IPRU (INV)

Interim Prudential sourcebook: Investment businesses

FSA

The Interim Prudential Sourcebook for Investment Businesses

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November 2007

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INTERIM PRUDENTIAL SOURCEBOOK FOR INVESTMENT BUSINESSES

1 Chapter 1: Application and General Provisions

1.1 PURPOSE

1.1.1 G Before 1 January 2007, the Interim Prudential Sourcebook for Investment Businesses (*IPRU (INV)* was the part of the *Handbook* that dealt with capital requirements for *investment firms* subject to the position risk requirements of the previous version of the *Capital Adequacy Directive*. Now, however, *investment firms* which are subject to the risk-based capital requirements of the *Capital Adequacy Directive* are subject to the General Prudential sourcebook (*GENPRU*) and the Prudential sourcebook for Banks, Building Societies and Investment Firms (*BIPRU*).

1.1.2 G The *rules* and *guidance* in this sourcebook will assist the *FSA* to meet the statutory objectives of protecting consumers and maintaining market confidence. This sourcebook does so by setting minimal capital and other risk management standards thereby mitigating the possibility that *firms* will be unable to meet their liabilities and commitments to *consumers* and counterparties.

1.1.3 G The general scheme of this sourcebook is, wherever appropriate, to apply the financial and other prudential standards which applied to a *firm* immediately prior to it becoming authorised by the *FSA* under the *Act*. For convenience, the chapter numbers adopted in this sourcebook correspond with those of the rulebooks of *previous regulators*.

1.1.3A G This sourcebook does not apply to *BIPRU* investment firms except as follows:

(1) it does apply to certain *exempt BIPRU commodities fi*rms; and

(2) chapter TP of *BIPRU* applies parts of *IPRU(INV)* to certain *BIPRU investment firms* on a transitional basis.

1.1.4 G This sourcebook does not apply to *banks*, *building societies*, *insurers*, *the Society of Lloyd's* (except in relation to *underwriting agents*), *friendly societies* and certain other categories of *firm* and *members' advisers*.

1.1.5 G On becoming authorised by the *FSA* a *firm* will have to comply with the particular chapter of this sourcebook appropriate to its business. The *firm* will be able to seek guidance on this during the authorisation procedure. If subsequently, the business for which a *firm* has *permission* changes it may be necessary for it to comply with a different set of financial resources requirements. *Firms* will be able to discuss this aspect with the *FSA* during the application process.

1.1.6 G The *Supervision manual* sets out provisions relating to the periodic reporting and notification of financial information to the *FSA* or to the auditing of accounts. However, this sourcebook contains a few additional notification requirements (*notification rules*).

1.2 APPLICATION

1.2.1 R The Glossary applies to the transitional provisions, this chapter (*IPRU(INV)* 1), *IPRU(INV)* 2, *IPRU(INV)* 4 and *IPRU(INV)* 6.

1.2.2 R (1) *IPRU (INV)* applies to:

(a) a *members' adviser*;

(b) an *investment management firm*;

(c) a *personal investment firm*;

(d) an *authorised professional firm*;

(e) a *securities and futures firm*;

(f) a *service company*;

(g) the *Society of Lloyd's* (in relation to *underwriting agents*);

(i) a *credit union* which is a *CTF provider; and*

(j) an *exempt CAD firm*.

(2) *IPRU (INV)* does not apply to:

(a) a *lead regulated firm*; or

(b) a *media firm*;

(c) a *BIPRU investment firm* (unless it is an *exempt BIPRU commodities firm*).

(3) The definitions in the *Glossary* (which is applicable to the *Handbook* generally) apply to this chapter.

1.2.3 G For the avoidance of doubt, *IPRU (INV)* does not apply to any of the following:

(a) a *bank*; or

(b) a *building society*; or

(c) a *friendly society*; or

(d) an *ICVC*; or

(e) an *incoming EEA firm* or an *incoming Treaty firm* which does not have a *top up permission*; or

(f) an *insurer*; or

(g) a *UCITS* qualifier; or.

(h) a *UCITS management company*

1.2.3A R **The record-keeping requirements listed in the table at *IPRU(INV)* 1.2.3B R do not apply to *common platform firms*.**

1.2.3B R **Table: List of IPRU(INV) record-keeping requirements that do not apply to common platform firms.**

IPRU(INV)	Provision
Chapter 3	3-10(1)R to 3-10(3)R 3-12(1)R to 3-12(2)R 3-13(1)R to 3-13(5)R
Chapter 5	5.3.1(1)R to 5.3.1(6)R
Chapter 13	13.1.10R to 13.1.17R

OBLIGATION TO COMPLY

1.2.4 R **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.**

1.2.5 R **Table**

This table belongs to IPRU (INV) 1.2.4R

Authorised professional firm	Chapters 1 and 2
Securities and futures firm (which is not a *MiFID investment firm*)	Chapters 1 and 3
Securities and futures firm (which is an *exempt BIPRU commodities firm)*	Chapters 1 and 3
The Society of Lloyd's (in relation to *underwriting agents*) and *members' advisers*	Chapters 1 and 4
Investment management firm	Chapters 1 and 5
An *exempt CAD firm or a local firm*	Chapters 1 and 9
Service company	Chapters 1 and 6
Personal investment firm	Chapters 1 and 13
Credit union which is a *CTF provider*	Chapters 1 and 8

CAPITAL SUBSTITUTES: TRANSITIONAL PROVISION

1.2.6 G The financial resource requirements of the Financial Services Act regulators permitted certain types of borrowings or facilities to be treated as part of a *firm's* capital resources. The most common example is that of a subordinated loan which met the relevant conditions. The following provisions permit *firms* to continue to use these borrowings or facilities in the same way as under the relevant *previous regulator's* rules, provided that certain conditions are met.

1.2.7 R (1) If a *firm* was, immediately before *commencement* permitted to treat "relevant funds" as part of its capital resources under the financial resource rules of a *previous regulator* applicable to the *firm*, it may treat those funds in an equivalent manner under the corresponding provisions of *IPRU (INV)*, provided that the conditions in (3) are met.

(2) For the purposes of this *rule* "relevant funds" are funds provided to the *firm* under the terms of

(a) a subordinated loan agreement; or

(b) qualifying undertaking; or

(c) any other instrument treated in an equivalent manner under the financial resources *rules* applicable to the *firm*.

(3) The conditions referred to in (1) are either:

(a) in the case of a subordinated loan agreement, qualifying undertaking or other relevant instrument to which the *firm's previous regulator* is not party:

(i) the parties to it treat all rights (including, without limitation, rights to notice) which the agreement, undertaking or instrument grants to the *firm's previous regulator* as having been granted to the *FSA*; and

(ii) if there is a variation of the commercial terms the parties include, in the terms of the instrument executed to effect the variation, provision to substitute reference to the *FSA* in place of any reference to the *firm's previous regulator*; or

(b) in the case of a subordinated loan agreement, qualifying undertaking or other relevant instrument to which the *firm's previous regulator* is party, the parties treat the rights accorded to the self regulating organisation under the relevant instrument as having been assigned to the *FSA* immediately before *commencement*.

1.2.8 G An instrument treated in an equivalent manner would, for example, include (in relation to a *personal investment firm*) a "PASS loan".

2 Chapter 2: Authorised professional firms

2.1 Application

2.1.1 R (1) This chapter applies to an *authorised professional firm* in accordance with *IPRU (INV)* 2.1.2R and 2.1.3R.

(2) The definitions in the *Glossary* apply to this Chapter.

2.1.2 R (1) An *authorised professional firm* of a kind falling within (2) must comply with such of *IPRU (INV)* 3, 5, 9 or 13 which in accordance with *IPRU (INV)* 2.1.4R, most appropriately correlates to the type and scale of the business which it conducts.

(2) The type of *authorised professional firm* to which (1) applies is one:

(a) which is also an *exempt CAD firm*;

(b) which acts as a *market maker*;

(c) which acts as a *stabilising manager*;

(d) which acts as the trustee or *operator* of a *regulated collective investment scheme*;

(e) which acts as a *broker fund adviser* or otherwise participates in a *broker fund* arrangement;

(f) whose main business, having regard to (3), is not the practice of its profession or professions;

(g) whose *permission* includes a requirement that it acts in conformity with the financial resources *rules* applicable to another type of *firm*; or

(h) whose *permission* includes *establishing, operating or winding up a personal pension scheme*.

(3) For the purposes of (2)(f), a *firm's* professional business practice is not the "main business" of the *firm* unless the proportion of income it derives from *professional fees* is, during its annual accounting period, at least 50% of the *firm's* total income (a temporary variation of not more than 5% may be disregarded for this purpose).

(4) An *authorised professional firm* which, in accordance with (1), is required to comply with *IPRU (INV)* 3, 5, 9 or 13 must immediately give notification of that fact to the *FSA* in accordance with *SUP* 15.7 (Forms and method of notification).

2.1.3 R An *authorised professional firm* which does not fall within *IPRU (INV)* 2.1.2R must comply with sections 2.2, 2.3 and 2.4 of this chapter.

2.1.4 R This table belongs to *IPRU (INV)* 2.1.1R

TYPE OF BUSINESS ACTIVITY	CHAPTER OF SOURCEBOOK
(i) *managing investments* other than for *retail clients*; or (ii) *OPS activity*; or (iv) acting as the *ACD* or *depositary* of an *ICVC*; or (v) *establishing, operating or winding-up* other *collective investment schemes*; or (va) *establishing, operating or winding up a personal pension scheme*; or (vi) *safeguarding and administering investments*;	*Investment management firm* - *IPRU (INV)* 5 *Investment management firm* (which is an *exempt CAD firm) – IPRU(INV)* 5 and 9
(i) *advising* on, or *arranging deals* in, *packaged products*; or (ii) *managing investments* for *retail clients*;	*Personal investment firm - IPRU (INV)* 13
(i) a *regulated activity* carried on as a member of an *exchange*; or (ii) acting as *a market maker* in *securities* or *derivatives*; or	*Securities and futures firm (which is an* exempt CAD firm*) IPRU(INV)* 9 *Securities and futures firm* (which is not a *MiFID investment firm*) - *IPRU (INV)* 3

iii) *corporate finance business*; or	
(iv) *dealing* or *arranging* deals in *securities* or *derivatives*, other than *inter-professional investments*; or **(v) the provision of clearing services as a *clearing firm*; or** **(vi) spread betting;**	

2.1.5 G An *authorised professional firm* will be a *MiFID investment firm* if its business activities include the provision of *investment services and/or activities* for a third party. An *authorised professional firm* will not however be a *MiFID investment firm* if it falls within one of the exclusions contained in Article 2 of *MiFID*. Article 2(1)(c) provides an exclusion for an *authorised professional firm* which provides *investment services and/or activities* in an incidental manner in the course of a professional activity and that activity is regulated by the *firm's designated professional body*.

2.1.6 G The *FSA* considers the scope of this exclusion cannot be precisely defined. Ultimately questions of interpretation are for the Court to determine. The *FSA* considers that to satisfy the exclusion the services cannot be the major part of the practice of the *firm*. The *FSA* also considers the following factors to be among those that are relevant:

(1) the scale of *regulated activity* in proportion to other professional services provided;

(2) whether and to what extent activities that are *regulated activities* are held out as separate services;

(3) the impression given as to how the *firm* provides *regulated activities*, for example through its advertising or other promotions of its service.

2.2 Financial Resources Requirements

2.2.1 R (1) A *firm* must be able to meet its liabilities as they fall due.

(2) In complying with (1) a *firm* may use any assets which are available to meet any of its liabilities.

2.2.2 G *Firms* are reminded that:

(1) requirements relating to the systems and controls which *firms* must establish and maintain for ensuring compliance with financial resources and other requirements are set out in *SYSC*.

(2) the financial reports that a *firm* is required to make to the *FSA* are set out in SUP 16.

2.3 Professional Indemnity Insurance

2.3.1 R A *firm* must effect and maintain at all times adequate professional indemnity insurance cover for all the business activities which it carries on, or for which it is responsible.

2.3.2 G In assessing the adequacy of a *firms*' professional indemnity insurance cover for the purposes of *IPRU(INV)* 2.3.1R, the *FSA* may have regard to a *firm's* compliance with the professional indemnity insurance requirements of its *designated professional body* in force at the time.

2.4 Bonding Requirement for Accountants

2.4.1 R This section applies to a *firm* of accountants practising as such in the UK.

2.4.2 R (1) If the aggregate value of *client money* and *bonded investments* a *firm* holds for a *client* is over £50,000 then the *firm* must ensure that it holds a bond for the excess over £50,000.

(2) A *firm* must:

(a) ensure that the bond is in the form prescribed by the *FSA*;

(b) ensure that the *person* specified to act as trustee in the bond is a *designated professional body* or a solicitor practising as such in the UK;

(c) ensure that the bond is lodged with the trustee; and

(d) be able at all times to show that the amount of the bond is sufficient to meet the requirements of (1).

2.4.3 R A *firm* must notify the *FSA* immediately:

(1) of any bond taken out specifying the amount and where it is lodged; and

(2) of the arrangements it has made to comply with *IPRU (INV)* 2.4.2R if a bond is not renewed or is cancelled.

2.4.4 G (1) *Firms* which hold *client money* or *bonded investments* for more than one *client*, may hold one bond to cover all of the *clients* concerned. The bonding requirements may be complied with by taking out a global bond. In firms with numerous offices compliance may be achieved in practice by calculating the requirement based on figures supplied by offices which is likely to be at least quarterly. These figures would need to be supplied and assessed soon after the end of each quarter.

(2) To ensure the global cover is sufficient, this approach would require an estimated safety margin to be incorporated, to allow for changes in the amounts of *client money*, *investments* or assets held. An additional prudent measure would be to ensure that exceptional amounts of these assets are notified by branch offices so that the *firm* can check whether the safety margin can absorb them and reconsider whether the total global bond cover remains sufficient.

2.4.5 G *Firms* which do not expect to hold *bonded investments* or *client money* in excess of the value limit need not hold a bond. However, *firms* may wish to make contingency arrangements with a surety whereby a bond facility is available and can be executed and delivered at short notice.

3 Chapter 3: Financial resources for Securities and Futures Firms which are not MiFID Investment Firms or which are Exempt BIPRU Commodities Firms

3-A R The definitions in the glossary at Appendix 1 apply to this chapter.

3-1 R This chapter applies to a *securities and futures firm* which:

(a) is not a *MiFID investment firm*;

(b) is an *exempt CAD firm* that carries on any *regulated activity* other than *MiFID business*; or

(c) is an *exempt BIPRU commodities firm*.

G An *exempt BIPRU commodities firm* is subject to the non-capital requirements of *GENPRU* and *BIPRU* as indicated in *BIPRU* TP 15.

3-1A R This chapter does not apply to an *oil market participant* unless it is a member of a *recognised* or *designated investment exchange* which is, under the rules of that exchange, entitled to trade with other members.

G An *oil market participant* to which this chapter does not apply is still subject to the requirement of *Principle* 4 to have adequate financial resources.

3-1B R The provisions on concentrated risk in this chapter do not apply to an *exempt BIPRU commodities firm* which applies the *large exposure* requirements in *BIPRU* 10.

G *BIPRU* 10 applies to an *exempt BIPRU commodities firm* unless it qualifies for exemption under *BIPRU* TP 16.

3-1C G The table in *IPRU(INV)* 3-1D G sets out the parts of the *Handbook* containing provisions on *large exposure* or concentrated risk which apply to a *securities and futures firm.*

3-1D G Table

Applicability of the provisions to securities and futures firms

This table belongs to *IPRU(INV)* 3-1C G

(1)	(2)	(3)
Type of securities and futures firm	Whether conditions in BIPRU TP 16 are satisfied	Part of Handbook applicable for large exposure or concentrated risk requirements

Energy market participant (which is an *exempt BIPRU commodities firm*) with a *waiver* from *IPRU(INV)* 3	Yes	Not applicable
	No	*BIPRU* 10 applies
Energy market participant (which is an *exempt BIPRU commodities firm*) to which *IPRU(INV)* 3 applies	Yes	*IPRU(INV)* 3 applies
	No	*BIPRU* 10 applies
Oil market participant (which is an *exempt BIPRU commodities firm*) if it is a member of a *recognised investment exchange* or a *designated investment exchange* which is, under the rules of that exchange, entitled to trade with other members to which *IPRU(INV)* 3 applies	Yes	*IPRU(INV)* 3 applies
	No	*BIPRU* 10 applies
Other *oil market participant* (which is an *exempt BIPRU commodities firm*) to which *IPRU(INV)* 3 does not apply	Yes	Not applicable
	No	*BIPRU* 10 applies
Exempt BIPRU commodities firm which is not an *energy market participant* or *oil market participant*	Yes	*IPRU(INV)* 3 applies
	No	*BIPRU* 10 applies
Securities and futures firm (which is not a *MiFID investment firm*)	Not applicable	*IPRU(INV)* 3 applies

3-2 R **A *firm* must at all times have available the amount and type of *financial resources* required by the rules of the *FSA*.**

3-5 R **A *firm* must notify the *FSA* immediately it becomes aware that it is in breach of, or that it expects shortly to be in breach of, rule 3-2.**

3-6 G The financial and non-financial resources rules for an *exempt CAD firm* are set out in *IPRU(INV)* chapter 9. As such, rules 3-61 to 3-182 do not apply to an *exempt CAD firm* unless it carries on any *regulated activity* other than *MiFID business* (see *IPRU(INV)* 9.2.3R).

3-10 Keeping of records

Records to be up-to-date

3-10(1) R **A *firm* must keep accounting records in accordance with rules 3-10 to 3-13 on a continual basis so that at all times records are up-to-date or able to be brought up-to-date within a reasonable time.**

Adequacy of records

3-10(2) R A *firm* must keep accounting records in such a manner that they are sufficient to show and explain the *firm's* transactions and commitments (whether effected on its own behalf or on behalf of others) and in particular so that these records:

(a) disclose with reasonable accuracy the financial position of the *firm* at any point in time within the previous six years when the *firm* was a member of the *FSA* or a predecessor regulator;

(b) demonstrate whether or not the *firm* is or was at that time complying with its *financial resources requirement*; and

(c) enable the *firm* to prepare within a reasonable time any *financial reporting statement* as at the close of business of any date within the previous six years when the *firm* was regulated by the *FSA* or a predecessor regulator, and such that the statement complies with the requirements of the rules of the *FSA*.

Content of records

3-10(3) A *firm* must ensure that its accounting records shall as a minimum contain:

(a) entries from day to day of all sums of money received and expended by the *firm* whether on its behalf or on behalf of others, and the matters in respect of which the receipt and expenditure takes place;

(b) a record of all income and expenditure of the *firm* explaining its nature;

(c) a record of all assets and liabilities of the *firm* including any commitments or *contingent liabilities*;

(d) entries from day to day of all purchases and sales of *investments* by the *firm* distinguishing those which are made by the *firm* on its own account and those which are made by or on behalf of others;

(e) entries from day to day of the receipt and dispatch of *documents of title* which are in the possession or control of the *firm*; and

(f) a record of all *investments* or *documents of title* in the possession or control of the *firm* showing the physical location, the beneficial owner, the purpose for which they are held and whether they are subject to any charge.

G The *FSA* does not consider it possible to prepare an exhaustive and prescriptive list of record keeping requirements applicable to all *firms*. The detailed requirements will vary according to the manner in which the business is structured, organised and managed; its size; and the nature, volume and complexity of its transactions and commitments. The overriding principle, however, is that the records and systems must be adequate to fulfil the general requirements set out in rule 3-10.

3-11 Reconciliation of firm's balances

Reconciliation

3-11(1) R **(b) A *firm* must reconcile all balances and positions with *exchanges*, *approved exchanges*, *clearing houses* and *intermediate brokers* as recorded by the *firm* to the balance or position on a statement or circularisation obtained by the *firm* from the *exchange* etc and must correct any differences by agreement with the *exchange* etc on a timely basis.**

(c) A *firm* must perform reconciliations under (b) above as frequently as is appropriate for the volume of transactions on the accounts and in any event not less than once every five weeks.

(d) A *firm* must reconcile all balances and *securities* positions with each *eligible counterparty* which is a member of an *exchange* or *approved exchange* as recorded by the *firm* to the balance or position on a statement or circularisation obtained by the *firm* from the *eligible counterparty* except to the extent that the balances and *securities* positions due to and from the *eligible counterparty* have been agreed by other means, and must correct any differences by agreement with the *eligible counterparty* on a timely basis.[*]

(e) A *firm* must perform reconciliations under (d) above as frequently as is appropriate for the volume of transactions on the accounts and in any event not less than once every year.

Circularisation

3-11(2) **A *firm* must circularise or request statements from banks, building societies, *exchanges*, *approved exchanges*, *clearing houses*, *intermediate brokers* and *market counterparties* which are members of *exchanges* or *approved exchanges* in good time in order to be able to comply with (1) above.**

Response to requests

[*] For guidance notes on the reconciliation of a *firm's* balances with *market counterparties* see, **Appendix 20**

3-11(3) **A *firm* must use its best endeavours to respond within one month of receipt to any circularisation from another *firm* requesting confirmation of outstanding balances.**

3-12 Risk management and internal control

Exposure limits

3-12(1) **R** **A *firm* must ensure that its accounting and other records contain details of exposure limits for trading positions, and for commitments under its *ACMP,* which are appropriate to the type, nature and volume of business undertaken and that the information contained in the records is capable of being summarised in such a way as to enable actual exposures to be measured readily and regularly against these limits.**

Management information

3-12(2) R **A *firm* must maintain its records in a manner such that they disclose, or are capable of disclosing, in a prompt and appropriate fashion, the financial and business information which will enable the *firm's* management to:**

(a) identify, quantify, control and manage the *firm's* risk exposures;

(b) make timely and informed decisions;

(c) monitor the performance of all aspects of the *firm's* business on an up-to-date basis;

(d) monitor the quality of the *firm's* assets; and

(e) safeguard the assets of the *firm*, including assets for which the *firm* is responsible belonging to *customers* and other persons.

3-13 Nature, accessibility and retention of records

Nature of records

3-13(1) R **(a) A *firm* may keep a record in a form other than a document or copy of a document provided that the record can be reproduced in hard printed form.**

(b) Where all the records relating to a *counterparty* are not kept together, a *firm* must ensure that each location where documents relating to that *counterparty* are retained contains an indication that other records relating to that *counterparty* exist and how access to them can be obtained.

(c) A *firm* may accept and rely on records supplied by a third party so long as those records are capable of being and are reconciled with records held by the *firm*.

(d) A *firm's* records must generally be in English but may be in another language if the *firm* has facilities for producing a translation of the record into English within a reasonable time of any request for production of such a translation being made by the *FSA* or the *firm's* auditor or *reporting accountant*.

Audit trail

3-13(3) **A *firm* must record the information required by rules 3-10 to 3-13 in such a way as to enable a particular transaction to be identified at any time and traced through the accounting systems of the *firm*, in particular in such manner as to enable early identification of aggregates and of the particular items which have contributed to those aggregates.**

Prompt access

3-13(3) R **A *firm* must ensure that all records are arranged, filed and indexed so as to permit prompt access to any particular record.**

Retention of records

3-13(4) R **(a) A *firm* must keep all records required by rules 3-10 to 3-13 as well as any working papers necessary to show the preparation of any *reporting statement* or any other periodic return to the *FSA*.**

(b) A *firm* must keep these records and working papers for a period of six years after the date on which they are first made or prepared.

(c) During the most recent of those years, a *firm* must keep these records and working papers either at a place where the *firm* carries on business or in such a manner that they can be produced at such a place within 24 hours of their being requested and after the first year in such a manner that they can be produced at a place of business of the *firm* within 48 hours.

Security of records

3-13(5) R **A *firm* must maintain adequate procedures for the maintenance, security, privacy and preservation of records, working papers and *documents of title* belonging to the *firm* or others so that they are reasonably safeguarded against loss, unauthorised access, alteration or destruction.**

Valuation of positions *

3-41(9) R A *firm* must value a position on a prudent and consistent basis, as well as having regard to the liquidity of the instrument concerned and any special factors which may adversely affect the closure of the position, and must adopt the following general policies:

(a) a position must be valued at its close out price (close out price means that a long position shall be valued at current bid price and a short position at current offer price); where firm two way prices are not available a *firm* must value its position in accordance with the notes to this rule; *

(b) where a *firm* is entitled to use a risk assessment model in the calculation of its *PRR* on *options* positions, it may value its *options* using the values derived from the model;

(c) where a *firm* does not use a model as described in (b) above and prices are not published for its *options* positions, a *firm* must determine the *mark to market* value as follows:

(i) for purchased *options*, the *mark to market* value must be the product of:

(aa) the *in the money* amount; and

(bb) the quantity underlying the *option*;

(ii) for written *options* the *mark to market* value must be the initial premium received for the *option* plus the product of:

(aa) the amount by which the current *in the money* amount exceeds either the *in the money* amount at the time the contract was written, or zero if the contract was *out of the money* at the time it was written; and

(bb) the quantity underlying the *option*;

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* For notes on the valuation of positions, see **Appendix 21**

(d) a *firm* must calculate the value of a *swap* contract or an *FRA* having regard to the net present value of the *future* cash flows of the contract, using current interest rates relevant to the periods in which the cash flows will arise;

(e) notwithstanding (d) above, a *firm* may refrain from marking a *swap* or an *FRA* to market where it enters into such transactions on a matched principal basis, provided that it is confident that such positions are fully matched;

(f) a *firm* that is a partnership which experiences *exceptional* administrative or technical difficulties complying with the valuation procedure outlined above should notify the *FSA* immediately; and

(g) in the case of interest rate *swaps*, currency *swaps* and *FRAs*, a *firm* may limit the bid/offer valuation required under (a) to its net position.

G The *FSA* does not lay down a precise formula for calculating the value of *swaps* and *FRAs* for the purposes of this rule. However, it will expect a *firm* to employ a valuation formula which accords with generally accepted market practice.

G The *FSA* may permit by modification or waiver of this rule an alternative arrangement if it is satisfied that neither the *firm* nor its *counterparties* will be put at risk by the adoption of that alternative procedure.

3-60 **FIRMS TO WHICH RULES 3-61 TO 3-182 APPLY**

Broad scope firms

3-60(1) R Rules 3-61 to 3-182 apply to a *broad scope firm* except that rules 3-80 to 3-178 do not apply to a *venture capital firm*.

Arrangers

3-60(2) R Rules 3-61 to 3-182 apply to an *arranger*, except that:

(a) **Rule 3-61 and rules 3-63 to 3-182 do not apply to a *corporate finance advisory firm* or a *derivative fund manager*; and**

(b) **rules 3-80 to 3-178 do not apply to a *venture capital firm*.**

Corporate finance advisory firms

3-60(3) R Rule 3-61 and rules 3-63 to 3-182 do not apply to a *corporate finance advisory firm* which must instead comply with the following two capital requirements at all times:

(a) *tangible net worth* must exceed £10,000; and

(b) net current assets must exceed £10,000.

3-60(3A) R (a) Net current assets for the purposes of rule 3-60(3)R(b) shall be as calculated for the purposes of producing a balance sheet in accordance with the following provisions, as applicable:

(i) Format 1 of the Balance Sheet Format of Schedule 4 to the Companies Act 1985; or

(ii) Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409); or

(iii) Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410); or

(iv) Schedule 1 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); or

(v) Schedule 1 to the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913).

Advisers and locals/traded options market makers

3-60(4) R Rules 3-61 to 3-182 do not apply to an *adviser* or *local*/traded *options market maker* which must instead comply with the following capital requirements at all times:

(a) *tangible net worth* must be positive;

(b) in the case of an *adviser*, net current assets must be positive; and

(c) in the case of a *local*/traded *options market maker*, the *firm* must be able to meet its liabilities as they fall due.

3-60(4A) R (a) Net current assets for the purposes of rule 3-60(4)R(b) shall be as calculated for the purposes of producing a balance sheet in accordance with the following provisions as applicable:

(i) Format 1 of the Balance Sheet Format of Schedule 4 to the Companies Act 1985; or

(ii) Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409); or

(iii) Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410); or

(iv) Schedule 1 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); or

(v) Schedule 1 to the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913).

Derivative fund managers

3-60(5) R Rule 3-61 and rules 3-63 to 3-182 do not apply to a *derivative fund manager* which must instead comply with the following two capital requirements at all times:

(a) ***tangible net worth* must exceed £10,000; and**

(b) **net current assets , excluding investment in any pooled fund or *unregulated collective investment scheme* which it manages, must exceed £10,000.**

3-60(5A) R (a) Net current assets for the purposes of rule 3-60(5)R(b) shall be as calculated for the purposes of producing a balance sheet in accordance with the following provisions as applicable:

(i) Format 1 of the Balance Sheet Format of Schedule 4 to the Companies Act 1985;

(ii) Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409); or

(iii) Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410); or

(iv) Schedule 1 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); or

(v) Schedule 1 to the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913).

Dematerialised instruction transmitters

3-60(6) R Rules 3-61 to 3-182 apply to a *dematerialised instruction transmitter*.

3-60(7) R Rules 3-61 to 3-182 apply to a *firm* whose *permission* includes *establishing*, *operating or winding-up* a *personal pension scheme*.

Exempt CAD firms

3-60(8) R Rules 3-61 to 3-182 do not apply to an *exempt CAD firm*, unless it carries on any *regulated activity* other than *MiFID business*.

Exempt BIPRU commodities firms

3-60(9) G An *exempt BIPRU commodities firm* should determine whether it is a *broad scope firm* or one of the other categories in this *rule*.

3-61 THE BASIC COMPUTATION

3-61(1) R A *firm* must, at all times, maintain *financial resources* in excess of its *financial resources requirement*.

3-61(2) R A *firm* must calculate its *financial resources* and its *financial resources requirement* in accordance with the table below and rules 3-62 to 3-182.

R Table 3-61. The basic financial resources calculation

Financial resources	**Financial resources requirement**
Capital ("A") the sum of - - ordinary share capital - preference share capital - share premium account - profit and loss account - other approved reserves, and - partners' current and capital accounts, and - *eligible LLP members' capital* Intangible assets and *excess LLP members' drawings* ("B") A - B = *tangible net worth* ("C")	Primary requirement ("E") the sum of - - base requirement - total liquidity adjustment - charged assets - *contingent liabilities* - deficiencies in *subsidiaries*
Eligible capital substitutes ("D") the sum of - - subordinated loans - *approved bank bond*s - approved undertakings	Total PRR ("F") Total CRR ("G")
C + D = *financial resources*	E + F + G =*financial resources requirement*

3-62 Tangible net worth

Calculation

3-62(1) R A *firm* must calculate its *tangible net worth* in accordance with table 3-61, subject to (2), (3) and (4) below.

Redeemable shares

3-62(2) R A *firm* may include redeemable *share* capital as part of *tangible net worth* only if:

(a) the *firm*'s memorandum and articles of association or a shareholders' agreement contain provisions that:

(i) redemption may not occur if the *firm's financial resources* after redemption would be less than or equal to 120% of its *financial resources requirement*;

(ii) dividends may not be paid if the *firm's financial resources* after payment would be less than or equal to 120% of its *financial resources requirement*; and

(iii) in the case of a shareholder's agreement, any assignee of the shares is subject to the provisions of the agreement; and

(b) the *firm*, before issuing any preference shares, notifies the *FSA* of its intention to do so.

Notice of redemption

3-62(3) R A *firm* must provide the *FSA* with six months' written notice of redemption of any of its redeemable shares.

Approved reserves

3-62(4) R A *firm* may not include reserves other than retained profits as part of *tangible net worth*.

G A *firm* that wishes to include other reserves will need to apply for a modification or waiver of this rule.

Profit and loss account/partners' current and capital accounts

3-62(5) R For the calculation of *tangible net worth*, a *firm* must:

(a) deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;

(b) in respect of a defined benefit occupational pension scheme, derecognise any defined benefit asset.

3-62(6) R A *firm* may, for the purposes of calculating *tangible net worth*, substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

3-62(7) G A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* the reasons for any difference between *the deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme*.

3-62(8) R Where applicable, a *firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

3-63 Eligible capital substitutes

Calculation

3-63(1) R A *firm* must calculate its *eligible capital substitutes* in accordance with table 3-61, subject to (2) to (9) below.

Approved eligible capital substitutes

3-63(2) R A *firm* may treat a subordinated loan, *approved bank bond* or approved undertaking as an *eligible capital substitute* only if it is:

(a) drawn up in accordance with the relevant standard form obtained from the *FSA*; and

(b) signed by authorised signatories of all the parties.

G If a *firm* wishes to use a form which differs from the standard form it will need to seek a modification to, or modification or waiver of, this rule.

G A *firm* may, under the provisions of IPRU(INV) 1.2.5R continue to treat a subordinated loan, bank bond or approved undertaking as an eligible capital substitute if it was entitled to do so immediately prior to the *specified day*, and the other conditions set out in IPRU(INV) 1.2.5R are met.

Approved lenders

3-63(3) R A *firm* may treat a subordinated loan as an *eligible capital substitute* only if the lender is:

(a) the *firm's controller*;

(b) a *regulated banking institution*;

(c) an *approved person*; or

(d) a *regulated financial institution*.

G If the *firm* wishes to include as an *eligible capital substitute* a subordinated loan from a lender not within the above list, it will need to apply for a modification or modification or waiver of 3-63.

Notice of repayment and termination

3-63(4) R A *firm* must provide the *FSA* with five *business days* written notice of any repayment, prepayment or termination of a subordinated loan, *approved bank bond* or approved undertaking, except when the *firm*'s *financial resources* after payment of interest or principal etc would be less than or equal to 120% of its *financial resources requirement*, in which case the *firm* must not repay, prepay or terminate any subordinated loan, *approved bank bond* or approved undertaking otherwise than in accordance with the terms of the relevant agreement.

Amounts repayable within three months

3-63(5) R A *firm* may not treat any amount of a subordinated loan which is repayable within three months as an *eligible capital substitute*.

Limit on eligible capital substitutes

3-63(6) R The total amount of *eligible capital substitute*s which a *firm* may take into account in its *financial resources* must not exceed four times *tangible net worth*.

Limit on approved bank bonds

3-63(7) R **The total of *approved bank bond*s which a *firm* may treat as an *eligible capital substitute* must not exceed:**

(a) 30% of the base requirement; and

(b) *CRR* on *exchange-traded-margined-transactions* plus concentrated risk to one *counterparty* arising from *exchange-traded-margined-transactions* calculated under rules 3-173A and 3-175.

Limit on approved undertakings

3-63(8) R **A *firm* may only treat approved undertakings as an *eligible capital substitute* to the extent that its *approved bank bonds* are less than 30% of its base requirement.**

Approved undertakings

3-63(9) R **A *firm* may treat an undertaking as an *eligible capital substitute* only if the provider of the undertaking is:**

(a) a *regulated banking institution*; or

(b) a *regulated financial institution*;

G A *firm* that wishes to include an undertaking where the provider is neither of the above, it will need to seek a modification or waiver from the *FSA*.

PRIMARY REQUIREMENT

Definition of primary requirement - General rule

3-70 R **A *firm's primary requirement* is the sum of:**

(a) the base requirement calculated in accordance with rule 3-71;

(b) the total liquidity adjustment calculated in accordance with rule 3-75;

(c) charged assets calculated in accordance with rule 3-76;

(d) *contingent liabilities* calculated in accordance with rule 3-77; and

(e) deficiencies in *subsidiaries* calculated in accordance with rule 3-78;

Base requirement - General rule

3-71 R **A *firm's* base requirement is the highest of:**

(a) the absolute minimum requirement, calculated in accordance with rule 3-72;

(b) the expenditure requirement, calculated in accordance with rule 3-73; or

(c) the volume of business requirement, calculated in accordance with rule 3-74.

Absolute minimum requirement - General rule

3-72 R A *firm's* absolute minimum requirement is:

(a) for an *arranger*: £10,000;

(b) for a *financial bookmaker*: £50,000;

(c) for an *agency broker*: £50,000;

(d) for a *firm* which handles *client money* and assets relating to *margined transactions* and segregates all *money* received from clients as *client money*: £50,000;

(e) for a *non clearing floor member*: £50,000;

(f) for a *broad scope firm* other than one within (b) to (e) above: £100,000; or

(g) for a *dematerialised instruction transmitter*: £50,000.

3-73 Expenditure requirement

General rule

3-73(1) R A *firm*'s expenditure requirement is:

(a) for an *investment manager;* an *introducing broker* who is not responsible for its *counterparties'* performance; a *venture capital firm* which is an *arranger;* a *model A clearing firm;* a *dematerialised instruction transmitter*; or a *firm* that does not hold *client money* or assets but whose *permission* includes *establishing, operating or winding-up a personal pension scheme*: 6/52nds of *relevant annual expenditure*; or

(b) for any other *firm*: 1/4 of *relevant annual expenditure*.

Calculation of relevant annual expenditure

3-73(2) R Subject to (3), (4) and (5) below, a *firm* must calculate its *relevant annual expenditure* with reference to the *firm's* most recent *annual financial statements*, as follows:

(a) its total revenue; and

(b) any loss before taxation;

less the aggregate of the following items:

(c) profit before taxation;

(d) *bonuses*;

(e) *profit shares* and other appropriations of profit, except for fixed or guaranteed remuneration of a partner which is payable even if the *firm* makes a loss for the year;

(f) paid *commissions shared*, other than to *employees*, *directors*, half commission men or *appointed representatives* of the *firm*;

(g) fees, brokerage and other charges paid to *clearing houses*, *exchanges*, *approved exchanges* and *intermediate brokers* for the purposes of executing, registering or clearing transactions;

(h) interest payable to *counterparties*;

(i) interest payable on borrowings to finance the *firm's investment business* and *associated business*; and

(j) *exceptional* or *extraordinary items*, provided that it first notify the *FSA* in writing of the nature and amount of the item(s) concerned.

Absence of annual financial statements

3-73(3) R If a *firm* does not have *annual financial statements*, it must:

(a) where it has just commenced trading, base its *relevant annual expenditure* on budgeted or other accounts which it submitted to the *FSA* as part of its application; or

(b) where its accounts do not represent a 12 month period, calculate *relevant annual expenditure* on a proportionate basis agreed by the *FSA*.

Adjustments to relevant annual expenditure

3-73(4) R A *firm* must use a *relevant annual expenditure* adjusted to take account of its circumstances where:

(a) there has been a significant change in the circumstances or activities of the *firm*; or

(b) the *firm* has a material proportion of its expenditure incurred on its behalf by third parties and such expenditure is not fully recharged to the *firm*.

G *FSA* would for example consider an application to vary a *firm's* permitted activity as a significant change.

G *FSA* would consider 10% of a firm's expenditure incurred on its behalf by third parties to be material.

G If a *firm* is in any doubt, it should always seek guidance from the FSA.

Recent Authorisation

3-73(5) R **If a *firm* has not been authorised long enough to have prepared *annual financial statements* after authorisation, it must base its *relevant annual expenditure* on budgeted or other accounts which it submitted to the *FSA* as part of its application.**

Application

3-74(1) R **The volume of business requirement applies only to a *firm* which settles *margined transactions* for *counterparties*.**

Margined transactions

3-74(2) R **A *firm's* volume of business requirement is 3.5% of the aggregate gross amounts of any initial margin (as calculated in (3) below) of the *firm's counterparties* at the relevant time.**

Initial margin

3-74(3) R **A *counterparty's* initial margin for the purposes of (2) above is the sum of the following amounts:**

(a) in respect of *exchange traded* transactions, the *counterparty's initial margin requirement*; and

(b) in respect of *OTC* transactions, the amount of margin that the *counterparty* is required by the *firm* to deposit.

3-75 Liquidity adjustment

General rule

3-75(1) R **A *firm*'s total liquidity adjustment is the sum of amounts specified as liquidity adjustments below.**

Intangible assets

3-75(2) R **The liquidity adjustment for intangible assets is nil (these must be deducted from capital to arrive at *tangible net worth* under 3-62). Intangible assets do not include a deferred acquisition cost asset.**

Tangible fixed assets

3-75(3) R The liquidity adjustment for tangible fixed assets is the total net book value of such assets, with the exception of land and buildings used as *security* for *non recourse loans* or other loans which a *firm* must treat under (4) and (5) below.

Land and buildings used as security for non recourse loans

3-75(4) R The liquidity adjustment for land or buildings used as security for a *non recourse loan* is the difference between the net book value of the land or building and the loan principal outstanding, except where the loan principal outstanding is higher than the net book value in which case there is no liquidity adjustment.

Land and buildings used as security for other loans

3-75(5) R The liquidity adjustment for land or buildings used as security for loans other than *non recourse loans* is the difference between the net book value of the land or building and the lower of:

(a) 85% of a professional valuation of the land and buildings (which must have been carried out in the last two years); or

(b) the principal outstanding,

except where both (a) and (b) are higher than the net book value in which case there is no liquidity adjustment.

Physical stocks

3-75(6) R The liquidity adjustment for physical stocks is the balance sheet value of such stocks, except for stock positions associated with the *firm's investment business* which are:

(a) *physical commodities* for which the full contract price has been paid;

(b) work in progress and finished goods which result from the processing of *physical commodities*; or

(c) raw materials which will be combined with *physical commodities* to produce a finished processed commodity,

in which case there is no liquidity adjustment (but see *PRR* rules).

Investments in connected companies

3-75(7) R The liquidity adjustment for an *investment* in a *connected company* is the balance sheet value of the *investment*, except where the *investment* is a *marketable investment* which is not in a *subsidiary*, in which case there is no liquidity adjustment but such *investment* must be subject to the *PRR* rules.

Other investments

3-75(8) R Other *investments* have no liquidity adjustment but instead are subject to the *PRR* rules.

Prepayments

3-75(9) R The liquidity adjustment for a prepayment is the balance sheet value of that prepayment, except that there is no liquidity adjustment to the extent that it relates to goods and services to be received or performed in the next three months (or six weeks in the case of an *investment manager*; an *introducing broker* who is not responsible for its *counterparties'* performance; a *venture capital firm* which is an *arranger*; or a *model A clearing firm*).

Debtors arising from investment business or dealing activities

3-75(10) R Debtors arising from *investment business* or *dealing activities* have no liquidity adjustment but instead are subject to the *CRR* rules.

Other debtors

3-75(11) R The liquidity adjustment for debtors other than debtors arising from *investment business* or *dealing activities* is the balance sheet value of the debtor, except that there is no liquidity adjustment in the following circumstances:

(a) amounts due from *connected companies* which are *adequately secured* and are repayable within 90 days;

(b) unsecured amounts due at the request of the *firm* from a *connected company* which is a *regulated banking institution* within 90 days;

(c) unsecured amounts due at the request of the *firm* from a *connected company* which is a *regulated financial institution* within seven days;

(d) having given prior written notice to the *FSA*, unsecured amounts receivable at the request of the *firm* from a *connected company* within seven days under an *approved treasury arrangement*, up to a maximum of the *firm*'s excess of *financial resources* over its *financial resources requirement* before taking into account the *approved treasury arrangement*;

(e) amounts receivable in respect of cash dividends declared by either *exchange traded* companies or *authorised person*s which have been outstanding for 30 days or less from the date the dividends were due to be paid;

(f) amounts accrued or receivable in respect of interest on *marketable investments* which have been outstanding for 30 days or less from the date the interest was due to be paid;

(g) amounts receivable on U.K. value added tax which have been outstanding for 30 days or less from the date that the value added tax return was due to be received by HM Customs & Excise; and

(h) amounts receivable on taxation other than U.K. value added tax which have been agreed with the appropriate tax authorities and have been outstanding for 30 days or less from the date that the amounts were due to be received.

Cash deposits

3-75(12) R The liquidity adjustment for a cash deposit is the balance sheet value of the deposit, except for *qualifying deposits* and those other deposits which are subject to rule 3-180.

Other assets

3-75(13) R The liquidity adjustment for assets other than those specifically stated above is the balance sheet value of the asset concerned. Other assets do not include a *defined benefit asset* or a deferred acquisition cost asset.

Charged assets - General rule

3-76 R A *firm* must calculate the *primary requirement* for charged assets as the aggregate balance sheet value of each asset of the *firm* over which a third party has the right of *sale* or retention on default by the *firm* except:

(a) to the extent of any liability of the *firm* plus a reasonable margin in respect of the charged asset; or

(b) where the asset is collateral for a transaction which is subject to the *CRR* rules.

Contingent liabilities - General rule

3-77 **R** **A *firm* must calculate a *primary requirement* for each of its *contingent liabilities*.**

Deficiencies in subsidiaries - General rule

3-78 **R** **A *firm* must calculate the *primary requirement* for deficiencies in *subsidiaries* as an amount equal to any deficiency in shareholders' funds at any time of a *subsidiary* of the *firm* except to the extent that:**

(a) provision has already been made by the *firm*; or

(b) the *firm* has already calculated a liquidity adjustment or *CRR* because the deficiency arises or partially arises out of a liability of the *subsidiary* to the *firm*.

SECONDARY REQUIREMENT

Risk Profile

3-79(1) R **A *firm* must include in its secondary requirement any amount specified in any *requirement* to cover an unusual risk profile**

Operational risks

3-79(2) A *firm* must include in its secondary requirement any amount specified in any *requirement* to cover the inadequate management of operational risk to which a *firm* is exposed.

G In assessing whether to impose a *requirement* on a *firm* to cover an unusual risk profile or operational risks, the *FSA* will consider various criteria. In addition, the *FSA* will take into account material group risks to a *firm*, where these have not been captured in a group financial resources test. Secondary requirements may be applied, for example, where there has been a major failure on the part of a *firm* to maintain adequate controls, as a means of providing an additional capital buffer whilst these problems are addressed.

POSITION RISK REQUIREMENT

3-80 GENERAL PRINCIPLES OF PRR

Application

3-80(1) R Rules 3-80 to 3-169B apply to any *arranger* or *broad scope firm*, except a *venture capital firm* or a *corporate finance advisory firm*.

Obligation to calculate PRR *

3-80(2) R A *firm* must calculate a minimum *PRR* in respect of any position according to one of the methods available to it under the rules below, as appropriate, but may calculate a higher *PRR* in any other way at its option.

G Notwithstanding the methods available for calculating the *PRR*, a *firm* may, in respect of any individual position, calculate a *PRR* which is more conservative than that calculated under the appropriate rule. However, in that case, the *firm* will need to be able to demonstrate that, in all circumstances, the calculation being employed does give rise to a higher *PRR* for the position.

Frequency of calculation

3-80(3) R A *firm* must be able to monitor its *total PRR* on an intra-day basis and must re-calculate it in a full and detailed manner before executing any trade which is likely to increase it to such a level that the *firm's financial resources requirement* might exceed the *firm's financial resources*.

Marking to market

3-80(4) R A *firm* must *mark to market* its positions, whether or not on the balance sheet, in accordance with the valuation rule 3-41(9) at least once every *business day* and more frequently as appropriate.

Marketable investments

3-80(4A) R A *firm* must calculate the *PRR* for any position which is a *marketable investment* as 8% of the *mark to market* value of the position, other than in respect of a derivative (whatever the nature of the underlying instrument) or off balance sheet contract, when the *PRR* is 8% of the value of the notional position underlying the contract.

* For guidance notes as to which methods to apply, see **Appendix 20**

Non marketable investments

3-80(5) R A *firm* must calculate the *PRR* for any position which is not a *marketable investment* as 100% of the *mark to market* value of the position, other than in respect of a derivative (whatever the nature of the underlying instrument) or off balance sheet contract, when the *PRR* is 100% of the value of the notional position underlying the contract.

Instruments for which no PRA has been specified

3-80(6) R A *firm* must calculate the *PRR* for any on or off balance sheet position in a *marketable investment* for which no *PRA* is specified under the *PRR* rules as an appropriate percentage of the current *mark to market* value of any position or notional position underlying the contract and must notify the *FSA* of the terms of the instrument and the proposed *PRR* treatment.

3-80(6A) E (1) In 3-80(6) "an appropriate percentage" is:

(a) 100%; or

(b) A percentage which takes account of the characteristics of the instrument concerned and of discussions with the *FSA* or a predecessor regulator;

(2) Compliance with (1) may be relied on as tending to establish compliance with 3-80(6).

(3) Contravention of (1) may be relied on as tending to establish contravention of 3-80(6).

Group hedging arrangements

3-80(7) R A *firm* may amend its PRR to take account of a group hedging arrangement to which the *firm* **is party, provided the group hedging arrangement is recorded by an agreement in writing between all the relevant parties and the *firm* first notifies the *FSA* in writing of the terms of the arrangement and of the proposed amendment to the *PRR*.**

Alternative treatments

3-80(8) R Where a *firm* has the alternative of treating a position under two or more different methods or treatments within methods, it must treat the position under one of those methods.

Simpler approach to PRR calculation

3-80(9) R As a simpler approach to calculating *PRR*, a *firm* may calculate the *total PRR* by multiplying all positions in *marketable investments* by the relevant percentage stated in the table below and summing the results.

TABLE 3-80(9)
Position risk requirement - simpler approach

C: Stock positions in *physical commodities*

Stock positions in *physical commodities* associated with a *firm's investment business*	30% of realisable value

D: Certain *derivatives* and foreign exchange

Exchange traded futures and written *options*	4 x *initial margin requirement*
OTC futures and written *options*	Apply the percentage shown in C above to the *mark to market* value of the underlying position
Purchased *options*	Apply the percentage shown in C above to the *mark to market* value of the underlying position but the result may be limited to the *mark to market* value of the *option*
Contracts for differences	20% of the *mark to market* value of the contract
Foreign exchange exposure	10% of the net open long position

F: Other investments

Single premium unit linked bonds and units in a *regulated collective investment scheme*	50% of realisable value
Any other *investments*	100% of *mark to market* value of *investment* or underlying instrument
Notes	
	Percentage
1	A percentage means, unless otherwise indicated, a percentage of the *mark to market* value of the aggregate of the long and the short positions in the particular category.

	Netting	
2	The long or (short position) in a particular instrument is the net of any long or short positions held in that same instrument (i.e. a long position in ICI shares can be offset on a *share* for *share* basis against a short position in ICI shares) but positions in similar instruments (e.g. ICI shares against BP shares) cannot be offset in this way.	
	Stock positions in physical commodities	
3	A stock position in *physical commodities* is the *mark to market* value of the sum of -	
	(i)	commodities where the full contract price has been paid;
	(ii)	work in progress and finished goods which result from the processing of commodities; and
	(iii)	raw materials which will be combined with commodities to produce a finished processed commodity.
4	A stock position in *physical commodities* is regarded as being associated with a *firm*'s *investment business* if the contract associated with the *physical commodity* was made for *investment* rather than commercial purposes. Indications of this are -	
	(i)	the contract is *exchange traded* or
	(ii)	the performance of the contract is guaranteed by an *exchange* an *approved exchange* or a *clearing house*.

Models approach to PRR calculation

3-80(10) G A *firm* that wishes to use its internal model to calculate *PRR* in respect of all, or some, of its positions will need to apply for a modification or waiver of the relevant *FSA* rules.

G Further guidance on the criteria which such models must meet, and the review process, can be obtained from the *FSA*.

FOREIGN CURRENCY EXPOSURES AND FOREIGN CURRENCY DERIVATIVES METHODS

Summary of foreign currency exposures and derivatives methods

3-150 R **A *firm* must calculate an additional *PRR* under the *foreign currency exposures* or *foreign currency derivatives method* where it has any asset or liability or any off-balance sheet contract which is denominated in a currency other than the currency of its books of account. For these purposes, gold must be treated as another currency.**

3-151 Types of exposures to be treated as foreign currency exposures

General rule

3-151(1) R **A *firm* must apply the *foreign currency exposures* or *foreign currency derivatives method* to the following positions, identifying each currency separately including the currency of its books of account:**

(a) any currency *future* at the nominal value of the contract;

(b) any currency *option*;

(c) any forward contract for the purchase or *sale* at the contract value, including any future exchange of principal associated with cross-currency *swaps*, but excluding any purchase or *sale* of known but unaccrued future income or expense;

(d) any other balance sheet asset or liability; and

(e) any other off balance sheet commitment to purchase or sell an asset denominated in that currency.

Dual currency bonds

3-151(2) R **In respect of a *dual currency bond*, a *firm* must include within the *foreign currency exposures method* a notional *forward* contract:**

(a) for the purchase of the redemption currency derived from the *dual currency bond*, for an amount determined by reference to the terms of issue of the *dual currency bond*; or

(b) for the *sale* of the issue currency, for an amount equal to the *mark to market* value of the *dual currency bond*, with a deemed settlement date equal to the maturity of the bond.

Determining the currency of investments

3-151(3) R **For the purposes of determining the currency in which a position in an *investment* is denominated, a *firm* must apply the following principles:**

(a) where the price of an instrument is quoted in only one currency, a position in that instrument must be treated as an asset or liability in that currency;

(b) where the price of an instrument is quoted in more than one currency, a position in that instrument must be treated as an asset or liability in the currency in which the *firm* accounts for the instrument; and

(c) notwithstanding (a) and (b) above, a position in an American depository receipt or similar form of instrument must be treated as a position, translated at current spot rate, in the currency of the underlying instrument.

3-152 Application of *foreign currency exposures* and *derivatives* methods to foreign currency *derivatives*

Risk assessment models

3-152(1) G A *firm* may seek a modification or waiver from the *FSA* to use a risk assessment model in respect of its currency *options* to calculate notional positions which may be included in the *foreign currency exposures method*, provided the model forms part of the day to day management supervision of the *firm's options* business and meets other criteria (further guidance on the criteria for the approval of such models can be obtained from the *FSA*).

Obligatory use of foreign currency derivatives method

3-152(2) R A *firm* must apply the *foreign currency derivatives method* to any currency *option* which is less than 5% "*in the money*".

Optional use of foreign currency derivatives method

3-152(3) R Subject to (2) above, a *firm* may apply the *foreign currency derivatives method* to any *exchange traded* currency *option* or *future* instead of applying the *foreign currency exposures method*.

Obligatory use of foreign currency exposures method

3-152(4) R A *firm* must apply the *foreign currency exposures method* to any *OTC* currency *future*.

Calculation of "in the money"

3-152(5) R For the purposes of this rule, a *firm* must determine the extent to which the *option* contract is "in the money" by reference to the difference between the exercise price and the current forward rate for the final date on which the *option* may be exercised as a percentage of that forward rate.

3-153 Foreign currency derivatives method

Exchange traded futures and options

3-153(1) R (a) A *firm* must calculate the *PRR* of an *exchange traded* foreign currency *future* or *option* as 100% of the *initial margin requirement* of the *exchange* or *approved exchange* or, where the *initial margin requirement* is zero, under (2) below.

(b) Where the *exchange* or *approved exchange* calculates the margin requirement on an overall basis, the *PRR* must equal that margin requirement.

(c) Where the *exchange* offsets *futures* and *options* in the margin calculations, the *firm* may take into account such offsetting.

OTC foreign currency options

3-153(2) R A *firm* must calculate the *PRR* of an *OTC* foreign currency *option* as 5% of the nominal value of the contract, adjusted as follows:

(a) long position: the *PRR* may be restricted to the *mark to market* value of the *option*; and

(b) short position: the *PRR* may be reduced (but to no less than zero) by any excess of the exercise value over the *mark to market* value for a *call option* or vice versa for a *put option*.

3-154 Foreign currency exposure method

Application

3-154(1) R A *firm* must apply the *foreign currency exposure method* to any foreign currency exposure for which the *firm* has not calculated a *PRR* under the *foreign currency derivatives method*.

Calculation of PRR

3-154(2) R A *firm* must calculate a *PRR* for its *foreign currency exposures* as 5% of the aggregate of its net open long positions in each currency, including the currency of the *firm's* books of account when this is a long open position.

Calculation of net open position

3-154(3) R (a) A *firm* must calculate a net open position for all currencies including the currency of the *firm's* books of account by netting all *foreign currency exposures* to which the method applies.

