PRUDENTIAL REQUIREMENTS (CAPITAL PLANNING BUFFER) INSTRUMENT 2010

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of:

(1) the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(a) section 138 (General rule-making powers); and
(b) section 157(1) (Guidance);

(2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.

B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 24 September 2010.

Amendments to the Handbook

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

(1)	(2)
Glossary of definitions	Annex A
General Prudential sourcebook (GENPRU)	Annex B
Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)	Annex C

Citation

E. This instrument may be cited as the Prudential Requirements (Capital Planning Buffer) Instrument 2010.

By order of the Board
23 September 2010

Annex A

Amendments to the Glossary of definitions

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

Insert the following new definition in the appropriate alphabetical position. The text is not underlined.

capital planning buffer	(in *BIPRU* 2.2) the amount and quality of capital resources that a *firm* should hold at a given time in accordance with the *general stress and scenario testing rule*, so that the *firm* is able to continue to meet the *overall financial adequacy rule* throughout the relevant capital planning period in the face of adverse circumstances, after allowing for realistic management actions.

Amend the following as shown.

individual capital guidance .	*guidance* given to a *firm* about the amount and quality of capital resources that the *FSA* thinks the *firm* should hold <u>at all times</u> under the *overall financial adequacy rule* as it applies on a solo level or a consolidated level.

Annex B

Amendments to the General Prudential sourcebook (GENPRU)

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

1.2.16 G This section also has *rules* requiring a *firm* to carry out appropriate stress tests and scenario analyses for the risks it has previously identified and to establish the amount of financial resources needed in each of the circumstances and events considered in carrying out the stress tests and scenario analyses. In the case of a *BIPRU firm*, the *FSA* will consider as part of its *SREP* whether the *BIPRU firm* should hold a *capital planning buffer* and, in such a case, the amount and quality of that buffer. The *capital planning buffer* is an amount separate, though related to, the *individual capital guidance*, insofar as its purpose is to ensure that a *BIPRU firm* is able to continue to meet the *overall financial adequacy rule* throughout the relevant capital planning period in the face of adverse circumstances, after allowing for realistic management actions Therefore, when forming its view on a *BIPRU firm's capital planning buffer*, the *FSA* will take into account the assessment made in relation to the *firm*'s *ICG.*

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1.2.19 G (1) …

(2) *BIPRU* 2.2 and *INSPRU* 7.1 also have information on how the *FSA* will review and respond to the assessments referred to in *GENPRU* 1.2.15 G and, in the case of *BIPRU firms*, in *GENPRU* 1.2.16G. In particular they deal with the giving of ~~individual capital~~ *individual capital guidance* to a *firm*, which is *guidance* about the amount and quality of capital resources that the *FSA* thinks a *firm* should hold at all times under the *overall financial adequacy rule* as it applies on a solo level and a consolidated level. *BIPRU* 2.2. also deals with the giving of a *capital planning buffer* to a *BIPRU firm* on a solo level and a consolidated level.

Annex C

Amendments to the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)

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

The ICAAP and the SREP: the SREP

2.2.8 G The *FSA* will review ~~an~~ a *firm*'s *ICAAP* ~~and, if the *firm* has an *IRB permission*~~, including the ~~result~~ results of the *firm*'s stress ~~test~~ tests carried out under *GENPRU* and *BIPRU* ~~4.3.39R to *BIPRU* 4.3.40R (Stress tests used in assessment of capital adequacy for a *firm* with an *IRB permission*)~~, as part of its *SREP*. Provided that the *FSA* is satisfied with the appropriateness of a *firm*'s capital assessment, the *FSA* will take into account that *firm*'s *ICAAP* and stress ~~test~~ tests in its *SREP*. More material on stress tests for a *firm* with an *IRB permission* can be found in *BIPRU* 2.2.41R to *BIPRU* 2.2.45G.

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2.2.11 G As part of its *SREP*, the *FSA* will consider whether the amount and quality of capital which a *firm* should hold to meet its *CRR* in *GENPRU* 2.1 (Calculation of capital resources requirements) is sufficient for that *firm* to comply with the *overall financial adequacy rule*. ~~Where the amount of capital which the *FSA* considers a *firm* should hold is not the same as that which results from a *firm*'s *ICAAP*, the *FSA* expects to discuss any such difference with the *firm*. Where necessary, the *FSA* may consider the use of its powers under section 166 of the *Act* (reports by skilled persons) to assist in such circumstances.~~

2.2.12 G After completing a review as part of the *SREP*, the *FSA* will normally give that *firm* individual *guidance* (*individual capital guidance*), advising it of the amount and quality of capital which it should hold to meet the *overall financial adequacy rule*.

