment or obligation is revocable or irrevocable, conditional or unconditional.

4.2.14

R

When calculating total assets, the *firm* may exclude a loan or plan which has been transferred to a third party only if it meets the following conditions:

- (1) the first condition is that the loan or the plan has been transferred in a legally effective manner by:
  - (a) novation; or
  - (b) legal or equitable assignment; or
  - (c) sub-participation; or
  - (d) declaration of trust; and

- (2) the second condition is that the *home finance provider*:
- (a) retains no material economic interest in the loan or the plan; and
  - (b) has no material exposure to losses arising from it.
- 4.2.15** **E** (1) When seeking to rely on the second condition, a *firm* should ensure that the loan or plan qualifies for the 'linked presentation' accounting treatment under Financial Reporting Standard 5 (Reporting the substance of transactions) issued in April 1994, and amended in December 1994 and September 1998 (if applicable to the *firm*).
- (2) Compliance with (1) may be relied upon as tending to establish compliance with the second condition.
- 4.2.16** **G** The requirement that the loan qualifies for the 'linked presentation' accounting treatment under FRS 5 is aimed at those *firms* which report according to FRS 5. Other *firms* which report under other standards, including *UK-adopted international accounting standards*, need not adopt FRS 5 in order to meet the second condition.
- 4.2.17** **E** (1) When seeking to rely on the second condition, a *firm* should not provide material credit enhancement in respect of the loan or plan unless it deducts the amount of the credit enhancement from its capital resources before meeting its capital resources requirement.
- (2) Credit enhancement includes:
- (a) any holding of subordinated loans or notes in a transferee that is a special purpose vehicle; or
  - (b) over collateralisation by transferring loans or plans to a larger aggregate value than the *securities* to be issued; or
  - (c) any other arrangement with the transferee to cover a part of any subsequent losses arising from the transferred loan or plan.
- (3) Contravention of (1) may be relied upon as tending to establish contravention the second condition.
- Capital resources requirement: home finance administration only**
- 4.2.18** **R** The capital resources requirement for a *firm* carrying on *home finance administration* only, which has all or part of the *home finance transactions* that it administers on its balance sheet, is:
- (1) in the case of a *firm* carrying on only *home finance administration* which is not connected to *regulated mortgage contracts*, the amount which is applied to a *firm* under ■ MIPRU 4.2.12 R; or

- (2) in the case of a *firm* carrying on any *home finance administration* which is connected to *regulated mortgage contracts*, the amount which is applied to a *firm* under ■ MIPRU 4.2.23 R.

4.2.19 **R** The capital resources requirement for a *firm* carrying on *home finance administration* only, which has all the *home finance transactions* that it administers off its balance sheet, is the higher of:

- (1) £100,000; and  
 (2) 10% of its *annual income*.

#### Capital resources requirement: insurance distribution activity and home financing or home finance administration

4.2.20 **R** The capital resources requirement for a *firm* carrying on *insurance distribution activity* and *home financing* or *home finance administration* is the sum of :

- (1) the capital resources requirement for a *firm* carrying on *insurance distribution activity* or *home finance mediation activity* (and no other *regulated activity*) (see ■ MIPRU 4.2.11 R); and
- (2) (a) in the case of a *firm* carrying on *home financing* which is not connected to *regulated mortgage contracts*, or *home finance administration* which is not connected to *regulated mortgage contracts*, the amount which is applied to a *firm* under ■ MIPRU 4.2.12 R; or
- (aa) in the case of a *firm* carrying on any *home financing* which is connected to *regulated mortgage contracts* or any *home finance administration* that it administers on its balance sheet which is connected to *regulated mortgage contracts*, the amount which is applied to a *firm* under ■ MIPRU 4.2.23 R; or
- (b) in the case of a *firm* carrying on *home finance administration* with all the *home finance transactions* that it administers off balance sheet, the amount which is applied to a *firm* under ■ MIPRU 4.2.19 R.

#### Capital resources requirement: home finance mediation activity and home financing or home finance administration

4.2.21 **R** (1) If a *firm* carrying on *home finance mediation activity* and *home financing* or *home finance administration* does not hold *client money* or other *client assets* in relation to its *home finance mediation activity*, the capital resources requirement is:

(a) in the case of a *firm* carrying on *home financing* which is not connected to *regulated mortgage contracts* or *home finance administration* which is not connected to *regulated mortgage contracts*, the amount applied to a *firm* under ■ MIPRU 4.2.12 R; or

(aa) in the case of a *firm* carrying on any *home financing* which is connected to *regulated mortgage contracts* or any *home finance administration* that it administers on its balance sheet which is

connected to *regulated mortgage contracts*, the amount applied to a *firm* under ■ MIPRU 4.2.23 R; or

- (b) in the case of a *firm* carrying on *home finance administration* with all the *home finance transactions* that it administers off balance sheet, the amount applied to a *firm* under ■ MIPRU 4.2.19 R

(2) If the *firm* holds *client money* or other *client* assets in relation to its *home finance mediation activity*, the capital resources requirement is:

- (a) the amount calculated under (1); plus
- (b) the amount which is applied to a *firm* carrying on *insurance distribution activity* or *home finance mediation activity* (and no other *regulated activity*) that holds *client money* or other *client* assets in relation to these activities (see ■ MIPRU 4.2.11R (2)).

### Capital resources requirement: other combinations of activities

4.2.22

R

The capital resources requirement for a *firm* carrying on any combination of *regulated activities* which is not set out in ■ MIPRU 4.2.10 R to ■ MIPRU 4.2.21 R and ■ MIPRU 4.2.23 R is:

(1) if the combination of *regulated activities* includes carrying on any *home financing* connected to *regulated mortgage contracts* or *home finance administration* connected to *regulated mortgage contracts*, the sum of the amounts which are applied to a *firm* under:

- (a) ■ MIPRU 4.2.20R (1); and
- (b) ■ MIPRU 4.2.23 R; or

(2) in all other cases, the sum of the amounts which are applied to a *firm* under:

- (a) ■ MIPRU 4.2.20R (1); and
- (b) ■ MIPRU 4.2.12 R.

### Capital resources requirement: home financing and home finance administration connected to regulated mortgage contracts

4.2.23

R

The *capital resources requirement* for a *firm* carrying on any *home financing* which is connected to *regulated mortgage contracts*, or *home financing* and *home finance administration* which is connected to *regulated mortgage contracts* (and no other *regulated activity*), is the higher of:

- (1) £100,000; and
- (2) the sum of:
  - (a) the *credit risk capital requirement* calculated in accordance with ■ MIPRU 4.2A; and
  - (b) 1% of:
    - (i) its total assets plus total undrawn commitments and unreleased amounts under the *home reversion plan*; less
    - (ii) intangible assets (see Note 1 in the table in ■ MIPRU 4.4.4 R) plus loans, *securitisation positions* and *fund* positions subject to ■ MIPRU 4.2A.4 R.

## 4.2A Credit risk capital requirement

### Application

- 4.2A.1 **R** This section applies to a *firm* carrying on any *home financing* connected to *regulated mortgage contracts* or *home financing* and *home financing administration* connected to *regulated mortgage contracts* see ■ MIPRU 4.2.23 R .

### Purpose

- 4.2A.2 **G** ■ MIPRU 4.2A sets out how a *firm* should calculate its *credit risk capital requirement*.

- 4.2A.3 **G** A *firm* may use credit risk mitigation to reduce the credit risk associated with an *exposure*. The *firm* should refer to ■ MIPRU 4.2C to determine the effect of credit risk mitigation on its *risk weighted exposure amounts*.

### Calculation of credit risk capital requirement

- 4.2A.4 **R** The *credit risk capital requirement* of a *firm* is 8% of the total of its *risk weighted exposure amounts* for *exposures* that:

- (1) are on its balance sheet; and
- (2) derive from:
  - (a) a loan entered into; or
  - (b) a *securitisation position* originated; or
  - (c) a *fund* position entered into; on or after 26 April 2014; and
- (3) have not been deducted from the *firm's capital resources* under ■ MIPRU 4.4.4 R or ■ MIPRU 4.2BA;

calculated in accordance with ■ MIPRU 4.2A.

- 4.2A.4A **R** Loans, *securitisation positions* and *fund* positions entered into before 26 April 2014 are excluded from the *credit risk capital requirement* calculation.

- 4.2A.5 **R** Any arrangements entered into on or after 26 April 2014 which increase the amount of a loan already advanced or change the security to a loan already

advanced or change the contractual terms (other than if the *firm* is exercising forbearance) of a loan already advanced will be subject to the credit risk capital requirement under ■ MIPRU 4.2A.4R (2)(a) provided that, where the arrangements only increase the amount of a loan already advanced, such requirement shall only apply to the amount of such increase.

4.2A.5A **G** The arrangements excluded from the *credit risk capital requirement* include:

- (1) a loan acquired by a *firm* on or after 26 April 2014 if that loan was made before 26 April 2014;
- (2) arrangements made as a result of forbearance procedures, including:
  - (a) a change in the basis of interest payments from variable to fixed rate; or
  - (b) a change from a repayment mortgage to interest only; or
  - (c) the capitalisation of interest which increases the principal outstanding, where there is no element of new borrowing.

4.2A.5B **G** A *firm* may exclude loans or *home reversion plans* entered into before 26 April 2014 where they meet the conditions in ■ MIPRU 4.2.14 R, applied in accordance with ■ MIPRU 4.2.15 E to ■ MIPRU 4.2.17 E.

4.2A.6 **R** Unless a *rule* requires otherwise, the *exposure* value of an asset or liability held on the balance sheet of a *firm* must be its balance sheet value.

### Exposure classes

4.2A.6A **R** A *firm* must assign each *exposure* to one of the following *exposure* classes:

- (1) loans or contingent loans secured on real estate property;
- (2) other loans;
- (3) *securitisation positions*;
- (4) *exposures* in the form of *funds*; or
- (5) past due items.

4.2A.7 **R**

4.2A.8 **R**

### Risk weights

4.2A.9 **R** For the purposes of applying a *risk weight*, the *exposure* value must be multiplied by the *risk weight* determined in accordance with ■ MIPRU 4.2A.10 R, ■ MIPRU 4.2A.10A R, ■ MIPRU 4.2A.10B R, ■ MIPRU 4.2A.11 R,

- MIPRU 4.2A.12 R or ■ MIPRU 4.2A.17 R, unless it is deducted from *capital resources* under ■ MIPRU 4.4.4 R or ■ MIPRU 4.2BA.
- 4.2A.10 R** To calculate *risk weighted exposure amounts* on exposures secured by mortgages on residential property, *risk weights* must be applied to all such exposures, in accordance with ■ MIPRU 4.2F.4 R to ■ MIPRU 4.2F.10 G.
- 4.2A.10A R** To calculate *risk weighted exposure amount* on exposures secured by mortgages on commercial property, *risk weights* must be applied to all such exposures in accordance with ■ MIPRU 4.2F.37 R.
- 4.2A.10B R** To calculate *risk weighted exposure amounts* on other loans, *risk weights* must be applied to all such exposures in accordance with ■ MIPRU 4.2F.38 R.
- 4.2A.11 R** To calculate *risk weighted exposure amounts* on exposures in funds, *risk weights* must be applied to all such exposures, in accordance with ■ MIPRU 4.2F.39 R to ■ MIPRU 4.2F.49 R.
- 4.2A.12 R** To calculate *risk weighted exposure amounts* for securitised exposures, *risk weights* must be calculated in accordance with ■ MIPRU 4.2BA (Securitisation).
- 4.2A.13 R**
- 4.2A.14 G**
- 4.2A.15 R**
- 4.2A.16 R**
- 4.2A.17 R** A firm must apply ■ MIPRU 4.2F.50 R to ■ MIPRU 4.2F.55 R to all past due items
- 4.2A.17A R**
- (1) The application of *risk weights* must be based on the *exposure class* to which the *exposure* is assigned and, to the extent specified in ■ MIPRU 4.2BA and ■ MIPRU 4.2F (Exposures and risk weights), its credit quality.
  - (2) Credit quality must be determined by reference to solicited credit assessments of *eligible ECAs* where these are available, in accordance with ■ MIPRU 4.2E (Use of external credit assessments).
- 4.2A.17B R** Where an *exposure* is subject to credit risk mitigation, the *risk weighted exposure amount* applicable to that item may be modified in accordance with ■ MIPRU 4.2C (Credit risk mitigation).
- 4.2A.18 G**

## 4.2BA Securitisation

### Application

- 4.2BA.1** **R** This section applies to a *firm* carrying on any *home financing* connected to *regulated mortgage contracts* or *home financing and home financing administration* connected to *regulated mortgage contracts* (see ■ MIPRU 4.2.23 R).