(b) **The net open position for the currency of the *firm's* books of account may be calculated as the difference between the aggregate net open long positions and aggregate net open short positions of all other currencies.**

COMMODITIES METHOD

Types of positions to be included in the commodities method

3-166 General rule

3-166(1) R **A *firm* must calculate *PRR* on all positions in commodities in accordance with one of the four approaches set out in rules 3-167 to 3-169A. All spot, physical trading, *derivative* and other off balance sheet items whose price is affected by changes in commodities prices must be included in the calculation.**

G In general, a commodity is a physical product which is or can be traded on the secondary market. Commodities include precious metals (except gold, which is to be treated as a foreign currency), agricultural products, minerals and base metals, oil and other energy products.

3-166(2) R **A *firm* must calculate the *PRR* for each commodity separately, except that:**

(a) different sub-categories of the same commodity that are deliverable against each other may be treated together; and

(b) commodities which are close substitutes for each other, and whose price movements over a minimum period of one year can be shown by the *firm* to exhibit a stable and reliable correlation of at least 0.9, may be treated together.

G The onus is on the *firm* to show that the correlation referred to in (b) above exists on a continuing basis.

3-166(3) R (a) **Positions which are purely stock financing may be omitted from the calculation of *PRR* on commodities positions under rule 3-166 and a *firm* may net notional long and short government *securities* arising from *swaps*, *FRAs*, *futures* and *options* on interest rates and debt *securities,* cash borrowings, *qualifying deposits*, the cash legs of "repurchase or similar agreements", forward foreign exchange and foreign currency futures against each other, provided:**

(i) they are in the same currency;

(ii) the interest rates are within 15 basis points;

(iii) (aa) if the maturity dates are less than one month, the dates are the same;

(bb) if the maturity dates are between one month and one year, the dates are within seven days of each other; or

(cc) if the maturity dates are over one year, the dates are within 30 days of each other;

(iv) for a cash borrowing, the next interest rate refix date is within two years and repayment is within two years; and

(v) for a *qualifying deposit*, the next interest rate refix date is within three months.

(b) In respect of a cash borrowing or *qualifying deposit*, the maturity date is the earlier of the re*payment date* and the next interest rate refix date.

(c) "Repurchase or similar agreement" means a *repurchase*, *reverse repurchase*, *securities* or *physical commodities* lending, *securities* or *physical commodities* borrowing, *sale and buy back*, *buy and sale back*, *undocumented sale and buy back*, or *undocumented buy and sale back agreement*.

G Stock financing is defined under the *Capital Adequacy Directive*. Where physical stock has been sold forward, the cost of funding must be locked in until the date of the forward *sale*.

3-167 Simplified approach

3-167(1) R All positions in commodities or commodity *derivatives* must be expressed in terms of the standard unit of measurement for that commodity (such as tonnes, barrels or kilos).

3-167(2) R A *firm* must multiply the position in each commodity by the current spot price for the commodity converted to the *firm*'s reporting currency at current spot rates, and calculate the *PRR* as the sum of:

(a) **the overall net position multiplied by 15%; and**

(b) **the gross position multiplied by 3%.**

3-167(3) R A *firm* must sum the results for each commodity to arrive at the total *PRR* for positions treated under the simplified approach.

3-168 Maturity ladder approach

3-168(1) R All positions in each commodity or commodity *derivatives* must be expressed in terms of the standard unit of measurement for that commodity (such as tonnes, barrels or kilos) or in terms of value. A *firm* must allocate net positions on any given day to the appropriate maturity band in the table below. Physical stock must be assigned to the first band.

Table 3-168

Maturity Bands for Maturity Ladder Approach	
0-1 month	1-2 years
1-3 months	2-3 years
3-6 months	over 3 years
6-12 months	

3-168(2) R A *firm* may then offset long and short positions within and between maturity bands in accordance with the following:

(a) For markets which have daily delivery dates, a *firm* may offset contracts in the same commodity against each other provided that the expiry dates are within 10 *business day*s of each other.

(b) For each maturity band, the *firm* must sum all the open long positions, and sum all the open short positions. The *firm* may then subtract the shorts from the longs to form the overall net position. The amount subtracted is the "matched amount". The *firm* must multiply twice the matched amount by the spread rate of 1.5%, and then by the spot price for the commodity to arrive at the spread risk charge.

G If the total of all longs in a maturity band is 100, and the total of all shorts is 75, the "matched amount" is 75 and the overall net position 25. Algebraically, if the total of all longs is A, and the total of all shorts is -B, the "matched amount" is min{A,B}, and the overall net position is A-B.

(c) The *firm* may then carry backwards or forwards all or part of the overall net position within a band to an adjacent maturity band for further netting allowances. Where this is the case, the *firm* must calculate:

(i) a carry charge by multiplying the amount carried by the carry rate of 0.6%, and

(ii) a spread charge, in accordance with (b) above, where the carried position is matched against a position in an adjacent maturity band.

The *firm* may repeat the procedure for carrying positions through to other maturity bands as appropriate. An additional carry charge and spread charge must be calculated at each stage of the process.

(d) The *firm* must multiply any positions remaining after the permitted offsetting by the outright rate of 15%, and then by the spot price of the commodity to arrive at the outright charge.

(e) The total *PRR* for each commodity is the sum of the spread risk charge, the carry charge, and the outright charge converted to the *firm's* reporting currency at current spot rates.

Extended maturity ladder approach

3-169 R A *firm* may adopt the same approach as that outlined under rule 3-168(2), but apply the rates in the table below, if the *firm*:

(a) **undertakes significant commodities business, and**

(b) **has a diversified commodities portfolio.**

Table 3-169

	Precious metals	**Base metals**	**Soft commodities**	**Other commodities**
Spread rate %	1.0	1.2	1.5	1.5
Carry rate %	0.3	0.5	0.6	0.6
Outright rate %	8.0	10.0	12.0	15.0

Models approach

3-169A G A *firm* may seek a modification or waiver from the *FSA* to use a VaR model as the basis for calculating the *PRR* on its commodity positions.

G The *FSA* will grant a modification or waiver permitting the use of a VaR model only where a number of qualitative and quantitative standards are met. In assessing the VaR model the *FSA* will have regard to the the matters set out in *BIPRU* 7.10.

3-169B Options

Proprietary options pricing models

3-169B (1) G A *firm* may seek a modification or waiver from the *FSA* permitting it to use its proprietary *options* pricing model to calculate the *PRR* on *options* positions and their related hedges. The application for a modification or waiver may request that the *firm* be permitted to include an *option* in the maturity ladder approach.

G A *firm* may propose any methodology that it believes will capture spread, carry and outright risks and that reflects its own day-to-day risk management. A *firm* is strongly advised to contact the *FSA* at the earliest point if it is considering introducing a model or adapting an existing one.

No models

3-169B (2) R A *firm* may only include an *option* in the maturity ladder approach, the extended maturity ladder approach or the simplified approach if it is in the money by more than the appropriate outright rate. Such *options* must be included as a position in the underlying commodity, of an amount equal to the "tonnage" underlying the *option* (long or short as appropriate), and with a maturity equal to the expiry date of the spot, *forward* or *futures* contract underlying the *option*.

3-169B (3) R An *option* which does not satisfy the condition in rule 3-169B(2) attracts a *PRR* in accordance with the following:

(a) In the case of a purchased *option*, the *PRR* must be the *mark to market* value of the full position underlying the *option* multiplied by the appropriate outright rate, but the result may be limited to the *mark to market* value of the *option*.

(b) In the case of a written *option*, the *PRR* must be the *mark to market* value of the full position underlying the *option* multiplied by the appropriate outright rate, reduced by the out-of-the-money amount. The *PRR* must be limited to zero if the calculation results in a negative number.

G The out-of-the-money amount is any excess of the exercise value over the *mark to market* value of the underlying commodity in the case of a *call option*, or vice versa for a *put option*.

COUNTERPARTY RISK REQUIREMENT

3-170 GENERAL PRINCIPLES OF CRR

Application

3-170(1) R (a) Rules 3-170 to 3-182 apply to a *broad scope firm*, except a *venture capital firm* which is subject only to rules 3-180 to 3-182.

(b) Rules 3-180 to 3-182 apply to an *arranger*, except a *corporate finance advisory firm*.

General rule

3-170(2) R A *firm* must calculate its total *CRR* on exposures to *counterparties* as the sum of all the amounts calculated in accordance with the rules referred to in the table below.

R Table 3-170(2) - Counterparty Risk Requirement

Rules

3-171	Cash against documents transactions
3-173	Free deliveries of physical securities and commodities
3-173A	Derivatives transactions
3-175	Concentrated risk to one counterparty
3-176	Repurchase and reverse repurchase, securities lending and borrowing and sale and buy back agreements
3-177	Money brokers
3-178	Options purchased for a counterparty
3-180	Qualifying and other deposits
3-181	Loans to counterparties
3-182	Other amounts owed to a firm arising out of investment business or investment dealing activities

Frequency of calculation

3-170(3) R A *firm* must calculate its *CRR* at least once each *business day*; for the purposes of the relevant calculations the *firm* may use prices of *investments* and *physical commodities* as at the close of business on the previous day.

Negative amounts

3-170(4) R A *firm* must not include any *CRR* if it is a negative amount.

Instruments for which no CRR has been specified

3-170(5) R Where a *firm* is in doubt as to the classification of an item for the purposes of *CRR*, the *firm* must add to its *CRR* an appropriate part of the exposure on the item concerned and must immediately notify the FSA in writing of details of the transaction, the counterparty and the proposed *CRR* treatment.

3-170(5A) E (1) In 3-170(5) "an appropriate part" is:

(a) the whole; or

(b) A proportion which takes account of the characteristics of the transaction and the counterparty concerned, and of discussions with the *FSA* or a predecessor regulator.

(2) Compliance with (1) may be relied on as tending to establish compliance with 3-170(5).

(3) Contravention of (1) may be relied on as tending to establish contravention of 3-170(5).

Provisions

3-170(6) R A *firm* may reduce the exposure on which its *CRR* is calculated to the extent that it makes provision for a specific *counterparty* balance.

Connected companies

3-170(7) R For the avoidance of doubt, a *firm* must calculate a *CRR* as appropriate on exposures to or from *connected companies*.

Basis of valuation

3-170(8) R For the purposes of valuing instruments and *physical commodities* at market value in the calculation of *CRR*, a *firm* must be consistent in the basis it chooses and may use either mid market value or bid and offer prices (as appropriate).

Acceptable collateral

3-170(9) R A *firm* may reduce the exposure to a *counterparty* on which its *CRR* is calculated to the extent that it holds *acceptable collateral* from that *counterparty*.

Nil weighted counterparty exposures

3-170 (10) R A *firm* may disregard any *counterparty* exposure calculated in accordance with rules 3-171 to 3-182, if the *counterparty* is or the contract is guaranteed by or is subject to the full faith and credit of a sovereign government or province or state thereof (or a corporation over 75% owned by such government, province or state), which is a member of the *OECD* and the government, province, state or corporation has not defaulted, or entered into any rescheduling or similar arrangement, or announced the intention of so doing, in respect of itself or its agency's debt within the last five years.

Netting

3-170 (11) R A *firm* which has offsetting exposures in similar types of transactions with a *counterparty* may offset these in accordance with rules 3-171(2A), 3-173(2A), 3-173A(3), 3-176(3), 3-180(2A), 3-181(1) and 3-182(4A) when calculating *CRR* if it has a contractual netting agreement with that *counterparty*, which:

(a) covers the transactions which the *firm* is seeking to net;

(b) creates a single obligation in each currency or a single overall obligation to pay (or receive) a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;

(c) does not include a *walkaway clause*;

(d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the *firm's* exposure to be the single net amount mentioned in (b) above.

G Legal opinions should relate to:

(a) the law of the jurisdiction in which the *counterparty* is organised;

(b) the law of the jurisdiction in which any branch involved is located;

(c) the law that governs the agreement and, if different, the law that governs individual transactions pursuant to it; and

(d) the law that governs the legal status of the *counterparty* who is entering into transactions of the type which the *firm* is seeking to net.

G Where a *firm* uses an industry standard agreement and the *firm's* netting/set-off clauses follow the form of that standard agreement, provided a legal opinion has already been obtained on the standard agreement which addresses the capacity of *counterparties* of the type with which the *firm* wishes to contract, that may be relied upon.

G Legal opinions on netting agreements should be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable. Where the regulator of the *counterparty* is not satisfied that the netting agreement is enforceable under its laws, the netting agreement cannot be relied upon regardless of the opinions obtained by the *firm*.

3-171 Cash against documents transactions

General rule

3-171(1) R A *firm* which enters into a transaction on a cash against documents basis must calculate the *counterparty* exposure for transactions still unsettled 16 calendar days after *settlement day* as set out in (2) below and must then multiply this by the appropriate percentage set out in the table below to calculate a *CRR* for each separate unsettled transaction.

R **Table 3-171(1) - Percentage to be applied to the counterparty exposure**

Calendar days after settlement day	**Percentage**
0 – 15	Nil
16 – 30	25%
31 – 45	50%
46 – 60	75%
Over 60	100%

Counterparty exposure calculation

3-171(2) R (a) Where a *firm* has neither delivered *securities* or *physical commodities* nor received payment when purchasing *securities* or *physical commodities* for, or selling *securities* or *physical commodities* to, a *counterparty*, the positive *counterparty* exposure is the excess of the contract value over the market value of the *securities* or *physical commodities*.

(b) Where a *firm* has neither received *securities* or *physical commodities* nor made payment when selling *securities* or *physical commodities* for, or purchasing *securities* or *physical commodities* from, a *counterparty*, the positive *counterparty* exposure is the excess of the market value over the contract value of the *securities* or *physical commodities*.

Netting

3-171 (2A) **R** **A *firm* may offset positive and negative *counterparty* exposures, calculated in accordance with (2) above, before it multiplies the residual exposure by the appropriate percentage in Table 3-171(1) provided that:**

(a) the exposures arise on transactions with the same *counterparty*; and

(b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).

Sub-total

3-171(3) **R** **The sum of the amounts calculated in accordance with (1) above is the *firm's* total *CRR* for cash against documents transactions.**

3-173 Free deliveries of physical commodities and securities

General rule

3-173(1) **R** **When a *firm* makes delivery to a *counterparty* of *physical commodities* or *securities* without receiving payment or pays for *securities* without receiving the certificates of good title, the *firm* must calculate the *free delivery* value for each transaction.**

Free delivery value calculation

3-173(2) **R** **A *firm* must calculate the *free delivery* value for each transaction as set out below and multiply this value by the appropriate percentage in Table 3-173(2) A for free deliveries of *physical commodities* and Table 3-173 (2) B for free deliveries of *securities* as follows:**

(a) if the *firm* has delivered *physical commodities* or *securities* to a *counterparty* and has not received payment, the *free delivery* amount is the full amount due to the *firm* (i.e. the contract value);

(b) if the *firm* has made payment to a *counterparty* for *securities* and not received the certificates of good title, the *free delivery* amount is the market value of the *securities*; and

(c) if a *firm* pays for *physical commodities* without receiving delivery or *documents of title* the exposure is to be treated as an unsecured loan to which rule 3-181 applies.

R Table 3-173(2)A - Percentage to be applied to free deliveries relating to physical commodities

	Nature of counterparty to whom free delivery is made	**Business days since delivery**		
1	*Firm* does not have an *ACMP* and delivery of *physical commodities* is made	0 - 3	4 - 15	earlier of 15 days or agreed contractual payment date
		15%	100% of contract value	100% of contract value
2	*Firm* has an *ACMP* and delivery of *physical commodities* is made with a *settlement day* longer than three days from delivery date	15% of contract value		100% of contract value

R **Table 3-173(2)B - Percentage to be applied to free deliveries relating to securities**

	Nature of counterparty to whom free delivery is made	Business days since delivery		
		0 - 3	4 – 15	over 15
1	A *counterparty* to whom *securities* have been delivered or to whom payment for *securities* has been made	nil	100% of contract or market value	100% of contract or market value
2	A *regulated financial institution* or *regulated banking institution* to whom *securities* have been delivered or payment made with the expectation that market practice will result in a *settlement day* longer than three days from delivery date	15% of contract or market value		100% of contract or market value
2A	A *counterparty* to whom *securities* have been delivered which settle through the Crest system or to whom payment for such *securities* has been made	15% of contract or market value		100% of contract or market value
3	A manager, underwriter, sub-underwriter or member of a selling syndicate or issuer to whom payment for *securities* has been made; or a manager of a *regulated collective investment scheme* to whom units of the scheme have been delivered or payment for units of the scheme has been made	nil		100% of contract or market value or, if the issue is in one of the countries specified in Appendix 46, 15% of contract or market value until the end of the period referred to in that Appendix

Netting

3-173 (2A) R **A *firm* may reduce the *free delivery* value for a transaction calculated in accordance with (2) above, before it multiplies the residual exposure by the appropriate percentage in Table 3-173(2)A or B, by:**

(a) the value of any free payment received from the *counterparty*; or

(b) the contract value of any *securities* received free from the *counterparty*,

provided that:

(i) the exposures arise on transactions with the same *counterparty*; and

(ii) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).

Partners and connected persons

3-173(3) R For the purpose of this rule, a *firm* must treat any amount due from a partner or his *connected person* in respect of *investment business* as a *free delivery* to a *counterparty*.

Sub-total

3-173(4) R The sum of the amounts calculated in accordance with (1), (2) and (3) above is the *firm's* total *CRR* for free deliveries of *physical commodities* and *securities*.

3-173A Derivative transactions

General rule

3-173A (1) R A *firm* must calculate for each *derivative* transaction a *CRR* either:

(a) by multiplying the *counterparty* exposure calculated in accordance with (2) and (3) below by the appropriate percentage in Table 3-173A(4)A or B, except for single premium *options* purchased on behalf of a *counterparty* and *traditional options* purchased for the *firm's* own account or on behalf of a *counterparty*, which shall be subject to rule 3-178; or

(b) after notifying the *FSA* in writing, in accordance with rule 3-173B.

Counterparty exposure

3-173A (2) R A *firm* must calculate the *counterparty* exposure on *derivative* transactions in accordance with either (a) or (b) below:

(a) where a *counterparty* has not fully paid an *initial margin requirement* or *variation margin requirement* on a transaction in a *derivative* listed on an *exchange* or *approved exchange* or met it through the deposit of *acceptable collateral* not otherwise used, the *firm* must calculate the *counterparty* exposure as the shortfall;

(b) where the *counterparty* exposure arising from a transaction in a *derivative* is not listed on an *exchange* or *approved exchange*, the *counterparty* exposure is the credit equivalent amount calculated in accordance with Table 3-173A(2A).

R Table 3-173A(2A) – Method of calculating credit equivalent amount

Type of derivative transaction	Credit equivalent amount	
	If A is positive	**If A is negative**
Interest rate swaps: single currency		
(a) floating rate swapped against floating rate	A	nil
(b) fixed rate swapped against floating rate:		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
Cross-currency interest rate swaps		
- under one year to maturity	A + 1% of N	1% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Other interest rate contracts*		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
Foreign exchange and gold contracts*		
- exchange rate contracts with an original maturity of 14 days or less	nil	nil
- under one year to maturity	A + 1% of N	1% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Equity contracts*		
- under one year to maturity	A + 6% of N	6% of N
- over one year to five years	A + 8% of N	8% of N
- over five years	A + 10% of N	10% of N
Precious metal (not gold) contracts*		
- under one year to maturity	A + 7% of N	7% of N
- over one year to five years	A + 7% of N	7% of N
- over five years	A + 8% of N	8% of N
Commodity contracts*		
- under one year to maturity	A + 10% of N	10% of N
- over one year to five years	A + 12% of N	12% of N
- over five years	A + 15% of N	15% of N
Notes *FRAs*, *swaps*, *futures*, purchased *options*, and other *contracts for differences* A = the replacement cost of the contract N = the notional or actual principal amount underlying the contract		

For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract.

In the case of a derivative referenced on a bond which satisfies the criteria for a *qualifying debt security,* the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.

For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.

R If a *firm* uses the extended maturity ladder approach to calculate *PRR* under rule 3-169, it may use Table 3-173A(2B).

R Table 3-173A(2B) – Method of calculating credit equivalent amount for commodities

Type of derivative transaction*	**Credit equivalent amount**	
	If A is positive	**If A is negative**
Precious metals (except gold)		
- under one year to maturity	A + 2% of N	2% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Base metals		
- under one year to maturity	A + 2.5% of N	2.5% of N
- over one year to five years	A + 4% of N	4% of N
- over five years	A + 8% of N	8% of N
Softs (agricultural)		
- under one year to maturity	A + 3% of N	3% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 9% of N	9% of N
Other commodity		
- under one year to maturity	A + 4% of N	4% of N
- over one year to five years	A + 6% of N	6% of N
- over five years	A + 10% of N	10% of N

Notes

FRAs, *swaps*, *futures*, purchased *options*, and other *contracts for differences*

A = the replacement cost of the contract

N = the notional or actual principal amount underlying the contract

For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract.

In the case of a derivative referenced on a bond which satisfies the criteria for a *qualifying debt security,* the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.

For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.

Netting

3-173A (3) R A *firm* may offset *counterparty* exposures arising on *derivative* transactions calculated in accordance with (2) above before it multiplies the residual exposure by the appropriate *CRR* percentage as follows:

(a) variation margin payable to a *counterparty* against an *initial margin requirement* or *variation margin requirement* receivable from a *counterparty*;

(b) variation margin payable to a *counterparty* against a positive "A" as calculated in accordance with Table 3-173A(2A);

(c) a negative "A" as calculated in accordance with Table 3-173A(2A) against an *initial margin requirement* or *variation margin requirement* receivable from a *counterparty*;

(d) a negative "A" against a positive "A" in each case as calculated in accordance with Table 3-173A(2A);

(e) losses on a closed out *derivative* transaction which has not been settled against variation margin payable to a *counterparty*; or

(f) losses on a closed out *derivative* transaction which has not been settled against negative "A" calculated in accordance with Table 3-173A(2A),

(g) profit on a closed out *derivative* transaction which has not been settled against an *initial margin requirement* or *variation margin requirement* receivable from a *counterparty*;

(h) profit on a closed out *derivative* transaction which has not been settled against a loss on a closed out *derivative* transaction;

(i) profit on a closed out *derivative* transaction which has not been settled against a positive "A" as calculated in accordance with Table 3-173A(2A);

(j) premium receivable in respect of written *options* against variation margin payable, initial margin payable or a closed out profit payable to the *counterparty* or a negative "A" as calculated in accordance with Table 3-173A(2A);

(k) positive "A" on purchased *options* calculated in accordance with Table 3-173A(2A) against negative "A" on written *options*; or

(l) in the case of *perfectly matched contracts* these may be treated as a single contract with a notional principal equivalent to the net receipts; or

(m) where transactions are subject to (3)(c) above, the potential future credit exposures (PFCE) on transactions with the same *counterparty* (i.e. % on N) may be netted in accordance with Table 3-173A(3) below,

provided that:

(i) the exposures arise on transactions with the same *counterparty*; and

(ii) the *firm* has a written agreement, supported by a legal opinion obtained in accordance with rule 3-170(11).

Table 3-173A(3)

The netted PFCE is the sum of:	
step one	**40% of gross PFCE**
step two	**60% of gross PFCE multiplied by the net-to-gross ratio (NGR)**
Notes: **NGR =** $\dfrac{\textbf{(net replacement cost)}}{\textbf{(gross replacement cost)}}$ **The NGR must be calculated on all contracts included in a legally valid bilateral netting agreement with a given *counterparty*.**	

CRR percentages

3-173A (4) **R** **(a) Where a *firm* does not offset *counterparty* exposures arising on *derivative* transactions in accordance with (3) above, it must multiply the *counterparty* exposure by the appropriate percentage from:**

(i) Table 3-173A(4)A if the *counterparty* exposure arises on a transaction in a *derivative* listed on an *exchange* or *approved exchange*; or

(ii) Table 3-173A(4)B if the *counterparty* exposure arises on a transaction in a *derivative* not listed on an *exchange* or *approved exchange*,

but may opt to calculate *CRR* using the highest available credit percentage in Tables 3-173A(4)A or B below in order to avoid undue complication.

(b) Where a *firm* does offset *counterparty* exposures on *derivative* exposures in accordance with (3) above, it must multiply the residual net *counterparty* exposure by the appropriate percentage from Table 3-173A(4)A or B.

(c) A *firm* may opt to calculate the *CRR* using the highest available *CRR* percentage in the tables below in order to avoid undue complication.

Table 3-173A(4)A - CRR percentages for transactions in derivatives listed on an exchange or approved exchange

Counterparty		**Business days since exposure occurred**	
		0 - 3	over 3
1	*Firm* has an *ACMP* and *counterparty* is not a *market counterparty*	10%	10%
2	*Firm* has an *ACMP* and *counterparty* is a *market counterparty*	5%	5%
3	*Firm* does not have an *ACMP*	10%	100%

Table 3-173A(4)B - CRR percentages for transactions in derivatives not listed on an exchange or approved exchange

	Status of the counterparty	%
1	A *firm*, a *supranational organisation*, a United Kingdom discount house, a gilt edged market maker, a *stock exchange money broker*, a *regulated banking institution*, a building society under the Building Societies Act 1986, a United Kingdom local authority, a *regulated financial institution*.	2%
2	Any other *counterparty*	5%

Exposures to locals

3-173A (5) R **A *firm* must calculate a 100% *CRR* for amounts of initial and variation margin not met with *acceptable collateral* or a positive *equity balance* owed to a *firm* by a *local* in respect of transactions in *derivatives* listed on an *exchange* or *approved exchange* from the date of any shortfall. However, a *firm* may use an alternative treatment if it:**

(a) participates in the profits or losses of the *local* for 25% or more when the *firm* may include the *local* position in its own position which will then be subject to *PRR*; or

(b) calculates *PRR* for *locals* in which case its requirement will be the sum of the following:

(i) 10% of the *PRR* result for each *local*; and

(ii) the excess over the "net liquidating balance" of the *PRR* applied to the positions of each *local*; and

(c) for the purposes of (b) above, "net liquidating balance" means the cash amount which would remain in a *local* account if all positions were liquidated and there were added (1) cash balances (2) the value of *marketable investments*, and (3) letters of credit and guarantees issued by a *regulated banking institution* which is not the *counterparty* or an *associate* of the *counterparty* in the control of the *firm*; and there were deducted all loans and overdrafts from, and other liabilities to the *firm*; and to the extent that a *firm* includes an exposure in the net liquidating balance calculation, it does not also need to apply the liquidity adjustment in rule 3-75 or the *CRR* to those exposures.

Sums due for payment or owed on closed out derivative transactions

3-173A (6) R **When a *counterparty* has not fully met amounts owed to a *firm* arising out of losses on closed out *derivative* transactions by depositing, *acceptable collateral* or, has not fully settled amounts owed in respect of periodic or final settlement of transactions, a *firm* must calculate a *CRR* equal to the amount outstanding after three days, unless:**

(a) the *firm* has offset the amount owed against variation margin payable in accordance with (3)(e) above; or

(b) the *firm* has offset the amount owed against a negative "A" in accordance with (3)(f) above,

in which case the *firm* must calculate a *CRR* equal to the residual amount outstanding after three days.

Equivalent contracts

3-173A (7) R **Rule 3-173A(2)(b) also applies to contracts which, although they are listed on an *exchange* or *approved exchange*, are fully dependent upon the issuer for performance (e.g. covered *warrants*).**

Regulated connected companies

3-173A (8)	**R**	**Where a *firm* carries out significant *swaps* business with a *connected company* which has adequate regulation applied to it, the *firm* need not comply with all or part of rule 3-173A so far as it applies to interest rate or foreign exchange *swaps* with that *connected company*, provided that it has given prior written notice of this to the *FSA*.**
		Sub-total
3-173A (9)	**R**	**The sum of the amounts calculated in accordance with this rule is the *firm's* total *CRR* for *derivative* transactions other than those subject to rule 3-178.**
3-173B		CRR for derivative transactions under 3-173A(1)(b)
		General rule
3-173B(1)	**R**	**A *firm* must calculate for each *derivative* transaction a *CRR* by multiplying the *counterparty* exposure calculated in accordance with (2) and (3) below, by the appropriate percentage in Table 3-173B(5) below.**
		Collateral
3-173B(2)	**R**	**A *firm* may:**
		(a) reduce the *counterparty* exposure on which its *CRR* is calculated to the extent that it holds *acceptable collateral* to cover that exposure; and
		(b) where it does not have an *ACMP,* may continue to multiply the *counterparty* exposure by 8% multiplied by the *counterparty* weight, to the extent that the *firm* holds *adequate collateral* to cover that exposure.
		Counterparty exposure
3-173B(3)	**R**	**A *firm* must calculate the *counterparty* exposure on *derivative* transactions in accordance with either (a), (b) or (c) below:**
		(a) where a *counterparty* has not fully paid a *margin requirement* on a *derivative* transaction listed on an *exchange* or cleared through a *clearing house,* or met it through the deposit of *acceptable collateral* not otherwise used, a *firm* must calculate the *counterparty* exposure as the shortfall;
		(b) where a *firm* sells or writes an *option* to a *counterparty* or buys an *option* on behalf of a *counterparty* and the *counterparty* has not paid the full *option* premium, or met it through the deposit of *acceptable collateral* not otherwise used, it must calculate the *counterparty* exposure as the uncovered premium on the transaction; or

(c) a *firm* must calculate the *counterparty* exposure arising from a *derivative* transaction other than a written or sold *option* or a *derivative* transaction listed on an *exchange* or cleared through a *clearing house*, as the credit equivalent amount calculated in accordance with Table 3-173B(3A), not covered by the deposit of *acceptable collateral* not otherwise used.

R Table 3-173B(3A) – Method of calculating credit equivalent amount

Type of derivative transaction	Credit equivalent amount	
	If A is positive	If A is negative
Interest rate swaps: single currency		
(a)floating rate swapped against floating rate A nil	A	nil
(b)fixed rate swapped against floating rate:		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
Cross-currency interest rate swaps		
- under one year to maturity	A + 1% of N	1% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Other interest rate contracts*		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
Foreign exchange and gold contracts*		
- exchange rate contracts with an original maturity of 14 days or less	nil	nil
- under one year to maturity	A + 1% of N	1% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Equity contracts*		
- under one year to maturity	A + 6% of N	6% of N

- over one year to five years	A + 8% of N	8% of N
- over five years	A + 10% of N	10% of N
Precious metal (not gold) contracts*		
- under one year to maturity	A + 7% of N	7% of N
- over one year to five years	A + 7% of N	7% of N
- over five years	A + 8% of N	8% of N
Commodity contracts*		
- under one year to maturity	A + 10% of N	10% of N
- over one year to five years	A + 12% of N	12% of N
- over five years	A + 15% of N	15% of N

Notes

* *FRAs*, *swaps*, *futures*, purchased *options*, and other *contracts for differences*

A = the replacement cost of the contract

N = the notional or actual principal amount or value underlying the contract

For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract.

In the case of a derivative referenced on a bond which satisfies the criteria for a *qualifying debt security,* the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.

For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.

If a *firm* uses the modified maturity ladder approach to calculate *PRR*, it may use Table 3-173B(3B).

R Table 3-173B(3B) – Method of calculating credit equivalent amount for commodities

Type of derivative transaction*	Credit equivalent amount	
	If A is positive	If A is negative
Precious metals (except gold)		
- under one year to maturity	A + 2% of N	2% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Base metals		
- under one year to maturity	A + 2.5% of N	2.5% of N
- over one year to five years	A + 4% of N	4% of N
- over five years	A + 8% of N	8% of N
Softs (agricultural)		
- under one year to maturity	A + 3% of N	3% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 9% of N	9% of N
Other commodity		
- under one year to maturity	A + 4% of N	4% of N
- over one year to five years	A + 6% of N	6% of N
- over five years	A + 10% of N	10% of N
Notes *FRAs*, *swaps*, *futures*, purchased *options*, and other *contracts for differences* A = the replacement cost of the contract N = the notional or actual principal amount or value underlying the contract For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract. In the case of a derivative referenced on a bond which satisfies the criteria for a *qualifying debt security,* the %N applicable to interest rate		

derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives. For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.

Sums due for payment or owed on closed out derivative transactions

3-173B(4) R **When a *counterparty* has not fully met amounts owed to a *firm* arising out of losses on closed out *derivative* transactions through the deposit of *acceptable collateral* not otherwise used, or has not fully settled amounts owed in respect of periodic or final settlement of transactions, a *firm* must calculate *CRR* equal to the unpaid loss multiplied by the appropriate percentage from the Table 3-173B(5) below.**

3-173B(4A) R **In the case of a failed FX transaction (whether originally contracted for *forward* settlement, or undertaken in the spot market) where the *firm* has released funds to its *counterparty*, but has not received the funds in the alternative currency, the *CRR* must be calculated as the gross value of the funds not received, multiplied by the appropriate percentage from Table 3-173B(5) below.**

CRR percentages

3-173B(5) R **A *firm* must multiply the *counterparty* exposure by the appropriate percentage from the table below, but:**

(a) may opt to calculate *CRR* using the highest available credit percentage in the table below in order to avoid undue complication; and

(b) may reduce the *counterparty* weight applicable to *counterparty* exposures calculated in accordance with (3)(c) above to 50%, where the *counterparty* would normally attract a *counterparty* weight of 100% in accordance with Table 1 in Appendix 47.

R TABLE 3-173B(5) - CRR percentages

Type of contract	Nature of *counterparty* to whom *counterparty* exposure exists	Business days after *counterparty* exposure first occurred	
		0 - 5	6 or more
Failed FX transactio n	Any	8% x *counterparty* weight*	100%
Other	A *counterparty* granted a credit line under an *ACMP*	8% x *counterparty* weight*	
	A *counterparty* not granted a credit line under an *ACMP*	8% x *counterparty* weight*	100%

Netting

3-173B(6) R **A *firm* may offset *counterparty* exposures arising on *derivative* transactions calculated in accordance with (2), (3) and (4) above before it multiplies the residual exposure by the appropriate *CRR* percentage as follows:**

(a) variation margin payable to a counterparty against an initial *margin requirement* or variation *margin requirement* receivable from a counterparty;

(b) variation margin payable to a counterparty against a positive "A" as calculated in accordance with Table 3-173B(3A);

(c) a negative "A" as calculated in accordance with Table 3-173B(3A) against an initial *margin requirement* or variation *margin requirement* receivable from a counterparty;

(d) a negative "A" against a positive "A" in each case as calculated in accordance with Table 3-173B(3A);

(e) loss on a closed out *derivative* transaction which has not been settled against variation margin payable to a counterparty;

(f) loss on a closed out *derivative* transaction which has not been settled against negative "A" calculated in accordance with Table 3-173B(3A);

(g) profit on a closed out *derivative* transaction which has not been settled against an initial *margin requirement* or variation *margin requirement* receivable from a *counterparty*;

(h) profit on a closed out *derivative* transaction which has not been settled against a loss on a closed out *derivative* transaction;

(i) profit on a closed out *derivative* transaction which has not been settled against a positive "A" as calculated in accordance with Table 3-173B(3A);

(j) premium receivable in respect of written *options* against variation margin payable, initial margin payable or a closed out profit payable to the counterparty or a negative "A" as calculated in accordance with Table 3-173B(3A);

(k) where the *firm* has received the premium due for a written *option*, a negative "A" (the replacement cost) for the written *option* against a positive "A" in each case as calculated in accordance with Table 3-173B(3A); or

(l) in the case of *perfectly matched contracts* these may be treated as a single contract with a notional principal equivalent to the net receipts; or

(m) where transactions are subject to (3)(c) above, the potential future credit exposures (PFCE) on transactions with the same *counterparty* (i.e. % o N) may be netted in accordance with Table 3-173B(6) below,

provided that:

(i) the exposures arise on transactions with the same *counterparty*; and

(ii) the *firm* has a written agreement, supported by a legal opinion obtained in accordance with rule 3-170(11).

Table 3-173B(6)

The netted PFCE is the sum of:	
step one	40% of gross PFCE
step two	60% of gross PFCE multiplied by the net-to-gross ratio (NGR)
Notes:	
NGR = $\dfrac{\text{(net replacement cost)}}{\text{(gross replacement cost)}}$ The NGR must be calculated on all contracts included in a legally valid bilateral netting agreement with a given counterparty.	

Equivalent contracts

3-173B(7) R **Rule 3-173B(3)(c) also applies to contracts, which, although they are listed on an *exchange* are fully dependent upon the issuer for performance (e.g. covered warrants).**

Sub-total

3-173B(8) R **The sum of the amounts calculated in accordance with this rule is the *firm's CRR* for *derivative* transactions.**

3-175 Concentrated risk to one counterparty

General rule

3-175(1) R **When the total amount due to a *firm* arising from *exchange traded* variation margins or free deliveries of *physical commodities* from a single *counterparty* (or several *counterparties* grouped together by the *firm* for margin or credit treatment) is outstanding under a credit line granted in accordance with an *ACMP* and exceeds 25% of the *firm's financial resources*, the *firm* must calculate an additional *CRR* according to the table below.**

Table 3-175(1) - Concentrated risk percentages

% of financial resources exposed to counterparty	Standard CRR for variation margin	Standard CRR for free delivery	Additional CRR
0 - 25%	10%	15%	nil
25% - 50%	10%	15%	lower of (1) the excess or (2) the sum of 15% for variation margin plus 10% for free deliveries
over 50%	10%	15%	lower of (1) the excess or (2) the sum of 40% for variation margin plus 35% for free deliveries

Use of approved bank bonds

3-175(2) R **If an *approved bank bond* forms a part of a *firm's financial resources*, a *firm* may include it in *financial resources* for the purposes of (1) above at its face value.**

Sub-total

3-175(3) R **The sum of the amounts calculated in accordance with (1) above is the total *CRR* for concentrated risk to one *counterparty*.**

3-176 R **All *repurchase*, *reverse repurchase*, *securities* or *physical commodities* (10) lending or borrowing *sale and buy back* and *buy and sale back agreements* with a stock exchange, *clearing house*, Clearstream or Euroclear are exempt from this rule.**

Repurchase, securities lending and sale and buy back agreements

3-176(1) R **Where a *firm* has entered into any *repurchase*, *securities* or *physical commodities* lending or *sale and buy back agreement* in respect of *securities* or *physical commodities*, it must calculate, subject to (3) below, a *CRR* for each such agreement in accordance with the table below.**

Table 3-176(1) - Repurchase, securities lending and sale and buy back agreements

Type of security sold or lent	CRR
Qualifying debt securities	The "mark to market value" of the *securities* less 105% of the *acceptable collateral* under the agreement, if the net figure is positive.
Other *securities* or *physical commodities*	The "mark to market value" of the *securities* or *physical commodities* less 110% of the *acceptable collateral* under the agreement, if the net figure is positive.

Reverse repurchase, securities borrowing and buy and sale back agreements

3-176(2) R Where a *firm* has entered into any *reverse repurchase*, *securities* or *physical commodities* borrowing or *buy and sale back agreement* in respect of *securities* or *physical commodities*, it must calculate, subject to (3) below, a *CRR* for each such agreement in accordance with the table below.

R **Table 3-176(2) - Reverse repurchase, securities borrowing and buy and sale back agreements**

Type of security purchased or borrowed			CRR
1	For all transactions where the *firm* has in its possession a "written agreement" evidencing the transaction, in accordance with rule 3-176(5)		
	a)	*qualifying debt securities*	The amount paid or collateral given for the *securities* less 105% of the current "mark to market value" of the *securities* received (see note), if the net figure is positive
	b)	other *securities* or *physical commodities*	The amount paid or collateral given for the *securities* or *physical commodities* less 110% of the current "*mark to market* value" of the *securities* or *physical commodities* received (see note), if the net fugure is positive
2	Where a *firm* does not have in its possession a "written agreement" evidencing the transaction, in accordance with rule 3-176(5)		The appropriate requirements from 1 plus the market value of the *securities* or *physical commodities* multiplied by the appropriate *PRA*

> Note: the *securities* or *physical commodities* received can be included only where they are held under the control of the *firm* or where they were delivered into the control of the *firm* upon initiation of the agreement.

Netting

3-176(3) R A *firm* may reduce the *CRR* by netting where it has more than one exposure to an individual *counterparty* provided that it has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11) as follows:

(a) in the case of *sale and buy back*, *repurchase* or *securities* or *physical commodities* lending *agreements* (Table 3-176(1)), a *firm* may reduce the *CRR* by the excess of the total value of collateral received, including accrued interest, over the "mark to market" value of any other *sale and buy back*, *repurchase* or *securities* or *physical commodities* lending *agreements* with the same *counterparty*;

(b) in the case of *sale and buy back*, *reverse repurchase* or *securities* or *physical commodities* borrowing *agreements* (Table 3-176(2)), a *firm* may reduce the *CRR* by the excess of the "mark to market value" over the total value of collateral given, including accrued interest, of any other of *buy and sale back*, *reverse repurchase* or *securities* or *physical commodities* borrowing *agreements* with the same *counterparty*; and

(c) to the extent that an excess has not been used under (a) or (b) above to reduce the *CRR*, a *firm* may use an excess on a *sale and buy back*, *repurchase* or *securities* or *physical commodities* lending *agreement* respectively to reduce the *CRR* on a *buy and sale back*, *reverse repurchase* or *securities* or *physical commodities* borrowing *agreement* and vice versa provided the agreements are with the same *counterparty*.

Margin percentages

3-176(4) R A *firm* may opt to calculate the *CRR* using the lower collateral rate (105%) in order to avoid undue complication.

"Written agreement"

3-176(5) R For the purpose of this rule and rule 3-177(2), a "written agreement" must, whether in a general agreement or in respect of specific occasions, include the following elements:

(a) the names of the persons involved;

(b) the type and quantity of *securities* or *physical commodities* subject to the *reverse repurchase*, *securities* or *physical commodities* borrowing, or *buy and sale back agreement*;

(c) the type and quantity of collateral;

(d) the commencement date of the *reverse repurchase*, *securities* or *physical commodities* borrowing or *buy and sale back agreement*;

(e) the completion date of the *reverse repurchase*, *securities* or *physical commodities* borrowing or *buy and sale back agreement*, where appropriate;

(f) interest or fee arrangements, where appropriate;

(g) arrangements for adjustments in the amount or type of *securities* or *physical commodities* to be returned, if appropriate;

(h) arrangements for the calling of margin, if appropriate; and

(i) agreements for completion,

except that having given prior written notice to the *FSA*, a *firm* may disregard certain of the "written agreement" requirements where it can show there are adequate *internal controls* to evidence the arrangements.

"Mark to market value"

3-176(6) R For the purposes of this rule, the current "mark to market value" of *securities* and the value of cash lodged must include accrued interest.

Daily valuation

3-176(7) R A *firm* must value collateral and *securities* or *physical commodities* lent or sold, or borrowed or purchased, at least daily.

Settlement failure and pre deliveries

3-176(8) R Where:

(a) simultaneous delivery of *securities* or *physical commodities* and collateral cannot be confirmed immediately due to settlement failure, or

(b) a *firm* has delivered collateral or *securities* or *physical commodities* prior to the receipt of *securities* or *physical commodities* or collateral,

the *firm* is not required to calculate a *CRR* for three *business days* from the date of payment or delivery by the *firm*.

Additional acceptable collateral

3-176(9) R Where the *firm* has called for additional *acceptable collateral* from the other party to the agreement, a *firm* is not required to calculate a *CRR* if that call has been outstanding for no more than one *business day*.

Exclusions

3-176 (10) R All *repurchase*, *reverse repurchase*, *securities* or *physical commodities* lending or borrowing *sale and buy back* and *buy and sale back agreements* with a stock exchange, *clearing house*, Clearstream or Euroclear are exempt from this rule.

Sub-total

3-176 (11) R The sum of the amounts calculated in accordance with this rule is the total *CRR* for *repurchase* and *reverse repurchase*, *securities* or *physical commodities* lending and borrowing and *sale and buy back agreements*.

3-177 Money brokers

Application

3-177(1) R This rule applies to *money brokers*.

Lending money

3-177(2) R When a *money broker* is lending money it must calculate a 100% *CRR* except to the extent that it holds *acceptable collateral*; except where the broker does not have a "written agreement" in accordance with rule 3-176(5) between the *firm* and *counterparty* specifying, inter alia, the interest rate on the loan and stating that the loan is repayable on demand or for a term no longer than 30 days, when the *CRR* is 100% of the amount outstanding.

Lending and borrowing securities etc

3-177(3) R For all *reverse repurchase* and *repurchase agreements*, *securities* borrowing and lending agreements and *buy and sale back* and *sale and buy back agreements* other than where *securities* are lent or sold or borrowed or purchased through an approved payments system, a *money broker* must calculate an additional *CRR* of 0.5% applied to the value of all *securities* transferred.

Sub-total

3-177(5) R The sum of the amounts calculated in accordance with (2) and (3) above is the *firm's* total *CRR* for *money brokers*.

3-178 Options purchased for a counterparty

Single premium options

3-178(1) R Where a *firm* has purchased a single premium *option* on behalf of a *counterparty* and the *counterparty* has not paid the full *option* premium cost by three *business days* after trade date, a *firm* must calculate a *CRR* as the amount by which the *option* premium owed to the *firm* exceeds the market value of the *option* or *acceptable collateral*.

Traditional options

3-178(2) R Where a *firm* has purchased a *traditional option* for its own account or a *counterparty* and paid the *option* premium, it must calculate a *CRR* equal to the value of the *option* premium.

Sub-total

3-178(3) R The sum of the amounts calculated in accordance with (1) and (2) above is the *firm*'s *CRR* in respect of purchased *options*.

3-180 Qualifying and other deposits

General rule

3-180(1) R Subject to (2) below, a *firm* must calculate a *CRR* for a deposit referred to in the table below by multiplying the value of the deposit by the appropriate percentage contained in the table below.

R Table 3-180(1) - Qualifying and other deposit risk percentages

Type of deposit	**%**
Qualifying deposits	nil
Other deposits with an *approved bank* related to a transaction creating an offsetting liability for the *firm* or subject to an agreement with the bank allowing its use as collateral for a loan that may be withdrawn within -	
- three months to one year - over one year	2.5% 4.0%
Note: all other deposits are subject to a liquidity adjustment (see rule 3-75(12))	

Timing

3-180(2) R *Qualifying deposits* and other deposits outstanding three days after a repayment request has been made or more than three days past maturity date are subject to a full *CRR*.

Netting

3-180 (2A) R A *firm* may reduce the value of the deposit by an amount owed by the *firm* to a *counterparty* before it multiplies the residual exposure by the appropriate percentage in Table 3-180(1) provided that:

(a) the exposures arise with the same *counterparty*; and

(b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rules 3-170(11).

Sub-total

3-180(3) R The sum of the amounts calculated in accordance with Table 3-180(1) is the *firm's CRR* for *Qualifying deposits* and other deposits.

3-181 Loans to counterparties

General rule

3-181(1) R A *firm* must calculate a 100% *CRR* on the amount by which a loan to a *counterparty* is not:

(a) secured by *acceptable collateral*; or

(b) offset against amounts owed by the *firm* to the *counterparty* where the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).

Sub-total

3-181(2) R The sum of the amounts calculated in accordance with this rule is the *firm's CRR* for loans to *counterparties*.

3-182 Other amounts owed to a firm arising out of investment business or investment dealing activities

Nil CRR items

3-182(1) R The following receivables arising out of *investment business* or *investment dealing activities* do not require a *CRR* at any time:

(a) any debt not covered elsewhere in the *CRR* rules to the extent that it is *adequately secured*;

(b) amounts in respect of 30 day items specified in (3) below which have been outstanding for less than 30 days from the date on which they were first recorded on the *firm's* balance sheet; and

(c) accrued income for interest on *marketable investments*, except where it has been outstanding for more than 30 days after the date that the interest was due to be received.

CRR on amounts owed to a firm in respect of international underwriting and stabilisation activities

3-182(2) R (a) Where management or other fees are owed to a *firm* in respect of international underwriting or stabilisation activities, the *firm* must calculate full *CRR* on any amounts remaining unpaid 30 days after they first appeared on the *firm's* balance sheet.

(b) A *firm* acting as stabilising manager must also calculate a *CRR* equal to 100% of any income accrued as a result of net profit on stabilising activities while the stabilising account remains open.

CRR on 30 day items

3-182(3) R A *firm* must calculate a 100% *CRR* in respect of the following receivables due to the *firm* if they have been outstanding for more than 30 days from the date on which they were first recorded on the *firm's* balance sheet:

(a) commissions and fees earned in connection with the *firm's investment business*;

(b) commissions and fees earned which are due and payable from *client* bank accounts;

(c) repayments of *marketable investments* at maturity or call;

(d) the value of scrip issues and rights issues;

(e) proceeds arising from takeovers and mergers;

(f) domestic *underwriting* or stabilisation fees; and

(g) accrued income and work in progress.

100% CRR items

3-182(4) R A *firm* must calculate a 100% *CRR* in respect of other receivables arising from *investment business* and *investment dealing activities* not covered elsewhere in this rule from the time that the receivable is recorded on the balance sheet.

Netting

3-182 (4A) **R** **A *firm* may reduce the value of the amounts owed to the *firm* by an amount owed by the *firm* to a *counterparty* before it multiplies this by 100% provided that:**

(a) the exposures arise with the same *counterparty*; and

(b) the *firm* has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).

Sub-total

3-182(5) **R** **The sum of the amounts calculated in accordance with this rule is the *CRR* for other amounts owed to the *firm* arising out of *investment business* or *investment dealing activities***

Consolidated Supervision

Under the Financial Conglomerates and Other Financial Groups Instrument 2004, the rules in Chapter 14 shall (with respect to a particular firm, group or financial conglomerate) apply from the first day of its financial year beginning in 2005 in place of rules 3-190(1) to 3-195.

3-300 ACMPs

3-300(1) **R** **A *firm* may only use an *ACMP* for the purposes of rules 3-170 to 3-182 if:**

(a) the policies and procedures making up the proposed *ACMP* are at all times adequate and appropriate to the *firm* and its business; and

(b) the *firm* gives to the *FSA* at least three months' notice in writing of its intention to use an *ACMP* for the purposes of these rules.

3-300(2) **R** **The notice referred to in (1)(b) above must include all relevant details of the policies and procedures making up the proposed *ACMP*.**

3-300(3) **R** **The notice referred to in (1)(b) is not required if the *firm* was permitted under the relevant requirements of a predecessor regulator, as they were in force immediately prior to the specified day, to use the proposed *ACMP* for the purposes of those requirements.**

3-300(4) E (a) A *firm's* policies and procedures should take full account of the principles described in Appendix 56.

(b) Compliance with 3-300(4)(a) may be relied on as tending to establish compliance with 3-300(1)(a).

(c) Contravention of 3-300(4)(a) may be relied on as tending to establish contravention of 3-300(1)(a).

G On receipt of notice under (1)(b) the *FSA* is likely to review the policies and procedures proposed by the *firm* and the degree to which they take full and appropriate account of the matters described in Appendix 56. The *FSA's* review will take account of the context in which the policies and procedures are to operate and the relevant circumstances of the *firm*. The *FSA* will indicate to the *firm* its views on the adequacy and appropriateness of the proposals in the light of its review and may make recommendations of improvements.

G The *FSA* may make a further review of the policies and procedures making up an *ACMP* at any time after their implementation for the purposes of these rules as part of its supervision of the *firm*. Any review after implementation will broadly follow the lines described above.

