

# List of questions in Part 1

## **Chapter 3 – defining which directive applies**

- Q3.1: Have you any comments on the proposed scope of the threshold tests?
- Q3.2: Have you any comments on the proposed process for applying the threshold tests?
- Q3.3: Have we given enough information for groups to implement the threshold tests?
- Q3.4: Have you any comments on how we propose to handle the relationship between sub-group and group requirements under different directives?

## **Chapter 4 – UK financial conglomerates**

- Q4.1: Have you any comments on the proposed role of the EU coordinator in supervising the group?
- Q4.2: Do you agree with our proposal to require groups to develop cross-sectoral summary reports on intra-group transactions and exposures and risk concentrations reports based on their own management information after discussion with supervisors, rather than introducing a new standardised report?
- Q4.3: Have you any comments on our proposed use of the own – initiative variation of permission power (OIVOP) to implement the requirements?

Q4.4: Do you agree with our proposal to direct groups to FGD Annex I method 4 in 2005, while work continues to develop technical principles for the other methods in light of the wider banking and investment capital review and new accounting standards?

## **Chapter 5 – Insurance groups**

- Q5.1: Do you have any comments on our proposal to phase in hard EEA group parent capital adequacy requirements from 2005?
- Q5.2: Do you have comments on how we should reflect individual firms' ICG in group ICG?
- Q5.3: Is the new location of group capital adequacy requirements for both insurance and holding company parents in a single chapter clearer?
- Q5.4: Do you have any comments on our proposal to retain our current approach to assets in excess of exposure limits for related insurance interests, and to extend this to related financial institutions?
- Q5.5: Do you have any comments on the proposed application of exposure limits to insurance parents and in the group capital adequacy calculations?
- Q5.6: Do you have any comments on the proposed treatment of related financial undertakings?

## **Chapter 6 – UK banking and investment firm groups**

- Q6.1: Have you any comments on our proposed treatment of significant insurance interests in the calculation of individual banks and investment firms' capital adequacy and in calculating their groups' capital adequacy?
- Q6.2: Have you any comments on the clarity and scope of application of the harmonised chapter of requirements for investment firm groups?
- Q6.3: Have you any comments on how we propose to harmonise our approach to implementing the CAD waiver?
- Q6.4: Have you any comments on the proposed capital adequacy method for investment firm groups based on consolidated rather than aggregated capital resources?

## **Chapter 7 – third country groups**

- Q7.1: Have you any comments on the process for determining whether there is equivalent third country group-wide supervision?
- Q7.2: Have you any comments on methods EU coordinators should propose in discussions with relevant supervisory authorities for each group?



# Compatibility statement

1. This statement explains why we believe that the rules and guidance proposed in Annexes 4, 5 and 6, are compatible with our general duties under section 2 of the FSMA.

## **Compatibility with the regulatory objectives**

2. We believe our proposed amendments to the FSA's rules and guidance to implement (in part) the requirements of the Financial Groups Directive (FGD), and amend the insurance group risk 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 and insurance groups for the fulfilment of their rights and expectations. So, we expect the measures proposed here to strengthen this ability.
4. The proposal for a hard capital adequacy test at insurance group level is part of a series of measures we have been taking to overhaul insurance regulation in the UK. We believe it is justified by the nature of the risks run by insurance companies, and by the risks posed to them arising elsewhere in the groups to which they belong. As a result, we believe our proposals will enhance confidence in the insurance industry, improve financial stability, and ensure

that the rights and expectations of policyholders are more securely protected. However, greater financial stability comes at a cost. For the insurance industry this is likely to be in some restructuring of the industry, or capital raising. Potentially this will have a consequential impact on prices and the availability of products for consumers.

### **Financial crime and public awareness**

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

### **Principles of good regulation**

6. 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.**

7. 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.
8. 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.
9. For insurance groups, a hard insurance group capital adequacy is an efficient way for us to set out, for all groups, the standard expected of them. This is in contrast to the current position where the test is soft, and supervisory action on an individual group basis usually follows the reporting of a group capital adequacy deficit.
10. 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.**

11. The proposals 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.
12. The conglomerate proposals 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.**

13. Some of the proposed rules are the result of European Community obligations laid down in the FGD, so we are required to implement these. We propose to implement 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 2.
14. Some of the changes to the insurance group risk rules, both to implement the FGD requirements and to make other proposed changes to the insurance group risk regime, 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 (see Annex 3). 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.**

15. The FGD was not specifically designed to facilitate innovation, nor were our proposals for insurance 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 proposed 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.

16. Our proposed 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.
17. 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.
18. 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 Risk Based Capital Directive<sup>1</sup>, 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.
19. 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.
20. Finally, our proposals for the insurance sector should strengthen the financial soundness of the UK insurance industry and, by improving market confidence in the UK insurance sector, improve its competitive position internationally.

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

21. FGD reduces the existing differences of scope and application of group capital adequacy requirements between different types of group. And changing our

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1 The Risk Based Capital Directive is the means by which the EU will implement the requirements of the Basel Accord once agreed. We are anticipating that it will be implemented in the UK in 2007.

rules to implement the directive requirements reduces competitive inequality between groups, as a result of their group capital adequacy requirements.

22. Where FGD does not fully harmonise between sectors, we have adopted the approach that avoids 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.**

23. Overall, for the reasons set out above, we think that our proposals for the supervision of insurance groups and financial conglomerate supervision will create more transparent regimes, promote consistency and provide a solid base from which firms can compete.
24. 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.
25. For insurance groups, the combination of implementing the FGD, and our other proposals, will effectively mean that insurance groups, and insurance conglomerates, are subject to the same supervisory requirements. This should ensure that insurance groups have no competitive advantage over insurance conglomerates.

### **The most appropriate way for us to meet our regulatory objectives**

26. 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 risk based capital directive 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 interim sourcebooks, 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 EU's risk based capital directive (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 Risk Based Capital Directive (RBCD). 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.
27. In our view, the first option is the most appropriate way of meeting our statutory obligations. It means 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 full PSB. 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.
28. 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.
29. We believe the most appropriate approach is to propose bringing together the four consolidated supervision chapters into one chapter. This will allow us to simplify and clarify the rules, and to get rid of inconsistencies in the presentation of our current requirements. At present, this can make it difficult

to understand the rules overall, and will complicate the introduction of new FGD requirements.

30. In developing our proposals to move to a hard capital test for insurance groups, we considered the following:
  - **Retaining the parent (holding company) capital adequacy test as a reporting requirement only.** This leaves a question mark for the market, and for every EEA group for which the FSA is the coordinator, as to what action we may take in response to a failure to meet the test. This is in contrast to the position for an EEA holding company parent of a banking, investment firm, or financial conglomerate group, where the FSA would require immediate notification of an insufficient buffer of group capital, and a remedial action plan.
  - **Retaining the parent (holding company) capital adequacy test as a reporting requirement only for parents outside the EEA, but making the test a hard requirement for the top EEA holding company parent.** This is the same position as our rules require for other types of financial group operating in the EEA, for which we are the lead EEA supervisor, and also with what we understand to be the way in which other EEA supervisory authorities have implemented the Insurance Groups Directive (IGD).
  - **Making the capital adequacy test a hard requirement for both the top EEA parent holding company, and the ultimate (world-wide) parent holding company.** This would remove the current flexibility implied for FSA supervisors to take into account features of overseas regulation and accounting approaches in interpreting the worldwide group capital adequacy measure, before requiring specific remedial action from the group concerned.
31. In our view, the second option is the most appropriate way of meeting our statutory obligations because:
  - the first option does not protect the rights and expectations of policyholders to the same degree as those of consumers exposed to other types of financial firms in Europe;
  - the third option would set too much store by a specific calculation which necessarily covers a wide variety of worldwide standards and approaches which may require supervisory interpretation; and
  - the second option is a reasonable requirement now that EEA groups and their supervisors have had two years' experience in analysing the EEA group calculations and their implications for firms within a group.

32. 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.
33. 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 is 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.

# Cost benefit analysis

## **Introduction**

- 1 We are required under sections 155(2)(a) and 157(3) of the FSMA to publish ‘an estimate of the costs together with an analysis of the benefits that will arise if the proposed rules are made’. This is a cost benefit analysis (CBA) of the policy proposals in this CP. It covers all UK based groups and third country groups and conglomerates for which we will be the lead regulator (groups) or co-ordinator (financial conglomerates). It also sets out the impact on consumers and other stakeholders.
- 2 This CBA focuses on each of the four key policy lines we have developed to implement the requirements of the FGD and the changes we are proposing to the insurance group risk regime.

## **Numbers of groups affected**

- 3 Our estimate of the population of firms and groups affected is set out in the tables below.

**a) UK based groups and financial conglomerates**

<b>Type of group</b> note 1	<b>No of groups</b> note 2	<b>UK Regulated firms</b>
Banking	100	430
Investment	180	670
Insurance	90	450
<b>Type of financial conglomerate</b> notes 1 & 3		
Banking dominated	10	50
Investment dominated	0	0
Insurance dominated	8	80

Notes

1. The two populations are not mutually exclusive. All of the conglomerates are included in the group population.
2. The number of groups includes only the highest group or sub-group supervised by the FSA.
3. The numbers of financial conglomerates are based on regulatory data available to us, and the results of two surveys in 2000 and 2001 to identify likely financial conglomerates based on the scope of the draft directive when each exercise was carried out. A further exercise is now in progress to identify likely UK financial conglomerates based on the final directive and current regulatory data – we shall take this into account in finalising our rules. Proposed changes to capital requirements for insurance firms in CPs 190 and 195 have been taken into account in estimating the number of financial conglomerates.

**b) Non-EEA (third country) groups and conglomerates**

<b>Type of group or conglomerate</b> Note 1	<b>No of groups/conglomerates</b> note 2	
<b>Banking dominated</b>	90	350
<b>Other</b> note 3	40	120

Notes

1. The numbers of financial conglomerates are based on regulatory data available to us, and the results of two surveys in 2000 and 2001 to identify likely financial conglomerates based on the scope of the draft directive when each exercise was carried out.
  2. The number of groups includes only the highest group or sub-group subject to the directive.
  3. Third country investment groups and third country financial conglomerates dominated by investment or insurance business.
- 4 The proposals affect firms that are already part of groups. This CBA considers the impact of proposals in this CP on regulated firms potentially affected, using a sampling approach where appropriate. The benefits to consumers are also analysed. Compliance costs are firm costs, Direct costs are FSA costs.

## Financial conglomerates

### Estimate of costs – Identifying financial conglomerates

- 5 All groups with a UK regulated entity in one of the two sectors (banking/investment or insurance), and a regulated entity in the other sector anywhere in the world, must check whether they are a financial conglomerate. For some firms this can be done simply by looking at their structure, but for most it will mean doing the FGD threshold calculations set out in the CP.
- 6 We have assumed in estimating the costs of identifying financial conglomerates, as set out in the table in paragraph 7 below, that there will be two somewhat distinct populations which need to carry out the threshold tests:
  - a) groups which are likely to be financial conglomerates, are already familiar with the requirements of the FGD, and are likely to have carried out an approximate threshold calculation at least once already. Most of these groups have already spent time, effort and money in training themselves on the requirements of the directive, taking part in our pre-consultation work, involving consultants in this work, and considering (and in some cases commissioning work on) the IT implications. These estimated costs are included in paragraph 7 ; and
  - b) groups with business in the insurance and either the banking or investment sectors, which are perhaps less likely to be financial conglomerates, are not yet familiar with FGD requirements, and have not yet carried out a threshold test of any sort. These are referred to as ‘cross-sectoral’ groups in the table below.

### 7. Total costs of identifying financial conglomerates – details in Annex A

	Compliance costs (£,000) <small>note 1</small>		Direct costs (£,000)
	Potential financial conglomerates <small>note 2</small>	Cross-sectoral groups <small>note 3</small>	
<b>Initial costs</b>	3,800	1,180	140
<b>Annual costs</b>	160		20

#### Notes

1. These estimates are based on man days to do the task concerned. We assume that for cross-sectoral groups, existing systems can, for the most part, be used to extract the relevant information.
2. Groups that are more likely to be financial conglomerates, are familiar with the requirements of the FGD, and likely to have done a rough threshold test at least once.
3. Groups with business in both the insurance and banking or investment sectors, which are not yet familiar with the FGD’s requirements, and have not yet done a threshold test of any sort, and are perhaps less likely to be financial conglomerates.

## **Estimate of costs – New financial conglomerate measures**

- 8 The total costs of these new measures are set out in the table at paragraph 16.

### *Establishing a financial conglomerate regime*

- 9 We will use the own initiative variation of permission (OIVOP) process to notify financial conglomerates of the details of the financial conglomerate regime that applies to them. This will involve costs for us, but is unlikely to involve any material costs for firms. Our costs are included in the table at para 16.

### *Capital adequacy requirements*

- 10 The FGD requires financial conglomerates to have positive capital adequacy at the level of the financial conglomerate. This will affect different types of conglomerate as follows.
- a) As explained in paragraphs 6.4 to 6.10 of this CP, banking and investment groups, other than third country groups, which will become financial conglomerates will experience minimal change. This is because banking and investment groups already have to meet a capital test at group level as a regulatory requirement. Extending this requirement to the financial conglomerate level for such groups should be a minimal change from the current position and so has minimal cost. The position of third country groups is discussed in paragraphs 23 to 29.
  - b) We propose several changes to the capital adequacy requirements for insurance groups, which are discussed in paras 42 to 68 of this CBA. The proposed capital requirements for financial conglomerates are a minimal further change from the proposed insurance groups requirements.

- 11 We estimate that all conglomerates will have to spend some time assembling the financial information needed to do the conglomerate capital adequacy test. The information is needed to a greater degree of accuracy than for the threshold test, and this cost is included in the table at paragraph 16.

### *Large exposures and intra-group transaction requirements*

- 12 Sectoral groups already have to report group large exposures (in the case of banks and investment firms) and intra-group transactions (for insurance firms). The directive requires that this existing reporting be extended to the conglomerate level. We propose that each conglomerate should discuss with its supervisor how to achieve the directive's requirements by using its existing management information systems (if appropriate for the job).

- 13 We think that groups may incur costs in the following areas (and these are included in the table at paragraph 16):
- a) commissioning work to assess the adequacy of existing systems to meet the conglomerate level requirements, including a gap analysis of existing systems. We understand that this is likely to be a particular issue for banks;
  - b) all conglomerates will need to gather the information needed at conglomerate level;
  - c) all conglomerates will need to analyse the information collected before submitting it to us as required under the directive; and
  - d) there are likely to be systems costs, particularly for IT if the groups covered in a) identify work needed on their systems to comply with the directive requirements.

*Requirement for co-ordination with other regulators*

- 14 It is likely that we will be the co-ordinator of the majority of conglomerates in the UK, since most have their ultimate or EU parent here. We estimate the potential costs to us (included in the table at paragraph 16) will be:
- a) initial costs in co-ordinating with other competent authorities involved, formally agreeing who the co-ordinator is, and agreeing on any issues of discretion; and
  - b) ongoing costs, limited by the fact that similar arrangements are already in place between European regulators for the existing sectoral consolidated supervision regimes, being for additional co-ordination between regulators in different sectors.

*Systems and controls requirements*

- 15 Financial conglomerates are already subject to group consolidated supervision requirements (to some degree) and will already have in place the systems and controls necessary to meet the directive requirements for the existing single sector groups. For group structures where the financial conglomerate includes a higher parent, these systems may need to be extended to cover the larger group, and this may result in some additional, although minimal, cost.

**16. Overall estimated costs for the new financial conglomerate requirements – details in Annex B**

	Compliance costs (£,000)		Direct costs (£,000)
	Banking dominated	Investment or insurance dominated	
<b>Initial costs</b>	4,660-5,200	1,730-1,760	90
<b>Annual costs</b>	280-360		10

**Market impact of new financial conglomerates measures**

- 17 Our overall approach to implementing the directive has been to minimise the changes between the existing groups regime and the new financial conglomerate regime. This means that the costs to groups that are conglomerates of complying with the new conglomerate requirements are minimised. These costs, which are set out in the table in paragraph 16 are not significant given the size of the groups affected, and should therefore have a minimal effect on the prices and quantity of products offered by such groups.
- 18 For the consumer, the fact of and transparency of the new conglomerate regime should increase market confidence. This may then result in more consumers buying products they wanted but were not prepared to buy previously because the product’s risk level exceeded their risk appetite.

**Analysis of benefits of new financial conglomerates measures**

*Prudential soundness*

- 19 The benefits of group-wide prudential supervision are the same for conglomerates as for sectoral and third country groups. These are that the benefits of supervision and regulatory capital adequacy requirements for regulated firms within the group are not undermined by excessive risk-taking or leverage of the group as a whole, through direct financial contagion or reputational contagion<sup>1</sup>.
- 20 Since financial conglomerates often have very complex structures, current gaps in the scope of group supervision may not be transparent to market participants. Closing gaps may reveal an existing shortfall in the capital adequacy of a financial conglomerate, which then needs to raise an additional buffer of capital (as envisaged by the directive). Market confidence should

<sup>1</sup> The methods for group-wide prudential supervision to achieve this were set out in the internationally agreed cross-sectoral Joint Forum Principles 1999.

benefit from the knowledge that the conglomerate position has been reported in full to a supervisory authority, and that in future conglomerates must have enough capital to support the risks in that conglomerate.

- 21 Consumers should benefit from the additional financial stability of conglomerates which may in turn generate increased confidence in the financial sector. This may result in more consumers buying financial products they want, but were not prepared to buy previously because the product's risk level exceeded their risk appetite.

#### *Co-ordination*

- 22 The requirement to co-ordinate and the need for supervisors to agree on standards and thresholds to apply should promote consistency of treatment of firms and standards of regulation across the EU. This will improve transparency and financial stability, and benefit firms by acting to encourage competition both within firms and across borders. Conglomerates will report to a single financial conglomerate group supervisor, who will communicate essential information about the position of the group to other key supervisors of the group. Encouraging supervisors to co-operate across sectors in this way may also have spin-off effects in building effective communication mechanisms which could be of wider benefit to supervisors, firms and consumers.

## **Non-EEA (third country) groups and financial conglomerates**

### **Estimate of costs**

- 23 As explained in Chapter 7, insurance groups are not affected by the third country provisions, unless they are deemed to be an insurance led conglomerate. The impact of the directive requirements on other groups (including insurance led conglomerates) will depend on whether they are found to be subject to equivalent group supervision by a home state supervisory authority. Guidance on this has yet to be developed by the relevant EU committees under the directive.
- 24 Groups potentially affected and their supervisory coordinator will need to familiarise themselves with the equivalence process and the requirements of the directive. In estimating these costs, we have divided groups affected into banking-dominated and other groups. This is because the Basel Accord which requires group supervision is already implemented at group level in most countries for banking dominated groups, and firms and their supervisors will have established group-wide supervision approaches and processes.
- 25 For other groups, we have assumed that firms and their supervisors may need to assess newer third country approaches and to establish new information-

sharing arrangements. These costs are summarised in the table in paragraph 26, and details of the calculation are in Annex C.

**26. Total estimated costs of identifying third country groups and financial conglomerates – details in Annex C**

	Compliance costs (£,000)		Direct costs (£,000)
	Note 1		
	Banking Note 2	Insurance/ investment Note 3	
<b>Initial costs</b>	40	380-470	100-130
<b>Annual costs</b>	-	50	10

Notes

1. We assume that existing group systems can be used to extract the relevant information. The time estimates do not distinguish between groups and conglomerates because both will need to educate themselves on the directive in order to assess if they are third country groups/financial conglomerates.
2. Third country banking groups and banking dominated financial conglomerates.
3. Third country investment groups and investment and insurance dominated financial conglomerates.

- 27 As explained in Chapter 7, if equivalence were not found, there are several options under the directive. We have not proposed any rules that apply automatically at this stage because the directive obliges the coordinator to consult other relevant EU competent authorities for each group before doing so. Even so, we have invited comments on what methods we should propose in these discussions.
- 28 Adopting any of the options is bound to result in additional costs for firms. It is impossible to provide a useful estimate here, given the relevance of as yet unknown factors involved.

**Analysis of benefits of third country measures**

- 29 The benefits of group-wide prudential supervision for third country groups are the same as for conglomerates and sectoral groups, and are set out in paragraphs 19 – 21.

**Banking and investment groups**

**Estimate of costs**

- 30 Following from our minimal implementation approach and the fact that our current requirements are largely compliant with the directive, the impact of our FGD implementation for banking and investment groups will be of minimal significance.

31 The changes we are proposing to the investment firm regime in addition to those minimal FGD changes are set out in Chapter 6, and will affect costs as follows.

- a) **Harmonisation of the existing four sets of consolidated supervision rules for investment firms into one consolidated supervision chapter.** We do not anticipate this will create other than minimal costs for the groups concerned, and estimate that on average, groups will need  $\frac{1}{2}$  day to familiarise themselves with the harmonised rules.
- b) **Use of the accounting consolidation method to calculate regulatory capital.** Groups will be able to estimate their financial resources directly from their existing consolidated accounts. This is a change from current practice for securities and futures firms and personal investment firms (interim sourcebook chapters 3,10 and 13 firms). But it will mean that they can use information from their annual accounts, rather than as now, doing an additional set of calculations. Given that existing information is being used, we believe that this change will not result in other than minimal additional reporting costs for firms affected.

The result of the new calculation should be broadly equivalent to the old, as both are based on the same information calculated according to the CAD requirements. So, we do not believe that this will result in a change to the capital adequacy position of the group, or in any material costs for the groups affected. It may, in fact, reduce the costs of collating the information needed.

- c) **Waiver from consolidated supervision.** Securities and futures firms (chapter 3 and 10 firms) can currently notify us that they do not wish to meet consolidated supervision requirements. (Although, in practice, most do not make use of this exemption and currently meet consolidated capital requirements.)

Under the new proposals in Chapter 6, securities and futures groups that need to do consolidated supervision can still notify us, although the circumstances under which they can do so have been tightened. It is no longer possible for them to forgo the requirement to report on a consolidated basis. We believe this will affect about 18 groups.

If firms do not meet these new notification conditions, they will have to meet consolidated capital requirements (unless they apply for and are granted a waiver from consolidated supervision).

The costs to the groups concerned (included in the table at paragraph 34) will therefore be:

- i) the costs of consolidated reporting; and

- ii) additional capital costs if the groups which currently have a consolidated capital deficit have to raise capital. Estimates of the costs of doing so for the firms affected are included in the table in paragraph 34. (Capital costs are calculated as the annual marginal cost of raising capital and this is explained in more detail in Annex C.)
- 32 Our estimate of the capital cost makes the worst case assumption that groups cover the deficits entirely by raising new equity capital. In practice, it is much more likely that the groups concerned will bolster their financial position in other ways, for example, by the redistribution of capital from other parts of the group, or by moving the principal position taking business to other parts of the group where the capital is located. Other potential options include raising capital other than equity at a lower cost, selling assets or business, or seeking strategic alliances with other firms or groups which are better capitalised. All alternative options to raising equity capital are also costly.
- 33 The costs for us (included in the table at paragraph 34) will mainly be the costs associated with monitoring and enforcing the rules. These include one off costs to assess waiver requests and annual costs of reviewing the twice-yearly consolidated returns for the groups. They also include training time for familiarisation with the harmonised rules.

**34. Total estimated capital and implementation costs for investment firms of harmonising the investment firm rules and updating the waiver regime – details in Annex D**

	Compliance costs (£,000)		Direct costs (£,000)	
	All investment groups	Additional SFA group costs	All investment groups	Additional SFA group costs
<b>Initial</b>	40	66,160	40	10
<b>Annual</b>	-	66,160	-	10

**Market impact of banking and investment group changes**

- 35 The population affected by the proposed changes to the waiver from consolidated supervision for securities and futures firms are principal position takers. By their nature they tend to be large complex operations with a systemic impact on the market. The financial impact of such groups needing to fund additional capital might result in a reduction of the size of their business, or the markets that they operate in.
- 36 For the remainder of the investment firm population, we do not expect our proposals to have a significant impact on the market, and they are unlikely to affect the availability and variety of products available, because of their minor impact on the costs for firms.

## **Analysis of benefits of banking and investment group changes**

- 37 The benefit of securities and futures groups being subject to consolidated supervision, is to decrease the risk of failure of such groups, thereby increasing financial stability, and in turn market confidence in the sector. Since sufficient regulatory capital will be held at the EEA group level to cover the risks within that group, they may benefit from lower costs of raising capital, and lower expenditure on reputation building. There should be a lower risk of failure of regulated firms and consequently groups, and a saving in the administrative costs of the failure of firms. In addition, the benefits of group-wide prudential supervision for securities and futures groups in Europe are the same as for conglomerates and sectoral groups, and are set out in paragraphs 19 – 21
- 38 This change to the notification approach for securities and futures groups is consistent with a risk-based approach, as it ensures a more proportionate balance between firms that are subject to consolidated capital requirements and those that are not. This should minimise adverse effects on competition between investment firms and groups.
- 39 Harmonising the investment firm requirements encourages consistency of treatment of all types of investment groups. It also makes it easier and more straightforward to implement the changes required under the FGD both for firms and us.
- 40 The change proposed to the calculations should provide for a more transparent treatment of deductions such as the deduction of goodwill, and this proposed single approach will increase clarity and consistency in the way that firms measure and report the adequacy of their group financial resources. In addition this should reduce costs for ex-SFA and ex-PIA firms as they will no longer have to do an additional regulatory calculation for their regulatory return.
- 41 In addition, implementing the directive so as to cause minimal change for the banking and investment sector ahead of inevitably significant changes post-Basel promotes ongoing stability in the regulatory regime. This is of benefit to firms and consumers alike.

## **Insurance groups and insurance conglomerates**

- 42 As noted in Chapter 5 and in paragraph 10b) of this CBA, our proposals concerning the capital adequacy regime are the same for insurance groups as they are for insurance led financial conglomerates. The exception is that the requirement to have positive capital adequacy is applied at the top EEA group level only for non-conglomerate insurance groups.
- 43 The two main changes which may cause groups to raise additional capital are amendments to the treatment of cross-sector holdings and the move to a hard

capital adequacy test at EEA level. These are discussed in turn below. The accuracy of the estimates is affected by these factors:

- a) our current rules do not prescribe a specific reporting format for the group capital adequacy calculation, and hence the starting group data for end 2002 are difficult to analyse and compare for some of the small and medium-sized groups;
  - b) the impact of the changes to the treatment of cross-sectoral interests depends on the precise specification of the new rules. Small and medium-sized groups have found it difficult or impossible to estimate the effect ahead of seeing and receiving advice on the new rules. (We have been able to obtain reliable estimates from the main groups affected, however, and have included ‘high-side’ estimates for others); and
  - c) in many cases we know of specific action taken by groups since end 2002 to raise capital, transfer in capital from other (non-financial or non-EEA) parts of the group, dispose of businesses or adjust their risk profiles to buttress their position under the ‘soft test’. Such specific action is not attributed to the impact assessment of the hard test in this CBA (see below), but any other action in response to the soft test of which we are not specifically aware has been attributed to the effect of the hard test (which may therefore overestimate it).
- 44 We estimate below the compliance costs and benefits for groups. We then estimate direct costs to us, and the market impact of the proposals taken together. The costs are set out in the table at paragraph 64. Capital costs are calculated as the annual marginal cost of raising capital and this is explained in more detail in Annex E.

### **Amendments to treatment of cross-sector holdings.**

#### *Estimate of costs for firms*

- 45 As explained in Chapter 5, insurance groups must change their valuation of subsidiaries and participations in banking and investment firms to comply with the directive. Groups which have such cross-sector interests will incur a one-off cost when amending reporting systems. We expect ongoing monitoring and reporting costs to be minimal, as the new treatment of cross-sector holdings will be part of an integrated reporting framework. Estimates of these costs are included in the table at paragraph 64.
- 46 Some groups may need to raise capital, and estimates of the costs of doing so for firms affected are included in the table at paragraph 64. Capital costs are calculated as the annual marginal cost of raising capital and this is explained in more detail in Annex E.

### *Analysis of benefits*

- 47 This directive requirement is a more prudent treatment of cross-sector holdings by insurance groups. It should benefit the financial stability of insurance groups by ensuring that the value recognised for such holdings in the group capital calculations does not double-count capital invested by the group in the cross-sectoral subsidiary. Increased financial stability should generate increased market confidence as set out in paragraph 64.
- 48 It also has the benefit of equalising treatment across the sectors so that banking and investment groups (which already comply with this part of the directive) can compete on more equal terms with insurance groups.

### **Hard group capital adequacy test**

#### *Estimate of costs for firms*

- 49 Insurance groups are already subject to a soft IGD test. The proposed move to a hard test at EEA level makes it a legal obligation for groups to rectify any group shortfall. This does not preclude some supervisory forbearance, but it implies that remedial action must be taken within some specific period of time.
- 50 Since the IGD was implemented, we have proposed a number of changes to insurance requirements, in Consultation Papers 145, 181, 190 and 195, and this is in addition to the proposals in this paper. For the purpose of estimating the impact of the hard test at group level, we assume that all of these changes will be in place when it is implemented – with the exception of the non-life ECR becoming a hard test at individual firm level (discussed below). Therefore we have added any additional capital requirements stemming from these other changes to the end 2002 reported insurance group capital positions, and then subtracted from the result the effects of specific action we know was taken during 2003. Where the result for a group is a deficit, this amount is included in the table at paragraph 64 on the basis that it will need to be made good when the hard test is applied.
- 51 These estimates suggest some groups may need to raise capital, and the costs of doing so for firms affected are included in the table at paragraph 64. Capital costs are calculated as the annual marginal cost of raising capital and this is explained in more detail in Annex E.
- 52 As explained in Chapter 5, we propose a phased approach to implementing the non-life ECR at both solo and group level. In the first phase, the non-life ECR is proposed to be a reporting requirement at solo level with no requirement at group level. This is reflected in this CBA. If and when the non-life ECR becomes a hard requirement at solo level – as explained and consulted on in CP190 – there is a presumption that this will be included in

the group hard requirement, increasing it by a corresponding amount. To capture this further impact, we shall consult further (including, of course, a cost benefit analysis) at the time we propose the updated group rule.

- 53 This commitment to consult when updating the group rule includes an assessment of the proposal against the background of the cumulative effect of our other sets of measures, to the extent possible, on the balance sheets of insurance companies under the market conditions prevailing at the relevant time, the equity market's appetite for insurance companies' capital and the markets for insurance companies' products.

#### *Analysis of benefits*

- 54 The move to a hard group capital adequacy test at the top EEA parent insurance holding company level will have the benefit of clearly signalling to firms our intention to enforce this requirement. This may improve the financial stability of insurance groups and market confidence in the insurance sector where we are the coordinator. For the consumer, increased market confidence may result in more consumers buying insurance products they want, but were not prepared to buy previously because the product's risk level exceeded their risk appetites.
- 55 Since sufficient regulatory capital will be held at the EEA insurance group level to cover the risks, groups may benefit from lower costs of raising capital, and lower expenditure on reputation building. There should be a lower risk of failure of regulated firms and consequently groups, and a saving in the administrative costs of the failure of firms.
- 56 As explained in Chapter 5, this proposal will realise fully the benefits of existing group requirements and recently proposed changes to solo requirements. The wider benefits of group wide prudential supervision, which apply equally here, were set out in paragraphs 19 – 21.

#### **Application of eligibility limits to capital.**

##### *Estimate of costs for firms*

- 57 The changes to eligibility limits set out in Chapter 5 are a considerable relaxation from the current position for insurance groups. We anticipate that the costs for firms flowing from this change will be limited to reporting, and these costs are included in the table at paragraph 64. We estimate that ongoing costs will be minimal as the required additional information will be part of an integrated reporting package.
- 58 In connection with this change we are proposing a standard IGD group capital return. We do not expect this form to cause material ongoing systems or implementation costs for the groups, as the information requested should

already be available as part of producing the current IGD return. A one-off systems and implementation cost is included in the table at paragraph 64.

### *Analysis of benefits*

- 59 Using debt as capital in this way is not likely to adversely affect the position of consumers. The proposed treatment is prudent, and harmonises the insurance sector with the current treatment in other sectors.
- 60 The proposal to change eligibility limits will improve consistency between the sectors and individual entities as all sectors will now be subject to the same requirements. Small changes in a group structure will be less likely to have a large impact on capital requirements.
- 61 Introducing a standard reporting form will improve the current position. Firms will know exactly what information they have to report (rather than currently where they have an indication of what to report), and can set their systems to automatically produce the information in the standard format. It should mean that:
- a) there is more transparency about the reporting process;
  - b) we are more easily able to analyse the information reported in a more efficient and effective way; and
  - c) comparison, and manipulation of the standardised results will be relatively straightforward.

### **Estimate of costs for the FSA**

#### *Initial costs*

- 62 Training of supervisors on the updates to the IGD and the new standard IGD return, as well as some limited updates to systems and processes will be needed.

#### *Annual costs*

- 63 We will consider a firm's individual and group capital needs as part of our normal risk assessment (Arrow) visits. The review of the calculation of the IGD position, will – as is also the case for the review of the new solo capital requirements – be more timely.

**64. Total estimated capital and implementation costs to firms of insurance proposals – details in Annex E**

	<b>Compliance costs (£'000)</b>	<b>Direct costs (£ ,000)</b>
<b>Initial costs</b>	157,150-166,350	100
<b>Annual costs</b>	134,330	Note

**Note**

There are no costs here, as it will be minimal change from the existing regime, once the initial changes have been made.

