

04/20

Financial Services Authority

Financial groups

Feedback on CP204 and made text

July 2004



HM TREASURY



Preface

CP204 was a joint consultation published in October 2003 by the FSA and HM Treasury on proposals to implement the requirements of the Financial Groups Directive through amendments to the FSA handbook and in HM Treasury Regulations. It also consulted on wider FSA proposals for insurance groups. This policy and feedback statement is itself issued jointly by the FSA and HM Treasury.

Part 1 sets out the FSA's final policy, and deals with the responses to and feedback on FSA's proposals and contains the final made Handbook text with which firms should comply.

Part 2 deals with the responses to HM Treasury's proposals to legislate for procedural aspects of the Directive and includes the Statutory Instrument.

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This policy statement reports on the main issues raised in CP204 and sets out the final rules and proposed Statutory Instrument.

Any comments or enquiries on part 1 (FSA's final policy and rules) should be addressed to:

Richard Sutcliffe
Institutional Business Policy
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Email: CP204@fsa.gov.uk

Any comments or enquiries on part 2 (HM Treasury's final policy and proposed Statutory Instrument) should be addressed to:

Natasha Cock
Financial Stability and Regulatory Policy Team
4/24
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Email: natasha.cock@hm-treasury.x.gsi.gov.uk

This document can be accessed via the Treasury's website (www.hm-treasury.gov.uk). To obtain further information about publication of this document, please contact:

HM Treasury, Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London SW1A 2HQ
Tel: 020 7270 4558
Fax: 020 7270 4574
Email: public.enquiries@hm-treasury.gov.uk

Copies of this Policy Statement are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

Part 1 – FSA

1 Overview

Introduction

1.1 In CP204 we consulted on three main proposals:

- to implement the Financial Groups Directive (FGD)¹ in our handbook;
- to move to a hard group capital adequacy test (i.e. one that must be passed as a matter of regulatory obligation) for UK insurance firms at the level of the most senior European parent in the group; and
- to harmonise the existing consolidated supervision rules for investment firms into a single set of rules.

CP204 also contained near final² rules and guidance on group systems and controls. We consulted on an earlier version of these in CP97.

Purpose of this policy statement

1.2 This policy statement sets out our policy, taking into consideration the responses received to CP204. It provides feedback on those responses, and includes the final rules and guidance.

1.3 This policy statement does not respond to every point raised in the consultation responses, neither does it cover issues that relate to individual firms; these are better taken up by the individual firms concerned with their supervisors. We have included our views on some technical points raised where we think that will help firms to apply the new requirements. An explanation of significant changes to the rules and guidance consulted upon in CP204 is in Annex 1.

1 Directive 2002/87/EC

2 Near final text is rules that we have already consulted on (in this case in CP97), amended to take account of consultation responses received. It is the post-consultation text that we intend to make, but have not yet made.

Readership

1.4 CP204 and this policy statement are of interest to:

- all firms that are part of a financial group whose parent is located within the EEA, particularly those in insurance and investment groups;
- regulated firms that are part of a financial group whose parent is located outside the EEA ('third country' groups); and
- all potential financial conglomerates.

Background to CP204

1.5 The formation of financial groups with activities in the banking, investment and insurance sectors is a continuing trend in the financial services industry. This has prompted international regulators to consider the regulatory approach necessary for containing and supervising the risks arising in these groups (known as financial conglomerates). Before the FGD, EU directives required financial groups to be supervised within each of those major business sectors, for example by setting, and requiring Member States to supervise compliance with, requirements relating to the prudential soundness of groups, such as group capital adequacy. The development of financial conglomerates has prompted the EEA to adopt internationally-agreed principles in the FGD, for the prudent supervision of such groups across the major business sectors.

Responses and our final policy

- 1.6 The consultation period ended on 9 February 2004, although responses from some of the 27 respondents came in after that date. The respondents who did not request anonymity are listed in Annex A. (Annex A includes respondents to both Part 1 (our consultation material) and to Part 2 (HMT's consultation material).)
- 1.7 Respondents were, for the most part, those with a vested interest in the key proposals in the CP and were mainly insurance groups or conglomerates, trade bodies or consultants. In general, the responses were helpful and focused, and positive about most of the proposals.
- 1.8 The main concerns of respondents, together with our final policy on the relevant points are set out in the paragraphs below.

New conglomerate requirements

1.9 Respondents supported our proposal to implement the requirements of the FGD through the minimum changes to existing sectoral requirements. They recognised the benefits of a single supervisor co-ordinating the supervision of groups within the EU, while raising some practical questions on implementation of the new arrangements. Respondents were also concerned to

understand how the proposed rules on capital adequacy, and on risk concentrations and intra-group exposures, would work in practice. There was some concern about the short timescale between our identifying conglomerates and their needing to comply with the new conglomerate requirements.

- 1.10 We have decided not to change our broad policy approach to implementing the financial conglomerate requirements, as set out in chapters 3 and 4 of CP204. Further detail is in chapter 2 of this policy statement. We have also made a number of minor changes to the rules and guidance implementing the conglomerate requirements in response to technical comments made by respondents.

Insurance group proposals

- 1.11 The key concern of respondents, as expected, was the move to a hard group capital adequacy test (i.e. one that must be passed as a matter of regulatory obligation). In addition, a number of respondents sought clarification of certain of the new rules, and had technical queries about how they would work in practice.
- 1.12 In view of the responses on the hard test proposal, and its potential impact, we will be considering the issue further and discussing it with the industry, before issuing a supplementary policy statement planned for September this year.
- 1.13 Comments on the other proposed changes for insurance groups, were essentially technical points on the detailed approach taken or on the rules implementing the requirements, rather than concerns about the underlying policy. We have amended where appropriate the new insurance groups material in PRU 8.3, and clarified certain areas by the addition of more guidance. Further detail is in chapter 3.
- 1.14 There is one further development on insurance groups. CP204 proposed to implement in PRU 8.3 the changes made by the FGD to the underlying insurance directives. However, PRU 8.3 depends significantly on the underlying solo insurance rules. As these solo insurance rules will not now be made by us until the end of 2004, the making of PRU 8.3 will be deferred until then. However, the requirements of the FGD need to be implemented by 11 August 2004 (even though they will not take effect until 2005). Consequently we are instead amending the existing insurance group rules in IPRU(INS) to implement the FGD changes to the insurance groups regime, to ensure that we implement the FGD by the required date. As the new solo insurance requirements together with PRU 8.3 are scheduled to be made by the end of 2004, we do not expect this IPRU(INS) text actually to be used. This is explained in more detail in paragraph 3.13, and the following text box. (Friendly Societies will also be covered by PRU 8.3, consequently a similar approach has been adopted with initial amendment of IPRU(FSOC) pending PRU 8.3 being made towards the end of 2004.)

Third country groups

- 1.15 Some respondents were concerned about the process and timetable for determining the equivalence of non-EEA regulators' supervisory requirements, and for notifying groups of any restructuring or other changes that may be required. There was also concern that EEA supervisors may reach different views about the equivalence of third country supervisory arrangements, and be inconsistent in their application of alternative supervisory measures for groups without equivalent supervision.
- 1.16 We explained in CP204 that our proposals for third country groups set out in PRU 8.5 remained brief, as they depend on European-level processes to produce guidance on third country supervision arrangements, and supervisory decisions that will be based on the individual circumstances of each group. This remains the case, and so in responding to the consultation comments we have given an update on the status of that process. Concerns of respondents about timing are recognised, and we confirm through this policy statement that we will take a reasonable approach to the introduction of alternative measures, if any, for the start of financial years in 2005. Further details on this and other comments are in chapter 5.

Other

- 1.17 In addition to proposals on the three key areas set out above, CP204 consulted on ways to implement the FGD requirements for banking and investment firm groups, and to harmonise the existing four sets of investment firm group rules into one. It also consulted on proposals to implement the FGD requirements on systems and controls for financial conglomerates, and included near final systems and controls text for groups, on which there had been previous consultation. The final policy on both these areas is broadly as proposed in CP204. Further details are in chapters 4 and 6 respectively.
- 1.18 For the two areas where we are changing the policy consulted upon in CP204, we have reviewed the applicable part of the cost benefit analysis (CBA), and our conclusions as to the effect of these changes on the CBA are set out with the explanation of the change in the text of this paper. Aside from those two areas, the CBA is unchanged. The compatibility statement in Annex 2 is the CP204 statement, amended primarily to reflect the fact that we are detaching our proposals on the hard capital adequacy test for insurance groups from this policy statement (see paragraph 1.12).

New prudential categories of firms

- 1.19 In CP97 we consulted on a new approach to categorise firms subject to our prudential supervision regime, based on:
- the main risk which firms incur in their business; and

- the impact, in terms of the scale of customer loss or adverse market confidence, if they were to suffer a prudential failure.

1.20 We need to refine this approach as:

- to a greater degree than originally anticipated in the CP97 categorisation of firms, the PRU needs to implement a number of EU Directives with different application; and
- the extension of the scope of our regulation makes it impractical to adopt a solely risk-based categorisation.

1.21 Consequently, we have revised the CP97 categorisations, moving towards an approach based on EU directives which nevertheless takes account of the type, and risk profile, of business done by firms. Further detail is in chapter 7 of this paper.

Structure of this paper

1.22 The structure of (part 1 of) this paper follows that of CP204. Within each chapter the structure is based on the key themes from respondents, rather than the specific questions raised in CP204.

1.23 Chapters 2 – 6 cover the key proposals as follows:

- chapter 2 deals with financial conglomerates;
- chapter 3 with insurance groups;
- chapter 4 with banking and investment groups;
- chapter 5 with third country groups; and
- chapter 6 with group systems and controls.

1.24 Chapter 7 deals with the new prudential categories used in the PRU text, and referred to in paragraphs 1.19 to 1.21.

1.25 The various annexes to this paper are mentioned in the text to which they relate. A list of respondents who did not request anonymity appears as Annex A at the end of part 2 of this paper.

1.26 The made handbook text is in Appendix 1.

Timings and next steps

- 1.27 The table below sets out when the made text included in this paper will come into force, focusing on the different sections of rules concerned.

Table 1. In force date for made text included with this policy statement

Rules	Subject	In force date
Prudential sourcebook (PRU) – new rules text		
PRU 8.1	Systems and controls	The earlier of 1 January 2005, for financial years beginning on or after that date <u>or</u> the date the new solo systems and controls requirements come into force (near final text was in PS142).
PRU 8.4	Cross-sector groups	1 January 2005 for financial years beginning on or after that date
PRU 8.5	Third country groups	
PRU 8 Annex 1	Capital adequacy calculations for financial conglomerates	
PRU 8 Annex 2	Prudential rules for third country groups	
PRU 8 Annex 3	Classification of groups	
PRU 8 Annex 4	Financial conglomerate decision tree	
Interim prudential sourcebook (IPRU) – amendments to existing rules text		
IPRU(BANK)	Banks	1 January 2005 for financial years beginning on or after that date
IPRU(BSOC)	Building societies	
IPRU(INS)	Insurance firms	
IPRU(INV)	Investment firms	
IPRU(FSOC)	Friendly societies	The earlier of the day on which rule 4.2 of IPRU(INS) ceases to be of effect and the first day of a group's financial year beginning in 2005.
Other handbook material – amendments to existing manuals/high level standards		
SUP	Supervision manual	1 January 2005 for financial years beginning on or after that date
COND	Threshold conditions	
AUTH	Authorisation manual	
DEC	Decision-making manual	

CONSUMERS

This paper will not be of direct interest to retail consumers. But the issues it covers and the rules that it makes are designed to enhance consumer protection as well as to further our market confidence objective.

2 Financial Conglomerates

CP204 proposals

- 2.1 The FGD was published in February 2003, and comes into effect for firms and groups affected for financial years beginning on or after 1 January 2005. The main purpose of the Directive is to introduce a new prudential regime for financial conglomerates, that is groups with significant activities in the banking and investment sectors on the one hand, and the insurance sector on the other. It does this by:
- building on key aspects of the existing sectoral group prudential supervision requirements, for example by requiring conglomerates to: measure and have sufficient capital to meet a capital adequacy test; and meet risk concentration and intra-group transaction requirements;
 - requiring a single supervisory co-ordinator for each conglomerate, with the aim of streamlining supervisory arrangements for each conglomerate;
 - requiring conglomerates to have adequate systems and controls so they can monitor intra-group exposures and risk concentrations across the sectors; and
 - setting out a process for assessing if non-EEA conglomerates operating in the EEA are subject to equivalent supervision in their home country, and if not, requiring European group oversight or alternative measures.
- 2.2 FGD also amends the existing European prudential supervision requirements for sectoral groups, and further details are in chapters 3, 4 and 5.

Key issues arising

- 2.3 Respondents were broadly supportive of our proposal to implement the new financial conglomerate requirements through minimal change to the existing sectoral requirements. However there was general concern about the shortage of time available for preparation. Respondents sought early confirmation of the groups that will be classified as financial conglomerates, and asked for clarification in four main areas:

- the process of identification of conglomerates;
- the role of the co-ordinator;
- intra-group exposures and risk concentrations requirements; and
- the method of calculating a conglomerate's capital resources and requirement.

All are considered separately below.

- 2.4 In addition, the need to ensure consistency of application was a theme throughout the responses on this section, particularly in relation to the role of co-ordinator, and also to our third country requirements (see chapter 5). This point is addressed specifically in our response on co-ordinators, and in other areas where it is particularly relevant.

Identification of conglomerates

- 2.5 Many respondents asked for clarification of where the responsibility lies for identifying both initially, and on a continuing basis, whether a group is a conglomerate and notification of that fact. Respondents were also concerned that financial conglomerates be identified promptly to allow as much time as possible to prepare for the new requirements.

Our response: We have amended the notification requirement in SUP 15.9 to clarify the circumstances under which a firm must notify us that it is (or has ceased to be) a member of a conglomerate. Firms have an ongoing responsibility to check whether they are (or have ceased to be) part of a financial conglomerate and if so to notify us, unless someone else in the group has already done so. We will then notify the firm that it is a financial conglomerate, and apply the relevant requirements of PRU 8.4 to create a bespoke regime for each conglomerate.

We have already conducted an exercise to help groups determine whether they are potential members of a UK based financial conglomerate, and have contacted those potentially identified again to ask them to confirm our findings on the basis of their 2003 annual accounts. We will formally advise UK conglomerates of their status after 11 August 2004. The identification of potential conglomerates with parents outside the EEA continues, and we hope to have identified the relevant population by the end of September.

We will inform groups that fall under the FGD Article 3.3 (which allows supervisors discretion over whether to treat groups meeting certain criteria as financial conglomerates), of the progress of consultations with other relevant competent authorities and notify them of decisions as soon as possible. We will use this consultation process to promote consistency of approach between relevant competent authorities, but groups should be aware that decisions made must take account of the individual circumstances of a group.

- 2.6 Some respondents asked for more specific definitions of items to be included in the threshold calculations.

Our response: We have added guidance in PRU 8 Annex 3, which is an amended version of a questionnaire in the form of a flowchart, and notes on its completion, which are currently on the financial groups section of our website at (www.fsa.gov.uk/international/fgd.html). This questionnaire is a tool to help groups determine whether and what type of conglomerate they are. The questionnaire and accompanying notes address most of the queries raised by respondents on this issue.

Role of the co-ordinator

- 2.7 Respondents welcomed the proposal and were generally positive about the benefits of a single supervisory co-ordinator, but wanted more clarification of the role of the co-ordinator, and specifically how the concept would work in practice. For example, they sought clarity on whether it would prevent the imposition of different reporting requirements and frequencies by different local supervisors involved in supervising a conglomerate. Respondents were also concerned that, for the co-ordinator role to be a success, EU regulators would need to work together at the earliest possible opportunity to ensure a co-ordinated approach to the implementation of the conglomerate regime.

Our response: The FGD specifies certain tasks for the co-ordinator as well as duties to consult and notify interested parties, and HM Treasury's SI expands on our existing powers to assist us in meeting these FGD requirements. Aside from these requirements, the co-ordinator's role is intended to be flexible so that it can be tailored to suit individual financial conglomerates.

Owing to the cross-border nature of the FGD requirements and the groups to which they apply, the development and implementation to date of the FGD has encouraged consistency throughout the EU. This will continue, particularly in relation to work on establishing co-ordinator arrangements, identification of EU conglomerates and the third country equivalence process.

Where we are the co-ordinator, we intend to build on the foundations of our existing co-operation arrangements with European supervision colleagues and arrangements already in place for the different types of groups. In response to a suggestion from one respondent, we have included a table in Annex 3 of this policy statement, that sets out the consultation requirements in the various circumstances in which they apply.