APPENDIX 1 – GLOSSARY OF TERMS FOR IPRU(INV) 3

If a defined term does not appear in the IPRU(INV) glossary below, the definition appearing in the main Handbook *Glossary* applies.

acceptable collateral

(1) (other than for the purposes of rule 3-173B) means any of the following items of collateral provided to a *firm* by a *counterparty* -

(a) cash;

(b) letters of credit and guarantees to the extent of their face value, issued by a *regulated banking institution* which is not the *counterparty* nor an *associate* of the *counterparty*;

(c) letters of credit and guarantees to the extent of their face value, issued by a bank which is not a *regulated banking institution* (not being the *counterparty*, an *associate* of the *counterparty* nor an *affiliated company*) which has been accepted under the *firm's ACMP*;

(d) gold and silver bullion and coinage; and

(e) *marketable investments*,

to which the following conditions apply -

(i) the *firm* must have an unconditional right to apply or realise the *acceptable collateral* for the purpose of repaying the *counterparty's* obligations;

(ii) *marketable investments* must -

(aa) be *marked to market* daily using the valuation principles in rule 3-41(9);

(bb) not be issued by the *counterparty* nor by an *associate* of the *counterparty*; and

(cc) be discounted by 8% (before allowances for hedging or diversification); and

(iii) each item of *acceptable collateral* must be discounted by 5% if it is denominated in a different currency to the *counterparty's* obligation;

(2) (for the purposes of rule 3-173B) means any of the following items of collateral provided to a *firm* by a *counterparty*:

(a) cash;

(b) gold and silver bullion and coinage;

(c) certificates of deposit issued by and lodged with the *firm*;

(d) securities issued by *Zone A* central governments and *Zone A* central banks; and

(e) *securities* issued by the *European Communities*,

to which the following conditions apply:

(i) the *firm* must have an unconditional right to apply or realise the *acceptable collateral* for the purpose of repaying the counterparty's obligations to the *firm*; and

(ii) *securities* must be *marked to market* daily using the valuation principles in rule 3-41(9);

ACMP means, subject to rule 3-300, a credit management policy and procedures according with the principles discussed in **Appendix 56**;

adequate collateral means any of the following items of collateral provided to a *firm* by a *counterparty*:

(a) cash;

(b) standby letters of credit and unconditional, irrevocable first on demand guarantees to the extent of their face value, issued by a *Zone A credit institution* which is not the counterparty nor an *associate* of the *counterparty*, and which is not an *affiliated company*, *associate* or a *controller* of the *firm*;

(c) standby letters of credit and unconditional, irrevocable first on demand guarantees to the extent of their face value, issued by a bank which is not a *Zone A credit institution* (not being the *counterparty* nor an *associate* of the *counterparty*) which has been accepted under the *firm's ACMP* and which is not an *affiliated company*, *associate* or a *controller* of the *firm*;

(d) *certificates of deposit*;

(e) gold and silver bullion and coinage;

(f) *securities*;

(g) *physical commodities*; and

(h) the performance guarantees issued in support of the securities lending and borrowing programmes of Euroclear and Clearstream, in respect only of exposure arising from participation in such programmes,

to which the following conditions apply -

(i) the *firm* must have an unconditional right to apply or realise the collateral for the purpose of repaying the *counterparty*'s obligations to the *firm*; and

(ii) *securities* must -

(aa) be *marked to market* daily using the valuation principles in rule 3-41(9); and

(bb) not be issued by the *counterparty* nor by an *associate* of the *counterparty*;

adequately secured means secured by cash or by *marketable investments* -

(a) in respect of which the firm has an unconditional right to apply or realise for the purpose of repaying the *counterparty's* obligations to the *firm*;

(b) which, in the case of *marketable investments*, *are marked to market* daily by the *firm* using the valuation principles in rule 3-41(9);

(c) with, in the case of *marketable investments*, *a marked to marke*t value not lower than the current value of that obligation after being discounted -

(i) by 8% (before allowances for hedging or diversification); and

(ii) at an additional 5% if it is denominated in a different currency to the obligation; and

(d) which, in the case of *marketable investments*, must not be issued by the *counterparty* nor by an *associate* of the *counterparty*;

adviser means a *firm* which -

(a) has *counterparties* who are investors or potential investors;

(b) restricts its *investment business* to activities within article 53 (advising on investments) of *the Regulated Activities Order*;

(c) does not hold, receive or control money or property belonging to another person, nor has a mandate over a *customer's* bank account;

(d) does not introduce its *counterparties* to other persons as its main business; and

(e) does not deal as principal or *agent* in *investments* or *physical commodities*;

affilitated company in relation to a *firm*, means any *body corporate* controlled by the *firm*, any parent company of the *firm*, and any *body corporate*

agency broker means a *broad scope firm* which deals as principal only on an incidental basis;

agent	in relation to a person, means any person (including an *employee*) who acts on that person's behalf;
allotment date	means the date on which allotments are first made in respect of the *securities* being offered;
annual accounting reference date	means the date as at which the *annual financial statements* are prepared as initially notified by the *firm* to the *FSA* or as subsequently notified under rule rule 3-31 for all other purposes and which may not be more than 55 weeks since the previous *annual accounting reference date* or, if applicable, the date on which the *firm* commenced trading;
annual financial statements	means statements drawn up in accordance with whichever of the following is applicable at the firm's annual accounting reference date: (i) Schedule 4 to the Companies Act 1985; (ii) Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409); (iii) Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410); or (iv) Schedule 1 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); or (v) Schedule 1 to the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913); or (vi) *international accounting standards.*
appointed representative	(in accordance with section 39 of the *Act*) means a person (other than an *authorised person*) who: (a) is a party to a contract with an *authorised person* (his principal) which: (i) permits or requires him to carry on business of a description prescribed in the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 (SI 2001/1217); and (ii) complies with the requirements prescribed in those Regulations; and (b) is someone for whose activities in carrying on the whole or part of that business his principal has accepted responsibility in writing;

approved bank

(in relation to a bank account opened by a *firm*) means:

(a) if the account is opened at a branch in the *United Kingdom*:

(i) the Bank of England; or

(ii) the central bank of a member state of the *OECD*; or

(iii) a *bank*; or

(iv) a *building society* which offers, unrestrictedly, banking services; or

(v) a bank which is supervised by the central bank or other banking regulator of a member state of the *OECD*; or

(b) if the account is opened elsewhere:

(i) a bank in (a); or

(ii) a *credit institution* established in an *EEA State* other than the United Kingdom and duly authorised by the relevant *Home State regulator*; or

(iii) a bank which is regulated in the Isle of Man or the Channel Islands; or

(c) a bank supervised by the South African Reserve Bank; or

(d) any other bank that:

(i) is subject to regulation by a national banking regulator;

(ii) is required to provide audited accounts;

(iii) has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and

(iv) has an annual audit report which is not materially qualified;

approved bank bond

means any instrument, by whatever name called, provided by an *approved bank* which -

(a) provides for the immediate payment of a stated sum to the *firm* on demand whether by the *firm* or the *FSA*;

(b) provides that the bank shall have no recourse to the assets of the *firm* in respect of the bond and that no other person shall have recourse to the assets of the *firm* arising in respect of the bond, until payment in full of all other creditors;

(c) prohibits the bank from terminating the bond unless -

    (i) the beneficiary will have *financial resources* equal to at least 120% of its *financial resource requirement* after termination; or

    (ii) receives authority from the *FSA* to do so;

(d) prohibits any automatic early termination of the bond whether arising out of any act or default of the *firm* or otherwise;

approved exchange	means an investment exchange listed as such in **Appendix 33**; controlled by a parent company of the *firm*;
approved person	means a *person* in relation to whom the *FSA* has given its approval under section 59 of the *Act* (Approval for particular arrangements) for the performance of a controlled function;
approved treasury arrangement	means an arrangement notified to the *FSA* in writing whereby a group of *connected companies* including the *firm* transfers all cash surpluses to one specified *connected company* of the *firm* for the sole purpose of obtaining preferential interest rates on money market deposits;
arranger	means a *firm* -

(a) whose sole *investment business* consists of activities within the following articles of the Regulated Activities Order -

    (i) articles 14 (dealing in investments as principal) or 21 (dealing in investments as agent) if -

        (aa) the *firm* is a *venture capital firm*; or

        (bb) the activity is own account business which would be excluded from being *investment business* by the provisions of article 16 of the Regulated Activities Order but for the fact that the *firm* is an *authorised person*; or

    (ii) article 25 (arranging deals in investments);

    (iii) article 37 (managing investments); and

    (iv) article 53 (advising on investments);

(b) whose *permission* is subject to a *limitation* or *requirement* preventing it from holding money or property belonging to other persons and does not have a mandate over a *customer's* bank account;

associate	in relation to a person ("A"), means - (a) an undertaking in the same *group* as A; (b) an *appointed representative* or where applicable, a *tied agent* of A or of any undertaking in the same *group* as A; and (c) any other person whose business or domestic relationship with A or its *associate* might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with third parties;
associated business	means business which is carried on in connection with *investment business*;
bonus	means that part of the remuneration paid by a firm to its *employees* (including *directors*) which is: (a) not a *profit share*; and (b) awarded by management entirely on a discretionary basis, to the extent that it does not exceed the profit for the financial year of the *firm* before accounting for such bonus;
bought deal	means an *offering* where a *firm* on its own gives an outright binding commitment to the issuer or seller to purchase or subscribe for the *securities* to be offered;
broad scope firm	means any *firm* which is not an *adviser*, an *arranger* or a *local*;
buy and sale back agreement	see *reverse repurchase agreement*;
call option	means an *option* to buy an *investment*, other instrument, foreign currency or *physical commodity* at a given price on or before a given date;
cap	means an agreement in respect of a borrowing under which a *counterparty* contracts to pay any interest costs arising as a result of an increase in rates above an agreed rate: the effect being to provide protection to the holder against a rise above that agreed rate;
certificate of deposit	means a negotiable or non-negotiable certificate issued by a bank;
client	means any *person* with or for whom a *firm* conducts or intends to conduct *designated investment business* or any other *regulated activity*; and: (a) every client is a *customer* or an *eligible counterparty*; (b) "client" includes: (i) a potential client;

(ii) a client of an *appointed representative* of a *firm* with or for whom the *appointed representative* acts or intends to act in the course of business for which the *firm* has accepted responsibility under section 39 of the *Act* (Exemption of appointed representatives);

(iii) a *collective investment scheme* even if it does not have separate legal personality;

(iv) if a *person* ("C1"), with or for whom the *firm* is conducting or intends to conduct *designated investment business*, is acting as agent for another *person* ("C2"), either C1 or C2 in accordance with *COBS* 2.4.3R (Agent as client);

(c) "client" does not include:

(i) a trust beneficiary;

(ii) a *corporate finance contact*;

(iii) a *venture capital contact*.

client money rules means CASS 4.1 to 4.3;

commissions shared means that part of the remuneration paid by a *firm* which is determined on the basis of the number, size or profitability of individual deals carried out;

connected company and "*connected credit institution*" mean, in relation to a *firm* which:

(a) is a *body corporate*, a *body corporate* or *credit institution* satisfying any of the following conditions -

(i) the same person is the *controller* of each *body corporate* or *credit institution*;

(ii) if a group of two or more persons are *controllers* of each *body corporate* or *credit institution* and the group either consists of the same persons or could be regarded as consisting of the same persons by treating a member of either group as replaced by -

(aa) that member's *close relative*;
(bb) a person with whom that member is in partnership; or
(cc) a *body corporate* of which the member is an officer; or

(iii) both *bodies corporate* are members of the same group; or

(b) is not a *body corporate*, a *body corporate* or *credit institution* which is controlled -

(i) by the *firm*;

(ii) by a *partner* in the *firm*;

(iii) by a *close relative* of a *partner* in the *firm* or, if the *firm* is a *sole trader*, by a *close relative* of the *sole trader*; or

(iv) collectively by any of the *partners* in the *firm* or their *close relatives*;

connected credit institution	see "*connected company*";
connected person	has the same meaning as given in sections 252, 253 and 254 of the Companies Act 2006 and a person described therein as being connected with a *director* will similarly be deemed to be connected with a *partner* of a *firm*;
contingency	means a future event the outcome of which is uncertain;
contingent liability	means a liability dependent upon the occurrence or non-occurrence of one or more uncertain future events;
convertible	means a *security* which gives the investor the right to convert the *security* into equity at an agreed price or on an agreed basis;
corporate finance advisory firm	means a *firm* which is an *arranger* and whose *permission* includes a *requirement* that it must not conduct *investment business* other than *corporate finance business*;
corporate finance business	means –

(a) *designated investment business* carried on by a *firm* with or for:

(i) any *issuer*, holder or owner of *designated investments*, if that business relates to the *offer*, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, those *investments*, or any related matter;

(ii) any *eligible counterparty* or *professional client*, or other *body corporate*, *partnership* or supranational organisation, if that business relates to the manner in which, or the terms on which, or the *persons* by whom, any business, activities or undertakings relating to it, or any *associate*, are to be financed, structured, managed, controlled, regulated or reported upon;

(iii) any *person* in connection with:

(A) a proposed or actual *takeover or related operation* by or on behalf of that *person*, or involving *investments* issued by that *person* (being a *body corporate*), its *holding company*, *subsidiary* or *associate*; or

(B) a merger, de-merger, reorganisation or reconstruction involving any *investments* issued by that *person* (being a *body corporate*), its *holding company*, *subsidiary* or *associate*;

(iv) any shareholder or prospective shareholder of a *body corporate* established or to be established for the purpose of effecting a *takeover or related operation*, where that business is in connection with that *takeover or related operation*;

(v) any *person* who, acting as a *principal* for his own account:

(A) is involved in negotiations or decisions relating to the commercial, financial or strategic intentions or requirements of a business or prospective business; or

(B) (provided he is acting otherwise than solely in his capacity as an investor) assists the interests of another *person* with or for whom the *firm*, or another *authorised person* or *overseas person*, is undertaking business as specified in (a)(i),(ii),(iii) or (iv), by himself undertaking all or part of any transactions involved in such business;

(vi) any *person* undertaking business with or for a *person* as specified in (a)(i), (ii), (iii), (iv) or (v) in respect of activities described in those sub-paragraphs;

(b) *designated investment business* carried on by a *firm* as a *principal* for its own account where such business:

(i) is in the course of, or arises out of, activities undertaken in accordance with (a); and

(ii) does not involve transactions with or for, or *advice on investments* to, any other *person* who is a *retail client* in respect of such business;

(c) *designated investment business* carried on by a *firm* as *principal* for its own account if such business:

(i) is in the course of, or arises out of:

(A) the *offer*, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*, or any related matter; or

(B) a proposed or actual *takeover or related operation* by or on behalf of the *firm*, or involving *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*; or

(C) a merger, de-merger, reorganisation or reconstruction involving any *shares*, share warrants, *debentures* or debenture warrants issued by the *firm*; and

(ii) does not involve giving *advice on investments* to any *person* who is a *private customer*;

in this definition, “share warrants” and “debenture warrants” mean any *warrants* which relate to *shares* in the *firm* concerned or, as the case may be, *debentures* issued by the *firm*;

counterparty	means any person with or for whom a *firm* carries on, or intends to carry on, any *regulated business* or *associated business*;
CRR	means the counterparty risk requirement, as calculated 3-170 to 3-182;
customer	means a *client* who is not a *eligible counterparty*;
dealing activities	means all *dealing activities* as principal or *agent* in *investments* and *physical commodities*;
dematerialised instruction transmitter	means a firm - (a) which restricts its *investment business* to activities within article 45 (sending dematerialised instructions) of the Regulated Activities Order; and (b) which does not hold or receive money or property belonging to another person nor has a mandate over another person’s bank account;
derivative fund manager	means an *arranger* - (a) whose *investment business* consists of discretionary management of funds which are invested predominately in *derivatives*; and (b) whose income is not related to the volume of business transacted on behalf of the funds managed by him;

documents of title	means documents of title and documents evidencing title to *investments* and commodities;
domestic offering	means an *offering* or a tranche of an *offering* which is directed primarily to investors in the United Kingdom and which uses methods normal in the United Kingdom domestic capital markets;
*dual currency bond*s	means debt securities, the issue price and coupon of which are fixed in one currency whilst the redemption value is fixed in a different currency;
eligible capital substitute	means a subordinated loan, *approved bank bond* or approved undertaking which a *firm* may treat as an *eligible capital substitute* in accordance with rule 3-63;
employee	in relation to any person, means an individual - (a) who is employed by that person under a contract of service, a contract for services, or any other contract under which the individual will provide services to the person; (b) who is a *director* of the person where the person is a *body corporate*; (c) who is a *partner* of the person where the person is a partnership; (d) who, where the person is an unincorporated association, is a member of its governing body, the secretary or treasurer; or (e) whose services are, under an arrangement between the person and a third party, placed at the disposal and under the control of the person;
equity balance	means - (a) a *counterparty's equity balance*; or (b) a *firm's equity balance*;
European Communities	means Euratom (European Atomic Energy Community), the European Coal and Steel Community and the European Economic Community;
exceptional items	means those items which derive from events or transactions within the ordinary activities of the business of a *firm* and which are both material and not expected to recur frequently or regularly;
exchange	means a *recognised investment exchange* or *designated investment exchange*;

exchange traded	means an *investment* which is traded or listed *on exchange* or on an *approved exchange*; or an *offering* where an investment pari passu to that being offered is traded or listed *on exchange* or on an *approved exchange*;
exchange-traded-margined-transaction	means a *margined transaction* effected by a *firm* under the rules of an *exchange* or an *approved exchange* or *clearing house*;
extraordinary items	means those items which derive from events or transactions outside the ordinary activities of the business of a *firm* and which are both material and not expected to recur frequently or regularly;
financial bookmaker	means a *firm* which conducts only spread-betting business;
financial reporting statement	means the periodic financial and other reporting statements required to be provided to the *FSA* under the provisions of Chapter 16 of the *Supervision manual*;
financial resources	means the sum of the *firm's tangible net worth* and *eligible capital substitutes*;
financial resources requirement	means the sum of the *firm's primary requirement, PRR* and *CRR*;
financial rules	means the financial rules in Chapter 3 of the *FSA's* Interim Prudential Sourcebook for Investment Businesses (IPRU(INV)3);
floor	means an agreement in respect of a deposit under which a *counterparty* contracts to pay any lost income arising as a result of a fall in rates below an agreed rate: the effect being to provide protection to the holder against a fall below that agreed interest rate;
foreign currency derivatives method	means the method of calculating *PRR* under rule 3-153;
foreign currency exposures method	means the method of calculating *PRR* under rule 3-154;
forward	means a *security* which is transacted for a settlement date beyond that which would normally apply in the market concerned, and where that forward settlement date is not yet passed;
FRA	means *forward* rate agreement, i.e. an agreement in which two parties agree on the payment by one party to another of an amount of interest based on an agreed interest rate for a specified period from a specified settlement date applied to an agreed principal amount; no commitment is made by either party to lend or borrow the principal amount; their exposure is only the interest difference between the agreed and actual rates at settlement;

free delivery	means - (a) the delivery of *securities* or *physical commodities* which takes place before the seller receives payment; or (b) payment made in settlement of a credit balance arising from a sale on behalf of, or a purchase from a counterparty in respect of which the *securities* are undelivered;
FRN	means floating rate note, i.e. all debt *securities* which pay interest at a rate which varies in response to general interest rates (including floating rate collateralised mortgage obligations);
in the money	means, in relation to *call options* and *warrants*, that the exercise price is less than the current *mark to market* value of the *underlying instrument* and, in relation to *put options*, that the current *mark to market* value is less than the exercise price;
initial margin requirement	means the total amount which under the rules of the relevant *exchange* or *exchanges* or *clearing house* or *clearing houses* the *firm* or an *intermediate broker* would be required to deposit in cash as a fidelity deposit in respect of all the *client's* open positions in *margined transactions* at that time, irrespective of any unrealised profit or loss on such positions, on the assumption that those transactions were the only transactions undertaken under the rules of that *exchange* or those *exchanges* or that *clearing house* or those *clearing houses* by the *firm* or the *intermediate broker* at that time;
intermediate broker	in relation to a *margined transaction*, means any person through whom the *firm* undertakes that transaction;
international offering	means an *offering* which is not a *domestic offering* or, where an *offering* has a tranche which is a *domestic offering*, those tranches which are not;
introducing broker	means an *arranger* who introduces all transactions in *investment business* or *dealing activities* arranged for *counterparties* to a *clearing firm* where the *clearing firm* accepts primary responsibility (including legal liability) for the settlement of those transactions;
investment	means a *designated investment*
investment agreement	means any agreement the making or performance of which by either party constitutes an activity which is *investment business*;
investment business	means any of the following regulated activities specified in Part II of the Regulated Activities Order and which is carried on by way of business: (a) dealing in investments as principal (article 14), but disregarding the exclusion in article 15 (Absence of holding out etc);

(b) dealing in investments as agent (article 21);

(c) arranging deals in investments for another person (article 25(1)) but only in relation to *investments*;

(d) making arrangements for deals in investments (article 25(2)) but only in relation to *investments*;

(e) managing investments (article 37);

(f) safeguarding and administration of assets (article 40);

(g) sending dematerialised instructions (article 45(1));

(h) causing dematerialised instructions to be sent (article 45(2));

(i) establishing, operating or winding up a collective investment scheme (article 51(1)(a));

(j) acting as trustee of an authorised unit trust scheme (article 51(1)(b));

(k) acting as the depository or sole director of an open-ended investment company (article 51(1)(c));

(l) advising on investments (article 53);

(m) agreeing to carry on the activities in (a) to (h) and (l) (article 64);[1]

investment manager	means a person who, acting only on behalf of a *customer*, either - (a) manages an account or portfolio in the exercise of discretion; or (b) has accepted responsibility on a continuing basis for advising on the composition of the account or portfolio;
investment services	means - (a) activities undertaken in the course of carrying on investment business; and (b) activities undertaken in connection with an ISA where those activities do not constitute investment business;
launch	means the time when any announcement, specifying the issuer or the guarantor of and indicating the final *pricing terms* of the *offering* is made for the first time to the public or the press or any *exchange* or *approved exchange* or information service;

2 These are the same activities as are included in the definition of "designated investment business" used in the Main Handbook Glossary.

margin requirement means, in relation to a *counterparty*, the value of any amounts which the *firm* or *intermediate broker* would be required to pay under the rules of an *exchange* or *clearing house* to -

(a) meet any *marked to market* losses occurring on contracts undertaken for that *counterparty* at that time; or

(b) as an initial margin fidelity deposit in respect of all the *counterparty's* open positions at that time,

on the assumption that those transactions were the only transactions undertaken on the *exchange* or *clearing house* by the *firm* or *intermediate broker* at that time;

margined transaction means a transaction effected by a *firm* with or for a *customer* relating to an *investment* of any description referred to in articles 83, 84 and 85 of the Regulated Activities Order (or any right or any interest in such an *investment*) under the terms of which the *customer* will or may be liable to make a deposit in cash or collateral to secure performance of obligations which he may have to perform when the transaction falls to be completed or upon the earlier closing out of his position;

mark to market means to value an *investment* at its current market value in accordance with rule 3-41(9);

marketable investment means -

(a) an *investment* which is traded on or under the rules of an *exchange* or an *approved exchange*;

(b) a debt instrument which may be transferred without the consent of the issuer or any other person (including a collateralised mortgage obligation);

(c) a *physical commodity*;

(d) a *warrant, option, future* or other instrument which entitles the holder to subscribe for or acquire -

  (i) an *investment* or *physical commodity* which falls under (a) to (c) above;

  (ii) any currency; or

  (iii) any combination of (i) and (ii) above;

(e) a *contract for differences* (including interest rate and currency *swaps*) relating to fluctuations in -

  (i) the value or price of an *investment* or *physical commodity* in (a) to (d) above;

(ii) any currency;

(iii) the rate of interest in any currency or any index of such rates;

(iv) the level of any index which is derived from the prices of an *investment* or *physical commodity* in (a) to (c) above; or

(v) any combination of (i) to (iv) above;

(f) *warrants, options, futures* or other instruments entitling the holder to obtain the rights of those contracts in (d) or (e) above; and

(g) a unit in a *regulated collective investment scheme*;

model A clearing firm	means a *regulated clearing firm* which uses its own money for settlement but is reimbursed on a daily basis by the non-*clearing firms* it settles for;
money broker	means a *firm* for which the total value of *repurchase, securities lending* and *sale and buy back agreements* is or has been at any time during the previous year, at least 25% of its total assets;*
new securities	means, in relation to a particular *offering, securities* which are issued pursuant or with a view to an *offering*;
new to the market	means, in relation to an *offering, securities* which are not already *exchange traded*;
non clearing floor member	means a *firm* which: (a) is authorised to trade on the floor of a *recognised investment exchange* which permits this category; (b) is not prohibited by the rules of that exchange from dealing with *customers*; (c) has entered in to an agreement with a *clearing firm* which accepts full responsibility for every deal entered into by the non clearing floor member; and (d) is not authorised to handle *client money*;
non recourse loan	means a loan to a *firm* secured on specific land or buildings, under the terms of which the lender has no claim on the other assets of the *firm* nor on assets for which the *firm* is accountable in any circumstances (including a winding up);

* For guidance notes on *money brokers*, see **Appendix 37**

note issuance facility	means an arrangement under the terms of which a borrower is able to issue short term notes in its own name with a guarantor, or consortium of guarantors ensuring the availability of funds to the borrower by agreeing to purchase any unsold notes, and which includes for example revolving underwriting facilities, note purchase facilities, euronote facilities and similar arrangements;
offering	means an offering of *securities* which are - (a) issued for the purpose of the offering; (b) *new to the market*; or (c) existing *securities* which are *exchange traded* subject to the purchase of those *securities* having the same characteristics as an *offering* of *new securities*, or *securities* which are *new to the market*;
open-priced deal	means an *international offering* which is not a *bought deal* or *pre-priced deal*;
option	(for the purposes of rule 3-173B) means a contract which confers the right to buy or sell a security, contractually based investment, currency, gold or commodity at a given price on or before a given date. (NB: the definition of an option used for this purposes deliberately differs from that in the main Handbook Glossary);
out of the money	means those *options* and *warrants* which are not *in the money*;
pari passu security	means a *security* which is the same as another *security*, except only in respect of payment, entitlement to initial dividend and the nature of *documents of title*;
passported institution	means an *incoming EEA firm*;
perfectly matching contracts	mean certain *OTC derivatives* contracts which are included in a legally binding netting agreement that are equal and exact opposites and perfectly matching in all material respects;
physical commodities method	means the method of calculating *PRR* under rules 3-166 to 3-169B;
physical commodity	means the actual commodity, *documents of title* to actual commodities or shipping documents conveying title to actual commodities;
PRA	means percentage risk addition, i.e. a percentage to be applied to the value of positions in investments held by the firm to determine its *PRR*;
preference security	means a *share* with rights, in respect of capital or dividends, superior to those of ordinary equity;

pre-priced deal — means an *international offering* other than a *bought deal* all the *pricing terms* of which have been fixed;

pricing terms — means, in relation to an *offering*, the amount of currency, maturity, *offering price*, rate of or means of calculating interest and any prices at which *securities* may be redeemed or converted or exchanged into other *securities*;

primary requirement — is the primary requirement calculated in accordance with Table 3-61;

profit share — means an appropriation of profit before tax on a predetermined basis for the benefit of management or *employees*;

property fund — means a scheme dedicated to permitted immovables and property related assets, whether with or without other transferable securities;

PRR — means the position risk requirement of a firm as calculated in accordance with rules 3-80 to 3-169B;

put option — means an *option* to sell an *investment*, other instrument, foreign currency or *physical commodity* at a given price on or before a given date;

qualifying debt security — means a *debt security* which:

(1) (other than for the purposes of rule 3-173B):

(a) represents or evidences indebtedness;

(b) is a *marketable investment*;

(c) if it or “equivalent debt” is rated by a “relevant agency” (and there has been no announcement that the rating will be cancelled) -

(i) the *security* or the “equivalent debt” is so rated at or higher than the level indicated in the table in **Appendix 34**;

(ii) there has been no announcement that the rating will be down-graded below the level so indicated; and

(iii) the *firm* has no reasonable cause to believe that another “relevant agency” has rated the security or “equivalent debt” below the level so indicated; and

(d) if neither it nor any “equivalent debt” is rated by a “relevant agency” (or there has been an announcement that such a rating will be cancelled), it satisfies one or more of the following -

pre-priced deal — means an *international offering* other than a *bought deal* all the *pricing terms* of which have been fixed;

(i) it is issued or guaranteed by or is subject to the full faith and credit of a sovereign government or province or state thereof (or a corporation over 75% owned by such sovereign government, or province or state), which is a member of the *OECD* and the government, province, state or corporation has not defaulted, or entered into any rescheduling or similar arrangement, or announced the intention of so doing, in respect of itself or its agency's debt within the last five years;

(ii) it is issued or guaranteed by a *supranational organisation*;

(iii) it is issued or guaranteed by a corporation (not being a bank, for which see (iv) below) the ordinary *shares* of which are included within the following categories -

(aa) UK : constituents of the FT All Share Index;

(bb) Japan : constituents of the First Section of the Tokyo Stock Exchange;

(cc) USA: constituents of the NYSE, AMEX or NASDAQ NMS; or

(dd) countries listed below: the constituents of the FT-Actuaries World Indices in respect thereof;

Australia

Belgium

Canada

Denmark

France

Germany

Hong Kong

Italy

Netherlands

Norway

Singapore

Spain

Sweden

Switzerland

(iv) it is issued or guaranteed by a bank which is supervised by an authority in a state such as is referred to above and has capital and reserves (including subordinated loans which are not repayable within five years) of not less than £100,000,000 or the equivalent as shown by its latest published audited consolidated accounts (or, in the absence of consolidated accounts, unconsolidated accounts); or

(v) is it issued or guaranteed by a local authority or building society in the United Kingdom;

provided that the issuer or guarantor of the *security* is not in default as to any payment on any other *security* issued or guaranteed by it; and

(2) for the purposes of (1) above -

(a) in respect of any *security* of, or guaranteed by, any issuer or guarantor, "equivalent debt" means any debt which ranks pari passu with, or subordinate to, the *security* or (as the case may be) the guarantee; and

(b) in relation to any issuer or guarantor, a "relevant agency" means one of the agencies named in **Appendix 34** by reference to the category of issuer or guarantor;

(3) (for the purposes of rule 3-173B) meets the following conditions:

(a) it attracts zero specific risk under Table 2 in Appendix 47; or

(b) it is issued by, or fully guaranteed by:

(i) a *Zone B* central government or central bank and the *security* is denominated in the local currency of the issuer;

(ii) a *multilateral development bank*;

(iii) a *Zone A* public sector entity;

(iv) a company whose *share* is a constituent of one of the indices making up the FTSE All-World Index; or

(v) an issue of, or fully guaranteed by an *investment firm* or *recognised third-country investment firm*; or

(c) it is issued by, fully guaranteed by, endorsed or accepted by:

(i) a *credit institution* incorporated in a *Zone A* country; or

(ii) a *credit institution* incorporated in a *Zone B* country and the debt *security* has a residual maturity of one year or less; or

(d) it is a mortgage backed *security* relating to residential real estate of the type referred to in *BIPRU* 3.4.94R(1)(d)(i) which meets the requirements about legal certainty referred to in *BIPRU* 3.4.62R; or

(e) it is rated by at least one of the agencies shown in Table 3 Appendix 47, and every such rating equals or exceeds the corresponding minimum shown in that table;

qualifying deposit means a deposit which is one of the following -

(a) balance on current account with an *approved bank*;

(b) money on deposit with an *approved bank*, United Kingdom local authority, member of the Finance Houses Association, *stock exchange moneybroker*, *regulated clearing firm*, the National Savings Bank, *exchange*, *approved exchange* or *approved depository* which may be withdrawn within three months;

(c) money on deposit with an *approved bank* directly related to a transaction creating an offsetting liability for the *firm* or subject to an agreement with the bank allowing its use as collateral for a loan that may be withdrawn within three months, which relates to a liability of the same maturity and arises out of a transaction;

(d) amount evidenced by a certificate of tax deposit;

(e) amount evidenced by a *certificate of deposit* issued by a *regulated banking institution* which matures within three months; or

(f) deposit of cash by way of margin with an *exchange*, *approved exchange*, *clearing house* or *intermediate broker*;

regulated banking institution — means any banking institution which has paid up share capital and reserves of over £5,000,000 as shown by its latest published audited accounts, and which is authorised by the *FSA* or supervised by the central bank or other regulatory authority of a member state of the *OECD* in which the bank is incorporated;

regulated business — means *investment business* which is

(a) business carried on from a permanent place of business maintained by a *firm* (or its *appointed representative*) in the United Kingdom; and

(b) other business carried on with or for *customers* in the United Kingdom, unless that business is -

(i) business carried on from an office of a *firm* outside the United Kingdom which, if that office were a separate person, would fall within the overseas persons exclusions set out in article 72 of the Regulated Activities Order; or

(ii) business of an *appointed representative* of the *firm* which is not carried on in the United Kingdom;

regulated clearing firm — means a *clearing firm* which is an *authorised person*;

regulated financial institution — means a *firm*, or an institution which is authorised to conduct *investment business* involving the execution of transactions on *exchanges* or on *securities* or *derivatives exchanges* by one or more of the following regulators -

(a) any regulator of *investment business* in any member state of the European Community (other than the United Kingdom) established by law in that state; or

(b) a body referred to in Part 1 of **Appendix 35;**

provided, in the case of any such institution that the *firm* has no reason to suppose that the institution is in breach, in any material respect, of the rules enforceable by the relevant regulator;

relevant annual expenditure	means the relevant annual expenditure of a *firm* calculated in accordance with rule 3-73;
reporting statement	means any one or more of the following types of report as required by the *Supervision manual*: (a) audited *annual financial statements*; (b) *annual reporting statement*; (d) internal control letter; (e) quarterly reporting statement; (f) position risk reporting statement; (g) counterparty risk reporting statement; (h) annual reconciliation; (i) monthly reporting statement; and (j) the audited accounts of a *subsidiary* of the *firm*;
repurchase agreement	(and *sale and buy back agreement*) means an agreement for the sale of *securities* or *physical commodities* subject to a commitment to repurchase from the same person the same or similar *securities* or *physical commodities*;
reverse repurchase agreement	(and "*buy and sale back agreement*") means an agreement for the purchase of *securities* or *physical commodities* subject to a commitment to resell to the same person the same or similar *securities* or *physical commodities*;
sale	includes any disposal for valuable consideration;
sale and buy back agreement	see *repurchase agreement;*
scheme management activity	means the management by an *operator* of a *collective investment scheme* of the property held for or within a *collective investment scheme* of which it is the *operator* and includes the management of the property of an *open-ended investment company* by the company itself as its *operator* but excludes the management of an *open-ended investment company* by another person as its *operator* (and excludes in all cases activities relating to transactions in units, *shares* or interests in the *collective investment scheme*);

settlement day	means the day on which under the recognised practice of an *exchange* or *approved exchange*, bargains are contracted for settlement; and in the case of bargains not transacted on an *exchange* or *approved exchange*, or entered into for forward settlement, 20 days from the date of the transaction, or, if earlier, the contractual due date;
stock exchange moneybroker	is a *moneybroker* which is an *authorised person* and acts as an intermediary in the gilt market;
supranational organisation	means any organisation referred to in Part 2 of **Appendix 35**;
swap	means a transaction in which two *counterparties* agree to exchange streams of payments over time according to a predetermined basis;
takeover or related operation	means: (a) any offer to which the *Takeover Code* applies and any transaction or arrangement which is of such a nature that the *Takeover Code* would have applied to it had it concerned a company whose shares are listed under Part VI of the *Act* and whose head office and place of central management are in the United Kingdom; (b) any offer, transaction or arrangement relating to the purchase of *securities* with a view to establishing or increasing a strategic holding of a person, or of a person together with his *associates* in the *securities* concerned; (c) any transaction or arrangement entered into in contemplation or furtherance of any offer, transaction or arrangement falling within (a) or (b) above; and (d) any transaction or arrangement entered into by way of defence or protection against any offer, transaction or arrangement falling within (a), (b) or (c) above which has taken place or which is contemplated;
tangible net worth	is the tangible net worth of a *firm* calculated in accordance with rule 3-62;
total PRR	means the sum of all the amounts calculated as a *PRR* under rules 3-80 to 3-169B;
traditional option	means any *option* arranged but not traded under the rules of the London Stock Exchange;

trust beneficiary	means a beneficiary under a trust (not being the settlor) who benefits from the performance by a *firm* as trustee of *investment services* relating to the management of the trust assets;
underwriting	means a commitment to take up *securities* where others do not acquire or retain them;
underwriting price	means the price at which the *firm* is committed to take up the securities or the price at which it is committed to do so if required under the *underwriting* commitment less any commissions or discounts paid or allowed in connection with the transaction, except to the extent that the *firm* has taken credit for them in its accounts;
variable rate note	means a debt *security* with the characteristics of an *FRN* except that the margin with respect to the index rate of interest is subject to variation depending on periodic negotiations;
variation margin requirement	means in relation to a *counterparty* the value of any amounts which the *firm* or *intermediate broker* would be required to pay under the rules of an *exchange*, *approved exchange* or *clearing house* to meet any *marked to market* losses occurring on contracts undertaken for that *counterparty* at that time on the assumption that those transactions were the only transactions undertaken on the *exchange, approved exchange* or *clearing house* by the *firm* or *intermediate broker* at that time;
venture capital schemes	means a scheme for providing capital to a *body corporate* whose equity is not traded or listed on an *exchange*;
walkaway clause	means a provision which permits a non-defaulting counterparty to make only limited payments, or no payment at all, to the estate of the defaulter, even if the defaulter is a net creditor;
warrant fund	means a scheme which is dedicated to *transferable securities* except that it is permitted to invest entirely in *warrants*;
zone A	see definition of *Zone A country* in the *Glossary*; and
zone B	means any country not in *Zone A.*

Appendix 20
GUIDANCE NOTES ON RECONCILIATION OF FIRM'S BALANCES WITH A COUNTERPARTY WHICH IS A MEMBER OF AN EXCHANGE (RULE 3-11(1)(d)) AND IPRU(INV) 9.6.1R (FOR AN EXEMPT CAD FIRM))

Introduction

1 The purpose of this guidance is to state how under rule 3-11(1)(d) and *IPRU(INV)* 9.6.1.R (for an *exempt CAD firm*) the reconciliation process with counterparties which are also members of exchanges should be performed.

Scope

2 The reconciliation to be performed with counterparties should cover all outstanding balances and *securities* positions with such counterparties from all sources except to the extent that the components of such balances and *securities* positions have been agreed by other means. Agreement by other means shall include (but is not to be limited to) those which have been–

(a) matched or cleared through an exchange, clearing house or clearing system; or

(b) verified by dispatch to or receipt from the counterparty of a confirmation or statement. Such verification should have been evidenced in writing or by electronic media.

3 The reconciliation should cover all remaining outstanding items including, for example, fee-based items, dividends where these are on the *firm*'s balance sheet, coupons, amounts arising under *OTC* contracts, *repurchase* and *reverse repurchase agreements* and *securities* lending and borrowing.

4 The items to be included should be all those past trade date which is consistent with *trade date accounting*.

5 Where necessary a *firm* should initially circularise a list of all relevant open items as set out above rather than a net balance. A *firm* should identify the assumptions made by them in ascertaining which balances (or types of balances) have been included in the reconciliation. A *firm* should also identify where the balances or *securities* positions with a counterparty arise from different accounts operated by them with that counterparty.

6 The scope of the rule is intended to cover nil balances although these may be covered on a sample basis only. They are included because discrepancies in such balances may only come to light as being incorrectly stated on the performance of a circularisation. However, reconciliations of nil balances do not need to be performed where–

(a) the counterparty is also a *firm*; or

(b) there has been no outstanding balance with the counterparty at any point during the year.

Timing

7 It is considered preferable for a *firm* to be aware in advance at which periods of the year they will receive reconciliations requests. This may be of use to a *firm* in enabling it to plan in advance the allocation of staff for the performance of the reconciliations. Thus, it is suggested that a *firm* submits such circularisations, where possible, at calendar quarter end dates. It is considered that, in any case, the majority of *firms* would be likely to circularise such statements at these dates. However, a *firm* will be eligible to circularise at other dates as, for example, when its own *annual* or *quarterly accounting reference dates* do not coincide with the calendar quarter end.

8 A *firm* may perform the reconciliation in conjunction with the work undertaken by its auditors for the purposes of the annual audit.

The obligation on firms

9 Where a *firm* receives a statement from a counterparty during the year, the recipient *firm* is not also required by virtue of rule 3-11(1)(d) (or *IPRU(INV)* 9.6.1(1)R for an *exempt CAD firm*) to send a further statement to that counterparty in the same year.

10 A recipient of a circularisation request from another *firm* must use its best endeavours to respond. Notwithstanding paragraphs 7 and 8 above, this obligation will apply even if this request is received more frequently than once a year from the same counterparty or is wider in scope than required by paragraphs 2 to 6 above (for example, by also covering balances which have already been agreed by other means). Rule 3-11 (or *IPRU(INV)* 9.6.1R for an *exempt CAD firm*) only requires that specific balances be covered. This is intended as a minimum requirement and not necessarily as the norm. If a *firm* need not reply to a request more than once a year or which covered balances of a wider scope, *firms* would be discouraged from requesting such reconciliations.

11 Rule 3-11(3) (or *IPRU(INV)* 9.6.1(1)R(4) for an *exempt CAD firm)* requires a *firm* to respond, within one month of receipt, to a circularisation request received from another *firm*. The one month response period should also be observed in relation to circularisation requests received under rule 3-11(1)(d) (or *IPRU(INV)* 9.6.1(1)R for an *exempt CAD firm)*.

12 It is not considered necessary to issue detailed guidance for the procedure to be adopted in cases where the recipient does not reply to a circularisation request sent by a *firm*. It is intended that a *firm* need only take reasonable steps to obtain any such reply. However, before a *firm* has taken such steps, it should not assume that the circularisation is agreed merely due to the absence of a reply from the counterparts.

Appendix 21
GUIDANCE NOTES ON THE VALUATION OF POSITIONS
(rule 3-41(9))

Introduction

1 Rule 3-41(9) states that a position must be valued at its close out price, where close out price means that a long position should be valued at current bid price and a short position at current offer price. In addition, rule 3-41(9) states that a *firm* must value a position on a prudent and consistent basis, and have regard to the liquidity of the instrument concerned and any special factors that may adversely affect the closure of the position.

2 The following paragraphs give general indications to *firms* on the appropriate valuation methodology. However, it is emphasised that prudence should be the overriding influence in the valuation exercise and that, where uncertainty exists as to the most appropriate price, the *firm* should use that price which gives the most conservative valuation.

General principles

3 *Firms* should value positions by reference to market prices, but where necessary should add a prudent and appropriate buffer to the bid or offer price to account for factors which would adversely affect the *firm's* ability to realise the close-out value, such as -

(a) the liquidity of the *security* in question;

(b) the size of the position held in that *security* relative to the sizes at which prices are quoted;

(c) the direction of the position (long or short) relative to the current direction of the market;

(d) the exposure of the *firm* to the relevant market as a whole;

(e) any conversion or foreign exchange costs that would be incurred if the position were closed out;

(f) any other factors which may affect the close-out price.

4 Where a mid-market or single price only is available for the *security* in question, *firms* must adjust this price by a prudent and appropriate buffer as outlined in paragraph 3 above.

5 With respect to paragraphs 3 and 4 above, *firms* should be able to demonstrate at all times how they determined the final price applied to any position in a *security*.

Appendix 26 (rules 3-81 to 3-165)
SUMMARY TABLES OF WHICH METHOD OF PRR TO APPLY TO AN INSTRUMENT

	INSTRUMENT	CIRCUMSTANCES	METHOD	RULES
1	*note issuance facilities*	all circumstances	*note issuance facilities*	3-80
2	foreign currency asset or capital or liability	all circumstances	*foreign currency exposures*	3-150 to 3-154
3	currency *option* and *future*	see rule 3-152	*foreign currency exposures* or *foreign currency derivatives*	3-150 to 3-154
4	*physical commodity*, actual and forward	all circumstances	commodities	3-166 to 3-169B
5	*physical commodity*, *option* and *future*	all circumstances	commodities	3-166 to 3-169B
6	concentrated position	all circumstances	method relevant to position + *concentrated position*	As above
7	forward	equity foreign currency *physical commodities*	*equity* *foreign currency exposures* commodities	3-80 3-150 to 3-154 3-166 to 3-169B
8	*regulated collective investment scheme*	all circumstances	*equity derivatives*	3-80
9	non *marketable investments* and others	all circumstances	100% *PRR*	3-80

Appendix 33 (exchanges)
LIST OF APPROVED EXCHANGES

The following exchanges are approved for the purposes of the definition of "approved exchange" –

Athens Stock Exchange (ASE)

Barcelona Stock Exchange (Bolsa de Valores de Barcelona)

Belgian Futures & Options Exchange (BELFOX)

Berlin Stock Exchange (Berliner Börse)

Bilbao Stock Exchange (Bolsa de Valores de Bilbao)

BVLP (Bolsa de Valori de Lisbao e Porto

Bolsa de Mercadorios & Futures (BM&F)

Boston Stock Exchange

Bovespa (The São Paulo Stock Exchange)

Bremen Stock Exchange (Bremer Wertpapierbörse)

BVRJ (The Rio de Janeiro Stock Exchange)

Cincinnati Stock Exchange

Copenhagen Stock Exchange (Kobenhavns Fondsbors)

Dusseldorf Stock Exchange (Rheinisch-Westfälische Börse zu Düsseldorf)

Frankfurt Stock Exchange (Frankfurter Wertpapierbörse)

Hannover (Niedersächsische Börse zu Hannover)

Italian Exchange

Kuala Lumpur Stock Exchange

Luxembourg Stock Exchange (Société de la Bourse de Luxembourg SA)

Madrid Stock Exchange (Bolsa de Valores de Madrid)

Mercato Italiano Futures (MIF)

Munich Stock Exchange (Bayerische Börse in München)

Nagoya Stock Exchange

New Zealand Stock Exchange

Oslo Stock Exchange (Oslo Bors)

Stuttgart Stock Exchange (Baden-Würtembergische Wertpapierbörse zu Stuttgart)

Swiss Exchange (SWX)

Taiwan Stock Exchange

Tel Aviv Stock Exchange

The Stock Exchange of Thailand

Valencia Stock Exchange (Bolsa de Valores de Valencia)

Appendix 34 *("qualifying debt security")*
RELEVANT AGENCY

The agencies in the table below are "relevant agencies" for the purposes of the definitions of "*qualifying debt security*".

		Securities minimum category	Money market obligations minimum category
1	**For all issuers** Moody's Investors Service Standard and Poor's Corporation Fitch Ratings Ltd	 Baa3 BBB- BBB-	 P3 A3 A3
2	**For all banks, Building Societies and parent companies and subsidiaries of banks** Thomson BankWatch	BBB-	TBW-3
3	**For Canadian issuers and issues in Canadian dollars** Canadian Bond Rating Service Dominion Bond Rating Service	B++low BBB low	A-3 R-2
4	**For Japanese issuers and issues in Japanese yen** Fitch Ratings Ltd Japan Credit Rating Agency, Ltd Japan Rating and Investment Information, Inc Mikuni & Co Ltd	BBB- BBB- BBB- BBB	F-3 J-2 a-2 M-3
5	**For United States issuers and issues in US dollars** Fitch Ratings Ltd	BBB-	F-3

Appendix 35 ("*regulated financial institution*" and "*supranational organisation*")

LIST OF REGULATED FINANCIAL INSTITUTIONS AND SUPRANATIONAL ORGANISATIONS

PART 1

List Of Regulators For The Purposes Of The Definition Of Regulated Financial Institution

Australian Stock Exchange Limited;

The Hong Kong Monetary Authority;

The Hong Kong Securities and Futures Commission;

Investment Dealers Association of Canada;

Japanese Ministry of Finance;

Sydney Futures Exchange;

Toronto Stock Exchange;

United States Commodity and Futures Trading Commission;

United States Securities and Exchange Commission;

Vancouver Stock Exchange.

PART 2

List Of Supranational Organisations

a *multilateral development bank;*

The Bank for International Settlements;

The Council of Europe;

Euratom (The European Atomic Energy Community);

Eurofina (The European Company for Financing of Railroad Rolling Stock);

The European Coal and Steel Community;

The European Economic Community;

The International Monetary Fund;

Appendix 37 (rule 3-177)
GUIDANCE NOTES FOR MONEY BROKERS

Application Of The Counterparty Risk Requirement

Introduction

1 This Appendix offers guidance to *money brokers* on the application of rule 3-177 relating to the counterparty risk requirement.

Calculation of 0.5% additional CRR

2 A *money broker* should calculate the additional *CRR* requirement as follows -

(a) if a *money broker* is satisfied that it has a legal right to net off exposures with an individual *counterparty*, valid and enforceable in the United Kingdom or any other relevant country, it may do so in accordance with the rule 3-176(3). The obligation rests with the broker to demonstrate that the method it uses is reasonable and justifiable. It is stressed that this right to net is at the option of the *firm* and is not mandatory;

(b) a *money broker* should then aggregate its total level of *securities* subject to a *repurchase* or *reverse repurchase agreement*, *securities* lending or borrowing agreement and *sale and buy back* or *buy and sale back agreement* (either net or gross) to or from individual *counterparties* outside an *approved payments system* and money lent against *Talisman short-term certificates*. A capital requirement of 0.5% of this sum should then be calculated.

Approved payments systems

3 The following are *approved payment systems* when the systems concerned provide for settlement on a delivery versus payment basis -

- Austraclear New Zealand
- Banca D'Italia's Giornaliera
- Banque Nationale de Belgique
- Bank of Spain Interbank Bond Settlements System
- Banque de France's SATURNE
- BOJ-NET DVP
- Central Gilts Office
- Clearstream
- Depository Trust Company
- Euroclear
- Fedwire - see The Federal Reserve System
- Kassenverein
- Necigef
- SICOVAM (Relit settlement only)

– Sociedad de Compensacion y Liquidacion de Valores
– The Canadian Depository for Securities Ltd
– The Federal Reserve System (Fedwire), and
– Vardepapperscentralen VPC AB

Collateral

4 It is recognised that letters of credit may be used as collateral and may have a value in excess of the amount of the *securities* transferred. Provided it is clearly established that claims cannot be made on the letter of credit in excess of the value of the *securities* borrowed, no *CRR* will be imposed on the amount by which the letter of credit exceeds the value of the *securities* borrowed. *Firms* are reminded that the definition of *acceptable collateral* includes *marketable investments* which may take the form of money market instruments.

Appendix 43
GUIDANCE NOTES ON THE FINANCIAL RESOURCES AND ACCOUNTING TREATMENT OF SOFT COMMISSION AGREEMENTS

(rules 3-73 and 3-182(3))

1 Introduction

This Appendix contains detailed guidance to the following rules–

Rules	
3-73	Expenditure requirement
3-182(3)	*CRR* requirement on other amounts owed to a *firm* arising out of *investment business* or *investment dealing activity*

2 The *FSA* is of the view that it is not responsible for setting accounting policies in relation to a *firm*'s *audited annual financial statements*. However, the *FSA* considers that it is preferable for all *firms* participating in "soft commission agreements" to have consistent accounting policies. Without such consistency, certain *firms* would have a competitive advantage in terms of their *financial resources*. Therefore, for the purposes of completing *financial reporting statement* submitted to the *FSA*, appropriate accounting policies should be used. The guidance and interpretations made in this Appendix should be considered in this context.

3 The guidance applies to all *firms* which participate in "soft commission agreements" whether or not this is the sole *investment business* of the *firm*.

4 Definition

A soft commission agreement means–

"any agreement, whether oral or written, under which a *firm* which deals in *securities* on an advisory basis, or in the exercise of discretion, receives goods or services in return for an assurance that not less than a certain amount of such business will be put through or in the way of another person;"

5 Description

A "soft commission agreement" is understood as being one in which a fund manager agrees, either formally or informally, to provide a broker with a certain amount of commission in any one period in return for the provision of services "free". Those services may be provided in-house or by third parties and may take the form of specific research provided by analysts, portfolio valuation systems, or information packages, plus the associated computer hardware and software.

6 Under traditional broking arrangements, the full service broker normally receives commission in return for the total servicing of a fund manager's account, a package which includes execution, perhaps custodianship and, almost certainly, research, also "free". The services provided under traditional broking arrangements are in-house i.e. within a broking group, and mostly are not conditional upon receipt by the broker of a certain level of commission, although there is usually an understanding which may never be articulated, that a certain volume of business will be generated.

7 Existing difference in accounting policies

The accounting policies used can in general be divided into those which are "profit & loss" based and those which are "balance sheet" based. Under the former, the *firm* will write-off such expenditure to its profit & loss account but will usually not accrue a liability in its *financial reporting statements* for commissions received in advance. Consequently, the "normal" profit & loss based accounting systems for expenses incurred and commissions received will be used. It should be noted that such *firms*, as they are fundamentally participating in traditional broking arrangements, may not have legally enforceable "soft commission agreements" with their counterparties, such that there may be no absolute contractual liability on the *firm* or counterparty to provide expenditure or commission.

8 *Firms* using the "balance sheet" approach will accrue for liabilities but will also tend to capitalise their expenditure under "soft commission agreements". This may be the policy used by *firms* which specialise in legally enforceable "soft commission agreements" and reflects the legal status of such agreements. These may contract the counterparty to pay a level of commission related to the level of expenditure incurred by the *firm* (and vice versa if the counterparty has paid advance commission in excess of the expenditure paid by the *firm*).

9 Expenditure and balances receivable

Once expenditure is incurred for a counterparty, the soft commission broker may claim that contractually the counterparty is bound to pay him a certain multiple of that expenditure in the form of commission within a certain period of time from the date the expenditure was incurred. Consequently, certain *firms* have previously capitalised their expenditure and shown it as an asset for the purposes of calculating their *financial resources*.

10 Required treatment

Where a *firm* incurs expenditure on behalf of a counterparty or counterparties in respect of "soft commission agreements" (whether or not it is incurred in relation to a written contract), the *firm* should immediately write off such expenditure to its profit & loss account.

11 Notwithstanding the above, expenditure may be capitalised (as an asset) in the balance sheet of the company which incurred the expenditure, **only**

where this amount is recoverable under a legally enforceable contract (see paragraph 18 below). Where such expenditure is capitalised it will be subject to rule 3-182(3)**.**

12 Income and balances payable

Once commission income is received from a counterparty, the *firm* may recognise that contractually it is bound to pay the counterparty a certain proportion of that income, in the form of the counterparty's expenses, within a certain period. Although certain *firms* are including this amount as a liability on their balance sheet (and thus reducing their *financial resources*), other *firms* are making no such provision.

13 Required treatment

Where a *firm* has a contractual liability to, or on behalf of, a counterparty or counterparties which arises from a legally enforceable "soft commission agreement", the *firm* should accrue in its *financial reporting statements* a liability for the relevant proportion of any advanced commission income received from the counterparty that will have to be subsequently incurred as an expense by the *firm* in the form of a payment on behalf of the counterparty for allowable goods and services.

14 Expenditure requirement

Once expenditure is incurred for a counterparty, the soft commission broker may claim that contractually the counterparty is bound to pay him a certain multiple of that expenditure in the form of commission within a certain period and thus such expenditure should not be included in the *firm*'s expenditure requirement.

15 Required treatment

Expenditure incurred by soft commission brokers should be included in a *firm*'s expenditure requirement, unless it is incurred under a legally enforceable "soft commission agreement" when it may be excluded from the expenditure requirement calculation.

16 The reasoning behind this treatment is that the expenditure of a *firm* participating in soft commission arrangements is similar to shared commissions and can, therefore, be treated as though it were shared commissions under rule 3-73(2)(f), except to the extent that such expenses are irrecoverable, i.e. except where there is no enforceable legal agreement.

17 It is considered that certain *firms* may have been under the misapprehension that there was a concession for all expenditure related to "soft commission agreements" regardless of whether the agreement was legally enforceable. Where a *firm* undertakes a mixture of business between legally enforceable contracts and informal arrangements (all of which the *firm* would classify as "soft commission agreements"), it must take great care in allocating expenditure between legally enforceable contracts and others. Alternatively, it may decide to include all expenditure in the expenditure requirement regardless of source**.**

18 Legally enforceable contracts

For the purposes of this guidance, for a "soft commission agreement" to be legally enforceable there should be a specific written legal contract governing the arrangements. The contract should be legally enforceable by the *firm* involved, both in the UK and in any other relevant country.

Appendix 46 (Table 3-173(2)B)

COUNTRIES/TERRITORIES IN WHICH CRR ON ISSUING MARKET FREE DELIVERIES MAY BE RELAXED

Introduction

This Appendix lists the countries/territories in which *free deliveries* made in the issuing market are subject to a reduced *CRR* of 15% of the *free delivery* value, and the time limit on this reduced *CRR*.

Country/Territory	Business days since delivery
Hong Kong SAR	20
Indonesia	30
Malaysia	30
Philippines	75
Singapore	21
Thailand	45

Appendix 47

Tables applicable to CRR for derivative transactions under the rule 3-173B

TABLE 1

Counterparty Weights To Be Applied In Calculating Liquidity Adjustment And CRR (rule 3-173B(5)(b))

Type of counterparty	Counterparty weight
claims on, or explicitly guaranteed by, or collateralised with *securities* issued by: - the central government or central bank of a *Zone A* country; - the *European Communities*; or - any other government or central bank, provided the *exposure* is denominated in that country's national currency.	NIL
claims on discount houses, gilt-edged *market makers*, institutions with a *money* market dealing relationship with the Bank of England and those Stock *Exchange money brokers* which operate in the gilt-edged market, where the claims are secured on gilts, UK Treasury bills, eligible *local* authority and eligible bank bills, or London CDs	10%
claims on, or explicitly guaranteed by: - a *multilateral development bank*; - the regional government or *local* authority of a *Zone A* country; - a *Zone A credit institution*; - a *recognised clearing house* or *recognised exchange*; - a recognised third country or *EEA investment firm*; - a *Zone B credit institution*, provided the *exposure* has a maturity of one year or less.	20%
any other *counterparty*	100%

Guidance

> The guarantee should be explicit and be legally enforceable by the *firm* and should prevent a *firm's* capital from becoming deficient as a result of experiencing a loss on such an exposure. The exposure must be retained on the *firm's* balance sheet.

TABLE 2

Specific risk *PRAs*

Issuer	Residual maturity	*PRA*
An issue of, or fully guaranteed by, or fully collateralised by a *Zone A* central government or central bank or the European Communities	Any	0%
An issue of, or fully guaranteed by, a *Zone B* central government or central bank denominated in the local currency	Zero to 12 months	0%

TABLE 3

Minimum ratings for *qualifying debt securities*

Issuer	Rating agency	Minimum Rating	
		Securities	Money Market Obligations
Any	Moody's Investors Service	Baa3	P3
	Standard & Poor's Corporation	BBB-	A3
	FITCH Ratings Ltd	BBB-	F-3
Canadian	Canadian Bond Rating Service	B++low	A-3
	Dominion Bond Rating Service	BBB low	R-2

Japanese	Japan Credit Rating Agency, Ltd Mikuno & Co Japan Rating & Investment Information Inc	BBB- BBB BBB-	J-2 M-3 a-2

Appendix 56

Guide To Adequate Credit Management Policy (ACMP)
(rules 3-173 to 3-175, 3-300 and "ACMP")

Introduction

1 This appendix contains general guidance on the standards which the FSA expects a *firm's ACMP* to meet.

Objective

2 the FSA*'s* objective is to ensure that adequate procedures and controls are in place to manage effectively the granting of credit and the monitoring and controlling of credit risk.

Scope

3 The guidance applies to any *firm* which wishes to take advantage of the lower *CRR* percentages (by which counterparty exposures must be multiplied).

4 Before a *firm* may use the lower percentages in calculating *CRR* and in preparing its financial reporting statements, it must meet the requirements set by 3-300. The *ACMP* and its operation will be reviewed periodically by the *FSA* and, where it is no longer operating effectively, the *firm* may be in breach of those requirements.

Background

5 The *FSA* is aware that *firms* grant credit to counterparties in many different ways, including for example, loans to cover actual margin calls as a result of delays between trade date and final settlement or of late settlement etc. This guidance is designed to cover all instances where a *firm* becomes exposed to credit risk although, depending on the way in which credit risk arises, the procedures for managing it may differ.