**Market impact of insurance proposals**

- 65 The proposed changes to the IGD test might result in the need to raise capital for some groups that do not have access to additional capital elsewhere within the group or where restructuring of the business is not an option. For some groups this could prove challenging under the current market conditions. To make this less of a hurdle we propose a staged implementation of the IGD hard test by first only including the minimum capital requirements for non-life insurers in the calculation.
- 66 Insurance groups needing to fund additional capital might reduce the range or quality of insurance products they offer to consumers. This will limit the choice of products to consumers and some of the consumers might not be able to buy the same products as in the past.
- 67 These groups might also seek to pass on their increased costs to their customers. Customers might as a result choose either to reduce the volume of insurance business they do with a particular insurer and transfer their business to another provider, or reduce the overall amount of insurance business they do. This would reduce consumers' surplus and could have wider economic impacts. We are not aware, however, of other product markets in which material impacts of this kind are anticipated. Conversely, increased confidence in insurers' financial strength might lead to higher volumes of business as consumers are now prepared to buy products they would not have previously bought because the product's risk level exceeded their risk appetite.
- 68 The improved quality of group capital adequacy reporting should improve market information and thus efficiency of competition. But for insurers with weak capital positions these changes might mean that insurers stop writing new business and exit the market. Where large numbers of insurers are issuing the same type of business, this is not likely to have a significant effect on competition and prices to consumers eg. mainstream personal lines type business. However, where a few insurers only are active in a particular type of

insurance business, any decrease in the number of active insurers, combined with an increase in their costs caused by higher capital standards, is likely to reduce competition in the market. This in turn would increase prices to consumers, as discussed above.

## Annex A

### Total estimated costs of identifying financial conglomerates

General assumptions are:

- Cost of FSA man day – £385 including overheads
- Cost of firm's man day – £450 including overheads

Specific assumptions are:

#### 1) Compliance costs – initial costs

##### a) Potential financial conglomerates

- Training time spent so far – 20 man days
- Time to do threshold test – 5 man days
- IT systems and consultants costs – £200k per conglomerate
- Number of conglomerates – 18

##### b) Cross-sectoral groups

- Training time needed – 10 man days
- Time to do threshold test – 5 man days
- IT systems and consultants costs – £5k per cross-sectoral group
- Number of cross-sectoral groups – 100

#### 2) Compliance costs – annual costs

- Time to do threshold test – 3 man days pa.
- To apply to 118 cross-sectoral groups including 18 conglomerates

#### 3) Direct costs – initial costs

- Time to review threshold test –  $\frac{1}{2}$  man day per cross-sector group
- To apply to 118 cross-sectoral groups including 18 conglomerates
- 2 man days training for 150 supervision staff

#### 4) Direct costs – annual costs

- Time to review threshold test –  $\frac{1}{2}$  man day pa. per cross-sector group
- To apply to 118 cross-sectoral groups including 18 conglomerates

## Annex B

### Total overall cost estimates for the new financial conglomerate requirements

General assumptions are:

- Cost of FSA man day – £385 including overheads
- Cost of firm's man day – £450 including overheads
- Number of conglomerates – 18

Specific assumptions are:

#### 1 Compliance costs – initial costs

##### a) Capital adequacy requirements

- Time to assemble information to do the calculation – 10 man days per conglomerate

##### b) LE and ITE requirements

- work to assess the adequacy of existing systems – range of £50-100k per conglomerate for the 10 banking conglomerates
- time to gather the information needed – 20-30 man days per conglomerate
- analysis of the information before submission to FSA – 5 man days per conglomerate
- IT systems costs – £400k each for the 10 banking conglomerates and £200k each for the 8 investment /insurance conglomerates

#### 2 Compliance costs – annual costs

##### a) Capital adequacy requirements

- Time to assemble information to do the calculation – 10 man days pa. per conglomerate

##### b) LE and ITE requirements

- time to gather the information needed – 20-30 man days pa. per conglomerate
- analysis of the information before submission to FSA – 5 man days pa. per conglomerate

3 Direct costs – initial costs

- a) Establishing a financial conglomerate regime
  - Time to develop OIVOP – 5 man days per conglomerate
- b) LE and ITE requirements
  - Time to agree reporting – 3 man days per conglomerate
- c) Requirement for co-ordination with other regulators
  - Time per conglomerate – 5 man days per conglomerate

4 Direct costs – annual costs

- Ongoing co-ordination with other regulators – 2 man days pa. per conglomerate

## Annex C

### Total estimated costs of identifying third country groups and financial conglomerates

General assumptions are:

- Cost of FSA man day – £385 including overheads
- Cost of firm's man day – £450 including overheads

Specific assumptions are:

#### 1 Compliance costs – initial costs

##### a) Third country investment groups and insurance or investment dominated conglomerates

- Time to confirm they are investment groups and insurance or investment dominated conglomerates – 1 man day per group
- Time to do the threshold calculation – 5 man days per group
- Training time needed – 15-20 man days per group or conglomerate
- To apply to 40 investment groups and insurance or investment dominated conglomerates

##### b) Banking groups and banking dominated conglomerates

- Time to confirm they are banking groups or banking dominated conglomerates – 1 man day per group
- To apply to 90 banking groups and banking dominated conglomerates

#### 2 Compliance costs – annual costs

- Time to do the threshold calculation – 3 man days pa. per group
- To apply to 40 investment groups and insurance or investment dominated conglomerates

#### 3 Direct costs – initial costs

##### a) Third country investment groups and insurance or investment dominated conglomerates

- Time to review threshold calculation –  $\frac{1}{2}$  – 2 man days per group
- Time for agreement about equivalent supervision and co-ordination needed – 4 man days per group

- To apply to 40 investment groups and insurance or investment dominated conglomerates
  - b) Banking groups and banking dominated conglomerates
    - Time for agreement about equivalent supervision and co-ordination needed – 1 man day per group
    - To apply to 90 banking groups and banking dominated conglomerates
- 4 Direct costs – annual costs
- Time to review threshold calculation –  $\frac{1}{2}$  man day pa. per group
  - To apply to 40 investment groups and insurance or investment dominated conglomerates

## Annex D

### Total estimated capital and implementation costs for investment firms of harmonising the investment firm rules and updating the waiver regime

General assumptions are:

- Cost of FSA man day – £385 including overheads
- Cost of firm's man day – £450 including overheads
- Cost of in-house accountant's time to do consolidated reporting – £500 including overheads
- Number of investment groups – 180
- Number of securities and futures groups affected – 18

Specific assumptions are:

#### 1. Compliance costs – initial costs

##### a) For harmonised rules

- Time for familiarisation –  $\frac{1}{2}$  man day for all investment groups

##### b) For securities and futures groups affected

- Time to do consolidated reporting – 5 man days
- Capital costs – Where we have been able to develop sensible estimates of the new levels of capital required by groups affected by these proposals, we have then derived an annual cost of raising and holding the new levels of capital needed, by applying the marginal cost of equity capital of 3.8%<sup>2</sup>.

#### 2. Compliance costs – annual costs

- Time to do consolidated reporting for securities and futures groups affected – 5 man days pa. per group
- Capital costs – see 1b) above. The capital cost has been calculated as an annual cost as set out in 1b) above, and so appears in the table as an annual recurring cost of raising and holding capital.

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2 The estimated cost of capital for investment firms is the difference between the cost of equity capital for those firms and the return that the firms could make on that capital if it were invested in risk-free assets. Different firms may have different costs of capital. Because of uncertainty about future returns, there is no single 'right' estimate of the cost of capital. Rather there is a range of reasonable estimates within which our estimate lies.

3. Direct costs – initial costs

a) For harmonised rules

- Time for familiarisation – 1 man day for 100 supervision staff

b) For securities and futures groups

- Time to review twice yearly consolidated returns – 2 man days per group

4. Direct costs – annual costs

- Time to review twice yearly consolidated returns for securities and futures groups – 2 man days pa. per group

## Annex E

### Total estimated capital and implementation costs to firms of insurance group proposals

#### General assumptions

- Cost of FSA man day – £385 including overheads
- cost of firm's man day – £450 including overheads
- number of insurance groups – 90

#### Specific assumptions

##### 1 Compliance costs – initial costs

###### a) Amendments to treatment of cross-sector holdings

- Time to implement (including training) – 5 man days per group
- Systems and controls costs – £10,000 – 15,000 per group
- To apply to 40 cross-sector groups

###### b) Hard capital adequacy requirement

- Agree action to rectify deficit – 3 man days per group
- To apply to 10 groups

###### c) Eligibility limits

- Time to implement (including training) – 20 man days per group
- Systems and IT costs – £90,000 – 140,000 per group
- To apply to all insurance groups

###### d) Standard reporting form

- Time to implement (including training) – 20 man days per group
- Systems and controls costs – £140,000 – 190,000 per group
- To apply to all insurance groups

###### e) Capital costs

- This includes estimates of the capital effect of:
  - CP145 – adjustment to the treatment of internally generated goodwill;
  - CP181 – implementing Solvency 1;

- CP190 – enhanced capital requirements and individual capital requirements for non-life insurers (solo requirements);
- CP195 – enhanced capital requirements and individual capital requirements for life insurers (solo requirements); and

from this CP

- The hard group capital adequacy test; and
- Amendments to the treatment of cross-sector holdings.
- Estimates of the capital effect have been reduced by actions taken since end 2002 to raise capital or adjust risk profiles. Some of this capital has become eligible because of the new eligibility criteria proposed in this CP.
- Where we have been able to develop sensible estimates of the new levels of capital required by groups affected by these proposals, we have then derived an annual cost of raising and holding the new levels of capital needed, by applying the marginal cost of equity capital of 3.5%<sup>3</sup>.

## 2 Compliance costs – annual costs

- Capital costs – see 1e) above. The capital cost has been calculated as an annual cost as set out in 1e) above, and so appears in the table as an annual recurring cost of raising and holding capital.

## 3 Direct costs – initial costs

- Systems and processes costs – £70,000
- Agree action to rectify deficit on hard capital adequacy requirement for 10 groups – 2 man days per group
- 1 day training time for 70 supervision staff

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3 The estimated cost of capital for insurance firms is the difference between the cost of equity capital for those firms and the return that the firms could make on that capital if it were invested in risk-free assets. Different firms may have different costs of capital. Because of uncertainty about future returns, there is no single ‘right’ estimate of the cost of capital. Rather there is a range of reasonable estimates within which our estimate lies. The rate used is consistent with that used in CPs 190 and 195.

# New requirements in the Integrated Prudential Sourcebook

## PRU 8.1 Systems and Controls

## 8.1 Group risk systems and controls requirement

### Application

- 8.1.1 G This chapter sets out how systems and controls requirements apply where a *firm* is part of a *group*.
- 8.1.2 R **PRU 8.1 applies to every *firm* in PRU categories 1, 2, 3 and 4a that is a member of a *group* except that:**
- (1) **PRU 8.1.10 R and PRU 8.1.11 R only apply to a *firm* that is a member of a *financial conglomerate* of which the FSA is the coordinator;**
  - (2) **PRU 8.1.6 R (2) – PRU 8.1.15 R do not apply to a *group* for which a competent authority in another EEA state is lead regulator or coordinator in the case of a *financial conglomerate*.**
- 8.1.3 G For the purposes of PRU 8.1, a *group* is defined in the *Glossary*, and includes the whole of a *firm*'s group, including financial and non-financial *undertakings*. It also covers *undertakings* with other links to *group* members if their omission from the scope of group risk systems and controls would be misleading. The scope of the group systems and controls requirements may therefore differ from the scope of the quantitative requirements set out in PRU 8.3, PRU 8.4 and PRU 8.5.
- 8.1.4 G *Financial conglomerate* is defined in the *Glossary*. PRU 8.4 sets out the new requirements for cross-sector groups meeting the definition of *financial conglomerate*.

### Purpose

- 8.1.5 G The purpose of this chapter is to set out how systems and controls requirements apply where a *firm* is part of a *group*. SYSC 3.1(*Systems and controls*) requires a *firm* to take reasonable care to establish and maintain such systems and controls as are appropriate to the nature, scale and complexity of its business. If a *firm* is a member of a *group*, it must be able to assess the potential impact of risks arising from other parts of its *group* as well as from its own activities.

### Systems and controls

- 8.1.6 R **A *firm* must ensure that:**
- (1) **it has adequate, sound and appropriate risk management processes and internal control mechanisms to ensure that it is able to assess and manage its own exposure to group risk; and**
  - (2) **its *group* has adequate, sound and appropriate risk management processes and internal control mechanisms at the level of the *group*.**

- 8.1.7 G For the purposes of *PRU 8.1.6 R*, the question of whether the risk management processes and internal control mechanisms are adequate, sound and appropriate must be judged in the light of the nature, scale and complexity of the *group's* business.

**Systems and controls: groups**

- 8.1.8 R The internal control mechanisms referred to in *PRU 8.1.6 R* must include:
- (1) mechanisms that are adequate for the purpose of producing any data and information required for the purpose of monitoring compliance with any prudential requirements, including any reporting requirements, to which it is subject by reference to the *firm's* membership of a *group* or that apply to or with respect to the *group* or part of it, including those relating to capital adequacy, solvency and large exposures; and
  - (2) mechanisms that are adequate to monitor funding within the *group*.
- 8.1.9 G The additional requirements set out in *PRU 8.1.10* and *PRU 8.1.11* apply to *financial conglomerates* only.

**Systems and Controls: financial conglomerates**

- 8.1.10 R In the case of a *firm* that is a member of a *financial conglomerate*, the risk management processes referred to in *PRU 8.1.6 R* (2) must include:
- (1) sound governance and management processes, which must include the approval and periodic review by the appropriate managing bodies within the *financial conglomerate*, of the strategies and policies of the *financial conglomerate* in respect of the risks assumed by the *financial conglomerate*, such review and approval being carried out at the level of the *financial conglomerate*;
  - (2) adequate capital adequacy policies at the level of the *financial conglomerate*, one of the purposes of which must be to anticipate the impact of the business strategy of the *financial conglomerate* on its risk profile and on the capital adequacy requirements to which it and its members are subject;
  - (3) adequate procedures for the purpose of ensuring that the risk monitoring systems of the *financial conglomerate* and its members are well integrated into the systems and controls of the *financial conglomerate* and its members; and
  - (4) adequate procedures for the purpose of ensuring that the systems and controls of the members of the *financial conglomerate* are sufficiently consistent and are capable of being measured, monitored and controlled at the level of the *financial conglomerate*.

- 8.1.11 R** In the case of a *firm* that is a member of a *financial conglomerate*, the internal control mechanisms referred to in *PRU 8.1.6 R (2)* must include:
- (1)** mechanisms that are adequate to identify and measure all material risks incurred by members of the *financial conglomerate* and appropriately relate capital in the *financial conglomerate* to risks; and
  - (2)** sound reporting and accounting procedures for the purpose of identifying, measuring, monitoring and controlling intra-*financial conglomerate* transactions and risk concentrations.

**Systems and controls: general**

- 8.1.12 R** In the case of a *firm* that:
- (1)** is a *credit institution* or *investment firm*; and
  - (2)** has a *mixed activity holding company* as a *parent undertaking*;
- the risk management processes and internal control mechanisms referred to in *PRU 8.1.6 R* must include sound reporting and accounting procedures and other mechanisms that are adequate to identify, measure, monitor and control transactions between the *firm*, the *mixed activity holding company*, and any of the *mixed activity holding company's subsidiaries*.
- 8.1.13 G *PRU 8.1.12 R* cannot apply to a building society as it cannot have a *mixed activity holding company parent undertaking*.

**Systems and controls: other considerations**

- 8.1.14 G Assessment of the adequacy of a *group's* systems and controls required by *PRU 8.1* will form part of FSA's risk management process.
- 8.1.15 G (1) The nature and extent of the systems and controls necessary under *PRU 8.1.6(1)* to address group risk will vary according to the materiality of those risks to the *firm* and the position of the *firm* within the *group*. If, for example, a *firm* is a *parent undertaking* of a *group*, it would normally be responsible for ensuring that systems and controls are in place across the *group* to enable it to monitor and control potential risks to it as a result of its membership of the *group*. However, it would be reasonable for a small *firm* within a larger *group* to rely on its *parent* to ensure that appropriate systems and controls are in place in other parts of the *group* to address such risks.
- (2) If both a *firm* and its *parent undertaking* are subject to the requirements of *PRU 8.1*, the FSA would not expect systems and controls to be duplicated. In this case, the *firm* should assess whether and to what extent it can rely on its *parent's* group risk systems and controls.

## PRU 8.3 Insurance groups

## 8.3 INSURANCE GROUPS

### Application

- 8.3.1R** This section applies to *firms in PRU category 2A*, referred to as *firms in this section*.
- 8.3.2G For the purposes of *PRU*, a *firm* is a *PRU category 2A firm* if its *Part IV permission* includes effecting *contracts of insurance* as principal or carrying out *contracts of insurance* as principal and it is not a *bank* or *building society*. The Society of Lloyd's is a *PRU category 2B firm*. [See PRAG1.36R in CP97].
- 8.3.3R** This section does not apply to:
- (1) a *firm which is a Swiss general insurer, or*
  - (2) a *firm which is an EEA-deposit insurer.*
- 8.3.4G *PRU8.3* does not apply to a *PRU category 2A firm* which is an *incoming EEA firm* or an *incoming Treaty firm*. [See PRAG 1.1.1R in CP97].

### Purpose

- 8.3.5G *PRU 8.3* implements 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 *financial service undertakings* that are *related undertakings* of an *insurance parent undertaking*.
- 8.3.6G The *Financial Groups Directive* introduces a capital adequacy requirement for *groups* with significant activities in the *insurance sector* and the *banking sector* and/or the *investment services sector* (*financial conglomerates*). This section sets out the rules for *insurance groups* and also forms the *sectoral rules* for an *insurance conglomerate*.
- 8.3.7G The *Insurance Groups Directive* requires a *firm* to calculate capital adequacy at the level of its *insurance parent undertaking* which is either an *insurance holding company* or an *insurance undertaking*. The *Financial Groups Directive* introduces a capital adequacy test for *regulated entities* at the level of a *parent undertaking* which is a *mixed financial holding company*. The definition of *insurance holding company* has been amended by the *Financial Groups Directive* to exclude a *mixed financial holding company*. As the rules for *insurance groups* in this section form the basis of the rules for an *insurance conglomerate*, both types of *group* will be subject to substantially the same group capital adequacy requirements.
- 8.3.8G The rules for calculation set out in this section implement the deduction and aggregation method in Method 1 as set out in Annex 1.3 of the *Insurance Groups Directive* and a combination of Method 2 and Method 3 as set out in

Annex 1(II) of the *Financial Groups Directive*. PRU8.3 therefore complies with *Financial Groups Directive* Method 4, which allows a mixture of two or more of the other three permitted methods of calculation in the *Financial Groups Directive*.

- 8.3.9G For the members of an *insurance group* listed in PRU8.3.61R, a *firm* is required to use the requirement deduction method of calculation (Method 3 of Annex 1(II) of the *Financial Groups Directive*).

### **Requirement to calculate GCR and GCRR**

- 8.3.10R A *firm* must on a regular basis calculate the *group capital resources (GCR)* and *group capital resources requirement (GCRR)* of each *undertaking* in PRU8.3.12R.

### **Requirement to maintain group capital**

- 8.3.11R (1) Subject to 8.3.21R, a *firm* must ensure that at all times its *capital resources* are of such an amount that the *group capital resources* of each *undertaking* in PRU8.3.12R 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.

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

- 8.3.12R The *undertakings* referred to in PRU8.3.10R and PRU8.3.11R 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 either an *insurance parent undertaking* or a *participating insurance undertaking*; and
- (2) for a *firm* which is:
- (a) a *pure reinsurer*; or
  - (b) a *non-EEA insurer*; or
  - (c) a *friendly society*;

the *firm* itself, if it is either an *insurance parent undertaking* or a *participating insurance undertaking*.

- 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:
    - (a) its inclusion would be inappropriate or misleading; or
    - (b) it is of negligible interest,
- with regard to the objectives of supplementary supervision.
- 8.3.14G It is the policy of the *FSA* generally to consider the value, in the circumstances described in 8.3.13G, of granting a *waiver* allowing the exclusion of an *undertaking* which is a member of an *insurance group* from the calculation of *group capital resources* and the *group capital resources requirement* required by *PRU8.3.10R*.
- 8.3.15G Examples of *undertakings* which may fall within 8.3.13G 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 *PRU8.3.13G* (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 The *FSA* may require the *firm* to provide information about any member of the *insurance group* excluded pursuant to a *waiver* granted in the circumstances described in 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 supervisor responsible for exercising supplementary supervision of a *firm* under Article 4(2) of the *Insurance Groups Directive*, the *firm* may prepare the calculations required under *PRU8.3.10R* in relation to the *ultimate EEA insurance parent undertaking* in accordance with the requirements in the *EEA State* of supplementary supervision.**

### **Non-EEA ultimate insurance parent undertakings**

- 8.3.19R **Where the *ultimate insurance parent undertaking* of a *firm* has its head office in a non-*EEA State*, the *firm* may elect (see *PRU 8.3.20R*) to calculate the *group capital resources* and the *group capital resources requirements* of its *ultimate insurance parent undertaking* in accordance**

with the accounting consolidation method (Method 3 in Annex 1.3 of the *Insurance Groups Directive*).

**8.3.20R** A *firm* may elect to use the calculation method referred to in *PRU 8.3.19R* 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*.

**8.3.21R** *PRU8.3.11R* 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

**8.3.22R** Subject to *PRU 8.3.24R*, when calculating *group capital resources* and the *group capital resources requirement* of an *undertaking* in *PRU8.3.12R*, only the relevant proportion of the following items (“calculation items”) are to be taken into account:

(1) the *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*.

**8.3.23R** In *8.3.22R*, the relevant proportion is the proportion of the total number of *shares* in the *regulated related undertaking* held, directly or indirectly, by the *undertaking* in *PRU8.3.12R*.

**8.3.24R** If the *individual capital resources requirement* of a *regulated related undertaking* 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* irrespective of the proportion of the *regulated related undertaking's shares* held by the *undertaking* in *PRU8.3.12R*.

### Calculation of the GCRR

**8.3.25R** Subject to *PRU 8.3.18R* and *8.3.19R*, the *group capital resources requirement* of an *undertaking* in *PRU8.3.12R* is the sum of the *individual capital resources requirement* of that *undertaking* and the *individual capital resources requirement* of each of its *regulated related undertakings*.

**8.3.26R** For the purposes of *PRU 8.3*, an *individual capital resources requirement* is:

(1) in respect of a *firm* that is not within (2), its *capital resources requirement* calculated in accordance with *PRU2.1*;

- (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 *UK*, 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, 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;
- (4) 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*;
- (5) in respect of an *insurance undertaking* that is not within (3) and whose head office is in a *designated State or territory*, either :
  - (i) the local capital resources requirement applicable to it in the *designated State or territory* in which it has its head office; or
  - (ii) its *proxy capital resources requirement*;
- (6) in respect of an *insurance undertaking* that is not within (1) to (5), its *proxy capital resources requirement*;
- (7) 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;
- (8) in respect of a *regulated entity* not within (7) (excluding an *insurance undertaking*), its *proxy capital resources requirement*; and
- (9) in respect of either a *financial holding company* (excluding an *insurance undertaking*) or an *insurance holding company*, zero.

8.3.27G

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 8.3.26R (2) and (3) 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 *UK*;
- (2) *firms* whose head office is in the *UK* 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*; and
- (4) reinsurers whose head office is outside the *EEA*.

### Calculation of GCR

**8.3.28R** Subject to *PRU 8.3.18R* and *8.3.19R*, the *group capital resources* of an *undertaking* in *PRU8.3.12R* are the amount obtained from stage G of the calculation in *PRU8.3.31R*, subject to the limits in *PRU8.3.33R* and *PRU8.3.35R*.

**8.3.29R** For the purposes of *PRU 8.3*, the following expressions, when used in relation to an *undertaking* in *PRU8.3.12R* or a *regulated related undertaking* that is not a *firm*, shall be construed as if that *regulated related undertaking* were a *firm*:

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

**8.3.30R (1)** In calculating *group capital resources*, a *firm* shall ignore the restricted assets of a *regulated related undertaking* save 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.

**8.3.31R** Table: Group capital resources

	Stage	Related text
Total group tier one capital	A	PRU8.3.36R
Total deductions from total group tier one capital	B	PRU8.3.38R & PRU8.3.39R

<b>Total group tier one capital after deductions</b>	<b>C=(A-B)</b>	
<b>Total group tier two capital</b>	<b>D</b>	<b>PRU8.3.50R</b>
<b>Group capital resources before deductions under requirement deduction method</b>	<b>E=(C+D)</b>	
<b>Total deductions under the requirement deduction method from group capital resources</b>	<b>F</b>	<b>PRU8.3.61R</b>
<b>Group capital resources</b>	<b>G=(E-F)</b>	

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

- 8.3.32G 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 **PRU8.3.12R**. These restrictions are set out in *PRU8.3.33R* and *PRU8.3.35R*
- 8.3.33R** **The total group tier one capital after deductions (calculated at stage C in *PRU8.3.31R*) must account for at least 50% of the group capital resources requirement of the undertaking in *PRU8.3.12R*; for this purpose a firm must exclude from the calculation of total group tier one capital:**
- (1) those *innovative instruments* that are in excess of 15% of the total group tier one capital after deductions (calculated at stage C in *PRU8.3.31R*); and
- (2) the amount (if any) by which the aggregate amount of *non-ordinary shares, capital instruments* and *innovative instruments* exceeds 50% of the total group tier one capital after deductions (calculated at that stage).
- 8.3.34G *Tier one capital resources* excluded under *PRU8.3.33R* can count towards tier two capital resources calculated in accordance with *PRU8.3.49R*.
- 8.3.35R** **A firm must exclude from the calculation of the group capital resources of an undertaking in *PRU8.3.12R* the following:**

- (a) the amount (if any) by which *total group tier two capital* (calculated at stage D in PRU8.3.31R) exceeds 100% of the *total group tier one capital* after deductions (calculated at stage C in PRU8.3.31R); and
- (b) the amount (if any) by which the sum of the *lower tier two capital resources* of the *undertaking* in PRU8.3.12R and its *regulated related undertakings* after any deductions required by PRU 8.3.50R exceeds 50% of the *total group tier one capital* after deductions (calculated at that stage).

### Calculation of GCR – Total group tier one capital

8.3.36R *Total group tier one capital* of an *undertaking* in PRU8.3.12R is the sum of:

- (1) the *tier one capital resources* of that *undertaking*; and
- (2) the *tier one capital resources* of each of the *regulated related undertakings* of that *undertaking* after the deduction in PRU 8.3.37R.

8.3.37R The deduction referred to in PRU 8.3.36 is the sum of:

- (1) the book value of the investment by the *undertaking* in PRU8.3.12R in the *tier one capital resources* of each of its *regulated related undertakings*; and
- (2) the book value of the investments by *related undertakings* of the *undertaking* in PRU8.3.12R in the *tier one capital resources* of each of its *regulated related undertakings*.

### Calculation of GCR – Deductions from total group tier one capital

8.3.38R The deductions from *total group tier one capital* are the sum of the following:

- (1) the group discount provision calculated in accordance with PRU8.3.47R;
- (2) the total of the inadmissible assets referred to in PRU8.3.46R;
- (3) the group intangible assets calculated in accordance with PRU8.3.48R; and
- (4) any investments by a *regulated related undertaking* or the *undertaking* in PRU8.3.12R in its own shares.

#### Assets in excess of market and counterparty exposure limits

8.3.39R Where the *undertaking* in PRU8.3.12R is a *firm*, in addition to the deductions referred to in PRU8.3.38R, an additional deduction from *total group tier one capital* must be made for the assets in excess of market and counterparty exposure limits referred to in PRU8.3.41R.

8.3.40G For the purposes of PRU8.3.31R, where the *undertaking* in PRU8.3.12R is a *firm* or a *regulated related undertaking* of that *undertaking* is a *firm* that is

itself either an *insurance parent undertaking* or a *participating insurance undertaking*, the investments referred to in *PRU8.3.37R(1)* are not subject to the market and counterparty exposure limits.

**8.3.41R** For the purposes of *PRU8.3.39R*, where a *firm (A)* is either a *participating insurance undertaking* or an *insurance parent undertaking* which has a *regulated related undertaking* that is a *firm (B)*, the assets of A in excess of the market and counterparty exposure limits set out in *PRCR 10* and *PRMR 11* (in *CP97*) must be calculated in accordance with *PRU8.3.43R*, subject to *PRU8.3.42R*.

**8.3.42R** For the purposes of *PRU8.3.41R*, the assets of A in excess of the market and counterparty exposure limits only need to be calculated in accordance with *PRU8.3.43R* if the *capital resources* of B exceed its *capital resources requirement* (as calculated in *PRU2.1* and *2.2*).

**8.3.43R** A's assets in excess of the market and counterparty exposure limits are calculated as follows:

- (1) the market and counterparty exposure limits are applied to the *admissible assets* of B chosen to cover the sum of the liabilities arising from its *insurance business* and its *capital resources requirement*;
- (2) after application of the market and counterparty exposure limits referred to in (1), the *admissible assets* of B that represent the amount by which the *capital resources* of B exceed its *capital resources requirement*, subject to *PRU8.3.44R*, and limited to the amount of transferable capital calculated in accordance with *PRU8.3.55R* and *8.3.56R* ("surplus assets"), are aggregated with the *admissible assets* of A;
- (3) the market and counterparty exposure limits are then applied to the aggregate of A's *admissible assets* and the surplus assets.

The amount by which the *admissible assets* aggregated in accordance with (3) exceed the market and counterparty exposure limits is the amount that must be deducted from A's *tier one capital resources* in accordance with *PRU8.3.39R*.

**8.3.44R** 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 *PRU8.3.43R*.

**8.3.45R** If B is itself either a *participating insurance undertaking* or an *insurance parent undertaking* with a *regulated related undertaking* that is a *firm*, then the *admissible assets* of B for the purposes of *PRU8.3.43R(1)* must be calculated as in *PRU8.3.43R(3)* but as if B were A.

#### Inadmissible assets

**8.3.46R** In *PRU8.3*, inadmissible assets means:

- (1) in the case of a *firm* that is a *regulated related undertaking* or an *undertaking in PRU8.3.12R*, all assets that are not *admissible assets*; and
- (2) in the case of a *regulated related undertaking* that is not a *firm*, all assets of the *undertaking* that are not admissible for the purpose of calculating the *undertaking's solo capital resources* in accordance with the *sectoral rules* applicable to it.

**Group discount provision**

**8.3.47R** The group discount provision is the sum of any downwards adjustments for discounting of technical provisions for *general insurance business* (which is optional under UK GAAP but not permitted under regulatory valuation) made by a *firm* that is a *regulated related undertaking* or an *undertaking in PRU8.3.12R*.

**Group intangible assets**

**8.3.48R** The group intangible assets are the sum of the intangible assets of the *undertaking in PRU8.3.12R* and each of its *regulated related undertakings*.

**8.3.49R** In *PRU8.3*, intangible assets means:

- (1) in the case of a *regulated related undertaking* that is a *firm*, the intangible assets, determined in accordance with *PRU 2.2.74R*; and
- (2) in the case of a *regulated related undertaking* that is not a *firm*, those assets that are identified as intangible assets for the purpose of calculating the *undertaking's solo capital resources* in accordance with the *sectoral rules* applicable to it.

**Calculation of GCR – Total group tier two capital**

**8.3.50R** Subject to *PRU 8.3.35R*, *total group tier two capital* of an *undertaking in PRU8.3.12R* is the sum of:

- (1) the *upper tier two capital resources* and the *lower tier two capital resources* of that *undertaking*; and
- (2) subject to *PRU8.3.52R*, the *upper tier two capital resources* and the *lower tier two capital resources* of each of the *regulated related undertakings* of that *undertaking* after the deduction in *PRU 8.3.51R*.

**8.3.51R** The deduction referred to in *PRU 8.3.50R* is the sum of:

- (1) the book value of the investments by the *undertaking in PRU8.3.12R* in the *upper tier two capital resources* and the *lower tier two capital resources* of each of its *regulated related undertakings*; and

- (2) the book value of the investments by *related undertakings* of the *undertaking* in *PRU8.3.12R* in the *upper tier two capital resources* and the *lower tier two capital resources* of each of its *regulated related undertakings*;

### Calculation of GCR – Transferable capital

- 8.3.52R** Unless permitted by *PRU8.3.54R*, where the *undertaking* in *PRU8.3.12R* is a *firm*, the *upper tier two capital resources* and *lower tier two capital resources* of any *regulated related undertaking* that is a *firm* shall be excluded from the calculation in *PRU8.3.50R*.
- 8.3.53G Where the *regulated related undertaking* is a *firm*, its *tier two capital resources* are excluded for the purposes of the calculation of *total group tier two capital* save to the extent that the *tier two capital resources* of the *firm* are included in the calculation of that *firm's* transferable capital in accordance with *PRU8.3.55R* and 8.3.56R.
- 8.3.54R** A *firm* which is a *regulated related undertaking* of either a *participating insurance undertaking* or an *insurance parent undertaking* that is itself a *firm* may only contribute transferable capital to the *total group tier two capital* of the *insurance parent undertaking* or *participating insurance undertaking*.
- 8.3.55R** The transferable capital of a *firm* is the amount calculated in accordance with *PRU8.3.56R* that can be paid by way of dividend to the *insurance parent undertaking* or *participating insurance undertaking* of the *firm* under UK GAAP without breaching the *capital resources requirement* of the *firm*.
- 8.3.56R** Transferable capital is calculated, subject to the limits in *PRU8.3.57R* and 8.3.58R, as the amount of:
- (1) the *tier one capital resources* of the *firm*; plus
  - (2) the *tier two capital resources* of the *firm* (having applied the limit on the use of different forms of capital set out in *PRU2.2.22R* [in CP 195] to those *tier two capital resources*); less
  - (3) the *capital resources requirement* of the *firm*.
- 8.3.57R** Transferable capital must not exceed that part of the *tier one capital resources* of the *firm* that comprises audited reserves.
- 8.3.58R** *Tier one capital resources* of the *firm*, after deduction of transferable capital, must not be equal to less than 50% of the *capital resources requirement* of the *firm*.
- 8.3.59G *PRU8.3.52R* does not apply to the calculation of *total group tier two capital* of an *insurance parent undertaking* which is not a *firm*.
- 8.3.60G Examples of transferable capital:

e.g. 1

<b>Share capital</b> 30	<b>Audited reserves</b> 20	<b>Tier two</b> 40	<b>Requirement</b> 50
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Transferable capital =  $(30 + 20) + 40 - 50 = 40$  (maximum 20)\*

\* (i) the issue of *tier two capital resources* of 40 creates a surplus of *capital resources* (after application of the limits in *PRU 2.2.22R*) over the *capital resources requirement* (40). However 8.3.57R limits transferable capital to the amount of audited reserves (20).