As firms hoped, we are already working with other European competent authorities on identifying conglomerates and on preparatory work on the likely equivalence of other non-EEA supervisory regimes.

Intra-group exposures and risk concentrations

- 2.8 There was general agreement with our proposed approach of minimal change, and with the use of existing management information systems where possible to satisfy the FGD requirements. There was however, some confusion about the detail of the information needed, together with some technical queries, and respondents asked for clarification in this area.
- 2.9 Respondents were concerned at the limited timescale for developing any new systems necessary by 1 January 2005, and that they may in any event need to be changed when the European Commission reviews this area in 2007.

Our response:

The requirements are:

- Firms must ensure that a mixed financial holding company heading a financial conglomerate complies with the large exposure and risk concentration requirements applicable to the most important financial sector (as defined) in the conglomerate (PRU 8.4.35R). This is to be reported on the usual sectoral reporting form, restated to take into account the requirements of PRU 8.4.35R. This reporting requirement has been added to the table in SUP 16.7.74.
- Firms must ensure that an annual summary report is produced for each conglomerate, giving an overview of significant risk concentrations at the level of the financial conglomerate, and significant intra-group transactions of regulated entities within the financial conglomerate (SUP 16.7.73-74R)

The format of the summary reports will be developed by supervisors on a bespoke basis with each conglomerate and in conjunction with any other relevant competent authorities. We recognise that groups do not wish to incur expense developing systems which may be subject to change. By having effective bespoke arrangements, we will be in a stronger position to argue against significant change and prescription at European level when this area is considered again by the Commission in 2007.

- 2.10 Respondents also asked how the risk concentration rules will work for insurance conglomerates, as there are currently no such requirements for insurance groups.

Our response: As respondents identified, there are currently no risk concentration requirements for insurance groups. The FGD requires us to apply the relevant sectoral requirements if any, to each corresponding type of conglomerate. Consequently as there are no risk concentration requirements for insurance groups, there are none for insurance conglomerates.

Capital adequacy calculation method

- 2.11 Some respondents were confused about the practical effect of the proposals, asking for clarification of the capital adequacy calculation method chosen, while others expressed a preference for a choice of methods, rather than the specification of a single method. Some respondents were also interested in the prospect of further change as a result of the Basel review, and any EU proposals on the same issue.
- 2.12 Others supported the proposals to apply one method for all as a sensible approach that provides a practical solution to the inherent technical difficulties in applying all the different methods to all the different sectors. Further, it allows groups affected to do their conglomerate capital adequacy calculation using their current sectoral calculation methodology.

Our response: In CP204 we explained that we are likely to require all conglomerates to use FGD method 4 to calculate their conglomerate capital adequacy. This is any mixture of methods 1, 2 and 3, and our sectoral capital calculation methods (for banking, investment and insurance groups) will all include an element of at least two of methods 1, 2 and 3. This effectively means that our sectoral capital calculation methods are FGD method 4, albeit each sector has different combinations of methods 1, 2 and 3. So, requiring conglomerates to use method 4, effectively means that they will calculate their group capital adequacy in the same way as they would under their sectoral rules. For example, a banking conglomerate will use the banking group capital methodology to calculate its conglomerate capital adequacy.

We continue to believe that method 4, being the conglomerate's existing group capital methodology, is the best way of implementing the requirements of the FGD, and is consistent with our policy of minimum change in implementing the FGD requirements.

Change to the sectoral group capital adequacy calculation methods as a result of the new Basel framework and of the Capital Requirements Directive is clearly a possibility for the future, although it will affect some types of firms more than others. Our policy of minimal change to implement the FGD requirements meanwhile should however reduce as far as possible the number of changes to which firms will be subject.

- 2.13 Some respondents were unclear how the calculation would work, and one suggested that a worked example should be included in the rules.

Our response: We have not taken up the suggestion of having a worked example in the rules, as the sectoral group reporting forms that are to be used to report conglomerate capital already set out in detail how the calculation should be done. In addition, a worked example is inevitably very stylised and unlikely to add further clarity in this situation where each conglomerate will vary considerably from all others.

2.14 Respondents wanted clarification about the position for investment firm groups that are part of a financial conglomerate, and which currently have a waiver under the Capital Adequacy Directive (CAD) from their group capital adequacy requirement. The concern here was that they may no longer benefit from this waiver if they are part of a conglomerate.

Our response: An investment management group in this situation does not lose the CAD waiver as such, but the conglomerate of which it is a part must have positive capital resources at the conglomerate level. Consequently if a conglomerate contains an investment group with a deficit and a CAD waiver, it has to ensure that overall at the conglomerate level, it has positive capital resources. So any deficit in the investment group will need to be met by cross sectoral capital from elsewhere in the conglomerate.

3 Insurance groups

CP204 proposals

- 3.1 Within our broader programme of the reform of insurance regulation in the UK, we proposed in CP204 that EEA insurance groups must at all times hold the amount of capital indicated by their group capital adequacy calculation.³ The Handbook text proposed in CP204 to implement these changes also incorporated the effects of the wider reform of UK insurance requirements proposed in CPs 190 and 195 on capital standards for life and non-life insurers respectively.
- 3.2 CP204 also set out proposals to implement, via amendment of our sectoral rules, the FGD amendments to the underlying insurance directives, the most significant of which for insurance groups is a new treatment for holdings in other financial sectors.

Hard group capital adequacy requirement

- 3.3 We proposed in CP204 that the parent capital adequacy calculation for EEA insurance groups (and any EEA sub-groups of third country groups) should become a “hard” test. This would have the effect that a negative result from the capital test at group level becomes a notifiable breach of regulatory requirements that may trigger disciplinary or remedial action. We also proposed that the top world-wide test should remain a “soft” test. In other words, the firm would report the results of the group calculation only, with no requirement to meet the calculated capital adequacy requirement.
- 3.4 We received many comments on the insurance proposals, particularly on the hard test proposal. Respondents wanted either to retain the soft test, or to have a transition period before its introduction. Some suggested that no change

³ Our intention to introduce this requirement was signalled in CP50 Implementing the EC Directive on Insurance Groups, also covered in CP97 (Integrated Prudential sourcebook) and is set out in the Interim Prudential Sourcebook for Insurers (Guidance Note 10.1 paragraph 22).

should be made until all the variables affecting the calculation are resolved (Solvency 2 and International Accounting Standards). Some respondents argued that a hard test is super-equivalent to the Insurance Groups Directive (IGD) requirements, and introduces competitive distortion in relation to other Member States that have not implemented it as a hard test.

- 3.5 Respondents expressed concern at what they perceive to be the uneven implementation of the IGD across Europe, not only in the application of a hard capital adequacy test, but in other areas as well. Some commented that applying the proposed new Enhanced Capital Requirement at the group level was not appropriate, and that group requirements should continue to be based on the aggregation of the minimum capital requirements for the individual entities making up the group.
- 3.6 In contrast, some respondents supported our proposal, commenting that it was a sensible approach that enhances the credibility of the supervision of insurance groups.

Our response: In light of the responses to CP204, we will be considering the issue further, and discussing it with affected firms, before issuing a supplementary policy statement planned for September this year.

Individual capital assessments

- 3.7 In CPs 190 and 195, we consulted on our proposed rules and guidance for a framework, under which a firm would make an individual capital assessment (ICA) of its own regulatory capital needs. It was also proposed to give most firms individual capital guidance (ICG) reflecting the supervisor's view of what adequate capital would be for their particular business, this ICG being closely informed by the firm's own ICA.
- 3.8 In CP204, we consulted on the implications of the ICAS framework for groups. Firms subject to the ICAS framework will need to assess the impact on their financial position of risks materialising in all group companies, whether or not these group companies are themselves subject to the ICAS framework. CP204 acknowledged the suggestion made by firms that the risk profile of groups is generally lower than the sum of the risk profiles of firms within the group, because of the benefits of diversification at the group level. The presumption is then that as a consequence, the group capital requirement could be lower than the sum of the individual requirements. So CP204 sought comments on how the group ICG should reflect the ICG given to individual firms that are members of that group.
- 3.9 PS 04/16 deals with consultation responses on the ICAS framework at group level, the conclusion being that ICAS rules and guidance will be implemented broadly as proposed in CPs 190 and 195. Respondents to CP204 were

consistent in wanting to be able to take account of diversification benefits at group level, clearly on the assumption that they would be present. Respondents focused on the benefits of diversification, but there were no suggestions on how such benefits could be taken account of.

Our response: When we determine group ICG, we will consider any reduction to the risk profile of a group below that of the sum of the individual risk profiles of the firms in the group. Respondents on this issue focused on diversification as being the main relevant benefit, but we still see two sides to diversification:

- it may reduce risks across groups, and we will take account of specific demonstrable evidence of this when giving groups ICG; and
- on the other hand, firms may be exposed to additional risks through their membership of a group. This has been borne out by some real examples and is one reason why we supervise groups.

We expect any proposed reduction in the risk profile of a group to be clearly demonstrable and evidenced in the group's ICA.

We will apply the ICAS framework at the group level in the same way that we do at the solo level – further details are set out in chapter 5 of PS04/16. However, briefly, we would expect a firm to indicate if it does not accept any ICG given to it. If agreement cannot be reached, we will consider using the own initiative variation of permission (OIVOP) process under section 45 of FSMA to impose a requirement on a firm's permission, so it becomes a regulatory requirement for firms to comply with the group ICG. If a group's capital was to fall below the level indicated by the group ICG, we would consider an appropriate regulatory response, though this will vary according to the circumstances, but is likely to include an explanation of the reason why the situation has occurred, and timetable for its rectification. The range and severity of the steps we then might take will vary according to the circumstances but could extend to the same actions we would take where a firm is in breach of a threshold condition. We are consulting in our Quarterly CP to be published in July 2004 on draft guidance on these last points.

Shape and format of the new rules

- 3.10 In CP204, we proposed to replace the existing rules in the interim prudential sourcebook with a new chapter of the Prudential sourcebook – PRU 8.3. This new chapter brings together in a single chapter both the group capital adequacy requirements, and the rules for calculating the capital adequacy of an insurer with interests in other insurance firms (adjusted solo). Moving the existing rules to the integrated prudential sourcebook was necessary because of the proposed new approach for calculating solo capital adequacy consulted on in CPs190 and 195 (which compares the capital resources available against the capital requirement, rather than the existing net asset approach). The insurance group

requirements rely heavily on the solo requirements, and so had to be rewritten in this way to be consistent with and to reflect the new solo requirements.

- 3.11 The responses we received reflected the fact that the rules were being expressed differently, with comments and queries about technical aspects of the new rules and how they would work. Firms had clearly worked through the proposed new rules, with their own situations in mind, and identified a number of areas where the new rules did not quite reflect the existing rules. Some were also concerned that the new rules in PRU 8.3 introduced changes not explained in the text of the CP.
- 3.12 Reflecting this significant change, respondents asked for examples of how the new rules would work in practice, particularly the group capital adequacy calculations. There were also concerns about where and how the valuation requirements currently in IPRU(INS) chapter 4 were reflected in the overall package of insurance material.

Our response: We are grateful to respondents who worked through the rules in detail and identified areas where the new did not quite match the old. We are reassured that most of the points raised were technicalities. Where appropriate we have responded to comments either in this chapter, or by amending the rules and guidance.

These technical changes will improve and clarify the rules, but our policy has not changed. It was explained, along with the proposed changes to the insurance group regime, in the CP204 text and there was no intention to make any others. Consequently, the result of the calculations required under PRU 8.3 will not be materially different to those done under (IPRU)INS, subject to the changes proposed in CP204.

We will not be producing examples but, in response to requests from firms prior to the consultation, have produced a pro forma return that effectively takes firms step-by-step through the new group calculation in PRU 8.3, and should therefore act as an example.

The rules for valuing holdings in non-insurance, non-financial undertakings remain in the valuation chapter (which will become PRU 1.3, near final text of which was published in PS04/16).

- 3.13 In CP204, we proposed to implement in PRU 8.3 the changes made by the FGD to the underlying insurance directives. As mentioned earlier, PRU 8.3 builds on and consequently relies heavily on the solo regimes proposed in CPs 190 and 195, which are to be implemented in the Prudential Sourcebook in chapters PRU 2.1, 2.2 etc. Near final text of the solo requirements was published in PS04/16 in July 2004, and the final text is scheduled to be made by the end of 2004. However, our rules implementing the FGD must be in place by 11 August 2004 (although they do not actually come into effect until 2005). Consequently it is necessary to review the plan to implement the FGD changes to the underlying insurance directives using PRU 8.3, ahead of the other text on which it relies.

Our response: Because of the close dependencies, we will make the final text of PRU 8.3 at the same time as the new solo insurance rules on which it relies, towards the end of 2004.

To meet the requirement to implement the FGD by 11 August 2004, we have amended the existing insurance requirements in IPRU(INS) to introduce the changes needed. The main change is to the treatment of cross-sector holdings in chapter 4.2, but there are also consequential changes to Guidance note 4.2. The amended text is in Appendix 1. It has been adopted, and will come into force for financial years beginning on or after 1 January 2005, with the other FGD requirements.

This IPRU(INS) text will be used by all groups subject to the insurance group regime until it is replaced by PRU 8.3, when we make that text. It is unlikely however that this revised IPRU(INS) text will be used by firms, as PRU 8.3 should be made later on this year before the FGD requirements come into force.

The near final text of PRU 8.3, that is CP204 text amended to reflect our decisions on points raised by respondents, including the issues discussed in this section (chapter 3), is in Annex 4 of this policy statement. (The final text will be substantially similar to the text attached to this paper. In the next few months we will conduct further work to ensure that the final PRU text is an adequate legal expression of the FSA's policy. We expect that, and will work to ensure that, this refinement of the final PRU text will not entail material change in our policy as expressed in the text attached to this policy statement and elsewhere. Accordingly we consider that the text we have included is clear enough in its intention for firms to use as a basis for preparing for PRU implementation.)

As a consequence of this change we are also making some changes to IPRU(FSOC) – the prudential rules for friendly societies. They are included in the scope of PRU 8.3, and this was the method by which we were implementing the FGD changes to the regulatory requirements for friendly societies. Consequently we have had to amend the existing IPRU(FSOC) text to implement the FGD requirements, and the final made text is included in Appendix 1. This text will continue to apply to friendly societies not subject to the European Directives. As for insurers, PRU 8.3 will replace this amended IPRU(FSOC) text for friendly societies that are subject to the European Directives.

We do not think that this change will result in any additional costs for firms.

Assets in excess of market and counterparty limits and transferability

- 3.14 Some respondents were concerned about the proposal to apply limits on assets in excess of market and counterparty limits at holding company level. Respondents also made a number of technical comments on the proposals that have been addressed by amendment to the PRU 8.3 text.
- 3.15 'Transferability' is about whether a subsidiary (that is an insurance undertaking) has surplus capital of a kind that can be transferred elsewhere in

the group without breaching the gearing limits of the subsidiary concerned. For example this could be done as a dividend, even though in reality the capital is not actually transferred to those other parts of the group. Broadly speaking, capital that fits this statement will be transferable capital.

- 3.16 In CP204 we proposed a partial easing of the current restrictions on the amount of surplus capital from a subsidiary which may be counted as transferable capital.
- 3.17 Many respondents were uncertain as to when the new transferability requirements would apply, how they work in practice, and how they interact with the requirements on assets in excess of exposure limits. Some thought that our policy intention was an attempt to limit the transferability of Tier 1 capital, and one respondent argued that it is inconsistent to apply transferability requirements at the adjusted solo level only, and not at holding company level.
- 3.18 These two issues were covered in questions 5.4 and 5.5 in CP204. The questions were unfortunately transposed incorrectly into the list of questions in Annex 1. Whilst most respondents answered the questions as they appeared in the body of the CP text, this undoubtedly caused confusion amongst some respondents.

Our response: Both of these concepts apply only to the adjusted solo calculation done by a firm that is a regulated parent undertaking with an insurance undertaking subsidiary (or participation). They do not apply to the parent undertaking solvency calculation done at insurance holding company level.

Assets in excess of market and counterparty limits

We will not make any changes to the existing requirements on assets in excess of market and counterparty limits, other than those which are a consequence of our implementation of the FGD. We will not be applying these requirements at the holding company level. It was not our policy intention to do so, and we have amended the rules and added guidance to clarify this.

The IGD does not currently require such limits at insurance holding company level, and consequently we will not be doing so either.

Transferability

Under the existing rules, the amount of transferable capital is effectively restricted by the operation of two factors: the amount of surplus Tier 1 capital; and the use of waivers to allow subordinated debt to count as capital. We consider that the new transferability rules produce broadly similar results to the existing rules, albeit that they do so in a different way.