6 In considering the credit management policies of a *firm*, the *FSA* will expect the *firm* to operate a robust control structure which is appropriate to the size, scale and nature of its business and the diversity and complexity of its exposures. The *FSA* recognises that different approaches to and styles of credit management can create an effective operational control environment. Therefore, it is not appropriate for the *FSA* to lay down prescriptive standards which it would expect a *firm* to meet, but rather to suggest a broad framework which is flexible, allows for individualised solutions and can accommodate and encourage evolutionary developments.

7 The prime components of a sound credit risk management process are:

- the definition by a *firm* of what constitutes a credit exposure/risk and is therefore covered by the *firm's ACMP*;

- a comprehensive credit risk measurement approach;

- the existence of guidelines and other parameters used to determine credit limits and govern the level and types of risk taken; together with

- a strong management information system for controlling, monitoring and reporting exposures.

Thus, when the *FSA* reviews a *firm's* credit management process, it will seek comfort that credit exposures are managed and controlled in a highly disciplined manner and that the relevant staff are well versed in the *firm's* credit procedures.

8 Where a *firm's* credit risk management is controlled or overseen by its parent or an affiliate in the same group, provided that the *firm* can identify reasonable grounds for believing that the level of control is suitable, this should not impede use of the *firm's ACMP*.

General principles

9 In forming its view as to the adequacy of a *firm's* credit risk management process, the general characteristics which the *FSA* may take into account include the following:

Role of senior management

(a) whether the framework of credit risk management, i.e. a *firm's* policies and procedures, is overseen by the board of directors or an equivalent management body;

Procedures

(b) whether there are clearly established lines of responsibility and levels of authority for:

- the granting of credit to a counterparty;
- extending its permitted use to cover risk arising on a product new to the counterparty;
- increasing existing credit facilities; and
- the monitoring and controlling of all credit risk;

(c) the extent to which the functions of granting, measuring, monitoring and controlling credit risk are managed independently of the front office with a direct reporting line to the senior management ultimately responsible for credit risk management;

(d) whether good channels of communication exist which ensure that the *firm's* credit management procedures are well understood and followed by all relevant personnel;

(e) whether procedures exist for identifying unintentional credit exposures and dealing with counterparty which has failed to settle its obligations to the *firm*,(whether merely due to a delay or actual default), or which is expected not to settle its obligations on the due date; including arrangements for closing out transactions. In addition, the *FSA* may consider whether a *firm* has the ability to identify and attempt to predict, as well as quantify, any shortfall as it arises and on an aged basis;

(f) whether mechanisms exist for a daily comparison of exposures with credit limits, including the production of exception reports, and the procedures to be followed to deal with the results of those exception reports;

Documentation

(g) whether a *firm's* credit management policies and procedures are properly documented and reviewed by the *firm* on a regular and thorough basis to ensure that they continue to remain appropriate and sound;

(h) whether records are kept in respect of each counterparty (identified on an individual legal entity basis) indicating in sufficient detail, the level of credit risk to a counterparty to which the *firm* is willing to expose itself. Where a *firm* grants a credit facility similar to a loan to cover, for example, margin calls, such records might give details of the credit facility extended to a counterparty together with any information gathered in support of the decision to grant that credit facility, the types of transaction which the *firm* may enter into with the counterparty and to which the credit facility may be allocated. Credit information relating to counterparties should be regularly updated and reviewed by the *firm* to ensure that any credit facility granted remains appropriate;

Collateral and margin

(i) whether the *firm* has written policies relating to the margining and collateral arrangements with its counterparties. Terms of business or customer agreements would normally detail the circumstances when margin might be called, and the type and level of collateral which would be acceptable to the *firm* on the basis of its liquidity, volatility and ability to be realised. In addition, it may be relevant to consider the degree to which a *firm's* collateral records are kept up to date and include details of the practical procedures for the realisation of such collateral.

Measurement and monitoring of exposures

(j) whether a *firm* has mechanisms for identifying the level of concentration of credit risk exposures to each individual counterparty, and each group of connected counterparties, etc on a regular and timely basis;

(k) where a *firm* uses risk reduction techniques (such as master agreements, netting agreements, collateralisation arrangements or the taking of third party credit enhancements, including letters of credit and guarantees), whether the *firm* has procedures for scrutinising documents and assessing their impact on the credit risk of the *firm* and assessing the quality of any guarantees or letters of credit;

(l) depending on the nature of the credit exposures to which a *firm* is subject, whether the *firm's* mechanisms for measuring such exposures are appropriate to cover the type or level of risk to which they give rise.

Additional Guidance on the FSA's Assessment of ACMPs

Preamble

This document is intended as a guide to those areas of Credit Management Policies which the *FSA* will address when considering their adequacy.

A definition of credit and the measurement of credit risk

The *FSA* expects that *firms* have a clear definition of what is considered to be "credit risk" (by whatever name it is known) within the *firm*.

The *FSA* expects *firms* to consider in depth the measurement of the extent of Credit Risk which is incurred vis a vis any given counterparty. *Firms* should be aware that the extent of credit risk incurred will not necessarily be the same as the nominal value of contracts entered into ("value at risk" concept).

The *FSA* will expect that firms measure and monitor the extent of Credit Risk incurred vis a vis any given counterparty by reference to a system of limits showing the maximum Credit Risk which the *firm* considers it prudent to incur vis a vis that counterparty having regard for the financial strength of the counterparty.

The *FSA* expects there to be adequate procedures within the *firm* for the recognition of where credit risk may be incurred, for the approval of incurring such risk, and, once incurred, for the monitoring of that risk to ensure the satisfactory recovery of all amounts owed to the *firm* by a counterparty.

The decision to grant credit

If there is a formal decision making body (e.g. a "Credit Committee") which reviews applications for credit:

- How does it derive its authority?
- What is the extent of any Credit Committee's authority as regards:
    - amount of credit granted
    - tenor of credit granted
    - products for which credit lines may be approved
    - industry sectors for which credit lines may be approved?
- How is any Credit Committee constituted?
- What are the qualifications of any Credit Committee's members to make the decisions required of them?

- Independence of Committee from profit centres
- Recording of Approvals

If there is no formal committee, what procedures exist to ensure adequate collective responsibility for credit decisions giving regard for the duality ("four eyes") principle and independence of decisions made from profit centres likely to benefit from income? e.g.

- "round robin" circulation of papers to Directors/Credit Management
- individual sign off on each transaction/deal

Many of the comments noted above concerning a "Credit Committee" will be relevant also where no formal Committee meets, as will the following remarks concerning the documentation provided to those making credit decisions.

What documentation is provided to those charged with reaching decision to grant credit?

Cover sheet detailing proposed credit.

- Name of proposed counterparty (identify correct legal entity)
- Address of proposed counterparty
- Amount of credit
- Currency of credit
- Tenor of credit
- Collateral/Security proposed (where applicable)
- Remuneration for credit granted
- Products
- Existing exposure to counterparty (in case of increase/review)
- Previous payment performance of counterparty (in case of increase/review)

Financial information on proposed counterparty.

In order to ascertain the financial strengths and weaknesses of a proposed counterparty the *FSA* expects *firms* to revert to financial information, some examples of which are given below.

- Annual report and accounts
- Analysis of annual reports and accounts

- Credit reference agency reports e.g. Dun and Bradstreet
- Rating agency reports e.g. Standard and Poors, Moody’s
- Brokers reports
- Bank status reports
- Statements of net worth

“Credit memorandum” or other internally produced paper outlining the reason for proposing the granting of credit to the counterparty.

Some areas which might be covered by such a memorandum are as follows:

- Background information on relationship with proposed counterparty
- Commentary/analysis of financial information
- Future prospects (for profitability, growth etc.)
- Reason for present proposal
- What benefit will it bring to a *firm's* relationship with company?
- Perceived risks in providing the credit proposed
- What measures have been taken to mitigate these risks?
- Provision of management accounts
- imposition of financial covenants
- Taking of security
- Comments on the collateral or security to be taken
- Comments on legal documentation to be employed
- Industry exposure
- Country exposure
- Spread of counterparties - large exposures

<u>The monitoring of credit exposure</u>

Once a proposal to grant credit has been approved the *FSA* will expect that there are adequate procedures in place to ensure the proper monitoring of all credit exposures entered into.

The *FSA* expects the monitoring function to be separate from and managed independently of those profit centres which may benefit from the incurring of credit risk.

In order to ensure adequate monitoring of credit exposure it will be necessary for firms to ensure that decisions concerning credit matters are communicated promptly and efficiently to those who are responsible for their utilisation and monitoring. firms may wish to consider how such matters are communicated to:

- Those entitled to commit the *firm*
- Credit Control Officers
- Senior Management
- Documentation Staff

The *FSA* will consider the methods by which this information is communicated e.g. memorandum, manual lists, credit procedures manuals etc.

Computer systems

Where use is made of computer systems the *FSA* will consider the various methods by which the integrity of databases is ensured. These could include

- Password protection/access rights
- Accuracy/key verification
- Duality principle
- Physical security of systems
- Back up

Where information is transferred between computer systems e.g. for reporting purposes or to PC based systems the *FSA* will consider any reconciliations which are performed.

Reporting

The *FSA* expects there to be an adequate reporting system for the monitoring of credit exposure. Many *firms* make use of a series of reports, analysing their credit exposure based on a number of different criteria. Examples of the kinds of reports which may be found useful by *firms* are given below.

- Excess reports/Exception reports
- Exposure reports
  - by customer/group/connected customers
  - by industry
  - by country
- Overdue payments reports
- Facilities due for review
- Facilities by collateral/security type
- Collateral/security held
- Large Exposures

The *FSA* will give consideration to the frequency of production of reports used in monitoring credit risk.

Credit Risk Management/Control

The *FSA* will expect to be given details of the action taken where monitoring shows that any aspect of credit exposure is not in line with previously agreed parameters.

For example where exposure is in excess of approved limits the *FSA* will expect to be informed about what action is taken, where payments are not received, how this is followed up. If a counterparty's financial standing deteriorates, what action is taken to attempt to mitigate possible credit loss?

Documentation

The *FSA* expects *firms* to have adequate procedures in place to be certain that all transactions which require documentation are documented and that this occurs within an acceptable time frame, and that any transactions which fail to be documented are identified and reported to Senior Management for appropriate action to be taken.

The *FSA* expects any staff responsible for documentation to be separate from front office/profit centres and have an independent reporting structure. This will ensure that the commercial wish to trade and do business does not cloud the negotiation of effective and binding legal documentation.

- Suitability of documentation to be used
- Preparation of documentation
- Qualification of staff (or choice of solicitors to be instructed)
- Training of documentation staff
- Tenacity of documentation staff

Basic documentation to be obtained from all counterparties might include

- Certificate of incorporation
- Memorandum and articles of association (M&AA)
- Board Resolution

Other documents which a *firm* may wish to call for prior to entering into transactions would include:

- a statement of officers authorised to act for the counterparty and to commit it to transactions
- a list of authorised signatories where one exists
- an audited annual report or interim figures
- credit reference report or bank status report

Other areas for consideration could include:

- Prompt execution of documentation
- Monitoring response to documents sent out
- Chasing where no response
- Reporting missing documentation to senior management
- Proper execution
- Secure storage of documentation
- Regular review of documentation held

Ongoing review of credit risk

The *FSA* expects firms to have in place adequate procedures for the annual (or more frequent) review of credit risk.

- Scope of the review
- Financial information
- Action where concern is raised
- Possible need for more frequent review
- Monitoring of counterparties' performance
- Defaults and delinquent and bad debts
- Provisioning policy

The *FSA* will expect a *firm* to be able to explain what action may be taken as the result of review e.g. reduction of credit limit, calling for further collateral etc. where the review indicates cause for concern.

Documentation of credit policies and procedures and customer files

The *FSA* will expect *firms* to consider the manner in which their Credit Policies are documented. Areas for comment could include:

- Credit Procedures manuals and the context in which they are used
- Internal Board Minutes showing delegated authority
- Credit Committee Minutes
- Operations manuals
- Training material for staff
- Internal memorandum detailing credit policy
- Customer Credit files, to contain
    - credit analysis information
    - copies of decisions to grant credit
    - copies of relevant documentation
    - press cuttings
    - copies of data input documents

Appendix 62

NETTING

Similar Types of Transactions

The rules set out the requirements to be met by firms before offsetting exposures in 'similar types of transactions ' with a counterparty (i.e.being those transactions falling under a particular counterparty risk rule).The netting of exposures within a particular rule is to be applied on a first in first out basis.

Derivative Transactions

Firms may offset the negative replacement cost on written OTC options against the positive replacement cost of OTC purchased options with the same counterparty.

Guidance On The Netting Of Counterparty Exposures

Introduction

1. This appendix contains guidance on the requirements to be attained in order for firms to net counterparty exposures assessed under the following areas.

Subject
Cash against documents transactions
Free deliveries of securities
Repurchase and reverse repurchase, securities lending and borrowing and sale and buy back agreements
Derivative transactions
Other amounts owed to a firm arising out of trading book business

Scope

2. The guidance applies to any firm subject to the CRR rules and which takes advantage of the netting provisions contained therein.

Background

3. Agreements which can effect set-off of counterparty exposures exist in two forms:

   (a) novation agreements (referred as netting by novation)which replace existing contracts with one new contract and therefore can only be used to cover similar transactions with payments in the same currency for the same value dates;and

   (b) netting agreements which can be used to cover transactions of very different types.

The guidance below applies to both novation agreements and netting agreements.

Principles of Offset

4. Before offsetting exposures in similar types of transactions with a counterparty a firm must have a contractual netting agreement with that counterparty which:

   (a) covers the transactions which the firm is seeking to net;

   (b) creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances;

   (c) does not include a walkaway clause; and

   (d) is supported by written and reasoned independent legal opinions to the effect that, in the event of a legal challenge, the relevant courts would find the firm 's exposure to be the single net amount mentioned in (b) above.

Statement of Law on Netting

5. The prerequisite of holding a netting agreement supported by an independent legal opinion in order to offset exposures is not required where the Financial Law Panel 's (November 1993) Statement of Law on netting applies. This Statement of Law indicates that under English law rule 4-90 of the Insolvency Rules 1986 imposes a requirement for complete set-off of transactions between parties incorporated in England and Wales, provided the transactions are mutual (i.e. credits, debts or claims arise from dealings between the same parties and that the parties are acting in the same capacity). Furthermore, it indicates that set-off is mandatory ,applies whether or not there is any contractual entitlement to set-off and cannot be excluded by agreement between the parties.

6. As mentioned above mutuality is required in order for there to be complete set-off of transactions. Accordingly, firms are expected to have procedures in

place to identify the counterparty and the capacity in which the counterparty is acting. Firms proposing to rely on the Statement of Law on netting must satisfy themselves of the appropriateness of such reliance and,where in doubt, obtain legal advice. It is important to note that Insolvency Rule 4.90 does not apply to building societies, statutory organisations generally, mutual societies, partnerships and individuals.

Legal Requirements

7. Legal opinions will be needed for the:
    - law of the jurisdiction in which the counterparty is organised;
    - law of the jurisdiction in which any branch involved is located;
    - law that governs the agreement and, if different, the law that governs individual transactions pursuant to it; and
    - law that governs the legal status of the counterparty who is entering into transactions of the type which the firm is seeking to net.

8. Where a firm uses an industry standard agreement which contains netting/set-off clauses the firm may rely only on a legal opinion relating to the netting/set-off clauses in that standard agreement where no amendment has been made to the agreement which would materially affect these clauses and where the legal opinion addresses the capacity of counterparties of the type with which the firm wishes to contract, the contract type and the relevant jurisdictions.

9. Where a netting agreement provides that one or both parties may enter into transactions with each other under the agreement through any of its (or certain designated) branches, then all such branches included in the agreement will be considered to be located in relevant jurisdictions for the purpose of this guidance.

10. Where a netting agreement involves more than one jurisdiction, a legal opinion is required for each to the effect that the agreement creates a single obligation in each currency or a single obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances.

11. As mentioned above legal opinions should relate to the law of the jurisdiction in which the counterparty is organised (i.e.incorporated or resident). However,certain circumstances may arise where this requirement could be considered not to be applicable; for example where:
    - a firm has no assets or exposure in that jurisdiction;
    - any judgement obtained in that jurisdiction against a firm would not be enforceable under any of the rules in the UK relating to the enforcement of foreign judgements; or

- there are no other factors relating to that jurisdiction which would affect the ability of a firm to make net payments as contemplated by the netting agreement.

12. Where a firm believes that the law of the jurisdiction in which a counterparty is organised is not relevant, that point must be addressed in the legal opinion supporting the netting agreement. The ability to exclude the law of the jurisdiction in which a counterparty is organised does not extend to the netting of those off balance sheet exposures listed in the Solvency Ratio Directive: the amendment to this directive (to permit netting)specifically requires this matter to be addressed in the legal opinion.

13. It is recognised that, with certain aspects of the agreement, it may not be possible to obtain a definite opinion or that a positive opinion regarding enforceability of the netting agreement can only be obtained subject to certain assumptions and/or qualifications. Where qualifications are made, they should be specific and their effect adequately explained. In the same way, assumptions should be specific, of a factual nature (except in relation to matters subject to the law of a jurisdiction other than that covered by the opinion)and should be explained in the opinion.

14. Legal opinions on netting agreements must be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable. Where the regulator in the jurisdiction of the counterparty is satisfied that the netting agreement is not enforceable under the laws of that jurisdiction, the netting agreement cannot be relied upon regardless of the opinions obtained by a firm.

Compliance with the Legal Requirements

15. It is the responsibility of firms to ensure that the legal requirements set out above are met (firms are to calculate CRR on the gross value of exposures to counterparties where this is not the case).Firms do not need to apply to the FSA in order to net exposures. Similarly, legal opinions on netting agreements and the agreements themselves are not required to be submitted to the FSA for approval. The FSA will establish the existence of legal opinions and netting agreements when compliance with the above requirements is being monitored by its staff.

16. Firms are expected to put procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in light of possible changes in the relevant law.

17. Firms are expected to maintain records demonstrating that, in relation to the legal requirements, the following considerations have been addressed:
    - the applicability of the netting agreement to the counterparties, jurisdictions and transactions involved;

- the applicability of the opinions to the counterparties, jurisdictions and transactions involved;
- where more than one jurisdiction is involved, the potential for conflicts in law;
- all documentation is complete and still valid and that the agreement has been properly executed (i.e. that the acceptance of terms have been evidenced);
- the nature and effect of any qualifications in the legal opinions and assessment that these do not impair the obligation to pay a net sum of cash in the event of default, bankruptcy, liquidation or similar circumstances; and
- where an industry standard agreement is used upon which a generic legal opinion has been obtained, identification of those clauses which if altered during the course of negotiating the agreement would affect the right to offset. Internal legal counsel is to evidence review of these agreements to ensure that the effectiveness of the set off clauses has not been altered directly or indirectly by virtue of other clauses being added or deleted.

18. Firms are expected to hold a copy of the legal opinion and the agreement to which it relates.

19. Firms are to net exposures within a particular rule on a FIFO basis. Firms may net only current exposures and cannot net potential future exposures.

Cross-Product Netting

Introduction

The FSA will consider granting rule waivers in order to permit firms to take account of cross-product netting in the calculation of their Counterparty Risk Requirement (CRR) in instances where the FSA regards it appropriate.

The current drafting of the FSA 's Financial Rules for securities and futures firms allows 'similar ' types of transactions to be netted (where those transactions are covered by a valid netting agreement, with a supporting legal opinion).In practice, 'similar ' has been defined as all transactions which fall within a particular CRR Rule treatment. Thus, currently, for the calculation of CRR in relation to exposures to a counterparty which are covered by valid netting arrangements, a firm would be required to assess, for example, a net exposure for all derivative transactions with that counterparty and a separate net exposure for all repo type transactions with that counterparty.

The FSA will consider granting waivers in accordance with SUP 8, though in general it will expect the following conditions to be met:

1. For the types of transaction which the firm is seeking to net, the firm must have the capability to monitor, and must in practice manage, the resultant exposures on a net basis.
2. All transactions which the firm is seeking to net must be covered by valid netting agreements and supported by legal opinions, in accordance with the requirements of the FSA's Financial Rules; and
3. Where underlying netting agreements are linked by a master netting agreement, the legal opinion must address the enforceability of the netting arrangements in their entirety;

One factor that the FSA will consider in assessing whether a particular applicant meets these requirements is whether the firm has had the use of its ACMP sanctioned for the purposes of calculating CRR.

4. Chapter 4: Lloyd's firms

4.1 APPLICATION

4.1.1 R This chapter applies to the *Society* and *members' advisers*.

4.1.2 R This chapter does not apply to a *members' adviser* which is subject to another chapter of *IPRU(INV)*.

4.1.3 D The directions in *IPRU(INV)* 4.4.1D to 4.4.5D and 4.5.1D are given to the *Council* and to the *Society* acting through the *Council*.

4.2 PURPOSE

4.2.1 G This chapter identifies the financial resource requirements and requirements as to accounts and statements to be met by certain *firms* conducting business at Lloyd's.

4.2.2 G The directions in *IPRU(INV)* 4.4.1D to 4.4.5D and 4.5.1D are given under section 318 of the *Act* (Exercise of powers through Council), for the purpose of achieving the objective specified, as required by section 318(2) of the *Act*, in *IPRU(INV)* 4.3.1D.

4.2.3 G *Underwriting agents* are subject to regulation by the *Society* as well as by the *FSA.* In particular, they are subject to requirements as to their financial resources and as to making and maintaining accounting records, set by the *Society*. The *FSA* is satisfied that *underwriting agents* will be subject to adequate financial resource and accounting requirements as long as they remain subject to and comply with requirements at least equivalent to Lloyd's Capital and Solvency Requirements 2001 and the relevant parts of, or requirements made under Lloyd's Underwriting Agents Byelaw (No. 4 of 1984), in each case as amended and in force immediately before *commencement*. Accordingly, instead of imposing an obligation directly on *underwriting agents*, the directions in *IPRU(INV)* 4.4.1D to 4.4.5D and 4.5.1D require the *Society* to require those firms to comply with the relevant requirements.

4.2.4 G A *members' adviser* is not regulated by the *Society* and accordingly this chapter specifies the financial resource and accounting requirements to be met. *Firms* which fall within the scope of this chapter will be *firms* with *permission* only to advise persons on *syndicate* participation at Lloyd's. The nature of that advisory business is akin to corporate finance advice and so the applicable requirements are those in *IPRU(INV)* 3 relevant to *firms* giving corporate finance advice. *Firms* with other *permissions* will fall within the scope of other chapters of *IPRU(INV)*, *GENPRU*, *BIPRU* or *INSPRU*.

4.3 SPECIFICATION OF OBJECTIVE

4.3.1 D The directions in *IPRU(INV)* 4.4.1D to 4.4.5D and 4.5.1D are given in relation to the exercise of the powers of the *Society* and of the *Council* generally, with a view to achieving the objective that *underwriting agents* have adequate financial resources to support, and keep and preserve adequate accounting records in respect of their business at Lloyd's.

4.4 FINANCIAL RESOURCE REQUIREMENTS

4.4.1 D The *Society* must maintain appropriate and effective arrangements to require *underwriting agents* to meet and continue to meet financial resource requirements at least equivalent to the requirements set out in Lloyd's Capital and Solvency Requirements 2001, as they are in force immediately before *commencement*.

4.4.2 D The *Society* must give the *FSA* a report on each *underwriting agent's* compliance with the financial resource requirements referred to in *IPRU(INV)* 4.4.1D as at the end of each quarter (determined by reference to each underwriting agent's *accounting reference date*).

4.4.3 D The report referred to in *IPRU(INV)* 4.4.2D must reach the *FSA* within two months of the end of the relevant quarter and must state:

(1) whether the *Society* has any information indicating or tending to indicate that, during the quarter to which the report relates, the *underwriting agent* failed to meet the financial resource requirements referred to in *IPRU(INV)* 4.4.1D;

(2) whether, at the end of the quarter to which the report relates, the *underwriting agent* failed to meet the financial resource requirements referred to in *IPRU(INV)* 4.4.1D; and

(3) the nature and extent of any failure to comply reported under (1) or (2) and the actions taken or to be taken by the *Society* in response to this.

4.4.4 D In addition to the reports required under *IPRU(INV)* 4.4.2D, the *Society* must give the *FSA* an annual report on each *underwriting agent's* compliance or non-compliance with financial resource requirements as at the end of that *underwriting agent's* financial year.

4.4.5 D The report in *IPRU(INV)* 4.4.4D must reach the *FSA* within seven months of that *underwriting agent's* accounting reference date and must:

(1) confirm that:

(a) the *Society* has received from that *underwriting agent* in respect of the financial year to which the report relates, all relevant attachments to the Annual Financial Return that the *underwriting agent* is required to make to the *Society* under the requirements identified in *IPRU(INV)* 4.4.1D;

(b) that *underwriting agent* met the applicable financial resource requirements at the end of the financial year to which the report relates; and

(c) the *Society* is not aware of any matters likely to be of material concern to the *FSA* relating to that *underwriting agent's* compliance with financial resource requirements during the year to which the report relates, or arising from the attachments referred to in (a); or

(2) if the *Society* is unable to give any of the confirmations required under *IPRU(INV)* 4.4.5D (1)(a), (b) or (c), set out in each case the reasons why it is unable to give that confirmation.

4.4.5A D The *Society* must submit the reports in *IPRU(INV)* 4.4.2D to *IPRU(INV)* 4.4.5D in accordance with the *rules* in *SUP* 16.3 (General provision on reporting).

4.4.6 R A *members' adviser* must comply with the requirements of *IPRU(INV)* 3-60(3) and 3-62.

4.5 ACCOUNTING RECORDS

4.5.1 D The *Society* must maintain appropriate and effective arrangements to require *underwriting agents* to meet the obligation to keep and preserve accounting records, set out in Lloyd's Underwriting Agents Byelaw (No 4 of 1984), Section III, paragraph 53B, as it is in force immediately before *commencement*.

4.5.2 R A *members' adviser* must comply with the requirements of *IPRU(INV)* 3-10 to 3-14.

Interim Prudential Requirements for Former IMRO Firms

5 CHAPTER 5: FINANCIAL RESOURCES

5.1.1 APPLICATION

APPLICATION OF CHAPTER 5

5.1.1(1)(a) R This chapter applies to an *investment management firm*, other than an *incoming EEA firm* or *MiFID investment firm* (unless it is an *exempt CAD firm* for the purpose of calculating its *own funds* and if it carries on any *regulated activity* other than *MiFID business*), as set out in Table 5.1.1(1)(a).

TABLE 5.1.1(1)(a) APPLICATION OF CHAPTER 5

	Exempt CAD firms	**OPS *Firms*** (see Note 1 below)	**Non-OPS Life Offices and Non-OPS Local Authorities**	**Individuals admitted to membership collectively**
Financial resources rules				
5.2.1(1) to 5.2.7(5)	**No (see Note 3 below)**	**No**	**No**	**Yes**
Accounting records rules				
5.3.1(1) to 5.3.1(6)	**No**	**Yes**	**Yes**	**Yes**

	Individuals whose sole *investment business* is giving investment advice to institutional or corporate investors	***Firm*s subject to "lead regulator arrangements"**	**All other *Firm*s**
Financial resources rules			
5.2.1(1) to 5.2.7(5)	**No**	**No** (see Note 2 below)	**Yes**
Accounting records rules			
5.3.1(1) to 5.3.1(6)	**No**	**Yes**	**Yes**

Note 1. *Firms* are referred to the specific compliance reports for *OPS firms* required by Chapter 16 of the Supervision Manual.

Note 2. A *firm* subject to "lead regulator arrangements" whereby a body other than *the FSA* is responsible for its financial regulation shall comply with the corresponding financial resources rules and financial returns rules of that body, and a breach of such rules shall be treated as a breach of the rules of *the FSA*.

Note 3. The financial and non-financial resources rules for an *exempt CAD firm* are set out in *IPRU(INV)* chapter 9. However, rules 5.2.1(1) to 5.2.7(5) apply to an *exempt CAD firm* for the purpose of calculating its *own funds* (see *IPRU(INV)* 9.2.9R(2)(a)) (although the Category A items of Tier 1 capital as set out in Table 5.2.2(1) are replaced by all the items in *IPRU(INV)* 9.3.1R) and if it carries on any *regulated activity* other than *MiFID business* (see *IPRU(INV)* 9.2.3R).

INTERPRETATION

(c) R The definitions in the glossary at Appendix 1 apply to this chapter.

5.2.1 GENERAL REQUIREMENT

ADEQUACY OF FINANCIAL RESOURCES

5.2.1(1) R A *firm* must at all times have available the amount and type of *financial resources* required by the *rules* in this chapter.

BASIC REQUIREMENT

5.2.1(2) R A *firm* must ensure that, at all times, its *financial resources* are not less than its *financial resources requirement.*

FINANCIAL RESOURCES

5.2.1(3) R A firm's financial resources means:

(a) **its *own funds*, if the *firm* is subject to an *own funds requirement* under rule 5.2.3(2); or**

(b) **its *liquid capital*, if the *firm* is subject to a *liquid capital requirement* under paragraph (a) of rule 5.2.3(1).**

5.2.2 FINANCIAL RESOURCES

OWN FUNDS

5.2.2(1) R A *firm* must calculate its *own funds* in accordance with Table 5.2.2(1).

Liquid capital

5.2.2(2) R A *firm* must calculate its *liquid capital* in accordance with Table 5.2.2(1).

5.2.3 FINANCIAL RESOURCES REQUIREMENT

DETERMINATION OF REQUIREMENT

5.2.3(1)(a) R **The *financial resources requirement* for a *firm* is a *liquid capital requirement*, determined in accordance with paragraph (a) of rule 5.2.3(4), unless the *firm* falls within any of the exceptions in rule 5.2.3(2).**

EXCEPTIONS FROM THE LIQUID CAPITAL REQUIREMENT

5.2.3(2) R **The *financial resources requirement* is an *own funds requirement* determined in accordance with paragraph (a) of rule 5.2.3(3) for a *firm* if its *permitted business* does not include *establishing, operating or winding up a personal pension scheme* and which:**

i. **is an *exempt CAD firm* which is also an *operator* of a *collective investment scheme* and that scheme only invests in *venture capital investments* for *non-retail clients;* or**

ii. **is not an *exempt CAD firm* if:**

(a) **the *firm's permitted business* does not include the holding of *customers'* monies or assets and it neither executes transactions (or otherwise arranges deals) in *investments* nor has such transactions executed for itself or its *customers*; *or***

(b) **the *firm's* permitted business includes the activities as in (a) above, but only in respect of venture capital investments for *non-retail clients;* or**

(c) **the *firm* is a *trustee* of an *authorised unit trust scheme* whose *permitted business* consists only of trustee activities and does not include any other activity constituting *specified trustee business* or the *firm* is a *depositary* of an *ICVC* whose *permitted business* consists only of *depositary* activities.**

(d) **the *firm's permitted business* limits it to acting as the *operator* of a *collective investment scheme* whose main purpose is to invest in *permitted immovables* whether in the *UK* or abroad.**

OWN FUNDS REQUIREMENT

5.2.3(3)(a) R The *own funds requirement* for a *firm* subject to rule 5.2.3(2) is:

(i) £4,000,000 for a firm which is a trustee of an authorised unit trust scheme or a depositary of an ICVC;

(ii) £5,000 for any other *firm*.

Liquid capital requirement

5.2.3(4)(a) R The *liquid capital requirement* for a *firm* subject to paragraph (a) of rule 5.2.3(1) is the greater of:

(i) £5,000; and

(ii) its *total capital requirement* calculated in accordance with rule 5.2.3(5).

TOTAL CAPITAL REQUIREMENT

5.2.3(5) R A firm's total capital requirement is the sum of its:

(a) ***expenditure based requirement* calculated in accordance with Table 5.2.3(5)(a);**

(b) ***position risk requirement* calculated in accordance with Table 5.2.3(5)(b);**

(c) ***counterparty risk requirement* calculated in accordance with Table 5.2.3(5)(c);**

(d) ***foreign exchange requirement* calculated in accordance with Table 5.2.3(5)(d); and**

(e) ***other assets requirement* calculated in accordance with Table 5.2.3(5)(e).**

5.2.3(6) G A *firm* which discloses clients' money or assets on its balance sheet need not calculate the requirements under paragraphs (b) to (e) of rule 5.2.3(5) on such items where these do not represent assets or liabilities of the *firm* itself.

5.2.4 ANNUAL EXPENDITURE

DETERMINATION

5.2.4(1) R *Annual expenditure* is:

(a) the sum of the amounts described as total expenditure in the four *quarterly financial returns* up to (and including) that prepared at the *firm's* most recent *accounting reference date*, less the following items (if they are included within such expenditure):

(i) **staff bonuses, except to the extent that they are guaranteed;**

(ii) ***employees'* and *directors'* shares in profits, except to the extent that they are guaranteed;**

(iii) **other appropriations of profits;**

(iv) **shared commission and fees payable which are directly related to commission and fees receivable which are included within total revenue;**

(v) **interest charges in respect of borrowings made to finance the acquisition of the *firm's readily realisable investments*;**

(vi) **interest paid to *customers* on *client money*;**

(vii) **interest paid to counterparties;**

(viii) **fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions;**

(ix) **foreign exchange losses; or**

(b) where the previous accounting period does not include twelve months' trading, an amount calculated in accordance with paragraph (a) above pro-rated to an equivalent annual amount; or

(c) where a *firm* has not prepared four *quarterly financial returns* since the commencement of its *permitted business*, an amount based on forecast expenditure included in its budget for the first twelve months' trading, as submitted with its application for membership.

5.2.4(2) G A *firm*'s *financial resources requirement* will be recalculated annnually when its fourth *quarterly financial return* is prepared. The *firm* must maintain *financial resources* sufficient to meet its new *financial resources requirement* from the date on which the fourth *quarterly financial return* is prepared and no later than 80 business days after the *firm's accounting reference date*. The *expenditure based requirement* applicable at the *accounting reference date* will be based on the four *quarterly financial returns* prepared up to and on that date.

5.2.5 QUALIFYING SUBORDINATED LOANS

CHARACTERISTICS OF LONG TERM QUALIFYING SUBORDINATED LOANS

5.2.5(1) R A long term *qualifying subordinated loan* (item 11 of Table 5.2.2(1)) must have the following characteristics:

(a) **the loan is repayable only on maturity or on the expiration of a period of notice in accordance with paragraph (c) below or on the winding up of the *firm*;**

(b) **in the event of the winding up of the *firm*, the loan ranks after the claims of all other creditors and is not to be repaid until all other debts outstanding at the time have been settled;**

(c) **either:**

(i) the minimum original maturity of the loan is 5 years; *or*

(ii) the loan does not have a minimum or fixed maturity but requires 5 years notice of repayment; and

(d) **the loan is fully paid-up.**

Amount allowable in the calculation of own funds

5.2.5(2) R A *firm* may only take into account the paid-up amount of a long term *qualifying subordinated loan* in the calculation of its *own funds*. This amount must be amortised on a straight-line basis over the five years prior to the date of repayment.

REQUIREMENTS APPLICABLE TO SHORT-TERM QUALIFYING SUBORDINATED LOANS

5.2.5(3)(a) R A short term *qualifying subordinated loan* (item 15 of Table 5.2.2(1)) must have the characteristics set out in rule 5.2.5(1) save that the minimum period set out in paragraph (c) of rule 5.2.5(1) shall be two years.

(b) R A *firm* must not make any payment of principal or interest which would result in a breach of rule 5.2.1(2).

FORM OF QUALIFYING SUBORDINATED LOAN AGREEMENT

5.2.5(4) R A *qualifying subordinated loan* must be in the form prescribed by *the FSA* for the purposes of this rule.

5.2.5(5) G *Firms* wishing to initiate a subordinated loan agreement other than in the prescribed form are advised to contact *the FSA.*

CONDITIONS APPLICABLE TO QUALIFYING SUBORDINATED LOANS

5.2.5(6) R A *firm* wishing to include a *qualifying subordinated loan* in its calculation of *liquid capital* must:

(a) provide *the FSA* with a copy of the agreement not less than 10 business days before the loan is to be made; and

(b) certify to the FSA that the loan agreement complies with the FSA's prescribed subordinated loan agreement.

REQUIREMENTS ON A FIRM IN RELATION TO QUALIFYING SUBORDINATED LOANS

5.2.5(7) R A *firm* including a qualifying subordinated loan in its calculation of *liquid capital* must not:

(a) secure all or any part of the loan;

(b) redeem, purchase or otherwise acquire any of the liabilities of the borrower in respect of the loan;

(c) amend or concur in amending the terms of the loan agreement;

(d) repay all or any part of the loan otherwise than in accordance with the terms of the loan agreement; *or*

(e) take or omit to take any action whereby the subordination of the loan or any part thereof might be terminated, impaired or adversely affected.

5.2.6 QUALIFYING PROPERTY AND QUALIFYING UNDERTAKINGS

QUALIFYING PROPERTY AND QUALIFYING AMOUNT DEFINED

5.2.6(1) R ***Qualifying property* is any freehold or leasehold (or the equivalent tenure in Scotland or other territories) land and buildings purchased or secured by way of a mortgage (or other form of secured long-term arrangement) where the security for the liability is the property (and does not include any other allowable assets). The *qualifying amount* is the lowest of:**

(a) **85 per cent of the current market value of the property (if known);**

(b) **85 per cent of the net book value of the property;**

(c) **the amount of the liability outstanding under mortgage or other secured long term arrangement, excluding any part of the liability repayable within one year.**

5.2.6(2) G Rule 5.2.6(1) can be illustrated as follows:

Current market value	£200,000
Net book value	£100,000
Mortgage	£70,000, including £5,000 payable within one year

Qualifying amount is the lowest of:

(a) 85% x £200,000 = £170,000

(b) 85% x £100,000 = £85,000

(c) £70,000 – £5,000 = £65,000

i.e. £65,000

QUALIFYING UNDERTAKINGS

5.2.6(3) R **A *qualifying undertaking* is an arrangement between a *firm* and an *approved bank* which:**

(a) is in the form prescribed by *the FSA* for the purposes of this rule; and

(b) complies with the appropriate limitations set out in paragraph (7) of Part II to Table 5.2.2(1).

TABLE 5.2.2(1) CALCULATION OF OWN FUNDS AND LIQUID CAPITAL

PART I
METHOD OF CALCULATION

A *firm* must calculate its *own funds* and *liquid capital* as shown below, subject to the detailed requirements set out in Part II.

Financial resources	Category	Part II Para
Tier 1		
(1) Paid-up share capital (excluding preference shares)	**A**	**2**
(1A) *Eligible LLP members' capital*		
(2) Share premium account		
(3) Reserves		**2A**
(4) Non-cumulative preference shares		
Less: (5) Investments in own shares	**B**	
(6) Intangible assets		**3**
(7) Material current year losses		**4**
(8) Material holdings in credit and financial institutions and, for *exempt CAD firms* only, *material insurance holdings*.		**5 and 5A**
(8A) *Excess LLP members' drawings*		
Tier 1 capital = (**A-B**)	**C**	
Plus: **TIER 2**		**1**
(9) Revaluation reserves	**D**	
(10) Fixed term cumulative preference share capital		**1(a)**
(11) Long-term Qualifying Subordinated Loans		**1(a); 6**

(12) Other cumulative preference share capital and debt capital but, for *exempt CAD firms*, only perpetual cumulative preference share capital and *qualifying capital instruments*		**6A**
(13) Qualifying arrangements		**7**
"Own Funds" = (**C+D**)	**E**	
Plus**: TIER 3**		
(14) Net trading book profits	**F**	**1(b)(i); 8**
(15) Short-term Qualifying Subordinated Loans and excess Tier 2 capital		**1(b)(ii); 1(c); 9**
Less*:* (16) **I**lliquid assets	**G**	**10**
Add*:* (17) Qualifying Property		**11**
"Liquid Capital" = (**E+F+G**)		

PART II
DETAILED REQUIREMENTS

1 Deductions and Ratios (Items 10, 11 and 15)	(a) Notwithstanding Table 5.2.2(1) for an *exempt CAD firm*, in calculating *own funds*, all of Item 8 must be deducted after the total of Tier 1 and Tier 2 capital and the following restrictions apply: (i) the total of fixed term cumulative preference shares (item 10) and long-term *qualifying subordinated loans* (item 11) that may be included in Tier 2 capital is limited to 50 per cent of Tier 1 capital; (ii) Tier 2 capital must not exceed 100 per cent of Tier 1 capital.
	(c) A *firm* which is not an *exempt CAD firm* and which is subject to a *liquid capital requirement* under rule 5.2.3(1)(a) may take into account *qualifying subordinated loans* in the calculation of *liquid capital* up to a maximum of 400% of its Tier 1 capital.

2 Non corporate entities	(a) In the case of partnerships or sole traders, the following terms should be substituted, as appropriate, for items 1 to 4 in Tier 1 capital: (i) partners' capital accounts (excluding loan capital); (ii) partners' current accounts (excluding unaudited profits and loan capital); (iii) proprietors' account (or other term used to signify the sole trader's capital but excluding unaudited profits). (b) Loans other than *qualifying subordinated loans* shown within partners' or proprietors' accounts must be classified as Tier 2 capital under item 12. (c) For the calculation of *own funds,* partners' current accounts figures are subject to the following adjustments in respect of a *defined benefit occupational pension scheme:* (i) a *firm* must derecognise any *defined benefit asset;* (ii) a firm may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year. Note A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme.*
2A Reserves	For the calculation of *own funds* the following adjustments apply to the audited reserves figure: (a) a *firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost; (b) in respect of a defined *benefit occupational pension scheme,* a firm must derecognise any *defined benefit asset;* (c) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year

	Note 1 A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme.* (d) a *firm* must not include any unrealised gains from investment property. Note Unrealised gains from investment property should be reported as part of revaluation reserves. (e) where applicable, a *firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax. **Note 2** Reserves must be audited unless the *firm* is exempt from the provisions of Part VII of the Companies Act 1985 (section 249A (Exemptions from audit)), or where applicable, Part 16 of the Companies Act 2006 (section 477 (Small companies: Conditions for exemption from audit))relating to the audit of accounts.
3 Intangible assets (Item 6)	Intangible assets comprise: (a) formation expenses to the extent that these are treated as an asset in the *firm's* accounts; (b) goodwill, to the extent that it is treated as an asset in the *firm's* accounts; and (c) other assets treated as intangibles in the *firm's* accounts. Intangible assets do not include a deferred acquisition cost asset.
4. Material current year losses (Item 7)	Losses in current year operating figures must be deducted when calculating Tier 1 capital if such losses are material. For this purpose profits and losses must be calculated quarterly or monthly, as appropriate. If this calculation reveals a net loss it shall only be deemed to be material for the purposes of this Table if it exceeds 10 per cent of the *firm's* Tier 1 capital.

5 Material holdings in credit and financial institutions (Item 8)	Material holdings comprise: (a) where the *firm* holds more than 10 per cent of the equity share capital of the institution, the value of that holding and the amount of any subordinated loans to the institution and the value of holdings in *qualifying capital items* or *qualifying capital instruments* issued by the institution; (b) in the case of holdings other than those mentioned in (a) above, the value of holdings of equity share capital in, and the amount of subordinated loans made to, such institutions and the value of holdings in *qualifying capital items* or *qualfying capital instruments* issued by such institutions to the extent that the total of such holdings and subordinated loans exceeds 10 per cent of the *firm's own funds* calculated before the deduction of item 8.
5A Material insurance holdings (Item 8)	(a) A *material insurance holding* means the holdings of an *exempt CAD firm* of items of the type set out in (b) in any: (i) *insurance undertaking*; or (ii) *insurance holding company*; that fulfils one of the following conditions: (iii) it is a *subsidiary undertaking* of that *firm*; or (iv) that *firm* holds a participation in it. (b) An item falls into this provision for the purpose of (a) if it is: (i) an *ownership share*; or (ii) subordinated debt or another item of capital that falls into Article 16(3) of the *First Non-Life* Directive or, as applicable, Article 27(3) of the *Consolidated Life Directive*.
6 Long term *qualifying subordinated loans* (Item 11)	Loans having the characteristics prescribed by rule 5.2.5(1) may be included in item 11, subject to the limits set out in paragraph (1) above.

6A Perpetual cumulative preference share capital	Perpetual cumulative preference share capital may not be included in the calculation of *own funds* by an *exempt CAD firm* unless it meets the following requirements: (a) it may not be reimbursed on the holder's initiative or without the prior agreement of the *FSA*; (b) the instrument must provide for the *firm* to have the option of deferring the dividend payment on the share capital; (c) the shareholder's claims on the *firm* must be wholly subordinated to those of all non-subordinated creditors; (d) the terms of the instrument must provide for the loss-adsorption capacity of the share capital and unpaid dividends, whilst enabling the *firm* to continue its business; and (e) it must be fully paid-up.
7 Qualifying arrangements (Item 13)	(a) An *exempt CAD firm* may only include a *qualifying undertaking* or other arrangement in item 13 if it is a *qualifying capital instrument* or a *qualifying capital item*. (b) A *firm* which is not an *exempt CAD firm* may only include *qualifying undertakings* in its calculation of *liquid capital* if: (i) it maintains *liquid capital* equivalent to 6/52 of its *annual expenditure* in a form other than *qualifying undertakings*; and (ii) the total amount of all *qualifying undertakings* plus *qualifying subordinated loans* does not exceed the limits set out in paragraph (1)(c) above.
8 Net trading book profits (Item 14)	For *firms* which are not *exempt CAD firms* unaudited profits can be included at item 14.

Note

Non-trading book interim profits may only be included in Tier 1 of the calculation if they have been independently verified by the *firm's* external auditors, unless the *firm* is exempt from the provisions of Part VII of the Companies Act 1985 (section 249A (Exemptions from audit)), or where applicable, Part 16 of the Companies Act 2006 (section 477 (Small companies: Conditions for exemption from audit)) relating to the audit of accounts.

For this purpose, the external auditor should normally undertake at least the following:

(a) satisfy himself that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records;

(b) review the accounting policies used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the *firm* in drawing up its annual financial statements;

(c) perform analytical review procedures on the results to date, including comparisons of actual performance to date with budget and with the results of prior periods;

(d) discuss with management the overall performance and financial position of the *firm*;

(e) obtain adequate comfort that the implications of current and prospective litigation, all known claims and commitments, changes in business activities and provisions for bad and doubtful debts have been properly taken into account in arriving at the interim profits; and

(f) follow up problem areas of which the auditors are already aware in the course of auditing the *firm's* financial statements.

A *firm* wishing to include interim profits in Tier 1 capital in a *financial return* should submit to the FSA with the financial return a verification report signed by its external auditor which states whether the interim results are fairly stated, unless the *firm* is exempt from the provisions of Part VII of the Companies Act 1985 (section 249A (Exemptions from audit)), or where applicable, Part 16 of the Companies Act 2006 (section 477 (Small companies: Conditions for exemption from audit)) relating to the audit of accounts.

	Profits on the sale of capital items or arising from other activities which are not directly related to the *investment business* of the *firm* may also be included within the calculation of *liquid capital*, but (unless the firm is exempt as above) only if they can be separately verified by the *firm's* auditors. In such a case, such profits can form part of the *firm's* Tier 1 capital as profits.
9 Short term *qualifying subordinated loans* (Item 15)	Loans having the characteristics prescribed by rule 5.2.5(3) may be included in item 15 subject to the limits set out in paragraph (1) above. Tier 2 capital which exceeds the ratios prescribed by paragraph (1)(a) and (b) may be included in item 15 subject to paragraph (1) above.
10 Illiquid assets (Item 16)	Illiquid assets comprise: (a) tangible fixed assets; **Note** In respect of tangible fixed assets purchased under finance leases the amount to be deducted as an illiquid asset shall be limited to the excess of the asset over the amount of the related liability shown on the balance sheet. (b) holdings in, including subordinated loans to, *credit* or *financial institutions* which may be included in the *own funds* of such *institutions* unless they have been deducted under item 8; (c) any *investment* in undertakings other than *credit institutions* and other *financial institutions* where such *investments* are not readily realisable; (d) any deficiency in net assets of a *subsidiary*; (e) deposits not available for repayment within 90 days or less (except for payments in connection with margined futures or options contracts); **Note** Where cash is placed on deposit with a maturity of more than 90 days but is repayable on demand subject to the payment of a penalty, then this is not required to be deducted as an illiquid asset but a deduction is required for the amount of the penalty. (f) loans, other debtors and accruals not falling due to be repaid within 90 days or which are more than one month overdue by reference to the contractual payment date;

Table 5.2.3(5)(b) POSITION RISK REQUIREMENT	
PART I **CALCULATION OF REQUIREMENT**	
	(g) physical stocks (except where subject to the *position risk requirement* as set out in Table 5.2.3(5)(b); and (h) prepayments to the extent that the period of prepayment exceeds six weeks in the case of a *firm* subject to the 6/52 *expenditure based requirement* or thirteen weeks in the case of a *firm* subject to the 13/52 *expenditure based requirement* or where a *firm* is required to meet the requirement in rule 5.2.3(4)(c)(i). (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 PRU 2. Illiquid assets do not include a *defined benefit asset* or a deferred acquisition cost asset.
11 ***qualifying property*** (Item 17)	This item comprises the qualifying amount calculated in accordance with rule 5.2.6(1).

Table 5.2.3(5)(a) EXPENDITURE BASED REQUIREMENT

PART I
CALCULATION OF REQUIREMENT

A *firm's expenditure based requirement* is a fraction of its *annual expenditure* determined in accordance with Part II of this Table.

PART II
FRACTIONS

1 The fraction is 6/52 where:

(a) the *firm* is an *authorised unit trust manager*; *or*

(b) the *firm* acts only as an *authorised corporate director* of an *ICVC*; *or*

(c) the *firm* is an *investment manager* (including the *operator* of an *unregulated collective investment scheme* in relation to which the *firm* carries on the activity of an *investment manager*), unless paragraph 2 applies.

2 The fraction is 13/52 where the *firm* is an *investment manager* as in paragraph 1(c) above, or is a *custodian*, and the *firm* either:

(a) itself holds *customers'* monies or assets; *or*

(b) procures the appointment as *custodian* of its *customers'* monies or assets of an *associate* of the *firm* which is not an *approved bank*.

Note*:* Paragraph 1(a) above includes a *firm* which acts as both an *authorised unit trust manager* and as *an authorised corporate director* of an *ICVC.*

A *firm*'s position risk requirement is determined by calculating on a daily mark to market basis, the sum of the weighted value of each position held by the *firm*. The weighted value for each position must be calculated by multiplying its current market value by the appropriate factor set out in Part II.

Note: This requirement does not attach to items deducted in full as illiquid assets.

PART II
WEIGHTINGS

Instrument		**Requirement**		
A Debt	**Maturity**	*0-2 years*	*2-5 years*	*>5 years*
Central Government		2%	5%	13%
Qualifying debt securities				
• fixed rate		8%	8%	15%
• floating rate		10%	10%	15%
Non-qualifying debt securities				
• fixed rate		10%	20%	30%
• floating rate		30%	30%	30%

B	**Equities**	
•	Traded on a *recognised* or *designated investment exchange.*	25%
•	other	100%
C	**Stock position in physical commodities**	
•	Physical positions associated with *firm's investment business*	30% of realisable value
D	**Derivatives**	
•	Exchange traded futures and written options	4 x initial margin requirement.
•	otc futures and written options	Apply the appropriate percentage shown in Sections A, B, & C above to the market value of the underlying position.
•	Purchased options	Apply the appropriate percentage shown in Sections A, B & C above to the market value of the underlying position but the result may be limited to the market value of the option.
•	Contracts for differences	20% of the market value of the contract.
E	**Other *investments***	
•	units in *regulated collective investment schemes*	25% of realisable value (see Section F).
•	with profit *life policies*	20% of surrender value.
•	other	100% of the value of investment or underlying instrument.

F Determination of disallowed value of *units*

The disallowed value of units held in a *UCITS management company's* box is the difference between**:**

(a) the amount at which stocks of units in the box are valued in the balance sheet; and

(b) the adjusted value of the units, being the value of the units calculated at cancellation prices less the value calculated at cancellation prices of the units multiplied by the following percentages based on the types of *investments* in the individual *UCITS schemes:*

Quoted, fixed or floating rate interest bearing securities:	3%
Equities:	
USA, Japan, Canada	5%
Europe	6%
Far East and other	10%

Note

This can be illustrated as follows:
100 units, comprising Far East equities, with unit cancellation price of 100 pence.

	£	£
Balance sheet value		104
Value of cancellation price	100	
Less £100 x 10%	10	90
Disallowed		14

Note

The percentages in the requirement column are applied to the market value (unless otherwise stated) of gross positions i.e. both longs and shorts in each category; netting and off-setting are prohibited. The long or short position in a particular instrument is the net of any long or short positions held in that same instrument.

Table 5.2.3(5)(c) COUNTERPARTY RISK REQUIREMENT (CRR)

1	**Receivables**	In the case of receivables due to the *firm* in the form of fees, commission, interest, dividends and margin in exchange-traded futures or options contracts, which are directly related to items included in the *trading book*, the CRR is calculated as follows: CRR = A x RF, where A = the amount of the sum due; and RF = the appropriate risk factor derived from Table 5.2.3(5)(c)(ii). **Note** This requirement attaches only to balances arising from proprietary activity falling within the definition of the *trading book*. **Note** This requirement does not attach to items deducted in full as illiquid assets.
2	**Delivery of cash against documents**	Where a *firm* enters into a *trading book* transaction and the transaction is to be settled by delivery of cash against documents, the *firm's* CRR in respect of that transaction is calculated as follows: CRR = (SP – MV) x RF, where SP = agreed settlement price; MV = current market value; RF = the appropriate risk factors derived from Table 5.2.3(5)(c)(i). The CRR should only be calculated where the difference between SP and MV would involve a loss if borne by the *firm*.

3	**Free deliveries**	Where a *firm* enters into a *trading book* transaction and the *firm* pays for the securities before it receives documents of title or delivers documents of title before receiving payment, the CRR in respect of that transaction is calculated as follows: CRR = V x RF, where V = (i) the full amount due to the *firm* (i.e. the contract value) where the *firm* has delivered securities to a counterparty and has not received payment; *or* (ii) the market value of the securities, where the *firm* has made payment to a counterparty for securities and has not received documents of title; and RF = the appropriate risk factor derived from Table 5.2.3(5)(c)(ii).
4	**Settlement outstanding 30 days or more**	In the case of trading book transactions entered into by a *firm* where the *firm* pays for the securities before it receives documents of title or delivers documents of title before receiving payment and settlement has not been effected within 30 days of falling due, CRR = V.
5	**Repos/Stock Lending and Reverse Repos/Stock Borrowing**	Where a *firm* enters into a transaction based on securities included in the trading book under the terms of a repurchase agreement or a securities lending agreement the *firm's* CRR in respect of that transaction is calculated as follows: CRR = V x RF, where RF = the appropriate risk factor derived from Table 5.2.3(5)(c)(ii); and for repos/stock lending: V = the excess of the market value of the securities over the value of the collateral provided under the agreement, if the net figure is positive; or

		for reverse repos/stock borrowing: V = the excess of the amount paid or the collateral given for the securities received under the agreement, if the net figure is positive.
6	**otc derivatives**	In the case of a transaction entered into by a *firm* as principal in an *otc derivative* the CRR is calculated as follows: CRR = A x RF, where A = the appropriate credit equivalent amount derived from Table 5.2.3(5)(c)(iii); and RF = the appropriate risk factor derived from Table 5.2.3(5)(c)(ii). This calculation shall not apply to contracts for interest rate and foreign exchange which are traded on a *recognised investment exchange* or *designated investment exchange* where they are subject to a daily margin requirement and foreign exchange contracts with an original maturity of 14 calendar days or less. A *firm* may net off contracts with the same counterparty in the same *otc derivative* contract for settlement on the same date in the same currency provided that the *firm* is legally entitled under the terms of the contracts with such a counterparty to net such contracts by novation.

