

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Text with EEA relevance)

PART TWO U.K.

OWN FUNDS

TITLE I U.K.

ELEMENTS OF OWN FUNDS

CHAPTER 2 U.K.

*Common Equity Tier 1 capital*

*Section 3 U.K.*

*Deductions from common equity tier 1 items, exemptions and alternatives*

*Sub-Section 1 U.K.*

*Deductions from Common Equity Tier 1 items*

*Article 36 U.K.*

**Deductions from Common Equity Tier 1 items**

- 1 Institutions shall deduct the following from Common Equity Tier 1 items:
  - a losses for the current financial year;
  - b intangible assets;
  - c deferred tax assets that rely on future profitability;
  - d for institutions calculating risk-weighted exposure amounts using the Internal Ratings Based Approach (the IRB Approach), negative amounts resulting from the calculation of expected loss amounts laid down in Articles 158 and 159;
  - e defined benefit pension fund assets on the balance sheet of the institution;
  - f direct, indirect and synthetic holdings by an institution of own Common Equity Tier 1 instruments, including own Common Equity Tier 1 instruments that an institution is under an actual or contingent obligation to purchase by virtue of an existing contractual obligation;
  - g direct, indirect and synthetic holdings of the Common Equity Tier 1 instruments of financial sector entities where those entities have a reciprocal cross holding with the institution that the competent authority considers to have been designed to inflate artificially the own funds of the institution;

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- h the applicable amount of direct, indirect and synthetic holdings by the institution of Common Equity Tier 1 instruments of financial sector entities where the institution does not have a significant investment in those entities;
- i the applicable amount of direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1 instruments of financial sector entities where the institution has a significant investment in those entities;
- j the amount of items required to be deducted from Additional Tier 1 items pursuant to Article 56 that exceeds the Additional Tier 1 capital of the institution;
- k the exposure amount of the following items which qualify for a risk weight of 1 250 %, where the institution deducts that exposure amount from the amount of Common Equity Tier 1 items as an alternative to applying a risk weight of 1 250 %:
  - (i) qualifying holdings outside the financial sector;
  - (ii) securitisation positions, in accordance with Article 243(1)(b), Article 244(1)(b) and Article 258;
  - (iii) free deliveries, in accordance with Article 379(3);
  - (iv) positions in a basket for which an institution cannot determine the risk weight under the IRB Approach, in accordance with Article 153(8);
  - (v) equity exposures under an internal models approach, in accordance with Article 155(4).
- l any tax charge relating to Common Equity Tier 1 items foreseeable at the moment of its calculation, except where the institution suitably adjusts the amount of Common Equity Tier 1 items insofar as such tax charges reduce the amount up to which those items may be used to cover risks or losses.

2 EBA shall develop draft regulatory technical standards to specify the application of the deductions referred to in points (a), (c), (e), (f), (h), (i) and (l) of paragraph 1 of this Article and related deductions referred to in points (a), (c), (d) and (f) of Article 56 and points (a), (c) and (d) of Article 66.

EBA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

3 EBA shall develop draft regulatory technical standards to specify the types of capital instruments of financial institutions and, in consultation with the European Supervisory Authority (European Insurance and Occupational Pensions Authority) (EIOPA) established by Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010<sup>(1)</sup>, of third country insurance and reinsurance undertakings, and of undertakings excluded from the scope of Directive 2009/138/EC in accordance with Article 4 of that Directive that shall be deducted from the following elements of own funds:

- a Common Equity Tier 1 items;
- b Additional Tier 1 items;
- c Tier 2 items.

EBA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

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Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

Article 37 **U.K.**

**Deduction of intangible assets**

Institutions shall determine the amount of intangible assets to be deducted in accordance with the following:

- (a) the amount to be deducted shall be reduced by the amount of associated deferred tax liabilities that would be extinguished if the intangible assets became impaired or were derecognised under the applicable accounting framework;
- (b) the amount to be deducted shall include goodwill included in the valuation of significant investments of the institution.

Article 38 **U.K.**

**Deduction of deferred tax assets that rely on future profitability**

1 Institutions shall determine the amount of deferred tax assets that rely on future profitability that require deduction in accordance with this Article.

2 Except where the conditions laid down in paragraph 3 are met, the amount of deferred tax assets that rely on future profitability shall be calculated without reducing it by the amount of the associated deferred tax liabilities of the institution.