(ii) *tier two capital resources* may count towards a maximum of 50% of the *capital resources requirement* (25) under 8.3.58R. Therefore all the 20 of capital identified in (i) is transferable.

e.g. 2

<b>Share capital</b> 10	<b>Audited reserves</b> 20	<b>Tier two</b> 20	<b>Requirement</b> 30
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Transferable capital =  $(10 + 20) + 20 - 30 = 20$  (maximum 15)\*

\* (i) the issue of *tier two capital resources* of 20 creates a surplus of *capital resources* (after application of the limits in *PRU 2.2.22R*) over the *capital resources requirement* (20). As this does not exceed the amount of audited reserves it is not limited by 8.3.57R.

(ii) however, in this example, *tier two capital resources* exceed the limit in 8.3.58R (50% of the *capital resources requirement* = 15). Therefore transferable capital is limited to 15.

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

**8.3.61R** For the purposes of *PRU 8.3.31R*, the deductions from the *group capital resources* (calculated at stage E in *PRU 8.3.31R*) are the sum of the value of the investments by the *undertaking* in *PRU 8.3.12R* in a *related undertaking* which is either:

- (1) a non-regulated *financial institution* (excluding a *financial holding company*); or
- (2) an *ancillary insurance services undertaking*, an *ancillary banking services undertaking* or an *ancillary investment services undertaking*,

calculated in accordance with *PRU 8.3.62R*.

**8.3.62R** The value of an investment in an *undertaking* referred to in *PRU 8.3.61R* is the higher of the book value of the investment by the *undertaking* in

***PRU 8.3.12R and the notional capital resources requirement of that undertaking.***

**8.3.63R**

**For the purposes of *PRU8.3.62R*, the notional capital resources requirement is:**

- (1) for an *ancillary insurance services undertaking*, zero;**
- (2) for any other *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*.**

# Insurance group transitional provisions

Insurance group transitional provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	PRU 8.3.10R and PRU 8.3.11R	R	(1) A <i>firm</i> may elect not to take a <i>regulated related undertaking</i> which is not an <i>insurance undertaking</i> or an <i>insurance holding company</i> into account for the purposes of the calculation of the <i>group capital resources and group capital resources requirement of an undertaking</i> in PRU 8.3.12R in accordance with, respectively, PRU 8.3.25R and PRU 8.3.28R.	From [ <i>insert date these rules come into force</i> ] until the first day of the <i>firm's</i> financial year beginning on 1 January 2005 or during that financial year.	[ <i>Insert date these rules come into force</i> ]
			(2) A <i>firm</i> may elect not to take a <i>regulated related undertaking</i> which is not an <i>insurance undertaking</i> or an <i>insurance holding company</i> into account as referred to in (1), if it has made the election by written notice to the <i>FSA</i> in a way that complies with the requirements for written notice in SUP 15.7		
			(3) A <i>regulated related undertaking</i> which is not to be taken into account as set out in (1) shall instead be treated in accordance with (4).		
			(4) A <i>regulated related undertaking</i> within (3) shall, for the purposes of the calculations referred to in (1) be valued in accordance with the general valuation requirements set out in [PRAG 5.3 in CP97],subject to (5).		
			(5) For the purposes of valuing a <i>regulated related undertaking</i> within (3), the value of that <i>regulated related undertaking</i> determined in accordance with		

			<p><b>[PRAG 5.3 in CP97] must be reduced:</b></p> <p><b>(i) by an approximate amount, to the extent that the value of the <i>regulated related undertaking</i> cannot effectively be realised to meet <i>capital resources requirement</i> of an <i>undertaking</i> in PRU8.3.12R;</b></p> <p><b>and</b></p> <p><b>(ii) by an approximate amount, to the extent needed to exclude value attributable to goodwill generated from the business of the <i>regulated related undertaking</i> with other members of the <i>insurance group</i> or <i>insurance conglomerate</i>.</b></p>		
2		G	<p>(1) The inclusion of a <i>regulated related undertaking</i> which is not an <i>insurance undertaking</i> or an <i>insurance holding company</i> in the scope of application of PRU8.3.25R and 8.3.28R implements the amendments to the <i>First Non-Life Directive</i>, <i>First Life Directive</i> and <i>Insurance Groups Directive</i> in Articles 22(2), 23(2) and 28(6) of the <i>Financial Groups Directive</i>.</p> <p>(2) This transitional provision postpones the requirement to include a <i>regulated related undertaking</i> which is not an <i>insurance undertaking</i> or an <i>insurance holding company</i> in the calculations required by PRU8.3 until the effective date of the <i>Financial Groups Directive</i>.</p> <p>(3) In the interim, a <i>firm</i> may elect either to apply PRU8.3 or the general valuation rules for <i>related undertakings</i> which do not fall within the scope of PRU8.3, as set out in [PRAG5.3 of CP97], subject to the adjustments in 1R(5). The intention is to allow <i>firms</i> to</p>		

		continue to take the <i>regulated related undertakings</i> referred to in 1R(1) and any other <i>related undertaking</i> not referred to in <i>PRU8.3</i> into account as they would formerly have done under IPRU(INS) for the purposes of calculating the <i>capital resources</i> of an <i>undertaking</i> in <i>PRU8.3.12R</i> .		
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## PRU 8.4 Cross sector groups

## **8.4 Cross sector groups**

### **Application**

**8.4.1 R** *PRU 8.4 applies to every firm that is a member of a financial conglomerate.*

### **Purpose**

8.4.2 G The purpose of *PRU 8.4* is to apply consolidated supervision to groups with significant activities in the *banking sector* and the *investment services sector* on the one hand and the *insurance sector* on the other.

8.4.3 G *PRU 8.4* ensures that consolidated supervision is applied to all *EEA regulated entities* in such groups on a group-wide basis and not on a *financial sector* by *financial sector* basis.

8.4.4 G *PRU 8.4* implements the *Financial Groups Directive*. However, material on the following topics is to be found elsewhere in the *Handbook* as follows:

- (1) further material on *third-country financial conglomerates* can be found in *PRU 8.5*;
- (2) *SUP 15.9* requires a *firm* to notify the *FSA* if a *consolidation group* of which it is a member is, has become or has ceased to be a *financial conglomerate*;
- (3) material on reporting obligations can be found in *SUP 16.7.73R - SUP 16.7.74R*; and
- (4) material on systems and controls in *financial conglomerates* can be found in *PRU 8.1*.

### **Introduction: Contents**

8.4.5 G *PRU 8.4* is organised as follows.

- (1) It begins with an introduction explaining lead supervision under the *Financial Groups Directive* and the role of other *competent authorities*. The introduction also explains the tools available under the *Act* that are relevant to carrying out supervision under *PRU 8.4*.
- (2) It then sets out the definition of *financial conglomerate*.
- (3) Finally it sets out substantive obligations about capital adequacy, *risk concentrations* and *intra group transactions*.

### **Introduction: Lead supervision and the start of supervision**

- 8.4.6 G A lead supervisor (called the *coordinator*) is appointed for each *financial conglomerate*. Article 10 of the *Financial Groups Directive* describes the criteria for deciding which *competent authority* is appointed as *coordinator*.
- 8.4.7 G Article 11 of the *Financial Groups Directive* sets out the tasks of the *coordinator*.
- 8.4.8 G Article 4(2) of the *Financial Groups Directive* says that a *financial conglomerate* should be notified by its *coordinator* that it has been identified as a *financial conglomerate* and of the appointment of the *coordinator*. This has been implemented in the *United Kingdom* by regulation 2 of the *Financial Groups Directive Regulations*. The notification should be given to the *parent undertaking* at the head of the group or, in the absence of a *parent undertaking*, the *regulated entity* with the largest balance sheet total in the *most important financial sector*.

#### **Introduction: The role of other competent authorities**

- 8.4.9 G A committee of other *competent authorities* acts in cooperation with the *coordinator*. These are called *relevant competent authorities*. The *competent authorities* that act as *relevant competent authorities* for a particular *financial conglomerate* are set out in Article 2(17) of the *Financial Groups Directive* (Definitions).

#### **Introduction: Tools for modifying obligations**

- 8.4.10 G There are a number of areas in which the *Financial Groups Directive* contemplates that *competent authorities* may modify the way in which the scheme in the *Financial Groups Directive* is applied. In general the *coordinator* is responsible for applying these modifications. In some cases the *coordinator* should consult with the other *relevant competent authorities* before taking the action or get their prior consent. The main areas are as follows:
- (1) adjustments to the definition of *financial conglomerate* referred to in *PRU 8.4.29G- PRU 8.4.32G*;
  - (2) application of supervision under the *Financial Groups Directive* to certain groups that do not qualify as a *financial conglomerate*, as referred to in *PRU 8.4.33G*; and
  - (3) the adjustments referred to in *PRU 8.4.52G*.
- 8.4.11 G The ways that the modifications referred to in *PRU 8.4.10G* may be applied include:
- (1) a modification of the *rules* in *PRU 8.4* or *PRU 8 Annex 1* applied for by the *firms* concerned;
  - (2) the use of the *own-initiative power*; and
  - (3) other variations of a *firm's Part IV permission*.

- 8.4.12 G The duty of the *FSA* to consult with the other *relevant competent authorities* or to obtain their consent referred to in PRU 8.4.10G is dealt with in regulations 3 (Exercise of functions under Part IV of the Act for the purposes of carrying on supplementary supervision) and 4 (Exercise of functions under section 148 of the Act for the purposes of carrying on supplementary supervision) of the *Financial Groups Directive Regulations*.

**Introduction: Unregulated group members**

- 8.4.13 G The exercise of supervision of a *financial conglomerate* does not in any way imply that the *FSA* or any other *competent authority* is required to play a supervisory role in relation to unregulated members of the *financial conglomerate*.

**Definition of financial conglomerate: Introduction**

- 8.4.14 G There are two questions when deciding whether a *firm* is a member of a *financial conglomerate*:
- (1) whether the *firm* is a member of a group structure that is capable of being a *financial conglomerate*; and
  - (2) (if the *firm* is part of such a structure) whether that structure falls within the definition of *financial conglomerate*.

**Definition of financial conglomerate: Introduction: Eligible group structures**

- 8.4.15 G There are two types of group structure that fall into PRU 8.4.14G(1). The *Financial Groups Directive* calls such structures a group. In the *Handbook* they are called *consolidation groups*. They are as follows:

- (1) a *conventional group*; and
- (2) a group based on a *consolidation Article 12(1) relationship*.

- 8.4.16 G A *conventional group* means the following *undertakings*:

- (1) a *parent undertaking*;
- (2) *subsidiary undertakings* of that *parent undertaking*;
- (3) *undertakings* in which the *parent undertaking* in (1) holds a *participation*; and
- (4) *undertakings* in which the *subsidiary undertakings* in (2) hold a *participation*.

- 8.4.17 G A *consolidation Article 12(1) relationship* arises between *undertakings* in the circumstances set out in Article 12(1) of the *Seventh Company Law Directive*. These are set out in the *Glossary* (in the definition of *consolidation Article 12(1) relationship*). Broadly speaking, *undertakings* come within this definition if they do not form a *conventional group* but:

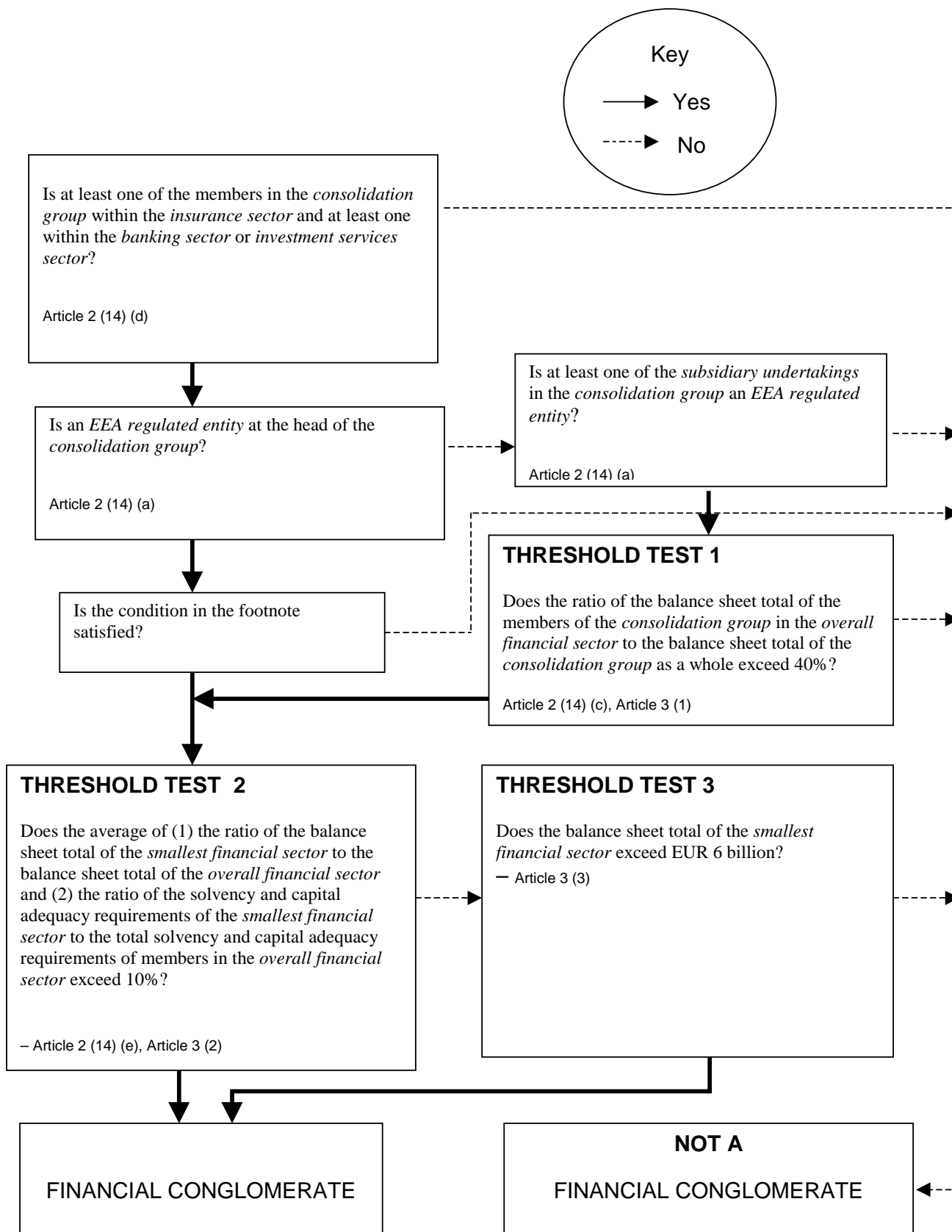
- (1) are managed on a unified basis; or
- (2) have common management.

**Definition of financial conglomerate: Introduction: Tests for being a financial conglomerate**

- 8.4.18 G Once it has been decided that a *firm* is in a group that potentially comes within the definition of a *financial conglomerate* as referred to in *PRU 8.4.14G(1)*, the next question is whether the group falls into the definition of *financial conglomerate*. The test for this is set out in the decision tree in *PRU 8.4.20R*.

**Definition of financial conglomerate: Basic definition**

- 8.4.19 R A *financial conglomerate* means a *consolidation group* that is identified as a *financial conglomerate* in accordance with the decision tree in *PRU 8.4.20R*.
- 8.4.20 R Decision tree defining a financial conglomerate  
This table belongs to *PRU 8.4.19R*



Footnote: The condition in this footnote is satisfied if the EEA regulated entity at the head of the consolidation group satisfies one of the following conditions:

- (1) it is a parent undertaking of a member of the consolidation group in the overall financial sector;
- (2) it has a participation in a member of the consolidation group that is in the overall financial sector; or
- (3) it has a consolidation Article 12(1) relationship with a member of its consolidation group that is in the overall financial sector.

**Definition of financial conglomerate: Sub-groups**

- 8.4.21 R A *consolidation group* is not prevented from being a *financial conglomerate* because it is part of a wider:
- (1) *consolidation group*;
  - (2) *financial conglomerate*; or
  - (3) group of persons linked in some other way.

**Definition of financial conglomerate: The financial sectors: General**

- 8.4.22 R For the purpose of the definition of *financial conglomerate*, there are two *financial sectors* as follows:
- (1) the *banking sector* and the *investment services sector*, taken together; and
  - (2) the *insurance sector*.
- 8.4.23 R For the purpose of the definition of *financial conglomerate*, any *mixed financial holding company* is considered to be outside the *overall financial sector* for the purpose of the tests set out in the boxes titled Threshold Test 1, Threshold Test 2 and Threshold Test 3 in the *financial conglomerate definition decision tree*.

**Definition of financial conglomerate: Adjustment of the percentages**

- 8.4.24 R Once a *financial conglomerate* has become a *financial conglomerate* and subject to supervision in accordance with the *Financial Groups Directive*, the figures in the *financial conglomerate definition decision tree* are altered as follows:
- (1) the figure of 40% in the box titled Threshold Test 1 is replaced by 35%;
  - (2) the figure of 10% in the box titled Threshold Test 2 is replaced by 8%; and
  - (3) the figure of six billion Euro in the box titled Threshold Test 3 is replaced by five billion Euro.
- 8.4.25 R The alteration in *PRU 8.4.24R* only applies to a *financial conglomerate* during the period that:
- (1) begins when the *financial conglomerate* would otherwise have stopped being a *financial conglomerate* because it does not meet one of the unaltered thresholds referred to in *PRU 8.4.24R*; and
  - (2) covers the three years following that date.
- 8.4.26 G As explained in Article 3(6) of the *Financial Groups Directive*, the reason for *PRU 8.4.24R* is to avoid sudden regime shifts.

#### Definition of financial conglomerate: Balance sheet totals

- 8.4.27 R The calculations referred to in the *financial conglomerate definition decision tree* relating to balance sheet totals shall be made on the basis of the aggregated balance sheet total of the members of the *consolidation group*, according to their annual accounts. For the purposes of this calculation, *undertakings* in which a *participation* is held shall be taken into account as regards the amount of their balance sheet total corresponding to the aggregated proportional share held by the *consolidation group*. However, where consolidated accounts are available, they shall be used instead of aggregated accounts.

#### Definition of financial conglomerate: Solvency requirement

- 8.4.28 R The solvency and capital adequacy requirements referred to in the *financial conglomerate definition decision tree* shall be calculated in accordance with the provisions of the relevant *sectoral rules*.

#### Definition of financial conglomerate: Discretionary changes to the definition

- 8.4.29 G Article 3(3) of the *Financial Groups Directive* contemplates that, if a *consolidation group* passes the 6 billion Euro test in the box titled Threshold Test 3 in the *financial conglomerate definition decision tree* but does not reach the threshold in the box titled Threshold Test 2 (balance sheet and solvency requirements ratio of 10%), the *relevant competent authorities* may decide by common agreement not to regard the group as a *financial conglomerate*, or to disapply certain obligations.
- 8.4.30 G Article 3(4) of the *Financial Groups Directive* contemplates that the *relevant competent authorities* may, by common agreement, make the following adjustments for the purpose of defining whether a *financial conglomerate* exists:
- (1) exclude a *person* when calculating the ratios in the *financial conglomerate definition decision tree*, in specified cases; or
  - (2) take into account compliance with the conditions set out in the boxes titled Threshold Test 1 (balance sheet ratio of 40%) and Threshold Test 2 (balance sheet and solvency requirements ratio of 10%) in the *financial conglomerate definition decision tree* for three consecutive years so as to avoid sudden regime shifts, and disregard such compliance if there are significant changes in the *consolidation group's* structure.
- 8.4.31 G Article 3(5) of the *Financial Groups Directive* contemplates that, for the application of the conditions set out in the boxes titled Threshold Test 1 (balance sheet ratio of 40%) and Threshold Test 2 (balance sheet and solvency requirements ratio of 10%) in the *financial conglomerate definition decision tree*, the *relevant competent authorities* may, in exceptional cases and by common agreement, use certain other parameters.

- 8.4.32 G Article 3(6) of the *Financial Groups Directive* contemplates that, during the three year period referred to in *PRU 8.4.24R*, the *coordinator* may, with the agreement of the other *relevant competent authorities*, decide that the lower ratios or the lower amounts referred to in that *rule* shall cease to apply.

#### **Definition of financial conglomerate: expanded definition**

- 8.4.33 G Article 5(4) of the *Financial Groups Directive* provides for the scheme in the *Financial Groups Directive* to be applied to *EEA regulated entities* in specified kinds of group structures that do not come within the definition of *financial conglomerate* if certain conditions are satisfied.

#### **Capital adequacy requirements: Introduction**

- 8.4.34 G The capital adequacy provisions of this chapter are limited to *EEA-based financial conglomerates*.
- 8.4.35 G *PRU 8.4.45R* is a high level capital adequacy *rule*. It applies whether or not the *FSA* is the *coordinator* of the *financial conglomerate* concerned. However, it does not apply with respect to a *third-country financial conglomerate*.
- 8.4.36 G Annex I of the *Financial Groups Directive* lays down four methods for calculating capital adequacy at the level of a *financial conglomerate*. Those four methods are implemented in *PRU 8 Annex 1* as follows.
- (1) Method 1 calculates capital adequacy using accounting consolidation. It is implemented in Part 1 of *PRU 8 Annex 1*.
  - (2) Method 2 calculates capital adequacy using a deduction and aggregation approach. It is implemented in Part 2 of *PRU 8 Annex 1*.
  - (3) Method 3 calculates capital adequacy using book values and the deduction of capital requirements. It is implemented in Part 3 of *PRU 8 Annex 1*.
  - (4) Method 4 consists of a combination of Methods 1, 2 and 3 from Annex I of the *Financial Groups Directive*, or a combination of two of those Methods. It is implemented in Part 4 of *PRU 8 Annex 1*.
- 8.4.37 G In the following cases, the *FSA* (acting as *coordinator*) may choose which of the four methods for calculating capital adequacy laid down in Annex I of the *Financial Groups Directive* should apply:
- (1) where a *financial conglomerate* is headed by a *regulated entity* that has been authorised by the *FSA*; or
  - (2) the only *relevant competent authority* for the *financial conglomerate* is the *FSA*.

As explained in *PRU 8.4.44G*, Method 4 from Annex I of the *Financial Groups Directive* is applied automatically in these circumstances.

- 8.4.38 G Where *PRU 8.4.37G* does not apply, the Annex I method to be applied must be decided by the *coordinator* after consultation with the *relevant competent authorities* and the *financial conglomerate* itself.
- 8.4.39 G The *rules* in *PRU 8 Annex 1* and *PRU 8.4.46R-PRU 8.4.51R* are only designed to be applied with respect to a *financial conglomerate* if the *FSA* is the *coordinator* for it. If another *competent authority* is *coordinator* of a *financial conglomerate*, that *coordinator* will be responsible for implementing Annex I of the *Financial Groups Directive* with respect to it.
- 8.4.40 G The method of calculating capital adequacy chosen in respect of a *financial conglomerate* as described in *PRU 8.4.38G* will be applied with respect to that *financial conglomerate* by varying the *Part IV permission* of a *firm* in that *financial conglomerate* to include a *requirement*. That *requirement* will have the effect of obliging the *firm* to ensure that the *financial conglomerate* has capital resources of the type and amount needed to comply with whichever of the methods in *PRU 8 Annex 1* is to be applied with respect to that *financial conglomerate*. *PRU 8.4.46R* deals with the application of Method 4 from Annex I of the *Financial Groups Directive*. *PRU 8.4.49R* deals with the other methods. Except as explained in *PRU 8.4.44G*, neither of those *rules* apply automatically. Instead they are applied by the variation of a *firm's Part IV permission* as described at the start of *PRU 8.4.40G*. *PRU 8.4.50R* and *PRU 8.4.51R* deal with such variations. The tools described in *PRU 8.4.10G* can be used to implement one of the methods from Annex I of the *Financial Groups Directive* in a way that is different from that set out in *PRU 8.4* and *PRU 8 Annex 1* if that is necessary to reflect the consultations referred to in *PRU 8.4.38G*.
- 8.4.41 G If there is more than one *firm* in a *financial conglomerate* with a *Part IV permission*, the *FSA* would not normally expect to apply the *requirement* described in *PRU 8.4.40G* to all of them. Normally it will only be necessary to apply it to one.
- 8.4.42 G Part 4 of *PRU 8 Annex 1* (Use of Method 4 from Annex I of the *Financial Conglomerates Directive*) applies the *FSA's sectoral rules* with respect to the *financial conglomerate* as a whole, with some adjustments. This is consistent with Method 4 from Annex I of the *Financial Groups Directive* because those *sectoral rules* are compatible with that Method. As respects:
- (1) the *insurance sector*, Part 4 involves a combination of Methods 2 and 3; and
  - (2) the *banking sector* and the *investment services sector*, Part 4 involves a combination of Methods 1 and 3.
- 8.4.43 G The *FSA* expects that in all or most cases falling into *PRU 8.4.38G*, *PRU 8.4.46R* (Use of Method 4 from Annex I of the *Financial Conglomerates Directive*) will be applied.
- 8.4.44 G Where a *financial conglomerate* falls into *PRU 8.4.37G*, *PRU 8.4.46R* (Use of Method 4 from Annex I of the *Financial Conglomerates Directive*) applies automatically. The process in *PRU 8.4.40R* does not apply.

**Capital adequacy requirements: High level requirement**

- 8.4.45** R A *firm* that is a member of a *financial conglomerate* must at all times have capital resources of such an amount and type that results in the capital resources of the *financial conglomerate* taken as a whole being adequate. This rule does not apply with respect to a *third-country financial conglomerate*.

**Capital adequacy requirements: Application of Method 4 from Annex I of the Financial Groups Directive**

- 8.4.46** R If this rule applies under PRU 8.4.47R to a *firm* with respect to a *financial conglomerate* of which it is a member, the *firm* must at all times have capital resources of an amount and type:
- (1) that ensure that the *financial conglomerate* has capital resources of an amount and type that comply with the rules applicable with respect to that *financial conglomerate* under Part 4 of PRU 8 Annex 1 (as modified by that Annex); and
  - (2) that as a result ensure that the *firm* complies with those rules (as so modified) with respect to that *financial conglomerate*.
- 8.4.47** R PRU 8.4.46R applies to a *firm* with respect to a *financial conglomerate* of which it is a member if:
- (1) notification has been made to the *financial conglomerate* in accordance with regulation 2 of the *Financial Groups Directive Regulations* that the *financial conglomerate* is a *financial conglomerate*;
  - (2) the FSA is *coordinator* of that *financial conglomerate*;
  - (3) the *financial conglomerate* is not part of a wider *financial conglomerate*:
    - (a) for which the FSA is *coordinator*; and
    - (b) with respect to which any of the FSA's *conglomerate capital adequacy rules* apply;
  - (4) the *financial conglomerate* is an *EEA financial conglomerate*; and
  - (5) one of the following conditions is satisfied:
    - (a) the condition in PRU 8.4.48R is satisfied; or
    - (b) this rule is applied to the *firm* with respect to that *financial conglomerate* as described in PRU 8.4.50R.

**Capital adequacy requirements: Compulsory application of Method 4 from Annex I of the Financial Groups Directive**

**8.4.48** R The condition in this *rule* is satisfied for the purpose of *PRU 8.4.47R(5)(a)* with respect to a *firm* and a *financial conglomerate* of which it is a member (with the result that *PRU 8.4.46R* automatically applies to that *firm* if the other conditions in *PRU 8.4.47R* are satisfied) if:

- (1) the *financial conglomerate* is headed by a *regulated entity* that is a *UK domestic firm*; or
- (2) the only *relevant competent authority* for that *financial conglomerate* is the *FSA*.

**Capital adequacy requirements: Application of methods 1, 2 or 3 from Annex I of the Financial Groups Directive**

**8.4.49** R If with respect to a *firm* and a *financial conglomerate* of which it is a member:

- (1) *PRU 8.4.47R* does not apply to that *firm* with respect to that *financial conglomerate* under *PRU 8.4.47R(5)(a)* and *PRU 8.4.48R* (compulsory application of Method 4); and
- (2) this *rule* is applied to the *firm* with respect to that *financial conglomerate* as described in *PRU 8.4.50R*;

the *firm* must at all times have capital resources of an amount and type that ensures that the *conglomerate capital resources* of that *financial conglomerate* at all times equal or exceed its *conglomerate capital resources requirement*.

**Capital adequacy requirements: Use of Part IV permission to apply Annex I of the Financial Groups Directive**

**8.4.50** R With respect to a *firm* and a *financial conglomerate* of which it is a member:

- (1) *PRU 8.4.46R* (Method 4 from Annex I of the *Financial Groups Directive*) is applied to the *firm* with respect to that *financial conglomerate* as referred to in *PRU 8.4.47R(5)(b)*; and
- (2) *PRU 8.4.49R* (Methods 1-3 from Annex I of the *Financial Groups Directive*) is applied to the *firm* with respect to that *financial conglomerate* as referred to in *PRU 8.4.49R(3)*;

if the *firm's Part IV permission* contains a *requirement* obliging the *firm* to comply with *PRU 8.4.46R* or, as the case may be, *PRU 8.4.49R*.

**8.4.51** R If *PRU 8.4.49R* (Methods 1-3 from Annex I of the *Financial Groups Directive*) applies to a *firm* with respect to a *financial conglomerate* of which it is a member, the definitions of *conglomerate capital resources* and *conglomerate capital resources requirement* that apply for the purposes of that *rule* are the ones from whichever of Part 1, Part 2 or Part 3 of *PRU 8 Annex 1* is specified in the *requirement* referred to in *PRU 8.4.50R*.

**Capital adequacy requirements: Adjusting the scope of coverage**

- 8.4.52 G Article 6(5) of the *Financial Groups Directive* contemplates that the *coordinator* may decide not to include a particular entity in the scope of capital adequacy requirements that apply with respect to a *financial conglomerate* in specified cases.

**Risk concentration and intra-group transactions: Introduction**

- 8.4.53 G *PRU 8.4.57R* implements Article 7(4) of the *Financial Groups Directive*, which says that where a *financial conglomerate* is headed by a *mixed financial holding company*, the *sectoral rules* regarding *risk concentration* of the *most important financial sector* in the *financial conglomerate*, if any, shall apply to that sector as a whole, including the *mixed financial holding company*.
- 8.4.54 G *PRU 8.4.57R* also implements Article 8(4) of the *Financial Groups Directive*, which says that where a *financial conglomerate* is headed by a *mixed financial holding company*, the *sectoral rules* regarding *intra-group transactions* of the *most important financial sector* in the *financial conglomerate* shall apply to that sector as a whole, including the *mixed financial holding company*.
- 8.4.55 G Articles 7(3) (*Risk concentration*) and 8(3) (*Intra-group transactions*) and Annex II (*Technical application of the provisions on intra-group transactions and risk concentration*) of the *Financial Groups Directive* say that Member States may apply at the level of the *financial conglomerate* the provisions of the *sectoral rules* on *risk concentrations* and *intra-group transactions*. This chapter does not take up that option, although the *FSA* may impose such obligations on a case by case basis.

**Risk concentration and intra-group transactions: Application**

- 8.4.56 R *PRU 8.4.57R* applies to a *firm* with respect to a *financial conglomerate* of which it is a member if:
- (1) the condition in Articles 7(4) and 8(4) of the *Financial Groups Directive* is satisfied (the *financial conglomerate* is headed by a *mixed financial holding company*); and
  - (2) the conditions in *PRU 8.4.47R(1)-PRU 8.4.47R(4)* are met.

**Risk concentration and intra group transactions: The main rule**

- 8.4.57 R A *firm* must:
- (1) comply with the *rules* that are applied with respect to a *financial conglomerate* of which it is a member by the table in *PRU 8.4.58R*;
  - (2) ensure that the *mixed financial holding company* referred to in *PRU 8.4.56R(1)* complies with those *rules*; and
  - (3) ensure that each other member of the *financial conglomerate* to which those *rules* apply or that come within the scope of those *rules* (as expanded by this *rule*) comply with them;

as if that *mixed financial holding company* and each member of the *most important financial sector* were included amongst the members of the *financial conglomerate* with respect to which the obligations in those *rules* apply.

**Risk concentration and intra-group transactions: Table of applicable sectoral rules**

- 8.4.58 R Table: application of sectoral rules  
This table belongs to *PRU 8.4.57R*

Type of financial conglomerate	Applicable sectoral rules	
	Risk concentration	Intra-group transactions
<i>Banking conglomerate</i>	<i>Rule 3.3.19 of chapter GN of IPRU(BANK) (as it applies to large exposures on a consolidated basis)</i>	<i>Rule 3.3.19 of chapter GN of IPRU(BANK) (as it applies to large exposures on a solo basis without any concession or exemption for exposures to other group members)</i>
<i>Insurance conglomerate</i>	<i>Section 4.14 of IPRU(INS)</i>	<i>Section 9.39 of IPRU(INS)</i>
<i>Investment services conglomerate</i>	<i>Rule 14.3.2 in Chapter 14 of IPRU(INV)</i>	<i>Rule 10-190 in Chapter 10 of IPRU(INV) as it applies on a solo basis</i>

- 8.4.59 G The material in *IPRU(BANK)* that has particular application to the *rule* in *IPRU(BANK)* referred to in the table in *PRU 8.4.58R* is:
- (1) (in the case of column 2) Chapter LE as it applies on a consolidated basis;
  - (2) (in the case of column 3) Chapter LE as it applies on a solo basis.
- 8.4.60 G The table in *PRU 8.4.58R* does not refer to a *building society conglomerate* as it cannot be headed by a *mixed financial holding company*.