### Purpose

- 4.2BA.2** **R** A *firm* must calculate the *risk weighted exposure amounts* for the *securitisation positions* it holds under ■ MIPRU 4.2BA.31 R to ■ MIPRU 4.2BA.53 R.

- 4.2BA.3** **G** Where a *firm* has transferred significant credit risk associated with *securitised exposures* which it has originated under ■ MIPRU 4.2BA.5 R (High-level principles) and has complied with other applicable requirements in this section, it may exclude those *securitised exposures* from the calculation of its *risk weighted exposure amount* and expected loss amounts.

### Organisation

- 4.2BA.4** **G** This section is organised as follows.
- (1) High-level principles (■ MIPRU 4.2BA.5 R to ■ MIPRU 4.2BA.8 G)
  - (2) Systems and controls (■ MIPRU 4.2BA.9 R to ■ MIPRU 4.2BA.16 R)
  - (3) Structural features (■ MIPRU 4.2BA.17 R to ■ MIPRU 4.2BA.22 R)
  - (4) Implied future support (■ MIPRU 4.2BA.23 R to ■ MIPRU 4.2BA.30 R)
  - (5) Calculation of risk weighted exposure amounts (■ MIPRU 4.2BA.31 R to ■ MIPRU 4.2BA.53 R)
  - (6) Disclosure to investors (■ MIPRU 4.2BA.54 R)

### High-level principles

- 4.2BA.5** **R**
- (1) Economic substance: the risk management and capital treatment of a *securitisation* must be determined on the basis of its economic substance and not its legal form.
  - (2) Eligible structures: only standalone *traditional securitisations* are eligible.



- (3) Eligible underlying assets: term assets (e.g. residential mortgages) originated by the *firm* are eligible.
- (4) Effective credit-risk transfer: the *securitisation* mechanism (e.g. true sale) must effectively transfer the risks of the *securitised exposures* to the holders of the *securitisation positions*, except those risks that remain adequately covered by the *firm's* capital. The securities issued must not represent payment obligations of the *firm*.
- (5) Significant credit risk transfer: the proportion of risk transferred must be commensurate with, or exceed, the proportion by which *risk weighted exposure amounts* are reduced.
- (6) Implied future support: a *firm* must not provide any support (direct or indirect) to investors in the *securitisation* beyond the *firm's* contractual obligations, with a view to reducing potential or actual losses, unless permitted in ■ MIPRU 4.2BA.27 R.
- (7) Maximum regulatory capital: the maximum regulatory capital requirement for retained *securitisation exposure* is the lowest of:
  - (a) the regulatory *capital resources requirement* plus expected losses for the *securitised exposures* before entering into the *securitisation*; or
  - (b) the *capital resources requirement* from the application of a *risk weight* of 1250% to the retained *securitisation positions*; or
  - (c) deduction of the retained *securitisation positions* from *capital resources*.

4.2BA.6 **G** Eligible structures exclude, for example, structures such as master trusts, synthetic securitisations and asset-backed commercial paper programmes. Financial derivatives (e.g. interest-rate swaps) used to structure the *securitisation* should be with third-party counterparties, not the *firm* or connected entities.

4.2BA.7 **G** Eligible underlying assets would exclude, for example, assets purchased from third-party entities, those arising from re-securitisations and any revolving *exposures* such as credit cards.

4.2BA.8 **G** Further provisions on implied future support are contained in ■ MIPRU 4.2BA.23 R to ■ MIPRU 4.2BA.30 R.

### Systems and controls

4.2BA.9 **R** Policies and procedures: a *firm* must evaluate and address all risks, including reputational risks, through appropriate policies and procedures, to ensure in particular that the economic substance of the transaction is fully reflected in risk assessments and management decisions.

4.2BA.10 **R** Monitoring: a *firm* must continuously monitor risks that it may be subject to when it has excluded the *securitised exposures* from its calculation of *risk weighted exposure amounts*.

- 4.2BA.11 **R** Exposure quality: a *firm* must consider the impact that *securitisation* has on the quality of the remaining *exposures* it holds and the capital planning implications.
- 4.2BA.12 **R** Stress testing: the *firm* must carry out regular stress testing which takes into account:
- (1) the *firm*-wide impact of *securitisation* activities and *exposures* in stressed market conditions; and
  - (2) the implications for other sources of risk including, but not limited to, credit risk, concentration risk, counterparty risk, market risk, liquidity risk and reputational risk.
- 4.2BA.13 **G** Stress testing of *securitisation* activities should take into account both existing *securitisations* and pipeline transactions, as there is a risk that the latter would not be completed in a stressed market scenario.
- 4.2BA.14 **G** The frequency and extent of the stress testing should be determined by the materiality of the *firm's* *securitisation* activities. A *firm* should have procedures in place to assess and respond to the stress-testing results.
- 4.2BA.15 **R**
- (1) Credit-granting: a *firm* must apply the same sound and well-defined criteria used under **SYSC 7.1.9 R** for credit-granting in respect of *exposures* held on the balance sheet to *exposures* to be *securitised*.
  - (2) These criteria must include the processes for approving and, where relevant, amending, renewing and re-financing credits.
- 4.2BA.16 **R** Legal opinions: legal opinions obtained in the context of *securitisation* transactions must be reviewed by an independent legal adviser periodically, or when there is a change in law (including case law) or any applicable rules that may affect the opinion.
- Structural features**
- 
- 4.2BA.17 **R** The transferee must be a *securitisation special purpose entity*.
- 4.2BA.18 **R** A *firm* must not maintain effective or indirect control over the transferred *exposures*.
- 4.2BA.19 **G** For the purposes of **MIPRU 4.2BA.18 R**, a *firm* will be considered to have maintained effective control over the transferred *exposures* if:
- (1) it has the right to repurchase previously transferred *exposures* to realise their benefits; or
  - (2) it is required to re-assume any previously transferred risk.

4.2BA.20 **G** For the purposes of **■** MIPRU 4.2BA.18 R, the *originator's* retention of servicing rights or obligations in respect of the *exposures* does not, of itself, constitute indirect control of the *exposures*.

4.2BA.21 **R** A *clean-up call option* must satisfy all of the following conditions:

- (1) it must be exercisable at the discretion of the *firm*;
- (2) it must only be exercised when 10% or less of the original value of the *exposures* securitised remains unamortised;
- (3) it must not be structured so that allocating losses to *credit enhancement* positions or other positions held by investors can be avoided; and
- (4) it must not otherwise be structured to provide *credit enhancement*.

4.2BA.22 **R** The *credit enhancement* documentation must not contain clauses that require *securitisation positions* to be improved by the *firm* in response to a deterioration in the credit quality of the *securitised exposures*, including:

- (1) altering the credit quality of the underlying *exposures*; or
- (2) increasing the yield payable to investors in the *securitisation positions*.

#### Implied future support

4.2BA.23 **R** The *securitisation* documentation must make clear, where applicable, that any repurchase of *securitised exposures* or *securitisation positions* by the *firm* beyond its contractual obligations is not mandatory and may only be made at fair market value.

4.2BA.24 **R** In general, any such repurchase must be subject to the *firm's* credit-granting process, which should be adequate to ensure that the repurchase does not provide support.

4.2BA.25 **R** If a *firm* repurchases *securitised exposures* or *securitisation positions*, it must:

- (1) be able to demonstrate that it has adequately considered the following:
  - (a) the price of the repurchase;
  - (b) the *firm's* capital and liquidity position before and after repurchase;
  - (c) the performance of the *securitised exposures*; and
  - (d) the performance of the *securitisation positions*;
- (2) have concluded, taking into account the factors in (1) and any other relevant information, that the repurchase is not structured to provide support; and

- (3) keep adequate records of the considerations and conclusions under (1) and (2).
- 4.2BA.26** **R** A *firm* must consider at least the following situations to determine whether there may be a breach of the prohibition against implied future support in ■ MIPRU 4.2BA.5R (6):
- (1) support given under a contractual obligation;
  - (2) support which is not provided for under the contractual documentation for the *securitisation*; and
  - (3) support given under the contractual documentation for the *securitisation* which the *firm* is entitled, but not obliged, to give.
- 4.2BA.27** **R**
- (1) The support described in ■ MIPRU 4.2BA.26R (1) is permitted.
  - (2) The support described in ■ MIPRU 4.2BA.26R (2) is not permitted.
  - (3) The support described in ■ MIPRU 4.2BA.26R (3) is permitted if the following conditions are met:
    - (a) contractual and marketing documents of the *securitisation* expressly envisage and allow for the possibility of the *firm* providing such support;
    - (b) the nature of any support that the *firm* may give is precisely described in the contractual and marketing documents of the *securitisation*;
    - (c) both the *firm* and a *person*, whose only information comes from the marketing documents, must be able to ascertain at the time of the *securitisation* the maximum amount of support that can be given in future;
    - (d) an assessment has been made by the *firm* of significant risk transfer, that must include the maximum possible contractual support; and
    - (e) the *firm's capital resources* and *capital resources requirement* are adjusted at the time of the *securitisation* on the basis that the *firm* has provided support to the maximum amount possible, whether by an immediate deduction from *capital resources* or appropriate *risk weighting*.
- 4.2BA.28** **G** A waiver of the right to future margin income will not breach the prohibition against implied future support in ■ MIPRU 4.2BA.5R (6) provided that:
- (1) the degree of support that can be given can be defined precisely by reference to the contractual documentation for the *securitisation*, even if the amount of support may not be ascertainable in absolute monetary terms; and
  - (2) no adjustment to the *firm's capital resources* or *capital resources requirement* is required, as a *firm* should not include future margin income in its income or *capital resources*.

**4.2BA.29** **G** If a *firm* is found to have provided support to a *securitisation* this implies that the *firm* may be likely to provide future support to its *securitisations*, thus failing to achieve a significant transfer of risk. The *FCA* will consider taking appropriate measures to reflect this increased expectation after any instance of support is found.

**4.2BA.30** **R** If a *firm* is found to have provided support to a *securitisation* it will be required to:

- (1) hold *capital resources* against all of the *securitised exposures* associated with the *securitisation* transaction as if they had not been securitised; and
- (2) disclose publicly in a timely fashion:
  - (a) where it has provided such support; and
  - (b) the regulatory capital impact of doing so.

#### Calculation of risk weighted exposure amounts

**4.2BA.31** **R** The *risk weighted exposure amount* equals the on-balance sheet *exposure* value multiplied by the *risk weight* associated with the *credit quality step* with which the credit assessment of that *exposure* value is associated.

**4.2BA.32** **R** Where there is an *exposure* to different *tranches* in a *securitisation*, the *exposure* to each *tranche* must be considered as a separate *securitisation position*.

**4.2BA.33** **R** The providers of credit protection to *securitisation positions* must be treated as holding positions in the *securitisation*.

**4.2BA.34** **R** *Securitisation positions* include *exposures* to a *securitisation* arising from interest rate or currency derivative contracts.

**4.2BA.35** **R** The *ECAI* rating of a *securitisation position* must, at a minimum, comply with the following:

- (1) there must be no mismatch between the types of payments reflected in the credit assessment and the types of payment to which the *firm* is entitled under the contract giving rise to the *securitisation position* in question;
- (2) the rating must be publicly available to the market; and
- (3) the rating must not be based, or partly based, on support provided by the *firm* itself.

**4.2BA.36** **G** Credit assessments may only be treated as publicly available under **■** MIPRU 4.2BA.35R (2) if they have been published in a publicly accessible forum and they are included in the *ECAI's* transition matrix; a rating that is

only made available to a limited number of entities may not be treated as publicly available.

**4.2BA.37** **G** ■ MIPRU 4.2BA.35R (3) refers, for example, to situations where a *firm* holds *securitisation positions* which receive a lower *risk weight* by virtue of credit protection provided by the *firm* itself acting in a different capacity in the *securitisation* transaction.

**4.2BA.38** **R** The assessment of whether a *firm* is providing unfunded support to its *securitisation* positions must take into account the economic substance of that support in the context of the overall transaction and any circumstances in which the *firm* could become exposed to a higher credit risk in the absence of that support. In this case the *firm* must consider the relevant position as if it were not rated and must apply the relevant treatment for unrated positions.

### Multiple credit assessments for a rated position

**4.2BA.39** **R** Where a *rated position* has credit assessments from two *nominated ECAs*, the *firm* must use the less favourable credit assessment.

**4.2BA.40** **R** Where a *rated position* has more than two *nominated ECAI* credit assessments, the two most favourable credit assessments must be used. If the two most favourable credit assessments are different, the less favourable of the two must be used.