In response to comments about the new transferability rules, we have amended them to more clearly reflect our policy. These amended rules produce the same result as the proposed rules in CP204, but do so by approaching the calculation in a different way. Rather than calculating the amount of transferable capital, the amount of non-

transferable capital is calculated and deducted from the total capital of the subsidiary, leaving only transferable capital. Capital that is not transferable cannot be included in the adjusted solo calculation because it cannot be moved to support capital requirements elsewhere.

As some respondents noted, this requirement does limit the amount of Tier 1 capital in a subsidiary that can in theory be transferred. However we believe this is more than compensated for by the ability of groups now to issue Tier 2 capital in a subsidiary and effectively to use this to release Tier 1 capital, subject to the usual limits on eligible capital (i.e. at least 50% of the subsidiary's minimum capital requirement must be met by Tier 1 capital).

We consider it appropriate to apply the concept of transferability at adjusted solo level only – rather than applying such limits at the group level – because the purpose of group capital is slightly different to solo capital. Solo capital rules require firms to have sufficient resources to support their own activities. Group capital requirements are broader, ensuring that overall there are sufficient resources of a suitable quality within the group to prevent threats to regulated entities from the rest of the group. At the group level, supervisors obtain a picture of the overall position and, knowing that adequate capital is already required in individual regulated entities, can consider the spread and availability of group capital and address any concerns through supervisory action – rather than the automatic application of limits for all groups.

As both these issues apply only to the adjusted solo calculation, we have moved the relevant provisions to a new adjusted solo section at the end of PRU 8.3.

Cross-sector holdings

- 3.19 FGD amended the IGD and the solo insurance directives to change the treatment of significant related investments in other financial sectors, including investments in unregulated financial institutions. Such investments must either be deducted from capital or treated according to one of the FGD methods. We proposed in CP204 to consolidate investments in regulated related undertakings using the FGD aggregation method. However, investments in unregulated financial institutions and ancillary insurance service undertakings should be deducted from group capital. This is a simpler way of treating unregulated entities rather than including them in the aggregation.
- 3.20 However, some respondents were concerned that this treatment would not recognise surpluses built up in such entities.

Our response: We accept that it is reasonable to expect surpluses to be built up in an unregulated financial institution and that these should be recognised in the group capital calculation. But we would not normally expect significant surpluses to be held in an ancillary services undertaking. The relevant rule has been amended so that unregulated financial institutions will be included in the group consolidation. This will mean that groups can use the surplus assets in such entities in the group capital calculation. The treatment of ancillary service undertakings remains as proposed in CP204.

4 UK banking and investment firm groups

CP204 proposals

- 4.1 CP204 consulted on consolidated supervision rules for investment firm groups, with a proposal to harmonise the consolidated supervision requirements for investment firms into one chapter of IPRU(INV) – Chapter 14.
- 4.2 CP204 also consulted on proposals to implement changes introduced by the FGD to our existing banking and investment firm group requirements.

Responses

- 4.3 Overall, respondents supported the harmonisation and accompanying clarification of consolidated supervision rules for all investment firms. They welcomed the consistent application of the CAD waiver and the change in the method for calculating group capital adequacy from an ‘aggregation’ basis to ‘accounting consolidation’.
- 4.4 Respondents did however ask for clarification on technical aspects of how the existing four sets of rules had been combined, and how they would work in practice. In response, we have made minor changes to Chapter 14. In addition, the commentary below explains further the operation of the new rules on certain issues that respondents queried.
- 4.5 Chapter 14 incorporates the changes made to IPRU(INV) Chapter 5 for investment management groups following CP173, and the minor changes proposed in Miscellaneous CP 04/5, and subsequently made in the policy statement following that CP. The CP173 policy statement (PS173) addressed the main concerns of firms. These included the method used for consolidated reporting and the ‘CAD waiver’. Consequently no real issues of policy arose on this part of the CP204 consultation, and this was reflected in the responses received.
- 4.6 The harmonised consolidated supervision rules for investment firms provide a consistent approach to waiving consolidated supervision requirements, subject to

firms meeting certain conditions. Firms must meet the conditions in IPRU(INV) 14.1.4 R and 14.1.5 R and notify us of their intention to use the CAD waiver. We would expect firms with relationship managers to discuss the conditions with them before submitting the required notification. There is no prescribed format for this notification for those firms without relationship managers, but included in this paper (Annex 5) is an example of the type of submission we would expect. In line with our risk-based approach to supervision, firms may be asked to justify how they meet those conditions. If a firm ceases to meet the conditions, it should inform us as it would otherwise be in breach of the regulatory requirements, and will then need to apply the consolidated supervision requirements.

- 4.7 The rules will come into effect for financial years beginning in 2005.

Audit requirements

- 4.8 In line with the changes made in IPRU(INV) Chapter 5, the harmonised rules on consolidated supervision require the accounting consolidation method to be used to calculate an investment group's consolidated capital position. In doing so, the group financial resources calculation should be based on consolidated accounts for the relevant group. A few respondents asked whether these consolidated accounts must be audited. In addition, respondents asked whether auditors are required to sign-off the consolidated supervision return that is to be submitted to us within the required timescale.

Our response: We expect most groups to prepare consolidated accounts for statutory purposes, but recognise that the 'relevant group' that is subject to consolidated supervision might not have them. In these circumstances we would expect consolidated accounts to be prepared for the relevant group, but they would not need to be audited. In addition, the half-yearly return can be based on information from management accounts. The audit requirements in SUP 3.9.5 do not require the consolidated supervision return to be audited. As currently, we require auditors to confirm the consolidated supervision return was prepared according to the relevant rules, in this case Chapter 14 of IPRU(INV).

Venture Capital firms

- 4.9 One respondent was concerned that Chapter 14 does not exclude venture capital firms from the scope of consolidated supervision, and that this is inconsistent with IPRU(INV) Chapter 5.

Our response: We do not intend to apply consolidated supervision rules to venture capital firms that are not subject to the CAD.

We have amended the rules to clarify this. Non-CAD venture capital firms are excluded from the need to do consolidated supervision – that is they will not trigger consolidated supervision requirements. This is consistent with Chapter 5 of IPRU (INV).

However, venture capital firms that are subject to the CAD will trigger consolidated supervision, and this is also consistent with the current IPRU(INV) Chapter 5.

Calculation method

- 4.10 One respondent questioned whether using the accounting consolidation method to calculate consolidated capital adequacy for all investment groups is appropriate for all such groups. In addition, the respondent requested flexibility in the choice of calculation method to use.

Our response: In CP204 we proposed changing the capital calculation method for all investment firm groups from aggregation to accounting consolidation. This was trailed in PS173, which made the same policy change for investment management groups only. We did not receive any persuasive arguments to re-consider this policy proposal. Consequently, investment firm groups will be required to use accounting consolidation to calculate their capital adequacy with effect from financial years beginning on or after 1 January 2005.

For the reasons set out in PS173, we continue to believe that a standard approach of accounting consolidation is the most straightforward (for firms) and transparent way (for firms and regulators) of calculating an investment firm group's capital adequacy. For further details refer to the comments made in PS173.

Banking groups

- 4.11 None of the responses to CP204 raised any policy issues in relation to our proposals for banking groups. In response to certain technical comments, minor changes have been made to the rules.
- 4.12 One respondent was concerned about the introduction of the concept of 'significant transaction' in paragraph 2, sub clause 4 (ii) in Chapter LE IPRU(BANK). The respondent concerned expressed a preference to limit the requirement to 'exposures' and questioned whether the proposed concept was being extended to other EU countries.

Our response: This is a basic FGD requirement and should therefore apply throughout the EU.

5 Third country groups

CP204 proposals

- 5.1 CP204 set out consultation proposals on the scope and proposed implementation of FGD requirements for banking and investment firm groups (and conglomerates) having their ultimate parent outside the EEA (so called ‘third country’ groups and conglomerates). The FGD requires that in principle group supervision be carried out for such financial groups on a world-wide basis. Our detailed proposals for third country groups were set out in PRU 8.5 and PRU 8 Annex 2.
- 5.2 A key aim of the FGD is the consistent application of consolidated supervision for all financial groups operating in Europe. To achieve this the FGD requires that a determination be made as to whether third country groups are subject to world-wide group supervision to a standard equivalent to that required for EEA groups. This determination is to be made by the group’s lead supervisor (or ‘co-ordinator’) in Europe, in consultation with other relevant EEA supervisors. If a group is equivalently supervised, there will be no additional requirements. In the absence of equivalent supervision, however, the EU co-ordinator must undertake consolidated supervision for the world-wide group or put in place alternative measures.
- 5.3 Three key aspects of the proposals attracted the most comment:
 - the process for determining equivalence;
 - our policy towards groups not subject to equivalent supervision; and
 - the timetable for making these decisions.

The process for determining equivalence

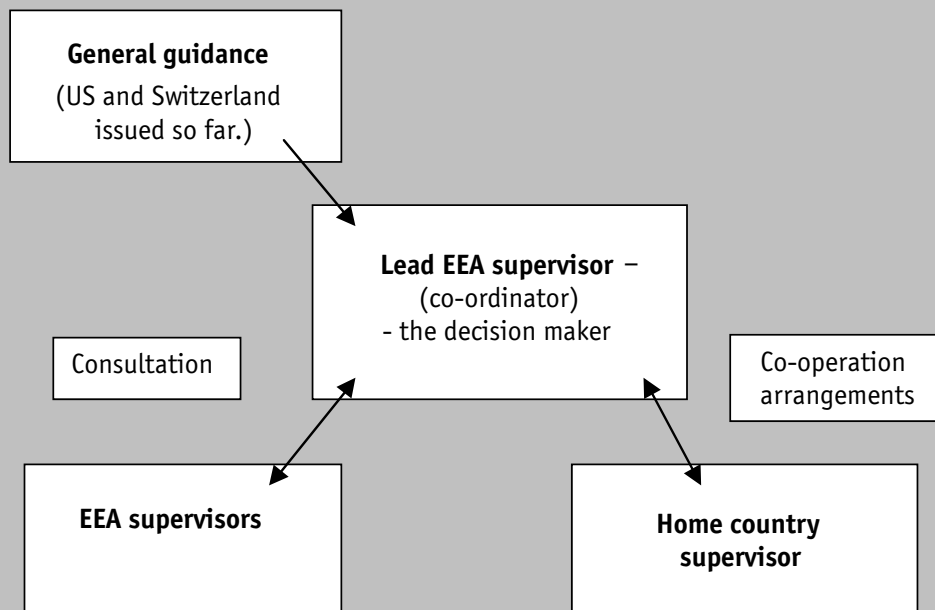
- 5.4 Some respondents were concerned that there could be a lack of consistency and transparency in decision-making across Europe, i.e. that co-ordinators in different Member States will form different views about the equivalence of a particular third country supervisor. But there was also recognition of the importance of achieving an appropriate balance between taking account of the characteristics of the group structure and having a consistent European framework.

Our response: The Directive is concerned with the supervisory arrangements for each group, and is clear that this is the main concern. But it also acknowledges the importance of a consistent European framework, and the need to balance this against taking account of the way in which each group is supervised in practice.

Under the FGD, the EU Financial Conglomerates Committee (EFCC) and the Banking Advisory Committee (BAC) can if they wish, issue general guidance to supervisors on the 'likely' equivalence of third country supervisory arrangements. (This stage is not mandatory and so does not have to be done for every third country supervisor.) This guidance will be a common EU position on 'likely' equivalence and will be kept under review. It is not decisive, and the final determination must have regard for the specific supervisory arrangements in place for each group.

This final determination is left to the lead EEA supervisor for each group, having consulted other relevant competent authorities involved in the supervision of the group and taken account of any general guidance from the EFCC or BAC. An important aspect of this stage of the process is that appropriate co-operation arrangements must be established between the lead EEA supervisor and the home country supervisory authority (FGD Recital 14)

This process is illustrated below:



The EFCC and the BAC has issued general guidance on a number of regulatory authorities in the US and Switzerland. The Directive does not require that these committees issue guidance on every third country supervisory authority. Whether there is guidance or not, the EEA co-ordinator for each group must consult the other EEA supervisors for the group concerned.

The EFCC and BAC have published their general guidance on the website of the European Commission.

Our policy towards groups not subject to equivalent supervision

- 5.5 Respondents commented on the cost and difficulty of implementing other measures, particularly if this involved establishing a European holding company and restructuring. There was also concern about the lack of clarity and transparency about the alternative measures that might be necessary. It was felt to be important that we discuss with specific groups any proposed supervisory action.
- 5.6 Some respondents requested a uniform approach across Europe to the imposition of alternative measures. However, others considered that while the general approach should be consistent, based on a common application of principles, the specific measures applied to a particular group should be tailored and proportionate to achieve the supervisory objectives.

Our response: The Directive does not set down a one-size-fits-all approach to 'other measures'. Rather, these measures should be specific to the circumstances of each group and established by the EEA co-ordinator in consultation with other relevant EEA supervisors. A uniform approach would probably result in the application of disproportionate measures for some groups.

Where we are the EEA co-ordinator for a third country group for which the home supervisory regime is determined to be non-equivalent, we will adopt an approach that is proportionate to the risk presented by the group concerned. We expect that in some cases, groups will already be subject to appropriate alternative measures in the UK. But where we propose to apply additional measures, these will be chosen having regard to the scale, nature and complexity of each group, and in practice we would discuss the measures needed with the group concerned.

Timing

- 5.7 A number of responses noted the lack of certainty on the timing of determinations of equivalence. There was also concern about the lack of time to implement other measures required if third country groups are determined not to be equivalently supervised.

Our response: In making our decisions on equivalence for groups where we are the EEA co-ordinator, we will take into account any general guidance that the relevant EU committees may give and consult any other relevant competent authorities. We will also need to ensure that there are adequate arrangements for information sharing and supervisory co-operation with the home supervisor. This means, as many respondents recognise, that the timetable is not entirely in our hands. But we plan to make a determination on equivalence before the start of a group's financial year in 2005.

Where we determine that a group is not subject to equivalent supervision, the nature of our supervisory response and timescale for implementation will be a matter for us to determine in consultation with other relevant EEA supervisors and the group concerned. We recognise that groups will need sufficient lead time to implement any changes

necessary in an orderly manner. This may mean that it might be difficult for some groups to implement changes from the start of their financial year in 2005, however this will be for supervisors to conclude during discussions with groups.

Changes to the rules

- 5.8 One change that we are making to the rules concerns the identification of third country groups. The Directive is not prescriptive about what competent authorities should do to identify third country groups. All firms should in any event be considering whether the FGD requirements for third country groups apply to them. However, to ensure that such groups do identify themselves, and because this is the first time such groups have been subject to any regulatory requirements by us, we are adding the identification of third country groups to the list of issues to be covered in the annual controllers report. This requirement is set out in SUP 16.4.5R. We have looked again at the cost benefit analysis in CP204, and concluded that whilst there will be an increase in costs overall, the increase will be of minimal significance.

6 Group systems and controls

CP204 proposals

- 6.1 CP97 consulted on draft rules on systems and controls that a firm in a group needs to maintain to monitor the risks it runs through being part of the group. This draft text was amended to take account of the comments received in response to CP97, and included as near final text group systems and controls rules in CP204.
- 6.2 The FGD builds on existing sectoral group requirements by requiring that financial conglomerates have adequate governance and management at the cross-sectoral level, and systems and controls to manage risk across its major financial sectors. It also requires that conglomerates have adequate systems and controls to monitor intra-group exposures and exposures across sectors, and significant risk concentrations to third parties. Conglomerates are required to report to the co-ordinator on these issues.
- 6.3 The near final group systems and controls text included in CP204 already implements some of these FGD requirements, and CP204 proposed the addition of two new rules for conglomerates only, to this text. These two new conglomerate rules cross-refer to and rely on the rest of the group systems and controls rules. Accordingly, CP204 covered all the group systems and controls material, giving respondents the opportunity to comment on the whole chapter, not just the new conglomerate requirements.

Responses

- 6.4 No comments were received about the policy intention of either the group or conglomerate requirements, and there were few comments in total on this chapter.

Our response: Our policy intention remains as set out in CP204. We have made some minor changes to the text, and have changed the application statement at the beginning of the chapter to reflect the new prudential categories (see chapter 7).

We have made the group systems and controls requirements and they will come into effect, together with the new conglomerate requirements, on 1 January 2005.

However, we proposed in CP204 that the group systems and controls requirements should come into force on the same date as the new Prudential sourcebook solo systems and controls requirements (on which near final text was published in PS142). The group material does not rely on, but complements the new solo requirements. As this chapter implements the FGD requirements, it must be in place for financial years beginning in 2005 at the latest, and this is the effect of the instrument making the text. However, the groups material (aside from the conglomerate requirements) will be brought into force with the solo systems and controls requirements if this is earlier. It is currently scheduled to be late December 2004.