3 The amount of deferred tax assets that rely on future profitability may be reduced by the amount of the associated deferred tax liabilities of the institution, provided the following conditions are met:

- a the entity has a legally enforceable right under applicable national law to set off those current tax assets against current tax liabilities;
- b the deferred tax assets and the deferred tax liabilities relate to taxes levied by the same taxation authority and on the same taxable entity.

4 Associated deferred tax liabilities of the institution used for the purposes of paragraph 3 may not include deferred tax liabilities that reduce the amount of intangible assets or defined benefit pension fund assets required to be deducted.

5 The amount of associated deferred tax liabilities referred to in paragraph 4 shall be allocated between the following:

- a deferred tax assets that rely on future profitability and arise from temporary differences that are not deducted in accordance with Article 48(1);
- b all other deferred tax assets that rely on future profitability.

Institutions shall allocate the associated deferred tax liabilities according to the proportion of deferred tax assets that rely on future profitability that the items referred to in points (a) and (b) represent.

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Article 39 **U.K.**

**Tax overpayments, tax loss carry backs and deferred tax assets that do not rely on future profitability**

1 The following items shall not be deducted from own funds and shall be subject to a risk weight in accordance with Chapter 2 or 3 of Title II of Part Three, as applicable:

- a overpayments of tax by the institution for the current year;
- b current year tax losses of the institution carried back to previous years that give rise to a claim on, or a receivable from, a central government, regional government or local tax authority.

2 Deferred tax assets that do not rely on future profitability shall be limited to deferred tax assets arising from temporary differences, where all the following conditions are met:

- a they are automatically and mandatorily replaced without delay with a tax credit in the event that the institution reports a loss when the annual financial statements of the institution are formally approved, or in the event of liquidation or insolvency of the institution;
- b an institution shall be able under the applicable national tax law to offset a tax credit referred to in point (a) against any tax liability of the institution or any other undertaking included in the same consolidation as the institution for tax purposes under that law or any other undertaking subject to the supervision on a consolidated basis in accordance with Chapter 2 of Title II of Part One;
- c where the amount of tax credits referred to in point (b) exceeds the tax liabilities referred to in that point, any such excess is replaced without delay with a direct claim on the central government of the Member State in which the institution is incorporated.

Institutions shall apply a risk weight of 100 % to deferred tax assets where the conditions laid down in points (a), (b) and (c) are met.

Article 40 **U.K.**

**Deduction of negative amounts resulting from the calculation of expected loss amounts**

The amount to be deducted in accordance with point (d) of Article 36(1) shall not be reduced by a rise in the level of deferred tax assets that rely on future profitability, or other additional tax effects, that could occur if provisions were to rise to the level of expected losses referred to in Section 3 of Chapter 3 of Title I.

Article 41 **U.K.**

**Deduction of defined benefit pension fund assets**

1 For the purposes of point (e) of Article 36(1), the amount of defined benefit pension fund assets to be deducted shall be reduced by the following:

- a the amount of any associated deferred tax liability which could be extinguished if the assets became impaired or were derecognised under the applicable accounting framework;
- b the amount of assets in the defined benefit pension fund which the institution has an unrestricted ability to use, provided the institution has received the prior permission of

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the competent authority. Those assets used to reduce the amount to be deducted shall receive a risk weight in accordance with Chapter 2 or 3 of Title II of Part Three, as applicable.

2 EBA shall develop draft regulatory technical standards to specify the criteria according to which a competent authority shall permit an institution to reduce the amount of assets in the defined benefit pension fund as specified in point (b) of paragraph 1.

EBA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

#### Article 42 **U.K.**

##### **Deduction of holdings of own Common Equity Tier 1 instruments**

For the purposes of point (f) of Article 36(1), institutions shall calculate holdings of own Common Equity Tier 1 instruments on the basis of gross long positions subject to the following exceptions:

- (a) institutions may calculate the amount of holdings of own Common Equity Tier 1 instruments on the basis of the net long position provided that both the following conditions are met:
  - (i) the long and short positions are in the same underlying exposure and the short positions involve no counterparty risk;
  - (ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book;
- (b) institutions shall determine the amount to be deducted for direct, indirect and synthetic holdings of index securities by calculating the underlying exposure to own Common Equity Tier 1 instruments included in those indices;
- (c) institutions may net gross long positions in own Common Equity Tier 1 instruments resulting from holdings of index securities against short positions in own Common Equity Tier 1 instruments resulting from short positions in the underlying indices, including where those short positions involve counterparty risk, provided that both the following conditions are met:
  - (i) the long and short positions are in the same underlying indices;
  - (ii) either both the long and the short positions are held in the trading book or both are held in the non-trading book.