Table 5.2.3(5)(c)(i)

COUNTERPARTY RISK FACTOR – CASH SETTLEMENTS

Number of working days after due settlement date	**Risk Factor**
0-4	0%
5-15	8%
16-30	50%
31-45	75%
46 or more	100%

Table 5.2.3(5)(c)(ii) COUNTERPARTY RISK REQUIREMENT

Type of *counterparty*		Risk Weighting	Solvency Ratio	Risk Factor
1	A counterparty which is, or the contract of which is, explicitly guaranteed by a *category a body*.	NIL	8%	NIL
2	A counterparty which is, or the contract of which is, explicitly guaranteed by a *category b body*.	20%	8%	1.6%
3	Any other counterparty.	100%	8%	8%

Table 5.2.3(5)(c)(iii)

OTC DERIVATIVES CALCULATION OF CREDIT EQUIVALENT AMOUNT

A By attaching current market values to contracts (marking to market), obtain the current replacement cost of all contracts with positive values.

B To obtain a figure for potential future credit exposure, the notional principal amounts or values underlying the *firm's* aggregate positions are multiplied by the following percentages:

Residual Maturity	Interest-Rate Contracts	Foreign-Exchange Contracts
One year or less	nil	1%
More than one year	0.5%	5%

C The credit equivalent amount is the sum of current replacement cost and potential future credit exposure.

Note

Except in the case of single-currency "floating/floating interest rate" swaps in which only the current replacement cost will be calculated, bought OTC equity options and covered warrants shall be subject to the treatment accorded to exchange rate contracts.

Table 5.2.3(5)(d) FOREIGN EXCHANGE REQUIREMENT

Calculation of Requirement

(1) A *firm's foreign exchange requirement* is determined by calculating the excess of its *foreign exchange position* (FEP) above 2 per cent of its *own funds* and multiplying this excess by 8 per cent.

(2) The FEP is the greater of:

(a) the total in the *reporting currency* of the net short positions in each currency other than the *reporting currency*; and

(b) the total in the *reporting currency* of the net long positions in each currency other than the *reporting currency*;

where the conversion to the *reporting currency* is performed using spot rates.

Note

For this purpose, long and short positions in the same currency can be netted to produce the net position.

(3) In calculating the FEP, a *firm* must include *relevant foreign exchange items*.

EXCHANGE POSITION FOR HEDGING PURPOSES

Any positions which the *firm* has taken in order to hedge against the adverse effect of exchange rates on an item already deducted in the calculation of *liquid capital* may not be excluded from the calculation of net open currency positions.

Table 5.2.3(5)(e) OTHER ASSETS REQUIREMENT

PART I
CALCULATION OF REQUIREMENT

The requirement to be met in respect of the assets set out in Part II of this Table, other than those to which *position risk requirements* and *counterparty risk requirements* apply or which have been deducted in full as illiquid assets, and in respect of off-balance sheet items set out in Part II of this Table, must be calculated as follows:

A	=	AV x RF where
A	=	the amount of the requirement;
AV	=	the current asset value; and
RF	=	the appropriate risk factor derived from Part II of this Table.

PART II
RISK FACTORS

Assets and Off-Balance Sheet Items	Risk Factor
Assets	
Cash at bank and in hand and equivalent items Assets secured by acceptable collateral including deposits and certificates of deposit with lending institutions	NIL
Amount due from trustees of authorised unit trusts	NIL
Note	
This only applies to *firms* who are *authorised unit trust managers* in relation to authorised unit trusts they manage.	
Amount due from *depositaries* of *ICVC's*	
Note This only applies to *firms* who are *authorised corporate directors* in relation to *ICVC's* they operate	NIL
Other receivables due from or explicitly guaranteed by or deposits with *category a bodies*	NIL

Other receivables due from or explicitly guaranteed by or deposits with *category b bodies*	1.6%

Pre-payments and accrued income (See paragraph 10 of Part II of Table 5.2.2(1)	8%
Defined benefit asset	NIL
Deferred acquisition cost asset	NIL
All other assets	8%
OFF-BALANCE SHEET ITEMS	
Full Risk Items e.g.	
Charges granted against assets	8% x counterparty weight *(see Table 5.2.3(5)(c)(ii))*
Guarantees given	
Medium Risk Items e.g.	
Undrawn credit facilities granted by the *firm* with an original maturity of more than one year	4% x counterparty weight *(see Table 5.2.3(5)(c)(ii))*
Low Risk Items e.g.	
Undrawn credit facilities granted by the *firm* with an original maturity of one year or less	Nil

Note

(1) In determining the appropriate *other assets requirement* (OAR) for guarantees given in a group context, *a firm* should follow the calculation below:

(a) Categorise the guarantee agreements into:

(i) those with the character of credit substitutes; or

(ii) those not having the character of credit substitutes; or

(iii) agreements to provide guarantees.

(b) Calculate the weighted value.

(i) For guarantees falling under (1)(a)(i), the weighted value will be 100% of the estimated current year liability under the guarantee.

(ii) For guarantees falling under (1)(a)(ii) the weighted value will be 50% of the estimated current year liability under the guarantee.

(iii) For guarantees falling under (1)(a)(iii), the weighted value will be nil.

(c) The OAR is calculated as:

Weighted value x 8% x counterparty weighting (Table 5.2.3(5)(c)(ii))

(2) For the purpose of this requirement, in assessing whether the guarantee has the characteristics of a credit substitute the following factors should be considered:

(a) do the agreements allow for periodic or ad-hoc calling of funds;

(b) have the guarantees been drawn upon on a regular basis;

(c) do *firm*s in the group rely on such guarantees to meet their working capital or regulatory capital requirements.

(3) Where a *firm* is part of a group including other *FSA* regulated entities which together have entered into cross group guarantee arrangements which give rise to an OAR, the estimate of the potential liability under the guarantee may be apportioned between the regulated entities for the purpose of calculating each *firm*'s OAR.

5.3.1 RECORDS

RECORDING REQUIREMENTS

5.3.1(1) R **A *firm* must ensure that it maintains adequate accounting records and must prepare and submit such reports as are required by *the FSA* in a timely manner. A *firm's* records must:**

(1) be up to date and must disclose, with reasonable accuracy, at any time, the *firm's* financial position at that time;
(2) enable the *firm* to demonstrate its continuing compliance with its *financial resources requirements*; and
(3) provide the information:

(a) **which the *firm* needs to prepare such financial statements and periodical reports as may be required by *the FSA*; and**
(b) **which the *firm's* auditor (where *the FSA* requires one to be appointed) needs to form an opinion on any statements of the *firm* on which the auditor is required to report.**

5.3.1(2) G Where a *firm* appoints a third party to maintain the *firm*'s accounting records, these records remain the responsibility and property of the *firm*, which must ensure that they are maintained in accordance with the *rules*.

FIRM'S OWN TRANSACTIONS

5.3.1(3) R **A *firm* must ensure that proper accounting records are kept in English to show and explain the *firm's own account transactions*, distinguishing between *trading book* and *non-trading book* transactions.**

CUSTOMERS' ACCOUNTING RECORDS

5.3.1(4) R **A *firm* must ensure that proper accounting records are kept in English which:**

(1) **record all purchases and sales of *customers'* assets effected by the *firm*;**
(2) **record all receipts and payments of money belonging to *customers* which arise from transactions effected by the *firm*;**
(3) **in relation to *client money*; have regard to the requirements of the *Client Money Rules*;**
(4) **disclose the assets and liabilities of a *firm's customers* individually and collectively, to the extent that they are managed by the *firm*;**
(5) **record all *customers'* assets (including *customer investments*) in the possession of the *firm* or of another person who is holding such assets for, or to the order of, the *firm*, showing the location of the assets, their beneficial owner and the extent to which they are subject to any charge of which the *firm* has been notified.**

5.3.1(5) G The requirement to maintain adequate records of movements and holdings of *client money* and any interest paid on *client money* balances, are set out in *CASS* 4.1 to 4.3 (with respect of *designated investment business* that is not *MiFID* business) and in *CASS* 7.1 to 7.8 (with respect of *MiFID* business).

RETENTION OF ACCOUNTING RECORDS

5.3.1(6) R The accounting records required by rule 5.3.1(1) to (4) must be maintained for a minimum period of six years. During the first two of these years they must be kept either at a place where the *firm* carries on business or in such a manner that they can be produced at such a place within 24 hours of their being requested.

5.7 CONSOLIDATED SUPERVISION

Under the Financial Conglomerates and Other Financial Groups Instrument 2004, the rules in Chapter 14 shall (with respect to a particular firm, group or financial conglomerate) apply from the first day of its financial year beginning in 2005 in place of rules 5.7.1(1) to 5.7.5(4).

APPENDIX 1 (INTERPRETATION)

GLOSSARY OF TERMS FOR CHAPTER 5 (FORMER IMRO FIRMS)

The following words or terms throughout Chapter 5 are to have the meanings given to them below if not inconsistent with the subject or context. If a defined term does not appear in the IPRU(INV) 5 glossary below, the definition appearing in the main Handbook *Glossary* applies.

Term	**Meaning**
accounting reference date	means: (a) the date to which a *firm's* accounts are prepared in order to comply with the relevant Companies Act legislation. In the case of a *firm* not subject to the Companies Act legislation, the equivalent date selected by the *firm*; and (b) in the case of an *OPS firm* which is not subject to the Companies Act legislation, the date to which the accounts of the *OPS* in respect of which the *firm* acts are prepared.
admission procedures	means the procedures set out in the Authorisation Manual together with any other procedures which the *Board* resolves, either generally or in relation to any specific case, should apply to the admission of *firms* and the admission of *approved persons*.
annual accounts	means accounts prepared to comply with the relevant Companies Act legislation and their equivalent in Northern Ireland or other statutory obligations.
annual expenditure	has the meaning given in rule 5.2.4(1) (Determination).
authorised unit trust manager	means the manager of an *authorised unit trust scheme*.
best execution	in relation to the effecting of a transaction, means the effecting of that transaction in compliance with *COBS* 11.2.
Board	means the board of *directors* of *FSA* or any duly authorised committee of such board**.**
category a body	means: (a) the government or central bank of a *zone a country*; or (b) the European Communities; or (c) the government or central bank of any other country, provided the receivable in question is denominated in that country's national currency.
category b body	means: (a) the *EIB* or a multi-lateral development bank; or (b) the regional government or local authority of a *zone a country*; or (c) an *investment firm* or *credit institution* authorised in a *zone a country*; or (d) a *recognised clearing house* or *exchange*; or (e) an *investment firm* or *credit institution* authorised in any other country, which applies a financial supervision regime at least equivalent to the *Capital Adequacy Directive*.
Client Money Rules	*CASS 4.1 to 4.3*.

company	means a *body corporate* or an unincorporated association and, where the context permits, includes a partnership.
compliance officer	means the individual from time to time appointed by a *firm* as responsible for compliance matters.

connected company and connected credit institution

means, in relation to a *firm* which:

(a) is a *body corporate*, a *body corporate* or *credit institution* satisfying any of the following conditions:

   (i) the same person is the *controller* of each *body corporate* or *credit institution*; or

   (ii) if a *group* of two or more persons are *controllers* of each *body corporate* or *credit institution*, the *group* either consists of the same persons or could be regarded as consisting of the same persons by treating a member of either *group* as replaced by:

      (A) that member's *close relative*; or

      (B) a person with whom the member is in partnership; or

      (C) a *body corporate* of which the member is an officer; or

   (iii) both *bodies corporate* are members of the same *group*; or

(b) is not a *body corporate* or *credit institution* which is controlled:

   (i) by the *firm*; or

   (ii) by a partner in the *firm*; or

   (iii) by a *close relative* or partner in the *firm* or, if the *firm* is a sole trader, by a *close relative* of the sole trader; or

   (iv) collectively by any of the partners in the *firm* or their *close relatives.*

controller

(as defined in section 422 of the *Act* (Controller))

in relation to a *firm* or other undertaking ("A"), means a person who:

(a) holds 10% or more of the *shares* in A; or

(b) is able to exercise significant influence over the management of A by virtue of his shareholding in A; or

(c) holds 10% or more of the *shares* in a parent undertaking ("P") of A; or

(d) is able to exercise significant influence over the management of P by virtue of his shareholding in P; or

(e) is entitled to exercise, or control the exercise of, 10% or more of the voting power in A; or

(f) is able to exercise significant influence over the management of A by virtue of his voting power in A; or

(g) is entitled to exercise, or control the exercise of, 10% or more of the voting power in P; or

(h) is able to exercise significant influence over the management of by virtue of his voting power in P.

and in this definition

(A) "person" means:

   (a) the person; or

   (b) any of the person's *associates*; or

   (c) the person and any of his *associates*;

(B) "associate", in relation to a person (H") holding shares in an undertaking ("C") or entitled to exercise or control the exercise of voting power in relation to another undertaking ("D") means:

1. the spouse of H
2. a child or stepchild of H (if under 18);
3. the trustee of any settlement under which H has a life interest in possession (or in Scotland a life interest);
4. an undertaking of which H is a *director*;

(e) a person who is an *employee* or *partner* of H;

(f) if H is an undertaking:

(i) a *director* of H;

(ii) a *subsidiary* undertaking of H;

(iii) a *director* or *employee* of such a *subsidiary* undertaking; and

(g) if H has with any other person an agreement or arrangement with respect to the acquisition, holding or disposal of shares or other interests in C or D or under which they undertake to act together in exercising their voting power in relation to C or D, that other person;

(a) "settlement" includes any disposition or arrangement under which property is held on trust (or subject to a comparable obligation);

(b) "shares" means;

(a) in relation to an undertaking with a share capital, allotted shares;

(b) in relation to an undertaking with capital but no share capital, rights to share in the capital of the undertaking;

(c) in relation to an undertaking without capital, interests:

(i) conferring any right to share in the profits, or liability to contribute to the losses, of the undertaking; or

(ii) giving rise to any obligation to contribute to the debts or expenses of the undertaking in the event of a winding up.

corporate finance business means:

(a) *designated investment business* carried on by a *firm* with or for:

(i) any issuer, holder or owner of *designated investments*, if that business relates to the offer, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, those *investments*, or any related matter;

(ii) any *eligible counterparty* or *professional client*, or other *body corporate*, partnership or supranational organisation, if that business relates to the manner in which, or the terms on which, or the persons by whom, any business, activities or undertakings relating to it, or any *associate*, are to be financed, structured, managed, controlled, regulated or reported upon;

(iii) any person in connection with:

(A) a proposed or actual *takeover or related operation* by or on behalf of that person, or involving investments issued by that person (being a *body corporate*), its *holding company*, *subsidiary* or *associate*; or

(B) a merger, de-merger, reorganisation or reconstruction involving any investments issued by that person (being a *body corporate*), its *holding company*, *subsidiary* or *associate*;

(iv) any shareholder or prospective shareholder of a *body corporate* established or to be established for the purpose of effecting a *takeover or related operation*, where that business is in connection with that *takeover or related operation*;

(v) any person who, acting as a *principal* for his own account:

(A) is involved in negotiations or decisions relating to the commercial, financial or strategic intentions or requirements of a business or prospective business; or

(B) (provided he is acting otherwise than solely in his capacity as an investor) assists the interests of another person with or for whom the *firm*, or another *authorised person* or *overseas person*, is undertaking business as specified in (a)(i),(ii),(iii) or (iv), by himself undertaking all or part of any transactions involved in such business;

(vi) any person undertaking business with or for a person as specified in (a)(i), (ii), (iii), (iv) or (v) in respect of activities described in those sub-paragraphs;

(b) *designated investment business* carried on by a *firm* as a *principal* for its own account where such *business*:

(i) is in the course of, or arises out of, activities undertaken in accordance with (a); and

(ii) does not involve transactions with or for, or *advice* to, any other person who is a *retail client* in respect of such business;

(c) *designated investment business* carried on by a *firm* as *principal* for its own account if such business:

(i) is in the course of, or arises out of:

(A) the offer, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, shares, share warrants, *debentures* or debenture warrants issued by the *firm*, or any related matter; or

(B) a proposed or actual *takeover or related operation* by or on behalf of the *firm*, or involving shares, share warrants, *debentures* or debenture warrants issued by the *firm*; or

(C) a merger, de-merger, reorganisation or reconstruction involving any shares, share warrants, *debentures* or debenture warrants issued by the *firm*; and

(ii) does not involve giving *advice on investments* to any person who is a *retail client*;

in this definition, "share warrants" and "debenture warrants" means any *warrant* which relates to shares in the *firm* concerned or, as the case may be, *debentures* issued by the *firm*.

counterparty	means any person with or for whom a *firm* carries on *regulated business* or an *ancillary activity*.
counterparty risk requirement	has the meaning given in Table 5.2.3(5)(c) (Counterparty risk requirement).
customer	see the meaning given to the term in the *Glossary*
customer investment	means an *investment* , or a document of title or a certificate or other record evidencing title to an *investment*, (other than an *investment* falling within articles 83, 84 and 85 of the *RAO*) which is legally or beneficially owned by a *customer* of a *firm*.
customer transaction	does not include an *own account transaction*.
EEA parent	means a *firm's* direct or indirect *parent* which has its head office in the *EEA*.
EIB	means the European Investment Bank.
expenditure based requirement	means the requirement calculated in accordance with Table 5.2.3(5)(a) (Expenditure based requirement).
finance officer	means the most senior individual from time to time directly responsible for the *firm's* finances and for compliance with the requirements of the Supervision Manual.
financial resources	has the meaning given in rule 5.2.1(3) (Financial resources).
financial resources requirement	has the meaning given in rule 5.2.3(1) (a) to (c) (Determination of requirement).

financial resources rules	has the meaning given in rules 5.2.1 to 5.2.7.
financial return	means *quarterly financial return* or *monthly financial return* as the case may be.
foreign exchange position	has the meaning given in Table 5.2.3(5)(d) (Foreign exchange requirement).
funds under management	(1) *collective investment schemes* other than *OEICs managed* by the *firm* including *schemes* where it has delegated the management function but excluding *schemes* that it is *managing* as delegate; and (2) *OEICs* for which the *firm* is the designated management company.
Group of connected counterparties	means: (a) two or more natural or legal persons who constitute a single risk because one of them, directly or indirectly, has *contro*l over the other or others; or (b) two or more natural or legal persons between whom there is no relationship of *control* as in (a)but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to exercise financial problems, the other or all of the others would be likely to encounter difficulties in performing its or their obligations.
IADB	means the Inter-American Development Bank.
IBRD	means the International Bank for Reconstruction and Development.
IFC	means the International Finance Corporation.
investigation	means an investigation authorised pursuant to the Enforcement Guide.
investment	means a *designated investment*.
investment business	means *designated investment business*.
investment firm	has the meaning given to *investment firm* in the main *Glossary* except that it excludes persons to which the *MiFID* does not apply as a result of articles 2 or 3 of *MiFID*. **Note:** An *investment firm* is not necessarily a *firm* for the purposes of the rules.
investment management firm	see the meaning given to the term in the *Glossary*
investment manager	means a person who, acting only on behalf of a *customer*, either: (a) manages an account or portfolio in the exercise of discretion; or (b) has accepted responsibility on a continuing basis for advising on the composition of the account or portfolio.
investment services	means activities undertaken in the course of carrying on *designated investment business* or undertaken as an *ISA manager*.
ISA cash deposit	means a cash deposit within Regulation 8 of the Individual Savings Account Regulations 1998 (SI 1998/1870) which is held within a cash component ISA.
liquid capital	has the meaning given in rule 5.2.2(1) (Calculation of own funds and liquid capital).
liquid capital requirement	has the meaning given in rule 5.2.3(4) (a) to (c) (Liquid capital requirement).
marketable investment	means: (a) an *investment* which is traded on or under the rules of an exchange; (b) a debt instrument which may be transferred without the consent of the issuer or any other person (including a collateralised mortgage obligation);

(c) a commodity;

(d) a *warrant*, option, future or other instrument which entitles the holder to subscribe for or acquire:

(i) an *investment* or commodity in (a) to (c); or

(ii) any currency; or

(iii) any combination of (i) and (ii);

(e) a contract for differences (including interest rate and currency swaps) relating to fluctuations in:

(i) the value or price of an *investment* or commodity in (a) to (d); or

(ii) any currency; or

(iii) the rate of interest in any currency or any index of such rates; or

(iv) the level of any index which is derived from the prices of an *investment* or commodity in (a) to (c); or

(v) any combination of (i) to (iv);

(f) *warrants*, options, futures or other instruments entitling the holder to obtain the rights of those contracts in (d) or (e);

(g) a *unit* in a *regulated collective investment scheme*.

marketing group	means a group of persons: (a) who are allied together (either formally or informally) for the purposes of marketing *packaged products* of the group; and (b) each of whom, if it holds itself out in the UK as marketing any *packaged products* to *retail clients*, does so only as an *investment manager* or in relation to those of the *marketing group*.
member state	means a member state of the *EEA*.
monthly financial return	means the return referred to in the Supervision Manual.
non-retail client	means a *professional client* or an *eligible counterparty*.
OPS or occupational pension scheme	means any scheme or arrangement which is comprised in one or more instruments or agreements and which has, or is capable of having, effect in relation to one or more descriptions or categories of employment so as to provide benefits, in the form of pensions or otherwise, payable on termination of service, or on death or retirement, to or respect of earners with qualifying service in an employment of any such description or category.
OPS activity	see the meaning given to the term in the *Glossary*

OPS firm	means: (a) a *firm* which: (i) carries on *OPS activity* but not with a view to profit; and (ii) is one or more of the following: (A) a trustee of the *occupational pension scheme* in question; (B) a *company* owned by the trustees of the *occupational pension scheme* in question; (C) a *company* which is: (I) an employer in relation to the *occupational pension scheme* in question in respect of its employees or former employees or their dependants; or (II) a *company* within the *group* which includes an employer within (I); or (III) an administering authority subject to the Local Government Superannuation Regulations 1986; or (b) a *firm* which: (i) has satisfied the requirements set out in (a) at any time during the past 12 *months*; but (ii) is no longer able to comply with those requirements because of a change in the control or ownership of the employer referred to in (a)(ii) during that period.
otc derivative	means interest rate and foreign exchange contracts covered by Annex III to the previous version of the *Banking Consolidation Directive* (i.e. Directive (2000/12/EC) and off balance sheet contracts based on equities which are not traded on a *recognised* or *designated investment exchange* or other exchange where they are subject to daily margin requirements, excluding any foreign exchange contract with an original maturity of 14 calendar days or less.
other assets requirement	has the meaning given in Table 5.2.3(5) (e) (Other assets requirement).
overseas person	see the meaning given to the term in the *Glossary*
own funds	has the meaning given in rule 5.2.2(1) (Calculation of own funds and liquid capital).
own funds requirement	has the meaning given in rule 5.2.3(3) (a) (Own funds requirement).
parent	means any parent undertaking as defined in section 1162 of the Companies Act 2006 and any undertaking which effectively exercises a dominant influence over another undertaking.
participation	has the meaning given to the term in the *Glossary*.
permitted business	means *regulated activity* which a *firm* has *permission* to carry on.
plan investment	means an *investment* included in any *ISA* component.
position risk requirement	has the meaning given in Table 5.2.3(5)(b) (Position risk requirement).
prescribed subordinated loan agreement	means the subordinated loan agreement prescribed by the FSA for the purposes of rule 5.2.5(4).
qualifying amount	has the meaning given in the Supervision Manual.
qualifying capital instrument	means that part of a *firm*'s capital which is a security of indeterminate duration, or other instrument, that fulfils the following conditions: (a) it may not be reimbursed on the bearer's initiative or without the prior agreement of *FSA*;

	(b) the debt agreement must provide for the *firm* to have the option of deferring the payment of interest on the debt; (c) the lender's claims on the *firm* must be wholly subordinated to those of all non-subordinated creditors; (d) the documents governing the issue of the securities must provide for debt and unpaid interest to be such as to absorb losses, whilst leaving the *firm* in a position to continue trading; and (e) only fully paid-up amounts shall be taken into account.
qualifying capital item	means that part of a *firm*'s capital which has the following characteristics: (a) it is freely available to the *firm* to cover normal banking or other risks where revenue or capital losses have not yet been identified; (b) its existence is disclosed in internal accounting records; and (c) its amount is determined by the management of the *firm* and verified by independent auditors, and is made known to, and is monitored by, *FSA*. **Note:** Verification by internal auditors will suffice until such time as EU provisions making external auditing mandatory have been implemented.
qualifying property	has the meaning given in rule 5.2.6(1) (Qualifying property and qualifying amount defined).
qualifying subordinated loan	has the meaning given in rule 5.2.5 (1) to (7) (Qualifying subordinated loans).
qualifying undertaking	has the meaning given in rule 5.2.6(3) (Qualifying undertakings).
quarterly financial return	means the return referred to in the Supervision Manual.
readily realisable investment	means a unit in a *regulated collective investment scheme*, a *life policy* or any *marketable investment* other than one which is traded on or under the rules of a *recognised* or *designated investment exchange* so irregularly or infrequently: (a) that it cannot be certain that a price for that *investment* will be quoted at all times; or (b) that it may be difficult to effect transactions at any price which may be quoted.
recognised overseas clearing house	means an *overseas clearing house* which is declared by a recognition order made under section 290 or 292 of the *Act* for the time being in force to be a *recognised clearing house*.
recognised overseas investment exchange	means an *overseas investment exchange* which is declared by a recognition order made under section 290 or 292 of the *Act* for the time being in force to be a *recognised investment exchange*.
recognised third country investment firm	means an *investment firm* which is authorised in a country other than a *member state* and which is subject to and complies with prudential rules equivalent to the requirements of the *Capital Adequacy Directive*. **Note:** A *recognised third country investment firm* is not necessarily a *firm* for the purposes of the *rules*. **Note**: A list of the non-EEA regulators which are approved by *FSA* for the purposes of recognising *recognised third country investment firms* under the Capital Adequacy Directive is available on request from the *FSA*.
registered individual	means an *approved person*.
registrable activity	in relation to a *firm*, means any one of the following:

(a) holding the post of *director* or *chief executive*;

(b) acting as an *investment manager* in the course of the *permitted business* of the *firm*;

(c) acting in a senior capacity with responsibility either alone or jointly with one or more other individuals for the management, supervision and control of a part of the *firm's permitted business* (including the *compliance officer* and the *finance officer*);

(d) procuring or endeavoring to procure other persons to enter into *investment agreements*, or giving advice to persons with whom he deals about entering into *investment agreements* or exercising rights conferred by *investments*, in the course of the *permitted business* of the *firm*;

(e) committing the *firm* or its *customers* in market dealings or in transactions in *securities* or in other *investments* in the course of the *firm's permitted business*.

regulated activity — see the meaning given to the term in the *Glossary*

regulated business — means *designated investment business*.

regulated friendly society — means, as respects *investment business* carried on for or in connection with any of the purposes mentioned in Schedule 1 to the Friendly Societies Act 1974, or, as the case may be, to the Friendly Societies Act (Northern Ireland) 1970, means a society which is a friendly society within the meaning of section 7(1)(a) of the Friendly Societies Act 1974 and is registered within the meaning of that Act or is a friendly society within the meaning of section 1(1)(a) of the Friendly Societies Act (Northern Ireland) 1970 and is registered or deemed to be registered under that Act; and

(a) under its rules, has its registered office at a place situated in Great Britain or, as the case may be, Northern Ireland; and

(b) carries on *investment business* in the UK.

relevant foreign exchange items — means:

(a) all assets less liabilities, including accrued interest, denominated in the currency (all investments at market or realisable value);

(b) any currency future, at the nominal value of the contract;

(c) any forward contract for the purchase or sale of the currency, at the contract value, including any future exchange of principal associated with currency swaps;

(d) any foreign currency options at the net delta (or delta-based) equivalent of the total book of such options;

(e) any non-currency option, at market value;

(f) any irrevocable guarantee;

(g) any other off-balance sheet commitment to purchase or sell an asset denominated in that currency.

reporting currency — means the currency in which the *firm*'s books of account are maintained.

specified trustee business — 1. means any *investment business* carried on in the UK by a *trustee firm*, but excluding each of the following activities:

(a) **Dealing or arranging deals in *investments***

(i) where the deal is transacted or arranged by a *trustee firm* with or through a *PTP*; or

(ii) where the dealing or arranging is done in the course of, or is incidental to, an activity of management falling within paragraph (b) below; or

(iii) where the trust is a *unit trust scheme* and the deal is or the arrangements are made with a view to either an issue or sale of units in such a *scheme* to, or a redemption or repurchase or conversion of such units or a dealing in investments for such a *scheme* carried out by with or through, the *operator* or on the instructions of the *operator*; or

(iv) where the *trustee firm*, being a bare trustee (or, in Scotland, a nominee) holding *investments* for another person, is acting on that person's instructions; or

(v) where any arrangements do not or would not bring about the transaction in question.

(b) **Managing Investments**

(i) where the *trustee firm* has no general authority to effect transactions in *investments* at discretion; or

(ii) if and to the extent that all day-to-day decisions in relation to the management of the *investments* or any discrete part of the *investments* are or are to be taken by a *PTP*; or

(iii) if and to the extent that investment decisions in relation to the *investments* or any discrete part of the *investments* are or are to be taken substantially in accordance with the advice given by a *PTP*; or

(iv) where the *trustee firm* is a personal representative or executor and is acting in that capacity; or

(v) where the trust is a *unit trust scheme* and all day-to-day investment decisions in the carrying on of that activity are or are to be taken by the *operator* of the *scheme*.

(c) **Investment advice**

(i) where the relevant advice:

(A) does not recommend the entry into any investment transaction or the exercise of any right conferred by any *investment* to acquire, dispose of, underwrite or convert such an *investment*; and

(B) is accompanied by a recommendation that independent advice be obtained; or

(ii) if and to the extent that the relevant advice is in substance the advice of a *PTP*; or

(iii) where the relevant advice is given by the *trustee firm* acting in the capacity of personal representative or executor.

(d) **Establishing, operating or winding up a *collective investment scheme* including acting as *trustee* of an *authorised unit trust scheme*** but only to the extent that such activities do not otherwise constitute *specified trustee business.*

(e) **Any *trustee activity* undertaken as trustee of an issue of debentures or government or public securities**

(i) where the issue is made by a company listed on a *recognised investment exchange* or on a *designated investment exchange* (or by a wholly-owned subsidiary of such a company); or

(ii) where the issue is listed or traded either on a *recognised* *investment exchange* or on a *designated investment exchange* or on the Société de la Bourse de Luxembourg; or

(iii) where the issue is made by a government, local authority or international organisation; or

(iv) where the aggregate amounts issued (pursuant to the trust deed or any deed supplemental thereto and ignoring any amounts redeemed, repurchased or converted) exceed the sum of £10,000,000.

2. For the purpose of this definition of "*specified trustee business*":

(a) a transaction is entered into through a person if that person:

(i) enters into it as agent; or

(ii) arranges for it to be entered into as principal or agent by another person and the arrangements are such that they bring about the transaction in question;

(b) **investment transaction** means a transaction to purchase, sell, subscribe for or underwrite a particular investment and "investment decision" means a decision relating to an investment transaction;

(a) **debentures** means any securities falling within article 77 of the *RAO*;

(d) **government or public securities** means any securities falling within article 78) of the RAO;

(e) *government, local authority or international organisation* means:

(i) the government of the *United Kingdom*, of Northern Ireland, or of any country or territory outside the United Kingdom;

(ii) a local authority in the *United Kingdom* or Anywhere; or

(iii) an international organisation the members of which include the *United Kingdom or another EEA State*.

(f) in determining the size of an issue of debentures or government or public securities made in a currency other than sterling, the amount of the issue shall be converted into sterling at the exchange rate prevailing in London on the date of issue.

statutory rules — means the rules made by *FSA* under the Act.

total capital requirement — has the meaning given in rule 5.2.3(5) (Total capital requirement).

trading book — in relation to a *firm*'s business or exposures, means:

(a) its proprietary positions in financial instruments:

(i) which are held for resale and/or are taken on by the *firm* with the intention of benefiting in the short term from actual and/or expected differences between their buying and selling prices or from other price or interest-rate variations;

(ii) arising from matched principal broking;

(iii) taken in order to hedge other elements of the *trading book*;

(b) exposures due to unsettled securities transactions, free deliveries, *OTC derivative* instruments, repurchase agreements and securities lending transactions based on securities included in (a)(i) to (iii) above, reverse repurchase agreements and securities borrowing transactions based on securities included in (a)(i) to (iii) above; and

(c) fees, commission, interest and dividends, and margin on exchange-traded derivatives which are directly related to the items included in (a) and (b) above.

trust beneficiary	means a beneficiary under a trust (not being the settlor) who benefits from the performance by a *firm* as *trustee* of *investment services* relating to the management of the trust assets (in accordance with section 2372 of the *Act* (Other definitions)).
trustee activity	means, in relation to a *firm*, any activity undertaken in the course of or incidental to the exercise of any of its powers, or the performance of any of its duties, when acting in its capacity as a trustee.
UCITS qualifier	see the meaning given to the term in the *Glossary*
unit trust manager	means the manager of a *unit trust scheme*.
zone a country	see definition of *Zone A country* in the *Glossary*
zone b country	means a country which is not a *zone a country*.

6 Chapter 6: Service Companies

6.1 Application

6.1.1 R This chapter applies to *service companies*.

Financial Resources Requirements

6.1.2 R

(1) A *service company* must be able to meet its liabilities as they fall due.

(2) In complying with (1) a *firm* may use any assets which are available to meet any of its liabilities.

7 UCITS MANAGEMENT COMPANIES

[Deleted: material moved to UPRU]

8 Requirements on credit unions which are CTF providers

8.1 Application, general and professional indemnity insurance requirements

Application

8.1.1R (1) This chapter applies to a *credit union* to the extent that it is a *CTF provider* whose *permissions* relate to *accepting deposits* and *making arrangements with a view to transactions in investments*.

(2) The definitions in the Glossary at Appendix 13(1) apply to this chapter.

General requirements

8.1.2R A *credit union* to which this chapter applies must:

(1) have and maintain at all times financial resources of the kinds and amounts specified in, and calculated in accordance with, the *rules* of this chapter, in *CRED* and, where applicable, in *MIPRU* 4 (Capital Resources); and

(2) be able to meet its liabilities as they fall due.

8.1.3G The *rules* in this chapter should be read with the *rules* relating to capital in *CRED* and, where applicable, *MIPRU*.

Requirement to hold professional indemnity insurance

8.1.4G (1) Under *Principles* 3 and 4, a *credit union* is required to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems and to maintain adequate financial resources.

(2) Although financial resources and appropriate systems and controls can generally mitigate operational risk*,* professional indemnity insurance has a role in mitigating the risks a *credit union* faces in its day to day operations. The purpose of *IPRU(INV)* 8.1.6R to *IPRU(INV)* 8.1.14E is to ensure that a *credit union* has in place the type, and level, of professional indemnity insurance necessary to mitigate these risks.

8.1.5R The term "relevant income" in *IPRU(INV)* 8.1 refers to all income received or receivable which is commission, brokerage, fees or other related income, whether arising from the *credit union's* activities related to *making arrangements with a view to transactions in investments* or not, for the last accounting year prior to inception or renewal of the professional indemnity insurance policy ("the policy").

8.1.6R A *credit union* must take out and maintain at all times professional indemnity insurance that is at least equal to the requirements of *IPRU(INV)* 8.1.7R to *IPRU(INV)* 8.1.14E.

Professional indemnity insurance policy terms

8.1.7R The professional indemnity insurance policy must incorporate terms which are appropriate and must make provision for:

(1) cover in respect of any claim for loss or damage, for which the *credit union* may be liable as a result of an act or omission by:

(a) the *credit union*; or

(b) any *person* acting on behalf of the *credit union* including *employees*, *appointed representatives* or its other agents;

(2) the minimum *limits of indemnity* in each year if the *credit union* is an *IMD insurance intermediary* are as set out in *MIPRU* 3.2.7R;

(3) the following *limits of indemnity* if the *credit union* is an investment intermediary other than an *IMD insurance intermediary*:

(a) if the *credit union* has relevant income of up to £3,000,000, no lower than £500,000 for a single claim against the *credit union* and £500,000 in the aggregate; or

(b) if the *credit union* has relevant income of more than £3,000,000, no lower than £650,000 for a single claim against the *credit union* and £1,000,000 in the aggregate.

(4) If (2) applies, and the policy is denominated in any currency other than euros, a *credit union* must take reasonable steps to ensure that the *limits of indemnity* are, when the policy is effected (i.e. agreed) and at renewal, at least equivalent to those required in *IPRU(INV)* 8.1.7R.

Readily realisable own funds

8.1.8G For the purposes of the following provisions relating to professional indemnity insurance, the *FSA* expects items included in *own funds* to be regarded as "readily realisable" only if they can be realised, at any given time, within 90 days.

Additional requirements

8.1.9E (1) In addition to the specific requirements in *IPRU(INV)* 8.1.7R, to incorporate appropriate terms, the policy should make provision for the following:

(a) for a *credit union* with relevant income of more than £6,000,000, the aggregate limit identified in the table below:

Relevant income is (£)	Minimum aggregate *limit of*

more than	up to	*Indemnity* (£)
6,000,000	7,000,000	1,150,000
7,000,000	8,000,000	1,300,000
8,000,000	9,000,000	1,450,000
9,000,000	10,000,000	1,600,000
10,000,000	12,500,000	2,000,000
12,500,000	15,000,000	2,400,000
15,000,000	17,500,000	2,800,000
17,500,000	20,000,000	3,150,000
20,000,000	25,000,000	3,800,000
25,000,000	30,000,000	4,250,000
30,000,000	35,000,000	4,500,000
35,000,000	40,000,000	4,750,000
40,000,000	50,000,000	5,500,000
50,000,000	60,000,000	6,000,000
60,000,000	70,000,000	6,750,000
70,000,000	80,000,000	7,250,000
80,000,000	90,000,000	7,750,000
90,000,000	100,000,000	8,500,000
100,000,000	150,000,000	11,250,000
150,000,000	200,000,000	14,000,000
200,000,000	250,000,000	17,000,000
250,000,000	300,000,000	19,750,000
300,000,000	n/a	22,500,000

(b) full retroactive cover in respect of the kinds of liabilities described in *IPRU(INV)* 8.1.7R for claims arising from work carried out by the *credit union*, or on its behalf, in the past; and

(c) cover in respect of *Ombudsman* awards made against the *credit union*.

(2) Compliance with (1)(a) may be relied on as tending to establish compliance with the requirement in *IPRU(INV)* 8.1.7R for the professional indemnity insurance terms to be appropriate.

(3) Contravention of (1)(a) may be relied on as tending to establish contravention of the requirement in *IPRU(INV)* 8.1.7R for the professional indemnity insurance terms to be appropriate.

8.1.10G A *credit union* should consider whether the overall cover is adequate taking account of *IPRU(INV)* 8.1.13G(2) and whether the *credit union* should seek additional cover or legal expenses insurance. (Legal defence costs are costs of defence against claims that fall under the terms of the policy.)

8.1.11G The cover provided by the policy should be wide enough to include the liability of the *credit union*, its *appointed representatives, employees* and its agents for breaches of the *credit union's* duty of skill and care, fiduciary duty, duty to look after documents or assets, fraud, and breaches of obligations imposed by or under the *Act*.

Exclusions

8.1.12R The policy must not be subject to conditions or exclusions which unreasonably limit the cover provided for in *IPRU(INV)* 8.1.7R (whether by exclusion of cover, by policy excesses or otherwise).

8.1.13 G (1) The *FSA* considers it reasonable for a *credit union's* policy to exclude cover for:

(a) specific business lines if that type of business has not been carried out by the *credit union* in the past and will not be carried out by the *credit union* during the life of the policy; or

(b) specific claims that have been previously notified to the *credit union's insurer* and claimed for under another policy.

(2) The *FSA* does not consider it reasonable for a *credit union's* policy to treat legal defence costs cover as part of the *limits of indemnity* if this reduces the cover available for any individual substantive claim.

8.1.14E (1) The policy should not:

(a) make provision for payment by the *credit union* of an excess on any claim of more than £5,000. (This does not apply to the extent that the *credit union* holds additional *own funds* in a readily realisable form, in accordance with *IPRU(INV)* 8.1.16E); or

(b) exclude any type of business or activity that has been carried out by the *credit union* in the past or will be carried out by the *credit union* during the time for which the policy is in force. (This does not apply to the extent that the *credit union* holds, by way of additional *own funds* in a readily realisable form, an amount equivalent to a reasonable provision against its potential liabilities for that business or activity. *Guidance* on this is given in *IPRU(INV)* 8.1.17G and *IPRU(INV)* 8.1.18G); or

(c) exclude liability which is identified or crystallised as a result of regulatory action against the *credit union* (either individually or as a member of a class of *authorised person*).

(2) Contravention of (1)(a) may be relied on as tending to establish contravention of *IPRU(INV)* 8.1.12R.

Excess level

8.1.15E The reference to "excess" in *IPRU(INV)* 8.1.14E(1)(a) is to the highest excess level required to be paid under the policy unless that excess relates to a type of business that has not been carried out by the *credit union* in the past. In those circumstances, the reference is to the next highest excess level required by the policy.

Additional own funds

8.1.16E The amount of additional *own funds* in *IPRU(INV)* 8.1.14E (1)(a) should be calculated by referring to the *credit union's* relevant income and excess obtained in the following table:

All amounts are shown in £000s													
Relevant income is		Excess obtained, up to and including											
more than	up to	5	10	15	20	25	30	40	50	75	100	150	200+
0	100	0	4	7	9	12	14	18	21	28	34	45	54
100	200	0	7	11	14	17	20	25	29	38	46	59	70
200	300	0	9	14	18	21	24	30	35	45	54	69	82
300	400	0	11	16	21	24	28	34	39	50	60	77	91
400	500	0	13	18	23	27	30	37	43	55	66	83	98
500	600	0	14	20	25	29	33	40	46	59	70	89	105
600	700	0	16	22	27	31	35	42	49	63	74	94	111
700	800	0	17	23	28	33	37	45	52	66	78	99	117
800	900	0	18	24	30	35	39	47	54	69	82	103	122
900	1,000	0	19	26	31	36	41	49	56	72	85	107	126
1,000	1,500	0	23	31	37	43	48	57	66	83	99	124	146
1,500	2,000	0	26	35	42	48	54	64	73	93	109	138	161
2,000	2,500	0	29	38	46	53	59	71	81	102	121	152	179
2,500	3,000	0	32	42	51	58	65	78	89	112	132	166	195
3,000	3,500	0	35	46	55	63	71	84	96	121	142	179	210
3,500	4,000	0	38	50	59	68	76	90	102	129	152	191	223
4,000	4,500	0	41	53	63	72	80	95	108	137	161	202	236
4,500	5,000	0	43	56	67	76	85	100	114	144	169	212	248
5,000	6,000	0	48	62	73	84	93	110	125	157	185	231	271

6,000	7,000	0	52	67	79	90	101	119	135	169	199	249	291
7,000	8,000	0	56	72	85	97	107	127	144	181	212	265	310
8,000	9,000	0	59	76	90	103	114	134	152	191	224	280	328
9,000	10,000	0	63	80	95	108	120	141	160	201	236	294	344
10,000	100,000	0	63y	80y	95y	108y	120y	141y	160y	201y	236y	294y	344y
100,000	n/a	0	630	800	950	1080	1200	1410	1600	2010	2360	2940	3440
For *firms* with relevant income more than £10m but up to £100m value y is calculated by relevant income/ £10m													

Exclusions

8.1.17G A *credit union* should take into account the following when assessing the amount of additional *own funds* to be held as provision as described in *IPRU(INV)* 8.1.14E(1)(b):

(1) the type of business line or activity excluded and the types of claim which might arise from it;

(2) the number of contracts written or volume of activity;

(3) the number of complaints received by the *credit union* relating to the excluded business or activity;

(4) generally accepted accounting principles applicable to provisions; and

(5) any other relevant information.

8.1.18G If the *credit union* holds additional *own funds* in accordance with *IPRU(INV)* 8.1.17G then the amount should be reviewed regularly. The reviews should take account of changes in the status of the policy exclusion(s) and any relevant changes to the *credit union's* circumstances.

Policies providing cover for more than one credit union

8.1.19R If the policy provides cover to more than one *credit union* then in relation to *IPRU(INV)* 8.1.7R:

(1) the relevant income for calculating the *limits of indemnity* is that of all the *credit unions* named in the policy combined;

(2) each *credit union* named in the policy must have the benefit of the minimum *limits of indemnity* as required in *IPRU(INV)* 8.1.7R;

(3) each *credit union* named in the policy must notify the *FSA* if the aggregate cover in the policy falls below the minimum in *IPRU(INV)* 8.1.7R.

Exemption from holding professional indemnity insurance

8.1.20R (1) A *credit union* is not required to effect or maintain professional indemnity insurance in relation to *insurance mediation activity*, if another *authorised person* which has net tangible assets of more than £10 million provides a comparable guarantee.

(2) A 'comparable guarantee' means a written agreement on terms at least equal to those in *MIPRU* 3.2.4R to finance the claims that might arise as a result of a breach by the *credit union* of its duties under the *regulatory system* or civil law.

8.1.21R A *credit union* must take out professional indemnity insurance from:

(1) any *insurance undertaking* which is authorised to transact professional indemnity insurance in the *EEA*; or

(2) *a person* of equivalent status in:

(a) a *Zone A country*;

(b) the Channel Islands, Gibraltar, Bermuda or the Isle of Man.

Notification requirements

8.1.22G *Rule IPRU(INV)* 8.1.24R is a *notification rule* and is in addition to any notification requirements in the Supervision manual (*SUP* 15).

8.1.23G *Credit unions* are reminded to comply with *SUP* 15.7 (Form and method of notification) when notifying the *FSA* in accordance with *IPRU(INV)* 8.1.24R.

8.1.24R A *credit union* must notify the *FSA* immediately it becomes aware, or has information which reasonably suggests, that any of the matters in Table 8.1(1) has occurred, may have occurred or may occur in the foreseeable future.

Table 8.1(1)

This table forms part of *IPRU(INV)* 8.1.24R

NOTIFIABLE EVENTS
In relation to professional indemnity insurance, required in accordance with *IPRU(INV)* 8.1.6R to *IPRU(INV)* 8.1.21R, if: (1) it cannot be obtained within 28 days of the inception or renewal date; (2) it is cancelled; (3) the amount of aggregate cover is exhausted; (4) the *credit union* commences business lines for which it had not obtained cover; (5) the *credit union* is relying on *IPRU(INV)* 8.1.19R; or

(6) the *credit union* is relying on *IPRU(INV)* 8.1.20R.

8.2 Capital requirements

8.2.1R 'Capital' in this chapter has the meaning described in *CRED* 8.2.1R.

8.2.2R A *version 1 credit union* with total assets of more than £5 million or a total number of members of more than 5,000, or both, or a *version 2 credit union,* which acts as a *CTF provider* and whose *permissions* include *regulated activities* relating to *accepting deposits* and *making arrangements with a view to transactions in investments* other than *contracts of insurance* or *rights to or interests in a life policy* must maintain at all times capital which is equal to the higher of:

(1) £10,000; and

(2) the capital requirements for the *credit union* under *CRED*.

8.2.3R A *version 1 credit union* with total assets of more than £5 million or a total number of members of more than 5,000, or both, or a *version 2 credit union,* which acts as a *CTF provider* which *makes arrangements with a view to transactions in investments* including *contracts of insurance* or *rights to or interests in a life policy* must maintain at all times capital which is equal to the highest of:

(1) £10,000;

(2) the capital requirements for the *credit union* under *CRED*; and

(3) the capital requirements for the *credit union* under *MIPRU* 4.

Chapter 9: Financial resources requirements for an exempt CAD firm

9.1 **Application**

9.1.1 **R** **(1) This chapter applies to an *exempt CAD firm* which is:**

(a) an *investment management firm*; or

(b) a *securities and futures firm*.

(2) This chapter also applies to a *local firm*.

9.2 **General requirements**

9.2.1 G For an *exempt CAD firm*, the *rules* contained within this chapter replace the *rules* in respect of financial resources, financial resources requirements and non-financial resources related requirements contained within Chapter 3 or 5, as applicable. However, an *exempt CAD firm* must continue to comply with the requirements of Chapter 3 or 5, to the extent it is referred to Chapter 3 or 5 by a *rule* in this chapter.

9.2.2 **R** **A *firm* must be able to meet its liabilities as they fall due.**

9.2.3 **R** **An *exempt CAD firm* that carries on any *regulated activity* other than *MiFID business* must also have and maintain at all times financial resources calculated in accordance with the chapter of *IPRU(INV)* to which the *firm* is otherwise subject (Chapters 3 or 5) at least equal to the requirements set out in the relevant chapter (except that if the only *designated investment business* an *exempt CAD firm* is carrying on in addition to *investment services and activities* is *making arrangements with a view to transactions in investments* (article 25(2) *Regulated Activities Order)* or agreeing to carry on that *regulated activity* or both, it only needs to comply with requirements set out in this chapter and not chapters 3 or 5).**

Initial capital and professional indemnity insurance requirements – exempt CAD firms that are not IMD insurance intermediaries

9.2.4 **R** **(1) An *exempt CAD firm* which is not an *IMD insurance intermediary* must have:**

(a) *initial capital* of € 50,000; or

(b) professional indemnity insurance covering the whole territory of the *EEA* or some other comparable guarantee against liability arising from professional negligence, representing at least € 1,000,000 applying to each claim and in aggregate € 1,500,000 per year for all claims; or

(c) **a combination of *initial capital* and professional indemnity insurance in a form resulting in a level of coverage equivalent to (a) or (b).**

[Note: Article 67(3) of *MiFID* and Article 7 of *CAD*]

(2) **If a *firm* chooses to meet the requirements of either (b) or (c) above, it must nevertheless have *initial capital* of at least £5,000.**

Initial capital and professional indemnity insurance requirements – exempt CAD firms that are also IMD insurance intermediaries

9.2.5 **R** (1) **A *exempt CAD firm* that is also an *IMD insurance intermediary* must comply with the professional indemnity insurance requirements at least equal to the limits set out in 9.2.4R(1)(b) and in addition has to have:**

(a) ***initial capital* of € 25,000; or**

(b) **professional indemnity insurance covering the whole territory of the *EEA* or some other comparable guarantee against liability arising from professional negligence, representing at least € 500,000 applying to each claim and in aggregate € 750,000 per year for all claims; or**

(c) **a combination of *initial capital* and professional indemnity insurance in a form resulting in a level of coverage equivalent to (a) or (b).**

[Note: Article 67(3) of *MiFID* and Article 8 of *CAD*]

(2) **If a *firm* chooses to meet the requirements of either (b) or (c) above, it must nevertheless have *initial capital* of at least £5,000.**

9.2.6 G A trade-off between *initial capital* and professional indemnity insurance is appropriate such that € 1 of *initial capital* is the equivalent of professional indemnity insurance cover of € 20 for a single claim against the *firm* and € 30 in aggregate.

Comparable guarantee

9.2.7 **R** (a) **If another *authorised person* which has net tangible assets of more than £10 million provides a comparable guarantee, an *exempt CAD firm* can treat it as an alternative to effecting or maintaining professional indemnity insurance pursuant to the rules relating to professional indemnity insurance above.**

(b) If the *exempt CAD firm* is a member of a *group* in which there is an *authorised person* with net tangible assets of more than £10 million, the comparable guarantee must be from that *person*.

(c) A comparable guarantee means a written agreement on terms at least equal to those required by the *initial capital* and professional indemnity insurance requirements above to finance the claims that might arise as a result of the breach by the *exempt CAD firm* of its duties under the *regulatory system* or civil law.

Initial capital and ongoing capital requirements for local firms

9.2.8 **R A *local firm* must:**

(a) have *initial capital* of €50,000; and

[Note: Article 67(2) of *MiFID* and Article 6 of CAD]

(b) maintain *own funds* calculated in accordance with the *rules* relating to own funds in 9.5, at least to the requirement for *initial capital*.

Ongoing capital requirements

9.2.9 **R (1) An *exempt CAD firm* must, at all times, maintain a combination of professional indemnity insurance and *own funds*, (*own funds* to be calculated in accordance with (2)), at least equal to the requirements in this chapter for professional indemnity insurance and *initial capital*.**

(2) (a) If the *exempt CAD firm* is an *investment management firm* its *own funds* must be calculated in accordance with the *rules* in *IPRU(INV)* 5.2.1(1) to 5.2.7(5).

(b) If the *exempt CAD firm* is a *securities and futures firm* its *own funds* must be calculated in accordance with the *rules* relating to *own funds* in 9.5.

9.3 **Calculating initial capital**

Initial capital

9.3.1 **R A *firm's initial capital* consists of the sum of the following items:**

(1) ordinary *share* capital which is fully paid;

(2) perpetual non-cumulative *preference share* capital which is fully paid;

(3) *share* premium account;

(4) reserves excluding revaluation reserves;

(5) audited retained earnings;

(6) externally *verified* interim net profits;

(7) partners' capital;

(8) *eligible LLP members' capital* (in accordance with the provisions of *IPRU(INV)* Annex A); and

(9) *sole trader* capital.

Perpetual non-cumulative preference share capital

9.3.2 **R** **A *firm* may include *preference share* capital in *initial capital* only where any *coupon* on it is not cumulative, and the *firm* is under no obligation to pay a *coupon* in any circumstances.**

Audited retained earnings

9.3.3 **R** **When calculating *initial capital*, a *firm* may include its audited retained earnings only after making the following adjustments:**

(1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;

(2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;

(3) a *firm* must not include any unrealised gains from investment property (these should be reported as part of revaluation reserves);

(4) where applicable, a *firm* must deduct any asset in respect of *deferred acquisition costs* and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Externally verified interim net profits or current account

9.3.4 **R** **A *firm* may include interim net profits or current account when calculating *initial capital* to the extent that they have been *verified* by the *firm's* external auditor and are net of any foreseeable tax, dividend and other appropriations.**

9.3.5 **R** **When calculating *initial capital*, a *firm* may includes its partners' capital only after making the following adjustments:**

(1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;

(2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;

(3) where applicable, a *firm* must deduct any asset in respect of *deferred acquisition costs* and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Defined benefit pension scheme: defined benefit liability

9.3.6 **R** **For the calculation of *initial capital*, a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.**

9.3.7 G A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme*.

9.4 Policy terms for professional indemnity insurance

Insurers whose professional indemnity insurance policies can be used by an exempt CAD firm

9.4.1 **R** **An *exempt CAD firm* that has professional indemnity insurance in accordance with this chapter must take out and maintain professional indemnity insurance that is at least equal to the requirements of the rule below from:**

(1) an *insurance undertaking* which is authorised to transact professional indemnity insurance in the *EEA*; or

(2) a person of equivalent status in:

(a) a *Zone A country*;

(b) the Channel Islands, Gibraltar, Bermuda or the Isle of Man.

Terms to be incorporated in the professional indemnity insurance policy

9.4.2 **R** **The policy of professional indemnity insurance must incorporate terms which make provision for:**

(1) cover in respect of claims for which an *exempt CAD firm* may be liable as a result of the conduct of itself, its *employees* and its *appointed representatives* or where applicable, its *tied agent* (acting within the scope of their appointment);

(2) the minimum *levels of indemnity* per year as set out in the rules relating to professional indemnity insurance above;

(3) appropriate cover in respect of legal defence costs; and

(4) cover in respect of *Ombudsman* awards made against the *exempt CAD firm*.

Policies in other currencies

9.4.3 **R** **If a professional indemnity insurance policy is denominated in any currency other than euros, an *exempt CAD firm* must take reasonable steps to ensure that the *limits of indemnity* are, when the policy is effected and at *renewal*, at least equivalent to those required for the purposes of the rules relating to professional indemnity insurance above.**

Conditions and exclusions

9.4.4 **R** **A professional indemnity insurance policy must not be subject to conditions or exclusions which unreasonably limit the cover provided (whether by exclusion of cover, by policy excesses or otherwise).**

9.5 **Calculation of own funds**

9.5.1 **R** **A *firm's initial capital*:**

minus the sum of the items set out against B

plus the sum of the items set out against C

minus *material holdings* in *credit* and *financial institutions* and *material insurance holdings*

equals *own funds*.