7 Prudential categories of firms

Background

- 7.1 CP97 consulted on a new approach to categorising firms that are subject to our prudential supervision regime based on:
- the main risks that the firm incurs in its business; and
 - the impact in terms of the scale of customer loss or adverse market confidence if the firm were to fail.
- 7.2 The proposed approach categorised firms in terms of the business they do, and with whom they do it. To a degree, this approach was likely to be constrained by EU legislation, and this has proved to be the case. In some instances Directives apply the same requirements to firms doing the same business – for example investment firms and credit institutions are both covered by the Capital Adequacy Directive requirements. But other Directives apply different standards according to how a firm does a particular activity, for example whether a firm is holding client money or not, or whether a firm is receiving and transmitting customer’s orders only rather than giving advice to customers. So CP97 described principles underpinning our development of three broad categories of firm and used these and the constraints imposed by EU directives to produce the new prudential categories of firms in chapter PRU 1 (Application).
- 7.3 We need to refine this approach because:
- to a greater degree than originally anticipated in the CP97 firm categories, the PRU needs to implement a number of EU Directives with different applications; and
 - the extension of the our scope of regulation to, for example, insurance intermediaries and mortgage brokers makes it impractical to adopt a solely risk-based categorisation approach across all the categories.

New categories

- 7.4 Consequently, those initial categorisations have been revised, moving to an approach based on EU Directive-driven categories, which can take account of the type and risk profile of business done by firms. For some firms this will mean no change. For example, the definitions of ‘banks’ and ‘insurers’ are as in the existing Glossary, and very much based on the relevant directive definitions. Others will need to focus on the activities of firms, for example an investment firm could be an ‘own account dealer’ or a ‘matched principal broker’.
- 7.5 In CP97 firms had to refer back to the application chapter for a description of each prudential category. However, to reduce the need to cross-refer in this way, in future the application statement at the beginning of each PRU chapter will set out the categories of firm to which it applies. (And the legal definitions will appear in the Glossary.) This categorisation is not intended to catch every type of firm to which prudential requirements may apply. Instead it deals with the main EU categories for banking, insurance and investment services, together with closely related types of business. We intend that some factors that distinguish firms, such as whether they do ISD business, or hold client money, will not be dealt with through the categories. Instead, this will be done by narrative in the application provisions of the PRU chapter concerned.
- 7.6 A firm’s activities may mean that it falls into more than one of these prudential categories, and in addition, may also be covered by other prudential requirements that do not use these categories, for example the requirements for insurance intermediaries.
- 7.7 Overall this approach should help us develop rules that take into account the particular characteristics of the many different types of firms to which the PRU will apply. Focusing on Directive-driven categorisations will help when implementing Directives, and assessing Directive compliance. Also, having a more uniform population in each prudential category should make costs easier to estimate in our cost benefit analysis.
- 7.8 Annex 6 lists the new categories and definitions. These are the legal definitions of the new categories which are in the made Glossary text included in this policy statement (Appendix 1). The new categories are used in the PRU text.

Summary of changes to Handbook text ¹

Provision	CP204 numbering	Change and reason
IPRU(FSOC) All changes	N/A	As explained in the response section following paragraph 3.13, we will be amending the existing IPRU(INS) and IPRU (FSOC) text to implement the changes made by the FGD to the underlying insurance directives, rather than using PRU 8.3 to do so. None of the changes to the insurance groups rules proposed in CP204, other than those required by the FGD, are included in these IPRU rules.
IPRU(INS) All changes	PRU 8.3	
PRU 1.8	N/A	We have excluded the right of a private person to damages for breaches of the rules in PRU
PRU	PRU 8.1 and Glossary	The PRU text uses a new approach to categorising firms subject to our prudential supervision regime. Further details are in chapter 7, and the new categories themselves are listed in Annex 6 of this paper.
PRU 8.1	PRU 8.1.5	The scope of PRU 8.1 now excludes third country groups.
PRU 8.1.19 and 20	PRU 8.1.15	The guidance on the allocation of responsibilities within groups has been expanded, some of which is relevant guidance that was published in PS146. This was in response to consultation responses.
PRU 8.1 and 8.4	N/A	The scope of 8.1 and 8.4 have been amended so that while a firm in which a conglomerate holds a participation is included in the supervision of that conglomerate, our group rules don't apply directly to the firm in which the participation is held.
PRU 8.4.3	PRU 8.4.8	Further guidance on procedures for identifying a financial conglomerate is provided, in response to comments from respondents.
N/A	PRU 8.4.9 to 18	This introductory guidance has been deleted in line with our objective of handbook simplification.

¹ This table covers significant changes to the handbook text consulted on in CP204, most of which are explained in detail in the relevant sections of the policy statement. Various minor amendments to the rules and guidance made as a result of consultation responses are not covered

PRU 8.4.25	PRU 8.4.45	The rule has been amended so that it does not apply automatically, but only when a financial conglomerate has been notified that it is such by the relevant competent authorities.
PRU 8.4.28	PRU 8.4.47	The automatic application of Method 4 will not apply if a group fails threshold test 2, and passes threshold test 3.
PRU 8.4.35	PRU 8.5.57	This rule has been revised in line with the FGD wording to clarify its application.
PRU 8.5	PRU 8.5	Much of the guidance in PRU 8.5 has been deleted in line with our objective of handbook simplification. The text removed was background explanation about the requirements for third country groups and is in the FGD. Given the restructured text, it was appropriate to move some of the rules in PRU 8 Ann 2 part 1 into PRU 8.5. This means that PRU 8 Ann 2 parts 2, 3 and 4 have become parts 1, 2 and 3 respectively.
PRU 8 Ann 1 4.5	PRU 8 Ann 1 4.5	In response to comments from respondents we have included on the chart in PRU 8 Ann 1 paragraph 4.5, the guidance previously in PRU 8 Ann 1 paragraph 6.2
New	PRU 8 Ann 1 5.5	New provisions for dealing with groups without capital ties are included.
New	SUP 16.4.5	As explained in paragraph 5.8 of this paper, we have introduced a new rule for the identification of third country groups.
New	PRU 8 Ann 3	In response to consultation comments we have included a questionnaire, which helps groups decide whether and what type of financial conglomerate they are.

Compatibility statement

1. This statement explains why we believe that the rules and guidance made in Appendix 1 is compatible with our general duties under section 2 of the FSMA.

Compatibility with the regulatory objectives

2. We believe our amendments to the FSA's rules and guidance to implement (in part) the requirements of the FGD, and harmonise the investment firm group requirements, will contribute to our regulatory objectives set out below.

Market confidence and consumer protection

3. The Directive aims to improve the stability of the financial system by implementing internationally agreed principles for the supervision of groups with significant business in both the banking/investment and insurance sectors. The new requirements should help to ensure that risks in cross-sector and cross-border organisations are properly supervised, and that adequate capital is held at the conglomerate level. Supervising groups in this way should also increase financial stability, enhance transparency and confidence in the industry, and have positive benefits for market confidence. Retail consumers depend on financial conglomerates for the fulfilment of their rights and expectations. So, we expect the rules made here to strengthen this ability.

Financial crime and public awareness

4. We do not think that our proposals have a direct effect on our public awareness or reducing financial crime objectives.

Principles of good regulation

5. We have had regard to the principles of good regulation in designing these amendments.

The need to use our resources in the most efficient and economic way.

6. In general our approach for banking and most investment groups that are financial conglomerates under these new requirements, is for little change from their current regulatory regime. But, this regime will be applied to the extended group that is the conglomerate. In this instance, minimum change for firms will mean minimal change from existing practice for us. And this is an efficient and economic way of implementing the financial conglomerate requirements of the Directive.
7. For investment groups, the harmonisation of the group requirements will mean that part of the population (ex-SFA and ex-PIA firms) change the method used to produce their regulatory capital returns. This means that information from their consolidated accounts can be used. So, all investment firms will report on the same consistent basis, which should be more efficient for FSA to supervise.
8. The Directive requires that non-EEA groups or conglomerates should be subject to consolidated supervision. Yet, this is waived if their home country does equivalent consolidated supervision to the standard required under the Directive. Wherever possible, we will encourage overseas regulators to achieve the required standards so that the Directive requirement can be waived, and we will not need to use our resources on supervising such groups.

The responsibility of those who manage the affairs of authorised persons.

9. The rules set out the internal control mechanisms and risk management processes that a conglomerate must have at the level of the conglomerate. The Directive requirements are set at a high level, leaving each conglomerate to decide how best to meet them in the most appropriate way – subject to agreement with their co-ordinator. The emphasis is on the conglomerate managing and controlling the risks to it, and being able to demonstrate that this is being done. The Directive requires management to take a key role in regularly reviewing, and approving, the strategies and policies that are designed to do this.
10. The conglomerate rules provide a framework for those managing conglomerates at that level, to ensure that such groups are adequately capitalised and that other key prudential requirements are in place. This includes monitoring large exposures and intra-group transactions at conglomerate level which should be done by extending the existing arrangements that groups have. This should help senior managers to make informed strategic choices.

The principle that a burden or restriction, which is imposed on a person or on the carrying out of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from imposing that burden or restriction.

11. Some of the rules are the result of European Community obligations laid down in the FGD, so we are required to implement these. We have implemented the Directive's requirements with the minimum change to the existing group supervision regimes of the banking and investment sectors. The exception being the harmonisation of the existing group requirements for all investment firms which will generate small change for part of the investment group population. We must do at least the minimum, but believe that in doing so we will, in most circumstances, be proportionate to the benefits conferred by this directive, and set out in the CBA in Annex 3 of CP204.
12. Some of the changes to the insurance group risk rules, needed to implement the FGD requirements, change significantly existing rules and guidance. These are likely to have major cost implications for some groups. The impact of the proposed changes are considered in a cost benefit analysis (in Annex 3 to CP204). We believe this analysis suggests that while the costs arising from the implementation of this framework are potentially significant, the benefits are proportionate.

The desirability of facilitating innovation connected with regulated activities.

13. The FGD was not specifically designed to facilitate innovation, nor were our proposals for investment groups. We think that for both, the effect on the desirability of facilitating innovation will be neutral. Although, it is possible, that if groups have to raise capital, or use existing capital to meet the requirements, this could prevent capital being used for innovative activity.

The international character of financial services and markets, and the desirability of maintaining the competitive position of the United Kingdom.

14. Our rules have been written largely to implement the FGD which, in turn, implements internationally agreed principles for the supervision of such cross-sector groups that operate in the EU. These principles were prompted by the increasingly international nature of financial organisations.
15. The regulatory treatment required under the FGD should increase the consistency of treatment of financial groups between countries (particularly, but not just within, the EU) and between different types of financial groups.
16. In choosing to implement the FGD by minimal change, and by choosing not to anticipate the introduction of the new standards proposed in the EU's Capital

Requirements Directive (CRD), we have had regard to the competitive position of the UK – particularly within Europe. And the Directive requirements on the treatment of cross-sector investments will remove the current competitive disadvantage of UK banking and investment groups, who already comply with this requirement.

17. In addition, the third country requirements of the Directive, requiring consolidated supervision for third country groups active in the UK, should ensure that the competitive position of UK based groups and conglomerates (also subject to consolidated supervision) is maintained against their competitors from outside the EEA.

The need to minimise the adverse effects on competition that may arise from anything done in the discharge of our functions.

18. FGD reduces the existing differences of scope and application of group capital adequacy requirements between different types of group. And changing our rules to implement the Directive requirements reduces competitive inequality between groups, as a result of their group capital adequacy requirements.
19. Where FGD does not fully harmonise between sectors, we have adopted the approach that minimises important differences of treatment between similar types of groups. We therefore state that the capital adequacy calculation method which we will normally require of a financial conglomerate, will be that of its dominant sector.

The desirability of facilitating competition between those who are subject to any form of regulation by us.

20. Overall, for the reasons set out above, we think that our rules for the supervision of investment firm groups and financial conglomerate supervision will create more transparent regimes, promote consistency and provide a solid base from which firms can compete.
21. In addition, the FGD amends the existing group supervision Directives to close gaps in coverage. This should reduce the opportunity for competitive advantage created by the different sectoral regimes. However the levelling of the current competitive distortion generated by the treatment of cross-sector investments will be at the expense of higher costs for the insurance sector, as it brings its current treatment into line with those of the banking and investment sectors.

The most appropriate way for us to meet our regulatory objectives

22. In developing our FGD approach we considered three options:
- **A minimal implementation of the FGD in 2005, building on the existing sourcebook requirements in advance of a more fundamental review (similar to that outlined in CP97) of the group risk requirements after the Basel and the EU Capital Requirements Directive (CRD) have been agreed.**
 - **Implementation of a new group risk module in 2005 in the Integrated Prudential Sourcebook (PSB), along the lines proposed in CP97, with the appropriate links to the existing sourcebooks.** This option would require significant change to the group risk regime now, and creates some awkward cross-referencing back to the IPRUs, particularly for the relevant capital and large exposure requirements. It would also introduce change to the group capital regime, but leave the solo regime as it is, until changed when the full PSB is introduced in 2007. Disconnecting the group and solo capital regimes in this way runs counter to the intention when developing group risk, to build on the solo regimes and maintain consistency between the two.
 - **Implementation of an integrated approach to group risk in 2005 to coincide with the implementation of new capital requirements for banks, building societies, investment firms and the ELMI sectors.** New capital requirements are already being implemented for insurance in 2004 independent of this process. New capital requirements for banks and building societies at this stage, would need to make assumptions about (perhaps incorrectly) the changes needed to implement the CRD (still under negotiation). And prudential capital requirements are heavily inter-linked with other aspects of prudential policy that are also dependent on the outcome of the CRD. These linkages mean it would be difficult to amend the capital requirements on their own, without serious knock on effects on the rest of the prudential regime. This option would, however, implement the integrated approach envisaged when drafting CP97, and would result in a more consistent approach across the sectors than either of the other options.
23. In our view, the first option is the most appropriate way of meeting our statutory obligations. It meant minimal regime change now for banking and investment firms, and groups affected, and is in line with feedback from the industry who have little appetite for change ahead of the major changes that will be introduced in 2007 in the Integrated Prudential Sourcebook. In addition, the full group risk module for the Integrated Prudential Sourcebook can be developed alongside some fundamental decisions to be made on capital and risk concentrations, rather than making assumptions about these

developments (as required in option 3), perhaps incorrectly, with significant and costly consequences for firms.

24. In developing our proposals to harmonise the consolidated supervision rules for investment firms, we considered the following:
 - **to retain the consolidated supervision requirements for investment firms in the existing four sets of rules**, while still making the changes needed to the CAD waiver requirements in each; or
 - **harmonise these four existing sets of rules into one consolidated supervision chapter**. This could also then take account of the outcome of the CP173 consultation.
25. We believe the most appropriate approach is to bring together the four consolidated supervision chapters into one chapter. This has allowed us to simplify and clarify the rules, and to get rid of inconsistencies in the presentation of our current requirements. At present, these make it difficult to understand the rules overall, and would have complicated the introduction of new FGD requirements.
26. In developing our proposals to implement the change the Directive makes to the IGD on the treatment of significant cross-sector investments, the Directive allows two choices:
 - **to value such holdings at zero in the firm's capital adequacy calculation; or**
 - **to include them in a group or adjusted group capital adequacy calculation.**
27. In our view, the second option is the most appropriate way of meeting our statutory obligations as it is:
 - a prudential treatment of cross-sector investments that brings insurance firms into line with the existing treatment for banks and investment firms; and
 - a less penal way of achieving this requirement than the first option, and at a lower cost to firms affected.

