Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):

(1) section 137A (The FCA’s general rules);
(2) section 137T (General supplementary powers); and
(3) section 139A (Power of the FCA to give guidance).

B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 31 January 2014.

Amendments to the FCA Handbook

D. The modules of the FCA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

<table>
<thead>
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<th>(1)</th>
<th>(2)</th>
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<tbody>
<tr>
<td>Glossary of definitions</td>
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Citation

E. This instrument may be cited as the Capital Requirements Directive IV (Handbook Administration) Instrument 2014.

By order of the Board of the Financial Conduct Authority
30 January 2014
Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

*article 18(5)*

the relationship where there are participations or capital ties other than those referred to in article 18(1) and (2) of the EU CRR (Methods for prudential consolidation).

*core UK group*

…

(2) (in relation to an IFPRU investment firm) all counterparties which:

…

(b) satisfy the conditions in article 113(6) of the EU CRR (Calculation of risk-weighted risk-weighted exposure amounts: intragroup); and

…
Annex B

Amendments to the Prudential sourcebook for Investment Firms (IFPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text.

1.2 Significant IFPRU firm

1.2.1 G Throughout CRD and the EU CRR there are various policies which have restricted application based on a firm’s scope, nature, scale, internal organisation and complexity. These policies are provided in the following:

…

(7) article 6(4) of the EU CRR on the scope of liquidity reporting on a solo an individual basis;

…

1.2.9 G (1) …

(2) The governance requirements referred to in (1) are:

(a) SYSC 4.3A.7R 4.3A.6R on the limitations in the number of directorships; or

(b) SYSC 4.3A.9R 4.3A.8R on the nomination committee; or

…

1.4 Directions and EU CRR permissions

1.4.1 R A firm which has applied for, or has been granted, a direction or permission under the EU CRR must notify the FCA immediately if it becomes aware of any matter which could affect the continuing relevance or appropriateness of the application, direction or permission.

…

2.2 Internal capital adequacy assessment process

…

2.2.10 G In the overall Pillar 2 rule, internal capital refers to the financial resources of a firm which it treats as being held against the risks listed in the overall Pillar 2 rule. The obligation in that rule to assess the distribution of such capital refers, in relation to a firm making an assessment on a solo an
individual basis, for example, to the need to take account of circumstances where part of a firm's financial resources are held by a branch of that firm which are subject to restrictions on its ability to transfer that capital. An assessment of internal capital distribution might also take account of such of a firm's financial resources as may be ring-fenced in the event of its insolvency.

2.3 Supervisory review and evaluation process: internal capital adequacy standards

Purpose

2.3.1 G (1) …

(2) IFPRU 2.3 is mainly written on the basis that IFPRU 2.2 (Adequacy of financial resources) applies to a firm on an individual basis. However, it is still relevant when IFPRU 2.2 applies on a consolidated basis. When IFPRU 2.2 applies on a consolidated basis, IFPRU 2.3 should be read with appropriate adjustments.

2.3.4 G The obligation to conduct an ICAAP includes requirements on a firm to:

…

(4) ensure that the processes, strategies and systems required by the overall Pillar 2 rule and used in its ICAAP, are both comprehensive and proportionate to the nature, scale and complexity of that firm’s activities (IFPRU 2.2.12R); and

…

2.3.5 G Where a firm is a member of a group, it should base its ICAAP on the consolidated financial position of the group. The group assessment should include information on diversification benefits and transferability of resources between members of the group and an apportionment of the capital required by the group as a whole to the firm (IFPRU 2.2.45G to IFPRU 2.2.57G (Application of IFPRU 2.2 on a solo an individual and consolidated basis)). A firm may, instead of preparing the ICAAP itself, adopt as its ICAAP an assessment prepared by other group members.

…

2.3.7 G The FCA will review a firm's ICAAP, including the results of the firm's stress tests carried out under IFPRU and the EU CRR, as part of its SREP. Provided that the FCA is satisfied with the appropriateness of a firm's capital assessment, the FCA will take into account that firm's ICAAP and stress tests in its SREP. More material on stress tests for a firm with an IRB permission
can be found in IFPRU 2.3.48R 2.3.50R to IFPRU 2.3.52G 2.3.54G.

2.3.18 G If, after discussion, the FCA and a firm still do not agree on an adequate level of capital, the FCA may consider using its powers under section 55J 55L of the Act to vary, on its own initiative, a firm’s Part 4A permission to require it to hold capital in line with the FCA’s view of the capital necessary to comply with the overall financial adequacy rule. In deciding whether it should use its powers under section 55J 55L, the FCA will take into account the amount and quality of the capital planning buffer which the firm should hold as referred to in IFPRU 2.3.13G and IFPRU 2.3.14G. SUP 7 provides further information about the FCA’s powers under section 55J 55L.