**The financial sectors: asset management companies**

- 8.4.61 R (1) This *rule* sets out how an *asset management company* must be allocated between the *financial sectors* for the purpose of *PRU 8.4.45R- PRU 8.4.58R*.

- R (2) All *asset management companies* must be allocated to one *financial sector*, being either the *investment services sector* or the *insurance sector*. But if that choice has not been made in accordance with (3) and notified to the *FSA* in accordance with (3)(d), an *asset management company* must be allocated to the *investment services sector*.**
- R (3) The choice in (2):**
- (a) must be made by the *undertaking in the consolidation group* holding the position referred to in Article 4(2) of the *Financial Groups Directive* (group member to whom notice must be given that the group has been found to be a *financial conglomerate*);**
  - (b) applies to all *asset management companies* that are members of the *consolidation group* from time to time;**
  - (c) cannot be changed; and**
  - (d) must be notified to the *FSA* as soon as reasonably practicable after the *consolidation group* becomes a *financial conglomerate*.**



# PRU 8.5

## Third country groups

## 8.5 Third country groups

### Application

8.5.1 G *PRU 8.5 applies to every firm that is a member of a third-country group.*

### Purpose

8.5.2 G *PRU 8.5 summarises Article 18 of the Financial Groups Directive and Article 56a of the Banking Consolidation Directive.*

### Equivalence

8.5.3 G *The first question that must be asked about a third-country financial group is whether the EEA regulated entities in that third-country group are subject to supervision by a third-country competent authority, which is equivalent to that provided for by the Financial Groups Directive (in the case of a financial conglomerate) or the EEA prudential sectoral legislation for the banking sector or the investment services sector (in the case of a banking and investment group).*

8.5.4 G *The judgment as to whether a third-country group is subject to equivalent supervision in accordance with PRU 8.5.3G is carried out by the competent authority that would be the EEA lead competent authority for a third-country group.*

8.5.5 G *In making the judgment in PRU 8.5.3G the EEA lead competent authority for a third-country group should:*

- (1) consult the other third-country group interested EEA competent authorities; and*
- (2) take into account any applicable guidance of the Financial Conglomerates Committee (in the case of a financial conglomerate) and the relevant EEA body specified by the applicable EEA prudential sectoral legislation.*

8.5.6 G *The committees and institutions referred to in PRU 8.5.5G may give general guidance as to whether the supervision arrangements of third-country competent authorities are likely to achieve the objectives of consolidated or supplementary supervision as defined in the applicable EEA legislation referred to in PRU 8.5.3G, in relation to EEA regulated entities in a third-country group. They will keep any such guidance under review and take into account any changes to the supervision carried out by the relevant third-country competent authority.*

8.5.7 G *The EEA lead competent authority for a third-country group may carry out the assessment referred to in PRU 8.5.3G on its own initiative. Alternatively, either the parent undertaking at the head of the third-country group or any EEA regulated entity in the third-country group may ask that competent authority to carry it out.*

- 8.5.8 G If the supervision of a *third-country group* by a *third-country competent authority* meets the equivalence test referred to in *PRU 8.5.3G*, the other methods referred to in *PRU 8.5.9G* and supervision by analogy as referred to in *PRU 8.5.12G* will not apply. However such a finding of equivalence does not stop the application of *PRU 8.4* or *IPRU* to any *EEA financial conglomerate* or *EEA banking and investment group* contained within that *third-country group*.

**Other methods: General**

- 8.5.9 G If the supervision of a *third-country group* by a *third-country competent authority* does not meet the equivalence test referred to in *PRU 8.5.3G*, *competent authorities* may apply other methods that ensure appropriate supervision of the *EEA regulated entities* in that *third-country group* in accordance with the aims of supplementary supervision under the *Financial Groups Directive* or consolidated supervision under the applicable *EEA prudential sectoral legislation*.

**Other methods: Procedure**

- 8.5.10 G The *EEA lead competent authority for a third-country group* must agree to the taking of the measures described in *PRU 8.5.9G*. It will consult the other *third-country group interested EEA competent authorities* before taking the decision.

- 8.5.11 G Once the decision described in *PRU 8.5.10G* is taken:

- (1) the other *competent authorities* involved; and
- (2) the European Commission.

will be notified.

**Supervision by analogy**

- 8.5.12 G If the supervision of a *third-country group* by a *third-country competent authority* does not meet the equivalence test referred to in *PRU 8.5.3G*, a *competent authority* may, rather than take the measures described in *PRU 8.5.9G*, apply, by analogy, the provisions concerning supplementary supervision under the *Financial Groups Directive* or, as applicable, consolidated supervision under the applicable *EEA prudential sectoral legislation*, to the *EEA regulated entities* in the *banking sector*, *investment services sector* and (in the case of a *financial conglomerate*) *insurance sector*.
- 8.5.13 G The *FSA* believes that it will only be right to adopt the option in *PRU 8.5.12G* in response to very unusual group structures.
- 8.5.14 G *PRU 8 Annex 2* sets out *rules* to deal with the situation covered in *PRU 8.5.12G*. Those *rules* do not apply automatically. Instead, they can only be applied to a particular *third-country group* as described in *PRU 8.4.39G-PRU 8.4.41G*.



PRU 8 Annex 1  
Capital adequacy  
calculations for  
financial conglomerates

## PRU 8 Annex 1

### Capital adequacy calculations for financial conglomerates

#### Part 1

#### 1. Method 1 of Annex I of the Financial Groups Directive (Accounting Consolidation Method)

##### Capital resources

- 1.1 R The *conglomerate capital resources* of a *financial conglomerate* calculated in accordance with this Part are the capital of that *financial conglomerate*, calculated on an accounting consolidation basis, that qualifies under paragraph 1.2.
- 1.2 R The elements of capital that qualify for the purposes of paragraph 1.1 are those that qualify in accordance with the *applicable sectoral rules*, in accordance with the following:
- (1) the *conglomerate capital resources requirement* is divided up in accordance with the contribution of each *financial sector* to it; and
  - (2) the portion of the *conglomerate capital resources requirement* attributable to a particular *financial sector* must be met by capital resources that are eligible in accordance with the *applicable sectoral rules* for that *financial sector*.

##### Capital resources requirement

- 1.3 R The *conglomerate capital resources requirement* of a *financial conglomerate* calculated in accordance with this Part is equal to the sum of the capital adequacy and solvency requirements for each *financial sector* calculated in accordance with the *applicable sectoral rules* for that *financial sector*.

##### Consolidation

- 1.4 R The information required for the purpose of establishing whether or not a *firm* is complying with PRU 8.4.49R (insofar as the definitions in this Part are applied for the purpose of that *rule*) must be based on the consolidated accounts of the *financial conglomerate*, together with such other sources of information as appropriate.
- 1.5 R The *applicable sectoral rules* that are applied under this Part are the *applicable sectoral consolidation rules*. Other *applicable sectoral rules* shall be applied if required.

## Part 2

### 2. Method 2 of Annex I of the Financial Groups Directive (Deduction and aggregation Method)

#### Capital resources

- 2.1 R The *conglomerate capital resources* of a *financial conglomerate* calculated in accordance with this Part are equal to the sum of the following amounts (so far as they qualify under paragraph 2.3) for each member of the *overall financial sector*:
- (1) (for the *person* at the head of the *financial conglomerate*) its *solo capital resources*;
  - (2) (for any other member):
    - (a) its *solo capital resources*; less
    - (b) the book value of the *financial conglomerate's* investment in that member.
- 2.2 R The deduction in paragraph 2.1(2) must be carried out separately for each type of capital represented by the *financial conglomerate's* investment in the member concerned.
- 2.3 R The elements of capital that qualify for the purposes of paragraph 2.1 are those that qualify in accordance with the *applicable sectoral rules*. In particular, capital resources of a member of a *financial sector* are eligible to meet the part of the *conglomerate capital resources requirement* attributable to it if they would be eligible under the *sectoral rules* that apply to the calculation of its *solo capital resources*.

#### Capital resources requirement

- 2.4 R The *conglomerate capital resources requirement* of a *financial conglomerate* calculated in accordance with this Part is equal to the sum of the *solo capital resources requirement* for each member of the *financial conglomerate* that is in the *overall financial sector*.

#### Partial inclusion

- 2.5 R The capital resources and capital resources requirements of a member of the *financial conglomerate* in the *overall financial sector* must be included in the calculation in paragraph 2.1 proportionally. If however the member is a *subsidiary undertaking* and it has a *solvency deficit*, it must be included in full.

## Accounts

- 2.6 R The information required for the purpose of establishing whether or not a *firm* is complying with *PRU 8.4.49R* (insofar as the definitions in this Part are applied for the purpose of that *rule*) must be based on the individual accounts of members of the *financial conglomerate*, together with such other sources of information as appropriate.

## Part 3

### 3. Method 3 of Annex I of the Financial Groups Directive (Book value/Requirement Method)

#### Capital resources

3.1 R The *conglomerate capital resources* of a *financial conglomerate* calculated in accordance with this Part are equal to the capital resources of the *person* at the head of the *financial conglomerate* that qualify under paragraph 3.2.

3.2 R The elements of capital that qualify for the purposes of paragraph 3.1 are those that qualify in accordance with the *applicable sectoral rules*, in accordance with the following:

- (1) the *conglomerate capital resources requirement* is divided up in accordance with the contribution of each *financial sector* to it; and
- (2) the portion of the *conglomerate capital resources requirement* attributable to a particular *financial sector* must be met by capital resources that are eligible in accordance with the *applicable sectoral rules* for that *financial sector*.

#### Capital resources requirement

3.3 R The *conglomerate capital resources requirement* of a *financial conglomerate* calculated in accordance with this Part is equal to the sum of the following amounts for each member of the *overall financial sector*:

- (1) (in the case of the *person* at the head of the *financial conglomerate*) its *solo capital resources requirement*;
- (2) (in the case of any other member) the higher of the following two amounts:
  - (a) its *solo capital resources requirement*; and
  - (b) the book value of the interest of the *person* at the head of the *financial conglomerate* in that member.

3.4 R A *participation* may be valued using the equity method of accounting.

#### Partial inclusion

- 3.5**        **R**    The capital resources requirement of a member of the *financial conglomerate* in the *overall financial sector* must be included in the calculation in paragraph 3.1 proportionally. If however the member has a *solvency deficit* and is a *subsidiary undertaking*, it must be included in full.

### **Accounts**

- 3.6**        **R**    The information required for the purpose of establishing whether or not a *firm* is complying with *PRU 8.4.49R* (insofar as the definitions in this Part are applied for the purpose of that *rule*) must be based on the individual accounts of members of the *financial conglomerate*, together with such other sources of information as appropriate.

## Part 4

### 4. Method 4 of Annex I of the Financial Groups Directive (Combination of Methods 1, 2 and 3)

#### Applicable sectoral rules

- 4.1 R The *rules* that apply to a particular *financial conglomerate* under PRU 8.4.46R are those set out in the table in paragraph 4.2.
- 4.2 R Table: application of sectoral consolidation rules  
This table belongs to paragraph 4.1.

Type of financial conglomerate	Applicable sectoral consolidation rules
<i>Banking conglomerate</i>	<i>IPRU(BANK) Chapter GN rule 3.3.13 (as it applies on a consolidated basis), subject to paragraph 4.7.</i>
<i>Insurance conglomerate</i>	<i>PRU 8.3</i>
<i>Building society conglomerate</i>	<i>IPRU(BSOC) (Volume 1) Chapter 1, rule 1.2.1 (as it applies on a consolidated basis).</i>
<i>Investment services conglomerate</i>	<i>Chapter 14 of IPRU(INV)</i>

#### How to apply chapter 14 of IPRU(INV)

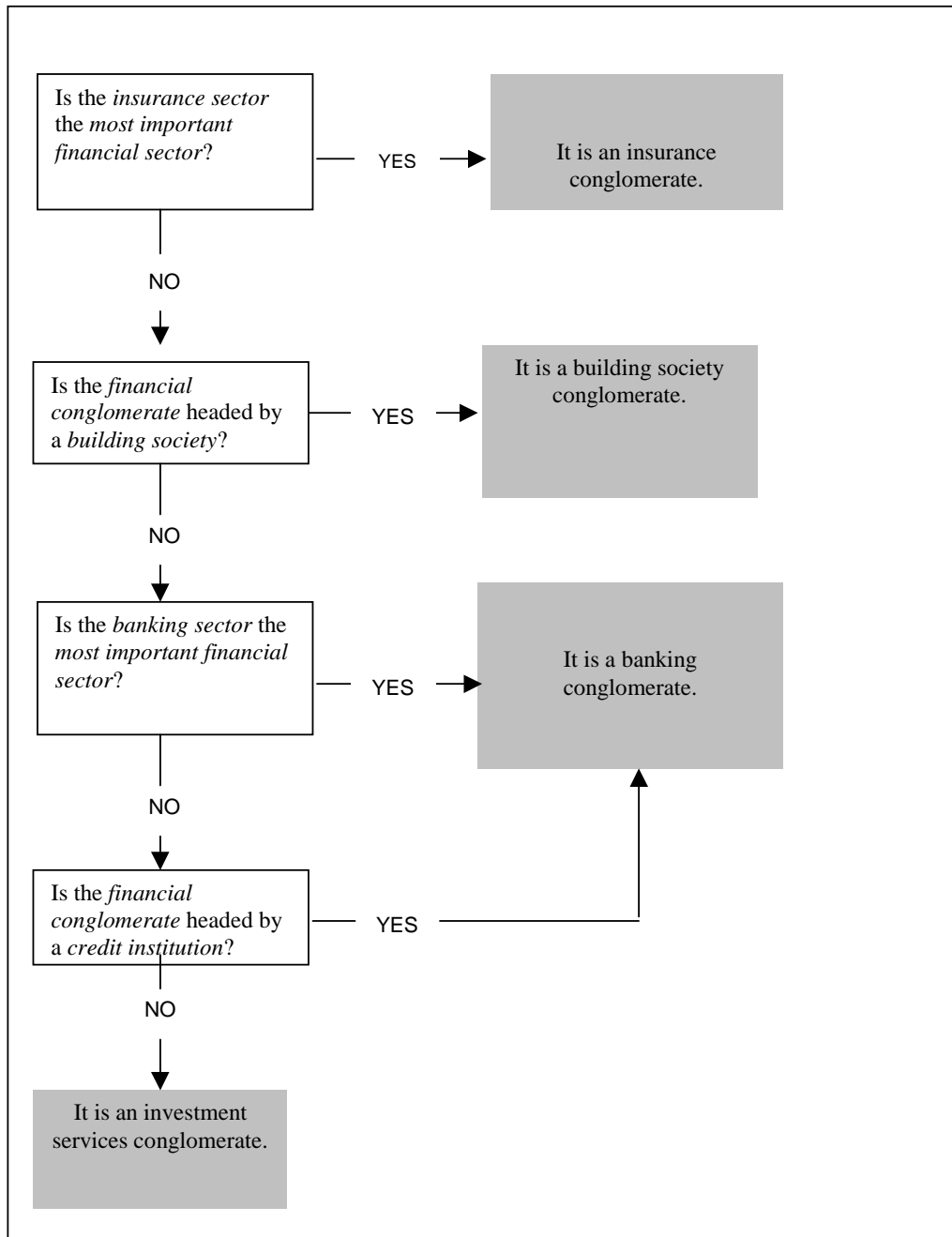
- 4.3 R Where chapter 14 of *IPRU(INV)* applies:
- (1) the *main investment services undertaking* is treated as being the main firm for the purpose of *rule 14.4.2* of chapter 14 of *IPRU(INV)*;
  - (2) if the *main investment services undertaking* is not subject to any of the *FSA's sectoral rules* applied by chapter 14 of *IPRU(INV)*, then the *FSA's sectoral rules* that are applied are those that would do so if:
    - (a) it were a *UK domestic firm*; and

- (b) it had a *permission* that includes all the *regulated activities* that it would need to have in its *Part IV permission* if it carried on all its activities in the *United Kingdom*.

### **The different types of financial conglomerate**

- 4.4 R The question of into which of the categories listed in the table in paragraph 4.2 a *financial conglomerate* falls is decided by the decision tree in paragraph 4.5.

**4.5 R Table: types of financial conglomerate**  
This table belongs to paragraph 4.5.



### **A mixed financial holding company**

- 4.6 R** *A mixed financial holding company must be treated in the same way as:*
- (1)** *a financial holding company (if the rules in IPRU(BANK) or IPRU(INV) are applied; or*
  - (2)** *an insurance holding company (if the rules in PRU 8.3 are applied).*

### **E-money**

- 4.7 R** *If there are no full credit institutions or investment firms in a banking conglomerate but there are one or more e-money issuers, the sectoral rules in IPRU(BANK) are amended as follows :*
- (1)** *the rules in ELM that apply on a solo basis must be used to establish the capital requirement for the e- money issuers; and*
  - (2)** *for the purpose of (1), those rules in ELM shall be amended by calculating the amount of the deductions in respect of ownership shares and capital falling into ELM 2.4.17R(6) in accordance with paragraph 3.3(2).*

## Part 5

### 5. Principles applicable to all methods

#### Transferability of capital

#### 5.1 R Capital may only be included in:

- (1) a *firm's conglomerate capital resources* under *PRU 8.4.49R*; or
- (2) in the capital resources of the *financial conglomerate* for the purposes of *PRU 8.4.46R*;

if it is freely transferable.

#### Double counting

#### 5.2 R Capital must not be included in:

- (1) a *firm's conglomerate capital resources* under *PRU 8.4.49R*; or
- (2) the capital resources of the *financial conglomerate* for the purposes of *PRU 8.4.46R*;

if:

- (3) it would involve double counting or multiple use of the same capital; or
- (4) it results from any inappropriate intra-group creation of capital.

#### Cross sectoral capital

#### 5.3 R In accordance with the second sub-paragraph of paragraph 2(ii) of Section I of Annex I of the *Financial Groups Directive* (Other technical principles):

- (1) the solvency requirements for each different *financial sector* represented in a *financial conglomerate* required by *PRU 8.4.46R* or, as the case may be, *PRU 8.4.49R* shall be covered by own funds elements in accordance with the corresponding *applicable sectoral rules*; and
- (2) if there is a deficit of own funds at the *financial conglomerate* level, only cross sectoral capital (as referred to in that sub-paragraph) shall qualify for verification of compliance with the additional solvency requirement required by *PRU 8.4.46R* or, as the case may be, *PRU 8.4.49R*.

#### Application of sectoral rules

#### 5.4 R The following adjustments apply to the *FSA's sectoral rules* as they are applied by the *rules* in this Annex:

- (1) the scope of the *FSA's sectoral rules* will be extended to cover any *mixed financial holding company* and each other member of the *overall financial sector*;**
- (2) if those *rules* would not otherwise apply, they shall still apply (and in particular, any of those *rules* that would otherwise have the effect of disapplying consolidated supervision do not apply);**
- (3) (if it would not otherwise have been included) an ancillary services undertaking (as defined in chapter 14 of *IPRU(INV)*, and excluding an *ancillary banking services undertaking*) is included in the *investment services sector*;**
- (4) (if it would not otherwise have been included) an *ancillary insurance undertaking* is included in the *insurance sector*;**
- (5) the scope of the *FSA's sectoral rules* is amended so as to remove restrictions relating to where members of the *financial conglomerate* are incorporated or have their head office, so that the scope covers every member of the *financial conglomerate* that would have been included in the scope of those *rules* if those members had their head offices in an *EEA State*; and**
- (6) (for the purposes of Parts 1-3) the *FSA's sectoral rules* must be adjusted, if necessary, when calculating the capital resources, capital resources requirements or solvency requirements for a particular *financial sector* to exclude those for a member of another *financial sector*.**

## Part 6

### 6. Definitions used in this Annex

#### Defining the financial sectors

- 6.1 R For the purposes of Parts 1–3 of this Annex (but not for the purposes of the definition of *most important financial sector* in paragraph 6.2):
- (1) the *banking sector* and the *investment services sector* are considered separately;
  - (2) if a *financial institution* could otherwise fall into both the *banking sector* and the *investment services sector*, it must be allocated to the *banking sector*;
  - (3) an *asset management company* is allocated in accordance with PRU 8.4.61R; and
  - (4) a *mixed financial holding company* must be treated as being a member of the *most important financial sector*.

#### Most important financial sector

- 6.2 R For the purpose of the decision tree in paragraph 4.5 and other references to the *most important financial sector* in this Annex, the definition of *most important financial sector* is adjusted as follows:
- (1) for the purpose of deciding whether the *insurance sector* is the *most important financial sector*, the *banking sector* and the *investment services sector* must be considered together;
  - (2) if the *most important financial sector* under (1) is the *banking sector* and the *investment services sector* considered together, the *most important financial sector* is whichever of the *banking sector* and the *investment services sector* is the more important;
  - (3) the calculation in (2) must be carried out using the *rules* for the calculation of the *most important financial sector* as modified by (4); and
  - (4) paragraph 6.1(2) (*financial institution* allocated to the *banking sector*) and paragraph 6.1(3) (allocation of *asset management companies*) apply.

#### Solo capital resources requirement: UK domestic firms

- 6.3 R The *solo capital resources requirement* for a *regulated entity* that is a *UK domestic firm* is its solo regulatory capital requirement under the *FSA's sectoral rules* for its *financial sector* applicable to it.

### **Solo capital resources requirement: EEA firms**

- 6.4 R The *solo capital resources requirement* for an *EEA regulated entity* that is subject to the *solo capital adequacy sectoral rules* for its *financial sector* of the *competent authority* that authorised it is equal to the amount of capital resources it is obliged to hold under those *sectoral rules*.

### **Solo capital resources requirement: Mixed financial holding company**

- 6.5 R The *solo capital resources requirement* for a *mixed financial holding company* is the capital adequacy and solvency requirements that apply to *regulated entities* in the *most important financial sector* under the table in paragraph 6.9.

### **Solo capital resources requirement: Non-EEA firms subject to equivalent regimes**

- 6.6 R The *solo capital resources requirement* for a *regulated entity* that:
- (1) does not fall into paragraphs 6.3–6.5;
  - (2) is subject to any of the *sectoral rules* referred to in paragraph 6.7 applicable to its *financial sector*; and
  - (3) is incorporated in and has its head office in:
    - (a) (where the *sectoral rules* in (2) are for the *banking sector* or the *investment services sector*) the same state or territory as the regulator for those *sectoral rules*, as referred to in paragraph 6.7(1) or 6.7(2)); or
    - (b) (where the *sectoral rules* in (2) are for the *insurance sector*) the designated state or territory in question, as referred to in 6.7(3);
- is equal to the amount of capital resources it is obliged to hold under those *sectoral rules*.

- 6.7 R The *sectoral rules* referred to in paragraph 6.6 are:
- (1) (for the *banking sector*) the *sectoral rules* of or administered by one of the regulators listed in Appendix D of chapter CS of *IPRU(BANK)*;
  - (2) (for the *investment services sector*) the *sectoral rules* of or administered by one of the regulators listed in Appendix 59 of chapter 10 of *IPRU(INV)*; and
  - (3) (for the *insurance sector*) the *sectoral rules* of the designated states or territories referred to in *PRU 8.3.26R(e)*.

### **Solo capital resources requirement: Other members: General**

- 6.8 R The *solo capital resources requirement* for any member of a *financial conglomerate* in the *overall financial sector* not treated under paragraphs 6.3-6.7 is the capital resources requirement that would apply to it under the following *rules*:
- (1) (in the case of an *asset management company*) the *rules* in Chapter 7 of *IPRU(INV)*; and
  - (2) (in any other case) the *rules* applicable to its *financial sector* under the table in paragraph 6.9.
- 6.9 R Table: The FSA's sectoral rules for the solo capital resources requirement  
This table belongs to paragraph 6.8.

Financial sector	FSA's sectoral rules
<i>Banking sector</i>	The <i>rules</i> for banks, except that <i>e-money issuers</i> are subject to <i>ELM</i>
<i>Insurance sector</i>	The <i>rules</i> for <i>insurance undertakings</i>
<i>Investment services sector</i>	(In the case of an <i>investment firm</i> ) the <i>rules</i> that would apply on the assumptions in paragraph 4.3(2). (In any other case) the <i>rules</i> that would be applied to it under <i>rule 14.5.2</i> of Chapter 14 of <i>IPRU(INV)</i> (Group financial resources requirement)

### Applicable sectoral consolidation rules

- 6.10 R The *applicable sectoral consolidation rules* for a *financial sector* are the *FSA's sectoral rules* that are applied in the table in paragraph 6.11.
- 6.11 R Table: application of sectoral consolidation rules  
This table belongs to paragraph 6.10.

<b>Financial sector</b>	<b>Type of financial conglomerate</b>	<b>FSA's sectoral rules</b>
<i>Banking sector</i>	<i>Building society conglomerate</i>	<i>The rules for building societies</i>
	<b>Any other type</b>	<b>The rules for banks</b>
<i>Insurance sector</i>	<b>All types</b>	<b>The rules for insurance undertakings</b>
<i>Investment services sector</i>	<b>All types</b>	<b>The rules for investment firms, as applied under paragraph 4.3 (How to apply chapter 14 of IPRU(INV))</b>
<b>Note</b>	<b>The rules referred to in the third column are those identified in the table in paragraph 4.2.</b>	

# PRU 8 Annex 2

## PRU 8 Annex 2

### 1. Purpose

1.1 G The purpose of this Annex is explained in *PRU 8.5.14G*.

### 2. Third-country financial conglomerates

2.1 R A *firm* must comply, with respect to a *third-country financial conglomerate* of which it is a member, with whichever of *PRU 8.4.46R* and *PRU 8.4.49R* (as adjusted under paragraph 4.1) is applied under paragraph 2.2 if:

- (1) the conditions in *PRU 8.4.47R(1)-PRU 8.4.47R(3)* are met; and
- (2) the *firm's Part IV permission* contains a *requirement* obliging it to comply with that *rule* (as so adjusted).

2.2 R The *rule* that applies for the purposes of paragraph 2.1 is the one that is specified by the *requirement* referred to in paragraph 2.1(2).

2.3 R If:

- (1) paragraph 2.1 applies to a *firm* with respect to a *financial conglomerate* of which it is a member; and
- (2) the condition in Articles 7(4) and 8(4) of the *Financial Groups Directive* is satisfied (the *financial conglomerate* is headed by a *mixed financial holding company*);

the *firm* must also comply with *PRU 8.4.57R* (as adjusted in accordance with paragraph 4.1) with respect to that *financial conglomerate*.

### 3. Third-country banking and investment groups

3.1 R A *firm* must comply with one of the sets of *rules* specified in paragraph 3.2 as adjusted under paragraph 4.1 with respect to a *third-country banking and investment group* of which it is a member if:

- (1) the *FSA* is the lead regulator for that *third-country banking and investment group* under the *Banking Consolidation Directive* or the *Capital Adequacy Directive*; and
- (2) the *firm's Part IV permission* contains an obligation to comply with whichever set of *rules* (as so adjusted) is applicable to the *third-country banking and investment group* under paragraph 3.3.

3.2 R The *rules* referred to in paragraph 3.1 are as follows:

- (1) *IPRU(BANK)* 3.3.13R (as it applies on a consolidated basis, both as respects capital adequacy and large exposures);
- (2) the *rules* in chapter 14 of *IPRU(INV)*; or
- (3) the *rules* in chapter 7 of *ELM*.

3.3 R The set of *rules* from paragraph 3.2 that apply with respect to a particular *third-country banking and investment group* (as referred to in paragraph 3.1) are those that would apply if they were adjusted in accordance with paragraph 4.1.

#### 4. Adjustment of scope

- 4.1 R The adjustments that must be carried out under this paragraph are that the scope of the *rules* listed in paragraph 2.1, paragraph 2.3 or paragraph 3.2, as the case may be, is amended:
- (1) so as to remove all limitations relating to where a member of the *third-country group* is incorporated or has its head office; and
  - (2) so that the scope covers every member of the *third-country group* that would have been included in the scope of those *rules* if those members had their head offices in an *EEA State*.



# Glossary of defined terms

This Glossary is in two parts. The first part contains proposed new definitions to be added to the main Handbook Glossary. The second part contains proposed amendments to existing terms in the Handbook Glossary.

Immediately following this Glossary is a reproduction of defined terms currently being consulted on in CP190 and CP195 that are also used in the draft rules and guidance in this CP. This material is not being consulted on as part of this consultation, but is reproduced here for the reader's ease of reference.