#### Article 43 **U.K.**

##### **Significant investment in a financial sector entity**

For the purposes of deduction, a significant investment of an institution in a financial sector entity shall arise where any of the following conditions is met:

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- (a) the institution owns more than 10 % of the Common Equity Tier 1 instruments issued by that entity;
- (b) the institution has close links with that entity and owns Common Equity Tier 1 instruments issued by that entity;
- (c) the institution owns Common Equity Tier 1 instruments issued by that entity and the entity is not included in consolidation pursuant to Chapter 2 of Title II of Part One but is included in the same accounting consolidation as the institution for the purposes of financial reporting under the applicable accounting framework.

Article 44 **U.K.**

**Deduction of holdings of Common Equity Tier 1 instruments  
of financial sector entities and where an institution has a  
reciprocal cross holding designed artificially to inflate own funds**

Institutions shall make the deductions referred to in points (g), (h) and (i) of Article 36(1) in accordance with the following:

- (a) holdings of Common Equity Tier 1 instruments and other capital instruments of financial sector entities shall be calculated on the basis of the gross long positions;
- (b) Tier 1 own-fund insurance items shall be treated as holdings of Common Equity Tier 1 instruments for the purposes of deduction.

Article 45 **U.K.**

**Deduction of holdings of Common Equity Tier 1 instruments of financial sector entities**

Institutions shall make the deductions required by points (h) and (i) of Article 36(1) in accordance with the following provisions:

- (a) they may calculate direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of the financial sector entities on the basis of the net long position in the same underlying exposure provided that both the following conditions are met:
  - (i) the maturity of the short position matches the maturity of the long position or has a residual maturity of at least one year;
  - (ii) either both the long position and the short position are held in the trading book or both are held in the non-trading book;
- (b) they shall determine the amount to be deducted for direct, indirect and synthetic holdings of index securities by calculating the underlying exposure to the capital instruments of the financial sector entities in those indices.

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## Article 46 **U.K.**

### **Deduction of holdings of Common Equity Tier 1 instruments where an institution does not have a significant investment in a financial sector entity**

1 For the purposes of point (h) of Article 36(1), institutions shall calculate the applicable amount to be deducted by multiplying the amount referred to in point (a) of this paragraph by the factor derived from the calculation referred to in point (b) of this paragraph:

- a the aggregate amount by which the direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of financial sector entities in which the institution does not have a significant investment exceeds 10 % of the aggregate amount of Common Equity Tier 1 items of the institution calculated after applying the following to Common Equity Tier 1 items:
  - (i) Articles 32 to 35;
  - (ii) the deductions referred to in points (a) to (g), points (k)(ii) to (v) and point (l) of Article 36(1), excluding the amount to be deducted for deferred tax assets that rely on future profitability and arise from temporary differences;
  - (iii) Articles 44 and 45;
- b the amount of direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1 instruments of those financial sector entities in which the institution does not have a significant investment divided by the aggregate amount of direct, indirect and synthetic holdings by the institution of the own funds instruments of those financial sector entities.

2 Institutions shall exclude underwriting positions held for five working days or fewer from the amount referred to in point (a) of paragraph 1 and from the calculation of the factor referred to in point (b) of paragraph 1.

3 The amount to be deducted pursuant to paragraph 1 shall be apportioned across all Common Equity Tier 1 instruments held. Institutions shall determine the portion of holdings of Common Equity Tier 1 instruments that is deducted pursuant to paragraph 1 by multiplying the amount specified in point (a) of this paragraph by the proportion specified in point (b) of this paragraph:

- a the amount of holdings required to be deducted pursuant to paragraph 1;
- b the proportion of the aggregate amount of direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1 instruments of financial sector entities in which the institution does not have a significant investment represented by each Common Equity Tier 1 instrument held.

4 The amount of holdings referred to in point (h) of Article 36(1) that is equal to or less than 10 % of the Common Equity Tier 1 items of the institution after applying the provisions laid down in points (a)(i) to (iii) of paragraph 1 shall not be deducted and shall be subject to the applicable risk weights in accordance with Chapter 2 or 3 of Title II of Part Three and the requirements laid down in Title IV of Part Three, as applicable.