2.3.22 G For the purposes of IFPRU 2.3.21G, IFPRU 2.3.30G 2.3.20G applies as it applies to individual capital guidance. References in those provisions to individual capital guidance should be read as if they were references to capital planning buffer. In relation to IFPRU 2.2.62R, where the general stress and scenario testing rule or SYSC 20 (Reverse stress testing), as part of the ICAAP rules, applies to a firm on a consolidated basis, the FCA may notify the firm that it should hold a group capital planning buffer. In these cases, the firm should ensure that the group holds a capital planning buffer of sufficient amount and adequate quality to allow it to continue to meet the overall financial adequacy rule in the face of adverse circumstances, after allowing for realistic management actions.

2.3.29 G Where a firm's capital planning buffer is being drawn down due to circumstances other than those in IFPRU 2.3.26G, such as poor planning or mismanagement, the FCA may ask the firm for more detailed plans for it to restore its capital planning buffer. In the light of the relevant circumstances, the FCA may consider taking other remedial actions, which may include using its powers under section 55J 55L of the Act to vary, on its own initiative, to impose a requirement on a firm’s Part 4A permission firm.

2.3.35 G For a firm that is a significant IFPRU firm (see IFPRU 1.1.20R 1.2.3R) and whose activities are moderately complex, in carrying out its ICAAP, IFPRU 2.3.34G(2) to (4) apply. In addition, it could:

2.3.37 G IFPRU 2.3.37G to IFPRU 2.3.47G set out guidance on some of the sources of risk identified in the overall Pillar 2 rule. IFPRU 2.3.48R 2.3.50R to
2.3.52G 2.3.54G contain material relating to a firm with an IRB permission.

2.3.51 R IFPRU 2.3.50R applies to a firm on an individual basis if Part Three, Title II, Chapter 3 of the EU CRR (IRB approach) applies to it on an individual basis and applies on a consolidated basis if the EU CRR does.

2.3.53 G If a firm's current available own funds are less than the own funds requirements indicated by the stress test, that does not necessarily mean there is a breach of IFPRU 2.3.50R. The firm may wish to set out any countervailing effects and off-setting actions that can be demonstrated to the satisfaction of the FCA as being likely to reduce that difference. The FCA is only likely to consider a demonstration of such actions as credible if those actions are set out in a capital management plan based on the procedures in IFPRU 2.2.73G (Capital planning) and include a plan of the type referred to in IFPRU 2.2.73G(5)(7) that has been approved by the firm's senior management or governing body.

2.3.71 G In relation to the use of an ECM (see IFPRU 2.3.36G), the FCA is likely to place more reliance on a firm's ICAAP if the firm provides the following information:

(2) evidence that the guidance in IFPRU 2.3.66G 2.3.68G to IFPRU 2.3.73G 2.3.75G has been followed.

3.2 Capital

3.2.20 G When a collective portfolio management investment firm calculates the total risk exposure amount in article 92(3) of the EU CRR, the own funds requirements referred to in article 92(3)(a) (Risk-weighted exposure amount for credit risk and dilution risk) and article 92(3)(b) (Risk-weighted exposure amount for position risk) should include only those arising from its designated investment business. For this purpose, managing an AIF or managing a UCITS is excluded from designated investment business.
4.2.9 Items associated with particularly high risk

4.3 Guidance on internal ratings based approach: high level material

4.3.16 G (1) Article 154(4)(d) of the EU CRR (Risk-weighted exposure amounts for retail exposures) specifies that, for an exposure to be treated as a qualifying revolving retail exposure (QRRE), it needs to exhibit relatively low volatility of loss rates. A firm should assess the volatility of loss rates for the QRRE portfolio relative to the volatilities of loss rates of other relevant types of retail exposures for these purposes. Low volatility should be demonstrated by reference to data on the mean and standard deviation of loss rates over a time period that can be regarded as representative of the long-run performance of the portfolios concerned.

4.5 Internal ratings based approach: definition of default

4.5.3 G Under article 178(2)(d)(1)(b) of the EU CRR, the FCA is empowered to replace 90 days with 180 days in the days past due component of the definition of default for exposures secured by residential or SME commercial real estate in the retail exposure class, as well as exposures to public sector entities (PSEs).

4.5.4 G The FCA would expect to replace 90 days with 180 days in the days past due component of the definition of default for exposures secured by residential real estate in the retail exposure class, and/or for exposures to PSEs, where this was requested by the firm. Where this occurred, it would be specified in the firm's IRB permission.

4.7 Internal ratings based approach: loss given default

4.7.16 G The FCA considers that both of the following approaches in relation to calculating unexpected loss of defaulted assets are acceptable in principle:

(1) the independent calculation approach, in which possible losses are estimated over the recovery period that are additional to the best
4.7.17 G Where an independent calculation approach is adopted for the calculation of unexpected loss on defaulted assets, the FCA expects a firm to ensure that estimates are at least equal, at a portfolio level, to a 100% risk weight, ie, 8% capital requirement on the amount outstanding net of provisions (see article 181(1)(h) of the EU CRR).