## GLOSSARY OF DEFINED TERMS

### NEW DEFINITIONS

<b>ancillary insurance services undertaking</b>	<b>(in relation to an <i>undertaking in an insurance group</i>) an <i>undertaking</i> complying with the following conditions:</b> <b>(1) its principal activity consists in:</b> <b>(a) owning or managing property;</b> <b>(b) managing data-processing services; or</b> <b>(c) any other similar activity;</b> <b>(2) the activity in (1) is ancillary to the principal activity of one or more <i>insurance undertakings</i>;</b> <b>(3) those <i>insurance undertakings</i> are also members of that <i>insurance group</i>; and</b> <b>(4) it is not an <i>ancillary banking services undertaking</i> or an <i>ancillary investment services undertaking</i>.</b>
<b>applicable sectoral consolidation rules</b>	<b>(in respect of a <i>financial sector</i> and in accordance with paragraph 6.10 of <i>PRU 8 Annex 1</i> (<i>Applicable sectoral consolidation rules</i>)) the <i>FSA's sectoral rules</i> applicable to that <i>financial sector</i> under the table in paragraph 6.11 of <i>PRU 8 Annex 1</i>.</b>
<b>applicable sectoral rules</b>	<b>(in respect of a <i>financial sector</i>) <i>applicable sectoral consolidation rules</i> for that <i>financial sector</i> and the <i>FSA's sectoral rules</i> applicable to that <i>financial sector</i> under the table in paragraph 6.9 of <i>PRU 8 Annex 1</i>; which of those sets of <i>rules</i> apply for the purpose of a particular calculation depends on the nature of that calculation.</b>
<b>asset management company</b>	<b>(for the purpose of <i>ELM</i>, <i>PRU 8.3</i>, <i>PRU 8.4</i> and <i>PRU 8.5</i> and in accordance with Article 2(5) of the <i>Financial Groups Directive</i> (<i>Definitions</i>)) a management company within the meaning of Article 1a(2) of the <i>UCITS Directive</i>, as well as an <i>undertaking</i> the registered office of which is outside the <i>EEA</i> and which would require authorisation in accordance with Article 5(1) of the <i>UCITS Directive</i> if it had its registered office within the <i>EEA</i>.</b>

<b>banking and investment group</b>	<p>a group of <i>persons</i> (at least one of which is an <i>EEA regulated entity</i> in the <i>investment services sector</i> or the <i>banking sector</i>) who:</p> <p>(1) form a group in respect of which the consolidated capital adequacy requirements for the <i>banking sector</i> or the <i>investment services sector</i> under:</p> <p>(a) the <i>FSA's sectoral rules</i>; or</p> <p>(b) the <i>sectoral rules</i> of another <i>competent authority</i>; apply; or</p> <p>(2) would form such a group if the scope of <i>those sectoral rules</i> were amended in accordance with paragraph 4.1 of <i>PRU 8 Annex 2</i> (removing restrictions relating to place of incorporation or head office of members of those <i>financial sectors</i>).</p>
<b>banking conglomerate</b>	<p>a <i>financial conglomerate</i> identified as a <i>banking conglomerate</i> in the decision tree in paragraph 4.5 of <i>PRU 8 Annex 1</i> (Decision tree for Method 4 of Annex I of the <i>Financial Groups Directive</i>).</p>
<b>banking sector</b>	<p>the following <i>persons</i>:</p> <p>(1) a <i>credit institution</i>;</p> <p>(2) a <i>financial institution</i>;</p> <p>(3) an <i>ancillary banking services undertaking</i>; and</p> <p>(4) (in the circumstances described in paragraph 5.4 of <i>PRU 8 Annex 1</i> (Application of sectoral rules)) an <i>asset management company</i>.</p>
<b>building society conglomerate</b>	<p>a <i>financial conglomerate</i> identified as a <i>building society conglomerate</i> in the decision tree in paragraph 4.5 of <i>PRU 8 Annex 1</i> (Decision tree for Method 4 of Annex I of the <i>Financial Groups Directive</i>).</p>
<b>coordinator</b>	<p>(in relation to a <i>financial conglomerate</i>) the <i>competent authority</i> which has been appointed, in accordance with Article 10 of the <i>Financial Groups Directive</i> (Competent authority responsible for exercising supplementary supervision (the coordinator)), as the <i>competent authority</i> which is responsible for the co-ordination and exercise of supplementary supervision of that <i>financial conglomerate</i>.</p>
<b>conglomerate capital resources</b>	<p>(in relation to a <i>financial conglomerate</i> with respect to which <i>PRU 8.4.49R</i> (Application of methods 1, 2 or 3 from Annex I of the <i>Financial Groups Directive</i>) applies) capital resources as defined in whichever of paragraphs 1.1, 2.1 or 3.1 of <i>PRU 8 Annex 1</i> applies with respect to that <i>financial conglomerate</i>.</p>
<b>conglomerate capital resources requirement</b>	<p>(in relation to a <i>financial conglomerate</i> with respect to which <i>PRU 8.4.49R</i> (Application of methods 1, 2 or 3 from Annex I of the <i>Financial Groups Directive</i>) applies) the capital resources requirement defined in whichever of paragraphs 1.3, 2.4 or 3.3 of <i>PRU 8 Annex 1</i> applies with respect to that <i>financial conglomerate</i>.</p>

<b>consolidation article 12(1) relationship</b>	<p>a relationship between one <i>undertaking</i> (the first undertaking) and one or more other <i>undertakings</i> satisfying the conditions set out in Article 12(1) of the <i>Seventh Company Law Directive</i>, which in summary are as follows:</p> <p>(1) those <i>undertakings</i> are not connected, as described in article 1(1) or (2) of that Directive; and</p> <p>(2) one of the following conditions is satisfied:</p> <p>(a) they are managed on a unified basis pursuant to a contract concluded with the first undertaking or provisions in the memorandum or articles of association of those <i>undertakings</i>; or</p> <p>(b) the administrative, management or supervisory bodies of those <i>undertakings</i> consist for the major part of the same <i>persons</i> in office during the financial year in respect of which it is being decided whether such a relationship exists.</p>
<b>consolidation group</b>	<p>the following:</p> <p>(1) a <i>conventional group</i>; or</p> <p>(2) <i>undertakings</i> linked by a <i>consolidation Article 12(1) relationship</i>. If a <i>parent undertaking</i> or <i>subsidiary undertaking</i> in a <i>conventional group</i> (the first person) has a <i>consolidation Article 12(1) relationship</i> with another <i>person</i> (the second person) the second person (and any <i>subsidiary undertaking</i> of the second person) is also a member of the same <i>consolidation group</i>.</p>
<b>conventional group</b>	<p>(for the purposes of <i>PRU 8.4</i> and <i>PRU 8.5</i>) a group of <i>undertakings</i> that consists of a <i>parent undertaking</i> and the rest of its <i>sub-group</i>.</p>
<b>EEA banking and investment group</b>	<p>a <i>banking and investment group</i> that:</p> <p>(1) is headed by:</p> <p>(a) an <i>investment firm</i> or <i>credit institution</i> that is authorised and incorporated in an <i>EEA State</i>; or</p> <p>(b) a <i>financial holding company</i> that has its head office in an <i>EEA State</i>; or</p> <p>(2) is otherwise required by <i>EEA prudential sectoral legislation</i> for the <i>banking sector</i> or the <i>investment services sector</i> (except Article 56a of the <i>Banking Consolidation Directive</i> (Third-country parent undertakings)) to be subject to consolidated supervision by a <i>competent authority</i>.</p>
<b>EEA financial conglomerate</b>	<p>a <i>financial conglomerate</i> that is of a type that falls under Article 5(2) of the <i>Financial Groups Directive</i> (Scope of supplementary supervision of regulated entities referred to in Article 1 of that Directive).</p>
<b>EEA insurance parent undertaking</b>	<p>an <i>insurance parent undertaking</i> that has its head office in the <i>United Kingdom</i> or another <i>EEA State</i>.</p>

EEA insurer	an <i>insurer</i> , other than a <i>pure reinsurer</i> , whose head office is in any <i>EEA State</i> except the <i>United Kingdom</i> and which has received authorisation under article 6 of the <i>First Non-Life Directive</i> or article 4 of the <i>Life Assurance Directive</i> from the <i>competent authority</i> in that <i>EEA State</i> .
EEA lead competent authority for a third-country group	(in relation to a <i>third-country group</i> ) the <i>competent authority</i> who: (1) (in the case of a <i>financial conglomerate</i> ) is the <i>coordinator</i> or would fulfil that role if the <i>financial conglomerate</i> were subject to supplementary supervision under the <i>Financial Groups Directive</i> ; and (2) (in the case of a <i>banking and investment group</i> ) is the lead regulator.
EEA prudential sectoral legislation	(in relation to a <i>financial sector</i> ) capital adequacy and solvency requirements applicable to <i>persons</i> in that <i>financial sector</i> in accordance with <i>EEA</i> legislation about prudential supervision of <i>regulated entities</i> in that <i>financial sector</i> and so that: (1) (in relation to the <i>banking sector</i> and the <i>investment services sector</i> ) in particular this includes the requirements laid down in the <i>Banking Consolidation Directive</i> and the <i>Capital Adequacy Directive</i> ; and (2) (in relation to the <i>insurance sector</i> ) in particular this includes requirements laid down in the <i>First Non-Life Directive</i> , the <i>Life Assurance Directive</i> and the <i>Insurance Groups Directive</i> .
EEA regulated entity	a <i>regulated entity</i> that is an <i>EEA firm</i> or a <i>UK firm</i> .
financial conglomerate	(in accordance with Article 2(14) of the <i>Financial Groups Directive</i> (Definitions)) a <i>consolidation group</i> that is identified as a <i>financial conglomerate</i> by the <i>financial conglomerate definition decision tree</i> .
financial conglomerate definition decision tree	the decision tree in <i>PRU 8.4.20R</i> .
Financial Conglomerates Committee	the Committee established pursuant to Article 21 of the <i>Financial Groups Directive</i> (Committee).
Financial Groups Directive	Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate.
Financial Groups Directive Regulations	the Financial Conglomerates and Other Financial Groups Regulations 2004 (SI 2004/XXXX)

<b>financial sector</b>	<p>one of the <i>banking sector</i>, the <i>insurance sector</i> and the <i>investment services sector</i>; and in addition the following applies:</p> <p>(1) a <i>mixed financial holding company</i> does not form a <i>financial sector</i> on its own;</p> <p>(2) in the circumstances set out in <i>PRU 8.4</i>, a <i>mixed financial holding company</i> is to be considered outside any <i>financial sector</i>;</p> <p>(3) in the circumstances set out in <i>PRU 8.4</i>, the <i>banking sector</i> and the <i>investment services sector</i> are considered as one <i>financial sector</i>; and</p> <p>(4) an <i>investment management firm</i> is allocated between the <i>financial sectors</i> in accordance with <i>PRU 8.4.61R</i> (The financial sectors: asset management companies) for the purpose set out in that <i>rule</i> and for the purposes of <i>PRU 8 Annex 1</i> and <i>PRU 8 Annex 2</i>.</p>
<b>FSA's conglomerate capital adequacy rules</b>	<p>the following:</p> <p>(1) <i>PRU 8.4.46R</i> (Method 4 from Annex I of the <i>Financial Groups Directive</i>) and <i>PRU 8.4.49R</i> (Methods 1-3 from Annex I of the <i>Financial Groups Directive</i>); and</p> <p>(2) (with respect to a <i>firm</i> and a <i>financial conglomerate</i> of which it is a member) any obligations imposed on that <i>firm</i> through its <i>Part IV permission</i> to observe capital adequacy requirements with respect to its membership of that <i>financial conglomerate</i> based on Annex I of the <i>Financial Groups Directive</i>.</p>
<b>FSA's sectoral rules</b>	<i>sectoral rules</i> in the form of <i>rules</i> .
<b>group capital resources</b>	(in relation to an <i>undertaking</i> in <i>PRU 8.3.12R</i> ) has the meaning in <i>PRU 8.3.28R</i> , subject to <i>PRU 8.3.18R</i> and <i>PRU 8.3.19R</i> .
<b>group capital resources requirement</b>	(in relation to an <i>undertaking</i> in <i>PRU 8.3.12R</i> ) has the meaning in <i>PRU 8.3.25R</i> , subject to <i>PRU 8.3.18R</i> and <i>PRU 8.3.19R</i> .
<b>individual capital resources requirement</b>	(for the purposes of <i>PRU 8.3</i> ) has the meaning in <i>PRU 8.3.26R</i> .
<b>insurance conglomerate</b>	a <i>financial conglomerate</i> identified as an <i>insurance conglomerate</i> in the decision tree in paragraph 4.5 of <i>PRU 8 Annex 1</i> (Decision tree for Method 4 of Annex I of the <i>Financial Groups Directive</i> ).
<b>insurance group</b>	<p>a <i>group</i> that consists of an <i>insurance parent undertaking</i> and its <i>related undertakings</i> that are:</p> <p>(1) <i>insurance undertakings</i>; or</p> <p>(2) <i>insurance holding companies</i>.</p>
<b>Insurance Groups Directive</b>	Directive of the European Parliament and of the Council of 27 October 1998 on the supplementary supervision of insurance undertakings in an insurance group (1998/78/EC).

<b>insurance holding company</b>	<p>a <i>parent undertaking</i>, other than an <i>insurance undertaking</i>, that fulfils the following conditions:</p> <p>(1) its <i>subsidiary undertakings</i> are either exclusively or mainly <i>insurance undertakings</i>;</p> <p>(2) at least one of those <i>subsidiary undertakings</i> is an <i>insurer</i>; and</p> <p>(3) it is not a <i>mixed financial holding company</i>.</p>
<b>insurance parent undertaking</b>	(in relation to an <i>insurer</i> ) a <i>parent undertaking</i> of the <i>insurer</i> which is either an <i>insurance undertaking</i> or an <i>insurance holding company</i> .
<b>insurance sector</b>	<p>the following <i>persons</i>:</p> <p>(1) an <i>insurance undertaking</i>; and</p> <p>(2) an <i>insurance holding company</i>.</p>
<b>intra group transaction</b>	<p>(in accordance with Article 2(18) of the <i>Financial Groups Directive</i> (Definitions)) a transaction by which a <i>regulated entity</i> within a <i>financial conglomerate</i> relies either directly or indirectly upon other <i>undertakings</i> within the same <i>financial conglomerate</i>, or upon any <i>person</i> linked to the <i>undertakings</i> within that <i>financial conglomerate</i> by close links, for the fulfilment of an obligation whether or not contractual, and whether or not for payment.</p> <p>For the purpose of this definition close links has the same meaning as it does in Article 2(13) of the <i>Financial Groups Directive</i> (Definitions) (which in summary defines close links as a situation in which two or more <i>persons</i> are linked by the following relationships:</p> <p>(1) the ownership, direct or by way of control, of 20% or more of the voting rights or capital of an <i>undertaking</i>;</p> <p>(2) the relationships described in Articles 1(1) and (2) of the <i>Seventh Company Law Directive</i>, or a similar relationship between any <i>person</i> and an <i>undertaking</i>; and so that any subsidiary undertaking of a subsidiary undertaking is also considered a subsidiary of the parent undertaking which is at the head of those <i>undertakings</i>; or</p> <p>(3) a situation in which two or more <i>persons</i> are permanently linked to one and the same <i>person</i> by a control relationship).</p>
<b>investment services conglomerate</b>	a <i>financial conglomerate</i> identified as an <i>investment services conglomerate</i> in the decision tree in paragraph 4.5 of PRU 8 Annex 1 (Decision tree for Method 4 of Annex I of the <i>Financial Groups Directive</i> ).
<b>investment services sector</b>	<p>the following <i>persons</i>:</p> <p>(1) an <i>investment firm</i>;</p> <p>(2) a <i>financial institution</i>; and</p> <p>(3) (for the purposes of PRU 8.3 and also in the circumstances described in paragraph 5.4 of PRU 8 Annex 1 (Application of sectoral rules)) an <i>asset management company</i>.</p>

<b>main investment services undertaking</b>	<p>(for the purposes of <i>PRU 8.4</i> and in relation to a <i>financial conglomerate</i>):</p> <p>(1) (if there is only one <i>investment firm</i> in that <i>financial conglomerate</i>) that <i>investment firm</i>; and</p> <p>(2) (if there is more than one <i>investment firm</i> in that <i>financial conglomerate</i>) the member of the <i>financial conglomerate</i> identified in the same way as the main firm for the purposes of <i>rule 14.4.2</i> of Chapter 14 of <i>IPRU(INV)</i> (Group Financial Resources), but so that the comparison required by that <i>rule</i> must be carried out with respect to all <i>investment firms</i> in the <i>financial conglomerate</i>.</p>
<b>mixed-activity holding company</b>	<p>one of the following:</p> <p>(1) (in accordance with Article 1(22) of the <i>Banking Consolidation Directive</i> (Definitions)) a <i>parent undertaking</i>, other than a <i>financial holding company</i>, a <i>credit institution</i> or a <i>mixed financial holding company</i>, the <i>subsidiary undertakings</i> of which include at least one <i>credit institution</i>; or</p> <p>(2) (in accordance with Article 7(3) of the <i>Capital Adequacy Directive</i> (Supervision on a consolidated basis) and in relation to <i>banking and investment group</i> without any <i>credit institutions</i> in it) a <i>parent undertaking</i>, other than a <i>financial holding company</i>, an <i>investment firm</i> or a <i>mixed financial holding company</i>, the <i>subsidiary undertakings</i> of which include at least one <i>investment firm</i>.</p>
<b>mixed financial holding company</b>	<p>(in accordance with Article 2(15) of the <i>Financial Groups Directive</i> (Definitions)) a <i>parent undertaking</i>, other than a <i>regulated entity</i>, which together with its <i>subsidiary undertakings</i>, at least one of which is an <i>EEA regulated entity</i>, and other entities, constitutes a <i>financial conglomerate</i>.</p>
<b>most important financial sector</b>	<p>(in relation to a <i>financial sector</i> in a <i>consolidation group</i> or a <i>financial conglomerate</i> and in accordance with <i>PRU 8.4</i>) the <i>financial sector</i> with the largest average referred to in the box titled <i>Threshold Test 2</i> in the <i>financial conglomerate definition decision tree</i> (10% ratio of balance sheet size and solvency requirements); and so that:</p> <p>(1) for the purpose of <i>PRU 8 Annex 1</i> (Capital adequacy calculations with respect to <i>financial conglomerates</i>) the definition is altered as set out in paragraph 6.2 of that Annex; and</p> <p>(2) the <i>banking sector</i> and <i>investment sector</i> are treated as one <i>financial sector</i> in the circumstances set out in <i>PRU 8.4</i>.</p>
<b>overall financial sector</b>	<p>the following types of <i>persons</i>:</p> <p>(1) members of each of the <i>financial sectors</i>; and</p> <p>(2) (except where <i>PRU 8.4</i> provides otherwise) a <i>mixed financial company</i>.</p>
<b>participating insurance undertaking</b>	<p>(for the purposes of <i>PRU 8.3</i>) an <i>insurance undertaking</i> that holds a <i>participation</i> in one or more other <i>insurance undertakings</i>, none of which is its <i>subsidiary undertaking</i>.</p>

<b>participation</b>	(for the purpose of <i>PRU 8.3, PRU 8.4, PRU 8.5</i> and <i>ELM</i> ): (1) a participating interest as defined in Part VII of the Companies Act 1985; or (2) the direct or indirect ownership of 20% or more of the voting rights or capital of an <i>undertaking</i> .
<b>regulated entity</b>	one of the following: (1) a <i>credit institution</i> ; (2) a <i>regulated insurance entity</i> ; or (3) an <i>investment firm</i> ; whether or not it is incorporated in, or has its head office in, an <i>EEA State</i> . An <i>asset management company</i> is treated as a regulated entity: (4) for the purposes described in <i>PRU 8.4.61R</i> (prudential requirements for <i>financial conglomerates</i> ); (5) (in accordance with Article 30 of the <i>Financial Groups Directive</i> (Asset management companies)) for the purposes of any other material in <i>PRU 8.4</i> (cross sector groups), <i>PRU 8.5</i> (Third country groups), <i>PRU 8 Annex 1</i> (Capital adequacy calculations for financial conglomerates) and <i>PRU 8 Annex 2</i> (Prudential rules for third country groups) relating to the supplementary supervision of a <i>financial conglomerate</i> once that <i>financial conglomerate</i> has become a <i>financial conglomerate</i> ; and (6) for the purposes of the material in <i>PRU 8.3</i> (Insurance Groups) relating to the supplementary supervision of an <i>insurance group</i> or <i>insurance conglomerate</i> .
<b>regulated insurance entity</b>	an <i>undertaking</i> pursuing the activity of direct insurance (within the meaning of Article 4 of the <i>Life Assurance Directive</i> , Article 1 of the <i>First Non-Life Directive</i> or Article 1(b) of the <i>Insurance Groups Directive</i> ).
<b>regulated related undertaking</b>	(for the purposes of <i>PRU 8.3</i> ) a <i>related undertaking</i> that is either a <i>regulated entity</i> , an <i>insurance undertaking</i> which is not a <i>regulated entity</i> , a <i>financial holding company</i> or an <i>insurance holding company</i> .
<b>related undertaking</b>	(for the purposes of <i>PRU 8.3</i> ) an <i>undertaking</i> in which a <i>participation</i> is held by another <i>undertaking</i> or which is a <i>subsidiary undertaking</i> .
<b>relevant competent authorities</b>	(in relation to a <i>financial conglomerate</i> ) those <i>competent authorities</i> which are, or which have been appointed as, relevant competent authorities in relation to that <i>financial conglomerate</i> under Article 2(17) of the <i>Financial Groups Directive</i> (Definitions).

<b>risk concentration</b>	<p>(in accordance with Article 2(19) of the <i>Financial Groups Directive</i> (Definitions)) any exposure, with potential for a loss that would be borne by entities within a <i>financial conglomerate</i>, that is large enough to threaten the solvency or the financial position in general of the <i>regulated entities</i> in the <i>financial conglomerate</i>; such exposure may be caused by counterparty risk, credit risk, investment risk, insurance risk, market risk, other risks, or a combination or interaction of these risks.</p>
<b>sectoral rules</b>	<p>(in relation to a <i>financial sector</i>) capital adequacy and solvency rules and requirements applicable to <i>regulated entities</i> in that <i>financial sector</i>:</p> <p>(1) of the <i>FSA</i>;</p> <p>(2) of or administered by another <i>competent authority</i>; or</p> <p>(3) (for the purpose of calculating <i>solo capital resources</i> and a <i>solo capital resources requirement</i> and to the extent provided for in that paragraph) referred to in paragraph 6.7 of <i>PRU 8 Annex 1</i> (<i>Solo capital resources requirement: Non-EEA firms subject to equivalent regimes</i>);</p> <p>and so that:</p> <p>(4) (in relation to prudential rules about consolidated supervision for any <i>financial sector</i>) those requirements include ones relating to the form and extent of consolidation;</p> <p>(5) (in relation to any <i>financial sector</i>) those requirements mean requirements to have capital or maintain solvency (hard limits) rather than merely to report a failure to meet a specified level of capital adequacy or solvency (soft limits);</p> <p>(6) (in relation to any <i>financial sector</i>) those requirements include ones relating to the eligibility of different types of capital; and</p> <p>(7) (in relation to any <i>financial sector</i>) those requirements include both ones applying on a solo basis and ones applying on a consolidated basis.</p>
<b>smallest financial sector</b>	<p>(in relation to a <i>financial sector</i> in a <i>consolidation group</i> and a <i>financial conglomerate</i> and in accordance with <i>PRU 8.4</i>) the <i>financial sector</i> with the smallest average referred to in the box titled <i>Threshold Test 2</i> in the <i>financial conglomerate definition decision tree</i> (10% ratio of balance sheet size and solvency requirements), the <i>banking sector</i> and <i>investment services sector</i> being treated as one <i>financial sector</i> in the circumstances set out in <i>PRU 8.4</i>.</p>
<b>solo capital resources</b>	<p>(for the purposes of <i>PRU 8.3</i>, <i>PRU 8.4</i> and <i>PRU 8.5</i> and in relation to a member of a <i>financial conglomerate</i> in the <i>overall financial sector</i>) capital resources that are or would be eligible as capital under the <i>sectoral rules</i> that apply for the purpose of calculating its <i>solo capital resources requirement</i>.</p>

<b>solo capital resources requirement</b>	(for the purposes of <i>PRU 8.3</i> , <i>PRU 8.4</i> and <i>PRU 8.5</i> ) a capital resources requirement calculated on a solo basis as defined in paragraphs 6.3-6.9 of <i>PRU 8 Annex 1</i> (solo capital requirements for members of <i>financial conglomerates</i> ).
<b>solvency deficit</b>	(in <i>PRU 8 Annex 1</i> (Capital adequacy calculations with respect to <i>financial conglomerates</i> ) and in respect of a member of the <i>overall financial sector</i> ) the amount (if any) by which its <i>solo capital resources</i> fall short of its <i>solo capital resources requirement</i> .
<b>third-country banking and investment group</b>	a <i>banking and investment group</i> that meets the following conditions: (1) it is headed by: (a) a <i>credit institution</i> ; (b) an <i>investment firm</i> ; or (c) a <i>financial holding company</i> ; that has its head office outside the <i>EEA</i> ; and (2) it is not part of a wider <i>EEA banking and investment group</i> .
<b>third-country competent authority</b>	the authority of a country or territory which is not an <i>EEA State</i> which is empowered by law or regulation to supervise (whether on an individual or group-wide basis) <i>regulated entities</i> .
<b>third-country financial conglomerate</b>	a <i>financial conglomerate</i> that is of a type that falls under Article 5(3) of the <i>Financial Groups Directive</i> ( <i>financial conglomerate</i> headed by a <i>regulated entity</i> or a <i>mixed financial holding company</i> that has its head office outside the <i>EEA</i> ).
<b>third-country group</b>	a <i>third-country financial conglomerate</i> or a <i>third-country banking and investment group</i> .
<b>third-country group interested EEA competent authorities</b>	(in relation to a <i>third-country group</i> ) the <i>competent authorities</i> who: (1) (in the case of a <i>financial conglomerate</i> ) are the <i>relevant competent authorities</i> or would fulfil that role if the <i>financial conglomerate</i> were subject to supplementary supervision under the <i>Financial Groups Directive</i> ; and (2) (in the case of a <i>banking and investment group</i> ) are involved with the supervision of that <i>third-country group</i> .
<b>total group tier one capital</b>	(for the purposes of <i>PRU 8.3</i> ) the sum calculated at stage A of the calculation in <i>PRU 8.3.31R</i> .
<b>total group tier two capital</b>	(for the purposes of <i>PRU 8.3</i> ) the sum calculated at stage D of the calculation in <i>PRU 8.3.31R</i> .
<b>ultimate EEA insurance parent undertaking</b>	an <i>EEA insurance parent undertaking</i> that is not itself the <i>subsidiary undertaking</i> of another <i>EEA insurance parent undertaking</i> .
<b>ultimate insurance parent undertaking</b>	an <i>insurance parent undertaking</i> that is not itself the <i>subsidiary undertaking</i> of another <i>insurance parent undertaking</i> .

## AMENDED DEFINITIONS

ancillary banking services undertaking	<p><del>(in ELM)</del> (as defined in article 1.23 of the <i>Banking Coordination Directive</i> (Definitions) <u>and in relation to an undertaking in a consolidation group, sub-group or another group of persons</u>) an undertaking <u>complying with the following conditions:</u></p> <p><u>(1) its the principal activity of which consists in:</u></p> <p><u>(a) owning or managing property;</u></p> <p><u>(b) managing data-processing services;</u> or</p> <p><u>(c) any other similar activity;</u></p> <p><u>(2) the activity in (1) which is ancillary to the principal activity of one or more credit institutions; and</u></p> <p><u>(3) those credit institutions are also members of that consolidation group, sub-group or group.</u></p>
competent authority	<p><i>[(1) (2) unchanged]</i></p> <p><u>(3) (for the purposes of PRU 8.1, PRU 8.4 and PRU 8.5) any national authority of an EEA State which is empowered by law or regulation to supervise regulated entities, whether on an individual or group-wide basis.</u></p>
designated State or territory	<p><del>any EEA State (other than the United Kingdom),</del> Australia, Canada or a province of Canada, Hong Kong, Singapore, South Africa, Switzerland, a State in the United States of America, the District of Columbia or Puerto Rico.</p>
financial holding company	<p><del>(in ELM)</del> a <i>financial institution</i>, <u>that fulfils the following conditions:</u></p> <p><u>(1) its the subsidiary undertakings of which are either exclusively or mainly relevant financial services companies or financial institutions;</u></p> <p><u>(2) one of which at least one of those subsidiary undertakings is a relevant financial services company; and</u></p> <p><u>(3) it is not a mixed financial holding company.</u></p>

financial institution	<p>(1) (in accordance with paragraph 5(c) of Schedule 3 to the <i>Act</i> (EEA Passport Rights: EEA firm) and article 1(5) of the <i>Banking Consolidation Directive</i> (Definitions), <u>but not for the purposes of <i>ELM</i>, PRU 8.4 and PRU 8.5</u>) an <i>undertaking</i>, other than a <i>credit institution</i>, the principal activity of which is to acquire holdings or to carry on one or more of the listed activities listed in points 2 to 12 of Annex I to the <i>BCD</i>, which is a subsidiary of the kind mentioned in article 19 of the <i>BCD</i> and which fulfils the conditions in articles 18 and 19 of the <i>BCD</i>.</p> <p>(2) <u>(for the purposes of <i>ELM</i>, PRU 8.4 and PRU 8.5 and in accordance with article 1(5) of the <i>Banking Consolidation Directive</i> (Definitions)) an <i>undertaking</i>, other than a <i>credit institution</i>, the principal activity of which is to acquire holdings or to carry on one or more of the listed activities listed in points 2 to 12 of Annex I to the <i>BCD</i> and (for the purposes of <i>ELM</i>) an <i>asset management company</i> is also included.</u> <del>(in <i>ELM</i>) an undertaking other than a credit institution, the principal activity of which is to acquire holdings or to carry on one or more of the activities listed in points 2 to 12 of Annex 1 of the Banking Consolidation Directive.</del></p>
FSA consolidation rule	<p>(in <i>ELM</i>) the following rules in <i>IPRU</i>:</p> <p>(a) 3.3.13R in chapter GN of <i>IPRU</i>(<i>BANK</i>) <u>(as it applies on a consolidated</u> <del>except as it applies to a <i>bank</i> purely on a sole basis);</del></p> <p>(b) <i>IPRU</i>(<i>BSOC</i>) 1.2.1R <u>(as it applies on a consolidated</u> <del>except as it applies to a <i>building society</i> purely on a sole basis);</del></p> <p>(c) <u>Chapter 14 of <i>IPRU</i>(<i>INV</i>) 5.7.1R;</u></p> <p>(d) <del><i>IPRU</i>(<i>INV</i>) 10.200R(1) to 10.204R;</del></p> <p>(e) <del><i>IPRU</i>(<i>INV</i>) 13.7.2AR and 13.2.7BR.</del></p>
relevant financial services company	<p>(in <i>ELM</i> and for the purposes of the definition of <i>financial holding company</i>) an <i>investment firm</i> or <i>credit institution</i>.</p>
group	<p><del>[(1) and (2) unchanged]</del></p> <p><u>(3) (for the purposes of PRU 8.1 and in relation to a person "A") A and any person:</u></p> <p><u>(a) who falls into (1);</u></p> <p><u>(b) who is a member of the same <i>financial conglomerate</i> as A;</u></p> <p><u>(c) who has a <i>consolidation Article 12(1) relationship</i> with A;</u></p> <p><u>(d) who has a <i>consolidation Article 12(1) relationship</i> with any person in (3)(a);</u></p> <p><u>(e) who is a <i>subsidiary undertaking</i> of a person in (3)(c) or (3)(d); or</u></p> <p><u>(f) whose omission from an assessment of the risks to A of A's connection to any person coming within (3)(a)-(3)(e) or an assessment of the financial resources available to such persons would be misleading.</u></p>

parent undertaking

- (a) *[unchanged]*  
*[(i) –(v) unchanged]*  
(vi) (except for the purposes of PRU 8.4 and PRU 8.5) it is a parent undertaking of a parent undertaking of S; or  
(vii) (except in REC and LLD and for the purposes of PRU 8.4 and PRU 8.5) he is an individual and would be a parent undertaking if he were an undertaking; or  
(viii) (except in REC and LLD and for the purposes of PRU 8.4 and PRU 8.5) it is incorporated in or formed under the law of another EEA State and is a parent undertaking within the meaning of any rule of law in that State for purposes connected with implementation of the Seventh Company Law Directive; or  
(ix) (for the purposes of PRU 8.1, PRU 8.4 and PRU 8.5) it effectively exercises a dominant influence over S;

*[the rest is unchanged]*

sub-group

- ~~(in ELM)~~ (in relation to a person):  
(a) that person; and  
(b) any person that is either:  
(i) a subsidiary undertaking of that person; or  
(ii) an undertaking in which that person or a subsidiary undertaking of that person holds a participation.

# Additional glossary terms

## Additional glossary terms

This glossary text is a reproduction of defined terms currently being consulted on in CP190 and CP195 that are also used in the draft rules and guidance in this CP. This glossary is not being consulted on as part of this consultation paper, but reproduced here for the user's ease of reference.

<b>admissible assets</b>	An asset that falls into one or more categories in <i>PRU2.2 Annex 1R</i> .
<b>capital instrument</b>	An item of capital that is stated in <i>PRU2.2.43R</i> to be a capital instrument.
<b>capital resources</b>	The types of qualifying capital, as set out in <i>PRU2.2.13R</i> .
<b>capital resources requirement</b>	An amount of <i>capital resources</i> that a <i>firm</i> must hold as set out in <i>PRU2.1.15R</i> .
<b>innovative instrument</b>	A <i>potential tier one instrument</i> that is stated in <i>PRU2.2.45R</i> to <i>PRU2.259R</i> to be an innovative instrument.
<b>Life Assurance Directive</b>	the Directive of the European Parliament and of the Council of 5 November 2002 concerning life assurance (No 2002/83/EC)
<b>long term insurance fund</b>	a fund maintained under [ <i>PRIR 5.5.3R</i> ].
<b>lower tier two capital resources</b>	The sum calculated at stage (H) of the calculation in <i>PRU2.2.13R</i> .
<b>minimum capital requirement</b>	An amount of <i>capital resources</i> that a <i>firm</i> must hold as set out in <i>PRU2.1.17R</i> and <i>2.1.18R</i> .
<b>non-ordinary shares</b>	(in relation to a <i>firm</i> ), any share except an ordinary <i>share</i> (if that ordinary <i>share</i> forms part of the <i>firm's permanent share capital</i> ).
<b>potential tier one instrument</b>	An item of capital that falls into <i>PRU2.2.22R</i> .
<b>proxy capital resources requirement</b>	The <i>minimum capital requirement</i> to which an undertaking 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> .
<b>PRU</b>	The Integrated Prudential Sourcebook.
<b>PRU Category 2A</b>	See <i>PRAG 1.3.6(1)R</i> .

<b>tier one capital resources</b>	The sum calculated at stage (F) of the calculation in <i>PRU</i> 2.2.13R.
<b>tier two capital resources</b>	The sum calculated at stage (I) of the calculation in <i>PRU</i> 2.2.13R.
<b>upper tier two capital resources</b>	The sum calculated at stage (G) of the calculation in <i>PRU</i> 2.2.13R.



# Changes to other parts of the Handbook

## Reporting instrument

## **FINANCIAL REPORTING AND NOTIFICATION INSTRUMENT [2004]**

### **Powers exercised**

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the “Act”):
- (1) section 138 (General rule-making power);
  - (2) section 156 (General supplementary powers); and
  - (3) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

### **Commencement**

- C. This instrument comes into force on 1 August 2004 and shall apply to the supervision of accounts from the first day of the financial year beginning on or after 1 January 2005.

### **Amendments to the Supervision manual**

- D. The Supervision manual is amended in accordance with the Annex to this instrument.

### **Citation**

- E. This instrument may be cited as the Financial Reporting and Notification Instrument [2004].

By order of the Board  
[June 2004]

**Annex**  
**Amendments to the Supervision manual**

In this Annex underlining indicates new text and striking through indicates deleted text (except when otherwise indicated).

**3.9.5 R Table Auditors report**

<b>whether in the auditor's opinion:</b>	
<b>(14)</b>	<b>... if the <i>firm</i> prepares a consolidated <del>reporting statement</del> <u>supervision return</u> at its <i>accounting reference date</i>, that it has been prepared in accordance with the <i>rules</i>.</b>

...

After SUP 15.8.3R insert (this text is not underlined):

**15.9 Notifications by members of financial conglomerates**

**15.9.1 R** A *firm* that is a *regulated entity* must notify the *FSA* immediately it becomes aware that any *consolidation group* of which it is a member:

- (1) is a *financial conglomerate*; or
- (2) has ceased to be a *financial conglomerate*.

**15.9.2 R** A *firm* does not have to give notice to the *FSA* under SUP 15.9.1R if another member of the *consolidation group* has already given notice of the relevant fact to:

- (1) the *FSA*; or
- (2) (if another *competent authority* is *coordinator* of the *financial conglomerate*) that *competent authority*; or
- (3) (in the case of a *financial conglomerate* that does not yet have a *coordinator*) the *competent authority* who would be *coordinator* under Article 10(2) of the *Financial Groups Directive* (*Competent authority* responsible for exercising supplementary supervision (the *coordinator*)).

...

**Reports from groups**

16.3.25 G If this chapter requires the submission of a report covering a *group*, a single report may be submitted, and so satisfy the requirements of all *firms* in the *group*. Such a report should contain the information required from all of them, meet all relevant due dates and indicate all the *firms* on

whose behalf it is submitted; if necessary a separate covering sheet should list the *firms* on whose behalf a report is submitted. Nevertheless, the requirement to provide a report, and the responsibility for the report, remain with each *firm* in the *group*.

However, reporting requirements that apply to a *firm*, by reason of the *firm* being a member of a *financial conglomerate*, are imposed on only one member of the *financial conglomerate* (see, for example, SUP 16.7.73R).

...