2.2.12A G As part of its *SREP*, the *FSA* will also consider whether a *firm* should hold a *capital planning buffer* and, in that case, the amount and quality of such *capital planning buffer*. In making these assessments, the *FSA* will have regard to the nature, scale and complexity of a *firm*'s business and of the major sources of risks relevant to such business as referred to in the *general stress and scenario testing rule*. Accordingly, a firm's *capital planning buffer* should be of sufficient amount and adequate quality to allow the *firm* to continue to meet the *overall financial adequacy rule* in the face of adverse circumstances, after allowing for realistic management actions.

2.2.12B G After completing a review as part of the *SREP*, the *FSA* may notify the *firm* of the amount and quality of capital which it should hold as a *capital planning buffer* over and above the level of capital recommended as its *ICG*. The *FSA* may set *a firm's capital planning buffer* either as an amount and quality of capital which it should hold now (that is, at the time of the

FSA's notification following the *firm's SREP*) or, in exceptional cases, as a forward looking target that the *firm* should build up over time.

2.2.12C G Where the amount or quality of capital which the *FSA* considers a *firm* should hold to meet the *overall financial adequacy rule* or as a *capital planning buffer* is not the same as that which results from a *firm*'s *ICAAP*, the *FSA* usually expects to discuss any such difference with the *firm*. Where necessary, the *FSA* may consider the use of its powers under section 166 of the *Act* (Reports by skilled persons) to assist in such circumstances.

2.2.13 G If a *firm* considers that ~~*ICG*~~ the *individual capital guidance* given to it is inappropriate to its circumstances it should, consistent with *Principle* 11 (~~relations~~ Relations with regulators), inform the *FSA* that it disagrees with that *guidance*. The *FSA* may reissue *individual capital guidance* if, after discussion with the *firm*, the *FSA* concludes that the amount or quality of capital that the *firm* should hold to meet the *overall financial adequacy rule* is different from the amount or quality initially suggested by the *FSA*.

2.2.13A G If a *firm* disagrees with the *FSA*'s assessment as to the amount or quality of *capital planning buffer* that it should hold, it should, consistent with *Principle* 11 (Relations with regulators), notify the *FSA* of its disagreement. The *FSA* may reconsider its initial assessment if, after discussion with the *firm*, the *FSA* concludes that the amount or quality of capital that the *firm* should hold as *capital planning buffer* is different from the amount or quality initially suggested.

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2.2.15 G If, after discussion, the *FSA* and a *firm* still do not agree on an adequate level of capital, the *FSA* may consider using its powers under section 45 of the *Act* to vary on its own initiative a *firm's Part IV permission* so as to require it to hold capital in accordance with the *FSA's* view of the capital necessary to comply with the *overall financial adequacy rule*. In deciding whether it should use its powers under section 45, the *FSA* will take into account the amount and quality of the *capital planning buffer* which the *firm* should hold as referred to in *BIPRU* 2.2.12AG and 2.2.12BG. *SUP* 7 provides further information about the *FSA's* powers under section 45.

The drafting of individual capital guidance and capital planning buffer

2.2.16 G If the *FSA* gives *individual capital guidance* to a *firm*, the *FSA* will state what amount and quality of capital the *FSA* considers the *firm* needs to hold in order to comply with the *overall financial adequacy rule*. It will generally do so by saying that the *firm* should hold *capital resources* of an amount which is at least equal to a specified percentage of that *firm's capital resources requirement* plus one or more static add-ons in relation to specific risks in accordance with the *overall Pillar 2 rule*. ~~Such amount should be sufficient to enable the *firm* to continue to meet the *overall financial adequacy rule* in the face of the adverse circumstances and events to which GENPRU 1.2.42R(2) refers, taking account of any risk mitigation available to the *firm*.~~

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2.2.19A G Where the *FSA* notifies a *firm* that it should hold a *capital planning buffer*, the notification will state what amount and quality of capital the *FSA* considers that is adequate for the *firm* to hold as such. This will normally be notified to the *firm* together with its *individual capital guidance* and expressed as a separate amount of *capital resources* that the *firm* should hold in excess of the amount of *capital resources* indicated as its *individual capital guidance*.