5 Institutions shall determine the portion of holdings of own funds instruments that is risk weighted by dividing the amount specified in point (a) by the amount specified in point (b):

- a the amount of holdings required to be risk weighted pursuant to paragraph 4;
- b the amount specified in point (i) divided by the amount specified in point (ii):

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- (i) the total amount of the Common Equity Tier 1 instruments;
- (ii) the aggregate amount of direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1 instruments of financial sector entities in which the institution does not have a significant investment.

Article 47 **U.K.**

**Deduction of holdings of Common Equity Tier 1 instruments where an institution has a significant investment in a financial sector entity**

For the purposes of point (i) of Article 36(1), the applicable amount to be deducted from Common Equity Tier 1 items shall exclude underwriting positions held for five working days or fewer and shall be determined in accordance with Articles 44 and 45 and Sub-section 2.

Sub-Section 2 **U.K.**

**Exemptions from and alternatives to deduction from Common Equity Tier 1 items**

Article 48 **U.K.**

**Threshold exemptions from deduction from Common Equity Tier 1 items**

1 In making the deductions required pursuant to points (c) and (i) of Article 36(1), institutions are not required to deduct the amounts of the items listed in points (a) and (b) of this paragraph which in aggregate are equal to or less than the threshold amount referred to in paragraph 2:

- a deferred tax assets that are dependent on future profitability and arise from temporary differences, and in aggregate are equal to or less than 10 % of the Common Equity Tier 1 items of the institution calculated after applying the following:
  - (i) Articles 32 to 35;
  - (ii) points (a) to (h), points (k)(ii) to (v) and point (l) of Article 36(1), excluding deferred tax assets that rely on future profitability and arise from temporary differences.
- b where an institution has a significant investment in a financial sector entity, the direct, indirect and synthetic holdings of that institution of the Common Equity Tier 1 instruments of those entities that in aggregate are equal to or less than 10 % of the Common Equity Tier 1 items of the institution calculated after applying the following:
  - (i) Article 32 to 35;
  - (ii) points (a) to (h), points (k)(ii) to (v) and point (l), of Article 36(1) excluding deferred tax assets that rely on future profitability and arise from temporary differences.

2 For the purposes of paragraph 1, the threshold amount shall be equal to the amount referred to in point (a) of this paragraph multiplied by the percentage referred to in point (b) of this paragraph:



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- a the residual amount of Common Equity Tier 1 items after applying the adjustments and deductions in Articles 32 to 36 in full and without applying the threshold exemptions specified in this Article;
  - b 17,65 %.
- 3 For the purposes of paragraph 1, an institution shall determine the portion of deferred tax assets in the total amount of items that is not required to be deducted by dividing the amount specified in point (a) of this paragraph by the amount specified in point (b) of this paragraph:
- a the amount of deferred tax assets that are dependent on future profitability and arise from temporary differences, and in aggregate are equal to or less than 10 % of the Common Equity Tier 1 items of the institution;
  - b the sum of the following:
    - (i) the amount referred to in point (a);
    - (ii) the amount of direct, indirect and synthetic holdings by the institution of the own funds instruments of financial sector entities in which the institution has a significant investment, and in aggregate are equal to or less than 10 % of the Common Equity Tier 1 items of the institution.

The proportion of significant investments in the total amount of items that is not required to be deducted is equal to one minus the proportion referred to in the first subparagraph.

- 4 The amounts of the items that are not deducted pursuant to paragraph 1 shall be risk weighted at 250 %.

Article 49 **U.K.**

**Requirement for deduction where consolidation, supplementary supervision or institutional protection schemes are applied**

- 1 For the purposes of calculating own funds on an individual basis, a sub-consolidated basis and a consolidated basis, where the competent authorities require or permit institutions to apply method 1, 2 or 3 of Annex I to Directive 2002/87/EC, the competent authorities may permit institutions not to deduct the holdings of own funds instruments of a financial sector entity in which the parent institution, parent financial holding company or parent mixed financial holding company or institution has a significant investment, provided that the conditions laid down in points (a) to (e) of this paragraph are met:
- a the financial sector entity is an insurance undertaking, a re-insurance undertaking or an insurance holding company;
  - b that insurance undertaking, re-insurance undertaking or insurance holding company is included in the same supplementary supervision under Directive 2002/87/EC as the parent institution, parent financial holding company or parent mixed financial holding company or institution that has the holding;
  - c the institution has received the prior permission of the competent authorities;
  - d prior to granting the permission referred to in point (c), and on a continuing basis, the competent authorities are satisfied that the level of integrated management, risk management and internal control regarding the entities that would be included in the scope of consolidation under method 1, 2 or 3 is adequate;
  - e the holdings in the entity belong to one of the following:
    - (i) the parent credit institution;

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- (ii) the parent financial holding company;
- (iii) the parent mixed financial holding company;
- (iv) the institution;
- (v) a subsidiary of one of the entities referred to in points (i) to (iv) that is included in the scope of consolidation pursuant to Chapter 2 of Title II of Part One.