Financial Conglomerates: Cooperative decision making by competent authorities and consultation requirements

Type of obligation	Directive reference (Article)	Description	Handbook text
<i>Relevant competent authorities:</i> Decisions needing common agreement	3(3)	Waiver where <i>financial conglomerate</i> fails threshold test 2 but passes threshold test 3	<i>PRU 8.4.13G</i>
	3(4)	Adjustments to the method for identifying a <i>financial conglomerate</i>	<i>PRU 8.4.13G</i>
	3(5)	Adjustments to the method for identifying a <i>financial conglomerate</i> by replacing balance sheet total as a criterion or adding others	<i>PRU 8.4.13G</i>
	3(6)	Disapplying the lower ratios in <i>PRU 8.4.24R</i>	<i>PRU 8.4.13G</i>
	5(4)	Supervision of <i>regulated entities</i> in group structures falling outside definition of <i>financial conglomerate</i>	<i>PRU 8.4.13G</i>
	10(3)	Changing the method of selecting the <i>coordinator</i>	
<i>Relevant competent authorities:</i> Requirement for shared opinion	2(17)	Additional <i>relevant competent authorities</i> may be appointed, where relevant in the opinion of the <i>relevant competent authorities</i>	

<i>Relevant competent authorities:</i> Requirement for consultation between authorities	6(2) (FC)	Appointment of <i>financial conglomerate</i> reporting entity for capital adequacy	SUP 16.7.73R
	6(5)	Exclusion of members of the <i>financial conglomerate</i> from the capital adequacy calculation	PRU 8.4.13G
	7(2) (FC)	Appointment of <i>financial conglomerate</i> reporting entity for <i>risk concentration</i>	SUP 16.7.73R
	8(2) (FC)	Appointment of financial conglomerate reporting entity for <i>intra group transactions</i>	SUP 16.7.73R
	18(1)	Ascertaining whether <i>third country financial conglomerate</i> subject to equivalent supervision	PRU 8.5.3G
	18(3)	Applying alternative measures to <i>third country financial conglomerate</i>	PRU 8.5.9G
	Second paragraph of Annex I (FC)	Choosing which way to calculate capital adequacy	PRU 8.4.21G- PRU 8.4.24G
	Technical principle 1 in Annex I	Consolidation where no capital ties	PRU 8.4.38G and paragraph 5.4 of PRU 8 Ann 1R
	Annex II (FC)	Reporting thresholds for <i>intra group transactions</i> and <i>risk concentration</i>	SUP 16.7.73R
	In cases marked by (FC), there is a duty to consult with the <i>financial conglomerate</i> too.		
<i>Competent authorities:</i> Requirement for consultation between authorities	12(2)	Taking of major sanctions and other regulatory measures	
Notifying other <i>competent authorities</i>	3(3)	Waiver where <i>financial conglomerate</i> fails threshold test 2 but passes threshold test 3	PRU 8.4.13G
	4(1)	Identification of possible <i>financial conglomerate</i>	PRU 8.4.3G
	4(2)	Formal identification of <i>financial conglomerate</i>	PRU 8.4.3G
General duties of cooperation	4(1)	Identification of possible <i>financial conglomerate</i>	PRU 8.4.3G

	11(1)	Coordination arrangements between <i>competent authorities</i>	
	12(1)	General duty of cooperation and exchange of information	
	16 and 17(2)	Coordination of enforcement measures	
Obtaining the consent of the <i>coordinator</i>	18(3)	Applying alternative measures to <i>third country financial conglomerate</i>	
Duty to consult and notify <i>financial conglomerate</i> (so far as not identified earlier in this table).	4(2)	Informing a <i>financial conglomerate</i> that it has been found to be a <i>financial conglomerate</i>	PRU 8.4.13G
	10(3)	Duty to consult <i>financial conglomerate</i> about changing the method of selecting the <i>coordinator</i>	

Near Final text

8.3 GROUP RISK: INSURANCE GROUPS

Application

8.3.1R *PRU 8.3 applies to every insurer, referred to as a firm in this section, that is:*

- (1) *a participating insurance undertaking; or*
- (2) *a member of an insurance group (which is not a participating insurance undertaking).*

8.3.2G *PRU 8.3 applies to a firm:*

- (1) *on a solo basis where that firm is a participating insurance undertaking; and*
- (2) *on a group basis where that firm is a member of an insurance group.*

8.3.3G *For the purposes of PRU 8.3, a firm includes a pure reinsurer, a friendly society and a non-EEA insurer.*

8.3.4R *PRU 8.3 does not apply to:*

- (1) *a Swiss general insurer; or*
- (2) *an EEA-deposit insurer; or*
- (3) *a non-directive friendly society; or*
- (4) *an incoming EEA firm; or*
- (5) *an incoming Treaty firm.*

Purpose

8.3.5G *The purpose of this section is to implement the Insurance Groups Directive on supplementary supervision of firms in an insurance group, as amended by the Financial Groups Directive. The Financial Groups Directive (by amending the Insurance Directives and the Insurance Groups Directive) introduces specific requirements for the treatment of related undertakings of an insurance parent undertaking or a participating insurance undertaking that are credit institutions, investment firms or financial institutions.*

8.3.6G *PRU 8.3 sets out the sectoral rules for insurers for:*

- (1) *firms that are participating insurance undertakings carrying out an adjusted solo calculation as contemplated by PRU 2.1.10R (2);*
- (2) *insurance groups; and*

(3) *insurance conglomerates.*

8.3.7G For a *firm* that is a *participating insurance undertaking*, the rules in PRU 8.3 set out the minimum capital adequacy requirements for the *firm* itself. A *firm* that satisfies the test in PRU 8.3.10R in relation to its *group capital resources* is deemed by PRU 2.1.10R(2) to be in compliance with the capital adequacy requirement set out in PRU 2.1.10R(1).

Requirement to calculate GCR and GCRR

8.3.8R A *firm* must on a regular basis calculate the *group capital resources (GCR)* and *group capital resources requirement (GCRR)* of each *undertaking* referred to in PRU 8.3.12R.

Requirement to maintain group capital

8.3.9R Where a *firm* is the *undertaking* referred to in PRU 8.3.12R (1)(c) or PRU 8.3.12R (2), it must maintain at all times *tier one capital resources* and *tier two capital resources* of such an amount that its *group capital resources* are equal to or exceed its *group capital resources requirement*.

8.3.10R (1) Subject to PRU 8.3.22R, a *firm* otherwise must ensure that at all times its *capital resources* are of such an amount that the *group capital resources* of each *undertaking* referred to in PRU 8.3.12R (excluding those referred to in PRU 8.3.9R) are equal to or exceed that *undertaking's group capital resources requirement*.

(2) The requirement in (1) only applies in respect of the *group capital resources* of a *firm's ultimate EEA insurance parent undertaking* [from the first day of the *firm's* financial year beginning on 1 January 2005 or during that calendar year].

8.3.11G *Principle 4* requires a *firm* to maintain adequate financial resources, taking into account any activity of other members of the *group* of which the *firm* is a member. PRU 8.3 sets out provisions that deal specifically with the way the activities of other members of the *group* should be taken into account. This results in the *firm* being required, subject to PRU 8.3.10R (2), to hold sufficient capital resources so that the *group capital resources* are at least equal to the *group capital resources requirement*. However, the adequacy of the *group capital resources* needs to be assessed both by the *firm* and the *FSA*. *Firms* are required to carry out an assessment of the adequacy of their financial resources (PRU 1.2.26 R) and the *FSA* will review this and may provide individual guidance on the amount and quality of *capital resources* the *FSA* considers adequate. As part of such reviews, the *FSA* may also form a view on the appropriateness of the *group capital resources requirement* and *group capital resources*. Where necessary, the *FSA* may also give individual guidance on the *capital resources* a *firm* should hold in order to comply with *Principle 4* expressed by reference to PRU 8.3.9R and PRU 8.3.10R.

Scope - undertakings whose group capital is to be calculated and maintained

- 8.3.12R The *undertakings* referred to in *PRU 8.3.8R*, *PRU 8.3.9R* and *PRU 8.3.10R* are:
- (1) for any *firm* that is not within (2), each of the following:
 - (a) its *ultimate insurance parent undertaking*;
 - (b) its *ultimate EEA insurance parent undertaking* (if different);
and
 - (c) the *firm* itself, if it is a *participating insurance undertaking*;
and
 - (2) the *firm* itself, where the *firm* is a *participating insurance undertaking* and is:
 - (a) a *pure reinsurer*; or
 - (b) a *non-EEA insurer*; or
 - (c) a *friendly society*.
- 8.3.13G Article 3(3) of the *Insurance Groups Directive* allows an *undertaking* to be excluded from supplementary supervision if:
- (1) its head office is in a non-*EEA State* where there are legal impediments to the transfer of the necessary information; or
 - (2) in the opinion of the *competent authority* responsible for exercising supplementary supervision, having regard to the objectives of supplementary supervision:
 - (a) its inclusion would be inappropriate or misleading; or
 - (b) it is of negligible interest.
- 8.3.14G If an application is made for waiver, it is the policy of the *FSA* to consider the effect, in the circumstances described in *PRU 8.3.13G*, of granting a *waiver* allowing the exclusion of a *related undertaking* from the calculation of *group capital resources* and the *group capital resources requirement* required by *PRU 8.3.8R*.
- 8.3.15G Examples of *related undertakings* which may be excluded from supplementary supervision by Article 3(3) of the *Insurance Groups Directive* include *insurance holding companies* in the *insurance group* that are not the

ultimate insurance parent undertaking or, if different, the *ultimate EEA insurance parent undertaking* of a *firm*.

- 8.3.16G If more than one member of the *insurance group* is to be excluded in the circumstances described in *PRU 8.3.13G (2)(b)*, they may only be excluded if, considered together, they are of negligible interest in the context of the *insurance group*.
- 8.3.17G When giving a waiver in the circumstances described in *PRU 8.3.13G*, the *FSA* may impose a condition requiring the *firm* to provide information about any member of the *insurance group* excluded pursuant to a *waiver* granted in the circumstances described in *PRU 8.3.13G*.

Optional alternative method of calculation for firms subject to supplementary supervision by another EEA competent authority

- 8.3.18R If the *competent authority* in an *EEA State* other than the *United Kingdom* has agreed to be the *competent authority* responsible for exercising supplementary supervision of an *insurance group* of which a *firm* is a member under Article 4(2) of the *Insurance Groups Directive*, the *firm* may prepare the calculations required under *PRU 8.3.8R* in relation to the *ultimate EEA insurance parent undertaking* in accordance with the requirements of supplementary supervision in that *EEA State*.
- 8.3.19G For the purposes of *PRU 8.3.18R*, if the *FSA* has agreed with the *competent authority* in an *EEA State* other than the *United Kingdom* in accordance with *PRU 8.3.18R*, the *FSA* shall notify the *firm*.

Non-EEA ultimate insurance parent undertakings

- 8.3.20R Where the *ultimate insurance parent undertaking* of a *firm* has its head office in a non-*EEA State*, the *firm* may:
- (1) calculate the *group capital resources* and the *group capital resources requirement* of its *ultimate insurance parent undertaking* in accordance with accounting practice applicable for the purposes of the regulation of *insurance undertakings* in the state or territory of the head office of the *ultimate insurance parent undertaking* adapted as necessary to apply the general principles set out in Annex I (1) paragraphs B, C and D of the *Insurance Groups Directive*; and
 - (2) elect (see *PRU 8.3.21R*) to carry out the calculation referred to in (1) in accordance with the accounting consolidation method set out in Annex I (3) of the *Insurance Groups Directive*.
- 8.3.21R A *firm* may elect to use the calculation method referred to in *PRU 8.3.20R (2)* if it has made the election by written notice to the *FSA* in a way that complies with the requirements for written notice in *SUP 15.7*.

8.3.22R *PRU 8.3.10R does not apply in respect of the group capital resources of a firm's ultimate insurance parent undertaking if that ultimate insurance parent undertaking has its head office in a non-EEA State.*

Proportional holdings

8.3.23R Subject to *PRU 8.3.25R* and *PRU 8.3.26R*, when calculating *group capital resources* and the *group capital resources requirement* of an *undertaking* in *PRU 8.3.12R*, a *firm* must only take the relevant proportion of the following items ("calculation items") into account:

- (1) the *solo capital resources* of a *regulated related undertaking*;
- (2) the assets of a *regulated related undertaking* which are required to be deducted as part of the calculation of *group capital resources*; and
- (3) the *individual capital resources requirement* of a *regulated related undertaking*.

8.3.24R In *PRU 8.3.23R*, the relevant proportion is either:

- (1) the proportion of the total number of issued *shares* in the *regulated related undertaking* held, directly or indirectly, by the *undertaking* in *PRU 8.3.12R*; or
- (2) where a *consolidation Article 12(1) relationship* exists between *related undertakings* within the *insurance group*, such proportion as the *FSA* determines in accordance with Article 28(5) of the *Financial Groups Directive* and Regulation 15 of the *Financial Groups Directive Regulations*.

8.3.25R Where the *undertaking* in *PRU 8.3.12R* is a *firm*, if the *individual capital resources requirement* of a *regulated related undertaking* that is a *subsidiary undertaking* and not a *firm* exceeds the *solo capital resources* of that *undertaking* less the amount calculated in *PRU 8.3.66R* (3) (if any), the full amount of the calculation items of that *regulated related undertaking* less the amount in *PRU 8.3.66R* (3) shall be taken into account in the calculation of *group capital resources* and the *group capital resources requirement*.

8.3.26R Except where *PRU 8.3.25R* applies, if the *individual capital resources requirement* of a *regulated related undertaking* that is a *subsidiary undertaking* of the *undertaking* in *PRU 8.3.12R* exceeds its *solo capital resources*, then the full amount of the calculation items of that *regulated related undertaking* shall be taken into account in the calculation of *group capital resources* and the *group capital resources requirement*.

Calculation of the GCRR

8.3.27R Subject to *PRU 8.3.19R* and *PRU 8.3.20R*, a *firm* must calculate the *group capital resources requirement* of an *undertaking* in *PRU 8.3.12R* as the sum of

the *individual capital resources requirement* of that *undertaking* and the *individual capital resources requirement* of each of its *regulated related undertakings*.

8.3.28R For the purposes of *PRU 8.3*, an *individual capital resources requirement* is:

- (1) in respect of a *firm* that is not within (2):
 - (a) its *capital resources requirement* calculated in accordance with *PRU 2.1*; less
 - (b) where the *capital resources requirements* of both the *firm* and its *insurance parent undertaking* that is a *firm* include *with-profits insurance capital components*, any element of double-counting that may arise from the aggregation of the *individual capital resources requirements* for the purposes of *PRU 8.3.27R*.
- (2) in respect of a *firm* that is either a *pure reinsurer* or whose main business otherwise consists of *reinsurance*, and whose head office is in the *United Kingdom*, the *capital resources requirement* that would apply to the *firm* in accordance with *PRU 2.1* if its *insurance business* was not restricted to *reinsurance*;
- (3) in respect of an *insurance undertaking* that is not within (1) or (2) and whose main business is *reinsurance* and whose head office is in a *designated State or territory*, either:
 - (a) the *proxy capital resources requirement* that would apply to it if, in connection with its *reinsurance* activities, the *permissions* on the basis of which that *proxy capital resources requirement* is calculated were *permissions* to carry on *insurance business* that is not restricted to *reinsurance*; or
 - (b) the *solo capital resources requirement* that would apply to it if, in connection with its *reinsurance* activities, the *insurance undertaking* were a *regulated insurance entity* whose *insurance business* is not restricted to *reinsurance* for the purposes of calculating the *solo capital resources requirement* in accordance with the relevant *sectoral rules* of the *designated State or territory*;
- (4) in respect of an *insurance undertaking* that is not within (1) to (3) and whose main business is *reinsurance*, the *proxy capital resources requirement* that would apply to it if, in connection with its *reinsurance* activities, the *permissions* on the basis of which that *proxy capital resources requirement* is calculated were *permissions* to carry on *insurance business* that is not restricted to *reinsurance*;

- (5) in respect of an *EEA insurer*, the equivalent of the *capital resources requirement* as calculated in accordance with the applicable requirements in its *Home State*;
- (6) in respect of an *insurance undertaking* that is not within (1) to (5) and whose head office is in a *designated State or territory*, either :
 - (a) the *solo capital resources requirement* applicable to it in that *designated State or territory*; or
 - (b) its *proxy capital resources requirement*;
- (7) in respect of an *insurance undertaking* that is not within (1) to (6), its *proxy capital resources requirement*;
- (8) in respect of a *regulated entity* with its head office in the *EEA* (excluding an *insurance undertaking*), its *solo capital resources requirement* calculated in accordance with the *sectoral rules* for the *financial sector* applicable to it in the *EEA State* in which it has its head office;
- (9) in respect of a *regulated entity* not within (8) (excluding an *insurance undertaking*), its *solo capital resources requirement*;
- (10) in respect of an *asset management company*, the *solo capital resources requirement* that would apply to it if, in connection with its activities, it were treated as an *investment firm* for the purposes of calculating the *solo capital resources requirement*;
- (11) in respect of a *financial institution* that is not a *regulated entity* (including a *financial holding company*), the *solo capital resources requirement* that would apply to it if, in connection with its activities, it were treated as being within the *banking sector*; and
- (12) in respect of an *insurance holding company*, zero.