**4.2BA.41** **R** Where eligible credit protection under ■ MIPRU 4.2C (Credit risk mitigation) is provided directly to the *securitisation special purpose entity* and that protection is reflected in the credit assessment of a position by a *nominated ECAI*, the *risk weight* associated with that credit assessment may be used. Where the credit protection is not provided to the *securitisation special purpose entity* but provided directly to a *securitisation position*, the credit assessment must not be recognised

### Minimum operational requirements

**4.2BA.42** **R** A *firm* must attribute to an unrated *position* an inferred rating equivalent to the rating of those *rated positions* (the reference positions) which are the most senior positions and are, in all respects, subordinate to the unrated *securitisation position* in question when the following minimum operational requirements are satisfied:

- (1) the reference positions must be subordinate in all respects to the unrated *securitisation position*;
- (2) the maturity of the reference positions must be equal to or longer than that of the unrated position in question; and
- (3) on an ongoing basis, any inferred rating must be updated to reflect any changes in the credit assessment of the reference positions.

**4.2BA.43 R** Where publicly available credit assessments for *securitisation positions* are available from *eligible ECAs*, a *firm* must:

- (1) nominate one or more of the *eligible ECAs*;
- (2) use the credit assessments of *nominated ECAs* in the calculation of its *risk weighted exposure* amounts under this section; and
- (3) apply those credit assessments consistently in respect of its *rated positions*.

**4.2BA.44 R** Where a *firm* holds a *rated position* it must use the credit assessment from the *nominated ECAs* to determine the *risk weight* for the position using:

- (1) the table in ■ MIPRU 4.2E.14 R to determine the *credit quality step* associated with that credit assessment; and
- (2) the table in ■ MIPRU 4.2BA.45 R to determine the *risk weight* to be applied to the rated position, based on the associated *credit quality step*.

**4.2BA.45 R** Table: Rated positions in securitisations for which a credit assessment by a nominated ECAI is available

This table belongs to ■ MIPRU 4.2BA.44 R.

Credit quality step	1	2	3	4	Other credit quality steps
<i>Securitisation positions</i>	20%	50%	100%	350%	1250%
<i>Resecuritisation positions</i>	40%	100%	225%	650%	1250%

**Concentration ratio approach for unrated securitisation positions**

**4.2BA.46 R** When calculating its *risk weighted exposure amount* for *securitised positions*, subject to satisfying the conditions in ■ MIPRU 4.2BA.47 R, a *firm* may apply the weighted-average *risk weight* that would be applied to the *securitised exposures* multiplied by a concentration ratio.

**4.2BA.47 R** The use of the concentration ratio approach for unrated *securitisation positions* is only permitted where all the following conditions are met:

- (1) the concentration ratio is equal to the sum of the nominal amounts of all the *tranches* divided by the sum of the nominal amounts of the *tranches* junior to, or equal to, the *tranche* in which the position is held, including that *tranche* itself;



- (2) where the resulting *risk weight* for a *securitisation position* is lower than any *risk weight* applicable to a more senior *tranche* than that higher *risk weight* must be applied to the *securitisation position*;
- (3) the composition of the pool of *securitised exposures* is known at all times;
- (4) the *firm* must be able, at all times, to calculate accurately the *risk weighted exposure amounts* of the pool of *securitised exposures* based on its knowledge of the composition of the pool;
- (5) any change to the composition of the pool of *securitised exposures* during the life of the transaction that would lead to an increase in the total *risk weighted exposure amount* of the pool, using the *risk weights* specified in ■ MIPRU 4.2F (Exposures and risk weights), is either
  - (a) prohibited by the documentation; or
  - (b) included in the *firm's* calculation of its *capital resources*.

**4.2BA.48** G It is sufficient for the purposes of ■ MIPRU 4.2BA.47R (4) for the composition of the pool of *securitised exposures* to be reported to the *firm* at least daily through information service providers, secure websites or other appropriate sources.

**4.2BA.49** R Where the *firm* is unable to determine the *risk weights* that would be applied to the *securitised exposures*, it must apply a *risk weight* of 1250%.

#### Conversion factor for unrated liquidity facilities

**4.2BA.50** R (1) A conversion factor of 100% must be applied to the nominal amount of unrated liquidity facilities unless the conditions in ■ MIPRU 4.2BA.51 R or ■ MIPRU 4.2BA.53 R for a conversion factor of 50% or 0% are met.

(2) The *risk weight* to be applied is the highest *risk weight* that would be applied to any of the *securitised exposures* by a *firm* holding those *exposures*.

**4.2BA.51** R (1) A conversion factor of 50% may be applied to the nominal amount of an unrated liquidity facility where all the conditions in ■ MIPRU 4.2BA.52 R are met.

(2) The *risk weight* to be applied is the highest *risk weight* that would be applied to any of the *securitised exposures* by a *firm* holding those *exposures*.

**4.2BA.52** R The conditions for the application of a conversion factor of 50% are:

(1) the liquidity facility documentation must clearly identify and limit the circumstances under which the facility may be drawn;



- (2) it must not be possible for the facility to be drawn so as to provide credit support by covering losses already incurred at the time of drawdown, for example by providing liquidity for *exposures* in default at the time of drawdown or by acquiring assets at more than fair value;
- (3) the facility must not be used to provide permanent or regular funding for the *securitisation*;
- (4) repayment of drawdowns on the facility must not be subordinated to the claims of investors, other than to claims arising in respect of interest rate or currency derivative contracts, fees or other such payments, nor be subject to waiver or deferral;
- (5) it must not be possible for the facility to be drawn after all applicable *credit enhancements* from which the liquidity facility would benefit are exhausted; and
- (6) the facility must include a provision that results in an automatic reduction in the amount that can be drawn by the amount of *exposures* that are in *default*.

**4.2BA.53** **R** A conversion factor of 0% may be applied to the nominal amount of an unrated liquidity facility where the following conditions are met:

- (1) the conditions for a conversion factor of 50% in **■ MIPRU 4.2BA.52 R** are met;
- (2) the liquidity facility is unconditionally cancellable; and
- (3) repayment of any drawings on the facility are senior to any other claims on the cashflows arising from the *securitised exposures*.

#### Disclosure to investors

**4.2BA.54** **R** A *firm* must ensure that investors have access to all materially relevant data determined as at the date of the *securitisation* and, where appropriate due to the nature of the *securitisation*, thereafter. These data must include:

- (1) the credit quality, performance, cashflows and supporting collateral of the *securitisation exposures*; and
- (2) information necessary to conduct comprehensive and well-informed stress tests on the cashflows and collateral values supporting the *securitisation exposures*.

## 4.2C Credit risk mitigation

### Application

- 4.2C.1 **R** This section applies to a *firm* carrying on any *home financing* connected to *regulated mortgage contracts* or *home financing and home financing administration* connected to *regulated mortgage contracts* see ■ MIPRU 4.2.23 R where it applies credit risk mitigation to the calculation of its *risk weighted exposure amounts* under ■ MIPRU 4.2A (Credit risk capital requirement).

### Purpose

- 4.2C.2 **G** ■ MIPRU 4.2C sets out the provisions a *firm* should comply with when calculating *risk weighted exposure amounts* for calculating the *credit risk capital requirement* under ■ MIPRU 4.2.23 R.

### Organisation

- 4.2C.2A **G** This section is organised as follows:
- (1) High-level principles (■ MIPRU 4.2C.5 R to ■ MIPRU 4.2C.9 R)
  - (2) Minimum operational requirements (■ MIPRU 4.2C.10 R to ■ MIPRU 4.2C.15 R)
  - (3) Eligibility (■ MIPRU 4.2C.16 R)
  - (4) Calculating the effects of credit risk mitigation (■ MIPRU 4.2C.17 R to ■ MIPRU 4.2C.31 G)
  - (5) Sovereign guarantees (■ MIPRU 4.2C.32 R)
  - (6) Combinations of credit risk mitigation (■ MIPRU 4.2C.33 R to ■ MIPRU 4.2C.34 R)

4.2C.3 **R**

4.2C.4 **R**

### High-level principles

- 4.2C.5 **R** A *firm* may recognise credit risk mitigation under this section in calculating *risk weighted exposure amounts* for calculating the *credit risk capital requirement*.
- 4.2C.6 **R**
- (1) If a *firm* transfers part of the risk of a loan in one or more *tranches*,
    - MIPRU 4.2BA (Securitisation) applies.
  - (2) Materiality thresholds below which no payment shall be made by the provider of credit protection in the event of loss are considered to be equivalent to retained first-loss positions and to give rise to a *tranche* transfer of risk.
- 4.2C.7 **R** The technique used to provide credit protection, together with the actions and steps taken and procedures and policies implemented by a *firm*, must result in credit protection arrangements which are legally effective and enforceable in all relevant jurisdictions.
- 4.2C.8 **R**
- (1) A *firm* must not recognise credit protection as eligible until it has conducted an adequate legal review confirming that the credit protection arrangements are legally effective and enforceable in all relevant jurisdictions, in accordance with ■ MIPRU 4.2C.7 R.
  - (2) A *firm* must conduct further legal reviews as necessary, to ensure continuing enforceability and effectiveness.
- 4.2C.9 **R** A *firm* must take steps to ensure the effectiveness of the credit protection arrangement and to address related risks.

### Minimum requirements: operational

- 4.2C.10 **R**
- (1) A *firm* must satisfy the *FCA* that it has adequate risk management processes to control the risks to which it may be exposed as a result of carrying out *credit risk mitigation*.
  - (2) These processes must include appropriate stress tests and scenario analyses relating to those risks, including *residual risk* and the risks relating to the intrinsic value of the credit risk mitigation.
- 4.2C.11 **R** A *firm* must:
- (1) satisfy the *FCA* that it has systems to manage risks arising from its use of credit protection; and
  - (2) demonstrate how its strategy on the use of credit protection interacts with the *firm's* management of its overall risk profile.
- 4.2C.12 **R** Even where a *firm* recognises credit risk mitigation when calculating *risk weighted exposure amounts*, it must:

- (1) continue to undertake full credit-risk assessment of the underlying *exposure*; and
- (2) demonstrate to the *FCA* the fulfilment of the requirement in (1).

#### Minimum requirements: effectiveness

4.2C.13 **R** For credit protection to be recognised, the following conditions must be met:

- (1) it must be direct;
- (2) the extent of the credit protection must be clearly defined and incontrovertible;
- (3) the credit protection contract must not contain any clause which is outside the direct control of the lender to fulfil and which:
  - (a) would allow the protection provider unilaterally to cancel the protection; or
  - (b) would increase the effective cost of protection as a result of deteriorating credit quality of the protected *exposure*; or
  - (c) could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original borrower fails to make any payments due; or
  - (d) could allow the maturity of the credit protection to be reduced by the protection provider; and
- (4) it must be legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.

4.2C.14 **G** A clause that allows the protection provider unilaterally to cancel the contract after a reasonable period due to non-payment of premiums and other monies due under the contract will not normally indicate non-compliance with **MIPRU 4.2C.13R (3)(a)**. The reason is that payment of such monies is within the control of the *firm*.

4.2C.15 **R** For a guarantee, including those in the form of mortgage indemnity products, to be recognised, the following conditions must be met in addition to those in **MIPRU 4.2C.13 R**:

- (1) on the qualifying default of and/or non-payment by the borrower, the *firm* must have the right to pursue, in a timely manner, the guarantor for any monies due under the claim for which the protection is provided;
- (2) payment by the guarantor must not be subject to the *firm* first having to pursue the borrower;
- (3) for credit protection covering residential mortgage loans, the requirement in **MIPRU 4.2C.13R (3)(c)** and in this *rule* have only to be satisfied within 24 months;
- (4) the guarantee must contain an explicitly documented obligation assumed by the guarantor;

(5) unless (6) applies, the guarantee must cover all types of payments the borrower is expected to make in respect of the claim, such as principal, interest payments and fees; and

(6) where certain types of payment are excluded from the guarantee, the recognised value of the guarantee must be adjusted to reflect the limited coverage.

### Eligibility

4.2C.16 **R** For *unfunded credit protection*:

(1) to be eligible for recognition:

(a) the party giving the undertaking must be sufficiently reliable; and

(b) the protection agreement must be legally effective and enforceable in the relevant jurisdictions, to provide appropriate certainty as to the credit protection achieved, having regard to the approach used to calculate *risk weighted exposure amounts* and to the degree of recognition allowed; and

(2) protection must be provided by central governments or *central banks*.

### Calculating the effects of credit risk mitigation

4.2C.17 **R** The calculation of *risk weighted exposure amounts* may be modified in accordance with this section where a *firm* has complied with ■ MIPRU 4.2C.7 R to ■ MIPRU 4.2C.16 R.

4.2C.18 **R** No *exposure* for which credit risk mitigation is obtained may produce a higher *risk weighted exposure amount* than an otherwise identical *exposure* for which there is no credit risk mitigation.