9.5.2 **R** **Table**

This table forms part of *rule* 9.5.1R

(1)	*Investments* in own *shares* at book value	
(2)	*Intangible assets*	B
(3)	*Material current year losses*	
(1)	Revaluation reserves	
(2)	Perpetual cumulative preference *share* capital	
(3)	Long-term subordinated loans	C
(4)	Perpetual long-term subordinated loans	
(5)	Fixed term preference *share* capital	

Perpetual long-term subordinated loans and perpetual cumulative preference share capital

9.5.3 **R** Perpetual long-term subordinated loans and perpetual cumulative preference *share* capital may not be included in the calculation of *own funds* unless they meet the following requirements:

(1) it may not be reimbursed on the holder's initiative or without the prior agreement of the *FSA*;

(2) the instrument must provide for the *firm* to have the option of deferring the dividend payment on the share capital;

(3) the shareholder's claims on the *firm* must be wholly subordinated to those of all non-subordinated creditors;

(4) the terms of the instrument must provide for the loss-absorption capacity of the share capital and unpaid dividends, whilst enabling the *firm* to continue its business; and

(5) it must be fully paid-up.

Subordinated loans

9.5.4 **R A *firm* may include a subordinated loan in the calculation of its *own funds* only:**

(a) if it is drawn up in accordance with the standard forms obtained from the *FSA*;

(b) if it is signed by authorised signatories of all the parties; and

(c) to the extent that it is fully paid up.

Long-term subordinated loans

9.5.5 **R A long-term subordinated loan may not be included in the calculation of *own funds* unless it meets the following requirements:**

(1) it must be fully paid-up;

(2) it has an original maturity of at least five years;

(3) the extent to which it may be used in the calculation of *own funds* shall be amortised on a straight line basis during at least the five years before repayment; and

(4) it must not become repayable before the agreed repayment date other than in the winding-up of the *firm* or unless the *firm* has provided the *FSA* with at least five years' written notice.

9.5.6 **R A *firm* must not (except in accordance with the terms of the loan) make any payment of interest if after such action the *firm's own funds* will fall below 120% of its *own funds requirement*.**

Perpetual non-cumulative and cumulative preference share capital

9.5.7 **R A *firm* may include perpetual non-cumulative and cumulative preference share capital in its *initial capital* and its *own funds* only if there is an agreement between the *firm* and the shareholders which provides that redemption of the shares may not take place, if after such redemption the *firm* would be in breach of its *own funds requirement*.**

Own funds - Restrictions

9.5.8 **R (1) In calculating *own funds*:**

(i) **the total amount of revaluation reserves, perpetual cumulative preference *share* capital, long-term subordinated loans, perpetual long-term subordinated loans and fixed term preference *share* capital must not exceed 100% of *initial capital* minus B; and**

(ii) **the total amount of fixed term preference *share* capital and long-term subordinated loans must not exceed 50% of *initial capital* minus B.**

9.6 **Non-financial resource requirements**

Reconciliation of balances

9.6.1 **R (1) A *firm* must reconcile all balances and positions with:**

(a) ***banks* and *building societies* (other than a client bank account subject to the *client money rules), exchanges*, *approved exchanges*, *clearing houses* and *intermediate brokers*; and**

(b) ***eligible counterparties* which are members of an *exchange* or *approved exchange***

as recorded by the *firm* to the balance or position on a statement or circularisation obtained by the *firm* from those entities and must correct any differences by agreement on a timely basis, unless:

(i) **the balances and positions due to and from the *eligible counterparty* have been agreed by other means; or**

(ii) **it arises solely as a result of identified differences in timing between the records of the *firm* and the *bank* or *building society*.**

(2) A *firm* must perform reconciliations under (1) above as frequently as is appropriate for the volume of transactions on the accounts and in any event not less than once every five weeks or, in relation to positions with *eligible counterparties*, not less than once every year.

(3) A *firm* must circularise or request statements from *banks, building societies*, *exchanges*, *approved exchanges*, *clearing houses*, *intermediate brokers* and *eligible counterparties* which are members of an *exchange* or an *approved exchange* in good time in order to be able to comply with (1) and (2) above.

(4) A *firm* must use its best endeavours to respond within one month of receipt to any circularisation from another *firm* requesting confirmation of outstanding balances.

9.6.2 G For guidance notes on the reconciliation of a *firm's* balance with *market counterparties* see Appendix 20 to Chapter 3.

Financial notification

9.6.3 **R A *firm* must notify the *FSA* in writing as soon as it has reason to believe that it is in breach of its *own funds requirement*.**

APPENDIX 9(1) (INTERPRETATION)

Glossary of defined terms for Chapter 9

Note: If a defined term does not appear in the glossary below, the definition appearing in the Handbook Glossary applies.

approved exchange	means an investment exchange listed as such in Appendix 33 to *IPRU(INV)* 3.
exchange	means a *recognised investment exchange* or *designated investment exchange*.
initial capital	means the initial capital of a *firm* calculated in accordance with section 9.3.
intangible assets	the full balance sheet value of a *firm's* intangible assets including goodwill, capitalised development costs, licences, trademark and similar rights etc.
intermediate broker	in relation to a *margined transaction*, means any person through whom the *firm* undertakes that transaction.
material current year losses	means losses of an amount equal to 10% or more of *initial capital* minus B (with B calculated in accordance with Table 9.5.2R).
material holding	means a *firm's* holdings of *shares* and any other interest in the capital of a *credit institution* or *financial institution*: (a) which exceeds 10% of the capital of the issuer, and, where this is the case, any holdings of subordinated debt of the same issuer, the full amount is a *material holding*; or (b) holdings not deducted under (a) if the total amount of such holdings exceeds 10% of that *firm's own funds*, in which case only the excess amount is a *material holding*.
material insurance holdings	(a) means the holdings of an *exempt CAD firm* of items of the type set out in (b) in any: (i) *insurance undertaking*; or (ii) *insurance holding company* that fulfils one of the following conditions: (iii) it is a *subsidiary undertaking* of that *firm*; or (iv) that *firm* holds a participation in it. (b) An item falls into this provision for the purpose of (a) if it is:

(i) an *ownership share*; or

(ii) subordinated debt or another item of capital that falls into Article 16(3) of the First Non-Life Directive or, as applicable, Article 27(3) of the Consolidated Life Directive.

own funds means the own funds of a *firm* calculated in accordance with 9.2.9R(2) and 9.2.8R(b).

own funds requirement means the requirement set out in 9.2.9R(1) and 9.2.8R(b).

verified means checked by an external auditor who has undertaken at least to:

(a) satisfy himself that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records;

(b) review the accounting policies used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the *firm* in drawing up its annual financial statements and are in accordance with the relevant accounting principles;

(c) perform analytical procedures on the result to date, including comparisons of actual performance to date with budget and with the results of prior period(s);

(d) discuss with management the overall performance and financial position of the *firm*;

(e) obtain adequate comfort that the implications of current and prospective litigation, all known claims and commitments, changes in business activities and provisioning for bad and doubtful debts have been properly taken into account in arriving at the interim profits; and

(f) follow up problem areas of which he is already aware in the course of auditing the *firm's* financial statements.

Chapter 13: Financial Resource Requirements for Personal Investment Firms

APPLICATION

13.1 R (1) **This chapter applies to a *firm* which is a *personal investment firm*.**

(2) **For a *personal investment firm* which is an *exempt CAD firm* the following apply:**

(a) sections 13.1 and 13.1A; and

(b) if it is not an *opted-in exempt CAD firm*, sections 13.2 to 13.8; or

(c) if it is an *opted-in exempt CAD firm*, sections 13.9 to 13.12 (but reading references to *Category B firm* as references to the *firm*).

(3) **Section 13.1 and sections 13.9 to 13.12 apply to a *personal investment firm* which is a *Category B firm*.**

(4) **The definitions in the Glossary at Appendix 13(1) apply to this chapter.**

13.1.1A G *Firms* are reminded that a *media firm* is not a *personal investment firm*.

GENERAL REQUIREMENTS

13.1.2 R **A *firm* must:**

(1) **have and maintain at all times financial resources of the kinds and amounts specified in, and calculated in accordance with, the *rules* of this chapter; and**

(2) **be able to meet its liabilities as they fall due.**

REQUIREMENT TO HOLD PROFESSIONAL INDEMNITY INSURANCE

13.1.3(1) G Under *Principles* 3 and 4 a *firm* is required to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems and to maintain adequate financial resources. Under *Principle* 9 a *firm* is obliged to take reasonable care to ensure the suitability of its *advice on investments* and discretionary decisions for any *customer* who is entitled to rely upon its judgement.

13.1.3(2) G Although financial resources and appropriate systems and controls can generally mitigate operational risk*,* professional indemnity insurance has a role in mitigating the risks a *firm* faces in its day to day operations, including those arising from not meeting the legally required standard of care when *advising on investments*. The purpose of 13.1.4(1) to 13.1.4(15) is to ensure that a *firm* has in place the type, and level, of professional indemnity insurance necessary to mitigate these risks. This includes, in the case of a *UK firm* exercising an *EEA right*, cover for breaches of obligations imposed by or under laws, or provisions having the force of law, in each *EEA State* in which the *firm* carries on business.

13.1.3(3) R **The term "relevant income" in IPRU(INV) 13.1 refers to all income received or receivable which is commission, brokerage, fees or other related income, whether arising from the *firm's permitted activities* or not, for the last accounting year prior to inception or renewal of the professional indemnity insurance policy ("the policy").**

13.1.4(1) R **(1) A *firm* must take out and maintain at all times professional indemnity insurance that is at least equal to the requirements of 13.1.4(2) to 13.1.4(15).**

(2) Paragraph (1) does not apply to an *exempt CAD firm* unless it chooses to comply with these rules (see 13.1A).

POLICY TERMS

13.1.4(2) R **The policy must incorporate terms which are appropriate and must make provision for:**

(a) **cover in respect of any claim for loss or damage, for which the *firm* may be liable as a result of an act or omission by:**

(i) **the *firm*; or**

(ii) **any *person* acting on behalf of the *firm* including *employees*, *appointed representatives* or its other agents;**

LIMITS OF INDEMNITY – IMD INSURANCE INTERMEDIARY OR AN EXEMPT CAD FIRM

(b) **if the *firm* is an *IMD insurance intermediary* or an *exempt CAD firm* that maintains professional indemnity insurance under 13.1A.3(1)(b), appropriate minimum *limits of indemnity* per year which are, no lower than:**

(i) **€1,000,000 for a single claim against the *firm*; and**

(ii) **€1,500,000 in the aggregate;**

[Note: Article 67(3) of *MiFID* and Article 7 of *CAD* (see also rule 13.1A.3]

(c) **if the *firm* is both an *IMD insurance intermediary* and an *exempt CAD firm* that maintains professional indemnity insurance under 13.1A.4(1)(b), appropriate additional *limits of indemnity* to 13.1.4(2)(b) per year which are no lower than:**

(i) **€ 500,000 for a single claim against the *firm*; and**

(ii) **€ 750,000 in the aggregate.**

[Note: Article 67(3) of *MiFID* and Article 8 of *CAD* (see also rule 13.1A.4]

LIMITS OF INDEMNITY – OTHER FIRMS

(d) **if the *firm* is not an *IMD insurance intermediary* or an *exempt CAD firm,* then the following *limits of indemnity* apply:**

(i) **if the *firm* has relevant income of up to £3,000,000, no lower than £500,000 for a single claim against the *firm* and £500,000 in the aggregate; or**

(ii) **if the *firm* has relevant income of more than £3,000,000, no lower than £650,000 for a single claim against the *firm* and £1,000,000 in the aggregate.**

13.1.4(3) R **If a policy is denominated in any currency other than euros, an *IMD insurance intermediary* must take reasonable steps to ensure that the *limits of indemnity* are, when the policy is effected (i.e. agreed) and at renewal, at least equivalent to those required in 13.1.4(2)(b).**

READILY REALISABLE OWN FUNDS

13.1.4(4) G For the purposes of the following provisions relating to professional indemnity insurance, the *FSA* expects items included in *own funds* to be regarded as "readily realisable" only if they can be realised, at any given time, within 90 days.

ADDITIONAL REQUIREMENTS

13.1.4(5) E (a) In addition to the specific requirements in 13.1.4(2), to incorporate appropriate terms, the policy should make provision for the following:

(i) for a *firm* with relevant income of more than £6,000,000, the aggregate limit identified in the table below:

Relevant income is (£)		Minimum aggregate *limit of indemnity* (£)
more than	up to	
6,000,000	7,000,000	1,150,000
7,000,000	8,000,000	1,300,000
8,000,000	9,000,000	1,450,000
9,000,000	10,000,000	1,600,000
10,000,000	12,500,000	2,000,000
12,500,000	15,000,000	2,400,000
15,000,000	17,500,000	2,800,000

17,500,000	20,000,000	3,150,000
20,000,000	25,000,000	3,800,000
25,000,000	30,000,000	4,250,000
30,000,000	35,000,000	4,500,000
35,000,000	40,000,000	4,750,000
40,000,000	50,000,000	5,500,000
50,000,000	60,000,000	6,000,000
60,000,000	70,000,000	6,750,000
70,000,000	80,000,000	7,250,000
80,000,000	90,000,000	7,750,000
90,000,000	100,000,000	8,500,000
100,000,000	150,000,000	11,250,000
150,000,000	200,000,000	14,000,000
200,000,000	250,000,000	17,000,000
250,000,000	300,000,000	19,750,000
300,000,000	n/a	22,500,000

(ii) full retroactive cover in respect of the kinds of liabilities described in 13.1.4(2) for claims arising from work carried out by the *firm*, or on its behalf, in the past; and

(iii) cover in respect of *Ombudsman* awards made against the *firm*.

(b) Compliance with (a) may be relied on as tending to establish compliance with the requirement in 13.1.4(2) for the *professional indemnity insurance* terms to be appropriate.

(c) Contravention of (a) may be relied on as tending to establish contravention of the requirement in 13.1.4(2) for the professional indemnity insurance terms to be appropriate.

13.1.4(6) G A *firm* should consider whether the overall cover is adequate taking account of 13.1.4(9)(b) and whether the *firm* should seek additional cover or legal expenses insurance. (Legal defence costs are costs of defence against claims that fall under the terms of the policy.)

13.1.4(7) G The cover provided by the policy should be wide enough to include the liability of the *firm*, its *appointed representatives,* or where applicable, its *tied agent*, *employees* and its agents for breaches of the *firm's* duty of skill and care, fiduciary duty, duty to look after documents or assets, fraud, and breaches of obligations imposed by or under *the Act* (or the Financial Services Act 1986 if relevant). If the *firm* operates outside the *UK* then the policy should cover other regulatory requirements imposed under the laws of other countries in which the *firm* operates.

EXCLUSIONS

13.1.4(8) R **The policy must not be subject to conditions or exclusions which unreasonably limit the cover provided for in 13.1.4(2) (whether by exclusion of cover, by policy excesses or otherwise).**

13.1.4(9) G (a) The *FSA* considers it reasonable for a *firm's* policy to exclude cover for:

(i) specific business lines if that type of business has not been carried out by the *firm* in the past and will not be carried out by the *firm* during the life of the policy; or

(ii) specific claims that have been previously notified to the *firm's insurer* and claimed for under another policy.

(b) The *FSA* does not consider it reasonable for a *firm's* policy to treat legal defence costs cover as part of the *limits of indemnity* if this reduces the cover available for any individual substantive claim.

13.1.4(10) E (a) The policy should not:

(i) make provision for payment by the *firm* of an excess on any claim of more than £5,000. (This does not apply to the extent that the *firm* holds additional *own funds* in a readily realisable form, in accordance with 13.1.4(12)); or

(ii) exclude any type of business or activity that has been carried out by the *firm* in the past or will be carried out by the *firm* during the time for which the policy is in force. (This does not apply to the extent that the *firm* holds, by way of additional *own funds* in a readily realisable form, an amount equivalent to a reasonable provision against its potential liabilities for that business or activity. Guidance on this is given in 13.1.4(13) and (14)); or

(iii) exclude liability which is identified or crystallised as a result of regulatory action against the *firm* (either individually or as a member of a class of *authorised person*).

(b) Contravention of (a) may be relied on as tending to establish contravention of 13.1.4(8).

EXCESS LEVEL

13.1.4(11) E The reference to "excess" in 13.1.4(10)(a)(i) is to the highest excess level required to be paid under the policy unless that excess relates to a type of business that has not been carried out by the *firm* in the past. In those circumstances, the reference is to the next highest excess level required by the policy.

ADDITIONAL OWN FUNDS

13.1.4(12) E The amount of additional *own funds* in 13.1.4(10)(a)(i) should be calculated by referring to the *firm's* relevant income and excess obtained in the following table:

All amounts are shown in £000s													
Relevant income is		Excess obtained, up to and including											
more than	up to	5	10	15	20	25	30	40	50	75	100	150	200+
0	100	0	4	7	9	12	14	18	21	28	34	45	54
100	200	0	7	11	14	17	20	25	29	38	46	59	70
200	300	0	9	14	18	21	24	30	35	45	54	69	82
300	400	0	11	16	21	24	28	34	39	50	60	77	91
400	500	0	13	18	23	27	30	37	43	55	66	83	98
500	600	0	14	20	25	29	33	40	46	59	70	89	105
600	700	0	16	22	27	31	35	42	49	63	74	94	111

700	800	0	17	23	28	33	37	45	52	66	78	99	117
800	900	0	18	24	30	35	39	47	54	69	82	103	122
900	1,000	0	19	26	31	36	41	49	56	72	85	107	126
1,000	1,500	0	23	31	37	43	48	57	66	83	99	124	146
1,500	2,000	0	26	35	42	48	54	64	73	93	109	138	161
2,000	2,500	0	29	38	46	53	59	71	81	102	121	152	179
2,500	3,000	0	32	42	51	58	65	78	89	112	132	166	195
3,000	3,500	0	35	46	55	63	71	84	96	121	142	179	210
3,500	4,000	0	38	50	59	68	76	90	102	129	152	191	223
4,000	4,500	0	41	53	63	72	80	95	108	137	161	202	236
4,500	5,000	0	43	56	67	76	85	100	114	144	169	212	248
5,000	6,000	0	48	62	73	84	93	110	125	157	185	231	271
6,000	7,000	0	52	67	79	90	101	119	135	169	199	249	291
7,000	8,000	0	56	72	85	97	107	127	144	181	212	265	310
8,000	9,000	0	59	76	90	103	114	134	152	191	224	280	328
9,000	10,000	0	63	80	95	108	120	141	160	201	236	294	344
10,000	100,000	0	63y	80y	95y	108y	120y	141y	160y	201y	236y	294y	344y
100,000	n/a	0	630	800	950	1080	1200	1410	1600	2010	2360	2940	3440
For *firms* with relevant income more than £10m but up to £100m value y is calculated by relevant income/ £10m													

EXCLUSIONS

13.1.4(13) G A *firm* should take into account the following when assessing the amount of additional *own funds* to be held as provision as described in 13.1.4(10)(a)(ii):

(a) the type of business line or activity excluded and the types of claim which might arise from it;

(b) the number of contracts written or volume of activity;

(c) the number of complaints received by the *firm* relating to the excluded business or activity;

(d) generally accepted accounting principles applicable to provisions; and

(e) any other relevant information.

3.1.4(14) G If the *firm* holds additional *own funds* in accordance with 13.1.4(13) then the amount should be reviewed regularly. The reviews should take account of changes in the status of the policy exclusion(s) and any relevant changes to the *firm's* circumstances.

POLICIES PROVIDING COVER FOR MORE THAN ONE FIRM

3.1.4(15) R **If the policy provides cover to more than one *firm* then in relation to 13.1.4(2) and (3):**

(a) **the relevant income for calculating the *limits of indemnity* is that of all the *firms* named in the policy combined;**

(b) **each *firm* named in the policy must have the benefit of the minimum *limits of indemnity* as required in 13.1.4(2);**

(c) **each *firm* named in the policy must notify the *FSA* if the aggregate cover in the policy falls below the minimum in 13.1.4(2).**

EXEMPTION FROM HOLDING PROFESSIONAL INDEMNITY INSURANCE

3.1.5 R (1) **A *firm* is not required to effect or maintain professional indemnity insurance if a *bank*, *building society, insurer* or a *firm* which is a *friendly society*** provides the *firm* with a comparable guarantee

(2) If the *firm* is a member of a *group* in which there is a *bank*, *building society*, *insurer* or a *firm* which is a *friendly society*, the *firm's* comparable guarantee must be from that *bank*, *building society*, *insurer* or *friendly society*.

(3) A comparable guarantee means **an enforceable, written agreement** on terms at least equal **to those required** by *IPRU(INV)* 13.1.4(2)R.

13.1.6 **R A *firm* must take out professional indemnity insurance from:**

(a) any *insurance undertaking* which is authorised to transact professional indemnity insurance in the *EEA*; or

(b) *a person* of equivalent status in

(i) a Zone A country;

(ii) the Channel Islands, Gibraltar, Bermuda or the Isle of Man.

NOTIFICATION REQUIREMENTS

13.1.7 G *Rule* 13.1.9 is a *notification rule* and is in addition to any notification requirements in the Supervision Manual (Sup 15).

13.1.8 G *Firms* are reminded to comply with SUP 15.7 (Form and method of notification) when notifying the *FSA* in accordance with *rule* 13.1.9.

13.1.9 R **A *firm* must notify the *FSA* immediately it becomes aware, or has information which reasonably suggests, that any of the matters in Table 13.1(1) has occurred, may have occurred or may occur in the foreseeable future.**

Table 13.1(1)

This table forms part of 13.1.9

NOTIFIABLE EVENTS		
1.	In relation to professional indemnity insurance, required in accordance with 13.1.4(1) to 13.1.4(15) and 13.1.5, if: (a) it cannot be obtained within 28 days of the inception or renewal date; (b) it is cancelled;	
	(c)	the amount of aggregate cover is exhausted;
	(d)	the *firm* commences business lines for which it had not obtained cover;
	(e)	the *firm* is relying on 13.1.4(15); or
	(f)	the *firm* is relying on 13.1.5.
2.	In respect of an *exempt CAD* firm complying with section 13.3: (a) *own funds* falling below the applicable reference level; (b) *own funds* reaching the applicable € level specified in *rule* 13.3.1; (c) change of control causing loss of eligibility for that alternative test;	

Record Keeping Requirements

13.1.10 R **A *firm* must take reasonable steps to ensure that it:**

(1) keeps records which are sufficient to show at any time that it has complied with the requirements of this chapter; and

(2) establish procedures and controls to ensure that those records are made promptly and accurately and, where appropriate, brought up-to-date at regular and frequent intervals.

13.1.11 G When establishing record keeping systems *firms* are expected to bear in mind the advantage of records which will enable them to demonstrate easily their compliance with the *rules* and the effectiveness of their own procedures and controls.

13.1.12 R **A *firm* must ensure that its records are kept up-to-date and:**

(1) show with reasonable accuracy at any time the *firm's* financial position at that time;

(2) enable the *firm* to demonstrate its continuing compliance with the applicable financial resource requirements; and:

(3) provide the information needed to enable

(a) **the *firm* to prepare the financial statements and reports required by or under the *rules*; and**

(b) **any auditor required to report on the *firm's* financial statement to form an opinion on them in accordance with the relevant requirements.**

13.1.13 G Records should be capable of presenting a clear picture of the *firm's* financial viability.

13.1.14 R **(1)** A ***firm* may hold its records in any form but it must**

(a) **keep them in English and up-to-date, and**

(b) **be able to produce them promptly at its business premises on paper at the *FSA's* request.**

(2) If a *firm* retains records away from the place or places at which it conducts business, it must notify the *FSA* in accordance with the provisions of SUP 15 of the address and telephone number of the place or places at which they are kept.

(3) The *firm* must keep its records in such a way that

(a) **any particular record is promptly accessible, and**

(b) **any particular transaction is clearly shown, easily traceable through the *firm's* accounting records and sufficiently explained.**

(4) If the *firm* does not keep all records relating to financial resource requirements in one place, the *firm* must ensure that there is a clear indication that this is the case and provide accessible and adequate means of tracing all relevant records.

RELIANCE ON THIRD PARTIES

13.1.15 **R** **A *firm* may rely on records provided by a third party provided that the *firm* reconciles those records with its own.**

SECURITY

13.1.16 **R** **A *firm* must take reasonable steps to protect its records at all times against loss, unauthorised access, alteration or destruction.**

RETENTION OF RECORDS

13.1.17 **R** **A *firm* must retain any record required by the *rules* or the rules of a *previous regulator* for a period of six years after the time the record is made.**

13.1A **Financial resources requirements for an exempt CAD firm**

Application

13.1A.1 **R** **This section applies to a *personal investment firm* which is an *exempt CAD firm*.**

Initial capital and professional indemnity insurance requirements

13.1A.2 **R** **The financial resources requirement for a *personal investment firm* which is an *exempt CAD firm* is the higher of:**

(1) the requirement that is applied by section 13.1A; and

(2) (a) the requirement that is applied by sections 13.2 to 13.8; or

(b) if it is an *opted-in exempt CAD firm*, the requirement that is applied by sections 13.9 to 13.12 (but reading references to *Category B firm* as references to the *firm*).

13.1A.3 **R** **(1) A *firm* which is not an *IMD insurance intermediary* must have:**

(a) *initial capital* of €50,000; or

(b) professional indemnity insurance at least equal to the requirements of 13.1.4(2)(b) and 13.1.4(3) to 13.1.6; or

(c) a combination of *initial capital* and professional indemnity insurance in a form resulting in a level of coverage equivalent to (a) or (b).

[Note: Article 67(3) of *MiFID* and Article 7 of *CAD* (see also rule 13.1.4(2)(b))]

(2) If a *firm* chooses to comply with either (b) or (c) above, it must nevertheless have *initial capital* of at least £10,000.

13.1A.4 **R** **(1) A *firm* that is also an *IMD insurance intermediary* must have professional indemnity insurance at least equal to the limits set out in 13.1.4(2)(b) and in addition has to have:**

(a) *initial capital* of €25,000; or

(b) professional indemnity insurance at least equal to the requirements of 13.1.4(2)(c) and 13.1.4(3) to 13.1.6; or

(c) a combination of *initial capital* and professional indemnity insurance in a form resulting in a level of coverage equivalent to (a) or (b).

[Note: Article 67(3) of *MiFID* and Article 8 of *CAD* (see also rule 13.1.4(2)(c))]

(2) If a *firm* chooses to comply with either (b) or (c) above, it must nevertheless have *initial capital* of at least £10,000.

13.1A.5 G A trade-off between *initial capital* and professional indemnity insurance is appropriate such that € 1 of *initial capital* is the equivalent of professional indemnity insurance cover of € 20 for a single claim against the *firm* and
€ 30 in aggregate.

Initial capital

13.1A.6 **R** **A *firm's initial capital* consists of the sum of the following items:**

(1) ordinary *share* capital which is fully paid;

(2) perpetual non-cumulative *preference share* capital which is fully paid;

(3) *share* premium account;

(4) reserves excluding revaluation reserves;

(5) audited retained earnings;

(6) externally *verified* interim net profits;

(7) partners' capital;

(8) *eligible LLP members' capital* (in accordance with the provisions of *IPRU(INV)* Annex A); and

(9) *sole trader* capital.

Perpetual non-cumulative preference share capital

13.1A.7 **R** **A *firm* may include *preference share* capital in *initial capital* only where any *coupon* on it is not cumulative, and the *firm* is under no obligation to pay a *coupon* in any circumstances.**

Audited retained earnings

13.1A.8 **R** **When calculating *initial capital*, a *firm* may include its audited retained earnings only after making the following adjustments:**

(1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;

(2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;

(3) a *firm* must not include any unrealised gains from investment property (these should be reported as part of revaluation reserves);

(4) where applicable, a *firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Externally verified interim net profits or current account

13.1A.9 **R** **A *firm* may include interim net profits or current account when calculating *initial capital* to the extent that they have been *verified* by the *firm*'s external auditor and are net of any foreseeable tax, dividend and other appropriations.**

13.1A.10 **R** **When calculating *initial capital*, a *firm* may include its partners' capital only after making the following adjustments:**

(1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;

(2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;

(3) where applicable, a *firm* must deduct any asset in respect of *deferred acquisition costs* and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Defined benefit pension scheme: defined benefit liability

13.1A.11 **R** **For the calculation of *initial capital*, a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.**

13.1A.12 **R** **A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme*.**

Ongoing capital requirements

13.1A.13 **R** **A *firm* must, at all times, maintain a combination of professional indemnity insurance and *own funds*, at least equal to the requirements in this chapter for professional indemnity insurance and *initial capital*.**

13.1A.14 **R** **A *firm's initial capital*:**

minus the sum of the items set out against B

plus the sum of the items set out against C

minus *material holdings* in *credit* and *financial institutions* and *material insurance holdings*

equals *own funds*.

13.1A.15 **R** **Table 13.1A.15R**

This table forms part of *rule* 13.1A.14

(1) *Investments* in own *shares* at book value **(2) Intangible assets** **(3) *Material current year losses*** **(4) Excess of current year drawings over current year profits**	**D**
(1) Revaluation reserves **(2) Perpetual cumulative preference *share* capital and *debt capital***	**C**

(3) Long-term subordinated loans (in accordance with *IPRU (INV)* 13.5.5AR)

(4) Fixed term preference *share* capital (if not redeemable by shareholders within 5 years)

Perpetual cumulative preference share capital

13.1A.16 **R** **Perpetual cumulative preference *share* capital may not be included in the calculation of *own funds* unless it meets the following requirements:**

(1) it may not be reimbursed on the holder's initiative or without the prior agreement of the *FSA*;

(2) the instrument must provide for the *firm* to have the option of deferring the dividend payment on the share capital;

(3) the shareholder's claims on the *firm* must be wholly subordinated to those of all non-subordinated creditors;

(4) the terms of the instrument must provided for the loss-absorption capacity of the share capital and unpaid dividends, whilst enabling the *firm* to continue its business; and

(5) it must be fully paid-up.

Own funds – Restrictions

13.1A.17 **R** **(1) In calculating *own funds*:**

(i) the total amount of revaluation reserves, perpetual cumulative preference *share* capital, long-term subordinated loans and fixed term preference *share* capital must not exceed 100% of *initial capital* minus the sum of the items set out against B; and

(ii) the total amount of fixed term preference *share* capital and long-term subordinated loans must not exceed 50% of *initial capital* minus the sum of the items set out against B.

13.2 FINANCIAL RESOURCES TESTS

13.2.1 **R** **An exempt CAD firm must meet:**

(2) **Financial Resources Test 1A (the Adjusted *Net current assets* Test) calculated in accordance with section 13.4; and**

(3) **Financial Resources Test 2 (the Expenditure-based Test) calculated in accordance with section 13.5.**

13.2.3 G Table 13A is a summary of the financial resources test for *exempt CAD firm.*

Table 13.A

This table forms part of guidance 13.2.3

SUMMARY OF FINANCIAL RESOURCES FOR EXEMPT CAD FIRMS			
Type of *firm*	**Financial Resources Test 1A Adjusted *net current assets* Test**	**Financial Resources Test 2 Expenditure-based Test**	***Rules*/section references**
Exempt CAD firm	Adjusted net current assets of £1	Financial resources equal to the highest of 4/52 of Relevant Annual Expenditure or 13/52 of Relevant Annual Expenditure without *special adjustments* or £400 per *adviser*	13.1A.14 13.4 13.5.1D and 13.5.2 to 13.5.4
Exempt CAD firm which is a network	Adjusted net current assets of £1	Financial resources equal to the higher of 13/52 of Relevant Annual Expenditure or £400 per *adviser*	13.1A.14 13.4 13.5.1B and 13.5.2 to 13.5.4

13.4 Financial Resources Test 1A - Adjusted net current assets

13.4.1 R **An *exempt CAD firm* must adjust its *net current assets* as follows:**

(1) exclude assets which cannot be realised or recovered within twelve months;

(2) exclude amounts receivable from *connected persons* to the extent that they are not *properly secured*, except amounts that are *deposits* referred to at item (11) in Part I of table 13.5.4(1) or at item (11) in Part I of table 13.5.4(2);

(3) value *investments* at current *market value*, using the *bid price* for a *net long position* in an investment and the *offer price* for a *net short position* in an investment;

(4) where applicable, deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

13.4.2 R **An *exempt CAD firm* must at all times have adjusted *net current assets* of at least £1.**

13.5 **Financial Resources Test 2 – Expenditure-based Requirement**

REQUIREMENT

13.5.1B **R** **An *exempt CAD firm* which is a network must have financial resources calculated in accordance with whichever of (1), or (2) produces the higher amount:**

(1) **13/52 of its relevant annual expenditure, calculated in accordance with *rule* 13.5.2; or**

(2) **an amount equal to £400 multiplied by the number of its *advisers*.**

13.5.1D **R** (2) **An *exempt CAD firm* which is not permitted to carry on the activity of *managing investments or* to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3), (4) or (5) produces the highest amount.**

(3) **Financial resources which taking into account all the *special adjustments* amount to 4/52 of its relevant annual expenditure calculated in accordance with *rules* 13.5.2; or**

(4) **financial resources which disregarding all the *special adjustments* amount to 13/52 of its relevant annual expenditure, calculated in accordance with *rules* 13.5.2; or**

(5) **financial resources taking into account all the *special adjustments* of an amount equal to £400 multiplied by the number of its *advisers*.**

CALCULATION OF RELEVANT ANNUAL EXPENDITURE

13.5.2 **R** (1) **An *exempt CAD firm* must calculate its relevant annual expenditure by reference to the amount described as total expenditure in its most recently prepared set of *annual financial statements*. If those statements were for a period other than 12 months, the amounts in the *firm's* profit and loss account must be adjusted proportionately.**

(2) **Where an *exempt CAD firm* has just begun trading or has not been authorised long enough to submit such statements, the *firm* must calculate its relevant annual expenditure on the basis of forecast or other appropriate accounts submitted to the *FSA*.**

(3) **An *exempt CAD firm* may, subject to *rule* 13.5.3, deduct from its total expenditure the items set out in table 13.5.2.**

Table 13.5.2

This table forms part of *rule* 13.5.2

DEDUCTIONS FROM EXPENDITURE	
(a)	Staff bonuses (except to the extent that they are guaranteed);
(b)	*employees*' and *directors*' *shares* in profits (except to the extent that the amount is guaranteed);
(c)	other appropriations of profits;
(d)	shared commissions paid which are directly related to commissions received;
(e)	interest charges in respect of borrowing made to finance the acquisition of its *readily realisable investments*;
(f)	interest paid to *clients* on *client money*;
(g)	interest paid to *counterparties*;
(h)	fees, brokerage and other charges paid to *recognised clearing houses*, *exchanges* and *intermediate brokers* for the purposes of executing, registering or clearing transactions;
(i)	foreign exchange losses;
(j)	a *firm* must not deduct any exceptional expenditure.

13.5.2A G (1) Salaries of *directors* or partners are not eligible for deduction, except to the extent that they can be demonstrated to be non-fixed costs of the *firm*.

(2) The deduction in item (c) is intended to cover forms of remuneration, other than those set out in (b), that are not fixed or guaranteed.

ADJUSTMENTS TO CALCULATION OF RELEVANT ANNUAL EXPENDITURE

13.5.3 **R** **A *firm* must ensure that the expenditure base properly reflects the ongoing annual operating costs of the *firm* by having proper regard to its circumstances when deciding whether to include or exclude any item of expenditure or to make any other adjustment to the calculation of relevant annual expenditure.**

13.5.3A G In *rule* 13.5.3 the *FSA* would expect a *firm* to take proper account of the effect of, for example, the ongoing annual operating costs of the *firm* being met by another party, or of a significant change in the structure of the *firm's* business during the year.

CALCULATION OF FINANCIAL RESOURCES TO MEET TESTS 1, 1A OR 2

13.5.4 **R** **An *exempt CAD firm* must be able to calculate its financial resources at any time on the basis of the balance sheet it could draw up at that time. For this purpose:**

(2) An *exempt CAD firm* must, adjust the assets in the balance sheet as specified in table 13.5.4(2) and include the liabilities after making the adjustments specified in table 13.5.4(2).

(3) the assets and liabilities in the balance sheet are also subject to the following adjustments:

(a) a *firm* must deduct any unrealised gains or, where applicable, back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;

(b) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined business asset*:

(c) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year;

(d) where applicable, a *firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

TABLE 13.5.4(2) PART I

This table forms part of *rule* 13.5.4

EXEMPT CAD FIRM		
ASSETS	**CALCULATION**	**TYPE OF ADJUSTMENT**
(1) Land and Buildings	Exclude in full. (A loan secured by a charge on land and buildings may be deducted from liabilities in accordance with item (14) of Part II of this table.	An Illiquid Adjustment
(2) *Investments*	Exclude in full the value of *shares* in *connected companies*. Include any *net long position* in any fixed or current asset investment (a) valued at its current *bid price* (or, in the case of a with profits *life policy*, at its surrender value), and (b) discounted by the applicable percentage specified in table 13.5.4A.	An Illiquid Adjustment A Position Risk Adjustment
(3) *Investments* subject to Repurchase, Reverse Repurchase, Stock Borrowing or Stock Lending transactions	Include *investments* for which the *firm* has entered as principal into a repurchase, reverse repurchase, stock borrowing or stock lending transaction, after making (I) a deduction in accordance with item (2), and (II) a deduction calculated by (a) computing the *firm*'s exposure (the difference between the *market value* of the *securities* and the loan or collateral (including accrued interest) where that difference is not in the *firm*'s favour, after adjusting for any excess collateral), and (b) multiplying that exposure by the applicable percentage in table 13.5.4C.	A Position Risk Adjustment A Counterparty Risk Adjustment

(4) Debtors relating to Unsettled *Securities* Transactions - Cash against Documents	Include debtors where the *firm* has entered into a transaction in *securities* or *units in collective investment schemes* as agent on a cash against documents basis and the transaction remains unsettled, after deducting an amount calculated by (a) computing the difference between the agreed settlement price for those *investments* and their current *market value* where that difference is not in the *firm*'s favour, and (b) multiplying that difference by the applicable percentage specified in table 13.5.4B.	A Counterparty Risk Adjustment
(5) Debtors relating to Unsettled *Securities* Transactions - Free Deliveries	Where the *firm* has delivered *securities* or *units in collective investment schemes* before receiving payment for them, or paid for such *investments* before receiving certificates of good title for them, and not more than 3 days have passed since delivery, include debtors after deducting an amount calculated by (a) (i) (where the *firm* has delivered them) computing the full amount due to a *firm* under the contract; (ii) (where the *firm* has paid for them) computing their current *market value*; and (b) multiplying the amount or value at (a) by the applicable percentage specified in table 13.5.4C.	A Counterparty Risk Adjustment
	Exclude debtors if more than 3 days have passed since delivery.	An Illiquid Adjustment

(6) *Regulated collective investment schemes*	Include an amount owing in respect of a transaction in *units* in a *regulated collective investment scheme* only (a) if the amount has been due and unpaid for less than 90 days after the settlement date of the transaction to which it relates, and (b) after discounting that amount by the applicable percentage specified in table 13.5.4C. Exclude amounts that have been due and unpaid for more than 90 days.	A Counterparty Risk Adjustment An Illiquid Adjustment
(7) Debts of *group* or *connected companies*	Include an amount due from *group* or *connected companies* (which does not relate to trade debts) (a) where the *firm* has no reason to doubt that it will be repaid in full on demand, and (b) after discounting the amount by the applicable percentage specified in table 13.5.4C. Exclude an amount that the *firm* has reason to doubt will be repaid in full on demand.	A Counterparty Risk Adjustment An Illiquid Adjustment
(8) Debtors	Include amounts due from debtors (including *group* or *connected companies*) which have been due and unpaid for less than 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C. Exclude amounts that have been due and unpaid for more than 90 days.	A Counterparty Risk Adjustment An Illiquid Adjustment

(9) Prepayments	Include the amount of prepayments which relate to goods or services to be received or performed within 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C. Exclude the amount of prepayments relating to more than 90 days.	A Counterparty Risk Adjustment An Illiquid Adjustment
(10) Accrued income	Include accrued income, including any such income not yet due and receivable in respect of fees earned in the performance of *investment management* services that is receivable within 90 days, after discounting the amount by the applicable percentage specified in table 13.5.4C. Exclude accrued income receivable after 90 days.	A Counterparty Risk Adjustment An Illiquid Adjustment
(11) *Deposits*	Include amounts in respect of (a) cash and balances on current accounts and on *deposit* accounts with an *approved bank* or National Savings Bank which can be withdrawn within 90 days; (b) money on *deposit* with a UK local authority which can be withdrawn within 90 days; (c) money *deposit*ed and evidenced by a certificate of tax *deposit*. Exclude amounts which can only be withdrawn after 90 days.	An Illiquid Adjustment
(12) Other amounts due from Government bodies or local authorities	Include other amounts due from UK Government bodies or local authorities if they are agreed and due within 90 days, after discounting the amounts by the applicable percentage specified in table 13.5.4C.	A Counterparty Risk Adjustment

	Exclude amounts that are not due to be paid within 90 days.	An Illiquid 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 PRU 2.	An Illiquid Adjustment
Where applicable - *Large exposures*	Deduct an amount calculated in accordance with *rule* 13.6.2.	A *Large exposure* Adjustment

TABLE 13.5.4(2) PART II

This table forms part of *rule* 13.5.4

EXEMPT CAD FIRM		
LIABILITY	CALCULATION	TYPE OF ADJUSTMENT
(14) Secured Liabilities	Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced by the smallest of the following amounts: (a) the aggregate amount of the *firm*'s secured liabilities which are due more than one year after the balance sheet date; (b) (if the land and buildings have been valued by an independent professional valuer within the past 18 months) 85% of the amount certified by the valuer as their *market value*; and (c) 85% of the net book value of land and buildings.	An Illiquid Adjustment
(15) Subordinated loans	Include in full except any long term or short term subordinated loan in the standard form prescribed by the *FSA* which may be treated as capital up to the limits specified in *SUP* 16.	

(16) Commission on indemnity terms from the sale of *life policies* or *pension contracts*	Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the *firm* has received on indemnity terms during the previous twelve months. This provision must be reasonable having regard to the *firm*'s circumstances and, in particular, its previous lapse ratio.	An Illiquid Adjustment
(17) *Investments* (Short Positions)	Include a *net short position* (a) valued at its *offer price*, and (b) increased by the applicable percentage specified in table 13.5.4A.	A Position Risk Adjustment
(18) Deficiency in *subsidiary*	Include as a liability the amount by which the liabilities of any *subsidiary* (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the *firm* has not already made such a provision elsewhere in its financial statements.	An Illiquid Adjustment
(19) Liability for tax	Include as a liability a provision for taxation on the whole of the profits of its business up to its balance sheet date.	An Illiquid Adjustment
(20) Creditors relating to Unsettled *Securities* Transactions Cash against Documents	Include creditors where a *firm* has entered into a transaction in *securities* or *units in collective investment schemes* as agent on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by (a) computing the difference between the agreed settlement price for those *investments* and their current *market value*, and (b) multiplying that exposure by the applicable percentage specified in table 13.5.4B.	A Counterparty Risk Adjustment

(21) Creditors relating to Unsettled *Securities* Transactions Free Deliveries	Include an amount for creditors where (acting as agent) the *firm* has delivered certificates of title for *securities* or *units in collective investment schemes* before receiving payment for them, or where the *firm* has bought such *investments* before receiving certificates of good title for them, after adding an amount calculated by	A Counterparty Risk Adjustment
	(a) (i) (where the *firm* has paid for them but not received certificates of good title for them) computing their current *market value*; (ii) (where the *firm* has delivered the certificates without receiving payment for them) computing the full amount due to a *firm* under the contract for sale; and (b) multiplying that exposure by the applicable percentage specified in table 13.5.4C.	
(22) *Over the counter derivatives*	Include as a liability an amount for its positions in such *derivatives* calculated by (a) computing the credit equivalent of those positions in accordance with table 13.5.4D, and (b) increasing that credit equivalent by the applicable percentage specified in table 13.5.4C, (in addition to making an adjustment in accordance with item (17) of this table and (in respect of bought *OTC* equity *options* and covered *warrants*) in accordance with item (25)).	A Counterparty Risk Adjustment
(23) Contingent Liabilities	A *firm* must include a provision for any contingent liabilities which exist at its balance sheet date that must be made.	An Illiquid Adjustment
(24) Preference *Shares*	Include as a liability any amounts in excess of the amounts which may be treated as financial resources specified in table 13.3.2(2) and *SUP* 16.	

(25) *Net open foreign currency position*	Include as a liability an amount in respect of its foreign exchange risk calculated in accordance with table 13.5.4E.	A Foreign Exchange Risk Adjustment
(26) All other liabilities	Include in full.	

TABLE 13.5.4A

This table forms part of *rule* 13.5.4

POSITION RISK			
The percentages in the table are applied to the *market value* (unless otherwise stated) of gross positions, i.e. both longs and shorts in each category; netting and offsetting are prohibited. The long or short position in a particular investment is the net of any long or short positions held in that same investment.			
INVESTMENT	DISCOUNT		
A. Debt		Maturity	
	0-2 years	2-5 years	>5 years
Central Government	2%	5%	13%
Qualifying debt security:			
- fixed rate	8%	8%	15%
- floating rate	10%	10%	15%
Non-*qualifying debt security*:			
- fixed rate	10%	20%	30%
- floating rate	30%	30%	30%
B. Equities			
- *exchange traded*	25%		
- other	100%		

C. *Derivatives*	
- *exchange traded futures*	4 x initial margin requirement
- *OTC futures*	Apply the appropriate percentage shown in A and B to the *market value* of the underlying position
- Purchased *options*	Apply the appropriate percentage shown in A and B to the *market value* of the underlying position but the result may be limited to the *market value* of the option
- *Contracts for differences*	20% of the *market value* of the contract
D. Other *Investments*	
- *Units* in *regulated collective investment schemes*	25%
- *units* in *higher volatility funds* or *property funds*	50%
- with profit *life policies*	20% of surrender value
- other	100%

TABLE 13.5.4B

This table forms part of *rule* 13.5.4

UNSETTLED SECURITIES TRANSACTIONS	
Number of *business days* after due settlement date	Percentage
0 – 4	0
5 – 15	8
16 – 30	50
31 – 45	75
46 or more	100

TABLE 13.5.4C

This table forms part of *rule* 13.5.4

COUNTERPARTY RISK	
Type of Counterparty	Deduction
A counterparty which is, or the contract of which is, explicitly guaranteed by: - the government or central bank of the *United Kingdom* or another *Zone A country*; or - the *European Economic Area*; or - any other government or central bank, provided the exposure is denominated in that country's national currency.	NIL
A counterparty which is, or the contract of which is, explicitly guaranteed by: - a local authority or regional government in the *United Kingdom* or another *Zone A country*; or - a *credit institution* authorised in the *United Kingdom* or another *Zone A country*; or - a recognised *clearing house* or recognised investment exchange; or - an *investment firm* or a comparable undertaking regulated by a *recognised third country*.	1.6%
Any other counterparty	8%

TABLE 13.5.4D

This table forms part of *rule* 13.5.4

OVER THE COUNTER DERIVATIVES
a. By attaching current *market value*s to contracts (marking to market), obtain the current replacement cost of all contracts with positive values.
b. To obtain a figure for potential future credit exposure (except in the case of single currency "floating/floating interest rate swaps" in which only the current replacement costs will be calculated), multiply the notional principal amounts or values underlying the *firm*'s aggregate positions by the following percentages: Residual Maturity — Interest Rate Contracts — Foreign Exchange Contracts One year or less — Nil — 1% More than 1 year — 0.5% — 5%
c. The credit equivalent is the sum of current replacement cost and potential future credit exposure.

TABLE 13.5.4E

This table forms part of *rule* 13.5.4

FOREIGN EXCHANGE RISK
(a) A *firm* must deduct a foreign exchange risk requirement for all the following items which are denominated in a foreign currency: (i) all assets and liabilities, including accrued interest, denominated in the currency (all *investments* at market or realisable value); (ii) any currency future, at the nominal value of the contract; (iii) any forward contract for the purchase or sale of the currency, at the contract value, including any future exchange of principal associated with currency swaps; (iv) any foreign currency *options* at the net delta (or delta-based) equivalent of the total book of such *options*;

(v) any non-currency option, at *market value*;

(vi) any irrevocable guarantee;

(vii) any other off-balance sheet commitment to purchase or sell an asset denominated in that currency.

(b) The requirement must be calculated as follows:

(i) using the spot rate, convert the *net long position* and *net short position* in each foreign currency into the currency in which its *annual financial statements* are reported;

(ii) total the *net open long positions* and the *net open short positions*;

(iii) the higher of (i) and (ii) above is the *firm*'s *net open foreign currency position*;

(iv) multiply the *firm*'s *net open foreign currency position* by 10%.

(c) A *firm* may not include any future income or expense not yet accrued but fully hedged (subject to deduction of an appropriate risk requirement).

SUBORDINATED LOANS

13.5.5 R **An *exempt CAD firm* may treat a subordinated loan as a financial resource, as specified in table 13.1A.15R and subject to *rule* 13.5.5C, if the long term subordinated loan is eligible for such treatment in accordance with *rule* 13.5.5A.**

13.5.5A R **A long term subordinated loan is eligible for such treatment if:**

(1) it is fully paid up;

(2) it has an original maturity of at least five years, or where it has no fixed term, it is subject to five years' notice of repayment;

(3) repayment, prepayment or termination is only permitted under the loan agreement:

(a) on maturity, or on expiration of the period of notice, if after such payment or termination a *firm* meets 120% of its financial resource requirement; or

(b) on winding up after the claims of all other creditors and all outstanding debts have been settled;

(4) the amount used in the calculation of its financial resources is reduced on a straight line basis over the last five years of its term;

(5) it is in the standard form prescribed by the *FSA* for long term subordinated loans.

13.5.5C **R** **The total amount of long term subordinated loans that an *exempt CAD firm* may include in the calculation of its financial resources is restricted as stipulated in 13.1A.17R and in *SUP* 16.**

13.7.2B R **An *exempt CAD firm* must, where it is *exposed* to undue risk in consequence of its membership of a *group*, provide against, reduce or eliminate that risk.**

13.9 Financial Resources Tests for Category B firms

13.9.1 **R A *Category B firm* must meet:**

(1) financial Resources Test 1 (the *Own funds* Test) calculated in accordance with section 13.10;

(2) Financial Resources Test 1A (the Adjusted *Net current assets* Test) calculated in accordance with section 13.11, unless the *firm* is a *low resource firm* which is not permitted to carry on the activity of *managing investments in* respect of portfolios containing only *life policies*; and

(3) Financial Resources Test 2 (the Expenditure-based Test) calculated in accordance with section 13.12 unless the *firm* is a *low resource firm*.

13.9.1A G Table 13B is a summary of the financial resources test for a *Category B firm*.

Table 13B This table forms part of *rule* 13.9.1

SUMMARY OF FINANCIAL RESOURCES FOR *CATEGORY B FIRMS*				
Type of *firm*	Financial Resources Test 1 *Own funds* Test	Financial Resources Test 1A Adjusted *Net current assets* Test	Financial Resources Test 2 Expenditure-based Test	*Rule*/section References
Category B1 (including any *Network* in this category)	£10,000	Adjusted *net current assets* of £1	Liquid capital equal to the highest of 13/52 of relevant annual expenditure or £400 per adviser or £10.000	13.10 13.11 13.12.1C 13.12.2 to 13.12.5A 0
Category B2 which is permitted to carry on the activity of *investment management* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm*	£10,000	Adjusted *net current assets* of £1	Adjusted capital equal to the higher of 13/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1D 13.12.2 to 13.12.5A
Category B2 with 26+ *advisers*	£10,000	Adjusted *net current assets* of £1	Adjusted capital equal to the higher of 8/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1E 13.12.2 to 13.12.5A
Category B2 with 1-25 *advisers*	£10,000	Adjusted *net current assets* of £1	Adjusted capital equal to the higher of 4/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1F 13.12.2 to 13.12.5A

Category B3 which is permitted to carry on the activity of *managing investments in* respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm*	£10,000	Adjusted *net current assets* of £1	Adjusted capital equal to the higher of 8/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1E 13.12.2 to 13.12.5A
Category B3 with 26+ *advisers*	£10,000	Adjusted *net current assets* of £1	Adjusted capital equal to the higher of 4/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1F 13.12.2 to 13.12.5A
Category B3 with 1 - 25 *advisers*	£10,000	N/A	N/A	13.10
Network in Category B2 or B3	£10,000	Adjusted *net current assets* of £1	Adjusted capital equal to the higher of 13/52 of relevant annual expenditure or £400 per adviser	13.10 13.11 13.12.1D 13.12.2 to 13.12.5A
All *Category B firms* that do not hold *client money* or assets, but are *permitted* to *establish, operate or wind up a personal pension scheme*.	£10,000	Adjusted *net current assets* of £1	Adjusted capital equal to the highest of 6/52 of relevant annual expenditure, £400 per adviser, £10,000 and any other expenditure-based requirement set out in 13.12.1 applicable to the *firm*.	13.10 13.11 13.12.1 13.12.2 to 13.12.5A
All *Category B firms* that do not hold *client money* or assets and are *permitted* to *establish, operate or wind up a personal pension scheme*.	£10,000	Adjusted *net current assets* of £1	Adjusted capital equal to the highest of 13/52 of relevant annual expenditure, £400 per adviser, and £10,000	13.10 13.11 13.12.1G 13.12.2 to 13.12.5A

13.10 Financial Resources Test 1- Own funds Requirement

REQUIREMENT

13.10.1 R **A *Category B firm's own funds* must at all times be at least £10,000.**

CALCULATION

13.10.2 R **A *Category B firm's own funds* must be calculated in accordance with table 13.10(2).**

Table 13.10(2).

This table forms part of *rule* 13.10.2

<table>
<tr><th colspan="2">OWN FUNDS</th></tr>
<tr><th>Companies</th><th>Sole Traders: Partnerships</th></tr>
<tr><td>Paid-up share capital (excluding preference shares redeemable by shareholders within 2 years)
Eligible LLP members' capital
Share premium account
Retained profits (see 13.10.2AR) and interim net profits (Note 1)
Revaluation reserves
Short-term subordinated loans

Debt capital</td><td>Balances on proprietor’s or partners’
capital accounts
current accounts
(see 13.10.2AR)

Revaluation reserves
Short-term subordinated loans</td></tr>
<tr><td>less
Intangible assets
Material current year losses
Excess LLP members' drawings</td><td>less
Intangible assets
Material current year losses
Excess of current year drawings over current year profits</td></tr>
<tr><td colspan="2">Note 1
Retained profits must be audited and interim net profits must be verified by the firm's external auditor, unless the firm is exempt from the provisions of Part VII of the Companies Act 1985 (section 249A (Exemptions from audit)), or where applicable, Part 16 of the Companies Act 2006 (section 477 (Small companies: Conditions for exemption from audit)) relating to the audit of accounts.</td></tr>
</table>

13.10.2A R For the purpose of calculating a *Category B firm's own funds,* the following adjustments apply to retained profits or, (for non-corporate entities), current accounts figures.

(1) a *Category B firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;

(2) a *Category B firm* must derecognise any *defined benefit asset*;

(3) a *Category B firm* may substitute for a *defined benefit liability* its *deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

(4) a *Category B firm* must deduct any unrealized gains on investment property and include these within revaluation reserves.

(5) where applicable, a *Category B firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

13.10.2B G A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme.*

Where a* Category B firm *is a sole trader or a partnership:

(1) it can use (to the extent necessary to make up any shortfall in the required resources) any of its personal assets (not being needed to meet liabilities arising from its personal activities and any business activities not regulated by the *FSA*);

(2) the *firm's* total financial resources, from whatever source, must at all times be sufficient to cover its total liabilities.