The method chosen shall be applied in a consistent manner over time.

2 For the purposes of calculating own funds on an individual basis and a sub-consolidated basis, institutions subject to supervision on a consolidated basis in accordance with Chapter 2 of Title II of Part One shall not deduct holdings of own funds instruments issued by financial sector entities included in the scope of consolidated supervision, unless the competent authorities determine those deductions to be required for specific purposes, in particular structural separation of banking activities and resolution planning.

Applying the approach referred to in the first subparagraph shall not entail disproportionate adverse effects on the whole or parts of the financial system in other Member States or in the Union as a whole forming or creating an obstacle to the functioning of the internal market.

3 Competent authorities may, for the purposes of calculating own funds on an individual or sub-consolidated basis permit institutions not to deduct holdings of own funds instruments in the following cases:

- a where an institution has a holding in another institution and the conditions referred to in points (i) to (v) are met:
  - (i) the institutions fall within the same institutional protection scheme referred to in Article 113(7);
  - (ii) the competent authorities have granted the permission referred to in Article 113(7);
  - (iii) the conditions laid down in Article 113(7) are satisfied;
  - (iv) the institutional protection scheme draws up a consolidated balance sheet referred to in point (e) of Article 113(7) or, where it is not required to draw up consolidated accounts, an extended aggregated calculation that is, to the satisfaction of the competent authorities, equivalent to the provisions of Directive 86/635/EEC, which incorporates certain adaptations of the provisions of Directive 83/349/EEC or of Regulation (EC) No 1606/2002, governing the consolidated accounts of groups of credit institutions. The equivalence of that extended aggregated calculation shall be verified by an external auditor and in particular that the multiple use of elements eligible for the calculation of own funds as well as any inappropriate creation of own funds between the members of the institutional protection scheme is eliminated in the calculation. The consolidated balance sheet or the extended aggregated calculation shall be reported to the competent authorities no less frequently than the frequency laid down in Article 99;
  - (v) the institutions included in an institutional protection scheme meet together on a consolidated or extended aggregated basis the requirements laid down in Article 92 and carry out reporting of compliance with those requirements in accordance with Article 99. Within an institutional protection scheme the

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deduction of the interest owned by co-operative members or legal entities, which are not members of the institutional protection scheme, is not required, provided that the multiple use of elements eligible for the calculation of own funds as well as any inappropriate creation of own funds between the members of the institutional protection scheme and the minority shareholder, when it is an institution, is eliminated.

- b where a regional credit institution has a holding in its central or another regional credit institution and the conditions laid down in points (a)(i) to (v) are met.

4 The holdings in respect of which deduction is not made in accordance with paragraph 1, 2 or 3 shall qualify as exposures and shall be risk weighted in accordance with Chapter 2 or 3 of Title II of Part Three, as applicable.

5 Where an institution applies methods 1 or 2 of Annex I to Directive 2002/87/EC, the institution shall disclose the supplementary own funds requirement and capital adequacy ratio of the financial conglomerate as calculated in accordance with Article 6 of and Annex I to that Directive.

6 EBA, EIOPA and the European Supervisory Authority (European Securities and Markets Authority) (ESMA) established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010<sup>(2)</sup> shall, through the Joint Committee, develop draft regulatory technical standards to specify for the purposes of this Article the conditions of application of the calculation methods listed in Annex I, Part II of Directive 2002/87/EC for the purposes of the alternatives to deduction referred to in paragraph 1 of this Article.

EBA, EIOPA and ESMA shall submit those draft regulatory technical standards to the Commission by 1 February 2015.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010, of Regulation (EU) No 1094/2010 and of Regulation (EU) No 1095/2010 respectively.

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- (1) OJ L 331, 15.12.2010, p. 48.
- (2) OJ L 331, 15.12.2010, p. 84.

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