4.2C.19 **R** Where the *risk weighted exposure amount* already takes account of credit protection, the calculation of the credit protection must not be further recognised under ■ MIPRU 4.2C (Credit risk mitigation).

### Valuation

4.2C.20 **R** The value of *unfunded credit protection* is the amount that the protection provider has undertaken to pay in the event of the default of, or non-payment by, the borrower or on the occurrence of other specified credit events.

### Currency mismatches

4.2C.21 **R** Where *unfunded credit protection* is denominated in a currency different from that in which the *exposure* is denominated (a currency mismatch) the value of the credit protection must be reduced by the application of a volatility adjustment HFX as follows:

$$G^* = G \times (1 - \text{HFX})$$

where:

- (1) G is the nominal amount of the credit protection;
- (2) G\* is G adjusted for any *foreign currency risk*; and
- (3) HFX is the volatility adjustment for any currency mismatch between the credit protection and the underlying obligation.

4.2C.22 **R** For the purpose of ■ MIPRU 4.2C.21 R, HFX is set at 10%.

4.2C.23 **R** For the purpose of ■ MIPRU 4.2C.21 R, where there is no currency mismatch:  
G\* = G

### Maturity mismatches

4.2C.24 **R** (1) In calculating *risk weighted exposure amounts*, a maturity mismatch occurs where the residual maturity of the credit protection is less than that of the protected *exposure*.

- (2) Protection of less than three months residual maturity, the maturity of which is less than the maturity of the underlying *exposure*, must not be recognised.

4.2C.25 **R** Where there is a maturity mismatch the credit protection must not be recognised if the original maturity of the protection is less than one year.

4.2C.26 **R** (1) Subject to a maximum of five years, the effective maturity of the underlying *exposure* is the longest possible remaining time before the borrower is scheduled to fulfil its obligations.

- (2) Unless ■ MIPRU 4.2C.27 R applies, the maturity of the credit protection is the length of time to the earliest date at which the protection may terminate or be terminated.

4.2C.27 **R** (1) Where there is an option to terminate the protection which is at the discretion of the protection seller, the maturity of the protection must be taken to be the length of time to the earliest date at which that option may be exercised.

- (2) Where there is an option to terminate the protection which is at the discretion of the protection buyer and the terms of the arrangement at the origination of the protection contain a positive incentive for the *firm* to call the transaction before contractual maturity, the maturity of the protection must be taken to be the length of time to the earliest date at which that option may be exercised; otherwise such an option may be considered not to affect the maturity of the protection.

4.2C.28 **R** (1) The maturity of the credit protection and that of the *exposure* must be reflected in the adjusted value of the credit protection according to the following formula:

$$GA = G^* \times (t-t^*) / (T-t^*)$$

where:

- (a)  $G^*$  is the amount of the protection adjusted for any currency mismatch;
  - (b)  $GA$  is  $G^*$  adjusted for any maturity mismatch;
  - (c)  $t$  is the number of years remaining to the maturity date of the credit protection calculated in accordance with ■ MIPRU 4.2C.27 R to ■ MIPRU 4.2C.28 R, or the value of  $T$ , whichever is the lower;
  - (d)  $T$  is the number of years remaining to the maturity date of the *exposure* calculated in accordance with ■ MIPRU 4.2C.27 R to ■ MIPRU 4.2C.28 R, or five years, whichever is the lower; and
  - (e)  $t^*$  is 0.25.
- (2)  $GA$  is then taken as the value of the credit protection for the purposes of ■ MIPRU 4.2C.6 R, ■ MIPRU 4.2C.21 R to ■ MIPRU 4.2C.23 R and ■ MIPRU 4.2C.29 R to ■ MIPRU 4.2C.31 G.

### Full protection

4.2C.29

R

Under ■ MIPRU 4.2A.9 R, ■ MIPRU 4.2A.12 R, ■ MIPRU 4.2A.17A R and ■ MIPRU 4.2A.17B R,  $g$  is the *risk weight* to be assigned to an *exposure*, the *exposure* value ( $E$ ) of which is fully protected by *unfunded credit protection* ( $GA$ ), where:

- (1)  $g$  is the *risk weight* of *exposures* to the protection provider;
- (2)  $GA$  is the value of  $G^*$  as calculated under ■ MIPRU 4.2C.22 R further adjusted for any maturity mismatch under ■ MIPRU 4.2C.24 R to ■ MIPRU 4.2C.28 R; and
- (3)  $E$  is the *exposure* value according to ■ MIPRU 4.2A.6 R.

### Partial protection: equal seniority

4.2C.30

R

- (1) Proportional regulatory capital relief is afforded if:
  - (a) the protected amount is less than the *exposure* value; and
  - (b) the protected and unprotected portions are of equal seniority, i.e. the *firm* and the protection provider share losses on a pro-rata basis.
- (2) Under ■ MIPRU 4.2A.9 R, ■ MIPRU 4.2A.12 R, ■ MIPRU 4.2A.17A R and ■ MIPRU 4.2A.17B R, *risk weighted exposure amounts* must be calculated in accordance with the following formula:
 
$$(E-GA) \times r + GA \times g$$
 where:
  - (a)  $E$  is the *exposure* value according to ■ MIPRU 4.2A.6 R;
  - (b)  $GA$  is the value of  $G^*$  as calculated under ■ MIPRU 4.2C.21 R further adjusted for any maturity mismatch under ■ MIPRU 4.2C.24 R to ■ MIPRU 4.2C.28 R;

- (c)  $r$  is the *risk weight* of exposures to the borrower; and
- (d)  $g$  is the *risk weight* of exposures to the protection provider.

4.2C.31 **G** Where the protected and unprotected portions of the *exposure* are not of equal seniority, **■** MIPRU 4.2C.6 R applies.

#### Sovereign guarantees

4.2C.32 **R** A *firm* may assign a *risk weight* of 0% to exposures or parts of exposures guaranteed by the UK government or its *central bank* if the following conditions are met:

- (1) the guarantee is denominated in the domestic currency of the borrower; and
- (2) the *exposure* is funded in that currency.

#### Combinations of credit risk mitigation

4.2C.33 **R** Where a *firm* calculating *risk weighted exposure amounts* has more than one form of credit risk mitigation covering a single *exposure*:

- (1) it must divide the *exposure* into parts covered by each type of credit risk mitigation; and
- (2) the *risk weighted exposure amount* for each portion must be calculated separately in accordance with **■** MIPRU 4.2A (Credit risk capital requirement).

4.2C.34 **R** When credit protection provided by a single protection provider has differing maturities, a similar approach to that described in **■** MIPRU 4.2C.33 R must be applied.



## 4.2D Liquidity resources requirements

### Application

- 4.2D.1 **R** This section applies to a *firm* carrying on any *home financing* or *home finance administration* connected to *regulated mortgage contracts*, unless as at 26 April 2014 its *Part 4A permission* was and continues to remain subject to a restriction preventing it from undertaking new *home financing* or *home finance administration* connected to *regulated mortgage contracts*.

### Adequacy of liquidity resources

- 4.2D.2 **R** A *firm* must at all times maintain liquidity resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.

- 4.2D.3 **G** In assessing the adequacy of liquidity resources, a *firm* should have regard to the overall character of the resources available to it, which enable it to meet its liabilities as they fall due. A *firm* should ensure that:

- (1) it holds sufficient assets which are marketable, or otherwise realisable;
- (2) it is able to generate funds from those assets in a timely manner; and
- (3) it maintains a prudent funding profile in which its assets are of appropriate maturities, taking into account the expected timing of its liabilities.

### Systems and controls requirements

- 4.2D.4 **R** A *firm* must have in place robust strategies, policies, processes and systems that enable it to identify, measure, manage and monitor *liquidity risk* over the appropriate set of time horizons for its business activities, to ensure that it maintains adequate levels of liquidity resources. These strategies, policies, processes, and systems must be appropriate to the *firm's* business lines, currencies in which it operates, and its *group* companies and must include adequate allocation mechanisms of liquidity costs, benefits and risks.

- 4.2D.5 **R** The strategies, policies, processes and systems referred to in **■** MIPRU 4.2D.4 **R** must be proportionate to the nature, scale and complexity of the *firm's* activities and the risk profile of the *firm*.

**4.2D.6** **R** A *firm* must have in place reliable management information systems to provide its *governing body*, *senior managers* and other appropriate personnel with timely and forward-looking information on the liquidity position of the *firm*.

**4.2D.7** **R** A *firm* must ensure that its *governing body* reviews regularly (and not less frequently than annually) the continued adequacy of any strategies, policies, processes and systems in place in accordance with ■ MIPRU 4.2D.4 R

### Stress testing and contingency funding plans

**4.2D.8** **R** A *firm* must consider alternative scenarios in which its liquidity position could be impacted. The consideration of alternative scenarios must include and deal with off-balance sheet items and other contingent liabilities, including those of *securitisation special purpose entities (SSPEs)* or other special purpose entities, in relation to which the *firm* acts as *sponsor* or provides material liquidity support. These scenarios must be incorporated into the stress testing under ■ MIPRU 4.2D.9 R.

**4.2D.9** **R** In order to ensure compliance with ■ MIPRU 4.2D.2 R, a *firm* must:

- (1) conduct on a regular basis appropriate stress tests so as to:
  - (a) identify sources of potential liquidity strain; and
  - (b) ensure that the risks of current liquidity exposures can be adequately managed; and
- (2) analyse the separate and combined impact of possible future liquidity stresses on its:
  - (a) cash flows;
  - (b) liquidity position; and
  - (c) solvency; and
- (3) make, as soon as is practicable after a test has been performed, and maintain a written record of all stress tests and their results

**4.2D.10** **R** A *firm* must ensure that its *governing body* reviews regularly the stresses and scenarios tested and the assumptions underlying the funding position of the *firm* to ensure that their nature and severity remain appropriate and relevant to it.

**4.2D.11** **G** For the purpose of ■ MIPRU 4.2D.10 R a review should take into account:

- (1) changes in market conditions;
- (2) changes in funding sources and inflows;
- (3) changes in the nature, scale or complexity of the *firm's* business model and activities; and
- (4) the *firm's* practical experience in periods of stress.

- 4.2D.12 **R** A *firm* must adjust its strategies, internal policies and limits on liquidity risk, taking into account the outcome of the alternative scenarios referred to in ■ MIPRU 4.2D.8 R.
- 4.2D.13 **R**
- (1) A *firm* must have in place contingency funding plans setting out adequate strategies and proper implementation measures in order to address potential liquidity shortfalls.
  - (2) The contingency funding plans must be:
    - (a) in writing;
    - (b) approved by the *firm's governing body*;
    - (c) regularly tested; and
    - (d) updated on the basis of the outcome of the stress tests, testing alternative scenarios set out in ■ MIPRU 4.2D.8 R.
- 4.2D.14 **G** A contingency funding plan sets out a *firm's* strategies for managing liquidity shortfalls in emergency situations. Its aim should be to ensure that, in each of the stresses set out in ■ MIPRU 4.2D.11 G, it would have sufficient liquidity resources to ensure that it can meet its liabilities as they fall due.

## 4.2E Use of external credit assessments

- 4.2E.1** **R** For the calculation of *risk weighted exposure amounts*, a *firm* must use solicited credit assessments from *ECAs* in the following manner:
- (1) consistently and in accordance with this section; and
  - (2) not selectively.
- Treatment**
- 
- 4.2E.2** **R** A *firm* must nominate one or more *eligible ECAs* to be used for the determination of *risk weights* to be assigned to on-balance sheet items.
- 4.2E.3** **R** A *firm* must only use a *nominated ECA's* credit assessments that take into account all amounts of both principal and interest owed to it.
- 4.2E.4** **R** A *firm* which uses the credit assessments produced by a *nominated ECA* must do so in a continuous and consistent way over time.
- 4.2E.5** **R** A *firm* which uses the credit assessments produced by a *nominated ECA* for a certain *exposure* class must use those credit assessments consistently for all *exposures* belonging to that class.
- 4.2E.6** **R** If only one credit assessment is available from a *nominated ECA* for a rated item, that credit assessment must be used to determine the *risk weight* for that item.
- 4.2E.7** **R** If two credit assessments are available from *nominated ECAs* and the two correspond to different *risk weights* for a rated item, the higher *risk weight* must be applied.
- 4.2E.8** **R**
- (1) If more than two credit assessments are available from *nominated ECAs* for a rated item, the two assessments generating the two lowest *risk weights* must be referred to.
  - (2) If the two lowest *risk weights* are different, the higher *risk weight* must be assigned.

(3) If the two lowest *risk weights* are the same, that *risk weight* must be assigned.

**Issuer and issue credit assessment**

**4.2E.9** **R** Where a credit assessment exists for a specific issuing programme or facility to which the item constituting the *exposure* belongs, this credit assessment must be used to determine the *risk weight* to be assigned to that item.