13.10.3 R **(1) Where a *Category B3 firm* with 1-25 *advisers* has a facility under the PASS Loan Agreement Scheme it may make an adjustment in its *own funds* calculation in accordance with (2).**

(2) a *firm* in (1) can regard as additional to its *own funds* the lower of either:

(a) **the amount of the loan facility agreed (less any loan repayments already made and less the amount of the facility withdrawn or lapsed); or**

(b) **the amount of the *firm's* provision for redress (net of any professional indemnity insurance recoverable) at the time of its application for the loan facility.**

13.11 Financial Resources Test 1A - Adjusted net current assets

APPLICATION

13.11.1 R **This section does not apply to a *low resource firm*.**

REQUIREMENT

13.11.2 R **A *Category B firm* must adjust its *net current assets* as follows:**

(1) exclude assets which cannot be realised or recovered within twelve months;

(2) exclude amounts receivable from *connected persons* to the extent that they are not *properly secured*, except amounts that are *deposits* referred to in item (11) of table 13.12.3(1) or item (11) in table 13.12.3(2);

(3) **value *investments* at current *market value*, using the *bid price* for a *net long position* in an investment and the *offer price* for a *net short position* in an investment;**

(4) **where applicable, deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.**

13.11.3 R **A *Category B firm* must at all times have adjusted *net current assets* of at least £1.**

13.12 Financial Resources Test 2 - Expenditure-based Requirement

APPLICATION

13.12.1A R **This section does not apply to a *low resource firm*.**

REQUIREMENT

13.12.1B R **A *Category B firm* must have at all times financial resources calculated in accordance with *rules* 13.12.2 to 13.12.5 which equal or exceed the amount specified in *rules* 13.12.1C to F as applicable.**

13.12.1C R **A *Category B1 firm*, including a *Network* must have financial resources calculated in accordance with whichever of (1), (2) or (3) produces the higher amount.**

(1) **13/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or**

(2) **an amount equal to £400 multiplied by the number of its *advisers*; or**

(3) **£10,000;**

13.12.1D R (1) **A *Category B2 firm* which is permitted to carry on the activity of *investment management* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**

(2) **A *Network* in Category B2 or B3 must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**

(3) **13/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or**

(4) **an amount equal to £400 multiplied by the number of its *advisers*.**

13.12.1E R (1) **A *Category B2 firm* with more than 25 *advisers* which is not a *Network* and is not permitted to carry on the activity of *managing investments in* respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**

(2) **A *Category B3 firm* which is permitted to carry on the activity of *investment management* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**

(3) **8/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or**

(4) **an amount equal to £400 multiplied by the number of its *advisers*.**

13.12.1F R (1) **A *Category B2 firm* with fewer than 26 *advisers* which is not a *Network* and is not permitted to carry on the activity of *managing investments in* respect of portfolios containing only *life policies* or to delegate such activity of *investment management* to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**

(2) **A *Category B3 firm* which is not permitted to carry on the activity of *investment management* in respect of portfolios containing only *life policies* or to delegate such activity to an *investment firm* must have financial resources calculated in accordance with whichever of (3) or (4) produces the higher amount.**

(3) **4/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D; or**

(4) **an amount equal to £400 multiplied by the number of its *advisers*.**

13.12.1G R **A *category B firm* whose permission includes *establishing, operating or winding up a personal pension scheme* must have financial resources calculated in accordance with (1) or (2):**

(1) **For a *firm* which holds *client money* or assets, the highest of:**

(a) **13/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D;**

(b) **an amount equal to £400 multiplied by the number of its advisers; and**

(c) **£10,000.**

(2) **For a *firm* which does not hold client money or assets, the highest of:**

(a) **6/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D;**

(b) **an amount equal to £400 multiplied by the number of its advisers;**

(c) **£10,000; and**

(d) **any other expenditure-based requirement set out in 13.12.1 applicable to the *firm*.**

CALCULATION OF RELEVANT ANNUAL EXPENDITURE

13.12.2 R **A *Category B firm* must calculate its relevant annual expenditure by reference to the amount described as total expenditure in its most recently prepared set of *annual financial statements*. If those statements were for a period other than 12 months, the amounts in its profit and loss account must be adjusted proportionately.**

13.12.2A R **Where a *Category B firm* has just begun trading or have not been authorised long enough to submit such statements the *firm* must calculate its relevant annual expenditure on the basis of forecast or other appropriate accounts submitted to the *FSA*.**

13.12.2B R **A *Category B firm* may deduct from its relevant annual expenditure items (a) to (f) set out in table 13.12.2, unless the *firm* is a *Category B1 firm*, in which case it may not deduct item (e).**

Table 13.12.2

This table forms part of *rule* 13.12.2

DEDUCTIONS FROM EXPENDITURE	
(a)	staff bonuses;
(b)	*employees*' and *directors*' *shares* in profits;
(c)	interest charges in respect of borrowing made to finance the acquisition of its *readily realisable investments*;
(d)	shared commissions paid which are directly related to commissions received;
(e)	emoluments of *directors*, partners or a sole trader;
(f)	a *firm* must not deduct any exceptional expenditure.

ADJUSTMENTS TO CALCULATION OF RELEVANT ANNUAL EXPENDITURE

13.12.2C R **A *firm* must ensure that the expenditure base properly reflects the ongoing annual operating costs of the *firm* by having proper regard to its circumstances when deciding whether to include or exclude any item of expenditure or to make any other adjustment to the calculation of relevant annual expenditure.**

13.12.2D G In *rule* 13.12.2C the *FSA* would expect a *firm* to take proper account of the effect of, for example, the ongoing annual operating costs of the *firm* being met by another party, or of a significant change in the structure of the *firm's* business during the year.

CALCULATION OF FINANCIAL RESOURCES TO MEET TESTS 1, 1A OR 2

13.12.3 R (1) **This *rule* does not apply to a *low resource firm*;**

(2) **A *Category B firm* must be able to calculate its financial resources at any time on the basis of the balance sheet the *firm* could draw up at that time. For this purpose:**

(a) **a *Category B1 firm* must adjust the assets in the balance sheet as specified in Part I of table 13.12.3(1) and include the liabilities after making the adjustments specified in Part II of table 13.12.3(1);**

(b) **a *Category B2* or *B3 firm* to which 13.12 applies must adjust the assets in the balance sheet as specified in Part I of table 13.12.3(2) and include the liabilities after making the adjustments specified in Part II of table 13.12.3(2).**

(3) the assets and liabilities in the balance sheet are also subject to the following adjustments:

(a) a *Category B firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;

(b) in respect of a *defined benefit occupational pension scheme*, a *Category B firm* must derecognise any *defined benefit asset*;

(c) a *Category B firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year;

(d) where applicable, a *Category B firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Table 13.12.3(1) Part I

This table forms part of *rule* 13.12.3

FIRMS CATEGORY B1	
CALCULATION OF ASSETS	
ASSETS	ADJUSTMENTS
(1) Land and Buildings	Exclude in full. (A loan secured by a charge on land and buildings may be deducted from liabilities in accordance with item (14) of Part II of this table.)
(2) *Investments*	Include any *net long position* in any fixed or current asset investment (including *shares* in any connected company) (a) valued at its current *bid price* (or, in the case of a with-profits *life policy*, at its surrender value), and (b) discounted by the applicable percentage specified in table 13.12.3A. A *firm* which acts as a market-maker in second-hand *life policies* must comply with the relevant requirements in respect of second-hand *life policies* held by the *firm* and include such a *policy*. (a) valued at its surrender value at the date on which the *firm* acquired it, or its latest available surrender value if different. (b) where a life office whose *policy* is held by the *firm* has altered adversely the basis on which it calculates surrender values, the *firm* must revise its valuation of the second-hand *policy* as soon as practicable after becoming aware of the alteration.
(3) *Investments* subject to Repurchase, Reverse Repurchase, Stock Borrowing or Stock Lending transactions	Include *investments* for which the *firm* has entered as principal into a repurchase, reverse repurchase, stock borrowing or stock lending transaction on its own behalf, after making (I) a deduction in accordance with item (2), and (II) a deduction calculated by computing its exposure (the difference between the *market value* of the *securities* and the loan or collateral (including accrued interest) where that difference is not in the *firm*'s favour, after adjusting for any excess collateral).

(4) Debtors relating to Unsettled *Securities* Transactions Cash against Documents	Include debtors where the *firm* has entered into a transaction on its own behalf in *securities* or *units in collective investment schemes* on a cash against documents basis, and the transaction remains unsettled, after deducting an amount calculated by (a) computing the difference between the agreed settlement price for those *investments* and their current *bid price* where that difference is not in the *firm*'s favour, and (b) multiplying that difference by the applicable percentage specified in table 13.12.3B.
(5) Debtors relating to Unsettled *Securities* Transactions Free Deliveries	(a) Include the full amount due to the *firm* from debtors if a *firm* has delivered *securities* or *units in collective investment schemes* before receiving payment for them, or paid for such *investments* before receiving certificates of good title for them, so long as not more than three days have passed since delivery (b) If more than three days have passed since delivery, exclude in full.
(6) *Regulated collective investment schemes*	Include an amount owing in respect of a transaction in *units* in a *regulated collective investment scheme* only if the amount has been due and unpaid for 30 days or less after the settlement date of the transaction to which it relates.
(7) Loans secured on *investments*	If the *firm* holds client title documents as security for (a) the repayment of money it has lent; or (b) money due to the *firm* in connection with the purchase for or sale to another person of those *investments*, which the *firm* has for genuine commercial reasons agreed to postpone, the *firm* may include as an asset the lower of the following: (i) the total amount due; (ii) the *market value* of the *investments* multiplied by the appropriate rates set out in table 13.12.3A.

(8) Trade debtors	Include amounts owing only in respect of (a) (i) commission; (ii) *investment management* fees; (iii) other fees earned in connection with the *firm*'s *investment business*, which are due from other authorised or *EEA firms*, *recognised investment exchanges* or *recognised clearing houses* and have been due and unpaid for 30 days or less; (b) (i) *investment management* fees; or (ii) pensions administration which have been due from its customers and unpaid for 30 days or less. (c) All other trade debtors must be deducted in full.
(9) Prepayments	Include prepayments which relate to goods or services to be received or performed within 90 days.
(10) Accrued income	(a) Accrued income relating to *investment management* fees not yet due and payable may be included if the fees relate to services provided within the previous six months. (b) Other accrued income may be included if it relates to interest on marketable debt instruments or on *deposits* included in item (11).
(11) *Deposits*	The following may be included: (a) cash and balances on current accounts and on *deposit* accounts with an *approved bank* or National Savings Bank which can be withdrawn within 90 days; (b) money on *deposit* with a UK local authority which can be withdrawn within 90 days; (c) money *deposit*ed and evidenced by a certificate of tax *deposit*.

(12) Other Debts	(a) Amounts owing in respect of (i) interest on *investments*; (ii) repayments of marketable debt instruments at maturity or call; (iii) dividends declared by authorised or not *EEA firms* or by companies in respect of *shares* listed on a recognised or designated investment exchange; which have been due and unpaid for 30 days or less may be included. (b) Other amounts due from UK government bodies may be included if they are agreed and due within 30 days.
(13) All other assets	Exclude in full.

Table 13.12.3(1) Part II

This table forms part of *rule* 13.12.3

FIRMS* IN *CATEGORY B1	
CALCULATION OF LIABILITIES	
LIABILITIES	**ADJUSTMENTS**
(14) Secured Liabilities	Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced by the smallest of the following amounts: (a) the aggregate amount of the *firm*'s secured liabilities which are due more than one year after the balance sheet date; (b) (if the land and buildings have been valued by an independent professional valuer within the past 18 months) 85% of the amount certified by the valuer as their *market value*; (c) 85% of the net book value of the land and buildings.
(15) Subordinated loans	Include in full, except any short-term subordinated loan in the standard form prescribed by the *FSA* which may be treated as capital up to the limits specified in *rules* 13.12.5 and 13.12.5A.

(16) Commission on indemnity terms from the sale of *life policies* or *pension contracts*	Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the *firm* has received on indemnity terms during the previous twelve months. This provision must be reasonable having regard to its circumstances and, in particular, its previous lapse ratio.
(17) Short Positions	Include a *net short position* (a) valued at its *offer price* and (b) increased using the applicable percentage rate in table 13.12.3A.
(18) Deficiency in *subsidiary*	Include as a liability the amount by which the liabilities of any *subsidiary* (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the *firm* has not already made such a provision elsewhere in its financial statements.
(19) Liability for tax	Include as a liability a provision for taxation on the whole of the profits of the *firm*'s business up to its balance sheet date.
(20) Creditors relating to Unsettled *Securities* Transactions -Cash against Documents	Include creditors where the *firm* has entered into a transaction on its own behalf in *securities* or *units in collective investment schemes* on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by (a) computing the difference between the agreed settlement price for those *investments* and their current *market value* where that difference is not in the *firm*'s favour, and (b) multiplying that difference by the applicable percentage specified in table 13.12.3B.
(21) Creditors relating to Unsettled *Securities* Transactions -Free Deliveries	Include an amount for creditors where (acting on the *firm*'s own behalf) the *firm* has delivered certificates of title for *securities* or *units in collective investment schemes* before receiving payment for them, or where a *firm* has bought such *investments* before receiving certificates of good title for them, as follows: (a) (if the *firm* has paid for them and not more than 3 days have passed since the payment was made) include in full: (b) (if more than 3 days have passed since the payment was made) include the full value of the *securities* at their current *offer price*.

(22) *Over the counter derivatives*	If the *firm* holds positions in *derivatives* on its own behalf must (a) make the adjustment in item (17) of this table, and (b) deduct the credit equivalent of those positions computed in accordance with table 13.12.3C. In addition, bought *OTC options* and covered *warrants* will be subject to table 13.12.3D.
(23) Contingent Liabilities	A *firm* must include a provision for any contingent liabilities which exist at its balance sheet date that must be made.
(24) Redeemable Preference *Shares*	Include as a liability any redeemable preference *shares* which fall due within two years. If *shares* are not redeemable by the shareholder within 2 years, they must be treated in accordance with *rules* 13.12.5 and 13.12.5A.
(25) Foreign currency risk	If the *firm* holds positions on its own behalf in foreign currencies or has assets or liabilities denominated in foreign currencies, the *firm* must calculate a provision to cover the risk in accordance with table 13.12.3D and include the amount as a liability
(26) All other liabilities	Include in full.

Table 13.12.3(2) Part I

This table forms part of *rule* 13.12.3

***FIRMS* IN CATEGORIES B2 AND B3** **(except low resource *firms*)**	
CALCULATION OF ASSETS	
ASSETS	**ADJUSTMENTS**
(1) Land and buildings	Include land and buildings which are not subject to any charge only if they have been valued either (a) at 60% of their net book value, or (b) (if valued by an independent professional valuer within the past three years) at 60% of the amount certified by the valuer to be the *market value*.

(2) Motor vehicles	(a) Include motor vehicles acquired less than 12 months ago valued at 50% of their cost (b) Include motor vehicles acquired within the past 24 months (but more than 12 months ago) valued at 25% of their cost (c) Exclude in full any other motor vehicles.
(3) *Investments*	Include any *net long position* in any fixed or current asset investment (including *shares* in any connected company) valued at its current *bid price* (or, in the case of a with profits *life policy*, at its surrender value) and discounted by the applicable percentage specified in table 13.12.3A.
(4) Debtors relating to Unsettled *Securities* Transactions Cash against Documents	Include debtors where a *firm* has entered into a transaction on its own behalf in *securities* or *units in collective investment schemes* on a cash against documents basis and the transaction remains unsettled after deducting an amount calculated by (a) computing the difference between the agreed settlement price for those *investments* and their current *bid price* where that difference is not in the *firm*'s favour and (b) multiplying that difference by the applicable percentage specified in table 13.12.3B.
(5) Debtors relating to Unsettled *Securities* Transactions Free Deliveries	(a) Where the *firm* has delivered *securities* or *units in collective investment schemes* before receiving payment for them or paid for such *investments* before receiving certificates of good title for them include the full amount due to a *firm* from debtors so long as not more than 3 days have passed since delivery. (b) Exclude in full if more than 3 days have passed since delivery.
(6) *Regulated collective investment schemes*	Include an amount owing in respect of a transaction in *units* in a *regulated collective investment scheme* only if the amount has been due and unpaid for not more than 90 days after the settlement date of the transaction to which it relates.
(7) Debts of *group* or *connected companies*	Include amounts due from *group* or *connected companies* (which do not relate to trade debts) where a *firm* has no reason to doubt that repayment will be made in full on demand.

(8) Trade debtors	Include amounts due from trade debtors (including *group* or *connected companies*) which have been due and unpaid for less than 90 days.
(9) Prepayments	Include prepayments which relate to goods or services to be received or performed within 90 days.
(10) Accrued income	(a) Include accrued income not yet due and payable in respect of fees earned in the performance of *investment management* services that is receivable within six months. (b) Include any other accrued income receivable within 90 days.
(11) *Deposits*	Include amounts in respect of (a) cash and balances on current accounts and on *deposit* accounts with an *approved bank* or National Savings Bank which can be withdrawn within 90 days; (b) money on *deposit* with a UK local authority which can be withdrawn within 90 days; (c) money *deposit*ed and evidenced by a certificate of tax *deposit*.
(12) Other amounts due from Government bodies or local authorities	Include other amounts due from UK Government bodies or local authorities if they are agreed and due within 90 days.
(13) All other assets	Exclude in full.

Table 13.12.3(2) Part II

This table forms part of *rule* 13.12.3

FIRMS IN CATEGORIES B2 AND B3 (except low resource *firms*)	
CALCULATION OF LIABILITIES	
LIABILITIES	**CALCULATIONS**
(14) Secured Liabilities	Include in full, except the amount of the liabilities secured by a charge on land and buildings which may be reduced as follows: (a) If the liabilities secured exceed 85% of the value of the land and buildings, then the excess is treated as a liability; (b) If the land and buildings have been valued by an independent professional valuer within the past three years, the value of the land and buildings is the amount certified by the valuer as their *market value*; otherwise it is their net book value. (If 60% of the value of the land and buildings which are subject to a charge exceeds the liabilities secured, then the amount of that excess may be treated as an asset.)
(15) Subordinated loans	Include in full, except any short term subordinated loan in the standard form prescribed by the *FSA* for such loans which may be treated as capital up to the limits specified in *rules* 13.12.5 and 13.12.5A.
(16) Commission on indemnity terms from the sale of *life policies* or *pension contracts*	Include as a liability a provision for repayment, in the event that premiums cease within the indemnity period, which must equal or exceed 2.5% of the commissions the *firm* has received on indemnity terms during the previous twelve months. This provision must be reasonable having regard to its circumstances and, in particular, its previous lapse ratio.
(17) Short Positions	Include a *net short position* (a) valued at its *offer price*, and (b) increased using the applicable percentage rate in table 13.12.3A.

(18) Deficiency in *subsidiary*	Include as a liability the amount by which the liabilities of any *subsidiary* (excluding its capital and reserves) exceed its tangible assets. This requirement applies only to the extent that the *firm* has not already made such a provision elsewhere in its financial statements.
(19) Liability for tax	Include as a liability a provision for taxation on the whole of the profits of its business up to its balance sheet date.
(20) Unsettled *Securities* Transactions - Cash against Documents	Include creditors where the *firm* has entered into a transaction on its behalf in *securities* or *units in collective investment schemes* on a cash against documents basis, and the transaction remains unsettled, after adding an amount calculated by (a) computing the difference between the agreed settlement price for those *investments* and their current *market value*, and (b) multiplying that difference by the applicable percentage specified in table 13.12.3B.
(21) Creditors relating to Unsettled *Securities* Transactions - Free Deliveries	Include an amount for creditors where (acting on its behalf) the *firm* has delivered certificates of title for *securities* or *units in collective investment schemes* before receiving payment for them, or where the *firm* has bought such *investments* before receiving certificates of good title for them, as follows: (a) (if the *firm* has paid for them and not more than 3 days have passed since the payment was made) include in full; (b) (if more than 3 days have passed since the payment was made) include the full value of the *securities* at the current *offer price*.
(22) *Over the counter derivatives*	Include as a liability an amount for any positions the *firm* holds on its own behalf in such *derivatives* calculated by computing the credit equivalent of those positions in accordance with table 13.12.3C. In addition, bought *OTC derivatives* and covered *warrants* will be subject to table 13.12.3D.
(23) Contingent Liabilities	A *firm* must include a provision for any contingent liabilities which exist at its balance sheet date that must be made.

(24) Long term liabilities	Include as a liability any amount which falls due more than 3 years from the balance sheet date and is due to *connected persons*, in accordance with *rules* 13.12.5 and 13.12.5A.
(25) Redeemable Preference *Shares*	Include as a liability any redeemable preference *shares* which fall due within two years. If *shares* are not redeemable by the shareholder within two years, they must be treated in accordance with *rules* 13.12.5 and 13.12.5A.
(26) *Net open foreign currency position*	A *firm* must calculate its foreign exchange risk requirement in accordance with table 13.12.3D and include the amount as a liability.
(27) All other liabilities	Include in full.

TABLE 13.12.3A

This table forms part of *rule* 13.12.3

DISCOUNTS FOR INVESTMENTS	
The percentages in the table are applied to the *market value* (unless otherwise stated) or gross positions, i.e. both longs and shorts in each category; netting and offsetting are prohibited. The long or short position in a particular investment is the net of any long or short positions held in that same investment.	
Investment	Discount
A. Debt	
UK Government or local authority stocks:	
- with less than one year to final redemption	2%
- with more than one year but less than five years to final redemption	5%
- with five years or more to final redemption	10%
Debt security:	
- debt instruments issued or accepted by an *approved bank* with less than 90 days to final redemption	2%

-	other debt instruments which are *marketable investments* with less than one year to final redemption	5%
-	other debt instruments which are *marketable investments* with less than five years to final redemption	10%
-	other debt instruments which are *marketable investments*	15%
-	floating rate notes which are *marketable investments*:	
-	with no more than 20 years to final redemption	5%
-	with more than 20 years to final redemption	10%
B.	Equities	
-	other *investments* listed on a recognised or designated investment exchange	25%
-	*shares* traded on a recognised or designated investment exchange	35%
-	other *shares* for which there is a *market maker* in the UK	35%
C.	*Derivatives*	
-	*exchange traded futures*	4 x initial margin requirement
-	*OTC futures*	Apply the appropriate percentage shown in A and B to the *market value* of the underlying position
-	Purchased *options*	Apply the appropriate percentage shown in A and B to the *market value* of the underlying position but the result may be limited to the *market value* of the option
-	*Contracts for differences*	20% of the *market value* of the contract

D.	Other *Investments*	
-	*Unit* linked bonds and *units* in *authorised unit trust schemes* (other than *higher volatility funds* and *property funds*) or *regulated collective investment schemes*	25%
-	*units* in *higher volatility funds* and *property funds*	50%
-	with profit *life policies* (only applicable to *firms* other than *traded life policy market makers*)	20% of the *surrender value* of the *policy*
-	*shares* in *subsidiary* companies and *shares* which are not *readily realisable securities* in *connected companies*	100%
-	*traded endowment policies*:	
	where a *traded life policy* is held for resale by a *firm* which is a *traded life policy market maker*:	
	(a) for 3 months or less	0% of the *surrender value* of the *policy*
	(b) for more than 3 months	10% of the *surrender value* of the *policy*
	when a *traded life policy* is held by a *firm* which is a *traded life policy market maker* for investment	10% of the *surrender value* of the *policy*
-	other	100%

TABLE 13.12.3B

This table forms part of *rule* 13.12.3

UNSETTLED SECURITIES TRANSACTIONS		
Number of *business days* after due settlement date	A %	B %
0 – 15	0	0
16 – 30	25	0
31 – 45	50	25
46 – 60	75	50
61 or more	100	75
over 90	100	100
Note 1 Column A applies to a transaction in a debt or debt-related instrument (unless the debt instrument is settled through the appropriate UK settlement system), and Note 2 Column B applies in all other cases (and, in particular, applies to equity and equity-related instruments).		

TABLE 13.12.3C

This table forms part of *rule* 13.12.3

OVER THE COUNTER DERIVATIVES
a. By attaching current *market value*s to contracts (marking to market), obtain the current replacement cost of all contracts with positive values.
b. To obtain a figure for potential future credit exposure (except in the case of single currency “floating/floating interest rate swaps” in which only the current replacement costs will be calculated), the notional principal amounts or values underlying the *firm's* aggregate positions are multiplied by the following percentages:
c. The credit equivalent is the sum of current replacement cost and potential future credit exposure.

Residual Maturity	Interest Rate Contracts	Foreign Exchange Contracts
One year or less	Nil	1%
More than 1 year	0.5%	5%

TABLE 13.12.3D

This table forms part of *rule* 13.12.3

FOREIGN EXCHANGE RISK	
(a)	A *firm* must deduct a foreign exchange risk requirement for all the following items which are denominated in a foreign currency: (i) all assets and liabilities, including accrued interest, denominated in the currency (all *investments* at market or realisable value); (ii) any currency future, at the nominal value of the contract; (iii) any forward contract for the purchase or sale of the currency, at the contract value, including any future exchange of principal associated with currency swaps; (iv) any foreign currency *options* at the net delta (or delta-based) equivalent of the total book of such *options*; (v) any non-currency option, at *market value*; (vi) any irrevocable guarantee; (vii) any other off-balance sheet commitment to purchase or sell an asset denominated in that currency.
(b)	The requirement must be calculated as follows: (i) using the spot rate, convert the *net long position* and *net short position* in each foreign currency into the currency in which the *firm*'s *annual financial statements* are reported; (ii) total the *net open long positions* and the *net open short positions*; (iii) the higher of (i) and (ii) above is its *net open foreign currency position*; (iv) multiply its *net open foreign currency position* by 10%;

(c)	A *firm* may not include any future income or expense not yet accrued but fully hedged (subject to deduction of an appropriate risk requirement).

13.12.4 **SHORT TERM SUBORDINATED LOANS**

13.12.4 R **A *Category B firm* may treat subordinated loan as a financial resource, as specified in *rules* 13.12.5 to 5A, if the short term subordinated loan is eligible for such treatment in accordance with *rule* 13.12.4A;**

13.12.4A R **A short term subordinated loan is eligible for such treatment if:**

(1) it has an original maturity of at least two years or, if it has no fixed term, it is subject to two years' notice of repayment;

(2) payment of interest is not permitted under the loan agreement unless after such payment a *firm* meet 120% of its financial resource requirement;

(3) repayment, prepayment or termination is only permitted under the loan agreement

(a) **on maturity, or on expiration of the period of notice, if after such payment or termination a *firm* meets 120% of its financial resources requirement; or**

(b) **on winding up after the claims of all other creditors and all outstanding debts have been settled;**

(4) it is in the standard form for short term subordinated loans prescribed by the *FSA*.

RESTRICTIONS

13.12.5 R **A *Category B firm* must calculate:**

(1) the aggregate amount of its short term subordinated loans, its preference *shares* which are not redeemable within two years, and for a *Category B firm* other than a *Category B1 firm* its long term liabilities which are not secured on its assets, if they do not fall due more than three years from the balance sheet date, and are not due to *connected persons*;

(2) the amount of the *firm's* total capital and reserves excluding preference *share* capital, less the amount of its intangible assets, multiplied by 400%.

13.12.5A R **A *Category B firm* must treat as a liability in the calculation or its financial resources any amount by which the sum of 13.12.5(1) exceeds the product of 13.12.5(2).**

APPENDIX 13 (1)

Defined terms for Chapter 13

If a defined term does not appear in the IPRU (INV) 13 glossary below, the definition appearing in the main Handbook *Glossary* applies.

50% controller	a *controller* in whose case the relevant percentage of shares or *voting power* is 50% or more.
adviser	an individual who is: (a) a *financial adviser*; or (b) a *representative*; or (c) an *appointed representative* or where applicable, *tied agent*.
affiliated persons	(a) persons who constitute a single risk because one of them has direct or indirect control over the other or others; (b) other persons who are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties;
allocation period	a single 24-hour period or, with the agreement of each *professional client* concerned, a period spanning five consecutive *business days*, during which an aggregated *series of transactions*, to achieve one investment decision or objective, may be *executed*.
annual accounting reference date	the date to which a corporate *firm's* accounts are prepared for the purposes of the Companies Acts, or, where the *firm* is not subject to the Companies Acts, the equivalent date chosen by the *firm* and notified to the *FSA*;
annual financial statement	the financial statements in respect of the year ending on the *firm's annual accounting reference date*;
Category B firm	a *personal investment firm*, other than an *exempt CAD firm*;
Category B1 firm	a *Category B firm* whose *permission* includes *dealing in investments as principal*;
Category B2 firm	a *Category B firm* whose *permission* does not include *dealing* as *principal*; and is not subject to a *requirement* preventing the holding or controlling of *client money* or *custody assets.*
Category B3 firm	a *Category B firm* whose *permission* includes only *insurance mediation activity* in relation to *non-investment insurance contracts*, *home finance mediation activity*, *assisting in the administration and performance of contracts of insurances*, *arranging* transactions in *life policies* and other insurance contracts, *advising on investments* and receiving and transmitting, on behalf of investors, orders in relation to *securities* and *units* in *collective investment scheme*s; but which is subject to a *requirement* not to hold or control *client money* or *custody assets.*
client	any *person* with or for whom a *firm* conducts or intends to conduct *designated investment business* or any other *regulated activity*; and: (a) every client is a *customer* or a *market counterparty*;

(b) "client" includes:

(i) a potential client;

(ii) a client of an *appointed representative* or where applicable, *tied agent* of a *firm* with or for whom the *appointed representative* or where applicable, *tied agent*, acts or intends to act, in the course of business for which the *firm* has accepted responsibility under section 39 of the *Act* (Exemption of appointed representatives);

(iii) a *collective investment scheme* even if it does not have separate legal personality;

(iv) if a *person* ("C1"), with or for whom the *firm* is conducting or intends to conduct *designated investment business*, is acting as agent for another *person* ("C2"), either C1 or C2 in accordance with *COBS* 2.4.3R (Agent as client);

(c) "client" does not include:

(i) a trust beneficiary;

(ii) a *corporate finance contact*;

a *venture capital contact*.

client money rules — *CASS 4.1 to 4.3*.

collateral — has the meaning given to the term in the *Glossary*.

connected person — in relation to a *person*,

(a) its *controller*;

(b) a partner in it, or his or its partner;

(c) a director of it;

(d) its employee (whether under a contract of service or a contract for services) or an employee of its *appointed representative* or where applicable, *tied agent*;

(e) another *undertaking* having the same *controller* as that *person*;

(f) an *undertaking* which is an *associate* of that *person*;

(g) (if the *person* is not a *body corporate*)

(i) a *close relative* of any *person* within (a) to (d) above; or

(ii) a *body corporate* controlled by that *person* or by any partner of that *person*; or

(h) a trustee of a trust (other than an *occupational pension scheme*) the beneficiaries of which the *firm* knows or ought to know include any individual within (a) to (d) or (g)(i) above.

contract for differences — (as specified in article 85 of the *Regulated Activities Order* (Contracts for differences etc)) rights under:

(a) a contract for differences; or

(b) any other contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in:

(i) the value or price of property of any description; or

(ii) an index or other factor designated for that purpose in the contract.

(c) a derivative instrument for the transfer of credit risk to which article 85(3) of the *Regulated Activities Order* applies.

contractually based investment

(in accordance with article 3 of the *Regulated Activities Order* (Interpretation: general)):

(a) rights under a *life policy*:

(b) an *option*, *future or contract for differences*;

(c) *rights to or interests in an investment* falling within (a) or (b).

controller

(as defined in section 422 of the *Act* (Controller))

(in relation to a *firm* or other *undertaking* ("A"))

a person (see I) who:

(a) holds 10 % or more of the shares in A; or

(b) is able to exercise significant influence over the management of A through his shareholding in A; or

(c) holds 10 % or more of the shares in a *parent undertaking* ("P") of A; or

(d) is able to exercise significant influence over the management of P through his shareholding in P; or

(e) is entitled to exercise, or control the exercise of, 10 % or more of the *voting power* in A; or

(f) is able to exercise significant influence over the management of A through his *voting power* in A; or

(g) is entitled to exercise, or control the exercise of, 10 % or more of the *voting power* in P; or

(h) is able to exercise significant influence over the management of P through his *voting power* in P;

in this definition:

(A) "*person*" means:

(i) the *person*;

(ii) any of the *person's* associates; or

(iii) the *person* and any of his associates;

(B) "associate", in relation to a *person* ("H") holding shares in an *undertaking* ("C") or entitled to exercise or control the exercise of *voting power* in relation to another *undertaking* ("D"), means:

(a) the spouse of H;

(b) a child or stepchild of H (if under 18);

(c) the trustee of any settlement under which H has a life interest in possession (or in Scotland a life interest);

(d) an *undertaking* of which H is a director;

(e) a *person* who is an employee or partner of H;

(f) if H is an *undertaking*:

(i) a director of H;

(ii) a *subsidiary undertaking* of H;

(iii) a director or employee of such a *subsidiary undertaking*; and

(g) if H has with any other *person* an agreement or arrangement with respect to the acquisition, holding or disposal or shares or other interests in C or D or under which they undertake to act together in exercising their *voting power* in relation to C or D, that other *person*;

(C) "settlement" includes any disposition or arrangement under which property is held on trust (or subject to a comparable obligation);

(D) "shares" means:

(a) in relation to an *undertaking* with a share capital, allotted shares;

(b) in relation to an *undertaking* with capital but no share capital, rights to share in the capital of the *undertaking*;

(c) in relation to an *undertaking* without capital, interests:

(i) conferring any right to share in the profits, or liability to contribute to the losses, of the *undertaking*; or

(ii) giving rise to any obligation to contribute to the debts or expenses of the *undertaking* in the event of a winding up.

(see also *50% controller*)

customer	(1) (except in *COBS* 4) a *client* who is not an *eligible counterparty.* (2) (in *COBS* 4) a *person* in (1) or a *person* who would be such a *person* if he were a *client.*
debt capital	a *security* of indeterminate duration or other instrument the debt agreement for which provides that (a) it may not be reimbursed on the holder's initiative; (b) the borrower has the *option* of deferring the payment of interest on the debt; (c) the lender's claims on the borrower must be wholly subordinated to those of all non-subordinated creditors; (d) debt and unpaid interest should be such as to absorb losses, whilst leaving the borrower in a *position* to continue trading; and which is fully paid-up;
deposit-taking firm	a *firm* which is a *bank*, *building society* or *credit union*.
exchange	a *recognised investment exchange* or *designated investment exchange*;
exchange traded	listed or traded on a *recognised* or *designated investment exchange*
exit charge	an amount levied by the *operator* of a *scheme*, together with any other expenses incurred, upon the redemption of *units*.
financial adviser	an individual appointed by an *independent intermediary* or by its *appointed representative* or where applicable, *tied agent* to provide any or all of the

	following services: (a) giving *advice on investments* to *clients*; (b) *arranging (bringing about) deals in investments* or *executing* transactions involving, in each case, *designated investments* with or for *clients*; (c) *managing investments*; (d) receiving or holding *client money* or other *client* assets; (e) *safeguarding and administering investments*.
independent intermediary	a *firm* acting as an intermediary but excluding: (a) a *firm* which is a member of a *marketing group*; (b) a *product provider* which *sells* its own *packaged products*.
initial capital	means the initial capital of a *firm* calculated in accordance with 13.1A.7.
initial margin	has the meaning given in the paragraph (2) of the definition of the term in the *Glossary*.
large exposure	any *exposure* to another *person*, or to two or more *affiliated persons*, which equals or exceeds 10 per cent. of the *firm's* own funds;
linked benefit	a benefit payable under a *life policy* or a *regulated collective investment scheme* the amount of which is determined by reference to: (a) the value of the property of any description (whether specified or not); or (b) fluctuations in the value of any such property; or (c) income from such property; or (d) fluctuations in an index of the value of such property.
long-term insurer	an *insurer* with permission to effect or carry out *long-term insurance contracts*.
low resource firm	a *Category B3 firm* which is not a *network*, has fewer than 26 *financial advisers* or *representatives* and is not *permitted* to: (a) carry on discretionary portfolio management; (b) *establish, operate or wind up a personal pension scheme*; or (c) delegate the activities in (a) or (b) to an *investment firm*.
marketable debt instrument	a *debt instrument* which is a *marketable investment*;
marketable investment	(a) an *investment* which is traded on or under the rules of an exchange; (b) a debt instrument which may be transferred without the consent of the *issuer* or any other *person* (including a collateralised mortgage obligation); (c) a *commodity*; (d) a *warrant*, *option*, *future* or other instrument which entitles the holder to subscribe for or acquire: (i) an *investment* or *commodity* in (a) to (c); or (ii) any currency; or

(iii)any combination of (i) and (ii);

(e) a *contract for differences* (including interest rate and currency swaps) relating to fluctuations in:

(i)the value or price of an *investment* or *commodity* in (a) to (d); or

(ii) any currency; or

(iii) the rate of interest in any currency or any index of such rates; or

(iv) the level of any index which is derived from the prices of an *investment* or *commodity* in (a) to (c); or

(v) any combination of (i) to (iv);

(f) *warrants*, *options*, *futures* or other instruments entitling the holder to obtain the rights of those contracts in (d) or (e);

(g) a *unit* in a *regulated collective investment scheme*.

marketing group	a group of *persons* who: (a) are allied together (either formally or informally) for purposes of marketing *packaged products* of the marketing group; and (b) each of whom, if it holds itself out in the *United Kingdom* as marketing *packaged products* to *private customers*, does so only as an *investment manager* or in relation to *packaged products* of the marketing group.
marketing group associate	a *firm* other than a *product provider* which is a member of a *marketing group*.
material current year losses	losses of an amount equal to 10 per cent or more of the amount by which the own funds of an *undertaking* exceed the own funds needed to meet financial resources test 1 as prescribed in chapter 13;
material insurance holdings	(a) means the holdings of an exempt CAD firm of items of the type set out in (b) in any: (i) *insurance undertaking*; or (ii) *insurance holding company*; that fulfils one of the following conditions: (iii) it is a *subsidiary undertaking* of that *firm*; or (iv) that firm holds a participation in it. (b) An item alls into this provision for the purpose of (a) if it is: (i) *an ownership share*; or (ii) subordinated debt or another item of capital that falls into Article 16 (3) of the *First Non-Life* Directive or, as applicable, Article 27(3) of the *Consolidated Life Directive*
material holding	means a *firm's* holdings of *shares* and any other interest in the capital of a *credit institution* or *financial institution*: (a) which exceeds 10% of the capital of the issuer, and, where this is the case, any holdings of subordinated debt of the same issuer, the full amount is a *material holding*; or (b) holdings not deducted under (a) if the total amount of such holdings exceeds 10% of that *firm's own funds*, in which case only the excess amount is a *material holding*.

material insurance holdings	(a) means the holdings of an *exempt CAD firm* of items of the type set out in (b) in any: (i) *insurance undertaking*; or (ii) *insurance holding company*; that fulfils one of the following conditions: (iii) it is a *subsidiary undertaking* of that *firm*; or (iv) that *firm* holds a participation in it. (b) an item falls into this provision for the purpose of (a) if it is: (i) an *ownership share*; or (ii) subordinated debt or another item of capital that falls into Article 16(3) of the *First Non-Life* Directive or, as applicable, Article 27(3) of the *Consolidated Life Directive*.
money-purchase benefits	(in relation to an *occupational pension scheme*) benefits the rate or amount of which are calculated by reference to a payment or payments made by a member of the scheme.
net current assets	the total, at a particular date, of all assets which are not intended for use on a continuing basis in the *firm's* business (i.e. current assets), less all the liabilities payable within 12 months of that date
net long position	the situation in which a *firm* holds or will hold more *units in a investment* than it has contracted to *sell* or, in respect of *options*, where it has bought rights which exceed rights sold;
net open foreign currency position	a *firm's net long position* or *net short position*, whichever is the higher, in a currency other than that in which the *firm's* books of account are maintained, calculated in accordance with the appropriate *rules* in chapter 13;
net short position	the situation in which a *firm* has contracted to *sell* more of an *investment* than it holds or will hold or, in respect of *options*, where it has sold rights which exceed the rights bought;
opted-in exempt CAD firm	an exempt CAD firm which complies with the requirements in regulation 4C (or any successor provision) of the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2007 (SI 2007/126).
own funds	means the own funds of a *firm* calculated in accordance with 13.1A.14R(a)
professional fees	*Fees*, *commission*s and other receipts receivable in respect of legal, accountancy or actuarial *service*s provide to *clients* but, excluding any items receivable in respect of *regulated activities*.
properly secured	fully secured by a first *charge* in favour of the *firm* on land and buildings, or on a *readily realisable investment* where the *firm* has in its possession or under its control a document of title or a document evidencing title to that *investment*;
property fund	(a) a *regulated collective investment scheme* dedicated to land and interests in land; (b) a fund of funds of which one or more of the funds to which it is dedicated falls within (a); (c) a constituent part of an umbrella fund which, if it were a separate fund, would fall within (a);
provider firm	a *firm*; that is:

(a) a *product provider*; or
(b) a *marketing group associate*.

relevant collateral — in relation to a transaction:

(a) cash;

(b) letters of credit and guarantees to the extent of their face value, issued by an *approved bank* which is neither a counterparty nor an *associate* of a counterparty;

(c) gold and silver bullion and coinage;

(d) *marketable investments*;

(e) the performance guarantees issued in support of the securities lending and borrowing programmes of Euroclear and Clearstream, in respect only of *exposure* arising from participation in such programmes;

subject to:

(i) the *firm* having an unconditional right to apply or realise the *relevant collateral* for the purpose of repaying a counterparty's obligations;

(ii) *marketable investments*:

(A) being marked to market daily using the valuation *principles* in *IPRU(INV)* 3.41(9)R;

(B) not being issued by a counterparty nor by an *associate* of a counterparty.

representative — (in relation to *designated investment business*) an individual appointed by a *provider firm* or by an *appointed representative* or where applicable, *tied agent* of that *firm*, to carry out either or both of the following activities:

(a) giving *advice on investments* to *customers* on the merits of *packaged products offered* by that *firm* (or any other *provider firm* within the same *marketing group*);

(b) *arranging (bringing about) deals in investments* in relation to such products.

special adjustment — a *position* risk adjustment, counterparty risk adjustment, foreign *exchange* adjustment, and any *large exposure* adjustment in accordance with chapter 13;

tax exempt policy — any contract of assurance, offered or issued by a *friendly society*, which is tax exempt life or endowment business as defined in section 466 (2) of the Income and Corporation Taxes Act 1988.

traded option — (a) *investments* falling within article 77 of the RAO which relate to

(i) *shares*, or

(ii) *debt instruments*, or

(b) *investments* falling within article 79 of the RAO which are *options* on equity indices,

provided that those *investments* are traded on, or under the *rules* of, a *recognised* or *designated investment exchange*;

verified — (where interim net profits are to be included in Financial Resources Test 1 (own funds) checked by an external auditor who has undertaken at least to

(a) satisfy himself that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records,

(b) review the accounting *policies* used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the *firm* in drawing up its *annual financial statement*s and are in accordance with the accounting principles set out in chapter 13,

(c) perform analytical procedures on the result to date, including comparisons of actual performance to date with budget and with the results of prior period(s),

(d) discuss with management the overall performance and financial *position* of the *firm*,

obtain adequate comfort that the implications of current and prospective litigation, all known claims and commitments, changes in business activities and provisioning for bad and doubtful debts have been properly taken into account in arriving at the interim profits, and

follow up problem areas of which he is already aware in the course of auditing the *firm's* financial statements,

a copy of whose report asserting that the interim net profits are reasonably stated has been submitted to the *FSA* (although this does not apply to *exempt CAD firms*);

Zone A country	all *EEA States* and all other countries which are full members of the *OECD* and those countries which have concluded special lending arrangements with the International Monetary Fund associated with the Fund's General Arrangements to Borrow.

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:

(1) It is:

(a) 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*; and

(2) It is not a *BIPRU firm*.

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 authorit*y other than the *FSA*; or

(2) the *firm* is a member of a *UK consolidation group* already included in the supervision on a consolidated basis of the group of which it is a member by the *FSA* under *BIPRU* 8.

14.1.3 G (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 *firm*s 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*;

(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 (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 money* and asset controls - for example, it may 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.

(6) Rule 14.1.4(5) refers to *large exposures*, which should be measured against group consolidated own funds or (if this would result in all *exposures* being classified as *large exposures*) by aggregating all the *exposures* of the individual entities in the group and measuring them against the own funds of the individual *firm* giving rise to the consolidated supervision requirement. If there is more than one *firm* in the group giving rise to the consolidated supervision requirement, the group *large exposures* should be measured against the *firm* with the smallest own funds.

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* either of the *firm* or of the *firm's EEA parent* as defined in (1); 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 14.2.1, 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 G (1) A *firm's parent* is a *financial holding company* if it is either a *financial institution* or a *securities and futures firm* that is subject to the financial rules in Chapter 3 and that is a *broad scope firm* (but not a *venture capital firm*) and if its *subsidiary undertakings* carry out mainly *listed activities,* activities of a *credit institution* or activities undertaken by a Chapter 3 *broad scope firm*. For this purpose the *FSA* interprets the phrases 'mainly' or 'main business' to mean where the balance of business is over 40% of the relevant group or sub-group's balance sheet (measured on the basis of total assets) or profit and loss statement (measured on the basis of gross income). 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 GENPRU 3.1 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. GENPRU 3.1 sets out what constitutes significant insurance holdings (broadly more than 10% of the financial sector activities of the group). A *firm's parent* is a *financial holding company* and not regarded as a mixed *financial holding company* unless:

(a) the *parent* has been notified by its *coordinator* that the group it heads is a *financial conglomerate* (in accordance with Article 4(2) of the *Financial Groups Directive)*; and

(b) it has not been notified that the *coordinator* and the *relevant competent authorities* have agreed not to treat the group as a *financial conglomerate* in accordance with Article 3(3) of the *Financial Groups Directive*.

14.2.4(2) G A *firm* with an ultimate non-EEA parent may also be subject to the provisions in GENPRU 3.2.

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), the *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*, other than one which is defined in rule 14.1.1(1), 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 *firm* in the group to which this chapter applies, with Tier 1 minority interests being allowed as Group Tier 1 capital and Tier 2 minority interests being allowed as Group Tier 2 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 *firm* in the group to which this chapter applies as follows:

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

14.4.4 G (1) The *FSA* interprets 'main' by reference to the share of the *firm's* business in the group, its contribution to the group's balance sheet (measured on the basis of total assets) or profit and loss statement (measured on the basis of gross income).

(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 *waive*r 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; and

(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.

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 are:

(1) for *firms* regulated by the *FSA,* their regulatory capital requirement under *FSA* rules;

(2) for entities regulated by an *EEA regulator* and which is subject to the local regulatory capital requirement of that regulator, that local regulatory capital requirement;

(2A) for entities that are *recognised third country credit institutions* or *recognised third country investment firms* and which is subject to the local regulatory capital requirement of that regulator, that local regulatory capital requirement;

(2B) for entities not in (2A) that are regulated by a *third country competent authority* named in the table in *BIPRU* 8 Annex 3R ad which is subject to the local regulatory capital requirement of that regulator, that 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. The interpretation of 'main' given in 14.4.4 G applies here.

(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.

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*. A *firm* should also demonstrate that calculating its requirement in this way does not result in a distortion of the *group financial resources requirement*.

APPENDIX 14(1) (INTERPRETATION)

Glossary of defined terms for Chapter 14

If a defined term does not appear in the IPRU(INV) 14 glossary below, the definition appearing in the main Handbook *Glossary* applies.

ancillary services undertaking	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 *firms* subject to this chapter.
broad scope firm	as in the Glossary in IPRU(INV) chapter 3.
CAD Article 5 exempting criteria	the following criteria in respect of the *firm*'s dealing positions: - such positions arise only as a result of the *firm's* failure to match investors orders precisely; - the total market value of all such positions is subject to a ceiling of 15% of the *firm's* initial capital; and - such positions are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question.
CAD investment firm	a *firm* subject to the requirements of the *Capital Adequacy Directive* excluding a person to whom the CAD does not apply under Article 3.1(b) of that Directive.
contingent liability	the meaning in FRS 12 which states that it is: (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 (b) a present obligation that arises from past events but is not recognised because: (i) it is not probable that a transfer of economic benefits will be required to settle the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability.
consolidated supervision	the application of the financial rules in the Interim Prudential sourcebook for investment businesses in accordance with rules and guidance in 14.1.1 to 14.5.4.
EEA parent	a *firm's* direct or indirect *parent* which has its head office in the *EEA*.
financial holding company	an undertaking that satisfies the following conditions: (a) it is: i. a *financial institution*; or ii. a *firm* falling within *IPRU(INV) rule* 14.1.1(1);

(b) is *subsidiary undertakings* are either exclusively or mainly:

i. *credit institutions*;,
ii. *investment firms*;
iii. *broad scope firms* or *undertakings* carrying on activities which (if they were *firms* doing those activities in the *United Kingdom)* would make them *broad scope firms;* and
iv. *financial institutions*;,

one of which at least is a *credit institution*, a *firm* falling within *IPRU(INV) rule* 14.1.1(1) or an investment firm; and

(c) it is not a *mixed financial holding company*.

financial institution	an undertaking other than a *credit institution*, the principal activity of which is to acquire holdings or to carry on a *listed activity*.
group financial resources	the resources of a *firm's* group calculated in accordance with rules 14.4 (Group financial resources).
group financial resources requirement	the requirement that a *firm*'s group maintains financial resources calculated in accordance with the rules in 14.5 (Group financial resources requirement).
investment firm	*investment firm* as in the main *Glossary* except that it excludes persons to which the *MiFID* does not apply as a result of article 2 or 3 of the *MiFID*.
Listed activity	a listed activity within the meaning of the *BCD*, that is one or more of the following activities: (a) lending; (b) financial leasing; (c) money transmission services; (d) issuing and administering means of payment; (e) guarantees and commitments; (f) trading for own account or for the account of customers in: (i)money market instruments (cheques, bills, certificates of deposit, etc); (ii)foreign exchange; (iii)financial futures and options; (iv)exchange and interest rate instruments; (v)transferable securities; (g) participation in share issues and the provision of services related to such issues; (h) corporate finance advice; (i) money broking; (j) portfolio management and advice; or (k) safekeeping and administration of securities.
Material holding	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 *credit institution* or a *financial institution* 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 *firm's own funds*, before deducting the holding.
Material insurance holding	the higher of – (1) the book value of an *investment* held in an insurance undertaking, reinsurance undertaking, or insurance holding company (*investment* for this purpose is either a *participation* or the *investment* in a *subsidiary* undertaking); or (2) the group's proportionate share of that undertaking's local or notional regulatory capital requirement."
Non-trading book	in relation to a *firm's* business or exposures, means any position, counterparty exposure or balance sheet item nit falling within the definition of *trading book*.
parent	any parent undertaking as defined in section 1162 of the Companies Act 2006 and any undertaking which effectively exercises a dominant influence over another undertaking.
participation	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 which is not a *subsidiary*.
subsidiary	as in section 1159(1) of the Companies Act 1985.
trading book	as in the Glossary in IPRU(INV) chapter 5

Annex A: LIMITED LIABILITY PARTNERSHIPS: ELIGIBLE MEMBERS' CAPITAL

1 Introduction

Application

1.1 R This annex applies to any *firm* :

(1) that is a *limited liability partnership*; and

(2) that is a kind of *firm* to whom the provisions of this sourcebook apply, or which is a *UCITS firm*.

1.2 R In this annex, an expression in italics has the meaning given in the *Handbook* Glossary.

1.3 G (1) *Firms* are reminded that a *limited liability partnership* incorporated under the Limited Liability Partnership Act 2000 is a *body corporate* with legal personality separate to that of its members and is not therefore a form of *partnership* for the purposes of this sourcebook.

(2) A *limited liability partnership* is not a separate prudential categorisation under this sourcebook but a kind of *firm* for whom the appropriate provisions of this sourcebook are modified to the extent indicated in this annex.

Purpose

1.4 G The purpose of this annex is to amplify *Principle* 8 (Financial resources) which requires a *firm* to maintain adequate financial resources to meet its investment business commitments and to withstand the risks to which its business is subject. This annex imposes various conditions that must be satisfied for members' capital to count as "Tier 1" or equivalent grade capital in meeting the *limited liability partnership's* financial resources requirement. These conditions are made up of conditions specific to *limited liability partnerships* and general conditions based for the most part on those set out in article 57 of the *Banking Consolidation Directive*. This assists in the achievement of the *regulatory objectives* of consumer protection and market confidence.

1.5 G The following *rules* allow inclusion of members' capital within a *firm's* capital if it meets the conditions in this annex:

Chapter	***IPRU(INV) rule***	**How *eligible LLP members' capital* should be treated for the purposes of the *IPRU(INV) rule***
3	Table 3-61	*Eligible LLP members' capital* may be counted as Tier 1 capital under item "A" within Table 3-61.
5	Table 5.2.2 (1):	*Eligible LLP members' capital* may be counted as

	Item (1A)	Tier 1 capital within Category A of Table 5.2.2(1).
10	Table 10-61(1)A Table 10-61(1)B Table 10-62(2)A Table 10-62(2)B Table 10-62(2)C	*Eligible LLP members' capital* may be counted as initial capital within the relevant table.
13	Table 13.3.2(1) Table 13.10(2)	*Eligible LLP members' capital* may be counted as *own funds* relating to companies in Table 13.3.2(1) and Table 13.10(2).

2. **CONDITIONS FOR USE OF MEMBERS' CAPITAL**

Members' capital of a limited liability partnership

2.1 R In this sourcebook, members' capital of a *limited liability partnership* may be included within a *firm's* resources if it complies with:

(1) the specific conditions; and

(2) the general conditions.

Specific conditions for eligibility

2.2 R The specific conditions are that:

(1) members' capital is made up of the members' capital account; and

(2) the members' capital account is an account:

(a) into which capital contributed by the members is paid; and

(b) from which under the terms of the *limited liability partnership* agreement an amount representing capital may be withdrawn by a member only if:

(i) he ceases to be a member and an equal amount is transferred to another such account by his former fellow members or any person replacing him as a member;

(ii) the *limited liability partnership* is wound up or otherwise dissolved; or

(iii) the *firm* has ceased to be *authorised* or no longer has a *Part IV permission*.

General conditions for eligibility

2.3 R The general conditions in respect of the members' capital are that:

(1) it is fully paid and the proceeds are immediately and fully available to the *firm;*

(2) it is not capable of being redeemed at all (otherwise than in the circumstances set out in the specific conditions) or can only be redeemed on a winding up of the *firm*;

(3) any *coupon* is non-cumulative;

(4) it is able to absorb losses to allow the *firm* to continue trading;

(5) the amount of the item included is net of any foreseeable tax charge;

(6) it is available to the *firm* for unrestricted and immediate use to cover risks and losses as soon as they occur;

(7) it ranks for repayment on a winding up of the *firm* no higher than a *share* of a company incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 (whether or not it is such a *share*); and

(8) the *firm* is under no obligation to pay a *coupon* on it at any time.

Surplus eligible LLP members' capital

2.4 G If a *firm* has surplus *eligible LLP members' capital* that it wishes to repay in circumstances otherwise than those in the specific conditions, it may apply to the *FSA* for a *waiver* to allow it to do so. If a *firm* applies for such a *waiver* the information that the *firm* supplies to support the application might include:

(1) a demonstration that the *firm* would have sufficient financial resources to meet its financial resources requirement immediately after the repayment; and

(2) a two to three year capital plan demonstrating that the *firm* would be able to meet the requirements in (1) and (2) at all times without needing further capital injections.