16.7.5 G Applicable rules and guidance on financial reports (see SUP 16.7.1G)

<b>Firm category</b>	<b>Applicable rules and guidance</b>
<i>Bank, other than an EEA bank with permission for cross border services only</i>	SUP 16.7.7R - SUP 16.7.15R <u>SUP 16.7.73R - SUP 16.7.74R</u>
<i>Building society</i>	SUP 16.7.16R - SUP 16.7.19R <u>SUP 16.7.73R - SUP 16.7.74R</u>
...	
<i>Securities and futures firm</i> (Note 1)	SUP 16.7.22R - SUP 16.7.34G <u>SUP 16.7.73R - SUP 16.7.74R</u>
<i>Investment management firm</i>	SUP 16.7.35R - SUP 16.7.41R <u>SUP 16.7.73R - SUP 16.7.74R</u>
<i>Personal investment firm</i>	SUP 16.7.42G - SUP 16.7.53G <u>SUP 16.7.73R - SUP 16.7.74R</u>
...	
<i>ELMI</i>	SUP 16.7.64R - SUP 16.7.66R <u>SUP 16.7.73R - SUP 16.7.74R</u>
....	

...

16.7.8 R Financial reports from a UK bank (see SUP 16.7.7R)

Content of Report	Form (Note 1)	Frequency	Due date
....			
Analysis of large exposures (Consolidated)	LE2 (Note 2)	Quarterly	20 business days after period end
<u>Analysis of significant transactions (other than those resulting in large exposures) with the mixed-activity holding company and its subsidiaries</u>	<u>LE2/LE3 Note 7</u>	<u>Quarterly</u>	<u>20 business days after period end</u>
...			
<p>...  <u>Note 7 = A bank must add the required information to the relevant large exposures reporting form (LE2 or LE3). For the purposes of this reporting requirement, a transaction will be presumed to be significant if its amount exceeds 5% of the total amount of capital adequacy requirements at the level of the group.</u></p>			

...

16.7.25 R Financial reports required from a securities and futures firm which is a category A or B firm or a broad scope firm (see SUP 16.7.24R)

Report	Frequency	Due date
....		
<u>Consolidated supervision return reporting statement (Note 2)</u>	Half yearly	<del>1 month after period end</del>  <u>3 months after end of the relevant six-month period</u>
...		
Large exposures quarterly reporting statement (Form LEM 1 or LEM 2) – consolidated (Notes 2 and 4)	Quarterly	1 month after quarter end

Report	Frequency	Due date
<u>(Only for ISD investment firms)</u> <u>Analysis of significant transactions (other than those resulting in large exposures) with the mixed-activity holding company and its subsidiaries (Note 5).</u>	<u>Quarterly</u>	<u>1 month after quarter end</u>
<u>If the firm's ultimate parent is a mixed-activity holding company, the annual accounts of the mixed-activity holding company</u>	<u>Yearly</u>	<u>As soon as available after year-end</u>
....		
... Note 2 = <del>Only for category A and B firms which are subject to the consolidation rules set out in IPRU(INV) 10-200R-Chapter 14. —10-203R, and are not exempt from the consolidation rules under IPRU (INV) 10-200R(2) or IPRU (INV) 10-204R.</del> ... <u>Note 5 = Securities and futures firms that are ISD investment firms must add the required information to the large exposures reporting form (QFS1). For the purposes of this reporting requirement, a transaction will be presumed to be significant if its amount exceeds 5% of the total amount of capital adequacy requirements at the level of the group.</u>		

16.7.27 R Financial reports from a securities and futures firm which is a category C or D firm or an arranger or venture capital firm (see SUP 16.7.26R)

Report	Frequency	Due date
....		
<u>Consolidated supervision return reporting statement (Note 2)</u>	<u>Half yearly</u>	<u>1-month after period end</u>  <u>3 months after end of relevant six-month period</u>
...		

Report	Frequency	Due date
Large exposures quarterly reporting (Form LEM 1 or LEM 2) - consolidated (Notes 2 and 4)	Quarterly	1 month after quarter end
<u>(Only for ISD investment firms)</u> <u>Analysis of significant transactions (other than those resulting in large exposures) with the mixed-activity holding company and its subsidiaries (Note 5).</u>	Quarterly	<u>1 month after quarter end</u>
<u>If the firm's ultimate parent is a mixed-activity holding company, the annual accounts of the mixed-activity holding company</u>	Yearly	<u>As soon as available after year-end</u>
....		
<p>...</p> <p>Note 2 = Only for category C firms (as defined in the glossaries located in IPRU(INV) 10), which are subject to the consolidation rules set out in <del>IPRU(INV) 10-200R—10-203R Chapter 14,</del> and are not exempt from the consolidation rules under <del>IPRU(INV) 10-200R(2) or IPRU(INV) 10-204R.</del></p> <p>...</p> <p><u>Note 5 = Securities and futures firms that are ISD investment firms must add the required information to their large exposures reporting. For the purposes of this reporting requirement, a transaction will be presumed to be significant if its amount exceeds 5% of the total amount of capital adequacy requirements at the level of the group.</u></p>		

...

16.7.31 R A securities and futures firm must submit the reports in accordance with, and in the same format as; the forms contained in SUP 16 Ann 10R, and as required by section 6 of that annex; the form contained in SUP 16 Ann 19R (consolidated supervision); and according to the requirements contained in SUP 16 Ann 20G.

...

16.7.36 R Table Financial reports from an investment management firm<sup>1</sup> (see SUP 16.7.35R)

Report	Frequency	Due date
--------	-----------	----------

<sup>1</sup> This is shown as modifications to the rules at September 2003. Further amendments will be made as part of an upcoming Board instrument. The final rules will reflect this.

Report	Frequency	Due date
Annual Financial Return (Note 1)	Annually	4 months after the <i>firm's accounting reference date</i>
<u>(Only for ISD investment firms) Analysis of significant transactions (other than those resulting in large exposures) with the mixed-activity holding company and its subsidiaries (Note 5).</u>	Annually	4 months after the <i>firm's accounting reference date</i>
<u>Consolidated supervision return (only for firms subject to IPRU(INV) Chapter 14)</u>	Half yearly	4 months after end of relevant six-month period
<u>If the firm's ultimate parent is a mixed-activity holding company, the annual accounts of the mixed-activity holding company.</u>	Yearly	As soon as available after year-end
...		
<p>...</p> <p><u>Note 5 = Investment management firms that are ISD investment firms must add the required information to their large exposure reporting in the Annual Financial Return. For the purposes of this reporting requirement, a transaction will be presumed to be significant if its amount exceeds 5% of the total amount of capital adequacy requirements at the level of the group.</u></p>		

...

16.7.38 R An investment management firm must submit the required reports in accordance with, and in the same format as; the forms contained in SUP 16 Ann 5R, and according to the requirements contained in section 4 of that annex; the forms contained in SUP 16 Ann 19R (consolidated supervision); and according to the requirements contained in SUP 16 Ann 20G.

...

16.7.47 R Additional financial reports required from a Category A1, A2 or A3 firm (see SUP 16.7.46R)

Report	Frequency	Due date
...		
<u>Consolidated supervision</u>	Quarterly	3 weeks after the

Report	Frequency	Due date
financial resources return (Note 1)	<u>Half yearly</u>	<del>quarter end-</del> <u>4 months after end of relevant six-month period</u>
<u>If the firm's ultimate parent is a mixed-activity holding company, the annual accounts of the mixed-activity holding company</u>	<u>Yearly</u>	<u>As soon as available after year-end</u>
...		
Form 13I (Consolidated statement of large exposures) (Note 1)	Quarterly	3 weeks after quarter end
<u>(Only for ISD investment firms) Analysis of significant transactions (other than those resulting in large exposures) with the mixed-activity holding company and its subsidiaries (Note 5).</u>	Quarterly	3 weeks after quarter end
...		
<p>Note 1 = This report is only required from a <i>firm</i> if it is a member of a <i>group</i>, and it is subject to consolidated supervision as set out in <i>IPRU(INV)</i> 13.7.1R to 13.7.2R-Chapter 14.</p> <p>...</p> <p><u>Note 5 = Personal investment firms that are ISD investment firms must add the required information to the large exposure reporting in Form 13I. For the purposes of this reporting requirement, a transaction will be presumed to be significant if its amount exceeds 5% of the total amount of capital adequacy requirements at the level of the group.</u></p>		

...

16.7.51 R

(1) A Category A1, A2 or A3 *firm* must submit the reports in *SUP* 16.7.45R and *SUP* 16.7.47R in accordance with, and in the same format as; the forms contained in *SUP* 16 Ann 7R (sections 1, 3 and 6), and as required by section 5 of that annex; the forms contained in *SUP* 16 Ann 19R (consolidated supervision); and according to the requirements contained in *SUP* 16 Ann 20G.

...

16.7.52 G *Guidance* notes for the completion of reports for the purposes of consolidated supervision, and of the annual questionnaire required under SUP 16.7.48R can be found in SUP 16 Ann 8G.

...

**16.7.66 R Financial reports from an ELMI (see SUP 16.7.65R)**

Content of Report	Form (Note 1)	Frequency	Due Date
....			
<b>Consolidated large exposures reporting statement</b>	<b>ELM-CA/LE</b>	<b>Half-yearly</b>	<b>20 business days after period end (22 business days if submitted electronically)</b>
<b><u>Analysis of significant transactions (other than those resulting in large exposures) with the mixed-activity holding company and its subsidiaries</u></b>	<b><u>ELM-CA/LE (Note 2)</u></b>	<b><u>Half-yearly</u></b>	<b><u>20 business days after period end (22 business days if submitted electronically)</u></b>
...			
...			<p><b><u>Note 2 = ELMIs must add the required information to the large exposures reporting form (QFS1). For the purposes of this reporting requirement, a transaction will be presumed to be significant if its amount exceeds 5% of the total amount of capital adequacy requirements at the level of the group.</u></b></p>

...

**16.7.68R Table: Financial reports from a UCITS management company**

Report	Frequency	Due date
....		
<b><u>Consolidated supervision return (only for firms subject to IPRU(INV) Chapter 14)</u></b>	<b><u>Half yearly</u></b>	<b><u>4 months after end of relevant six-month period</u></b>
<b><u>If the firm's ultimate parent is a mixed-activity holding company, the annual accounts of the</u></b>	<b><u>Yearly</u></b>	<b><u>As soon as available after year-end</u></b>

<u><i>mixed-activity holding company</i></u>		
...		

**16.7.69R** A UCITS management company must submit the required reports in accordance with, and in the same format as; the forms contained in SUP 16 Ann 16R, and according to the requirements contained in section 4 of that annex; the forms contained in SUP 16 Ann 19R (consolidated supervision); and according to the requirements contained in SUP 16 Ann 20G.

...

After SUP 16.7.72R, insert (this text is not underlined):

**Financial conglomerates**

**16.7.73 R (1)** A *firm* that is a member of a *financial conglomerate* must submit financial reports to the *FSA* in accordance with the table in SUP 16.7.74R if:

- (a) it is at the head of a *financial conglomerate* for which the *FSA* is the *co-ordinator*; or
- (b) its *Part IV permission* contains a relevant *requirement*.

(2) In (1)(b), a relevant *requirement* is one which:

- (a) applies SUP 16.7.74R to the *firm*; or
- (b) applies SUP 16.7.74R to the *firm* unless the *mixed financial holding company* of the *financial conglomerate* to which the *firm* belongs submits the report required under this *rule* (as if the *rule* applied to it).

**16.7.74 R Table** Financial reports from a member of a financial conglomerate (see SUP 16.7.73R)

Content of Report	Form (Note 1)	Frequency	Due Date
<b>Calculation of supplementary capital adequacy requirements in accordance with one of the four technical calculation methods</b>	Note 2	Note 5	Note 5
<b>Identification of significant <i>risk concentration</i> levels</b>	Note 3	Note 5	Note 5
<b>Identification of significant <i>intra-group transactions</i></b>	Note 4	Note 5	Note 5

Note 1 = When giving the report required, a *firm* must use the form indicated, if any. The content of the form has the status of *guidance* on the type of information that should be provided to meet the reporting obligation.

Note 2 = If Part 1 of *PRU 8 Annex 1* (method 1), Part 2 of *PRU 8 Annex 1* (method 2), or Part 3 of *PRU 8 Annex 1* (method 3) applies, form *SUP 16 Ann [..]* must be used.

If Part 4 of *PRU 8 Annex 1* applies (method 4):

- (1) a *banking conglomerate* must use form *SUP 16 Ann 1R (BSD3)*;
- (2) a *building society conglomerate* must use form *SUP 16 Ann 3R (MFS1 Tables D&F)*
- (3) an *investment services conglomerate* must use form *SUP 16 Ann 18R*;
- (4) an *insurance conglomerate* must use form [To be determined].

Note 3 = Rather than specifying a standard format for each *financial conglomerate* to use, each *financial conglomerate* for which the *FSA* is the *coordinator* will need to discuss with the *FSA* the form of the information to be reported. This should mean that usual information management systems of the *financial conglomerate* can be used to the extent possible to generate and analyse the information required.

These reporting obligations to the *FSA* as *coordinator* may be modified after consultation with other *relevant competent authorities* (see *PRU 8.4.10G - PRU 8.4.12G*).

When reviewing the *risk concentration* levels, the *FSA* will in particular monitor the possible risk of contagion in the *financial conglomerate*, the risk of a conflict of interests, the risk of circumvention of sectoral *rules*, and the level or volume of risks.

Note 4 = For the purposes of this reporting requirement, an *intra-group transaction* will be presumed to be significant if its amount exceeds 5% of the total amount of capital adequacy requirements at the level of the *financial conglomerate*.

Rather than specifying a standard format for each *financial conglomerate* to use, each *financial conglomerate* for which the *FSA* is the *coordinator* will need to discuss with the *FSA* the form of the information to be reported. This should mean that usual information management systems of the *financial conglomerate* can be used to the extent possible to generate and analyse the information required.

These reporting obligations to the *FSA* as *coordinator* may be modified after consultation with other *relevant competent authorities* (see *PRU 8.4.10G - PRU 8.4.12G*).

When reviewing the *intra-group transactions*, the *FSA* will in particular monitor the possible risk of contagion in the *financial conglomerate*, the risk of a conflict of interests, the risk of circumvention of sectoral *rules*, and the level or volume of risks.

Note 5 = The frequency and due date will be as follows:

1. *banking conglomerate*: frequency is half yearly with due date 20 *business days* after period end (22 *business days* if submitted electronically);
2. *building society conglomerate*: frequency is quarterly with due date 7 *business days* after *month end* (largest societies) and 10 *business days* after *month end* (other societies);
3. *investment services conglomerate*: frequency is half yearly with due date three *months* after period end;
4. *insurance conglomerate*: frequency is yearly with due date four *months* after period end for the capital adequacy return and three *months* after period end for the *intra-group transactions*.

...

Ann 2G: Guidance notes on completion of banks' reporting forms (including validations)

In "Form BSD3 –Reporting instructions", "D400-D470 Deductions from capital", insert the following paragraph at the end of item D460:

Where the reporting institution is required to deduct the amount of material insurance holdings (see IPRU (BANK) Chapter CA, section 10.2), the deduction should be the higher of the book value and the regulatory capital requirement of the affiliate concerned, the latter pro rata to the interest held. The book value should already have been included in item A160, and deducted from capital in item D400; where the regulatory capital requirement is a higher figure, the difference over the book value should be included here. "

...

Ann 3R: Building societies' reporting forms

Building society quarterly statement - QFS1; D Capital Available: Own Funds: Society and Group

Note (d) Capital instruments in other CFI's, deductions in respect of ~~life companies~~ material insurance holdings, mortgage indemnity insurance captives, securitisations etc. - [Chapter 1 (Solvency) of Volume 1 of the IPSB for building societies refers].

...

Ann 4G: Guidance notes on completion of building societies' reporting forms

Quarterly statement QSF1 – Guidance notes; Section D: Capital available: own funds

D3.1 Deductions not shown elsewhere

Deduct all holdings of capital instruments of other credit or financial institutions, CFIs. (See Annex of P/G for fuller definitions). This means holdings of share capital in a society's connected undertakings. For society columns it is any such holdings in CFIs; for Group columns only include holdings in such bodies that are not consolidated in Group figures.

Also include deductions (described in P/G) in respect of the following: ~~life and general insurance companies~~ material insurance holdings, mortgage indemnity insurance captives, securitisations, etc.

...

The following provisions in *SUP* are to be deleted:

*SUP* 16 Ann 7R - Section 6 - the consolidated financial resources return for personal investment firms.

*SUP* 16 Ann 8G – Part 1 – GUIDANCE NOTES on the completion of the pro forma consolidated financial resources return for personal investment firms.

*SUP* 16 Annex 10R – Section 2 - the consolidated reporting statement for securities and futures firms.

*SUP* 16 Annex 11G – Section 2 – guidance notes: - consolidated reporting statement for securities and futures firms.

Insert *SUP* 16 Ann 19R and 20G

**SUP 16ANN 19R: CONSOLIDATED SUPERVISION RETURN FOR INVESTMENT FIRMS**

**PART 1: GROUP FINANCIAL RESOURCES:**

Name of regulated firm:

Name of ultimate EEA financial holding company for group (“parent”):

	Group Tier 1:	Group Tier 2:	Group Tier 3:	
ordinary share capital	<input type="text"/>	non-fixed-term cumulative preference shares	<input type="text"/>	short term subordinated loan
share premium	<input type="text"/>	non-fixed-term long term subordinated loans	<input type="text"/>	unaudited consolidated trading book profits
audited consolidated reserves	<input type="text"/>	consolidated revaluation reserves	<input type="text"/>	
non-cumulative preference shares	<input type="text"/>		<b>B1</b>	<b>Total Group Tier 3:</b>
other reserves	<input type="text"/>			<i>C</i>
minority interests	<input type="text"/>			
<b>externally verified interim profits</b>	<input type="text"/>			
<b>Less:</b>				
intangible assets	<input type="text"/>	fixed-term cumulative preference shares	<input type="text"/>	<b>Group Material Holdings in credit and financial institutions:</b>
material unaudited consolidated losses since balance sheet date	<input type="text"/>	fixed-term long term subordinated loan	<input type="text"/>	<i>D1</i>
investments in own shares	<input type="text"/>		<b>B2</b>	<b>Group Material Insurance Holdings:</b>
<b>Total Group Net Tier 1:</b>	<b>A</b>	<b>Total Group Tier 2:</b>	<b>B</b>	<b>D2</b>
		<b>B=B1+B2</b>		

**Group Financial Resources:** *E*

$E = A + B1 + B2 + C - D1 - D2$   
*B, B1, B2, and C are subject to eligibility limits as set out in the relevant chapter of IPRU(INV).*

**SUP 16ANN 19R: CONSOLIDATED SUPERVISION RETURN FOR INVESTMENT FIRMS**

**PART 2: GROUP FINANCIAL RESOURCES REQUIREMENT:**

**Name of regulated firm:**


**Name of ultimate EEA financial holding company for group ("parent"):**

F	F1	F2
Name of <i>subsidiary</i> or <i>participation</i>	% ownership	Local regulator (or state if unregulated)

G	H
Financial Resources Requirement of F	State how Financial Resources Requirement has been calculated.


(G1)

Parent's Financial Resources Requirement

--

(I)

Large Exposures Requirement on Group Basis

--

(J)

Total Group Financial Resources Requirement (=G1+I+J)

--

(K)

Total Group Financial Resources (=E)

--

**Total Group Surplus / (Deficit) (=E-K)**

--

(L)

**SUP 16ANN 20G: CONSOLIDATED SUPERVISION RETURN FOR INVESTMENT FIRMS**

**GUIDANCE PART 1: Group Financial Resources**

<i>Ref</i>	<i>Guidance</i>
A	<p>The Group should calculate its financial resources based on the consolidated financial statements prepared at the level of the ultimate EEA financial holding company in the group. The financial statements should be prepared in accordance with the relevant accounting standards but investments in insurance companies should be de-consolidated.</p> <p>The Group Tier 1 capital should be calculated by taking the relevant capital items from the consolidated balance sheet. Deductions must be made in arriving at Tier 1 for intangible assets (including goodwill arising from consolidation), investments in own shares and for material unaudited losses since the balance sheet date. Unaudited losses should be regarded as material if they exceed 10% of Group Tier 1 before taking into account this deduction.</p>
B1	<p>This is the sum of non-fixed-term (undated) cumulative preference shares, non-fixed-term (undated) long-term subordinated loans and revaluation reserves and other consolidated reserves.</p>
B2	<p>This is the sum of fixed-term cumulative preference shares and fixed-term long-term subordinated loans.</p>
C	<p>The total of short-term subordinated loans external to the group and unaudited consolidated profits arising from trading book activities should be shown here.</p>
D1	<p>The definition of material holdings in non-group credit institutions and investment firms should be derived on the basis of the prudential rules applied to the most significant sector in the group except that references to “own funds” should be replaced by “consolidated own funds”. For this purpose consolidated own funds is equal to A+B after the application of the eligibility limits as set out in the relevant chapter of IPRU(INV).</p>
D2	<p>Insurance members of the group should be de-consolidated and material insurance holdings should be deducted here. They normally represent the book value of the investment in insurance undertakings, reinsurance undertakings and insurance holding companies in which the group holds a participation, unless the group’s share of the undertaking’s notional or local requirement is higher, in which case, there is a deduction in full.</p>
E	<p>The Group Financial Resources should be shown here. This represents the sum of eligible capital in A, B1, B2 and C, minus the deductions in D1 and D2. No other deductions should be made. Liquidity adjustments and other similar deductions that are made at the solo level should be included in the Group Financial Resources Requirement.</p> <p>The limits applied at the group level to the inclusion of items in the group financial resources should be the same as the limits applied at the level of the main firm in the group.</p>

## SUP 16ANN 20G: CONSOLIDATED SUPERVISION RETURN FOR INVESTMENT FIRMS

### GUIDANCE PART 2: Group Financial Resources Requirement

<i>Ref</i>	<i>Guidance</i>
F	<p>List the name of each <i>subsidiary</i> and <i>participation</i>.</p> <p>A <i>firm</i> may combine several entities together where these are not material in relation to the group. For example, entities where total assets are in aggregate less than 5% of the group's total assets. The <i>firm</i> should 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>
F1	List the percentage interest in the <i>subsidiary</i> or <i>participation</i> held by the parent. If the shares are not held directly by the parent, but by another group company, enter the effective percentage interest of the parent in the company. Where the entity is a <i>subsidiary</i> of a parent, indicate (S) after the effective percentage interest. Such an entity will be treated as a <i>subsidiary</i> of the parent and will be included in full in the calculations.
F2	Specify if the <i>subsidiary</i> or <i>participation</i> is regulated by the FSA or another regulator. If the entity is unregulated, state "unregulated".
G	<p>The financial resources requirement of entity F should be shown here. The financial resources requirement for a participation must be pro-rated (i.e. it should be multiplied by F1).</p> <p>This should be equal to the solo financial resources requirement plus any deductions from own funds made in arriving at the solo financial resources.</p> <p>In the case of a firm regulated by the FSA under IPRU(INV) Chapter 5 rules (as an investment management firm) this should be equal to the financial resources requirement calculated in accordance with IPRU (INV) 5.2.3 plus the illiquid assets adjustment calculated in accordance with IPRU (INV) Table 5.2.2(1) part II paragraph 10, but less any qualifying property adjustment.</p> <p>For unregulated firms this should be equal to the proxy financial resources requirement, which should also include illiquid assets and other deductions (where appropriate).</p>
G1	This is the sum of figures in column G.
H	<p>Details of the method used to calculate G (the financial resources requirement) for each firm should be given here. For example for an FSA-regulated firm column H should contain the IPRU reference (eg IPRU(INV) Chapter 5). For an overseas regulated firm where the prudential calculation is recognised by FSA as being equivalent the applicable overseas regulator should be given.</p> <p>For proxy requirements for unregulated firms column H should state the regulatory rules that have been applied to calculate the proxy requirement.</p>
I	The financial resources requirement of the parent should be shown here.

**SUP 16ANN 20G: CONSOLIDATED SUPERVISION RETURN FOR INVESTMENT FIRMS**

<i>Ref</i>	<i>Guidance</i>
	This should be equal to the solo financial resources requirement (excluding any large exposures requirement and requirements in respect of intra-group balances) and any adjustments made to financial resources in accordance with Rule 14.4.3R.
J	The group large exposures requirement should be shown here. This will only be calculated if there are trading book activities within the group. However, a group should ensure compliance with all group large exposures limits calculated in accordance with the rules in the most significant sector.
K	The Group Financial Resources Requirement should be shown here. It is equal to the sum of G1, I and J.
L	The overall group surplus or deficit is equal to the difference between the Total Group Financial Resources (E) and the Group Financial Resources Requirement (K).



# Consequential change instrument

**FINANCIAL GROUPS DIRECTIVE (CONSEQUENTIAL CHANGES)  
INSTRUMENT [2004]**

**Powers exercised**

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the “Act”):
- (1) section 138 (General rule-making power);
  - (2) section 156 (General supplementary powers); and
  - (3) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

**Commencement**

- C. This instrument comes into force on [2004].

**Amendments to the Threshold Conditions sourcebook**

- D. The Threshold Conditions sourcebook is amended in accordance with Annex A to this instrument.

**Amendments to the Authorisation manual**

- E. The Authorisation manual is amended in accordance with Annex B to this instrument.

**Amendments to the Supervision manual**

- F. The Supervision manual is amended in accordance with Annex C to this instrument.

**Amendments to the Decision making manual**

- G. The Decision making manual is amended in accordance with Annex D to this instrument.

**Citation**

- H. This instrument may be cited as the Financial Groups Directive (Consequential Changes) Instrument [2004].

By order of the Board  
[2004]

**Annex A**  
**Amendments to the Threshold Conditions sourcebook**

In this Annex, underlining indicates new text.

**Threshold condition 5: Suitability**

...

2.5.3 G (1) ...

(2) ...

(3) In relation to a firm which is an EEA regulated entity, the Financial Groups Directive provides that the FSA should consult other competent authorities when assessing the suitability of the shareholders and the reputation and experience of directors involved in the management of another entity in the same group.

**Annex B**  
**Amendments to the Authorisation manual**

In this Annex, underlining indicates new text.

**Connected persons**

3.9.22 G (1) ...

- (1A) The *Financial Conglomerates and Other Financial Groups Regulations* makes special provision where the *FSA* is exercising its functions under Part IV of the *Act* (Permission to carry on regulated activities) for the purposes of carrying on supplementary supervision. Broadly, where the *FSA*, in the course of carrying on supplementary supervision, is considering varying the *Part IV permission of a person* who is a member of a group which is a *financial conglomerate*, the consultation provisions in section 49(2) of the *Act* are disapplied. In their place, the regulations impose special obligations, linked to the *Financial Groups Directive*, to obtain the consent of the relevant *competent authorities*, to consult those authorities and to consult with the group itself.

## Annex C Amendments to the Supervision manual

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

### **When will the FSA grant an application for variation of permission?**

...

- 6.3.31 G In considering whether to grant a *firm's* application to vary its *Part IV permission*, the *FSA* will also have regard, under section 49(1) of the *Act* (Persons connected with an applicant), to any *person* appearing to be, or likely to be, in a relationship with the *firm* which is relevant (see *AUTH 3.9.22G* to *AUTH 3.9.24G* (Connected persons)). The *Financial Conglomerates and Other Financial Groups Regulations* makes special consultation provisions where the *FSA* is exercising its functions under Part IV of the *Act* (Permission to carry on regulated activities) for the purposes of carrying on supplementary supervision – see *AUTH 3.9.22G(1A)*.

...

### **7.3: Criteria for varying a firm's permission**

...

- 7.3.2 G The *FSA* may seek to vary a *firm's Part IV permission* on its own initiative in certain situations, including the following:

(1) ...

...

- (4) If a *firm* which is a member of *financial conglomerate* and the *FSA* is implementing supplementary supervision under that Directive with respect to that *financial conglomerate* by imposing obligations on the *firm*. Further material on this can be found in *PRU 8.4* (Cross sector groups) and *SUP 16.7.73R – SUP 16.7.74* (reporting requirements with respect to *financial conglomerates*).

...

## 8.9: Decision making

...

8.9.2 G If the FSA, in the course of carrying on supplementary supervision of a financial conglomerate, is considering exercising its powers under section 148 of the Act (Modification or waiver of rules), regulation 4 of the Financial Conglomerates and Other Financial Groups Regulations contains special provisions. The FSA must, in broad terms, do two things. Where required by those regulations, it must obtain the consent of the relevant competent authorities of the group. And, where required by those Regulations, it must consult those competent authorities.

...

## 11.5: Form of notification by firms

...

11.5.4A G Firms are also reminded that a change in control may give rise to a notification as a financial conglomerate or a change in the supplementary supervision of a financial conglomerate (see PRU 8.4 (Cross sector groups) and PRU 8.5 (Third country groups)).

...

## The FSA's timeframe for responding to a notification

...

11.7.13 G Before giving an approval notice or warning notice, the FSA must comply with certain requirements as to consultation with competent authorities outside the United Kingdom (sections 183(2) and 188(2) of the Act and the Financial Services and Markets Act 2000 (Consultation with Competent Authorities) Regulations 2001). The Financial Conglomerates and Other Financial Groups Regulations make special provision in relation to (the change in control over a UK authorised person (within the meaning of section 178(4) of the Act) which is a member of a third country group.

## Annex D Amendments to the Decision making manual

In this Annex, underlining indicates new text.

### Examples of allocation of decision making

...

- 4.1.8 G Examples of matters decided by *executive procedures* (where the FSA decides or is required to use the statutory powers in question rather than to achieve the action required in other ways, for example through individual *guidance* or securing the agreement of a *firm* to take action on a voluntary basis) include:

...

(4A) in relation to a *financial conglomerate*, using the *own-initiative power* to apply one of the methods for calculating capital adequacy in Annex 1 of the *Financial Groups Directive* (see *PRU 8.4.50R (Capital adequacy requirement: Use of Part IV permission to apply Annex 1 of the Financial Groups Directive)* or to impose a reporting requirement under *SUP 16 (Reporting requirements)*.

...



# Changes to Interim Prudential Sourcebooks

## IPRU(BANK) amendments

## **FGD IMPLEMENTATION : TEXT AMENDMENTS TO IPRU BANK**

Amendments sidelined, deleted text ~~struck through~~, new text underlined

### **(1) AMENDMENTS TO CHAPTER GN, SECTIONS 2 AND 3**

#### **PURPOSE**

3. ...
4. The purpose of the prudential standards set out in this sourcebook is to ensure that banks maintain capital and other financial resources commensurate with their risks and appropriate systems and controls to enable them to manage those risks. The FSA requires in particular that banks maintain adequate capital against their risks: capital enables banks to absorb losses without endangering customer deposits; that they maintain adequate liquidity; and that they identify and control their large credit exposures - which might otherwise be a source of loss to a bank on a scale that might threaten a bank's solvency.
5. This sourcebook, together with the separate prudential sourcebook applying to building societies, also implements EC directives setting out prudential standards as these apply to *credit institutions*. Where a bank is part of a financial conglomerate, it will also be subject to additional rules and guidance set out in PRU 8.4. A bank with an ultimate non-EEA parent may also be subject to some provisions in PRU 8.5. And all banks that are part of a group are subject to the general provisions in PRU 8.1.

#### **Definitions**

- 3.5.1 R In this section the term or phrase in the first column of the following table has the meaning given to it in the second column:

<b>exposure</b>	...
<b><u>financial holding company</u></b>	<b><u>A financial institution whose subsidiary undertakings are either exclusively or mainly credit institutions or financial institutions ( at least one being a credit institution ) and which is not a mixed financial holding company.</u></b>
<b><u>financial institution</u></b>	<b><u>( when used in chapters GN, CA and CS ) see definition in Glossary</u></b>
<b>firm</b>	...
<b>IPRU (BANK)</b>	The Interim Prudential Sourcebook for <i>banks</i> .
<b>initial capital</b>	...
<b><u>mixed activity holding company</u></b>	<b><u>A parent undertaking that is not a financial holding company, or a credit institution, or a mixed financial holding company, whose subsidiaries include at least one credit institution.</u></b>

<b><u>mixed financial holding company</u></b>	<b><u>See definition in the <i>Glossary</i></u></b>
<b>notification rules</b>	...
<b>Part IV permission</b>	...
<b><u>participation</u></b>	<b><u>See definition in the <i>Glossary</i>, except where the context otherwise requires (such as in the phrase "sub-participation" )</u></b>
<b>participating interest</b>	...

## (II) AMENDMENTS TO CHAPTER CA

### 1.2 Legal sources

- 3 The sources noted in the Legal Sources section of the Capital Adequacy Overview chapter are also relevant to this chapter.
- 4 The Banking Consolidation Directive (formerly The Directive on Own Funds, "Own Funds Directive", "OFD" - 89/299/EEC) establishes a standard EU definition of capital for prudential supervisory purposes. This follows closely the Basel Convergence Agreement on capital standards. The Directive has been amended by the Financial Groups Directive (2002/87/EC ) and some of the resulting changes are given effect in this chapter.
- 5 The Capital Adequacy Directive ("CAD" - 93/6/EC) introduced Tier 3 capital for use in supporting trading book activities.
- 6 The Banking Consolidation Directive (formerly the Second Banking Co-ordination Directive, "2BCD" - 89/646/EEC) sets the minimum initial capital requirement and minimum ongoing capital requirement for banks incorporated in the European Economic Area.

See s3

### 10.2 Deductions from the total of Tier 1 capital and Tier 2 capital

- 2 Certain deductions should be made from the total of Tier 1 (after Tier 1 deductions) and Tier 2 capital:
  - (a) Investments in subsidiaries and associates which fall outside the scope of a bank's capital adequacy return (including all *material insurance holdings*);
  - (a) ...

(b) ...

(c) ...