**4.2E.10** **R** Where no directly applicable credit assessment exists for a certain item but a general credit assessment exists for the issuer, that general credit assessment must be used where it produces either of the following:

- (1) a higher *risk weight* than would otherwise be the case;
- (2) a lower *risk weight* and the *exposure* in question ranks as equally senior or senior in all respects to senior unsecured *exposures* of that issuer, as relevant.

**4.2E.11** **R** Credit assessments for issuers within a *group* cannot be used as the credit assessment of another issuer within the same *group*.

**Domestic and foreign currency items**

**4.2E.12** **R** A credit assessment that refers to an item denominated in the borrower's domestic currency cannot be used to derive a *risk weight* for another exposure on that same borrower that is denominated in a foreign currency.

**Mapping of credit assessments of nominated ECAIs to credit quality steps**

**4.2E.13** **R** *Exposures* for which a credit assessment by a *nominated ECAI* is available must be assigned a *credit quality step* according to the table in ■ MIPRU 4.2E.14 R.

**4.2E.14** **R** Table: Exposures for which a credit assessment by a nominated ECAI is available

This table belongs to ■ MIPRU 4.2E.13 R.

		Credit Quality Step					
		1	2	3	4	5	6
Credit assessment	Fitch	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	B+ to B-	CCC+ and below
	Moody's	Aaa to Aa3	A1 to A3	Baa1 to Baa3	Ba1 to Ba3	B1 to B3	Caa1 and below
	S & P	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	B+ to B-	CCC+ and below

DBRS	AAA to AAL	AH to AL	BBBH to BBBL	BBH to BBL	BH to BL	CCCH and below
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## 4.2F Exposures and risk weights

### Application

- 4.2F.1 **R** This section applies to a *firm* carrying on any *home financing* connected to *regulated mortgage contracts* or *home financing* and *home financing administration* connected to *regulated mortgage contracts* (see [■ MIPRU 4.2.23 R](#)).

### Purpose

- 4.2F.2 **R** [■ MIPRU 4.2F](#) sets out the *risk weights* that a *firm* should apply to *exposures* in the form of loans secured on real estate property, other loans, *exposures* in the form of *funds*, and past due items, when calculating *risk weighted exposure amounts* for calculating the *credit risk capital requirement* under [■ MIPRU 4.2.23 R](#).

### Organisation

- 4.2F.3 **G** This section is broadly organised according to the type of exposure class.
- (1) Exposures secured by mortgages on residential property ([■ MIPRU 4.2F.4 R](#) to [■ MIPRU 4.2F.36 R](#))
  - (2) Exposures secured by mortgages on commercial property ([■ MIPRU 4.2F.37 R](#))
  - (3) Exposures to other loans ([■ MIPRU 4.2F.38 R](#))
  - (4) Exposures to funds ([■ MIPRU 4.2F.39 R](#) to [■ MIPRU 4.2F.49 R](#))
  - (5) Exposures to past due items ([■ MIPRU 4.2F.50 R](#) to [■ MIPRU 4.2F.56 G](#))

### Exposures secured by mortgages on residential property

- 4.2F.4 **R** Without prejudice to [■ MIPRU 4.2F.36 R](#), an *exposure* or any part of an *exposure* must be assigned a *risk weight* of 35% where:
- (1) the *exposure* is fully and completely secured, to the satisfaction of the *firm*, by mortgages on residential property; and
  - (2) the residential property is, or will be, occupied or let by the owner or the beneficial owner in the case of personal investment companies.

- 4.2F.5** **R** Without prejudice to **■ MIPRU 4.2F.36 R**, an *exposure*, or any part of an *exposure*, must be assigned a *risk weight* of 75% where:
- (1) the *exposure* arises from a mortgage on residential property up to a limit of 100% of the value of the property which is not fully and completely secured, to the satisfaction of the *firm*, by that mortgage; and
  - (2) the residential property is, or will be, occupied or let by the owner or the beneficial owner in the case of personal investment companies.

- 4.2F.6** **R** An *exposure* or any part of an *exposure* must be assigned a *risk weight* of 100% where the *exposure* arises from a mortgage on residential property that exceeds the value of the available collateral, as assessed in accordance with **■ MIPRU 4.2F.29 R**.

### Exposures secured by mortgages on residential property: lifetime mortgages

- 4.2F.7** **R** (1) A *firm* must not treat a *lifetime mortgage* as an *exposure* fully and completely secured on residential property for the purposes of **■ MIPRU 4.2F.4 R** unless the amount of the *exposure* is calculated according to the following formula:

$$\text{exposure amount} = P \frac{(1+i)^T}{(1+d)^T}$$

where:

- (a) *P* is the current outstanding balance on the *lifetime mortgage*;
  - (b) *i* is the interest rate charged on the *lifetime mortgage*, which for the purposes of this calculation must not be lower than the discount rate referred to in (c);
  - (c) *d* is the discount rate which is the risk-free rate as represented by the yield on 10-year UK government bonds; and
  - (d) *T* is the projected number of years to maturity of the *exposure*.
- (2) Notwithstanding **■ MIPRU 4.2F.7R (1)(c)**, a *firm* may calculate an annual average discount rate, provided there is no obvious bias in its calculation and it is consistent in its approach.

- 4.2F.8** **G** (1) For the purposes of **■ MIPRU 4.2F.7R (2)**, a *firm* may use the FTSE UK gilt 10-year yield index which the Council of Mortgage Lenders makes available to its members.
- (2) If a *firm* offers a variable interest rate on a *lifetime mortgage*, it should calculate an average interest rate in a way which is consistent with the calculation of the discount rate.
- (3) To determine the projected number of years to maturity of the *exposure*, a *firm* may use the standard mortality tables published by the Institute of Actuaries or the Faculty of Actuaries.



- (4) For internal risk management purposes, the *firm* should use factual data or seek actuarial advice to determine how the information in these tables may be adjusted to take account of regional and other relevant variations.

#### Exposures secured by property leasing transactions

4.2F.9 **R** Without prejudice to ■ MIPRU 4.2F.36 R, an *exposure*, or any part of an *exposure*, to a tenant under a property leasing transaction must be assigned a *risk weight* of 35% where:

- (1) the transaction concerns residential property;
- (2) under the transaction, the *firm* is the lessor and the tenant has an option to purchase; and
- (3) the *firm* is satisfied that the *exposure* is fully and completely secured by its ownership of the property.

4.2F.10 **G** An Ijara mortgage is an example of an *exposure* described in ■ MIPRU 4.2F.9 R.

#### Conditions for mortgages

- 4.2F.11 **R**
- (1) In exercising its judgment under ■ MIPRU 4.2F.4 R to ■ MIPRU 4.2F.9 R, a *firm* may be satisfied only if the conditions in (2) to (6) are met.
  - (2)
    - (a) The value of the property does not materially depend upon the credit quality of the borrower.
    - (b) The condition in (a) does not preclude situations where purely macroeconomic factors affect both the value of the property and the performance of the borrower.
  - (3) The minimum requirements about:
    - (a) legal certainty in ■ MIPRU 4.2F.12 R;
    - (b) monitoring of property values in ■ MIPRU 4.2F.14 R;
    - (c) documentation in ■ MIPRU 4.2F.20 R; and
    - (d) insurance in ■ MIPRU 4.2F.21 R;
 are met.
  - (4) The valuation provisions in ■ MIPRU 4.2F.26 G to ■ MIPRU 4.2F.29 R are met.
  - (5) The value of the property exceeds the *exposures* by a substantial margin, as set out in ■ MIPRU 4.2F.29 R.

#### Legal certainty

4.2F.12 **R** The requirements about legal certainty referred to in ■ MIPRU 4.2F.11R (3)(a) are as follows:

- (1) the mortgage or charge must be enforceable in all relevant jurisdictions which are relevant at the time of conclusion of the credit

agreement, and the mortgage or charge must have been properly filed on a timely basis;

- (2) the arrangements must reflect a perfected lien (i.e. all legal requirements for establishing the pledge must have been fulfilled); and
- (3) the protection agreement and the legal process underpinning it must enable the *firm* to realise the value of the protection within a reasonable timeframe.

**4.2F.13** **G** The term 'protection agreement' in **■ MIPRU 4.2F.12R (3)** refers to the contract or deed by which the mortgage or charge is established.

### Monitoring of property values

**4.2F.14** **R** (1) The requirements about monitoring of property values referred to in **■ MIPRU 4.2F.11R (3)(b)** are as follows:

- (a) the value of the property must be monitored on a frequent basis and, at a minimum, once every three years;
- (b) more frequent monitoring must be carried out where the market is subject to significant changes in conditions;
- (c) statistical methods may be used to monitor the value of the property and to identify property that needs revaluation;
- (d) the property valuation must be reviewed promptly by an independent valuer when information indicates that the value of the property may have declined materially relative to general market prices; and
- (e) for loans exceeding the higher of £2.5 million or 5% of the *capital resources* of the *firm*, the property valuation must be reviewed by an independent valuer at least every three years.

(2) In (1), 'independent valuer' means a person who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process.

**4.2F.15** **G** A property will need to be revalued over time to ensure that the original purchase price does not overstate the degree of security provided by the property. Ijara providers should undertake revaluations in the same way as providers of conventional mortgages.

**4.2F.16** **G** For **■ MIPRU 4.2F.14R (1)(a)**, the monitoring of property values should be an ongoing part of risk managing and tracking the portfolio. The requirement to monitor property values does not include the physical assessment of each property in the portfolio.

**4.2F.17** **G** For **■ MIPRU 4.2F.14R (1)(d)** and **■ MIPRU 4.2F.14R (1)(e)**, the review of a property valuation is more in-depth than the normal monitoring process required by **■ MIPRU 4.2F.14R (1)(a)**. This requirement is likely to include a review of the

property value on an individual *exposure* basis. Where an *exposure* is secured by multiple properties, the review can be undertaken at the level of the *exposure*, rather than at the level of each individual property.

4.2F.18 **G** The review of property values required by ■ MIPRU 4.2F.14R (1)(e) may lead to an amendment of the value assigned to the property under ■ MIPRU 4.2F.29 R.

4.2F.19 **G** For ■ MIPRU 4.2F.14R (2), necessary qualifications need not be professional qualifications, but the *firm* should be able to demonstrate that the person has the necessary ability and experience to undertake the review.

### Documentation

4.2F.20 **R** The requirements in ■ MIPRU 4.2F.11R (3)(c) are that the types of residential real estate accepted by the *firm* and its lending policies in this regard must be clearly documented.

### Insurance

4.2F.21 **R** The requirements about insurance in ■ MIPRU 4.2F.11R (3)(d) are that the *firm* must have procedures to monitor that the property taken as protection is adequately insured against damage.

4.2F.22 **G** For ■ MIPRU 4.2F.12 R, a *firm* should, as a minimum, ensure that it is a requirement of each loan that the property taken as collateral must have adequate buildings insurance at all times, which should be reviewed when any new loan is extended against the property.

4.2F.23 **G** A *firm* may deal with the risk that insurance on properties taken as protection may be inadequate by taking out insurance at the level of the portfolio.

### Valuation rules

4.2F.24 **G** The valuation provisions in ■ MIPRU 4.2F.11R (4) are set out in ■ MIPRU 4.2F.25 R to ■ MIPRU 4.2F.29 R.

4.2F.25 **R** The property must be valued by an independent valuer at or less than the market value using reliable standards for the valuation of residential property.