8.3.29G

The *Insurance Groups Directive* defines reinsurers in terms of the 'main business' they carry on. Under the directive, the individual capital resources requirements for reinsurers (including those whose head office is in the *United Kingdom*) are to be calculated on the basis of requirements analogous to those applicable to direct insurers (that is, firms carrying on insurance business that is not restricted to *reinsurance*). Although *firms* that are *pure reinsurers* are already subject to *PRU*, there are a number of respects in which the capital regime that applies to them differs from that applicable to *firms* who are direct insurers. The effect of *PRU* 8.3.28R (2) to (4) is to calculate the *individual capital resources requirement* for all reinsurers as if they were carrying on direct insurance. This applies to:

- (1) *pure reinsurers* whose head office is in the *United Kingdom*;

- (2) *firms* whose head office is in the *United Kingdom* and whose main business is *reinsurance* (because a *firm* that is not a *pure reinsurer* with their business restricted to *reinsurance* may nevertheless in principle still have *reinsurance* as its main business);
- (3) reinsurers whose head office is in another *EEA State*;
- (4) reinsurers whose head office is in a *designated State or territory* (other than an *EEA State*); and
- (5) reinsurers whose head office is outside the *EEA*.

Calculation of GCR

8.3.30R For the purposes of *PRU* 8.3.8R and subject to *PRU* 8.3.19R and *PRU* 8.3.20R, a *firm* must calculate the group capital resources of an *undertaking* in *PRU* 8.3.12R in accordance with the table in *PRU* 8.3.35R, subject to the limits in *PRU* 8.3.37R.

8.3.31R For the purposes of *PRU* 8.3, the following expressions, when used in relation to an *undertaking* in *PRU* 8.3.12R or a *regulated related undertaking*, are applied to that *undertaking* as if it were a *firm* and construed making the necessary changes for the purposes of the *sectoral rules* applicable to that *undertaking*:

- (1) *tier one capital resources*;
- (2) *tier two capital resources*;
- (3) *upper tier two capital resources*;
- (4) *lower tier two capital resources*;
- (5) *innovative tier one capital resources*; and
- (6) *core tier one capital*.

8.3.32R For the purposes of *PRU* 8.3.31R, the *sectoral rules* applicable to:

- (1) an *asset management company* are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as an *investment firm*; and
- (2) a *financial institution* that is not a *regulated entity* are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as being within the *banking sector*.

8.3.33R (1) In calculating *group capital resources*, a *firm* must exclude the restricted assets of a *regulated related undertaking* except insofar as

those assets are available to meet the *individual capital resources requirement* of that *regulated related undertaking*.

- (2) In (1), "restricted assets" means assets of a *regulated related undertaking* which are subject to a legal restriction or other requirement having the effect that those assets cannot be transferred or otherwise made available to another *regulated related undertaking* for the purposes of meeting its *individual capital resources requirement* without causing a breach of that legal restriction or requirement.

8.3.34G For the purposes of *PRU 8.3.33R*, in respect of an *insurance undertaking* that is a member of an *insurance group*, the assets of a *long term insurance fund* are restricted assets within the meaning of *PRU 8.3.33R*. Any excess of assets over liabilities in a *long term insurance fund* may only be included in the calculation of the *group capital resources* up to the amount of the *capital resources requirement* related to that *long term insurance fund*.

8.3.35R Table: Group capital resources

	Stage	Related text
Total group tier one capital	A	<i>PRU 8.3.39R</i>
Total group tier two capital	B	<i>PRU 8.3.41R</i>
Group capital resources before deductions	$C=(A+B)$	
Total deductions of inadmissible assets	D	<i>PRU 8.3.50R</i>
Total deductions under the requirement deduction method from group capital resources	E	<i>PRU 8.3.53R</i>
Total deductions of non-transferable capital*	F	<i>PRU 8.3.56R</i>
Deduction of assets in excess of market and counterparty exposure limits*	G	<i>PRU 8.3.62R</i>
Group capital resources	$H=(C-(D+E+F^*+G^*))$	
* = section (F) of the table (the deductions for non-transferable capital) and section (G) of the table (assets in excess of market and counterparty exposure limits) only apply and are		

required to be calculated for the purposes of the adjusted solo calculation of an *undertaking* in PRU 8.3.12R that is a *participating insurance undertaking*.

Calculation of GCR - Limits on the use of different forms of capital

8.3.36G As the various components of capital differ in the degree of protection that they offer the *insurance group*, restrictions are placed on the extent to which certain types of capital are eligible for inclusion in the *group capital resources* of the *undertaking* in PRU 8.3.12R. These restrictions are set out in PRU 8.3.37R.

8.3.37R (1) For the purposes of PRU 8.3.9R and PRU 8.3.10R, a *firm* must ensure that at all times its *tier one capital resources* and *tier two capital resources* are of such an amount that the *group capital resources* of the *undertaking* in PRU 8.3.12R comply with the following limits:

- (a) $(P - Q) \times \frac{1}{2} (R - S)$;
- (b) $(P - Q + T) \times (R - S - U)$;
- (c) $(P - Q + T - W) \times \frac{3}{4} (R - S)$;
- (d) $V \times \frac{1}{2} P$;
- (e) $Q \leq 15\%$ of P ;
- (f) $T \leq P$; and
- (g) $W \leq \frac{1}{2} P$

(2) For the purposes of (1):

- (a) P is the *total group tier one capital* of the *undertaking* in PRU 8.3.12R;
- (b) Q is the sum of the *innovative tier one capital resources* calculated in accordance with PRU 8.3.44R;
- (c) R is the *group capital resources requirement* of the *undertaking* in PRU 8.3.12R;
- (d) S is the sum of all the *with-profits insurance capital components* of an *undertaking* in PRU 8.3.12R that is a *firm* and each of its *regulated related undertakings* that is a *firm*;
- (e) T is the *total group tier two capital* of the *undertaking* in PRU 8.3.12R;

- (f) U is the sum of all the *resilience capital requirements* of an *undertaking* in *PRU 8.3.12R* that is a *firm* and each of its *regulated related undertakings* that is a *firm*;
- (g) V is the sum of all the *core tier one capital* calculated in accordance with *PRU 8.3.46R*; and
- (h) W is the sum of the *lower tier two capital resources* calculated in accordance with *PRU 8.3.48R*.

8.3.38G Any *innovative tier one capital resources* that exceed the limit in *PRU 8.3.37R (1)(e)* can count towards the *total group tier two capital* calculated in accordance with *PRU 8.3.41R*.

Calculation of GCR – Total group tier one capital

8.3.39R For the purposes of *PRU 8.3.35R*, the *total group tier one capital* of an *undertaking* in *PRU 8.3.12R* is the sum of:

- (1) the *tier one capital resources* of the *undertaking* in *PRU 8.3.12R*; and
- (2) the *tier one capital resources* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in *PRU 8.3.40R*.

8.3.40R The deduction referred to in *PRU 8.3.39R* is the sum of:

- (1) the book value of the investment by the *undertaking* in *PRU 8.3.12R* in the *tier one capital resources* of each of its *related undertakings* that is a *regulated related undertaking*; and
- (2) the book value of the investments by *related undertakings* of the *undertaking* in *PRU 8.3.12R* in the *tier one capital resources* of each of its *related undertakings* that is a *regulated related undertaking*.

Calculation of GCR – Total group tier two capital

8.3.41R For the purposes of *PRU 8.3.35R*, the *total group tier two capital* of an *undertaking* in *PRU 8.3.12R* is the sum of:

- (1) the *upper tier two capital resources* and the *lower tier two capital resources* of that *undertaking*; and
- (2) the *upper tier two capital resources* and the *lower tier two capital resources* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in *PRU 8.3.42R*.

8.3.42R The deduction referred to in *PRU 8.3.41R* is the sum of:

- (1) the book value of the investments by the *undertaking* in *PRU 8.3.12R* in the *upper tier two capital resources* and the *lower tier two capital resources* of each of its *related undertakings* that is a *regulated related undertaking*; and
- (2) the book value of the investments by *related undertakings* of the *undertaking* in *PRU 8.3.12R* in the *upper tier two capital resources* and the *lower tier two capital resources* of each of its *related undertakings* that is a *regulated related undertaking*.

8.3.43G For the purposes of *PRU 8.3.41R* (2), the limits in *PRU 2.2.23R* apply to the *upper tier two capital resources* and the *lower tier two capital resources* of any *regulated related undertaking* that is a *firm*. Similar limits may apply to other *related undertakings* under the relevant *sectoral rules*.

Calculation of GCR – Innovative tier one capital resources, lower tier two capital resources and core tier one capital

8.3.44R For the purposes of *PRU 8.3.37R* (2)(b), the *innovative tier one capital resources* is the sum of:

- (1) the *innovative tier one capital resources* of the *undertaking* in *PRU 8.3.12R*; and
- (2) the *innovative tier one capital resources* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in *PRU 8.3.45R*.

8.3.45R The deduction referred to in *PRU 8.3.44R* is the sum of:

- (1) the book value of the investments by the *undertaking* in *PRU 8.3.12R* in the *innovative tier one capital resources* of each of its *related undertakings* that is a *regulated related undertaking*; and
- (2) the book value of the investments by *related undertakings* of the *undertaking* in *PRU 8.3.12R* in the *innovative tier one capital resources* of each of its *related undertakings* that is a *regulated related undertaking*.

8.3.46R For the purposes of *PRU 8.3.37R* (2)(g), the *core tier one capital* is the sum of:

- (1) the *core tier one capital* of the *undertaking* of *PRU 8.3.12R*; and
- (2) the *core tier one capital* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in *PRU 8.3.46R*.

8.3.47R The deduction referred to in *PRU 8.3.46R* is the sum of:

- (1) the book value of the investments by the *undertaking* in *PRU 8.3.12R* in the *core tier one capital* of each of its *related undertakings* that is a *regulated related undertaking*; and
- (2) the book value of the investments by *related undertakings* of the *undertaking* in *PRU 8.3.12R* in the *core tier one capital* of each of its *related undertakings* that is a *regulated related undertaking*.

8.3.48R For the purposes of *PRU 8.3.37R* (2)(h), the *lower tier two capital resources* is the sum of:

- (1) the *lower tier two capital resources* of the *undertaking* in *PRU 8.3.12R*; and
- (2) the *lower tier two capital resources* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in *PRU 8.3.49R*.

8.3.49R The deduction referred to in *PRU 8.3.48R* is the sum of:

- (1) the book value of the investments by the *undertaking* in *PRU 8.3.12R* in the *lower tier two capital resources* of each of its *related undertakings* that is a *regulated related undertaking*; and
- (2) the book value of the investments by *related undertakings* of the *undertaking* in *PRU 8.3.12R* in the *lower tier two capital resources* of each of its *related undertakings* that is a *regulated related undertaking*.

Calculation of GCR – Inadmissible assets

8.3.50R For the purpose of *PRU 8.3.35R*, a *firm* must deduct from the group capital resources before deduction of the *undertaking* in *PRU 8.3.12R* (calculated at stage C in the table in *PRU 8.3.35R*) the value of all assets of the *undertaking* in *PRU 8.3.12R* and each of its *regulated related undertakings* that are not admissible assets as set out in *PRU 8.3.51R*.

8.3.51R For the the purposes of *PRU 8.3.50R*, an asset is not an admissible asset if:

- (1) in respect of a *regulated related undertaking* or *undertaking* in *PRU 8.3.12R* that is a *firm*, it is not an *admissible asset* as listed in *PRU 2.2 Annex 1R*;
- (2) in respect of a *regulated related undertaking* or *undertaking* in *PRU 8.3.12R* that is not a *firm*, it is an asset of the *undertaking* that is not admissible for the purpose of calculating that *undertaking's solo capital resources* in accordance with the *sectoral rules* applicable to it.

8.3.52R For the purposes of *PRU 8.3.51R* (2), the *sectoral rules* applicable to:

- (1) an *asset management company* are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as an *investment firm*; and
- (2) a *financial institution* that is not a *regulated entity* are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as being within the *banking sector*.

Calculation of GCR – Deductions under requirement deduction method from group capital resources

- 8.3.53R For the purposes of *PRU 8.3.35R*, a *firm* must deduct from the group capital resources before deduction of an *undertaking* in *PRU 8.3.12R* (calculated at stage C in the table in *PRU 8.3.35R*) the sum of the value of the direct or indirect investments by the *undertaking* in *PRU 8.3.12R* in each of its *related undertakings* which is an *ancillary services undertaking*, calculated in accordance with *PRU 8.3.54R*.
- 8.3.54R The value of an investment in an *undertaking* referred to in *PRU 8.3.53R* is the higher of the book value of the direct or indirect investment by the *undertaking* in *PRU 8.3.12R* and the notional capital resources requirement of that *undertaking*.
- 8.3.55R For the purposes of *PRU 8.3.54R*, the notional capital resources requirement is:
- (1) for an *ancillary insurance services undertaking*, zero;
 - (2) for any other *ancillary services undertaking*, the *capital resources requirement* that would apply to that *undertaking*, if it were a *regulated related undertaking*, in accordance with the *sectoral rules* applicable to a *regulated related undertaking* whose activities are closest in nature and scope to the activities of that *undertaking*.

Calculation of GCR – Deductions of non-transferable capital

- 8.3.56R Where the *undertaking* in *PRU 8.3.12R* is a *participating insurance undertaking*, the *firm* must, for the purposes of *PRU 8.3.35R*, deduct from its group capital resources before deduction (calculated at stage C in the table in *PRU 8.3.35R*) the sum of the non-transferable capital of each of its *regulated related undertakings* that is an *insurance undertaking*, calculated in accordance with *PRU 8.3.58R*.
- 8.3.57G The purpose of *PRU 8.3.56R* is to ensure that, where the *undertaking* in *PRU 8.3.12R* is a *firm*, *group capital resources* are not overstated by the inclusion of capital that, although surplus to the requirements of the relevant *related undertaking*, cannot practically be transferred to support requirements arising elsewhere in the group. Therefore, non-transferable surplus capital in a *regulated related undertaking* that is an *insurance undertaking* is deducted in

arriving at *group capital resources*. Surplus capital is regarded as transferable only to the extent that:

- (1) it is represented by audited reserves;
- (2) that can be paid by way of dividend; and
- (3) without breaching the *regulated related undertaking's* own limits on the use of different forms of capital.

- 8.3.58R
- (1) For the purposes of *PRU 8.3.56R*, the non-transferable capital of a *regulated related undertaking* that is an *insurance undertaking* is calculated by deducting B from A where:
 - (a) A is the *regulatory surplus value* of that *insurance undertaking*; and
 - (b) B is the transferable capital of that *undertaking*.
 - (2) If A minus B is negative, the non-transferable capital is zero.

- 8.3.59R
- For the purposes of *PRU 8.3.58R (1)(b)*, the transferable capital is, subject to *PRU 8.3.60R*, the lower of:
- (1) the amount that can be paid by way of dividend to the *insurance parent undertaking* or *participating insurance undertaking* of that *insurance undertaking* under applicable company law without breaching the *individual capital resources requirement* of the *insurance undertaking*; and
 - (2) that part of the *tier one capital resources* of the *insurance undertaking* that comprises audited reserves.

8.3.60R

The *tier one capital resources* of the *insurance undertaking* in *PRU 8.3.59R*, after deduction of transferable capital, must not be equal to less than 50% of the *individual capital resources requirement* of that *undertaking* less any *with-profits insurance capital component* of that *undertaking*.

8.3.61G

Examples of transferable and non-transferable capital:

Example 1

Share capital	Audited reserves	Tier two	Requirement
30	20 (all distributable)	40	50

Transferable capital = 20*

Non-transferable capital = $((30 + 20 + 40 - 50) - 20) = 20$
 Surplus capital = 20 (transferable Tier 1) + 20 (non-transferable Tier 2) = 40

- * (i) The audited reserves are all distributable (under criteria in *PRU* 8.3.59R(1) & (2)) and therefore count as transferable capital.
- * (ii) *PRU* 8.3.59R, tier one capital resources, after deduction of transferable capital of 20, must be at least 50% of the capital resources requirement (25) in accordance with *PRU* 8.3.60R. The tier one capital resources amount to 30 (50-20) and therefore all the 20 of capital identified in (i) is transferable.

Example 2

Share capital	Audited reserves	Tier two	Requirement
10	20 (all distributable)	20	30

Transferable capital = 20 (maximum 15)*
 Non-transferable capital = $(10 + 20 + 20 - 30) - 15 = 5$
 Surplus capital = 15 (transferable Tier 1) + 5 (non-transferable Tier 2) = 20

- * (i) the audited reserves are all distributable (under the criteria in *PRU* 8.3.59R(1) & (2)) and therefore count as transferable capital.
- * (ii) however, in this example, tier one capital resources (30), after deduction of transferable capital of 20, amount to only 10, which is less than the limit in *PRU* 8.3.60R (50% of the capital resources requirement = 15). Therefore, a further 5 of the audited reserves must be held back so limiting the transferable capital to 15.