(d) ~~Investments in life assurance companies should be treated on the same principle as other investments.~~ The amount of any *material insurance holding* should ( subject to (i) below ) be deducted from the total of Tier 1 and Tier 2 capital. A material insurance holding means the higher of

(1) the book value of an *investment* held in an insurance undertaking, reinsurance undertaking , or insurance holding company ; or

(2) the bank's proportionate share of that undertaking's local or notional regulatory capital requirement.

*Investment* for this purpose includes both a participation and the investment in a subsidiary undertaking. Where the undertaking is a subsidiary and it has a solvency deficit, the subsidiary's local or notional regulatory requirement should be deducted in full. A description of how a notional capital requirement is to be calculated is set out in Part 6 of PRU 8 Annex 1. A notional requirement should be calculated in all cases where the undertaking is not regulated to EEA or equivalent standards: this is also explained in Part 6 of PRU 8 Annex 1.

(i) ~~However, w-Where an insurance affiliate undertaking is accounted for using the *embedded value* method, theis following treatment should be appliedmodified as follows ( unless the regulatory capital requirement is the higher figure ):~~

- On acquisition, any “goodwill” element, i.e. the difference between the acquisition value according to the *embedded value* method and the actual investment, should be deducted from Tier 1 capital.
- The *embedded value* should be deducted from the total of Tier 1 & 2 capital.
- Post-acquisition, where the embedded value of the company increases, the increase should be added to reserves, while the new embedded value is deducted from total capital. This means that the net impact on the level of capital is zero, although Tier 2 headroom will increase with any increase in Tier 1 reserves.

- (ii) *Embedded value* is the value of the company taking into account the present value of the expected future inflows from existing life assurance business.

See ch CS s2 & s9

(e) ...

(b) ...

(c) All holdings of capital instruments issued by other *credit institutions* and *financial firms* ~~*institutions*~~ unless these are covered by a *trading book concession*;

(a) ...

See s3.1

(b) ...

(c) ~~For the purposes of this sub-section~~ The definition of a financial institution is defined as a directly supervised institution (or a financial holding company above a supervised financial institution) whose exclusive or main business is to carry out one or more of the activities listed in points 2-12 in Annex I to the banking Consolidation Directive (formerly the Annex to 2BCD). These activities are listed in items (b) to (1) of the Appendix to chapter EU, given in the Glossary

- (i) The FSA assumes that parent companies which are primarily engaged in commercial activities but which have a financial subsidiary do not fall within the definition of a financial institution.

(d) ...

#### 10.4 Deductions of qualifying holdings from Tiers 1 and 2 capital

21 ...

22 For the purposes of qualifying holding deductions, ~~commercial~~ non-financial undertakings are defined as all undertakings other than:

See s10.4

(a) *Credit* and certain *financial institutions*;

~~The above are defined to be credit institutions, supervised financial firms and financial holding companies whose exclusive or main business is to carry out one or more of the activities listed in points 2-12 of Annex I to The Banking Consolidation Directive (formerly the Annex to 2BCD). These activities are also listed in points (b) to (1) of the Appendix to Chapter EU~~ a) The capital instruments of institutions which meet the definition of financial and credit institutions in section 10.2 therefore fall outside the scope of qualifying

holdings. (The full definition of *financial institution* is in the Glossary:-)

- (b) Institutions whose exclusive or main activities are a direct extension of banking, or concern services ancillary to banking, such as leasing, factoring, the management of unit trusts, the management of data processing services supporting banking services or any other similar activity; and
  - (a) These activities are set out in Article 43(2)(f) of the Bank Accounts Directive (86/635/EEC).
- (c) Insurance and reinsurance companies.
  - (a) The definition of an insurance ~~company~~ undertaking is contained in the First Non-Life Insurance Directive (73/239/EC) as amended by the ~~Second Non Life Insurance Directive~~ and Article 4 of the First Life Insurance Assurance Directive (~~79/267/EEC~~) (2002/83/EC) as amended by the Act of Accession of 1985. The definition of reinsurance undertaking is contained in the Insurance Groups Directive (98/78/EC).

23 ...

### (III) AMENDMENTS TO CHAPTER LE

#### 2 The rationale for a large exposures policy

1 ...

2 ...

3 ...

4 The need to control risk concentration was the main reason for the minimum standards for a limits-based approach towards large exposures brought in by the LED (now replaced by The Banking Consolidation Directive). Where appropriate, the FSA's policy goes further, to reflect its own view of what constitutes a prudent approach in this key area of banks' internal management controls. ( Following the amendments to the Banking Consolidation Directive resulting from the Financial Groups Directive, FSA is also required to supervise transactions between a bank and a mixed activity holding company (MAHC), to have significant transactions with the MAHC reported to the FSA; and to take appropriate action if these intra group transactions pose a threat to the bank's financial position.)

- (i) The FSA's existing requirements for the control and monitoring of exposures to connected counterparties , set out in this chapter LE (particularly section 9.2.2 ) and the large exposures reporting forms in SUP 16 Ann 1R.

- (ii) A specific new requirement in SUP 16.7 to report significant transactions with an MAHC that do not constitute exposures; and
- (iii) The requirements (Rule 3.3.19 and PRU 8.1) for a bank to have the systems to enable the control and monitoring described above, and provide the necessary information for reporting to FSA.

#### (IV) AMENDMENTS TO CHAPTER CS

##### CONSOLIDATED SUPERVISION

##### 1. INTRODUCTION

##### 1.1 Legal sources

See COND

- 1 A bank’s compliance with the policy set out in this chapter will help establish that it satisfies the Threshold Conditions (as to “Adequate resources” and “Suitability”) and complies with the Principles (as to “Management and control” and “Financial prudence”).
- 2 The Banking Consolidation Directive (2000/12/EC) ~~formerly the Second Consolidated Supervision Directive (92/30/EEC)~~ sets required minimum standards for the performance of consolidated supervision of groups including banks within the EEA. This chapter on consolidated supervision is the principal vehicle implementing 2CSD (now replaced by those parts of The Banking Consolidation Directive) that derive originally from the Second Consolidated Supervision Directive (92/30/EEC) and have now been further amended by the Financial Groups Directive (2002/87/EC). Banks that are part of a group should also refer to the rules and guidance on group risks in PRU 8.1.
- 3 The Capital Adequacy Directive (CAD - 93/6/EEC) introduced both a framework for capital requirements for market risk and a requirement for a consolidated assessment of groups including investment firms. This chapter includes the updates to the consolidated supervision regime applied to banks which resulted from its implementation, most notably the introduction of aggregation plus as a technique for consolidating trading book exposures in some cases for CAD banks.
- 4 The obligations in these directives require consolidation ~~only~~ up to the highest relevant parent incorporated in the EEA, ~~and not to~~ Where the ultimate parents is outside the EEA, FSA also needs to establish whether the bank is subject to equivalent consolidated supervision by the competent authorities in the ultimate parent's home country, and if not, to take appropriate measures to achieve the objectives of the Banking Consolidation Directive. This is covered in more detail in PRU 8.5: banks with non-EEA parents should therefore note that they are also subject to the relevant provisions in PRU 8.5

5 \_\_\_\_ It is open, however, to supervisors to go further than the minimum requirements. It may be important to consolidate other parts of the group, in order to have all the relevant risks included. The FSA is committed to extending its consolidated supervision beyond the requirements of the directives if the result is a more accurate assessment of risk to a bank. Moreover, where a banking group includes an entity active in the insurance sector, it may possibly constitute a *financial conglomerate* and would then be subject to additional rules and guidance necessary to implement the Financial Groups Directive in such cases. The exact definitions and criteria as to what constitutes a *financial conglomerate*, and the additional rules and guidance that apply to them, are set out in PRU 8.4. If a banking group is, or becomes, a *financial conglomerate*, it will be subject to these additional rules and guidance, as well as to the rules and guidance in this chapter.

## 1.2 Application

5 This chapter applies to UK-incorporated banks (and banking groups with UK-incorporated non-bank parents) only.

- (a) Banks incorporated elsewhere in the EEA with UK branches are, of course, subject to the requirements of the “~~2CSD~~” (now replaced by The Banking eConsolidation Directive) as implemented by their home supervisors.

## 1.3 How this chapter is organised

6 ...

7 ...

8 ~~Section 8 covers~~ Material on qualitative consolidated supervision, formerly in section 8 of this chapter ( now deleted ) , has been replaced by the rules and guidance in PRU 8.1. And Section 9 explains the solo consolidation treatment which may be adopted for solo purposes.

9 ...

## 2 THE FSA'S APPROACH TO CONSOLIDATED SUPERVISION

1 ...

2 ...

3 ...

4 ...

5 The FSA regards consolidated supervision as a complement to, not a substitute for, solo supervision.

- (a) Solo supervision is needed as well. For events elsewhere in the group and the activities of other group companies can pose a threat to the bank in ways which consolidated supervision alone cannot detect: for example, intra-group linkages arising from transactions between the bank and other group companies will only be revealed by solo supervision. And a complementary assessment of solo capital adequacy permits an assessment of whether, so far as the bank itself is concerned, there is an appropriate distribution of capital in a group.
- (b) So institutions should comply with the FSA's policy on capital adequacy and large exposure on both a solo (or solo-consolidated) and a consolidated basis.

The FSA also seeks to ensure that persons who effectively direct the business of a financial holding company are of sufficiently good repute and have sufficient experience to perform these duties. This requirement was introduced into the Banking Consolidation Directive by the Financial Groups Directive ( article 54a of the Banking Consolidation Directive as inserted by article 29(8) of the Financial Groups Directive). But without prejudice to this specific requirement , the Directive also makes clear that the consolidation of the financial situation of a financial holding company ( as part of the consolidated supervision of its banking subsidiary by FSA ) in no way implies that FSA is required to play a supervisory role in relation to that financial holding company on a stand-alone basis .

Article 55a of the Banking Consolidation Directive (as inserted by article 29(9) of the Financial Groups Directive also requires the FSA to exercise general supervision over transactions between a bank that is a subsidiary of a mixed activity holding company ( MAHC ), and the MAHC itself and its other subsidiaries. The relevant guidance to banks is set out in section 3 of this chapter , para 3.1.4. If these intra-group transactions were to pose a threat to the bank's financial position , FSA will take appropriate measures.

## **PART OF CHAPTER CS , SECTION 3 : QUANTITATIVE CONSOLIDATED SUPERVISION**

### **3.1.2 Large exposures**

4 ...

### **3.1.3 Adequate controls**

See ch GN s3

5 A bank should have adequate internal control mechanisms to produce any data and information which might be relevant for the purpose of supervision on a consolidated basis : this is now placed on a new and stronger footing in PRU 8.1 (see also rule 3.3.19 which requires a bank to have adequate systems and controls which enable it to monitor, control and calculate its large exposures).

### **3.1.4 Intra group transactions with MAHC.**

5A Where a bank's parent is a mixed activity holding company ( MAHC ), FSA is required to supervise transactions between the bank, and the MAHC and its other subsidiaries, and any significant transactions are to be reported to FSA. The most important category of such transactions will be those ( i.e. credit exposures and off balance sheet items ) that give rise to "exposures" to the relevant connected counterparty for the purposes of chapter LE the large exposure reporting and forms LE2. FSA considers that in these cases the directive requirement is adequately met by the existing arrangements under which the bank's exposures to individual, or groups of, connected counterparties are reported and monitored ( see 3.1.2 above, and also chapter LE section 9.2.2, and the large exposure reporting forms in SUP 16Ann 1R ). Reporting of other significant transactions (that do not give rise to "exposures") is also now required as a separate item by SUP 16.7.8R. The requirements for the bank to have adequate systems and controls to produce the necessary information (see 3.1.3 above), and systems and controls generally to mitigate group risk are also covered in PRU 8.1 which applies to all banks that are part of groups.

## 4 SCOPE OF CONSOLIDATION

### 4.1 Introduction

See Supervision Manual chapter 16

1 ...

4.2 Domain of consolidation within a group including a bank

2 Consolidation should be undertaken in the following cases:

(a) ...

(b) when the bank is not the *parent* company, but:

(i) the bank is part of a group or sub-group whose business wholly or *mainly* comprises the *listed activities*; and

(ii) the *parent* of the group or sub-group is itself a *financial institution*.

See a10.1

(a) The *listed activities* are those given in the first paragraph of the first appendix to this chapter.

See s4.3

(b) The definition of *parent* is given below.

(c) To qualify as a *financial institution*, the exclusive or *main business* of a company should be either to carry out one or more of the listed activities or to acquire holdings in companies undertaking these activities. The formal definition of a *financial institution* is given in the Glossary.

(d) ...

(e) ...

(f) ...

### 4.3 Companies to be consolidated

3 Consolidation then extends to all relevant financial companies within that domain: that is the *parent company*; its *subsidiaries*; and companies in which the parent or its subsidiaries have a *participation*.

(a) The definitions used of *parent* and *subsidiary* are those contained in the Seventh Company Law Directive (83/349/EEC); these are implemented in the United Kingdom in section 258 of the Companies Act 1985. The definition of *participation* is set out in the Table in chapter GN.

(b) The notion of *subsidiary* is also normally extended to cover a company over which the parent or one of its subsidiaries exercises *dominant influence*. The criteria used to determine whether dominant influence exists are those provided by the contemporary UK accounting standards.

(i) The relevant accounting standard is FRS2, Accounting for Subsidiary Undertakings.

(c) The threshold for the consolidation of group companies which are not subsidiaries - *participations* - is the ownership of 20% or more of the voting rights or capital.

(d) In the case where undertakings are linked to the domain of consolidation by a relationship within the meaning of article 12(1) of Directive 83/349/EEC, FSA will determine how consolidation is to be carried out.

(e) *Asset management companies* ( which for this purpose has the meaning given in the Handbook Glossary ) are also to be consolidated, whether or not they come within the definition of *financial institution* , thereby fulfilling specific requirements in the Financial Groups Directive.

4 Companies whose business is not financial are not usually included in the consolidation; however, the FSA may consider that it is appropriate to include them.

(a) Insurance and the broking of insurance are not financial activities for this purpose, and so these companies are not usually included in a consolidation.

(i) For an explanation of the treatment of investments in insurance companies, see the chapter on the definition of capital.

See ch CA s10

5 A non-financial subsidiary or *participation* should be excluded from the consolidation only with the FSA's prior agreement. If the exclusion is agreed, the investment in that company should be deducted from consolidated capital and its assets not included in group weighted risk assets.

(a) The method of valuation used for the investment should be the normal accounting practice followed by the bank.

See ch CA s10

(b) Some stakes below the threshold for consolidation should also be deducted. For details of these and of the other deductions from capital base, see the chapter on the definition of capital.

#### 4.4 General exceptions to the above policy

6 As provided for by ~~article 3.3 of the 2CSD (now replaced by~~ Article 52.3 of The Banking Consolidation Directive), in a limited number of cases the FSA may permit the exclusion from a bank's consolidated returns of subsidiaries or participations which otherwise meet the criteria for consolidation, where:  
...

#### 4.5 The policy where a bank is subject to consolidated supervision elsewhere

9 Where a bank is a member of a group including a number of EEA-incorporated banks, the FSA may following discussion with the other supervisor(s), agree that consolidation is not necessary.

10 For a group including a bank whose ultimate parent is incorporated in a country outside the EEA, the treatment of the whole group is set out in PRU 8.5. This does not affect the usual operation of the Banking Consolidation Directive for the EEA sub-group i.e. from the highest relevant EEA parent down. ~~consolidation of the whole group is not normally necessary.~~

~~In determining the appropriate treatment in these cases, the FSA takes into account whether the parent company is subject to consolidated supervision (by another supervisor) that adheres to the Basel minimum standards for the supervision of international banking groups and their cross border establishments~~

In those cases in which it determines that a whole-group consolidation would not be appropriate, the FSA nonetheless considered that sub-consolidation from the highest relevant EEA parent down, as outlined above, would be appropriate.

#### 4.6 Groups not subject to consolidation

11 When a bank belongs to a group or sub-group for which the FSA determines consolidation would be inappropriate (for example in cases where the preponderance of the group's business comprises industrial or insurance business), the FSA may ask the parent institution and its other subsidiaries to supply it with any data or information which it considers relevant to the purpose of supervising the bank.

- 12 When the parent of a bank is an insurance company ( but the whole group does not constitute a *financial conglomerate* ), the FSA does not normally consider it necessary to consolidate down from the insurance company, pending further harmonisation of the basis of accounting for banks and insurance companies. However, the FSA seeks to liaise with the supervisors of the insurance company parent if that supervisor is not the FSA. Where the group as a whole constitutes a *financial conglomerate*, it will in any case be subject to the additional rules and guidance on consolidated supervision set out at PRU 8.4.

## **8 QUALITATIVE CONSOLIDATED SUPERVISION**

**( DELETE WHOLE OF SECTION 8 )**



# IPRU(BSOC) amendments

# FGD AMENDMENTS TO IPRU ( BSOC ) , VOLUME 1

## CHAPTER 1 : SOLVENCY

Amendments sidelined, deleted text ~~struckthrough~~ , new text underlined.

(i)

### 1.4 EU Directives

1.4.1 G The EU has harmonised capital adequacy requirements for credit institutions in the EU by the following principal directives:

- (1) Council Directive of 17 April 1989 on the Own Funds of Credit Institutions (89/299/EEC);
- (2) Council Directive of 18 December 1989 on a Solvency Ratio for Credit Institutions (89/647/EEC).

1.4.2 G In March 2000, these directives, along with the Large Exposures Directive, the 1<sup>st</sup> and 2<sup>nd</sup> Banking Co-ordination Directives and the 2<sup>nd</sup> Consolidated Supervision Directive, were consolidated into a single Directive, known as the Banking Consolidation Directive (2000/12/EC). Elsewhere in this sourcebook, references will be to the consolidated directive ("BCD").

1.4.3 G A further directive, 93/6/EEC on the capital adequacy of investment firms and credit institutions (the "CAD", not included in the BCD), sets out the capital requirements for credit institutions which have trading books and foreign exchange exposures. Building societies which are on the "Trading Book" approach to Treasury management may engage in those activities (see section 1.18).

1.4.4 G The BCD requires national authorities to ensure that all credit institutions maintain sufficient capital resources in relation to their business to ensure a minimum solvency ratio of 8%. The BCD specifies the types of capital resources whose inclusion is permitted in the calculation of the solvency ratio: those resources are

known, collectively, as "own funds". It also sets out the calculation of the solvency ratio as follows:

$$\text{solvency ratio} = \frac{100 \times \Sigma \text{ own funds}}{\Sigma(\text{risk weighted assets} + \text{off balance sheet items})} \geq 8\%$$

i.e. the solvency ratio equals own funds divided by the sum of risk weighted assets and off balance sheet items, expressed as a percentage and should be 8% or more.

1.4.5 G The BCD specifies the minimum risk weights which should be applied to assets in the balance sheet and the "credit conversion factors" to be applied to off balance sheet items, in order to calculate the denominator of the solvency ratio.

1.4.6 G The BCD also requires the FSA to carry out consolidated supervision of building society groups. The EU provisions for consolidated supervision have been supplemented by the Financial Groups Directive ( 2002/87/EC ) . Where a building society group includes an entity active in the insurance sector, while the group's main business lies in the deposit-taking sector, it may possibly constitute a "financial conglomerate" ( though the FSA expects this will be rare, at least in the near future ). The exact definitions and criteria as to what constitutes a "financial conglomerate" and the additional rules and guidance that apply to them, are set out in PRU 8.4. If ( but only if ) a building society is , or becomes , a financial conglomerate, it will be subject to these additional rules and guidance , as well as to the rules and guidance in this IPRU ( BSOC ) . Moreover, all building societies that are part of a group are subject to the general provisions in PRU 8.1.

(ii)

## **1.8 Deductions**

1.8.1 G Societies should make certain deductions from own funds and observe certain restrictions on the inclusion of Tier 2 items. The deductions comprise:

- (1) intangible fixed assets, including goodwill;

- (2) all holdings of capital instruments of other credit or financial institutions (see Annex 1D for definitions);
- (3) all holdings of capital instruments of regulated broker-dealers (subject to CAD or an analogous regime);
- (4) (a) the amount of the capital deficit of any subsidiary undertaking which has such a deficit (only required for society only calculations). The entire deficit should be excluded even if the subsidiary is only partially owned;
- (b) the proportion attributable to outside minority interests in the capital deficit of any subsidiary undertaking which has such a deficit (required for consolidated calculations)-;
- (5) the amount of any material insurance holding ( see Annex 1 D for definitions ), relating to an insurance undertaking, reinsurance undertaking, or insurance holding company.

1.8.2 G Societies may be expected to make a deduction from own funds to reflect the existence of a contingent liability which, if called, would create an asset that societies would be required to deduct from own funds.

N B: See section 1.13 for ~~deductions in respect~~the treatment of insurance companies that are subsidiaries, section 1.14 for MIG captives, section 1.16 for holdings in other institutions, and for possible deductions arising out of securitisation, section 1.15.

(iii)

### **1.13 Exclusions from Consolidation**

1.13.1 G Subject to a limited degree of discretion allowed to the supervisory authorities, the BCD requires building societies to consolidate subsidiary undertakings

which are financial or credit institutions (defined in Annex 1D) for the purposes of calculating their solvency ratio. However unless:

- (1) the inclusion of a particular non financial institution or non-credit institution subsidiary undertaking would result in a higher solvency ratio than if it were to be excluded; or
- (2) the FSA specifically requires the subsidiary undertaking to be excluded;

societies should include all their subsidiary undertakings when calculating their solvency ratio. Exclusion is likely where the FSA believes that a subsidiary's inclusion in the consolidation would be misleading or inappropriate. Life insurance ~~and~~ general insurance, reinsurance and insurance holding companies fall into this category : societies are already expected to deduct material insurance holdings from own funds (see section 1.8 above ). ~~and~~ Societies should calculate their solvency ratio after reversing the impact of the investment in, or consolidation of, these subsidiary undertakings. In the society only ratio calculation, the carrying value of the investment should be removed from the weighted asset total, and an equal deduction made from the society's own funds. In the consolidated ratio calculation, the weighted assets of the insurance subsidiary should be removed from the consolidated weighted assets, ~~and the reserves of the subsidiary consolidated into group own funds should be reversed out, including any benefit of the embedded value taken through the group's reserves. The only profits of the subsidiary that may count as group own funds are those that have been distributed to the parent society i.e. as dividends.~~ Societies should also note that the consolidation of asset management companies ( which for this purpose have the meaning given in the Handbook Glossary ) is now required by article 30 of the Financial Groups Directive, whether or not they come within the definition of a financial institution.

(iv)

#### **1.16 Deductions in Respect of Holdings in Other Institutions**

1.16.1 G Articles 51.1 and 51.2 of the BCD prohibit a credit institution from having a "qualifying holding" in excess of 15% of its own funds in an undertaking or 60% in several undertakings which are neither credit institutions, financial institutions, nor undertakings which carry on "ancillary banking services".

1.16.2 G A qualifying holding is defined as "a direct or indirect holding in an undertaking which represents 10% or more of the capital or of the voting rights, or which makes it possible to exercise a significant influence over the management of the undertaking in which the holding subsists".

1.16.3 G The Directive gives member states the option not to apply the restrictions to life and general insurance companies or reinsurance companies; and not to apply them in other cases provided they require a deduction from the credit institution's own funds of 100% of the amount in excess of the 15% or 60% limits.

1.16.4 G The FSA has decided not to apply the limits to participation in insurance or reinsurance companies but under section 1.8 above - "material insurance holdings" – see Annex 1D for definitions - are already subject to deduction from the society's own funds; see also section 1.13 for capital treatment in respect of holdings in the exclusion of insurance companies subsidiaries from consolidation. The FSA has also decided not to apply the limits in other cases but to recommend a 100% deduction from own funds of the amount of the holding in excess of 15%.

(v)

## **1A.6 Own funds**

1A.6.1 Gross own funds comprise Tier 1 capital plus Tier 2 capital. From this should be deducted:

- (1) all holdings of capital instruments of other credit or financial institutions, or in regulated broker-dealers (subject to CAD or an analogous regime);

- (2) the amount of capital deficit of any subsidiary undertaking which has such a deficit (for society only calculations);
- (3) the proportion attributable to outside minority interests in the capital deficit of any subsidiary undertaking which has such a deficit (for consolidated calculations);
- (4) any deductions in respect of insurance , reinsurance or insurance holding companies (section ~~1.13~~1.8), MIG Captives (section 1.14), holdings in other undertakings (section 1.16) and securitisation (paragraph 1.15.2);

to arrive at "own funds".

1A.6.2 Article 34.2(3) of the BCD allows "funds for general banking risks" to be counted as Tier 1 capital. Such funds are not general provisions for bad debt but are akin to banks' "hidden reserves" and are therefore not applicable to building societies.

(vi)

## ANNEX 1D

### ~~HOLDINGS OF CAPITAL INSTRUMENTS OF OTHER CREDIT AND FINANCIAL INSTITUTIONS TO BE EXCLUDED DEDUCTIONS FROM "OWN FUNDS" CALCULATIONS – DEFINITIONS ( for~~ section 1.8 )

#### G

#### ~~1D.1 Definitions~~

**1D.1.1 Capital Instruments** Includes without limitation any constituent of own funds (as set out in Article 34 of the BCD) or the equivalent in a financial institution

**1D.1.2 Credit Institution** An undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account

**1D.1.3 Financial Institution** An undertaking other than a credit institution the principal activity of which is to acquire holdings or to carry on one or more of the following activities:

- (1) lending
- (2) financial leasing
- (3) money transmission services
- (4) issuing and administering means of payment (e.g. credit cards, travellers cheques and bankers drafts)
- (5) guarantees and commitments
- (6) trading for own account or for account of customers in
  - (a) money market instruments (cheques, bills, CDs etc)
  - (b) foreign exchange
  - (c) financial futures and options
  - (d) exchange and interest rate instruments
  - (e) transferable securities

- (7) participation in securities issues and the provision of services related to such issues
- (8) advice to undertakings on capital structure, industrial strategy and related questions and advice and services relating to mergers and the purchase of undertakings
- (9) money broking
- (10) portfolio management and advice
- (11) safekeeping and administration of securities.

**1D.1.4 Material Insurance Holdings** means the higher of

- a. the book value of an investment held in an insurance undertaking , reinsurance undertaking , or insurance holding company, or
- b. the society's proportionate share of that undertaking's local or notional regulatory capital requirement.

Investment for this purpose includes both a participation and the investment in a subsidiary undertaking. Where the undertaking is a subsidiary and it has a solvency deficit, the subsidiary's local or notional regulatory requirement should be deducted in full.

A description of how a notional capital requirement is to be calculated is set out in Part 6 of PRU 8 Annex 1. A notional requirement should be calculated in all cases where the undertaking is not regulated to EEA or equivalent standards : this is also explained in Part 6 of PRU 8 Annex 1.

**1D.1.5 Participation** means

- (1) a participating interest as defined in section 260 of the Companies Act 1985  
(participating interests): or
- (2) the direct or indirect ownership of 20% or more of the voting rights or capital  
of an undertaking.

# ELMI amendments

## FINANCIAL GROUPS DIRECTIVE: AMENDMENTS FOR ELM

(1) Add the following entry to the table in ELM 1.5.2G:

Block	Module	Application
Block 2 (Business Standards)	The Integrated Prudential Sourcebook (PRU)	Chapters 1.1, 8.1, 8.4 and 8.5 apply to an <i>ELMI</i>

(2) Amend the entry in the table in *ELM* 2.4.2R relating to material holdings so that it reads as follows:

~~material holdings in financial institutions or credit institutions~~ the total amount of material holdings in certain persons (see *ELM* 2.4.17R)

(3) Amend *ELM* 2.4.17R as follows:

**2.4.17 R (1) The total amount of a firm's material holdings means in financial institutions or credit institutions are the sum of:**

- (a) **the total value of all ownership shares and all ~~subordinated loan capital coming within (6)~~ owned by the firm (or in which it has a position) in any relevant financial services company or financial institution in which the firm owns more than 10% of the ownership shares; and**
- (b) **the amount by which the total amount specified in (3) exceeds 10% of the firm's own funds (calculated before the deduction of material holdings at stage F of the calculation in *ELM* 2.4.2 R);**
- (c) **ownership shares in any:**

- (i) **insurance undertaking; or**

- (ii) **insurance holding company;**

**if it fulfils one of the following conditions:**

- (iii) **it is a subsidiary undertaking of the firm; or**

- (iv) **the firm holds a participation in it; and**

- (d) **any item of capital of a type referred to in (6) in an insurance undertaking or insurance holding company coming within (1)(c).**

- R (2) *[Unchanged]*
- R (3) The amount referred to in (1)(b) is the sum of the total value of all the *ownership shares* and all ~~subordinated loan capital~~ coming within (6) owned by the *firm* (or in which it has a position) in *financial institutions* or ~~*credit institutions*~~ *relevant financial services companies* except for ~~*financial institutions* or *credit institutions*~~ *relevant financial services companies* that fall into (1)(a).
- R (4) The *firm* must include *ownership shares* and ~~subordinated loan capital~~ any item of capital of the type referred to in (6);~~and *ownership shares*, and subordinated loan capital~~
- (a) of which it is not the registered owner but which it owns beneficially; or
- (b) that are or should be included as an asset in its accounting records.
- R (5) The value of *ownership shares* and ~~subordinated loan capital~~ coming within (6) for the purposes of *ELM 2.4.17R* (1)(a) and (3) is the full balance sheet value.
- R (6) An item falls into this paragraph if it is a subordinated debt or other item of capital that:
- (a) (in the case of an *insurance undertaking* or *insurance holding company*) falls into Article 16(3) of the *First Non-Life Directive* or, as applicable, Article 27(4) of the *Consolidated Life Directive*; or
- (b) (in the case of a *relevant financial services company* or *financial institution*) falls into Article 35 or Article 36(3) of the *Banking Consolidation Directive*.

(4) Amend *ELM 7* by inserting new paragraphs as follows:

7.8.9 G If a *firm* is linked to other *financial services undertakings* by a *consolidation Article 12(1) relationship*, the *FSA* will determine how to apply the provisions of this chapter.

7.8.10 G If a *firm* is part of a *financial conglomerate*, the provisions of *PRU 8.4* apply. If a *firm* is part of a *third-country group*, the provisions of *PRU 8.5* apply.

# IPRU(INV) Chapter 14

**CHAPTER 14: CONSOLIDATED SUPERVISION FOR INVESTMENT BUSINESSES  
(NEW CHAPTER)**

**Chapter 14 replaces the following provisions in IPRU(INV) which are to be deleted:**

Rules 3.190 to 3.195

Section 5.7.1 (Rules 5.7.1(1) to 5.7.5(4))

Rule 7.4.1(d)

Rules 10.200 to 10.204

Section 13.7 (Rules 13.7.1 to 13.7.2B)

**The following change is necessary to incorporate reference to Chapter 14 into Chapter 1.**

<b>1.2.4</b>	<b>R</b>	A firm of a kind listed in the left-hand column of Table 1.2.4R must comply with the provisions of IPRU(INV) shown in the right hand column and, where relevant, the provisions of chapter 14.
--------------	----------	--

**The following are the changes necessary to incorporate article 29(4) of the FGD and relate to holdings in insurance companies – it is not sufficient to include these in Chapter 14 as this article is an amendment to the rules governing solo own funds.**

In Table 5.2.2(1), insert the following:

<b>PART II DETAILED REQUIREMENTS</b>	
<p>...</p> <p><b>10 Illiquid assets</b> (Item 16)</p>	<p>Illiquid assets comprise:</p> <p>.....</p> <p><u>(i) if not otherwise covered, any holding in eligible capital instruments of an insurance undertaking, insurance holding company, or reinsurance undertaking that is a subsidiary or participation. Eligible capital instruments include ordinary share capital, cumulative preference shares, perpetual securities and long-term subordinated loans, that are eligible for insurance undertakings under PRU2.</u></p>

In Table 7.3.1 R, insert the following:

**PART II  
DETAILED REQUIREMENTS**

**10 Illiquid assets (Item 14)**

Illiquid assets comprise:

(i) if not otherwise covered, any holding in eligible capital instruments of an insurance undertaking, insurance holding company, or reinsurance undertaking that is a subsidiary or participation. Eligible capital instruments include ordinary share capital, cumulative preference shares, perpetual securities and long-term subordinated loans, that are eligible for insurance undertakings under PRU2.

In table 10-62(2)A insert the following items:

**R TABLE 10-62(2)A - Financial resources - version I**

the sum of - (G)  
*material holdings in credit and financial institutions*  
*material insurance holdings*

In table 10-62(2)B insert the following items:

**R TABLE 10-62(2)B - Financial resources - version II**

the sum of - (H)  
*material holdings in credit and financial institutions*  
*material insurance holdings*

In table 10-62(2)C insert the following items:

**R TABLE 10-62(2)C - Financial resources - version II.2**

the sum of - (G)  
*non-trading book material holdings in credit and financial institutions*  
*material insurance holdings*

Insert in the Chapter 10 Glossary

Material insurance holdings This is calculated as the higher of –

(a) the book value of an investment held in an insurance undertaking, reinsurance undertaking or insurance holding company; and

(b) the group's proportionate share of that undertaking's local or notional regulatory requirement.

-

Investment for this purpose includes both a *participation* and the investment in a *subsidiary* undertaking. Where the undertaking is a subsidiary and it has a solvency deficit, the subsidiary's local or notional regulatory requirement should be deducted in full. A description of how a notional capital requirement is to be calculated is set out in Part 6 of PRU 8 Annex 1. A notional requirement should be calculated in all cases where the undertaking is not regulated to EEA or equivalent standards : this is also explained in Part 6 of PRU 8 Annex 1.