4.2F.26 **G** For ■ MIPRU 4.2F.25 R:

- (1) reliable standards for the valuation of residential property include internationally recognised valuation standards, in particular those developed by the International Valuation Standards Committee (IVSC), the European Group of Valuers' Associations (EGoVA) or the Royal Institution of Chartered Surveyors (RICS) as well as the standards in ■ MIPRU 4.2F.27 R to ■ MIPRU 4.2F.29 R; and

- (2) the requirement to use reliable standards of valuation of residential property is not limited to on-site inspections where it is possible to demonstrate that any risks posed have been adequately assessed through the overall collateral management process.
- 4.2F.27** **R** (1) Market value means the estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing, where the parties had each acted knowledgeably, prudently and without compulsion.
- (2) The market value must be documented in a transparent and clear manner.
- 4.2F.28** **R** (1) Mortgage lending value means the value of the property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, and the current use and alternative appropriate uses of the property.
- (2) Speculative elements must not be taken into account in the assessment of the mortgage lending value.
- (3) The mortgage lending value must be documented in a transparent and clear manner.
- 4.2F.29** **R** The value of the collateral must be the market value or mortgage lending value reduced as appropriate to reflect the results of the monitoring required under **■ MIPRU 4.2F.11R (3)(b)** and **■ MIPRU 4.2F.14 R** and to take account of any prior claims on the property, such as a first-charge mortgage from another lender.
- Treatment of secured and unsecured portions of residential mortgages**
- 4.2F.30** **R** A *firm* may not treat an *exposure* as fully and completely secured by residential property located in the *United Kingdom* for **■ MIPRU 4.2F.4 R** (residential mortgages) or **■ MIPRU 4.2F.9 R** (property leasing transactions) unless either of the following is 80% or less of the value of the residential property on which it is secured:
- (1) the amount of the *exposure*;
- (2) the secured part of the exposure in **■ MIPRU 4.2F.4 R** or **■ MIPRU 4.2F.9 R**.
- 4.2F.31** **G** (1) The application of **■ MIPRU 4.2F.30 R** may be illustrated by an example. If a *firm* has a mortgage *exposure* of £100,000 secured on residential property in the *United Kingdom* that satisfies the criteria listed in **■ MIPRU 4.2F.4 R** to **■ MIPRU 4.2F.9 R** and the value of that property is £100,000, then £80,000 of that *exposure* may be treated as fully and completely secured and *risk weighted* at 35%. The remaining £20,000 should be *risk weighted* at 75%. A diagrammatic illustration of this example is in **■ MIPRU 4.2F.31G (2)**.

- (2) A diagrammatic illustration of the example in ■ MIPRU 4.2F.31G (1).

Unsecured component risk weighted at 75%	Example
Secured component risk weighted at 35%	£100,000 loan secured on residential property valued at £100,000
	First £80,000 (i.e. 80% LTV) risk weighted at 35%
	Remaining £20,000 (i.e. above 80% LTV) risk weighted at 75%
	Overall risk weight is 43%

- (3) The same approach applies to *exposures* described in ■ MIPRU 4.2F.9 R. On inception, a *risk weight* of 35% should be applied to the first 80% of the principal/"purchase price" outstanding, with a *risk weight* of 75% being applied to the remainder of the principal *exposure*.

**4.2F.32** **G** If a *firm* has more than one *exposure* secured on the same property they should be aggregated and treated as if they were a single *exposure* secured on the property for the purposes of ■ MIPRU 4.2F.4 R, ■ MIPRU 4.2F.9 R and ■ MIPRU 4.2F.30 R.

**4.2F.33** **R** If a *firm* has an *exposure* arising through a second-charge mortgage secured on the same property as a first-charge loan from a different *firm*, the *exposure*, taking into account the first-charge mortgage, must be split into the following components and *risk weighted* as follows, after taking into account the seniority of the first-charge loan:

- (1) the amount of the *exposure* or any part of the *exposure*, up to a limit of 80% of the value of the residential property, must be assigned a *risk weight* of 35% where:
  - (a) the *exposure* is fully and completely secured, to the satisfaction of the *firm*, by a mortgage on residential property; and
  - (b) the residential property is, or will be, occupied or let by the owner, or the beneficial owner in the case of personal investment companies; and
- (2) the amount of the same *exposure* that is unsecured, above 80% of the value of the residential property up to a limit of 100% of the value of the residential property, must be assigned a *risk weight* of 75%; and
- (3) any remaining part of the *exposure*, above 100% of the value of the property, must be assigned a *risk weight* of 100%.

**4.2F.34** **G** (1) The application of ■ MIPRU 4.2F.33 R may be illustrated by an example. Where a first-charge mortgage exposure of £50,000 from another lender is secured on residential property in the *United Kingdom* that satisfies the criteria in ■ MIPRU 4.2F.4 R to ■ MIPRU 4.2F.29 R and the value of that property is £100,000, then a *firm* with a second-charge mortgage of £60,000 on the same property may treat £30,000 of that *exposure* as fully and completely secured and *risk weight* it at 35%,

treat a further £20,000 as unsecured and *risk weight* it at 75%, and *risk weight* the remaining £10,000 at 100%. A diagrammatic illustration of this example is in (2).

(2) A diagrammatic illustration of the example in (1)

Property value	Exposure and risk weightings	Example
£100,000	£10,000 of second-charge - risk weighted at 100%	• Remaining second-charge mortgage, i.e. £10,000
	£20,000 of second-charge - risk weighted at 75%	• Second-charge mortgage up to maximum of 100% of property value, i.e. £20,000
	£30,000 of second-charge - risk weighted at 35%	• Second-charge mortgage up to maximum of 80% of property value, i.e. £30,000
	First-charge mortgage (£50,000)	• Other lender has first-charge over property with outstanding loan balance of £50,000

**4.2F.35** G If an *exposure* is secured on property that is used partly for residential purposes under ■ MIPRU 4.2F.4 R and partly for commercial purposes (such as a farm, public house, guest house or shop) it may be treated as secured by residential real estate if the *firm* can demonstrate that:

- (1) the property's main use is, or will be, residential; and
- (2) the value of the property is not significantly affected by its commercial use.

**4.2F.36** R *Exposures* to residential property situated in a *third-country* must be assigned a *risk weight* of 75% up to a limit of 100% of the value of the property.

**Exposures secured by mortgages on commercial property**.....

**4.2F.37** R *Exposures*, or any part of an *exposure*, secured by mortgages on offices or other commercial premises must be assigned a *risk weight* of 100% where the *exposure*:

- (1) cannot properly be considered to fall within any other standardised credit risk *exposure* class specified in ■ MIPRU 4.2A.6A R (Exposure classes); or
- (2) does not qualify for a lower *risk weight* under this section.

### Exposures to other loans

**4.2F.38** **R** Exposures to other loans must be assigned a *risk weight* of 100%.

### Exposures to funds

**4.2F.39** **R** Except where a different *risk weight* is assigned to exposures in the form of *funds* by **■ MIPRU 4.2F.40 R**, **■ MIPRU 4.2F.42 R** or **■ MIPRU 4.2F.45 R**, these exposures must be assigned a *risk weight* of 100%.

**4.2F.40** **R** Exposures in the form of *funds* for which a credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* using:

- (1) the table in **■ MIPRU 4.2E.14 R** to determine the *credit quality step* associated with that credit assessment; and
- (2) the table in **■ MIPRU 4.2F.41 R** to determine the *risk weight* to be applied to the *rated position*, based on the associated *credit quality step*.

**4.2F.41** **R** Table: Exposures in the form of funds for which a credit assessment by a *nominated ECAI* is available

This table belongs to **■ MIPRU 4.2F.40 R**.

Credit quality step	1	2	3	4	5	6
Risk weight	20%	50%	100%	100%	150%	150%

**4.2F.42** **R** Where a *firm* considers that a position in a *fund* is associated with particularly high risks, it must assign that position a *risk weight* of 150%.

**4.2F.43** **G** A *firm* should consider a *fund* as being high risk where there is no external credit assessment from an *eligible ECAI* and where the *fund* has specific features (such as high levels of leverage or lack of transparency).

**4.2F.44** **G** Other examples of high-risk *funds* are:

- (1) those in which a substantial element of the *fund's* property is made up of items that would attract a *risk weight* of over 100%; and
- (2) those whose mandate (as referred to in **■ MIPRU 4.2F.46 R** would permit it to invest in a substantial amount of items that would attract a *risk weight* of over 100%.

**4.2F.45** **R** If the eligibility criteria in **■ MIPRU 4.2F.46 R** are met, a *firm* must decide whether to:

- (1) assign a 100% *risk weight* to its *exposures* in *funds*, as required by **■ MIPRU 4.2F.39 R**; or



- (2) determine the *risk weight* for an *exposure* in *funds*, as set out in ■ MIPRU 4.2F.47 R to ■ MIPRU 4.2F.48 R.

4.2F.46 **R** The eligibility criteria in ■ MIPRU 4.2F.45 R are:

- (1) the *fund's* prospectus or equivalent document includes:
- (a) the categories of assets in which the *fund* is authorised to invest; and
  - (b) if investment limits apply, the relative limits and the methodologies to calculate them; and
- (2) the business of the *fund* is reported on at least an annual basis to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period.

4.2F.47 **R** Where a *firm* is not aware of the underlying *exposures* of a *fund*, it may calculate an average *risk weight* for the *fund* in the following manner:

- (1) it will be assumed that the *fund* first invests, to the maximum extent allowed under its mandate, in the *exposure* classes attracting the highest *capital resources requirement*; and
- (2) then continues making investments in descending order until the maximum total investment limit is reached.

4.2F.48 **R** A *firm* may rely on a third party to calculate and report, in accordance with the method in ■ MIPRU 4.2F.47 R, a *risk weight* for the *fund*, provided that the correctness of the calculation and report is adequately ensured.

4.2F.49 **R** *Exposures* in the form of funds that are not past due items, that have been assigned a *risk weight* of 150% or greater, and for which value adjustments have been established, may be assigned a *risk weight* of:

- (1) 100% if value adjustments are no less than 20% of the *exposure* value gross of value adjustments; or
- (2) 50%, if value adjustments are no less than 50% of the *exposure* value gross of value adjustments

#### Exposures to past due items

4.2F.50 **R** *Exposures* must be treated as past due in their entirety where any payment due is past its contractual date by more than 90 days.

#### Exposures to past due item: treatment of secured part of mortgages on residential property

4.2F.51 **R** Where value adjustments are taken against the secured part of an *exposure* secured by a mortgage on residential property and that is past due, the secured part net of value adjustments must be assigned a *risk weight* of:



- (1) 100% if value adjustments are less than 20% of the secured part of the *exposure* gross of value adjustments; or
- (2) 50% if value adjustments are no less than 20% of the secured part of the *exposure* gross of value adjustments.

**4.2F.52** **G** A *firm* may treat the secured part of an *exposure* covered by a mortgage indemnity product that meets the relevant eligibility criteria for credit risk mitigation as secured for the purposes of ■ MIPRU 4.2F.51 R.

### Exposures to past due items: treatment of secured part of other exposures

**4.2F.53** **R** For the purpose of defining the secured part of a past due item other than *exposures* secured on residential property, credit protection must be eligible for credit risk mitigation purposes under ■ MIPRU 4.2C (Credit risk mitigation).

**4.2F.54** **G**

- (1) For ■ MIPRU 4.2F.53 R, the secured part of a past due item is dealt with under ■ MIPRU 4.2C (Credit risk mitigation).
- (2) The *risk weight* to be applied to the secured part is determined under ■ MIPRU 4.2C.6 R, and ■ MIPRU 4.2C.29 R to ■ MIPRU 4.2C.30 R.
- (3) The *risk weight* of the unsecured part of the past due item is determined in accordance with ■ MIPRU 4.2F.55 R.

### Treatment of unsecured part: all exposures

**4.2F.55** **R** The unsecured part of any past due item, net of any value adjustments taken against the unsecured part, must be assigned a *risk weight* of:

- (1) 150% if value adjustments are less than 20% of the unsecured part of the *exposure* gross of value adjustments; or
- (2) 100% if value adjustments are no less than 20% of the unsecured part of the *exposure* gross of value adjustments.

### Example: mortgages on residential property

**4.2F.56** **G** The application of value adjustments to either the secured or the unsecured component of an *exposure* secured on residential property may be illustrated on the basis of a £110,000 loan on a property valued at £100,000, where £80,000 of the loan is secured, £30,000 of the exposure is unsecured and a value adjustment of £20,000 is taken.

- (1) Value adjustment applied to unsecured component:
  - (a) Value adjustment of £20,000 taken on £30,000 unsecured *exposure*.
  - (b) Value adjustment exceeds 20%, so the *firm* should *risk weight* the remaining £10,000 unsecured *exposure* at 100% (as per ■ MIPRU 4.2F.55 R).
  - (c) The *risk weight* to be applied to the secured *exposure* of £80,000 is 100% (as per ■ MIPRU 4.2F.51 R).

