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Prudential Standards

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Prudential Standards

The following standards apply to all approved individuals and firms.

Integrated Prudential Source Book: This set out the requirements for groups, insurers, insurance companies and mortgage firms with their relation to Building societies, Banks and account dealers. The general requirements cover the Capital, Market Risk, credit Risk, Insurance, liquidity Risk and operational Risk.

GENPRU (General Prudential Source Book): The GENPRU relates to the Capital and Application requirements for Building societies, Banks, Investment companies and Insurers. The Application part covers the Financial resources, Penalties for damages and company's valuation.

A firm should maintain liquidity and capital resources as to the quality and amount in order to assure that liabilities will be repaid as they fall due. The liabilities include the firms Prospective and contingent liabilities. The GENPRU rules restrict a person from right of action as per the section 150 of Act. The valuation method provided by INSPRU and BIPRU includes Marking to Model and Marking to Market. A firm should also maintain efficient system and control to provide realistic estimates of valuation. The controls and systems should include the documented procedures and policies valuation purpose. The timing for ending prices and different sources of market information should also be disclosed. [1]

The FSA has set standard for minimum Capital requirement for companies. It also provides a detailed analysis for assets & liabilities. The firms should also have systems in place to monitor that whether it has sufficient capital resources to adhere with GENPRU requirements.

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[1] Turner, C. (2008) FSA Financial Regulation: The Official Learning and Reference Manual (13th Edn), London, Securities and Investment Institute

An insurer should also comply with capital requirements in its long term business and general insurance business. The Assets deployed in long term business cannot be utilised in meeting the capital requirements, but only surplus Assets held under the general insurance business can be used to meet the capital requirements its long term business. The revaluation gain is arising from land & Buildings and unrealised gains resulting from Available for Sale assets are not classified as permanent assets and hence excludes from contributing to capital requirement.

Prudential Sourcebook for Building Societies, Banks and Investment Groups: It deals with the different types of Risk facing business such as Credit Risk, Market Risk, Operational Risk, Counterparty Risk and liquidity standards.

The firm must adopt Risk management Process to ensure the mitigation of credit Risk. These processes will include scenario analyses, residual risk reporting and stress tests. The firm should calculate the Risk exposure amount through likelihood and expected loss amount. In the case of Borrowing and lending transactions, the risk should be mitigated from the net amount resulting from exposure. The BIPRU has set capital requirements for managing the operational risk. A firm must calculate the interest rate PRR which spreads the risk from interest rate into the loss from changing interest rates in the market and changing price of Debt Security.[2] The firms must hold sufficient liquid assets which are realisable or marketable. A firm might carry out the netting exposure to reduce the counter party credit risk.

Prudential Sourcebook for Insurers (INSPRU): This principle is applied to insurers that is a Treaty firm or EEA firm. This deals with the risk of natural uncertainties or the timing of insurance payments. The credits obtain by companies for transference of Risk to the third party

[2] Prudential categories and Sub Categories, (2003)

should be measured by complying with standards mentioned in INSPRU. During the Risk transference to the third party, company should assess that whether reinsurance document affects the economic value of transactions, whether it would raise the transaction costs to the firm, whether the transaction involves any conditions or terms that is not in control of firm and would the transaction be cancelled if the third party is facing a higher likelihood of Risk.

Prudential Sourcebook for Home Finance & Mortgage Firms and Insurance Intermediaries (MIPRU): This section grants the permission to firms for carrying on Home Financing and insurance business. The responsibility of firm's Insurance mediation activity must be directed to a senior member or the director of the company. The sole traders are exempted from this requirement. The firm will not appoint non executive directors but a person should be previously handling the governing function or the oversight function.

Prudential Sourcebook for firms of UCITS (UPRU): These are the investment firms and their license authority is limited. The purpose of this source book is to ensure the financial stability and market confidence of investment firms by imposing some commitments. The minimum limit for beginning capital requirement is 10 million Euros. The firm annual fixed expenditure includes the total expenditure in 4 quarters plus the Accruals at year end and less staff bonuses, interest payments to counterparties & customers, foreign exchange losses, Brokerage fees and director's & employees share in profits.[3] A firm will calculate it's financial resources as (Paid up share capital (Equity) + share premium + Non Cumulative preference shares + Audited Reserves) less (Intangible assets + Investment in own shares + members drawings + current year losses).

[3] Reader's Guide: an introduction to the FSA Handbook, (2010),

The other Prudential Sourcebook includes for Building Societies, Banks, Insurers, Investment Businesses and friendly Societies.

References

Prudential categories and Sub Categories, (2003)

Reader's Guide: an introduction to the FSA Handbook, (2010),

Turner, C. *FSA Financial Regulation: The Official Learning and Reference Manual* (13th Edn), Securities and Investment Institute, London, 2008