4.8 Internal ratings based approach: own estimates of exposure at default (EAD)

4.8.24 G The FCA considers that there is scope within the EU CRR for a firm to recognise on-balance sheet netting (including in respect of cross-currency for current balances). Netting may be applied through EAD as an alternative to LGD in cases where a firm meets the general conditions for on-balance sheet netting, as set out in article 205 of the EU CRR.

4.10 Validation

4.10.5 G In the case of a portfolio for which there is insufficient default experience to provide any confidence in statistical measures of discriminative power, the FCA expects a firm to use other methods. For example, analysis of whether the firm's rating systems and an external measurement approach (eg, external ratings) rank common obligors in broadly similar ways. Where such an approach is used, the FCA would expect a firm to ensure it does not systematically adjust its individual ratings with the objective of making them closer to the external ratings as this would be counter to the philosophy of an internal rating approach. The FCA expects a firm to be able to explain the methodology it uses and the rationale for its use.

4.11 Income-producing real estate portfolios

4.11.15 G Where the firm has less fewer than 20 defaults in their internal data set, the FCA expects it to be necessary for firms to perform a statistical low default portfolio calibration, as set out in the guidance in this section.

4.11.16 G The FCA expects that a firm will not be compliant with the validation
requirements unless only where it can demonstrate, in respect of discriminatory power, that:

...  

4.11.17 G The FCA expects that a firm will not be compliant with the validation requirements unless only where it can demonstrate in respect of the calibration that:

...  

4.11.18 G The FCA also expects that a firm will not be compliant with the validation requirements unless only where it can demonstrate that:

Other requirements  

4.11.19 G The FCA expects that a firm would not will be able to comply with certain other EU CRR requirements unless only where it could can demonstrate that:

...  

4.12 Securitisation  

...  

4.12.4 G IFPRU 4.12.1R requires A a firm should to notify the FCA of each transaction on which it is seeking seeks capital relief under the options in IFPRU 4.12.3G(1) (option 1) and (2) (option 2).  

...  

4.12.6 G For IFPRU 4.12.3G(3) (option 3), The the FCA intends to grant permission for an originator to make its own assessment of significant risk transfer only where it is satisfied that:

...  

4.12.8 G A firm seeking to achieve capital relief by deducting or applying a 1250% risk weight where permitted under articles 243 or 244 of the EU CRR to all retained securitisation positions does not need to comply with make the notification and permissions requirements in IFPRU 4.12.1R. However, in such cases, a firm should consider whether the characteristics of the transaction are such that the FCA would reasonably expect prior notice of it.

...  

4.12.13 G A firm may apply for permissions under articles 243 (Traditional securitisation) or 244 (Synthetic securitisation) of the EU CRR to consider
significant risk transfer to have been achieved without needing to rely on options (1) or (2). The scope of such permission can be defined to cover a number of transactions or an individual transaction.

4.12.36 G The FCA expects the instruments used to transfer credit risk not to contain provisions which limit the amount of risk transferred. For example, should losses or defaults on the securitised exposures occur in the pool (ie, deterioration in the credit quality of the underlying pool) the FCA expects the originator’s net cost of protection or the yield payable to investors should not increase as a result.

Sch 1G Record-keeping requirements

<table>
<thead>
<tr>
<th>Handbook reference</th>
<th>Subject of record</th>
<th>Contents of record</th>
<th>When record must be made</th>
<th>Retention period</th>
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<tbody>
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<td>…</td>
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Sch 2G Notification and reporting requirements

<table>
<thead>
<tr>
<th>Handbook reference</th>
<th>Matter to be notified</th>
<th>Contents of notification</th>
<th>Trigger event</th>
<th>Time allowed</th>
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</thead>
<tbody>
<tr>
<td>…</td>
<td>…</td>
<td>…</td>
<td>Intention to rely on deemed transfer of significant risk</td>
<td>…</td>
</tr>
<tr>
<td>IFPRU 4.12.1R</td>
<td>Reliance on deemed transfer of significant risk under articles</td>
<td>Sufficient information to allow the FCA to assess whether the possible reduction in risk weighted exposure amounts achieved by the transfer, not</td>
<td>…</td>
<td>…</td>
</tr>
</tbody>
</table>
243(2) and 244(2) of the *EU CRR*, including for the purposes of article 337(5) of the *EU CRR*... *securitisation* is justified by a commensurate transfer of credit risk to third parties being later than one month after the date of transfer...
Annex C

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text.

…

13 Annex 1
1R Passporting: Notification of intention to establish a branch in another EEA state

This annex consists of only one or more forms. Forms can be completed online now by visiting:

http://www.bankofengland.co.uk/prapages/authorisations/passporting/notifications.aspx for a PRA-authorised person

or http://www.fca.org.uk/firms/being-regulated/passporting/notification-forms for an FCA-authorised person

The forms are also to be found through the following address:

Passporting: Notification of intention to establish a branch in another EEA state - SUP 13 Annex 1

…