2.2.19B G For the purposes of *BIPRU* 2.2.19AG, *BIPRU* 2.2.17G to *BIPRU* 2.2.19G apply as they apply to *individual capital guidance*. References in those provisions to *individual capital guidance* or *guidance* should be read as if they were references to *capital planning buffer*. In relation to *BIPRU* 2.2.19G(3) and *GENPRU* 1.2.59R, where the *general stress and scenario testing rule*, as part of the *ICAAP rules*, applies to a *firm* on a consolidated basis, the *FSA* may notify the *firm* that it should hold a group *capital planning buffer*. In these cases, the *firm* should ensure that the group holds a *capital planning buffer* of sufficient amount and adequate quality to allow it to continue to meet the *overall financial adequacy rule* in the face of adverse circumstances, after allowing for realistic management actions.

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Failure to meet individual capital guidance and monitoring and reporting on the capital planning buffer

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2.2.23 G ~~*BIPRU* 2.2.20G – *BIPRU* 2.2.22G also apply to *individual capital guidance* on a consolidated basis as referred to in *BIPRU* 2.2.19G.~~ Monitoring the use of a *firm's capital planning buffer* is also a fundamental part of the *FSA's* supervision of that *firm.* A *firm* should only use its *capital planning buffer* to absorb losses or meet increased capital requirements if certain adverse circumstances materialise. These should be circumstances beyond the *firm's* normal and direct control, whether relating to a deteriorating external environment or periods of stress such as macroeconomic downturns or financial/market shocks, or firm-specific circumstances.

2.2.23A G Consistent with *Principle* 11 (Relations with regulators), a *firm* should notify the *FSA* as early as possible in advance where it has identified that it would need to use its *capital planning buffer*. The *firm*'s notification should at least state:

(1) what adverse circumstances are likely to force the *firm* to draw down its *capital planning buffer*;

(2) how the *capital planning buffer* will be used up in line with the *firm*'s capital planning projections; and

(3) what plan is in place for the eventual restoration of the *capital*

planning buffer.

2.2.23B G Following discussions with the *firm* on the items listed in BIPRU 2.2.23AG(1) to (3), the *FSA* may put in place additional reporting arrangements to monitor the *firm's* use of its *capital planning buffer* in accordance with the plan referred to in *BIPRU* 2.2.23AG(3). The *FSA* may also identify specific trigger points as the *capital planning buffer* is being used up by the *firm*, which could lead to additional supervisory actions.

2.2.23C G Where a *firm's capital planning buffer* is being drawn down due to circumstances other than those referred to in *BIPRU* 2.2.23G, such as poor planning or mismanagement, the *FSA* may ask the *firm* for more detailed plans for it to restore its *capital planning buffer*. In the light of the relevant circumstances, the *FSA* may consider taking other remedial actions, which may include using its powers under section 45 of the *Act* to vary on its own initiative a *firm's Part IV permission.*

2.2.23D G A *firm* should inform the *FSA* where its *capital planning buffer* is likely to start being drawn down even if it has not accepted the FSA's assessment as to the amount or quality of its *capital planning buffer*.

2.2.23E G Where a *firm* has started to use its *capital planning buffer* in circumstances where it was not possible to notify in advance, it should notify the *FSA* and provide the information referred to in *BIPRU* 2.2.23AG as soon as practicable afterwards.

2.2.23F G *BIPRU* 2.2.20G to *BIPRU* 2.2.23EG also apply to *individual capital guidance* and to *capital planning buffer* on a consolidated basis as referred to in *BIPRU* 2.2.19G.

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2.2.29 G (1) A *firm* may take into account factors other than those identified in the *overall Pillar 2 rule* when it assesses the level of capital it wishes to hold. These factors might include external rating goals, market reputation and its strategic goals. However, a *firm* should be able to distinguish, for the purpose of its dialogue with the *FSA*, between capital it holds in order to comply with the *overall financial adequacy rule* ~~and to meet the risks set out in the *overall Pillar 2 rule*~~, capital that it holds as a *capital planning buffer* and ~~that~~ capital held for other purposes.

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2.2.39 G To reduce the impact of cyclical effects, a *firm* should aim to maintain an adequate ~~capital buffer~~ *capital planning buffer* during an upturn in business and economic cycles such that it has sufficient capital available to protect itself in unfavourable market conditions.

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2.2.72 G A *firm* should not expect the *FSA* to accept as adequate any particular model that it develops or automatically to reflect the results from the model in any *individual capital guidance* or *capital planning buffer*. However, the *FSA* will take into account the results of a sound and prudent model when giving *individual capital guidance* or when dealing with the *firm* in relation to its *capital planning buffer* (see GENPRU 1.2.19G (Outline of provisions related to GENPRU 2.1 (Adequacy of financial resources))).