- (2) Value adjustment applied to secured component:
  - (a) Value adjustment of £20,000 taken on £80,000 secured *exposure*.
  - (b) Value adjustment exceeds 20%, so the *firm* should *risk weight* the remaining £60,000 secured exposure at 50% (as per ■ MIPRU 4.2F.51 R).
  - (c) The *risk weight* to be applied to the unsecured exposure of £30,000 is 150% (as per ■ MIPRU 4.2F.55 R).
- (3) A diagrammatic illustration of how ■ MIPRU 4.2F.56G (1) and ■ MIPRU 4.2F.56G (2) operate is as follows:

Value ad-justment applied to unsecured component (MIPRU 4.2F.51 R)	Risk weightings	Exposure	Risk weightings	Value ad-justment to secured component (MIPRU 4.2F.55 R)
£20,000	£10,000 <i>risk weighted</i> at 100%	<b>Unsecured component of £30,000</b>	£30,000 <i>risk weighted</i> at 150%	£20,000
	£80,000 <i>risk weighted</i> at 100%	<b>Secured component of £80,000</b>	£60,000 <i>risk weighted</i> at 50%	

## 4.3 Calculation of annual income

### Annual income

- 4.3.1 **R** This section contains provisions relating to the calculation of *annual income* for the purposes of:
- (1) the *limits of indemnity* for professional indemnity insurance; and
  - (2) the capital resources requirements.
- 4.3.2 **R** 'Annual income' is the annual income given in the *firm's* most recent annual financial statement from the relevant *regulated activity* or activities.
- 4.3.3 **R** For a *firm* which carries on *insurance distribution activity* or *home finance mediation activity*, *annual income* is the amount of all brokerage, fees, *commissions* and other related income (for example, administration charges, overrides, profit shares) due to the *firm* in respect of or in relation to those activities. But it does not include income generated from carrying on any *home finance mediation activity* for:
- (1) *second charge regulated mortgage contracts*; or
  - (2) *legacy CCA mortgage contracts*.
- 4.3.4 **G**
- (1) The purpose of the *rule on annual income* that applies to *insurance intermediaries* and *mortgage intermediaries* is to ensure that the capital resources requirement is calculated on the basis only of brokerage and other amounts earned by a *firm* which are its own income.
  - (2) *Annual income* includes *commissions* and other amounts the *firm* may have agreed to pay to other *persons* involved in a transaction, such as sub-agents or other intermediaries.
  - (3) A *firm's annual income* does not, however, include any amounts due to another *person* (for example, the product provider) which the *firm* has collected on behalf of that other *person*.
- 4.3.5 **R** If a *firm* is a *principal*, its *annual income* includes amounts due to its *appointed representative* in respect of activities for which the *firm* has accepted responsibility.

4.3.6 **G** If a *firm* is a *network*, it should include the relevant income due to all of its *appointed representatives* in its *annual income*.

#### Annual income for home finance administration

4.3.7 **R** For the purposes of the calculation of the capital resources of a *firm* carrying on *home finance administration* only with all the assets it administers off balance sheet, *annual income* is the sum of:

- (1) revenue (that is, *commissions*, fees, net interest income, dividends, royalties and rent); and
- (2) gains;
- (3) arising in the course of the ordinary activities of the *firm*, less profit:
  - (a) on the sale or termination of an operation;
  - (b) arising from a fundamental reorganisation or restructuring having a material effect on the nature and focus of the *firm's* operation; and
  - (c) on the disposal of fixed assets, including *investments* held in a long-term portfolio.

4.3.7A **R** In the calculation of the capital resources of a *firm* that carries on any *home finance administration activity*, the *annual income* does not include annual income from:

- (1) *second charge regulated mortgage contracts*; or
- (2) *legacy CCA mortgage contracts*.

#### Annual income: periods of less than 12 months

4.3.8 **R** If the *firm's* most recent annual financial statement does not cover a 12 *month* period, the *annual income* is taken to be the amount in the statement converted, proportionally, to a 12 *month* period.

#### Annual income: no financial statements

4.3.9 **R** If the *firm* does not have annual financial statements, the *annual income* is to be taken from the forecast or other appropriate accounts which the *firm* has submitted to the *appropriate regulator*.

## 4.4 Calculation of capital resources

### The calculation of a firm's capital resources

- 4.4.1** **R** (1) A *firm* must calculate its capital resources only from the items which are eligible to contribute to a *firm's* capital resources from which it must deduct certain items (see ■ MIPRU 4.4.4 R).
- (2) If the *firm* is subject to the Prudential sourcebook for MiFID Investment Firms ( *MIFIDPRU* ) or the Interim Prudential sourcebook for investment businesses ( *IPRU(INV)* ), the capital resources are the higher of:
- the amount calculated under (1); and
  - the financial resources calculated under those sourcebooks.

- 4.4.2** **R** Table: Items which are eligible to contribute to the capital resources of a firm

Item	Additional explanation
1. <i>Share capital</i>	This must be fully paid and may include: <ol style="list-style-type: none"> <li>ordinary <i>share</i> capital; or</li> <li>preference <i>share</i> capital (excluding preference <i>shares</i> redeemable by shareholders within two years).</li> </ol>
2. Capital other than <i>share</i> capital (for example, the capital of a <i>sole trader</i> , <i>partnership</i> or <i>limited liability partnership</i> )	The capital of a <i>sole trader</i> is the net balance on the <i>firm's</i> capital account and current account. The capital of a <i>partnership</i> is the capital made up of the <i>partners'</i> : <ol style="list-style-type: none"> <li>capital account, that is the account:               <ol style="list-style-type: none"> <li>into which capital contributed by the <i>partners</i> is paid; and</li> <li>from which, under the terms of the <i>partnership</i> agreement, an amount representing capital may be withdrawn by a <i>partner</i> only if:                   <ol style="list-style-type: none"> <li>he ceases to be a <i>partner</i> and an equal amount is transferred to another such account by his</li> </ol> </li> </ol> </li> </ol>

Item	Additional explanation
	<p>former <i>partners</i> or any <i>person</i> replacing him as their <i>partner</i>; or</p> <p>(ii) the <i>partnership</i> is otherwise dissolved or wound up; and</p> <p>(2) current accounts according to the most recent financial statement.</p> <p>For the purpose of the calculation of capital resources, in respect of a <i>defined benefit occupational pension scheme</i>:</p> <p>(1) a <i>firm</i> must derecognise any <i>defined benefit asset</i>;</p> <p>(2) a <i>firm</i> may substitute for a <i>defined benefit liability</i> the <i>firm's deficit reduction amount</i>, provided that the election is applied consistently in respect of any one financial year.</p>
3. Reserves (Note 1)	<p>These are, subject to Note 1, the audited accumulated profits retained by the <i>firm</i> (after deduction of tax, dividends and proprietors' or <i>partners'</i> drawings) and other reserves created by appropriations of share premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a <i>parent undertaking</i>.</p> <p>For the purposes of calculating capital resources, a <i>firm</i> must make the following adjustments to its reserves, where appropriate:</p> <p>(1) a <i>firm</i> must deduct any unrealised gains or, where applicable, add back in any unrealised losses on debt instruments held, or formerly held, in the available-for-sale financial assets category;</p> <p>(2) a <i>firm</i> must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;</p> <p>(3) in respect of a <i>defined benefit occupational pension scheme</i>:</p> <p>(a) a <i>firm</i> must derecognise any <i>defined benefit asset</i>;</p> <p>(b) a <i>firm</i> may substitute for a <i>defined benefit liability</i> the <i>firm's deficit reduction amount</i>, provided that the election is applied consistently in respect of any one financial year.</p>
4. Interim net profits (Note 1)	<p>If a <i>firm</i> seeks to include interim net profits in the calculation of its capital resources, the profits have, subject to Note 1, to be verified by the <i>firm's</i> external auditor, net of tax, anticipated dividends or proprietors' drawings and other appropriations.</p>

Item	Additional explanation
5. Revaluation reserves	
6. General/ collective provisions (Note 1)	These are provisions that a <i>firm</i> carrying on <i>home financing</i> or <i>home finance administration</i> holds against potential losses that have not yet been identified but which experience indicates are present in the <i>firm's</i> portfolio of assets. Such provisions must be freely available to meet these unidentified losses wherever they arise. Subject to Note 1, general/collective provisions must be verified by external auditors and disclosed in the <i>firm's</i> annual report and accounts.
7. Subordinated loans	Subordinated loans must be included in capital on the basis of the provisions in this chapter that apply to subordinated loans.
Note:	
1	Reserves must be audited and interim net profits, general and collective provisions must be verified by the <i>firm's</i> external auditor unless the <i>firm</i> is exempt from the provisions of Part VII of the Companies Act 1985 (section 249A (Exemptions from audit)) or, where applicable, Part 16 of the Companies Act 2006 (section 477 (Small companies: Conditions for exemption from audit)) relating to the audit of accounts.

**4.4.3** **G** A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *appropriate regulator* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme*.

**4.4.4** **R** Table: Items which must be deducted from capital resources

1	<i>Investments</i> in own <i>shares</i>
2	Intangible assets (Note 1)
3	Interim net losses (Note 2)
4	Excess of drawings over profits for a <i>sole trader</i> or a <i>partnership</i> (Note 2)
Notes	Notes 1. Intangible assets are the full balance sheet value of goodwill (but not until 14 January 2008 - see transitional provision 1), capitalised development costs, brand names, trademarks and similar rights and licences.  2. The interim net losses in row 3, and the excess of drawings in row 4, are in relation to the period following the date as at which the capital resources are being computed.

### Personal assets

**4.4.5** **R** In relation to a *sole trader's firm* or a *firm* which is a *partnership*, the *sole trader* or a *partner* in the *firm* may use personal assets to meet the general solvency requirement and the general capital resource requirement, to the extent necessary to make up any shortfall in meeting those requirements, unless:

- (1) those assets are needed to meet other liabilities arising from:
  - (a) personal activities; or
  - (b) another business activity not regulated by the *appropriate regulator*; or
- (2) the *firm* holds *client money* or other *client assets*.

**4.4.6** **G** A *sole trader* or a *partner* may use any personal assets, including property, to meet the capital requirements of this chapter, but only to the extent necessary to make up a shortfall.

### Subordinated loans

**4.4.7** **R** A subordinated debt must not form part of the capital resources of the *firm* unless it meets the following conditions:

- (1) (for a *firm* which carries on *insurance distribution activity*, *home finance mediation activity* (or both) but not *home financing* or *home finance administration*) it has an original maturity of:
  - (a) at least two years; or
  - (b) it is subject to two years' notice of repayment;
- (2) (for all other *firms*) it has an original maturity of:
  - (a) at least five years; or
  - (b) it is subject to five years' notice of repayment;
- (3) the claims of the subordinated creditors must rank behind those of all unsubordinated creditors;
- (4) the only events of default must be non-payment of any interest or principal under the debt agreement or the winding up of the *firm*;
- (5) the remedies available to the subordinated creditor in the event of non-payment or other default in respect of the subordinated debt must be limited to petitioning for the winding up of the *firm* or proving the debt and claiming in the liquidation of the *firm*;
- (6) the subordinated debt must not become due and payable before its stated final maturity date except on an event of default complying with (4);
- (7) the agreement and the debt are governed by the law of England and Wales, or of Scotland or of Northern Ireland;
- (8) to the fullest extent permitted under the rules of the relevant jurisdiction, creditors must waive their right to set off amounts they



owe the *firm* against subordinated amounts owed to them by the *firm*;

(9) the terms of the subordinated debt must be set out in a written agreement or instrument that contains terms that provide for the conditions set out in this *rule*; and

(10) the debt must be unsecured and fully paid up.

## 4.4.8

R

(1) This *rule* applies to a *firm* which:

(a) carries on:

(i) *insurance distribution activity* ; or

(ii) *home finance mediation activity* (or both); and

in relation to those activities, holds *client money* or other *client assets*; or

(b) carries on *home financing* or *home finance administration* connected to *regulated mortgage contracts* (or both) unless as at 26 April 2014 its *Part IV permission* was and continues to remain subject to a restriction preventing it from undertaking new *home financing* or *home finance administration* connected to *regulated mortgage contracts*.

(2) In calculating its capital resources, the *firm* must exclude any amount by which the aggregate amount of its subordinated loans and its redeemable preference *shares* exceeds the amount calculated as follows:

four times (a - b - c);

where:

a	=	items 1 to 5 in the Table of items which are eligible to contribute to a <i>firm's</i> capital resources (see MIPRU 4.4.2 R)
b	=	the <i>firm's</i> redeemable preference <i>shares</i> ; and
c	=	the amount of its intangible assets (but not goodwill until 14 January 2008 - see transitional provision 1).

## 4.4.9

G

If a *firm* wishes to see an example of a subordinated loan agreement which would meet the required conditions, it should refer to the Forms page.

### Reversion providers: additional requirement for instalment reversions

## 4.4.10

R

(1) If the *reversion provider* agrees under the terms of an *instalment reversion plan* to pay the *reversion occupier* for the *qualifying interest in land* over a period of time, then the provider must:

- (a) take out and maintain adequate insurance from an *insurance undertaking* authorised in the *UK* or a *person* of equivalent status in:
    - (i) a *Zone A country*; or
    - (ii) the Channel Islands, Gibraltar, Bermuda or the Isle of Man; or
  - (b) enter into a written agreement with a *credit institution*;
- to meet these obligations in the event that the *reversion provider* is unable to do so.
- (2) This rule does not apply if:
- (a) the *instalment reversion plan* is linked to an *investment* and it is reasonably anticipated that the amounts due to the *reversion occupier* under the plan will be paid out of the proceeds of the *investment* to the occupier by a *product provider* other than the *reversion provider*; or
  - (b) the *reversion provider* acquires its interest in the property in steps proportionate to the instalments paid.