Calculation of GCR – Assets in excess of market and counterparty exposure limits

- 8.3.62R Where the *undertaking* in *PRU* 8.3.12R is a *participating insurance undertaking*, the *firm* must deduct from its group capital resources before deduction (calculated at stage C in the table in *PRU* 8.3.35R) the assets in excess of market and counterparty exposure limits calculated in accordance with *PRU* 8.3.66R.
- 8.3.63G For the purposes of *PRU* 8.3.35R, where the *undertaking* in *PRU* 8.3.12R is a *participating insurance undertaking*, the investments referred to in *PRU* 8.3.39R and *PRU* 8.3.41R are not subject to the market and counterparty exposure limits.
- 8.3.64R The *firm* (A) must, subject to *PRU* 8.3.65R, include in the calculation in *PRU* 8.3.66R each *related undertaking* (B) that is:

- (1) a *regulated related undertaking*; or
- (2) a *related undertaking* where the *firm* has elected to value the *shares* held in that *undertaking* by the *firm* in accordance with *PRU 1.3.35R* for the purposes of calculating the *tier one capital resources* of the *firm*.

8.3.65R The *related undertakings* in *PRU 8.3.64R* need only be included in the calculation in *PRU 8.3.66R* if:

- (1) where B is a *regulated related undertaking*, the *solo capital resources* of that *undertaking* exceed its *individual capital resources requirement*; or
- (2) where B is an *undertaking* in *PRU 8.3.64R* (2), its assets that fall within one or more of the categories in *PRU 2.2 Annex 1R* exceed its accounting liabilities.

8.3.66R A's assets in excess of the market and counterparty exposure limits are calculated as follows:

- (1) Subject to (2), a *firm* must apply the market and counterparty exposure limits in *PRU 3.2* to:
 - (a) where B is a *firm*, the *admissible assets* of B;
 - (b) where B is a *regulated related undertaking* that is not a *firm*, the assets of that *undertaking* less those assets identified in *PRU 8.3.51R* (2) as not being admissible assets.
- (2) The market and counterparty exposure limits do not need to be applied to an *undertaking* in *PRU 8.3.64R* (2).
- (3) Where the assets of B in *PRU 8.3.66R* (1) exceed the limits in *PRU 3.2.25R*(3), the assets of B in excess of the limits must be deducted by the *firm* from B's *solo capital resources* for the purposes of *PRU 8.3.25R*.
- (4) After the application of (1) and (2), the surplus assets of B are aggregated with the *admissible assets* of A, where the surplus assets of B are:
 - (a) where B is a *firm*, the *admissible assets* of B that represent the amount by which the *capital resources* of B exceed its *capital resources requirement*, subject to *PRU 8.3.69R*, and limited to the amount of transferable capital calculated in accordance with *PRU 8.3.59R*;

- (b) where B is a *regulated related undertaking* that is not a *firm*, the assets of the *undertaking* in *PRU 8.3.66R(1)(b)* that represent the amount by which the *solo capital resources* of B exceed its *individual capital resources requirement* and, where B is an *insurance undertaking* that is not a *firm*, limited to the amount of transferable capital calculated in accordance with *PRU 8.3.59R*; and
- (c) where B is an *undertaking* in *PRU 8.3.64R(2)*, the assets of the *undertaking* which represent those assets that fall within one or more of the categories in *PRU 2.2 Annex 1R* which exceed its accounting liabilities.

(5) The market and counterparty exposure limits are then applied to the aggregate of A's *admissible assets* and the surplus assets in *PRU 8.3.66R(4)*.

8.3.67R The *firm* (A) must then deduct the amount by which the *admissible assets* aggregated in accordance with *PRU 8.3.66R (5)* exceed the market and counterparty exposure limits from A's group capital resources before deduction (calculated at stage C in the table in *PRU 8.3.35R*) in accordance with *PRU 8.3.62R*.

8.3.68R In relation to any of its *regulated related undertakings* that is not a *firm*, A may modify the calculation in *PRU 8.3.66R* by:

- (1) omitting the calculation in *PRU 8.3.66R (1)* and (3); and
- (2) aggregating all of the assets of B identified in *PRU 8.3.66R(1) (b)* as *admissible assets* with the *admissible assets* of A in *PRU 8.3.66R (4)*.

8.3.69R The *admissible assets* of either A or B that are part of a *long-term insurance fund* of A or B are excluded for the purposes of the calculation in *PRU 8.3.66R* except insofar as those assets are available to meet the liabilities and *capital resources requirement* of that *long-term insurance fund*.

8.3.70R If B is itself either a *participating insurance undertaking* or an *insurance parent undertaking*, the *admissible assets* of B for the purposes of *PRU 8.3.66R(1)* must be calculated as in *PRU 8.3.67R* but as if B were A.

Amendments to the Glossary

Part I (NEW DEFINITIONS)

For the purposes of *PRU* 8.3 and this policy statement, these defined terms represent new definitions to be added to the Handbook Glossary of Definitions when *PRU* 8.3 is made. The definitions reproduced in this part have been consulted on as part of CP204 and include definitions, with some amendments, contained in PS 04/16.

<i>ancillary services undertaking</i>	an <i>ancillary insurance services undertaking</i> , an <i>ancillary banking services undertaking</i> or an <i>ancillary investment services undertaking</i> .
<i>capital resources</i>	in relation to a <i>firm</i> , the <i>firm's</i> capital resources as calculated in accordance with <i>PRU</i> 2.2.12R.
<i>capital resources requirement</i>	an amount of <i>capital resources</i> that a <i>firm</i> must hold as set out in <i>PRU</i> 2.1.15R to <i>PRU</i> 2.1.21R.
<i>EEA insurance parent undertaking</i>	an <i>insurance parent undertaking</i> that has its head office in the <i>United Kingdom</i> or another <i>EEA State</i> .
<i>EEA insurer</i>	an <i>insurer</i> , other than a <i>pure reinsurer</i> or a <i>non-directive insurer</i> , whose head office is in any <i>EEA State</i> except the <i>United Kingdom</i> and which has received <i>authorisation</i> under article 4 of the <i>Consolidated Life Directive</i> or article 6 of the <i>First Non-Life Directive</i> from its <i>Home State Regulator</i> .
<i>Group capital resources</i> (or <i>GCR</i>)	in relation to an <i>undertaking</i> in <i>PRU</i> 8.3.12R, that <i>undertaking's</i> group capital resources as calculated in accordance with <i>PRU</i> 8.3.30R.
<i>Group capital resources requirement</i> (or <i>GCCR</i>)	in relation to an <i>undertaking</i> in <i>PRU</i> 8.3.12R, that <i>undertaking's</i> group capital resources requirement as calculated in accordance with <i>PRU</i> 8.3.27R.
<i>innovative tier one capital resources</i>	the amount of <i>capital resources</i> at stage C of the table in <i>PRU</i> 2.2.14R.
<i>individual capital resources requirement</i>	has the meaning in <i>PRU</i> 8.3.28R
<i>insurance group</i>	(1) an <i>insurance parent undertaking</i> and its <i>related undertakings</i> ; or (2) a <i>participating insurance undertaking</i> (not within 1) and its <i>related undertakings</i> .
<i>insurance parent undertaking</i>	a <i>parent undertaking</i> which is:

	<ol style="list-style-type: none"> (1) a <i>participating insurance undertaking</i> which has a <i>subsidiary undertaking</i> that is an <i>insurance undertaking</i>; or (2) an <i>insurance holding company</i> which has a <i>subsidiary undertaking</i> which is an <i>insurer</i>; or (3) an <i>insurance undertaking</i> (not within (1)) which has a <i>subsidiary undertaking</i> which is an <i>insurer</i>.
<i>long term insurance fund</i>	a fund maintained under <i>PRU 7.6.21R</i> .
<i>lower tier two capital resources</i>	the sum calculated at stage H of the calculation in <i>PRU 2.2.14R</i> .
<i>minimum capital requirement</i>	an amount of <i>capital resources</i> that a <i>firm</i> must hold as set out in <i>PRU 2.1.22R</i> and <i>PRU 2.1.23R</i> .
<i>participating insurance undertaking</i>	<p>an <i>insurer</i> which has:</p> <ol style="list-style-type: none"> (1) a <i>subsidiary undertaking</i> that is an <i>insurance undertaking</i>; or (2) holds a <i>participation</i> in an <i>insurance undertaking</i>; or (3) is linked to an <i>insurance undertaking</i> by a <i>consolidation article 12(1) relationship</i>.
<i>participating undertaking</i>	an <i>undertaking</i> which is either a <i>parent undertaking</i> or other <i>undertaking</i> which holds a <i>participation</i> or an <i>undertaking</i> linked with another <i>undertaking</i> by a <i>consolidated Article 12(1) relationship</i> .
<i>proxy capital resources requirement</i>	the <i>minimum capital requirement</i> to which an <i>undertaking</i> would have been subject if it had a <i>permission</i> for each activity it carries on anywhere in the world, so far as that activity is a <i>regulated activity</i> .
<i>regulated related undertaking</i>	<p>a <i>related undertaking</i> that is any of the following:</p> <ol style="list-style-type: none"> (a) a <i>regulated entity</i>; or (b) an <i>insurance undertaking</i> which is not a <i>regulated insurance entity</i>; or (c) an <i>asset management company</i>; or (d) a <i>financial institution</i> which is not either a <i>credit institution</i> or <i>investment firm</i>; or

	(e) a <i>financial holding company</i> ; or
	(f) an <i>insurance holding company</i> .
<i>regulatory surplus value</i>	has the meaning set out in <i>PRU 1.3.36R</i> .
<i>related undertaking</i>	in relation to an <i>undertaking 'U'</i> : <ul style="list-style-type: none"> (a) any <i>subsidiary undertaking</i> of U; or (b) any <i>undertaking</i> in which U or any of U's <i>subsidiary undertaking</i> holds a <i>participation</i>; or (c) any <i>undertaking</i> linked to U by a <i>consolidation Article 12(1) relationship</i>; or (d) any <i>undertaking</i> linked by a <i>consolidation Article 12(1) relationship</i> to an <i>undertaking</i> in (a), (b) or (c).
<i>resilience capital requirement</i>	the capital component for <i>long term insurance business</i> calculated in accordance with <i>PRU 4.2.10R</i> to <i>PRU 4.2.27R</i> .
<i>tier one capital resources</i>	the sum calculated at stage F of the calculation in <i>PRU 2.2.14R</i> .
<i>tier two capital resources</i>	the sum calculated at stage I of the calculation in <i>PRU 2.2.14R</i> .
<i>total group tier one capital</i>	the sum calculated at stage A of the calculation in <i>PRU 8.3.35R</i> .
<i>total group tier two capital</i>	the sum calculated at stage B of the calculation in <i>PRU 8.3.35R</i> .
<i>ultimate EEA insurance parent undertaking</i>	an <i>EEA insurance parent undertaking</i> that is not itself the <i>subsidiary undertaking</i> of another <i>EEA insurance parent undertaking</i> .
<i>ultimate insurance parent undertaking</i>	an <i>insurance parent undertaking</i> that is not itself the <i>subsidiary undertaking</i> of another <i>insurance parent undertaking</i> .
<i>upper tier two capital resources</i>	the sum calculated at stage G of the calculation in <i>PRU 2.2.14R</i> .
<i>with-profits insurance capital component</i>	the capital component for <i>with-profits insurance business</i> of <i>realistic basis life firms</i> calculated in accordance with <i>PRU 7.4</i> .

PART V

GROUP CAPITAL ADEQUACY

- 9.40 (1) Subject to (2), an *insurer* to which *PRU* 8.3 applies must, in respect of its *ultimate insurance parent undertaking* and its *ultimate EEA insurance parent undertaking* (if different), submit a report of:
- (a) the *group capital resources* of that *undertaking* (as calculated in accordance with *PRU* 8.3.30R); and
 - (b) the *group capital resources requirement* of that *undertaking* (as calculated in accordance with *PRU* 8.3.27R).
- (2) An *insurer* is not required to submit the report referred to in (1) where:
- (a) the *insurer* is an *undertaking* listed in *PRU* 8.3.12R (2); or
 - (b) under Article 4(2) of the *Insurance Groups Directive*, the *competent authority* of an *EEA State* other than the *United Kingdom* has agreed to be the *competent authority* responsible for exercising supplementary supervision of the *insurance group* of which the *insurer* is a member ("the co-ordinating supervisor").
- 9.41 (1) Subject to (2), an *insurer* must include, in the report in rule 9.40(1), the details of any *regulated related undertaking* in the *insurance group* where the *individual capital resources requirement* of that *undertaking* exceeds its *solo capital resources*, stating in each case:
- (a) where the *undertaking* in rule 9.41(1)(a) is a *subsidiary undertaking* of the *ultimate insurance parent undertaking* or *ultimate EEA insurance parent undertaking* (if different), the full amount of the calculation items set out in *PRU* 8.3.23R of that *undertaking* in accordance with *PRU* 8.3.25R and *PRU* 8.3.26R; or
 - (b) where the *undertaking* in rule 9.41(1)(a) is not a *subsidiary undertaking*, the *ultimate insurance parent undertaking's* or *ultimate EEA insurance parent undertaking's* relevant proportion, as set out in *PRU* 8.3.24R, of the calculation items set out in *PRU* 8.3.23R of that *undertaking*.
- (2) An *insurer* can exclude a *regulated related undertaking* where the *individual capital resources requirement* of that *undertaking* exceeds its *solo capital resources* if:
- (a) the *group capital resources* of the *ultimate insurance parent undertaking* or the *ultimate EEA insurance parent undertaking* (as the case may be) exceed its *group capital resources requirement*; and

- (b) paragraph 3 applies to the *regulated related undertaking*.
- (3) This paragraph applies to a *regulated related undertaking* if:
 - (a) in respect of the *insurance group*, it is not;
 - (i) the *insurer*; or
 - (ii) a *parent undertaking* of the *insurer*; or
 - (iii) a *participating undertaking* in the *insurer*; or
 - (iv) a *related undertaking* of the *insurer*; and
 - (b) the amount by which its *individual capital resources requirement* exceeds its *solo capital resources* does not exceed 5% of the amount referred to in rule (2)(a)
- (4) An *insurer* must include *regulated related undertakings* to which paragraph (2) applies if the amount of D less E exceeds 10% of the amount referred to in rule (2)(a), where:
 - (a) D is the sum of the *individual capital resources requirement* of the *regulated related undertakings* to which paragraph (2) applies; and
 - (b) E is the sum of the *solo capital resources* of the *regulated related undertakings* to which paragraph (2) applies.
- 9.42 (1) The report in rule 9.40(1) must include information and calculations required by 9.40 and 9.41:
 - (a) as at the end of the *financial year* of:
 - (i) the *insurer*; or
 - (ii) the *ultimate EEA insurance parent undertaking*; or
 - (iii) the *ultimate insurance parent undertaking*.
 - (b) following the relevant principles in Financial Reporting Standard 2 (issued by the Accounting Standards Board in June 1992), as at the same date for every member of the *insurance group* to which the report relates; and
 - (c) as at a date no later than 12 months from the day after the end of the financial year by reference to which the information and calculations required in the report were last provided under Chapter 10 of *IPRU(INS)*.
- (2) If for any reason the end of the *financial year* chosen for the purposes of

- (1)(a) is changed so as to end on a date later than that specified in 1(c):
- (a) the report after the change takes effect must be as at the later date; but
 - (b) unless the report contains information and calculations that do not materially differ from what they would be as at the date specified in 1(c), the *insurer* must also provide the *FSA* with an interim statement.
- (3) Subject to (4), the report in rule 9.40(1) must be provided to the *FSA* no later than 4 months from the end of:
- (a) the *financial year in question*; or
 - (b) the financial year of the relevant parent, where the report is provided as at the end of its financial year under (1)(a).
- (4) Where a *competent authority* in an *EEA State* has agreed to be the *competent authority* responsible for supplementary supervision in accordance with *PRU* 8.3.19R, the *insurer* must provide the report to the *FSA* on the earlier of:
- (a) 6 months from the end of the financial year selected in 1(a); and
 - (b) the date by which the equivalent report to rule 9.40(1) is required in the *EEA State* of the *competent authority* responsible for supplementary supervision.

Guidance

- 9.43G
- (1) An *insurer* may use Annex 9 Form A for the purposes of the report required by rule 9.40(1).
 - (2) The report required by rule 9.40(1) does not form part of the *insurer's* return.
 - (3) The *FSA* may rely on the report in rule 9.40(1) prepared in accordance with *PRU* 8.3.19R for the purpose of monitoring compliance with *PRU* 8.3.11R.
 - (4) Where several *insurers* to which rule 9.40 applies have the same *ultimate insurance parent undertaking* or *ultimate EEA insurance parent undertaking* or both, rule 9.40 applies to all of them. In these circumstances one *insurer* may submit the report in rule 9.40 on behalf of the other *insurers* in the *insurance group*. This should consist of one package of the relevant information with confirmation that the *insurer* submitting the information has made it available to the Boards of directors of the other *insurers* in the *insurance group*. The purpose of this requirement is to ensure that all the *insurers* in the group are aware of the relevance of the group information to themselves.