In Table 13.5.4(1) PART I

Insert the following:

ASSETS	FIRMS IN CATEGORY A1 CALCULATION	TYPE OF ADJUSTMENT
...	...	...
(13) All other assets	<p>Exclude in full.</p> <p><u>If not otherwise excluded in full in this table, this category should include any holding in eligible capital instruments of an insurance undertaking, insurance holding company, or reinsurance undertaking that is a subsidiary or participation.</u></p> <p><u>Eligible capital instruments include ordinary share capital, cumulative preference shares, perpetual securities and long-term subordinated loans, that are eligible for insurance undertakings under PRU2.</u></p>	An Illiquid Adjustment
...	...	...

In Table 13.5.4(2) PART I

Insert the following:

ASSETS	FIRMS IN CATEGORY A2 AND A3 CALCULATION	TYPE OF ADJUSTMENT
...	...	...

(13) All other assets

Exclude in full.  
If not otherwise excluded in full in this table, this category should include any holding in eligible capital instruments of an insurance undertaking, insurance holding company, or reinsurance undertaking that is a subsidiary or participation.  
Eligible capital instruments include ordinary share capital, cumulative preference shares, perpetual securities and long-term subordinated loans, that are eligible for insurance undertakings under PRU2.

An Illiquid Adjustment

...

...

...

## CHAPTER 14: CONSOLIDATED SUPERVISION FOR INVESTMENT BUSINESSES

### 14.1 APPLICATION

**14.1.1 R** Subject to rule 14.1.2, *consolidated supervision* and this Chapter apply to a *firm* which is a member of a group if it is:

- (1) a *securities and futures firm*, subject to the financial rules in Chapter 3, which is a *broad scope firm* but not a *venture capital firm*;
- (2) an *investment management firm*, which is an *investment firm* subject to the financial rules in Chapter 5;
- (3) a *UCITS investment firm*, subject to the financial rules in chapter 7;
- (4) a *securities and futures firm*, subject to the financial rules in Chapter 10, unless the firm is a *category D firm*; or
- (5) a *category A personal investment firm*, subject to the financial rules in Chapter 13.

**CASES WHERE *CONSOLIDATED SUPERVISION* UNDER THIS CHAPTER WILL NOT APPLY**

**14.1.2 R** A *firm* is not subject to *consolidated supervision* under the rules in this Chapter where any of the following conditions are fulfilled:

- (1) the *firm* is included in the supervision on a consolidated basis of the group of which it is a member by a *competent authority* other than the *FSA*; or
- (2) the *firm* is already included in the supervision on a consolidated basis of the group of which it is a member by the *FSA* under IPRU(BANK) or IPRU(BSOC).

14.1.3 G (1) The rules in this chapter apply even if the firm is subject to the rules in PRU 8.4 (the financial conglomerates rules) or PRU 8.3 (the insurance group rules), if the firm is part of an investment sub-group. Financial conglomerates are subject to the Financial Groups Directive (2002/87/EC). Insurance groups are subject to the Insurance Groups Directive (98/78/EC). Neither directive allows a waiver of consolidation of a Capital Adequacy Directive group. So if there is an investment sub-group within an insurance group, the rules in this Chapter apply, regardless of the application of a group capital assessment to the wider group.

- (2) Where firms authorised in two or more member states have as their parent the same *financial holding company*, supervision on a consolidated basis will be exercised by the competent authority of the firms authorised in the member state in which the *financial holding company* was set up. If no firm has been authorised in the Member State in which the financial holding company was set up, the competent authorities of the Member States concerned will seek to reach agreement as to who amongst them will exercise supervision on a consolidated basis. In the absence of such an agreement, supervision on a consolidated basis will be exercised by the competent authority that granted authorisation to the firms with the greatest balance-sheet total (measured on the basis of total assets). If that figure is the same for more than two authorised firms, supervision on a consolidated basis will be exercised by the competent authority which first gave the authorisation.
- (3) Where there is more than one authorised *firm* in the group, subject to the rules of this chapter, one consolidated supervision return may be submitted on behalf of all the *firms* in the group in accordance with SUP 16.3.25G.

#### EXEMPTION FROM CONSOLIDATED SUPERVISION

**14.1.4 R** A *firm* need not meet the requirements in rules 14.3.1 and 14.3.2 if:

- (1) there is no *credit institution* in the group;
- (2) 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*;
- (3) each member of the group which is a *CAD firm*:
  - (a) deducts any *material holdings in credit and financial institutions* from its financial resources;
  - (b) complies with its solo applicable financial resources requirement and the large exposures requirements; and
  - (c) has systems and controls to monitor and control the sources of capital and funding of all other *financial institutions* within the group;
- (4) 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;
- (5) 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;
- (6) the *firm* meets the conditions in rule 14.1.5; and

- (7) **the *firm* has first notified the *FSA* in writing that it intends to rely on this rule.**

**14.1.5 R** If the *firm* notifies the *FSA* under *rule* 14.1.4 that it will not apply the rules in this section, it must:

- (1) **submit to *FSA* a consolidated supervision return within the time period specified by *SUP* 16, together with a consolidated profit and loss account;**
- (2) **ensure that each *firm* in the group deducts from its solo financial resources any quantifiable *contingent liability* in respect of other group entities;**
- (3) **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**
- (4) **make a note in its audited financial statements that it is not subject to regulatory consolidated capital requirements.**

- 14.1.6 G
- (1) The Capital Adequacy Directive (articles 7(4) to 7(6)) provides that a *competent authority* such as the *FSA* may waive *consolidated supervision* provided certain conditions are met. The conditions in *rule* 14.1.4 are mainly derived from the Capital Adequacy Directive.
  - (2) The conditions in *rule* 14.1.5 aim to ensure that the *firm* is protected from weaknesses in other group entities.
  - (3) In *rule* 14.1.5(2), *contingent liabilities* includes direct and indirect guarantees.
  - (4) 14.1.5(3) aims to ensure that the expenditure-based requirement incorporates the *firm's* actual ongoing annual expenditures (including any share of depreciation on fixed assets) where these have been met by another group entity.
  - (5) The *FSA* may require further information from the *firm* if it considers that the *firm's* consolidated financial position raises undue risks to consumers. It may also seek reassurance that the *firm* has sufficiently robust *client assets* and *client money* controls - for example require a *skilled person's report*. The *FSA* may also use its *own initiative power* to impose conditions on the *firm*. This could include raising additional capital or further limitations on the *firm's* intra-group exposures.

## **14.2 SCOPE OF CONSOLIDATION**

**14.2.1 R** For the purposes of the rules in this Chapter, a *firm's* group means the *firm* and:

- (1) any *EEA parent* in the group which is a *financial holding company*, a *credit institution*, or an *investment firm*;
- (2) any *credit institution*, *investment firm* or *financial institution* which is a *subsidiary of the firm* or of the *firm's EEA parent*; and
- (3) any *credit institution*, *investment firm* or *financial institution* in which the *firm* or one of the entities in (1) or (2) holds a *participation*.

**14.2.2 R** If a group exists under rule 14.2.1R, the *firm* must also include in the scope of consolidation any *ancillary services undertaking* and *asset management company* in the group.

14.2.3 G Rule 14.1.1 states what type of firm may be subject to consolidated supervision (trigger firm). Rule 14.2.1 states what type of relationship triggers the existence of a group for consolidated supervision purposes. Rules 14.2.1 and 14.2.2 specify what entities should be included in the scope of consolidated supervision.

14.2.4(1) G A *firm's parent* is a *financial holding company* if it carries out mainly *listed activities* or activities undertaken by a Chapter 3 *broad scope firm* or if its main business is to acquire holdings in companies undertaking these activities. For this purpose the *FSA* interprets the phrases 'mainly' or 'main business' to mean the balance of business, i.e. over 40% of the relevant group or sub-group's balance sheet (measured on the basis of total assets). In addition, if the *firm's parent* has significant holdings in *insurance undertakings* or *reinsurance undertakings*, it is a *mixed financial holding company*, and the *firm* is subject to the rules in PRU 8.4 instead of the rules in this chapter. This is because a *parent* cannot be a *financial holding company* and a *mixed financial holding company* at the same time. PRU 8.4 sets out what constitutes significant insurance holdings (broadly more than 10% of the financial sector activities of the group).

14.2.4(2) G A firm with an ultimate non-EEA parent may also be subject to the provisions in PRU 8.5.

14.2.4(3) G In the case where undertakings are linked to the domain of consolidation by a relationship within the meaning of article 12(1) of Directive 83/349/EEC, *FSA* will determine how consolidation is to be carried out.

#### EXCLUSIONS

**14.2.5 R** A *firm* may, having first notified the *FSA* in writing, exclude from its group the following:

- (1) any entity the total assets of which are less than the smaller of the following two amounts:
  - (a) 10 million euros; or

- (b) **1% of the total assets of the group's *parent* or the undertaking that holds the *participation*;**

**provided that the total assets of such entities do not collectively breach these limits.**

- (2) **any entity the inclusion of which within the group would be misleading or inappropriate for the purposes of *consolidated supervision*.**

- 14.2.6 G (1) The *FSA* may require a *firm* to provide information about the position in the group of any undertaking excluded from the consolidation under rule 14.2.5.
- (2) An exclusion under rule 14.2.5(2) would normally be appropriate when an entity would be excluded from the scope of consolidation under the relevant UK generally accepted accounting principles.

### **14.3 CONSOLIDATED SUPERVISION REQUIREMENT**

**14.3.1 R A *firm* must at all times ensure that its group maintains *group financial resources* in excess of its *group financial resources requirement*.**

**14.3.2 R A *firm* must at all times comply with *large exposures* limits applied on a group basis.**

### **14.4 GROUP FINANCIAL RESOURCES**

**14.4.1 R A *firm* must calculate its *group financial resources* on the basis of the consolidated accounts of the relevant group, subject to the adjustments in rule 14.4.2 and on the basis specified in rule 14.4.3.**

**14.4.2 R (1) If more than one *firm* in the group is subject to the rules of this chapter, *group financial resources* are defined according to the relevant rules applicable to the main *investment firm* in the group, with minority interests being allowed as Group Tier 1 capital.**

(2) **In calculating the *group financial resources*, deductions should be made for intangible assets, material unaudited losses incurred since the balance sheet date and investments in own shares.**

(3) ***Material holdings* and *material insurance holdings* must be recalculated on a group basis and deducted in arriving at the *group financial resources*.**

**14.4.3 R Financial resources will be defined based upon the main *investment firm* in the group as follows:**

- (1) **if a *broad scope securities and futures firm* (excluding a *venture capital firm*), Table 3-61.**

- (2) **if an *investment management firm*, Table 5.2.2(1)R but excluding any illiquid assets or qualifying property adjustments required by that Table.**
  - (3) **if a *UCITS investment firm*, Table 7.3.1 but excluding any illiquid assets or qualifying property adjustments required by that Table.**
  - (4) **if an *ISD securities and futures firm*, Table 10-62(2)A, but excluding any adjustment in (E) of that Table.**
  - (5) **if a *personal investment firm*, Table 13.3.2(1).**
- 14.4.4 G (1) The FSA interprets ‘main’ by reference to the share of the *firm’s* business in the group, i.e. its contribution to the group’s balance sheet (measured on the basis of total assets).
- (2) The form in *SUP 16 Ann 19 R*, together with the guidance in *SUP 16 Ann 20G*, shows the mechanics of the calculation.
- 14.4.5G *A firm may apply for a waiver of rule 14.4.1 to permit an aggregation approach to determine group financial resources. Any waiver application should guarantee future compliance with any relevant own funds limit.*

## **14.5 GROUP FINANCIAL RESOURCES REQUIREMENT**

- 14.5.1 R** *A firm must calculate its group financial resources requirement as the aggregate of:*
- (1) **the sum of the financial resources requirements of all group entities within the scope of consolidation calculated in accordance with rule 14.5.2, except that:**
    - (a) **requirements in respect of intra-group balances with other entities within the scope of consolidation should be excluded;**
    - (b) ***large exposures requirements* of individual group entities should be excluded;**
  - (2) **the sum of any adjustments that are made to each firm's financial resources, calculated on a solo basis in accordance with Rule 14.4.3, in order to arrive at the amount of financial resources used to meet its solo financial resources requirement. These adjustments must exclude deductions in respect of the investment in and other relationships with other entities that are included within the scope of consolidation; and:**
  - (3) **if the main firm in the group is a *securities and futures firm*, a group *large exposures requirement*.**

**The financial resources requirements of entities in which the group holds a participation must be included proportionately.**

**14.5.2 R Financial resources requirements for individual entities in the group shall be:**

- (1) for firms regulated by the FSA, their regulatory capital requirement under FSA rules;**
- (2) for entities regulated by an EEA regulator or one of the regulators listed in IPRU(INV) 10-App 59 or IPRU(BANK) CS Appendix D, their local regulatory capital requirement; and**
- (3) for other entities in the group, a notional financial resources requirement calculated as if the entity were regulated by the FSA.**

- 14.5.3 G
- (1) For the purposes of rule 14.5.2(3) the notional financial resources requirements of group entities should normally be calculated as if the entities were subject to the financial rules in IPRU(INV) relevant to the main *firm* in the group.
  - (2) For the purposes of calculating an expenditure-based requirement, no account should be taken of expenses that have been recharged to another entity included in the scope of consolidation. For example, in calculating the notional requirement for a service company, the expenditure-based requirement should be calculated net of recharged expenses. This is to avoid double counting of the expenses.
  - (3) In 14.5.1(2), the adjustments referred to, are for *investment management firms*, the illiquid assets and qualifying property adjustments, and for *securities and futures firms*, the adjustments referred to in item (E) of Table 10-62(2)A. For *personal investment firms*, the adjustment required by 14.5.1(1) and (2) combined is the higher of:
    - (a) the own funds requirement in 13.3.1R or 13.10.1R and;
    - (b) the sum of the relevant expenditure-based requirement and illiquid, position risk, and counterparty risk adjustments required by Chapter 13 of IPRU(INV).

14.5.4G A *firm* may apply for a *waiver of rule 14.5.1R*, to permit a line-by-line approach to determine its *group financial resources requirement*. Any *waiver* application should demonstrate (where relevant) that the constraints for intra-group offsets under the Capital Adequacy Directive (article 7) are met. A *firm* should also demonstrate that calculating its requirement in this way does not result in a distortion of the *group financial resources requirement*.

## Definitions (for inclusion in the Chapter 14 Glossary):

### APPENDIX 1 (INTERPRETATION)

1. Insert the following definitions.

<i>ancillary services undertaking</i>	means an undertaking the principal activity of which consists of owning or managing property, managing data-processing services, or any other similar activity which is ancillary to the principal activity of one or more of the <i>firms</i> subject to this chapter.
<i>asset management company</i>	means a management company within the meaning of Article 1a(2) of Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (9), as well as an undertaking the registered office of which is outside the Community and which would require authorisation in accordance with Article 5(1) of that Directive if it had its registered office within the Community.
<i>broad scope firm</i>	means as in the Glossary in IPRU(INV) chapter 3.
<i>CAD Article 3 exempting criteria</i>	means the following criteria in respect of the <i>firm's</i> dealing positions: <ul style="list-style-type: none"><li>- such positions arise only as a result of the <i>firm's</i> failure to match investors orders precisely;</li><li>- the total market value of all such positions is subject to a ceiling of 15% of the <i>firm's</i> initial capital; and</li><li>- such positions are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question.</li></ul>
<i>Category A personal investment firm</i>	means as in the Glossary in IPRU(INV) chapter 10
<i>Category D firm</i>	means as in the Glossary in IPRU(INV) chapter 13
<i>contingent liability</i>	has the meaning in FRS 12 which states that it is: <ul style="list-style-type: none"><li>(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the entity's control or</li><li>(b) a present obligation that arises from past events but is not recognised because:<ul style="list-style-type: none"><li>(i) it is not probable that a transfer of economic benefits will be required to settle the obligation; or</li><li>(ii) the amount of the obligation cannot be measured with sufficient reliability.</li></ul></li></ul>
<i>consolidated supervision</i>	means the application of the financial rules in the Interim Prudential Sourcebook for Investment Businesses in accordance with rules 14.1.1 to 14.5.3.

<i>EEA parent</i>	means a <i>firm's</i> direct or indirect <i>parent</i> which has its head office in the <i>EEA</i> .
<i>financial holding company</i>	means a <i>financial institution</i> the <i>subsidiary undertakings</i> of which are either exclusively or mainly <i>credit institutions, investment firms</i> and <i>financial institutions</i> , one of which at least is a <i>credit institution</i> or an <i>investment firm</i> and which is not a <i>mixed financial holding company</i> within the meaning of PRU 8.4.
<i>financial institution</i>	means an undertaking other than a <i>credit institution</i> , the principal activity of which is to acquire holdings or to carry on a <i>listed activity</i> .
<i>group financial resources</i>	means the resources of a firm's group calculated in accordance with rules 14.4 (Group financial resources).
<i>group financial resources requirement</i>	means the requirement that a firm's group maintains financial resources calculated in accordance with the rules in 14.5 (Group financial resources requirement).
<i>investment firm</i>	means <i>investment firm</i> as in the main <i>Glossary</i> except that it excludes persons to which the ISD does not apply as a result of article 2.2 of the <i>ISD</i> .
<i>large exposures requirement</i>	means as set out in Rule 10-194 of IPRU(INV).
<i>listed activity</i>	means a listed activity within the meaning of the <i>BCD</i> , that is one or more of the following activities: <ul style="list-style-type: none"> <li>(a) lending;</li> <li>(b) financial leasing;</li> <li>(c) money transmission services;</li> <li>(d) issuing and administering means of payment;</li> <li>(e) guarantees and commitments;</li> <li>(f) trading for own account or for the account of customers in: <ul style="list-style-type: none"> <li>● money market instruments (cheques, bills, certificates of deposit, etc);</li> <li>● foreign exchange;</li> <li>● financial futures and options;</li> <li>● exchange and interest rate instruments;</li> <li>● transferable securities;</li> </ul> </li> <li>(g) participation in share issues and the provision of services related to such issues;</li> <li>(h) corporate finance advice;</li> <li>(i) money broking;</li> <li>(j) portfolio management and advice; or</li> </ul>

(k) safekeeping and administration of securities.

<i>material holding</i>	means a holding of - (a) ordinary share capital and non cumulative preference share capital; or (b) subordinated loan and non fixed-term cumulative preference share capital, in a <i>credit institution</i> or a <i>financial institution</i> where - (i) (a) or (b) above exceeds 10% of the share capital plus share premium of the issuer; or (ii) the aggregate of (a) and (b) above exceeds 10% of the <i>firm's own funds</i> , before deducting the holding.
<i>material insurance holding</i>	means the higher of – (c) the book value of an investment held in an <i>insurance undertaking</i> , <i>reinsurance undertaking</i> or insurance holding company; and (d) the group's proportionate share of that <i>undertaking's</i> local or notional regulatory requirement.  Investment for this purpose includes both a <i>participation</i> and the investment in a <i>subsidiary</i> undertaking. Where the <i>undertaking</i> is a <i>subsidiary</i> and it has a solvency deficit, the <i>subsidiary's</i> local or notional regulatory requirement should be deducted in full. A description of how a notional capital requirement is to be calculated is set out in Part 6 of PRU 8 Annex 1. A notional requirement should be calculated in all cases where the undertaking is not regulated to EEA or equivalent standards: this is also explained in Part 6 of PRU 8 Annex 1.
<i>parent</i>	means any parent undertaking as defined in section 258 of the Companies Act 1985 or paragraph 14 of Financial Reporting Standard No 2 and any undertaking which effectively exercises a dominant influence over another undertaking.
<i>participation</i>	means a participation within the meaning of Article 17 of Directive 78/660/EEC or the ownership either direct or indirect of 20% or more of the voting rights or capital of another undertaking.
<i>securities and futures firm</i>	means as in the Glossary in IPRU(INV) chapter 3.
<i>subsidiary</i>	means as in section 736 of the Companies Act 1985.
<i>UCITS investment firm</i>	means a <i>firm</i> which: (1) is the <i>operator</i> of a <i>UCITS scheme</i> including where in addition the <i>firm</i> is the <i>operator</i> of a <i>collective investment scheme</i> which is not a <i>UCITS scheme</i> ; and (2) has <i>permission to manage investments</i> where the <i>investments</i>

*managed* include one or more of the instruments listed in Section B of the Annex to the *ISD*.

*venture capital firm* means as in the Glossary in IPRU(INV) chapter 3.

# IPRU(INS) reporting rules

## IPRU(INS) 9 Annex: Group capital adequacy for insurers

- XX1 R (1) Subject to (2), an *insurer* to which *PRU8.3* 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* (as calculated in accordance with *PRU8.3.28R*); and
  - (b) the *group capital resources requirement* (as calculated in accordance with *PRU8.3.25R*)
- (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 supervisor responsible for exercising supplementary supervision of the *insurance group* of which the *insurer* is a member (that is, the co-ordinating supervisor).
- XX2 G (1) The report in XX1R(1) does not form part of the *return* and will not be publicly disclosed.
- (2) The *FSA* will rely on information provided under XX1R(2)(b) by the co-ordinating supervisor to monitor and control compliance with *PRU8.3.9R*.
- (3) An *insurer* which itself is an *insurance parent undertaking* may use form *XX* to take account of its holdings in *related undertakings* when calculating its *group capital resources* and *group capital resources requirement*; but this will not affect the application of the requirements as to reporting in [*IPRU(INS)* Chapter 9] that otherwise relate to the reporting of those holdings .

- XX3 R (1) An *insurer* may choose whether or not to submit the report required by XX1R(1) in the format of form XX.
- (2) Subject to (3), if an *insurer* chooses not to use form XX it must, at the same time as submitting the report required by XX1R(1), also report on any shortfall between the *capital resources* and the *capital resources requirement* of any member of the *insurance group*, stating in each case -
- (a) the full amount of that shortfall where the group member is a *subsidiary undertaking* of the *ultimate insurance parent undertaking* or the *ultimate EEA insurance parent undertaking* (as the case may be); or
  - (b) the *ultimate insurance parent undertaking's* or the *ultimate EEA insurance parent undertaking's* proportional share of that shortfall in any other case.
- (3) An insurer need not make a report under (2) on a shortfall with respect to any member of the *insurance group* 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 (4) applies in relation to the group member.
- (4) This paragraph applies :
- (a) in relation to any group member other than :
    - (i) the *insurer*;
    - (ii) a *parent undertaking* of the *insurer*;
    - (iii) a *participating undertaking* in the *insurer*; or
    - (iv) a *related undertaking* of the *insurer*; or
  - (b) except where the group member is the *insurer*, where :
    - (i) the shortfall in respect of the group member does not exceed 5% of the amount referred to in (3)(a); or
    - (ii) there is more than one group member in respect of which there is a shortfall and the sum of the shortfalls in respect of all of them does not exceed 10% of the amount referred to in (3)(a).

- XX4 R (1) The first report made under XX1R must be as at the end of the *financial year* of either :
- (a) the *insurer*; or
  - (b) the *ultimate EEA insurance parent undertaking* or the *ultimate insurance parent undertaking* (as the case may be).
- (2) The first and any subsequent report must be at the same date for every member of the insurance group to which the information and calculations relate (that is, in accordance with the relevant principles in the Financial Reporting Standard 2 issued by the Accounting Standards Board in June 1992).
- (3) Unless (4) applies, any report other than the first must be 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 were last provided under this chapter or under [IPRU (Ins) 10].
- (4) If for any reason the end of the *financial year* chosen for the purposes of (1) is changed so as to end on a date later than that specified in (3):
- (a) the information and calculations in the first report made after that change takes effect may be as at the later date; but
  - (b) unless that first report contains information and calculations that do not materially differ from what they would be as at the date specified in (3), the insurer must also provide the *FSA* with an interim statement of that information and calculations as that date.
- XX5 R (1) The report required by *PRU XX1R* must be provided to the *FSA* no later than 4 months after the end of the *financial year* chosen as the reference point for the purposes of *PRU XX4*.
- (2) Any interim statement required by *PRU XX4(4)(b)* must be provided to the *FSA* no later than 4 months after the date specified in *PRU XX4(3)*.

- XX6 R (1) The report required by XX1R:
- (a) must comply with the requirements of *SUP* 16.3;
  - (b) subject to (2), must be signed by the *persons* described in *IPRU(INS)* 9.33(1)(a) [or the subsequent requirement in *SUP*]; and
  - (c) must include a statement from the auditors of the *insurer* (or of an *insurer* under (2)) that, in their opinion, it has been properly compiled in accordance with *PRU* 8.3 from information provided by members of the *insurance group* and from the *insurer's* own records.
- (2) A report may be provided on behalf of the *insurer* (the first *insurer*) by any other *insurer* to which *PRU* 8.3. applies and which is a member of the *insurance group* (the second *insurer*) where:
- (a) it is signed by two *directors* of the second *insurer*, and
  - (b) it contains a statement that it has been copied to the board of *directors* of the first *insurer*.



# IPRU(INS) reporting form

FORM XX (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:**

		£'000	Limits on capital (see notes)	
<b>TIER 1</b>				
Group Core Tier 1	Sum of column G1 (page 4)		-	H1
Group Non-Ordinary Tier 1	Sum of column G2 (page 4)		Limit 1 & 2	H2
Group Innovative Tier 1	Sum of column G3 (page 4)		Limit 1	H3
<b>Total Group Tier 1 before deductions</b>	= H1 + H2 + H3			GT1
Total Group Tier 1 deductions	Sum of columns C1 to D2 (page 2)			H4
<b>Total Group Tier 1 after deductions</b>	= GT1 – H4			NT1
<b>TIER2</b>				
Group Upper Tier 2	Sum of column G4 (page 4)			H5
Group Lower Tier 2	Sum of column G5 (page 4)		Limit 3	H6
<b>Total Group Tier 2</b>	= H5 + H6		Limit 4	TT2
Total group capital resources deductions	Sum of column D3 (page 2)			H7
<b>Total Group Capital Resources :</b>	= NT1 + TT2 – H7			GCR
<b>Total Group Capital Resources Requirement:</b>	Sum of column B (page 2)			GCRR
<b>Group surplus/(deficit)</b>	= GCR – GCRR			I





FORM XX (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
Core tier 1	Non-ordinary tier 1	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
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**FORM XX (IPRU(INS) 9 ANNEX: INSURANCE GROUP CAPITAL ADEQUACY REPORTING INSTRUCTIONS**

Insurance Group Capital Adequacy

Ref	Instructions
A (pages 2, 3 & 4)	<p>List the name of each <i>regulated undertaking</i> which is a <i>regulated related undertaking</i> or a non-regulated <i>financial institution, ancillary insurance undertaking, ancillary banking services undertaking and ancillary investment services undertaking</i></p> <p>A <i>firm</i> may combine several entities together where these are not material in relation to the group. For example, entities where total assets are in aggregate less than 5% of the group's total assets. 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>parent undertaking</i>. If the interest is not held directly by the <i>parent undertaking</i> but by another group company, enter the effective percentage interest of the ultimate <i>parent undertaking</i> in the company (e.g. where a parent has a 50% holding in a subsidiary which in turn has a 50% holding in another subsidiary, the ultimate <i>parent undertaking's</i> effective percentage interest in the second <i>subsidiary</i> is 25% etc.). Where the entity is a subsidiary 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 PRU8.3.22R to 24R).</p>
A2 (page 2)	<p>Specify if the <i>related undertaking</i> listed in A is an <i>insurer/re-insurer, intermediate insurance holding company or ancillary insurance services undertaking, credit institution or ancillary banking services undertaking, investment firm or ancillary investment services undertaking</i> or other <i>financial institution</i>.</p> <p>For <i>related undertakings</i> which are non-regulated <i>financial institutions</i> (other than <i>financial holding companies</i>), <i>ancillary insurance undertakings, ancillary banking services undertakings and ancillary investment services undertakings</i>, entries must only be made in this column and column D3 on page 2.</p>
B (page 2)	<p>Specify the group's percentage interest (i.e multiplied by the percentage in A1) in the <i>capital resources requirement of the regulated related undertaking</i> (A). This should be the requirement as set out in PRU8.3.26R.</p>

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

Ref	Instructions
C1 (page 2)	List the group's percentage interest (see B) in any intangible assets held by the <i>regulated related undertaking's</i> (see PRU2.2.74R or relevant sector rules).
C2 (page 2)	Specify the group's percentage interest (see B) in the <i>regulated related undertaking's</i> investments in own shares.
D1 (page 2)	Specify the group's percentage interest (see B) in any inadmissible assets held by the <i>regulated related undertaking</i> (see PRU2.2.76R or relevant sector rules)
D2 (page 2)	Specify the group's percentage interest (see B) in any amounts that the <i>regulated related undertaking</i> has deducted from technical provisions for discounting and any other negative valuation differences (see PRU2.2.70R & 2.2.71G).
D3 (page 2)	This column must be completed only for <i>related undertakings</i> which are non-regulated <i>financial institutions</i> (other than <i>financial holding companies</i> ), <i>ancillary insurance undertakings</i> , <i>ancillary banking services undertakings</i> and <i>ancillary investment services undertakings</i> . The entry must be the higher of the book value of the interest taken together of the individual members of the group in the <i>related undertaking</i> and the <i>related undertaking's proxy capital resources requirement</i> (see PRU8.3.61R to 63R)
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 group in the <i>capital resources</i> of each <i>regulated related undertaking</i> listed in A (this represents internal group holdings of the <i>capital resources</i> of each <i>regulated related undertaking</i> to be excluded from <i>group capital resources</i> under PRU8.3.37R and 8.3.51R).</p> <p>The book value of the group's interest in core <i>tier 1 capital resources</i> (as defined in PRU 2.2.29R) must be shown in E1; investments in non-ordinary <i>tier1 capital resources</i> (as described in PRU 2.2.42G to 2.2.44G) must be shown in E2; and investments in innovative <i>tier 1 capital resources</i> (as described in 2.2.47R to 2.2.61R) must be shown in E3.</p>
	The book value of the group's interest in <i>tier 2 capital resources</i> (as described in PRU 2.2.79G to 2.2.97G) must be shown in E4 ( <i>upper tier 2 capital resources</i> ) and E5 ( <i>lower tier 2 capital resources</i> ).

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

<i>Ref</i>	<i>Instructions</i>
F1 F2 F3 F4 F5 (page 3)	The entries in F1 to F5 must be the group's percentage interest (see B) in the tier 1 and tier 2 elements of the <i>capital resources</i> of the <i>regulated related undertaking</i> (A). (see PRU8.3.36R(2) & 8.3.50R(2)).
G1 G2 G3 G4 G5 (page 4)	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). The sum of the respective columns (G1, G2, G3) represent the group's <i>core tier 1 capital, non-ordinary tier 1 capital resources</i> and <i>innovative tier 1 capital</i> (see H1 to H3 on page 1).
H1 H2 H3 (page 1)	The sum of the respective columns (G4, G5) represent the group's <i>tier 2 capital resources</i> (see H5 and H6).
GT1 (page 1)	These entries represent the total contribution of the <i>regulated related undertakings</i> and the <i>parent undertaking</i> to <i>total group tier 1 capital resources</i> .
H4 (page 1)	This entry is the sum of H1, H2 and H3 which represents <i>total group tier 1 capital resources</i> (see stage A of PRU8.3.31R) before deductions.
NT1 (page 1)	This entry is calculated as the sum of columns C1 to D2 on page 2 which represents the deductions to be made from <i>total group tier 1 capital resources</i> in accordance with stage B of PRU8.3.31R.
	This entry is total <i>group tier 1 capital resources</i> after deductions (see stage C of PRU8.3.31R) and after application of limits 1 & 2 (see below). Capital eligibility limits apply as follows:
	Limit 1: The aggregate of <i>non-ordinary shares, capital instruments</i> and <i>innovative instruments</i> must not exceed 50% of <i>total tier 1</i>

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

<i>Ref</i>	<i>Instructions</i>
	<p><i>capital</i> (see <i>PRU8.3.33R(2)</i>).</p> <p>Limit 2: <i>Innovative instruments</i> must not exceed 15% of <i>total tier 1 capital</i> (see <i>PRU8.3.33 R(1)</i>),</p> <p>Amounts in excess of these limits may be included in <i>upper tier 2 capital resources</i> (see <i>PRU8.3.34G</i>).</p>
<p>H5 H6 (page 1)</p>	<p>These entries represent the total contribution of the <i>regulated related undertakings</i> and the <i>parent undertaking</i> to <i>group tier 2 capital resources</i> (stage D of <i>PRU8.3.31R</i>). Capital eligibility limits apply as follows:</p> <p>Limit 3: <i>Total group tier 2 capital resources</i> must not exceed 100% of <i>total group tier 1 capital resources</i> (see <i>PRU8.3.35R(a)</i>).</p> <p>Limit 4: <i>Total group lower tier 2 capital resources</i> must not exceed 50% of <i>total group tier 2 capital resources</i> (see <i>PRU8.3.35R(b)</i>),</p>
<p>TT2 (page 1)</p>	<p>This entry is calculated as the sum of H5 and H6 which represents <i>total group tier 2 capital resources</i> after application of limits 3 and 4.</p>
<p>H7 (page 1)</p>	<p>This entry is the sum of column D3 on page 2 which represents deductions to be made from <i>total group capital resources</i> in respect of the group's interest in non-regulated <i>financial institutions</i> and ancillary insurance, banking and investment services undertakings (see <i>PRU8.3.61R</i> to <i>63R</i>).</p>
<p>GCR (page 1)</p>	<p>This entry is calculated as the sum of NT1 and TT2 less H7 which represents <i>total group capital resources</i> (see <i>PRU8.3.28R</i>).</p>
<p>GCRR (page 1)</p>	<p>This entry is calculated as the sum of column B on page 2 which represents <i>total group capital resources requirement</i> (stage G of <i>PRU8.3.31R</i>).</p>
<p>I (page 1)</p>	<p>This is calculated as <i>total group capital resources</i> less <i>total group capital resources requirement</i> (GCR – GCRR). This represents the amount by which <i>group capital resources</i> exceed or fail to exceed <i>group capital resources</i>.</p>