**4.4.11** G The additional requirement for *reversion providers* aims to protect the *reversion occupier* against the insolvency of the *reversion provider* where the *reversion occupier* has agreed to receive the price for the part of the *qualifying interest in land* sold in instalments rather than in a lump sum. The requirement does not arise, for example, in relation to reversions linked to annuities as the *reversion occupier* has no credit risk on the *reversion provider*. Also, the requirement does not arise in relation to 'mini-reversions' (or 'staged reversions') as under these plans the *reversion occupier* continues to own the *qualifying interest in land*.

#### Regulated sale and rent back agreements: additional requirement

**4.4.12** R If a *SRB agreement provider* agrees, under the terms of a *regulated sale and rent back agreement*, to account to the *SRB agreement seller* for any monetary sum, whether after a qualifying period, over a period of time, on the occurrence of a contingent event or otherwise, the provider must:

- (1) take out and maintain adequate insurance from an *insurance undertaking* authorised in the *EEA* or a *person* of equivalent status in:
  - (a) a *Zone A country*; or
  - (b) the Channel Islands, Gibraltar, Bermuda, or the Isle of Man; or
- (2) enter into a written agreement with a *credit institution*;

to meet these obligations in the event that the *SRB agreement provider* is unable to do so.

**4.4.13** G An example of where this additional requirement would apply would be a term of a *regulated sale and rent back agreement* under which the *SRB agreement seller* was to receive from the *SRB agreement provider* a refund of an agreed percentage of the discount on the sale price of the property to which the agreement relates after an agreed qualifying period.

## Chapter 5

# Insurance distributors and home finance providers using insurance distribution or home finance mediation services

## 5.1 Application and purpose

### Application

5.1.1 **R** This chapter applies to a *firm* with a *Part 4A permission* to carry on:

- (1) *insurance business*; or
- (1A) *insurance distribution activity*; or
- (2) *home financing*;
- (3) [deleted]

5.1.1A **R** (1) This chapter also applies to a *firm* which is a *P2P platform operator* facilitating a *regulated mortgage contract*, *home purchase plan*, *home reversion plan* or *regulated sale and rent back agreement* where the lender or provider under that contract does not fall within the definition of a *mortgage lender*, *home purchase provider*, *reversion provider* or *regulated sale and rent back firm*.

(2) Where (1) applies, references to a *firm* using the services of another *person* consisting of *insurance distribution*, *insurance distribution activity* or *home finance mediation activity* are to be read as references to the *P2P platform operator* using those services.

### Purpose

5.1.2 **G** The purpose of this chapter is to implement article 16 of the *IDD* in relation to *insurance undertakings* and *insurance intermediaries*. The provisions of this chapter have been extended to *home finance providers* in relation to *insurance distribution activity*, and to *insurance undertakings* and *home finance providers* in relation to *home finance mediation activity*, to ensure that *firms* using these services are treated in the same way and to ensure that *clients* have the same protection. To avoid the loss of protection where an intermediary itself uses the services of an *unauthorised person*, this chapter also ensures that each *person* in the chain of those providing services is authorised.

5.1.3 **G** This chapter supports the more general duties in *Principles 2* and *3*, and the relevant *rule* in the Senior Management Arrangements, Systems and Controls sourcebook (see **SYSC 3.1.1 R** and **SYSC 4.1.1 R**).

## 5.2 Use of intermediaries

- 5.2.1 **R** A *firm* must not use, or propose to use, the services of another *person* consisting of:
- (1) *insurance distribution*; or
  - (1A) *reinsurance distribution*; or
  - (2) *insurance distribution activity*; or
  - (3) *home finance mediation activity*;
- unless ■ MIPRU 5.2.2 R is satisfied.  
[Note: Article 16 of the *IDD*]
- 5.2.1-A **R** ■ MIPRU 5.2.1R does not apply to a *firm* carrying on an *insurance distribution activity* if it uses or proposes to use the services of a *person* consisting of *home finance mediation activity*. In that case, ■ MIPRU 5.2.2R does not need to be satisfied.
- 5.2.1A **G** The *appropriate regulator* regards a *firm* as 'using' the services of, in particular, its immediate counterparty (typically the intermediary that passed the business to the *firm*) and of all other *persons* who have been granted the right or authority directly by the *firm* to effect a *contract of insurance* or enter into a *home finance transaction*.
- 5.2.2 **R** For the purposes of ■ MIPRU 5.2.1 R, the *person*, in relation to the activity must:
- (1) have *permission*; or
  - (2) be an *exempt person*; or
  - (3) be an *exempt professional firm*; or
  - (4) [deleted]
  - (5) in relation to *insurance distribution activity*, not be carrying this activity on in the *UK*; or

(6) in relation to *home finance mediation activity*, not be carrying this activity on in the *United Kingdom*.

[Note: article 16 of the *IDD*]

5.2.3

E

(1) A *firm* should:

(a) before using the services of the intermediary, check:

(i) the *Financial Services Register*;

(ii) [deleted]

for the status of the *person*

; and

(b) use the services of that *person* only if the relevant register indicates that the *person* is registered for that purpose.

(2) (a) Checking the *Financial Services Register* before using the services of the intermediary and using the services of that *person* only if the *Financial Services Register* indicates that the *person* is registered for that purpose may be relied on as tending to establish that:

(i) the *person*, in relation to the activity, has *permission*; or

(ii) the *person*, in relation to *insurance distribution activity*, is an *exempt person* or an *authorised professional firm*.

(b) [deleted]

5.2.4

R

[deleted]

5.2.5

R

[deleted]

5.2.6

G

The *Financial Services Register* can be accessed through the *FCA* website under the link [www.fsa.gov.uk/register/home.do](http://www.fsa.gov.uk/register/home.do)

# Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries

## MIPRU TP 1 Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	MIPRU 4.4.4 R and MIPRU 4.4.8 R (3)	R	[expired]		
2	MIPRU 5.2.2 R and MIPRU 5.2.4 R	R	[expired]		
3	MIPRU 3.2.7 R	R	[deleted]		
4	MIPRU 1.3.2 R and MIPRU 1.3.4 R	R	A firm to which MIPRU 1.3.2 R will apply from 21 March 2016 may elect to comply with MIPRU 1.3.2 R from 21 September 2015.  If a firm elects to comply with MIPRU 1.3.2 R, it must also comply with MIPRU 1.3.4 R.	21 September 2015 to 20 March 2016	21 March 2016
5	MIPRU 2.2.1BR(2)(b) and MIPRU 2.2.1BR(2)(c) (c)	R	If a <i>Directory person</i> does not submit a <i>Directory person</i> report, a notification must be made in a way set out in MIPRU 2.2.1BR(2)(c).	1 October 2020 to 31 March 2021	1 October 2020
6	MIPRU 3.2.7R	R	The new <i>limits of indemnity</i> apply to a professional indemnity policy or a comparable guarantee agreement commenced, renewed or extended with effect from or after 1 August 2021. Any other existing non-annual arrangements must be aligned with the new <i>limits of indemnity</i> before 1 August 2022.	1 August 2021 to 31 July 2022	1 August 2021





## Transitional Provisions for former exempt CAD firms

### MIPRU TP 2

#### Transitional Provisions for former exempt CAD firms

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
2.1	MIPRU 3.2	R	<p>This <i>rule</i> applies to a <i>MIFID-PRU investment firm</i> that was classified as an <i>exempt CAD firm</i> subject to IPRU-INV 9 on 31 December 2021.</p> <p>Instead of complying with the requirements relating to professional indemnity insurance in MIPRU 3.2, a <i>firm</i> may comply with the professional indemnity insurance requirements set out in IPRU-INV 9.2.4R(1)(b) (except that the minimum limits of indemnity are at least EUR 1,250,000 for a single claim and EUR 1,850,000 in aggregate), together with IPRU-INV 9.2.7R and IPRU-INV 9.4.</p>	Until 31 December 2024	1 January 2022
2.2	MIPRU 3.2	R	<p>This <i>rule</i> applies to a <i>MIFID-PRU investment firm</i> that was classified as an <i>exempt CAD firm</i> and was subject to IPRU-INV 13 on 31 December 2021.</p> <p>Instead of complying with the requirements relating to professional indemnity insurance in MIPRU 3.2, a <i>firm</i> may comply with IPRU-INV 13.1.5R; IPRU-INV 13.1.7R to 13.1.10R; and IPRU-INV 13.1.15R to 13.1.29G.</p>	Until 31 December 2024	1 January 2022
2.3	MIPRU 3.2	R	<p>References in this transitional provision to <i>IPRU-INV</i> are to the version of <i>IPRU-INV</i> that applied on 31 December 2021.</p> <p>References to an <i>exempt CAD firms</i> in <i>IPRU-INV</i> are to the <i>firm</i> to which this</p>	Until 31 December 2024	1 January 2022

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
2.4	MIPRU 3.2	G	<p>transitional provision applies.</p> <p><i>Exempt CAD firms</i> that carried on activities in scope of MIPRU 3.2 were exempt from the requirements in MIPRU 3.2, on the basis that they were subject to similar professional indemnity insurance requirements in IPRU-INV 9 or 13.</p> <p>The category of <i>exempt CAD firm</i> ceases to exist on 1 January 2022. These <i>firms</i> will no longer be subject to IPRU-INV, and instead will become subject to prudential requirements in MIFIDPRU. MIFIDPRU does not require the holding of professional indemnity insurance.</p> <p>Former <i>exempt CAD firms</i> that carry on activities in scope of MIPRU 3.2 will therefore have to comply with the requirements to hold professional indemnity insurance in MIPRU 3.2 for the first time, consistent with other <i>investment firms</i> that have always had to comply with MIPRU 3.2.</p> <p>The purpose of this transitional provision is to give former <i>exempt CAD firms</i> time to comply with any new requirements in MIPRU 3.2. In particular, former <i>exempt CAD firms</i> should note that the minimum <i>limit of indemnity</i> for claims in aggregate can be higher under MIPRU 3.2.7R(2)(b) than under the relevant provisions in IPRU-INV. MIPRU 3.2 also contains material relating to excess levels that differs from the material in IPRU-INV.</p> <p>IPRU-INV 9.4.4R requires that professional indemnity insurance policies must not be subject to unreasonable limits. IPRU-INV 13.1.9R requires that policies must incorporate terms which are</p>	Until 31 December 2024	1 January 2022

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
			appropriate. The <i>FCA</i> therefore expects former <i>exempt CAD firms</i> to have regard to the requirements in <b>MIPRU 3.2</b> when renewing their professional indemnity insurance whilst this transitional applies.		



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## Schedule 1 Record keeping requirements

### Sch 1.1 G

- 1 The aim of the *guidance* in the following table is to give the reader an overview of the relevant record keeping requirements.
- 2 It is not a complete statement of those requirements and should not be relied on as if it were.

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
MIPRU 4.2D.9 R (3)	Stress tests	All stress tests performed by a <i>firm</i> to which MIPRU 4.2D.1 R applies, and the results of those tests	As soon as practicable after a test has been performed	Not specified



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## Schedule 2 Notification requirements

### Sch 2.1 G

There are no notification requirements in MIPRU





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## Schedule 3 Fees and other required payments

### Sch 3.1 G

There are no requirements for fees or other payments in MIPRU.



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## Schedule 4 Powers exercised

Sch 4.1 G  
[deleted]

Sch 4.2 G  
[deleted]



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## Schedule 5 Rights of actions for damages

### Sch 5.1 G

The table below sets out the *rules* in MIPRU contravention of which by an *authorised person* may be actionable under section 138D of the Act (Actions for damages) by a person who suffers loss as a result of the contravention.

### Sch 5.2 G

If a 'Yes' appears in the column headed 'For private person', the *rule* may be actionable by a 'private person' under section 138D of the Act (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001 No 2256)). A 'Yes' in the column headed 'Removed' indicates that the *appropriate regulator* has removed the right of action under section 138D(3) of the Act. If so, a reference to the *rule* in which it is removed is also given.

### Sch 5.3 G

The column headed 'For other person' indicates whether the *rule* may be actionable by a person other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of person by whom the *rule* may be actionable is given.

### Sch 5.3 G

Table

Chapter/ Appendix	Section/Annex	Right of action under section 138D		
		For private person	Removed	For other person
All <i>rules</i> in MIPRU with the status letter "E"		No	No	No
All other <i>rules</i> in MIPRU		No	Yes, MIPRU 1.2.1 R	No



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## Schedule 6 Rules that can be waived

### Sch 6.1 G

The *rules* in MIPRU may be waived by the *appropriate regulator* under section 138A and 138B of the *Act* (Modification or waiver of rules).