- (5) Where an *insurance group* consists of an *ultimate insurance parent undertaking* which is itself an *insurer* whose head office is in the UK and which has a UK *insurance subsidiary* or *subsidiaries* which is or are themselves *insurers*, the report in rule 9.40 will cover the same *group undertakings* as the parent's own adjusted solvency requirement. The subsidiary *insurer* need not in these circumstances deposit the report in rule 9.40. However, this does not affect the requirement to provide information under rule 9.41.

FORM A (IPRU(INS) 9): INSURANCE GROUP CAPITAL ADEQUACY REPORTING FORM

INSURANCE GROUP CAPITAL ADEQUACY (page 1)

Name of reporting insurance firm:

Name of insurance parent undertaking:

Calculation of Consolidated Position:

		Limits on capital (see notes)	
TIER 1			£'000
Group Core Tier 1	Sum of column G1 (page 4)		H1
Group Non-Cumulative Preference Shares	Sum of column G2 (page 4)		H2
Group Innovative Tier 1	Sum of column G3 (page 4)		H3
Total Group Tier 1	= H1 + H2 + H3	Limits 1, 2 & 3	TT1
TIER 2			
Group Upper Tier 2	Sum of column G4 (page 4)		H5
Group Lower Tier 2	Sum of column G5 (page 4)		H6
Total Group Tier 2	= H5 + H6	Limits 4 & 5	TT2
Total Capital Resources (before deductions)	= TT2 + TT1	Limits 6 & 7	TCR
Total group capital resources deductions	Sum of column D1 & D2 (page 2)		H7
Total Group Capital Resources :	= TT1 + TT2 – H7		GCR
Total Group Capital Resources Requirement:	Sum of column B (page 2)		GCRR
Group surplus/ (deficit)	= GCR – GCRR		I

FORM A (IPRU(INS) 9): INSURANCE GROUP CAPITAL ADEQUACY REPORTING FORM

INSURANCE GROUP CAPITAL ADEQUACY (page 2)

Name of reporting insurance firm:

Name of insurance parent undertaking:

A	A1	A2	B	D1	D2
Name of related undertaking	% interest	Type of firm	CRR	Inadmissible assets	Ancillary services undertakings deduction

Related undertaking 1					
Related undertaking 2					
Related undertaking 3					
Parent:					
Totals:					

FORM A (IPRU(INS) 9): INSURANCE GROUP CAPITAL ADEQUACY REPORTING FORM

INSURANCE GROUP CAPITAL ADEQUACY (page 4)

Name of reporting insurance firm:

Name of insurance parent undertaking:

A	Name of related undertaking
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G1	G2	G3	G4	G5
Net Contribution to Group Capital Resources				
Core tier 1	Non-cumulative preference shares	Innovative tier 1	Upper tier 2	Lower tier 2
=F1-E1	=F2-E2	=F3-E3	=F4-E4	=F5-E5

Related undertaking 1
Related undertaking 2
Related undertaking 3

Parent's Capital Resources (by class of capital)

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Totals

--	--	--	--	--

FORM A (IPRU(INS) 9 ANNEX: INSURANCE GROUP CAPITAL ADEQUACY REPORTING INSTRUCTIONS

Insurance Group Capital Adequacy

<i>Ref</i>	<i>Instructions</i>
A (pages 2, 3 & 4)	<p>List the name of each <i>related undertaking</i> which is a <i>regulated related undertaking</i> or an <i>ancillary services undertaking</i>.</p> <p>A <i>firm</i> may combine several entities together where these are not material in relation to the group as set out in rule 9.41(2). The <i>firm</i> must list the relevant entities in a note to the return and should be able to demonstrate the contribution of the individual entities to the group calculation.</p>
A1 (page 2)	<p>List the percentage interest in the <i>regulated related undertaking</i> listed in A held by the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> (as applicable). If the interest is not held directly by the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> but by another member of the <i>insurance group</i>, enter the effective percentage interest of the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> in that <i>undertaking</i> (e.g. where a <i>parent</i> has a 50% holding in a <i>subsidiary</i> which in turn has a 50% holding in another <i>subsidiary</i>, the <i>ultimate parent undertaking's</i> effective percentage interest in the second <i>subsidiary</i> is 25% etc.). Where the entity is a <i>subsidiary</i> of a <i>subsidiary</i> of the <i>parent undertaking</i> (etc.), indicate (S) after the effective percentage interest. Such an entity must be treated as a <i>subsidiary</i> of the <i>parent undertaking</i> and will be included in the calculations in proportion to the <i>parent undertaking's</i> effective percentage interest (or in full if there is a capital resources deficit) (see PRU 8.3.23R to 26R).</p>
A2 (page 2)	<p>State if the <i>related undertaking</i> listed in A is a <i>regulated insurance entity</i>, <i>pure reinsurer</i>, <i>insurance undertaking</i>, <i>intermediate insurance holding company</i>, <i>investment firm</i>, <i>credit institution</i>, <i>other financial institution</i>, <i>asset management company</i> or <i>ancillary services undertaking</i>.</p> <p>For <i>related undertakings</i> which are <i>ancillary services undertakings</i> entries must only be made in this column and column D2 on page 2.</p>
B (page 2)	<p>State the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking's</i> share (i.e multiplied by the percentage in A1) of the <i>individual capital resources requirement</i> of the <i>regulated related undertaking</i> (A). This is the requirement set out in PRU 8.3.28R.</p>

FORM A (IPRU(INS) 9 ANNEX: INSURANCE GROUP CAPITAL ADEQUACY REPORTING INSTRUCTIONS

<i>Ref</i>	<i>Instructions</i>
D1 (page 2)	State the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking's</i> share of any inadmissible assets held by the <i>regulated related undertaking</i> (see PRU 8.3.50R)
D2 (page 2)	This column must be completed only for <i>related undertakings</i> which are <i>ancillary services undertakings</i> . The entry must be the higher of the book value of the investment by <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> in the <i>related undertaking</i> and the <i>related undertaking's</i> notional capital resources requirement (see PRU8.3.53R-55R)
E1 E2 E3 E4 E5 (page 3)	<p>The entries in E1 to E5 must be the book value of the investments taken together of the individual members of the <i>insurance group</i> in the <i>solo capital resources</i> of each <i>regulated related undertaking</i> listed in A (this represents internal group holdings of the <i>solo capital resources</i> of each <i>regulated related undertaking</i> to be excluded from <i>group capital resources</i> under PRU8.3.40R and 8.3.42R).</p> <p>The book value of the group's interest in <i>core tier one capital resources*</i> must be shown in E1; investments in perpetual, non-cumulative <i>preference shares*</i> must be shown in E2; and investments in <i>innovative tier 1 capital resources*</i> must be shown in E3. The book value of the group's interest in <i>tier two capital resources</i> must be shown in E4 (<i>upper tier two capital resources*</i>) and E5 (<i>lower tier two capital resources*</i>).</p> <p>[* these terms should be applied according to the descriptions in PRU2.2 making the necessary changes for the purposes of the <i>sectoral rules</i> applicable to the <i>undertaking</i> in question).</p>
F1 F2 F3 F4 F5 (page 3)	The entries in F1 to F5 must be the group's share of the tier 1 and tier 2 elements of the <i>solo capital resources</i> of the <i>regulated related undertaking</i> (A). (see PRU8.3.39R(2) & 8.3.41R(2)).
G1 G2 G3 G4 G5	These entries represent the contribution to <i>group capital resources</i> of the <i>regulated related undertaking</i> . G1 is calculated as the difference between column F1 and E1. (G1 can be positive or negative. A negative figure would principally represent goodwill on acquisition). Similarly G2 is the difference between F2 and E2, G3 is the difference between F3 and E3 etc. (G2, G3, G4 & G5 would normally be positive).

FORM A (IPRU(INS) 9 ANNEX: INSURANCE GROUP CAPITAL ADEQUACY REPORTING INSTRUCTIONS

<i>Ref</i>	<i>Instructions</i>
(page 4)	<p>The sum of the respective columns (G1, G2, G3) represent the group's <i>core tier one capital</i>, perpetual non-cumulative preference shares and <i>innovative tier one capital resources</i> (see H1 to H3 on page 1).</p> <p>The sum of the respective columns (G4, G5) represent the group's <i>tier two capital resources</i> (see H5 and H6).</p>
H1 H2 H3 (page 1)	These entries represent the total contribution of the <i>regulated related undertakings</i> and the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> to <i>total group tier one capital resources</i> .
TT1 (page 1)	<p>This entry is <i>total group tier one capital resources</i> (see stage A of PRU8.3.35R) after application of limits 1, 2 & 3 below:</p> <p>Limit 1: <i>Total group tier one capital resources</i>, less <i>innovative tier one capital resources</i> included in <i>total group tier one capital resources</i>, must account for at least 50% of the <i>group capital resources requirement</i>, less any <i>with-profit insurance capital component</i> included in the <i>group capital resources requirement</i> (see PRU8.3.37R(1)(a)).</p> <p>Limit 2: <i>Core tier one capital resources</i> included in <i>total group tier one capital resources</i> must account for at least 50% of <i>total group tier one capital</i> (see PRU8.3.37R(1)(d)).</p> <p>Limit 3: <i>Innovative tier one capital resources</i> included in <i>total group tier one capital resources</i> must not exceed 15% of <i>total group tier one capital resources</i> (see PRU8.3.37R(1)(e)).</p> <p>Elements of <i>tier one capital resources</i> excluded by these limits may be included in <i>upper tier two capital resources</i> (see PRU8.3.38G).</p>
H5 H6 (page 1)	<p>These entries represent the total contribution of the <i>regulated related undertakings</i> and the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> to <i>group tier two capital resources</i> (stage B of PRU8.3.35R). Capital eligibility limits apply as follows:</p> <p>Limit 4: <i>Total group tier two capital resources</i> must not exceed <i>total group tier one capital resources</i> (see PRU8.3.37R(1)(f)).</p> <p>Limit 5: <i>Lower tier two capital resources</i> included in <i>total group tier two capital resources</i> must not exceed 50% of <i>total group tier one capital resources</i> (see PRU8.3.37R(1)(g)).</p>
TT2	This entry is calculated as the sum of H5 and H6 which represents <i>total group tier two capital resources</i> after application of limits 4

FORM A (IPRU(INS) 9 ANNEX: INSURANCE GROUP CAPITAL ADEQUACY REPORTING INSTRUCTIONS

Ref	Instructions
(page 1) TCR (page 1)	<p>and 5.</p> <p>This entry is calculated as the sum of TT1 and TT2 and represents <i>total group capital resources</i> before deductions after application of limit 6 and 7 (stage C in PRU 8.3.35R). Capital eligibility limits apply as follows:</p> <p>Limit 6: <i>Total group tier one capital resources, less innovative tier one capital resources included in total group tier one capital resources, plus total group tier two capital resources</i> must account for at least one third of the <i>group capital resources requirement</i> less any <i>with-profit insurance capital component</i> and any <i>resilience capital requirements</i> included in the <i>group capital resources requirement</i> (see PRU8.3.37R(1)(b)).</p> <p>Limit 7: <i>Total group tier one capital resources, less innovative tier one resources included in total group tier one capital resources, plus total group tier two capital resources</i> less any <i>lower tier two capital resources</i> included in <i>total tier two capital resources</i> must account for at least 75% of the <i>group capital resources requirement</i> less any <i>with-profit insurance capital component</i> included in the <i>group capital resources requirement</i> (PRU8.3.37R(1)(c)).</p>
H7 (page1)	<p>This entry is the sum of columns D1 and D2 on page 2 which represent deductions to be made from total <i>group capital resources</i> in respect of the group's interest in inadmissible assets (see 8.3.46R), and ancillary services undertakings (see PRU 8.3.47R).</p>
GCR (page1)	<p>This entry is calculated as TCR less H7. This represents <i>total group capital resources</i> (see stage H in PRU8.3.35R).</p>
GCRR (page 1)	<p>This entry is calculated as the sum of column B on page 2 which represents total <i>group capital resources requirement</i> (see PRU8.3.27R).</p>
I (page 1)	<p>This is calculated as total <i>group capital resources</i> less total <i>group capital resources requirement</i> (GCR – GCRR). This represents the amount by which <i>group capital resources</i> exceed or fail to exceed the <i>group capital resources requirement</i>.</p>

Notification under rule IPRU(INV) 14.1.4

Name and FSA number of firm:

Names of other entities within the consolidated group* (and FSA number where applicable):

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* Where the entity is regulated by another regulator, please specify which

I confirm that the above-mentioned firm and its group meet the following conditions:

- (a) there is no *credit institution* in the group.

- (b) no *firm* in the group *deals in investments as principal*, except where it is an *operator of a collective investment scheme* dealing solely as a result of its activity of operating a *collective investment scheme*, or where the *firm's* positions fulfil the *CAD Article 3 exempting criteria*.

- (c) each member of the group which is a *CAD firm*:
 - (i) deducts any *material holdings in credit and financial institutions* from its financial resources;
 - (ii) complies with its solo applicable *financial resources requirement and large exposures* requirements; and
 - (iii) has systems and controls to monitor and control the sources of capital and funding of all other *financial institutions* within the group.
- (d) the *firm* notifies the *FSA* of any serious risk that could undermine the financial stability of the group as soon as it becomes aware of that risk.
- (e) the *firm* reports to the *FSA* all group *large exposures* as at the end of each quarter, and within the period specified in *SUP 16*.
- (f) the *firm* will:
 - (i) submit to *FSA* a consolidated supervision return within the time period specified by *SUP 16*, together with a consolidated profit and loss account;
 - (ii) ensure that each *firm* in the group deducts from its solo financial resources any quantifiable *contingent liability* in respect of other group entities;
 - (iii) ensure that the solo financial resources requirement of each *firm* in the group incorporates the full value of the expenditures of the *firm* wherever they are incurred on behalf of the *firm*; and
 - (iv) make a note in its audited financial statements that it is not subject to regulatory consolidated capital requirements.

Signed

Date

Name

Position.....

The new prudential categories

arranger

- (1) a firm with permission for one or more of the following:
- (a) arranging (bringing about) deals in investments; or
 - (b) making arrangements with a view to transactions in investments;
- and which:
- (c) is not a bank, a building society or an ELMI;
 - (d) is not an insurer;
 - (e) is not a UCITS management company;
 - (f) is not a local; and
 - (h) does not have permission:
 - (i) to deal in investments as principal; or
 - (ii) for dealing in investments as agent ; or
 - (iii) for managing investments.

broker/manager

a firm with permission for dealing in investments as agent or managing investments (including an operator of an unregulated collective investment scheme) but which:

- (a) does not have permission to deal in investments as principal;
- (b) is not a UCITS management company;
- (c) is not an insurer; and
- (d) is not a bank, a building society or an ELMI.

exempt CAD firm

(in accordance with Article 2(2) of the *Capital Adequacy Directive* (Definitions)) a *firm* that satisfies the following conditions:

- (a) it is an *ISD investment firm*;
- (b) it is not an *insurer*, a *bank*, a *building society* or an *ELMI*;
- (c) its *permission* is subject to a *limitation* or *requirement* preventing it from holding *client* money or *clients' assets* and for that reason it may not at any time place itself in debit with its *clients*; and
- (d) the only *core investment service* for which it has *permission* is receiving and transmitting on behalf of investors orders in relation to one or more of the instruments listed in Section B of the Annex to the *ISD*.

matched principal broker

a *firm* with *permission* to deal in investments as *principal* other than:

- (a) a *bank*, a *building society* or an *ELMI*; or
- (b) a *UCITS management company*; or
- (c) an *insurer*; or
- (d) a *local*;

and which satisfies the following conditions:

- (e) it *deals* as *principal* only to fulfil customer orders;
- (f) it holds positions for its own account only as a result of a failure to match investors' orders precisely;
- (g) the total market value of the positions is no higher than 15% of the *firm's initial capital*; and
- (h) the positions are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question.

own account dealer

a *firm* with *permission* to deal in investments as *principal* other than:

- (a) a *bank*, a *building society* or an *ELMI*; or
- (b) an *insurer*; or
- (c) a *UCITS management company*; or
- (d) a *matched principal broker*; or

(e) an *ICVC*; or

(f) a *local*.

*Bank, building society and
ELMI* In accordance with the existing Glossary

Insurer In accordance with the existing Glossary

*UCITS management
company* In accordance with the existing Glossary

Local In accordance with the existing Glossary