Limited liability partnership excess drawings

2.5 R A *firm* which is a *limited liability partnership* must in calculating its tier one capital in accordance with the requirements of any chapter of this sourcebook deduct the amount by which the aggregate of the amounts withdrawn by its members exceeds the profits of that *firm* ("*excess LLP members' drawings*"). Amounts of *eligible LLP members' capital* repaid in accordance with the specific conditions are not to be included in this calculation.

ANNEX D

[Required Forms]

Interim Prudential Sourcebook for Investment Businesses:

Required Forms

[To be printed with FSA logo background]

These forms are the required forms referred to in IPRU(INV) and are listed below (a short contents list appears at the beginning of each section of the annex):

2. Authorised professional firms

FORM OF BOND FOR AUTHORISED PROFESSIONAL FIRMS
(SEE IPRU (INV) 2)

BY THIS BOND AS A DEED WE [ ] of [ ] ("the Principal") and [ ] of [ ] ("the Surety") as witnessed by its common seal (so that the Surety whose seal is affixed below shall alone be bound) are jointly and severally bound upon the terms and conditions herein set out to [ ] ("the Trustee") in the sum of £[ ] ([sum in words]) or such other sum as may from time to time be agreed between the Surety and the Principal ("the Penalty Sum").

WHEREAS:-

(1) The Trustee has consented to enter into this bond as trustee and to hold the rights and benefits under this bond upon trust for any Customer of the Principal in accordance with the terms of this bond.

(2) The Surety at the request of the Principal has agreed to be bound in the Penalty Sum upon the terms and conditions hereinafter contained.

NOW THIS DEED WITNESSES as follows:-

(1) For the purposes of this bond a claim shall arise if the following conditions are satisfied:-

a. the Scheme has determined the Principal to be in default;

b. the Trustee has determined to pay compensation to an eligible claimant whose claim is in respect of a Civil Liability incurred by the Principal in connection with its carrying on of Regulated Activities; and

c. the claim in question relates to a Loss.

(2) The Surety and the Principal are held and firmly bound to the Trustee for the payment of any sum arising out of any claim under the provisions of Clause 1 hereof to the extent that any such claim exceeds the sum of fifty thousand pounds (£50,000) provided that the aggregate of any such sum or sums does not exceed the Penalty Sum.

(3) The Trustee hereby declares that it holds all its rights and benefits under this bond upon trust for the Customers in respect of whom or for which such claim or claims were made absolutely.

(4) The Trustee shall, insofar as it may lawfully do so, notify the Surety of any claim or Matter of which the Trustee is aware which may give rise to any claim hereunder such notice to be addressed to the Surety in writing at its address set out above or to such other address as may have been notified to the

Trustee in writing by the Surety and any such information which the Trustee shall when serving such notice designate as confidential shall be held and retained by the Surety in confidence.

(5) Payment of any sum to the Trustee in respect of any claim shall be due thirty (30) days after the giving of notice thereof pursuant to Clause 4 hereof the Surety shall pay any such sum or sums on demand.

(6) The Surety may give written notice to the Trustee sent by recorded delivery service to the address set out above or such other address as the Trustee shall from time to time advise in writing (and serving a copy of such notice upon the Principal) terminating its liability under this bond which liability shall accordingly cease sixty (60) days after receipt by the Trustee in writing of such notice ("the Termination Date") save in respect of any claim rising out of anything notified by the Trustee to the Surety pursuant to Clause 4 prior to or within the period of six months after the Termination Date.

(7) Notwithstanding the Release or Discharge of the Principal the Surety shall remain liable in respect of any claim arising during the period in which this bond was in force or which shall be made within six months of the Termination Date.

(8) The Principal and its executors administrators or representatives whosoever jointly and severally agree and covenant with the Surety and the Trustee as follows:-

a. That they shall and will from time to time and notwithstanding the Release or Discharge of the Principal indemnify the Surety and its successors and assigns from and against all claims losses costs and expenses which the Surety shall or otherwise might at any time sustain or be put to under or by virtue of this bond.

b. That the Principal is an authorised professional firm which has Permission under the Act to carry on Regulated Activities and will give notice forthwith to the Surety in writing if it shall cease to have such Permission or if it shall become aware of any Matter which might give rise to it being declared in default by the Scheme.

c. That the Principal will calculate the Penalty Sum that may be required under this bond from time to time so as to ensure that it complies with the Rules.

d. That the persons named herein are duly authorised for an on behalf of the Principal to execute this bond in the manner appearing below.

e. That the Trustee is irrevocably authorised to provide such information to the Surety as it shall think fit or as may be required for the purpose of making any claim and the Surety is irrevocably authorised to provide such information to the Trustee in relation to the obligations of the

Principal secured by this bond as it shall think fit.

f. That the Principal will duly and promptly pay the annual premium due in respect of this bond.

(9) In this bond words and expressions having capitalised initial letters shall have the meanings set out in this bond and where not so defined shall have the meanings set out in the Glossary annexed to the General Provisions Instrument 2001 and as the same may hereafter be varied amended or supplemented from time to time

"the Act"	means the Financial Services and Markets Act 2000 or any amendment or re-enactment of the provisions thereof;
"Civil Liability"	means a civil liability as defined in the Scheme Regulations;
"Customer"	means a customer as defined in the Scheme Regulations;
"Loss"	means a loss which has been the subject of a valid claim determined by the Scheme in respect of which the amount of the Civil Liability is in excess of £50,000;
"Matter"	means any proceedings initiated under the Act against the Principal in relation to its Regulated Activities;
"the Principal"	means the authorised professional firm named herein and includes each of the partners thereof where applicable;
"Release or Discharge"	means the release of the Principal in relation to the termination of any Authorisation under the provisions of the Act;
"Scheme"	means the Financial Services Compensation Scheme;
"Scheme Regulations"	means the Financial Services Compensation Scheme Regulations.

Save where the context otherwise requires words and expressions used herein and in the Act shall bear the meaning given to them in the singular shall include the plural.

IN WITNESS THEREOF the Principal acting by*
and*
as their duly authorised representatives and the Surety have executed and delivered this bond as a deed this day of

EXECUTED AND DELIVERED AS A DEED by

Witness ………………………………………………….

Signature ………………………………………………….

Occupation ………………………………………………….

Address ………………………………………………….

………………………………………………….

EXECUTED AND DELIVERED AS A DEED by

Witness ………………………………………………….

Signature ………………………………………………….

Occupation ………………………………………………….

Address ………………………………………………….

………………………………………………….

* **Where appropriate this bond should be executed by the compliance partner and the partner with overall responsibility for the Principal's Regulated Activities**

3. Securities and Futures Firms which are not *MiFID* Investment Firms or which are Exempt BIPRU Commodities Firms

3.1 Approved Form of Subordinated Loan Agreement

A. Front Page

THIS AGREEMENT is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

BETWEEN -

(1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement), and

(2) **the Borrower** (as defined in the Standard Terms)

WHEREAS the Borrower wishes to use the Loan, or each Advance under the Facility (as those expressions are defined in the Standard Terms) as an eligible capital substitute in accordance with the FSA's rule IPRU(INV) 3-63 and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective subordination of the Loan and each Advance.

IT IS AGREED THAT this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

Schedule 1

B. Variable Terms

1.	**Date of Agreement**	
2.	**Effective Date**	
3.	**Lender**	
4.	**Address of Lender**	
5.	**Borrower**	
6.	**Address of Borrower**	

7. **The Loan or Facility**
With reference to paragraph 2 of the Standard Terms,

8. **Interest**
With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

9. **Repayment**
With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -

10. **Additional terms**
With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

10. **Additional terms (contd)**

11. **Jurisdiction**
With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

of

(b) by the Borrower -

of

Schedule 2

C. Standard Terms

Interpretation

1 (1) In this Agreement -

"Advance" means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

"Borrower" means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

"Business Day" means any day except Saturday, Sunday or a bank or public holiday in England;

"Effective Date" means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

"Excluded Liabilities" means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in the Insolvency of the Borrower;

"Facility" means the loan facility referred to in paragraph 2(2);

"Financial Resources" has the meaning given in the Financial Rules;

"Financial Resources Requirement" has the meaning given it in the Financial Rules;

"Financial Rules" means the rules in IPRU(INV) 3 in the FSA handbook;

"Insolvency" means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

"Insolvency Officer" means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower's Insolvency;

1 (1) **“Lender”** means the person identified as such in the Variable Terms and includes its permitted successors and assigns;

“Liabilities” means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

“Loan” means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

“Partner” means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

“Senior Liabilities” means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

“Subordinated Liabilities” means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

“the FSA” means The Financial Services Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

(2) Any reference to any rules of the FSA is a reference to them as in force from time to time.

(3) Reference to any gender includes a reference to all other genders.

(4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

The Loan or Facility

2 (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby acknowledges its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.

(2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -

(a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;

(b) the Facility will be available until the last available date specified in the Variable Terms; and

2 (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.

(3) The Lender and the Borrower undertake to provide the FSA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FSA in the request.

Interest

3 Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

Repayment

4 (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5 (subordination).

(2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).

(3) (a) Unless the FSA otherwise permits, no repayment or prepayment of the Loan or any Advance may be made, in whole or in part, until five Business Days have elapsed from the FSA confirming in writing to the Borrower receipt of the Borrower's written notice of his intention to do so, except that -

(i) where, immediately after repayment or prepayment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement, the prior written approval of the FSA shall be obtained before any repayment or prepayment;

(ii) any notice under this sub-paragraph or the terms referred to in sub-paragraph (2) above shall be ineffective if -

(aa) the Insolvency of the Borrower commences before the date on which such notice expires; or

(bb) the FSA notifies the Borrower orally or in writing of its refusal to consent to such repayment or prepayment by the time such notice period expires.

(b) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the FSA, except that where -

(i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement; or

4 (3) (b) (ii) before payment, the Insolvency of the Borrower commences,

no such payment may be made without the prior written approval of the FSA.

(4) If in respect of the Loan or any Advance default is made for a period of -

(a) seven days or more in the payment of any principal due, or

(b) 14 days or more in the payment of any interest due,

the Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the FSA of its intention to do so.

(5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

(6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -

(a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;

(b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and

(c) the Lender has given seven Business Days' prior written notice to the FSA of its intention to institute such proceedings.

(7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

Subordination

5 (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -

(a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -

(i) paragraph 4(3) has been complied with; and

(ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement;

(b) (if an order has been made or effective resolution passed for the Insolvency of the Borrower or, if a partnership, the Borrower is to be dissolved) the Borrower being "solvent" at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be "solvent".

(2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be "solvent" if it is able to pay its debts (other than the Subordinated Liabilities) in full disregarding -

(a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and

(b) the Excluded Liabilities.

(3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.

(4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower's solvency or Insolvency.

5 (5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -

(a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or

(b) where such payment is prohibited under paragraph 4(3),

the payment of such sum shall be void for all purposes.

(6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.

(7) Any sum so returned shall then be treated for the purposes of the Borrower's obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.

(8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

Representations and undertakings of Borrower

6 From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FSA -

(a) secure all or any part of the Subordinated Liabilities;

(b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;

(c) amend any document evidencing or providing for the Subordinated Liabilities;

(d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;

(e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or

(f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and

other than as disclosed in writing to the FSA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Representations and undertakings of Lender

7 From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FSA -

(a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;

(b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;

(c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;

(d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;

(e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or

(f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FSA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Borrower being a partnership

8 Where the Borrower is a partnership -

(a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -

(i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FSA has agreed in writing to the release; and

8 (a) (ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FSA may consider necessary;

(b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

Partial invalidity

9 If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

The FSA and indemnity

10 The FSA shall not, by virtue of having rights under this Agreement, be taken to be a trustee for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FSA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FSA as a consequence of it having rights, or taking action under this Agreement.

Additional terms

11 Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

Entire agreement

12 This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

Amendments

13 Any amendments to this Agreement must be made by the prescribed Deed of Variation and any amendments made or purported to be made without the consent of the FSA shall be void. For the avoidance of doubt, nothing in this paragraph requires the FSA to be a party to this Agreement.

Notices to the FSA

14 A notice given to the FSA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FSA has given to the sender written confirmation of its receipt.

Law

15 This Agreement is governed by English law.

Jurisdiction

16 For the benefit of the FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

Rights of the FSA

17 Although not a party to the Agreement, the FSA may in its own right enforce a term of the Agreement to the extent that it purports to confer upon the FSA a benefit.

3.2 FORM OF DEED OF TERMINATION

THIS DEED OF TERMINATION is made on the .... day of .... 20…...

BETWEEN -

(1) * [insert full name of Lender] (registered in [England] number *) whose registered office is at [*if an individual or partnership* of] * ("the **Lender**").

(2) * [insert full name of Borrower] (registered in [England] number *) whose registered office is at [*if an individual or partnership* of] * ("the **Borrower**").

(3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS ("**the FSA**").

WHEREAS -

A subordinated loan agreement was entered in between the Lender (1); the Borrower (2); and the FSA (3) on [date] ("the Agreement") pursuant to which the Lender agreed to make available to the Borrower a [Loan/Facility] of up to [£]. [insert brief details of any Variations] The parties to the Agreement now wish to terminate the Agreement.

IT IS AGREED THAT -

1. The Agreement shall be deemed terminated [in accordance with its terms] with effect from [the date of this Deed of Termination/insert relevant future date]. All obligations and liabilities arising before that date shall remain continuing.

2. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.... Signed ....
Director

Signed ....
Director/Secretary

or

Signed as a deed by
[full names of individual partners of Lender]

(as such partners and as individuals)

Signed ....
Partner

Signed..................................
Partner/Witness

or

Signed as a deed by [full name of Lender]
(if an individual)

Signed..................................

in the presence of

Signed..................................
Witness

Executed as a deed by [full name of Borrower]	
....	Signed .... Director
	Signed .... Director/Secretary
or	
Signed as a deed by [full names of individual partners of Borrower] (as such partners and as individuals)	
	Signed.................................. Partner
	Signed.................................. Partner/Witness
or	
Signed as a deed by [full name of Borrower] *(if an individual)*	Signed..................................
in the presence of	Signed.................................. Witness
The Common Seal of THE FINANCIAL SERVICES AUTHORITY LIMITED was hereunto affixed in the presence of	Signed .... Authorised Signatory
	Signed .... Authorised Signatory

3.3 FORM OF DEED OF VARIATION

THIS DEED OF VARIATION is made on the .... day of .... 20…...

BETWEEN -

(1) * [insert full name of Lender] (registered in [England] number *) whose registered office is at [*if an individual or partnership* of] * ("the **Lender**");

(2) * [insert full name of Borrower] (registered in [England] number *) whose registered office is at [*if an individual or partnership* of] * ("the **Borrower**"); and

(3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS ("**the FSA**").

WHEREAS -

A subordinated loan agreement was entered into between the Lender (1); the Borrower (2); and the FSA (3) on [date] ("the Agreement") pursuant to which the Lender agreed to make available to the Borrower a (Loan/Facility] of up to [£].

The parties to the Agreement now wish to vary the Agreement to [insert brief details].

IT IS AGREED THAT -

1. The Agreement shall be deemed varied [, in accordance with its terms,] from [the date of this Deed of Variation/insert relevant future date] so that the FSA is no longer a party to the agreement. Any obligation owed to or by, and any requirement for any consent or permission to be given to or by FSA shall be of no further effect. FSA is hereby released from each and every obligation owed by it under the Agreement. Although on execution of this deed the FSA is no longer a party to the Agreement, it may in its own right enforce a term of the Agreement to the extent that it purports to confer upon the FSA a benefit.

   [insert additional clauses/details of amended clauses].

   [to the extent that any term of the Agreement is inconsistent with their terms and conditions contained in the Approved Form, the terms and conditions in the Approved Form shall prevail (provided that for the purposes of this clause 1, in clauses 11 and 12 of the Approved Form, the expressions "Variable Terms" and "Agreement" shall be deemed to include references to the Agreement and this Deed]*

2. All other terms and conditions of the Agreement remain unchanged.

3. This Deed is governed by English Law.

.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

....

Signed ....
Director

Signed ....
Director/Secretary

or

Signed as a deed by
[full names of individual partners of Lender]
(as such partners and as individuals)

Signed...................................
Partner

Signed...................................
Partner/Witness

or

Signed as a deed by [full name of Lender]
(if an individual)

Signed...................................

in the presence of

Signed...................................
Witness

Executed as a deed by [full name of Borrower]

....

Signed ....
Director

Signed ....
Director/Secretary

or

Signed as a deed by [full names of individual

partners of Borrower]
(as such partners and as individuals)

Signed...................................
Partner

Signed...................................
Partner/Witness

or

Signed as a deed by [full name of Borrower]
(if an individual)

Signed...................................

in the presence of

Signed...................................
Witness

The Common Seal of THE FINANCIAL SERVICES AUTHORITY LIMITED was hereunto affixed in the presence of

Signed ....
Authorised Signatory

Signed ....
Authorised Signatory

3.4 FORM OF GUARANTOR UNDERTAKING

This undertaking is entered into the [ ] day of [ ] 20[ ] by

[ ] (the "Guarantor") of [ ] in favour of

The Financial Services Authority Limited ("the FSA") whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS.

WHEREAS:-

(A) By a subordinated loan agreement (the "Loan Agreement") [made on]/ [of even date] between [ ] (the "Lender"), [ ] (the "Borrower") and the FSA, the Lender made available to the Borrower a loan [facility] on the terms and conditions contained in the Loan Agreement.

(B) By a guarantee (the "Guarantee") made [of even date] between the Guarantor and the Lender, the Guarantor guaranteed the obligations of the Borrower to the Lender under the Loan Agreement on the terms and conditions contained in the Guarantee.

IT IS HEREBY AGREED as follows:-

1 The Guarantor hereby undertakes to the FSA that all and any rights which the Guarantor may have against the Borrower in respect of the Guarantee (whether by subrogation or otherwise howsoever) shall be subordinated on the same terms and conditions (mutatis mutandis) set out in the Loan Agreement (as amended from time to time) and further undertakes and confirms that the Guarantor will be bound by the terms of the Loan Agreement as if the Guarantor were a party to it in place of the Lender.

2 This undertaking is governed by English law.

IN WITNESS whereof this deed has been executed by the Guarantor on the date first above written.

Executed as a Deed by
[ ]

Witness:.. ....

Witness's Name: ....

Witness's Address: ....

....

3.5 Guidance Notes on Completion of Agreements

A GENERAL

Introduction

1. These Notes are designed to accompany the Approved Forms of Subordinated Loan Agreement, each of which is in four parts: the front page, the Variable Terms in Schedule 1, the Standard Terms in Schedule 2 and the signature page. The parties will need to set out details of themselves and the transaction in the Variable Terms and complete the signature page. The front page and the Standard Terms should remain unaltered.

2. All communications with the FSA regarding the proposed Agreement should in the first instance be via the firm's usual contact.

3. Firms are advised to ensure that the appropriate form of subordinated loan agreement is used (Chap 9/Chap 3). This is, of course, dependent on the firm's authorisation categorisation. Should the firm's categorisation change, this should be discussed with the firm's usual contact as it is likely that any subordinated loan agreement in place will have to be revised.

Preparation of the Agreement

4. (a) The form containing the Variable Terms may be completed or re-typed according to preference.

   (b) Rather than re-type the Standard Terms (Schedule 2), firms should simply **photocopy Schedule 2 of the FSA precedent (or print it from the website) and include it as part of the original Agreement**.

Financial Rule IPRU(INV) 3-63

6. Firms are referred to rule IPRU(INV) 3-63 on the use of subordinated loans, including restrictions on approved lenders, repayment provisions and gearing limits.

B NOTES ON VARIABLE TERMS

Dates

7. If the **Effective Date of the Agreement** is to be different from the Date of the Agreement, care should be taken to record this in paragraph 2. Where this is the case, the Effective Date will normally be expected to be later than the Date of the Agreement. If the Effective Date is to be a date prior to the date of the Agreement (for example because the loan was drawn down before the Agreement was put in place), the firm will be expected to provide a reasonable explanation to the FSA as to why it was not possible to document the loan more promptly.

Addresses

8. Paragraphs 4 and 6: The address given should be the firm's registered office or equivalent.

Partnerships

9. Paragraph 5: Where the Borrower is a partnership, insert "See Additional Terms, paragraph 10( ) below" and in paragraph 10 of Schedule 1, insert the names and addresses of each of the partners.

The Loan or Facility

10. Paragraph 7: Check that paragraph 2 of the Standard Terms accurately reflects the intentions of the parties.

11. Suggested wording for a loan is:

"This is an agreement for the Loan of £[ ]."

12. Suggested wording for a facility is:

"This is an agreement for a Facility under which the Lender is committed to make Advances in pounds sterling to the Borrower up to a maximum amount of £[ ] until the last available date of the Facility being [................(date)].

The terms (if any) agreed between the parties on the mechanics of drawdown are as follows - ". *

* For example, the parties may wish to provide that:

"Advances may be drawndown in integral multiples of £100,000.".

Interest

13. Paragraph 8: the FSA will be concerned if an excessive rate of interest compared with the market rate is charged. Broadly speaking a rate of interest will be regarded by the FSA as excessive if it is not a commercial one. Compound interest is not acceptable.

Repayment

14. Irrespective of the form of agreement being used, the specified notice period runs from the date of drawdown and, therefore, where a loan is in the form of a facility, each advance must be for a minimum of the required period.

15. Repayment clauses have given rise to confusion in the past. Sample wordings are set out below.

16. Under rule IPRU(INV) 3-63(5), an amount repayable within three months of the effective date of the loan or advance is only acceptable as an eligible capital substitute in the absence of a waiver. A notice period of less than three months will accordingly require a waiver which will not normally be given. In many cases the most convenient approach is to provide for repayment on the expiry of three months written notice, such notice to be given to the FSA as well as to the other party to the agreement.

17. Paragraph 9: Examples of suggested wordings for either a fixed repayment date or repayment on notice in relation to IPRU(INV) 3 are as follows:

(a) "The Borrower shall repay [the Loan/each Advance made to it] on the date which falls three months after the date of drawdown of the [Loan/relevant Advance]."

(b) "The Borrower shall repay [the Loan/each Advance made to it] three months after the date on which:

(a) the Borrower gives written notice to the Lender and to the FSA; or

(b) the Lender gives written notice to the Borrower and to the FSA."

Note: either (a) or (b) above by itself is sufficient.

(c) "[The Loan / Each Advance made to the Borrower] shall be repayable on the date specified by notice in writing given by the Lender to the Borrower and to the FSA or notice in writing given by the Borrower to the Lender and to the FSA, in either case that date being not less than three months after the date on which the notice is given."

Additional terms

18. Paragraph 10: Additional terms may be agreed between the borrower and lender such as those relating to -

- representations and warranties
- provision of financial and other information
- covenants
- costs and expenses
- taxes and increased costs
- mechanics of payment
- notices
- termination provisions.

However, they should not be inconsistent with the Agreement or the FSA rules. For example, any terms dealing with additional payments by the borrower (eg to compensate for taxes or increased costs) should be subject to the FSA's prior written consent. Covenants and additional representations and warranties should not be inconsistent with the existing representations and warranties in paragraphs 6 and 7 of the Standard Terms. Similarly, any notices clause should take into account paragraph 14 of the Standard Terms (notices to the FSA of no effect until receipt confirmed). Any inconsistency between the Variable Terms and the Standard Terms is resolved in favour of the Standard Terms (paragraph 11 of the Standard Terms).

The lender and borrower should note that the action which can be taken by the lender in response to any breach of representation, warranty or covenant by the borrower is considerably constrained by paragraphs 4 and 5 of the Standard Terms. Therefore the value to the lender of including additional representations, warranties or covenants is very limited.

19. See also note 9 above for the situation where the borrower is a partnership and notes 24 -25 below for additional terms relating to law and jurisdiction.

Law and jurisdiction

20. If the borrower or lender is resident in another jurisdiction and does not have a branch office within the United Kingdom, paragraph 11 of the Variable Terms should be completed.

21. The borrower should not be appointed agent for service of process on the lender in case a dispute arises between them.

C NOTES ON STANDARD TERMS

Representations and undertakings

22. Paragraphs 6(f) and 7(f): The guarantor or other provider of security must waive its right of subrogation against the borrower until all Senior Liabilities of the borrower have been paid in full. A form of deed for this purpose is available from the FSA.

23. On the effect of other terms relating to the subordinated liabilities not contained in this Agreement, see also paragraph 12 of the Standard Terms.

24. Paragraphs 15 and 16: See Notes 24-25 above.

D SIGNATURE PAGE

Arrangements for execution post FSA approval

25. **Two identical original Agreements** (i.e. the front page, the two Schedules and the signature page, each copy stapled or otherwise bound together) should be prepared for signature. Firms and lenders may use any of the execution forms set out in Notes 34-35 below.

E DEEDS OF VARIATION/ DEEDS OF TERMINATION

26. Firms are advised to ensure that the appropriate standard form is used. These forms are available from the FSA on request.

27. The recitals to the deed should refer to the amount of the loan/ each advance and where applicable, briefly summarise the effect of any previous variation of the agreement and of variation of the original agreement which is currently proposed.

28. A variation or termination of a subordinated loan agreement can only be effected by the execution of a further deed. In particular, this means that the formalities for executing a deed (see note 34-36 below) must be observed for all deeds of variation or termination and that all parties to the original agreement must also be parties to the subsequent deed of variation or termination. Only the forms set out at Notes 35(1) and (2) or 36(2) below are appropriate for execution as a deed.

29. A deed of variation will be required where the parties wish to change the terms of a subordinated loan agreement eg. where the amount of the loan or advance is to be increased. A deed of termination is needed where the parties wish to bring to terminate an agreement that is in place before it would otherwise come to an end. This could occur, for example, where the firm wants to substitute a new lender. Please note that where a subordinated loan agreement is terminated in this way, all obligations and liabilities of the parties arising before the date of termination remain in effect.

F Execution

30. In the case of English companies, reference is made to sections 36 and 36A of the Companies Act 1985 under which a company may contract

- under its common seal
- through any person acting under its authority, express or implied,

and a document signed by a director and the secretary of the company or by two directors and expressed to be executed by the company as a deed has the same effect as if executed under the common seal of the company.

31. Suggested wordings for English companies are:

(1) THE COMMON SEAL OF

[ ]
was hereunto affixed
in the presence of

…..............................	…................................
Director	Director/secretary

OR

(2) EXECUTED as a deed

by

…................................ …......................................

Director Director/secretary

(3) SIGNED for and on behalf of
[ ]

by …...................................

…...............................

Authorised signatory

(4) SIGNED for and on behalf of
[ ]
by

…................................ …....................................

Director Director/secretary

32. Suggested wording for individuals is –

(1) SIGNED by [ ] ....
in the presence of -

Signature of witness ....

Name of witness ....

Address of witness ....
....

OR

(2)	EXECUTED as a deed by [ ] in the presence of -	....
	Signature of witness	....
	Name of witness	....
	Address of witness	....

33. In the case of overseas companies or partnerships, appropriate wording should be used. If necessary, firms should obtain legal advice from lawyers qualified in the relevant jurisdiction.

FORM OF APPROVED BANK BOND
"A"

1. This Bond is issued by [ ] of [ ] (“the Bank") for the benefit of [ ] ("the Firm").

2. The Bank hereby IRREVOCABLY AND UNCONDITIONALLY undertakes to the Firm that forthwith upon receipt of a notice of demand in the form referred to in paragraph 3 of this Bond it shall pay to the Firm the sum of £[ ] ("the Bonded Amount").

3. The notice of demand referred to in paragraph 2 of this Bond is a notice duly executed by The Financial Services Authority Limited ("the FSA") on behalf of the Firm (pursuant to the power of attorney executed contemporaneously herewith) which :-

   (i) is deposited at any time during the currency of this Bond at the address of the Bank set out in paragraph 1 of this Bond (or such other address as may be notified by the Bank in writing to the FSA for this purpose from time to time);

   (ii) demands payment in full of the Bonded Amount; and

   (iii) certifies that the Firm is in default of its financial resources requirement as determined in accordance with the rules in IPRU(INV) 3 in the FSA handbook ("the Financial Rules") as in force at the relevant time. The Bank shall not be entitled to inquire into or require proof of the facts stated in the notice of demand which, as between the Bank, the FSA and the Firm, shall be conclusive.

4. The Bank shall have no recourse to the assets of the Firm in respect of the Bonded Amount and no other person shall have recourse to the assets of the Firm in respect of the Bonded Amount until payment in respect of all present and future sums, liabilities and obligations payable or owing by the Firm (whether actual or contingent, jointly or severally or otherwise howsoever) has been made in full to all other creditors.

5. The Bank may not terminate the Bond unless -

   (i) the Firm will have financial resources equal to at least 120% of its financial resources requirement as determined in accordance with the Financial Rules of the FSA as in force at the relevant time immediately after termination of the Bond; or

   (ii) the Bank is authorised by the FSA to terminate the Bond.

6. This Bond will not be terminated before the date specified in paragraph 8 below through any act or default of the Firm or otherwise.

7. This Bond shall not be affected by any change in:-

   (i) the constitution of the Bank or the Firm; or

   (ii) the provisions of the Financial Rules of the FSA.

8. This Bond shall remain valid from the date of its issue until [ ] [and the Bank[and the Firm] hereby irrevocably submit to the non exclusive jurisdiction of the English courts and irrevocably appoint [ ] as agents for the service of process in the said jurisdiction].*

9. This Bond shall be governed by and construed and take effect in all respects in accordance with English law.

EXECUTED as a deed this [ ] day of [ ] 20[ ].

THE COMMON SEAL of	)
[Bank]	)
was hereunto affixed	)
in the presence of:-	)

* Words in square brackets only necessary if the Bank or the Firm is incorporated outside the U.K.

POWER OF ATTORNEY

BY THIS POWER OF ATTORNEY given on the [ ] day of [ ] a company [incorporated in the United Kingdom] having its registered office at [ ] ("the Company") appoints The Financial Services Authority Limited ("the FSA") whose registered office is 25 The North Colonnade, Canary Wharf, London, E14 5HS to be the true and lawful attorney of the Company for the following purpose:-

By way of security for the obligation of the Company to maintain sufficient financial resources as required by the rules in IPRU(INV) 3 of the FSA handbook as in force from time to time to demand payment on behalf of the Company of the sums payable pursuant to the terms of the Approved Bank Bond (annexed hereto marked "A") in the manner prescribed by the terms of such Approved Bank Bond.

The Company declares the authority hereby conferred to be irrevocable as long as the Company shall remain authorised to conduct investment business in the United Kingdom by the FSA.

The authority hereby conferred may be exercised on behalf of the FSA by any one of its officers or employees duly authorised in that regard by a resolution of the FSA's Board or a duly authorised committee thereof.

This Power of Attorney shall be governed by and construed and take effect in all respects in accordance with English law.

IN WITNESS WHEREOF this deed has been duly executed by the Company and it is intended to be and is hereby delivered the day and year first above written.

THE COMMON SEAL of)
[Company])
was hereunto affixed)
in the presence of:-)

3.7 APPROVED FORM OF UNDERTAKING

THIS UNDERTAKING is entered into the [ ] day of [ ] 20[ ] BETWEEN:

(1) [ ] of [ ] ("the Covenantor");

(2) THE FINANCIAL SERVICES AUTHORITY LIMITED ("the FSA") whose registered office is 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

(3) [ ] of [ ] ("the Principal") [and [ ] of [ ], [ ] of [ ], and [ ] of [ ]] the individual partners of the Principal as such partners and as individuals **] +].

WHEREAS:

(A) The Principal is authorised to carry on one or more regulated activities in the United Kingdom (as defined under the Financial Services and Markets Act 2000) by the FSA.

(B) The Principal is required pursuant to the Financial Rules to maintain a Financial Resources Requirement (and the FSA has agreed that such Financial Resources Requirement may in part be represented by one or more undertakings in the form hereof to the extent that any undertaking(s) will not exceed the excess of 30% of the Principal's Base Requirement over the value of any Approved Bank Bond.

(C) The Principal has requested the Covenantor to give an undertaking to the FSA for the purposes of the Principal's Financial Resources Requirement which the Covenantor has agreed to do.

NOW IT IS HEREBY AGREED AND DECLARED as follows:

1. **Definitions**

In this Undertaking:

"Base Requirement" has the meaning given in the Financial Rules;

"Business Day" means a day on which The International Stock Exchange of the United Kingdom Limited is open for business;

"Excluded Liabilities" means Liabilities which are expressed to be and in the opinion of the Insolvency Officer of the Principal [or, where relevant, the Insolvency Officer of a Partner**], do, rank junior to the Subordinated Liabilities in the insolvency of the Principal;

"Financial Resources" has the meaning given in the Financial Rules;

"Financial Resources Requirement" has the meaning given in the Financial Rules;

"the Financial Rules" means the rules in IPRU(INV) 3 of the FSA handbook;

"Insolvency" means and includes liquidation, winding up, bankruptcy and sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Principal) or the equivalent in any other jurisdiction to which the Principal may be subject;

"Insolvency Officer" means and includes any person duly appointed to administer and distribute assets of the Principal in the course of the Principal's insolvency;

"Liabilities" means all present and future sums, liabilities and obligations payable or owing by the Principal [or any Partner**] (whether actual or contingent, jointly or severally or otherwise howsoever);

["Partner" means an individual partner of the Principal**];

"Senior Liabilities" means all Liabilities except all Liabilities in respect of any sums paid to the Principal under the terms of this Undertaking and Excluded Liabilities;

"Subordinated Liabilities" means all Liabilities to the Covenantor in respect of repayment of any sums paid to the Principal under the terms of this Undertaking.

Any reference to any rules of the FSA is a reference to them as already amended and includes a reference to any revoked rules which may be remade with or without amendments, and to any future rules and/or amendments of them.

2. In consideration of the FSA agreeing to take this Undertaking into account for the purpose of determining compliance by the Principal with its Financial Resources Requirement the Covenantor with intent to bind its successors and assigns and any body corporate with which it may amalgamate or merge HEREBY UNDERTAKES with and to the FSA and the Principal that at any time after the occurrence of any Event of Default specified in paragraph 6 hereof ("Event of Default") and notwithstanding that any other Event of Default may have occurred prior thereto the Covenantor will on demand in writing made upon it by the FSA accompanied by a certificate of the FSA as referred to in paragraph 9 hereof ("the Certificate") pay to the Principal or as the case may be the FSA (as determined in accordance with paragraph 3 below) the sum of £[ ] ("the Specified Amount").

3. In the case of an Event of Default falling within any of sub-paragraphs (1)(a), (1)(b) or (1)(c) of paragraph 6 below the sum to be paid pursuant to paragraph 2 above shall be paid to the FSA to be used at its discretion for any lawful purpose of the FSA , and in the case of an Event of Default falling within sub-paragraph (1)(d) of paragraph 6 below the sum to be paid pursuant to paragraph 2 above shall be paid to the Principal.

4. The liability of the Covenantor hereunder shall not be affected or discharged and the Covenantor shall not be released from its obligations hereunder by any act, omission, matter or thing whatsoever whereby, if the Covenantor was treated as a surety, guarantor or cautioner for the Principal, its liability would or might have been so affected or discharged or it might have been so released.

5. the FSA may without notification to or the consent of the Covenantor and without affecting or discharging the Covenantor's liability hereunder or releasing the Covenantor from its obligations hereunder from time to time waive or omit or fail to exercise or delay exercising its rights hereunder in respect of any Event of Default and any such waiver, omission, failure or delay shall not prejudice or affect the FSA 's rights hereunder in respect of that Event of Default (except in the case of a waiver) or any other or further Event of Default (whether or not of the same kind).

6. (1) The following shall be Events of Default for the purposes hereof:

(a) the Principal is deemed to be insolvent (as determined in accordance with sub-paragraph (2) below);

(b) the Principal is unable or admits its inability to pay its debts as they fall due or makes a general assignment for the benefit of, or a compensation with, its creditors;

(c) an encumbrancer takes possession or a receiver, judicial factor, or similar officer is appointed over all or any part of the undertaking or assets of the Principal;

(d) the Principal shall in the bona fide opinion of the FSA have failed to maintain an excess of Financial Resources over its Financial Resources Requirement and in the bona fide opinion of the FSA shall not have remedied the same within seven days after being required by the FSA to restore the deficiency.

[(2) The Principal is deemed to become insolvent:

(a) on the making of a winding-up order against it; or

(b) on the passing of a resolution for a voluntary winding up in a case in which no statutory declaration has been made under Section 89 of the Insolvency Act 1986 or Article 534 of the Companies (Northern Ireland) Order 1986; or

(c) on the holding of a creditors meeting summoned under Section 95 of that Act or Article 54 of that Order; or

(d) on the appointment of an administrator for it under Section 9 of that Act; or

(e) the occurrence of an event corresponding as nearly as may be to any of those mentioned in sub-paragraphs (a) to (d) above in any other jurisdiction to which the Principal may be subject.*]

[(2) The Principal is deemed to become insolvent:

(a) in England and Wales on the making of a winding-up order against it under any provision of the Insolvency Act 1986 as applied by an order under Section 420 of that Act; or

(b) in Scotland, on the making of an award of sequestration on the estate of the partnership; or

(c) in Northern Ireland, on the making of an adjudication of bankruptcy against any one of the partners; or

(d) elsewhere on the occurrence of an event corresponding as nearly as may be to any of those mentioned above in this sub-paragraph.**]

[(2) The Principal is deemed to become insolvent if:

(a) in England and Wales, a bankruptcy order is made against him; or in Scotland, an award of sequestration is made on his estate; or

(b) in Scotland, and award of sequestration is made on his estate; or

(c) in Northern Ireland, an adjudication of bankruptcy is made against him; or

(d) elsewhere than in the United Kingdom, there occurs in relation to him any event corresponding to those mentioned above in this paragraph. * * *]

7. This Undertaking shall be a continuing undertaking and shall apply irrespective of, and shall not be affected or discharged by, any matter relating to the compliance at any time by the Principal with its Financial Resources Requirement and in particular (but without limitation) the fact (if such be the case) that the Principal at any time complies or is able to comply with the Financial Resources Requirement without making use of this Undertaking or taking the same into account for the purposes of its Financial Resources Requirement.

8. This Undertaking shall apply in relation to any Event of Default occurring at or before the close of business on the earliest (if any) to occur of the following dates ("the Termination Date"):

(a) if the Covenantor gives the FSA not less than six months' written notice of its desire to terminate this Undertaking with effect from the date (being a date falling on or after the second anniversary of the date hereof) specified therein, such specified date;

(b) if the FSA and the Covenantor agree in writing to terminate this Undertaking with effect from the date specified in such agreement, such specified date; and

(c) if this Undertaking shall cease with effect from any day to be eligible to represent (in whole or in part) the Financial Resources Requirement to be maintained by the Principal pursuant to the Financial Rules, the date falling two business days after such day:

provided that no demand may be made upon the Covenantor hereunder later than midnight on the thirtieth business day after the Termination Date.

9. (a) In any demand proceedings or otherwise under this Undertaking the occurrence of any Event of Default shall be conclusively proved by a certificate signed by a duly authorised signatory of the FSA which shall specify the Event of Default which has occurred and to which the certificate relates and shall give brief particulars thereof.

(b) If the FSA requires the Principal to remedy a breach of its Financial Resources Requirement as referred to in paragraph 6(1)(d) hereof, it shall notify the Covenantor thereof as soon as reasonably practicable thereafter.

10. A demand shall be duly made upon the Covenantor hereunder if it is signed by a duly authorised signatory of the FSA (accompanied by evidence reasonably satisfactory to the Covenantor of the signatory's authority) and is addressed to the Covenantor at its registered office [principal place of business in the United Kingdom] and posted by first-class mail and (if it has not been received prior thereto) the Covenantor shall be taken to have received such demand forty-eight hours after it is posted.

1l. (1) The rights of the Covenantor to repayment of any sums paid to the Principal or, as the case may be, reimbursement by the Principal of any sums paid to the FSA under the terms of this Undertaking are subordinated to the Senior Liabilities and accordingly repayment of any such sums is conditional upon:

(a) (if an order has not been made or an effective resolution passed for the insolvency of the Principal) the Principal being in compliance with its Financial Resources Requirement prevailing at the time of payment by the Principal, and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that, subject to sub-paragraph (2) below, the Principal could make such payment and still be in compliance with such Financial Resources Requirement immediately thereafter;

(b) (if an order has been made or effective resolution passed for the insolvency of the Principal) [or if the Principal shall be dissolved**] the Principal being solvent at the time of payment by the Principal, and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Principal could make such payment and still be solvent immediately thereafter. For the purposes of this sub-paragraph, the Principal shall be solvent if it is able to pay its debts in full and in determining whether the Principal is solvent there shall be disregarded obligations which are not payable or capable of being established or determined in the insolvency of the Principal and the Excluded Liabilities.

(2) No payment of the Subordinated Liabilities shall be made at any time pursuant to sub-paragraph (l)(a) above unless:

(a) the Principal has given to the FSA prior written notification that it proposes to make such payment; and

(b) the FSA has notified the Principal in writing that it consents to such proposed payment.

The Principal shall give or procure that there are given to the FSA such information and auditor's certificate in relation to such proposed payment as the FSA may require.

(3) For the purposes of sub-paragraph (l)(b) above a report given at any relevant time as to the solvency of the Principal by its Insolvency Officer, in form and substance acceptable to the FSA , shall in the absence of proven error be treated and accepted by the FSA , the Covenantor and the Principal as correct and sufficient evidence thereof.

(4) If the Covenantor shall receive from the Principal [or any Partner**] payment of any sum in respect of the Subordinated Liabilities when any of the terms and conditions referred to in sub-paragraphs (1) or (2) above is not satisfied the payment of such sum shall be void for all purposes and [such sums shall be received by the Covenantor upon trust to return the same to the Principal+++] [the Covenantor shall at any time thereafter be bound to return such sum to the Principal or, as the case may be, its Insolvency Officer+] (and any sums so returned shall then be treated for the purposes of the Principal's obligations hereunder as if they had not been paid by the Principal and its original payment shall be deemed not to have discharged any of the obligations of the Principal hereunder). A request to the Covenantor for return of any sum under the foregoing provisions of this sub-paragraph (4) shall be in writing and shall be made by or on behalf of the Principal or, as the case may be, its Insolvency Officer.

12. The Covenantor will not without the prior written consent of the FSA :

(i) assign or purport to assign to any person the whole or any part of the Subordinated Liabilities;

(ii) purport to retain or set off at any time any amount payable by it to the Principal [or any Partner* *] against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Undertaking; amend any document evidencing or providing for the Subordinated Liabilities;

(iii) amend any document evidencing or providing for the Subordinated Liabilities;

(iv) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Undertaking;

(v) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected;

(vi) take any security from any person for all or any part of the Subordinated Liabilities, and the Covenantor shall, upon obtaining security in breach of this Undertaking, hold the same [on trust for+++][as agent of and for the benefit of+] the Principal.

13. The Covenantor acknowledges that the FSA would seek to enforce any breach of the undertaking of the Covenantor contained in Clause 2 hereof by seeking an order for specific performance thereof and the Covenantor acknowledges that an order for specific performance would be the remedy appropriate to be granted to the FSA for such a breach.

14. This Undertaking forms the entire agreement as to the agreement of the Covenantor to provide an undertaking in relation to the Principal's Financial Resources Requirement. If there are any other terms relating thereto existing at the date hereof and not comprised in this Undertaking such terms shall be of no further force and effect. No variation of or amendment to this Undertaking shall be of any effect unless it is in writing subscribed by all the parties hereto. Any amendment to this Undertaking made or purported to be made without the consent of the FSA shall be void.

[15. This Undertaking shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Principal by the retirement of the present partners or [either] [any] of them or the assumption of new partners or by a change of name it being provided that:

(a) A retired partner shall continue to be liable for the payment of all sums due hereunder and implementation of all other obligations herein contained until such time as the Bank and the remaining partner[s] shall agree in writing to release a retired partner from such obligations; and

(b) In the event of a new partner being assumed as a partner of the Principal the other partners shall procure that said assumed partner shall become bound to the Covenantor as a party to these presents and shall execute such addendum hereto as the Covenantor and the FSA may consider necessary. **] +]

[16. The Principal and the Partners hereby acknowledge to the Covenantor and the FSA that subject to the foregoing provisions of the Agreement they will be jointly and severally liable to the Covenantor for any sum paid by the Covenantor hereunder and that irrespective of whether such sum was paid by the Covenantor to the Principal or to the FSA . **] +]

17. This Undertaking is governed by [English law+++++] [the law of Scotland+] [Northern Irish law++++] [, and for the benefit of the FSA solely the Covenantor irrevocably submits to the jurisdiction of the [English Courts+++++] [Court of Session, Scotland+] [Northern Irish Courts++++] and appoints [ ] as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that such non-exclusivity prejudices the submission to such jurisdiction].

Notes:

(1) To be executed by the Covenantor under seal - other parties to execute either under seal or under hand.

(2) Words in brackets throughout this document marked with a single asterisk are for use where the Principal is a corporation, those marked with a double asterisk are for use where the Principal is a partnership, and those marked with a triple asterisk where the Principal is an individual.

(3) Words in brackets marked with a single cross are for use where the agreement is governed by Scottish law, with two crosses where the agreement is governed by either Scottish or Northern Irish law, three crosses where it is governed by either English or Northern Irish law, four crosses where it is governed by Northern Irish law and five crosses where it is governed by English law. Thus, for instance, words marked ++* * would be for use where the Borrower is a partnership and the agreement is governed by either Scottish or Northern Irish law.

(4) Words in brackets in paragraph 17 above only required where either the Covenantor or the Principal (or both) are not incorporated in any part of the United Kingdom.

5 Investment Management Firms (former IMRO Firms)

PRESCRIBED SUBORDINATED LOAN AGREEMENT

THIS SUBORDINATED LOAN AGREEMENT is made the _____day of _____20_____ between:

(1) [_____] of [_____] ("the Lender" which term includes its permitted successors and assigns);

(2) [_____] of [_____] ("the Borrower" which term includes its permitted successors and assigns).

WHEREAS

(A) The Borrower is [has applied to be] regulated by FSA.

(B) The Borrower is required to maintain financial resources to meet the provisions of Chapter 5 of the Interim Prudential Sourcebook as they apply to the Borrower at any particular time.

(C) The Lender has agreed to lend [has lent] to the Borrower an amount as set out herein upon and subject to the terms and conditions contained in this Agreement.

NOW IT IS HEREBY AGREED as follows:

1. Definitions

In this Agreement:

"Business Day"
means a day on which banks are open for all banking business in London;

"FSA"
means the Financial Services Authority;

"Interest Amount"
in respect of an Interest Period means the amount of interest payable in respect of such Interest Period calculated by applying the Rate of Interest in respect of such Interest Period to the average amount (calculated on a daily basis) of the principal of the Loan (together with any interest due but unpaid) outstanding during such Interest Period and multiplying the resulting sum by a fraction of which the numerator is equal to the actual number of days in the Interest Period concerned and the denominator is equal to 365;

"Interest Payment Date"
means [ ] and [ ] in each year;

"Interest Period"
means the period starting on the day following an Interest Payment Date and ending on the next following Interest Payment Date provided that the First Interest Period shall commence on the date hereof and end on the next following Interest Payment Date;

"Interim Prudential Sourcebook"
means the Interim Prudential Sourcebook for Investment Businesses made by the FSA;

"LIBOR"
in respect of an Interest Period means the rate determined by such London clearing bank as the Lender and Borrower shall agree to be the arithmetic mean (rounded to the nearest 1/16 of one per cent) of the offered quotations for 6 months sterling deposits in the London inter bank market at 11.00am (London time) on the Business Day prior to the commencement of such Interest Period;

"Loan"
means the Principal Amount (as defined in Clause 2) together with interest accrued thereon as may be outstanding from time to time;

"Rate of Interest"
in respect of an Interest Period means an amount expressed as a percentage per annum equal to the sum of LIBOR in respect of such Interest Period (expressed as a percentage per annum) and [ ] per cent per annum;

		"Senior Creditors" means all such persons who are: (a) unsubordinated creditors of the Borrower; or (b) subordinated creditors of the Borrower other than those whose claims are expressed to rank and do rank, pari passu with or junior to the claims of the Lender hereunder. Clause headings in this Agreement are inserted for ease of reference only and shall not affect the construction of this Agreement.
2.	The Loan	(a) The Lender [hereby agrees to advance]/[has on [ ] advanced] to the Borrower by way of loan the principal amount of [ ] (the "Principal Amount") upon and subject to the terms and conditions contained in this Agreement. [(b) [Upon signature hereof]/[On [ ]] the Lender shall pay, or procure the payment of, the Principal Amount to the Borrower in freely available funds at its account number [ ] with [ ] bank.]
3.	Interest	(a) Subject to the provisions of Clause 7 of this Agreement: (i) the Borrower will until repayment of the Loan in full pay to the Lender interest on the Loan or on any part or parts thereof for the time being remaining due hereunder in accordance with a written notice given by the Lender to the Borrower; (ii) on each Interest Payment Date the Borrower shall pay to the Lender the Interest Amount in respect of the Interest Period ending on such Interest Payment Date; provided that at no time during the continuance of this Agreement shall the Rate of Interest exceed an annual rate of 5 per cent above LIBOR.

		(b) No payment on account of interest shall be made at any time to the extent that such payment would cause the Borrower to be in breach of rule 5.2.1(1) of Chapter 5 of the Interim Prudential Sourcebook (or any equivalent Rule for the time being in force). Any amount of interest whose payment is deferred under this provision shall be paid when and to the extent that the Borrower would not be in breach of rule 5.2.1(1) of the Interim Prudential Sourcebook after such payment. [The Agreement may make provision for interest on interest.]
4.	Early Repayment	Subject to the provisions of Clause 7 of this Agreement the Borrower may make an early repayment of the whole or any part of the Loan provided that: (a) the written consent of FSA to such repayment is first obtained by the Borrower; (b) the Borrower must give to the Lender not less than one Business Day's prior notice of its intention to make such repayment, specifying the amount thereof and the date on which it is to be made (such notice to be ineffective if the winding up of the Borrower commences before the date on which such notice expires); and (c) the Borrower shall simultaneously pay all interest accrued to the date of repayment.
5.	Repayment of the Loan	Subject to the provisions of Clause 7 of this Agreement the Loan shall be repayable upon the expiry of [ ] months' written notice given by the Lender to the Borrower provided that: (a) such notice shall expire on a day falling after [five] [two] years from the date of [drawdown] [hereof]; and (b) the prior written consent of FSA to the repayment has first been obtained by the Borrower and not withdrawn; but (c) such notice shall cease to have effect if the winding up of the Borrower commences before the date on which such notice expires.
6.	Event of Default	Subject to the provisions of Clauses 7 and 10 of this Agreement: (a) if default is made for a period of five Business Days or more in the payment of any of the principal amount of the Loan [or for a period of 15 Business Days or more in the payment of any of the interest due in respect of the Loan] the Lender may, after taking such preliminary steps or actions as may be necessary, institute proceedings to wind up the Borrower;

		(b) if an order is made or an effective resolution is passed for the winding up of the Borrower, the Loan shall forthwith become repayable.
7.	Subordination	Notwithstanding the provisions of Clauses 4, 5 and 6 of this Agreement, the rights of the Lender in respect of the Loan are subordinated in all respects to the rights of Senior Creditors in respect of amounts outstanding to them payable by the Borrower ("Senior Liabilities") and accordingly payment of any amount (whether in respect of principal, interest or otherwise and whether by way of repayment or prepayment) of the Loan shall be in all respects conditional upon compliance with the provisions below: (a) The written consent of FSA to such payment is first obtained by the Borrower. (b) (i) If at any time or from time to time an order has been made or an effective resolution passed for the winding up of the Borrower, then any payment of any amount (whether in respect of principal, interest or otherwise and whether by way of repayment or prepayment) of the Loan which under any other Clause of this Agreement would fall due for payment whilst the Borrower was insolvent or in insolvent liquidation will not fall so due, and instead such payment will become due for payment only if and when and to the extent that the Borrower could make such payment in whole or in part and still be solvent (whether or not it was in liquidation) thereafter. [Interest pursuant to Clause 3 hereof will continue to accrue on each and every such payment which is suspended under this Clause. Any payment suspended under this Clause but ultimately made will be made according to the amount of principal or interest (as the case may be) due to the Lender and in the event of both principal and interest being so suspended, payment will be made on account of principal before any payment is made on account of interest, but such alteration in order of payment will not prejudice the right of the Lender (which the Borrower acknowledges and confirms) to receive, subject to this Clause 7(b)(i) the full amount to which it would have been entitled if monies from time to time available for payment had been applied instead on account of interest before principal].

(ii) For the purposes of Clause 7(a) and (b) the Borrower may, and will whenever requested by the Lender whilst any payment remains suspended, procure a report or opinion by its auditors or (if it is in liquidation) by its liquidator as to whether or not the Borrower would be solvent at any time in any circumstances or whether or to what extent any payment in respect of the Loan could be made without infringing the provisions of this Sub-Clause and in the absence of proven error such report or opinion shall be treated and accepted by the Borrower and the Lender as correct and sufficient evidence of such fact.

(iii) Nothing in this Clause shall prevent the Lender from presenting or supporting any petition to wind up the Borrower, and the Borrower shall not put forward or rely on the provisions of this Clause as a ground for opposing any petition presented or supported by the Lender.

8. Payments

Subject to the provisions of Clause 7 of this Agreement:

(a) all payments to be made by the Borrower hereunder shall be made in immediately available funds before [ ] on the date on which payment is due in such manner as the Lender may from time to time direct;

(b) if any sum becomes due for payment pursuant to this Agreement on a day which is not a Business Day, such payment shall be made on the next succeeding Business Day and interest shall be adjusted accordingly;

(c) all sums payable by the Borrower hereunder shall be paid in full without set off or counter claim and free and clear of and without deduction or withholding for or on account of any present or future taxes, duties or other charges. If any payment shall be subject to any such tax or if the Borrower shall be required by law to make any such deduction or withholding, the Borrower will pay such tax, will ensure that such payment, deduction or withholding, will not exceed the minimum legal liability therefore and will simultaneously pay to the Lender such additional amounts as will result in the Lender receiving a net amount equal to the full amount which the Lender would have received had no such payment, deduction or withholding been required.

9.	Regulatory Consent	The Lender will not without the prior written consent of FSA: (a) assign or purport to assign to any person this Agreement or the whole or any part of its rights against the Borrower in respect of the Loan; (b) purport to retain or set off at any time any amount of the Loan against any amount otherwise payable by it to the Borrower except to the extent that payment of such amount of the Loan would be permitted at such time by this Agreement; (c) amend or waive or concur in amending or waiving the terms of this Agreement; (d) attempt to obtain repayment of the whole or any part of the Loan otherwise than in accordance with the terms of this Agreement; (e) take or omit to take any action whereby the subordination of the Loan or any part thereof as provided for in Clause 7 of this Agreement might be terminated, impaired or adversely affected; or (f) take any security from any person for all or any part of the Loan and so that the Lender shall, upon obtaining security in breach of this Clause, hold the same on trust for the Borrower.
10.	Sole Remedy	The Lender shall not be entitled to any remedy against the Borrower in respect of any default by the Borrower in repayment or prepayment of the Loan, or to enforce any other term of this Agreement, other than to institute proceedings to wind up the Borrower, provided always that the Borrower shall not, by the institution of such proceedings, become or be obliged to pay any sums or sum sooner than the same would otherwise have been payable by it pursuant to this Agreement.
11.	Trust	Any amounts paid by the Borrower or received or recovered by the Lender or any security taken from any person in respect of the Loan in breach of the provisions of this Agreement and any distributions of any kind or character in respect of the Loan received or recovered by the Lender otherwise than in accordance with the provisions of this Agreement shall be held on trust by the Lender to return the same to the Borrower, or where applicable, the liquidator or other similar such officer.

12.	Entire Agreement	The Borrower and the Lender acknowledge that this Agreement forms the entire agreement relating to the Loan. If there are any other terms relating to the Loan existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.
13.	Continuing Obligations	The obligations of the Borrower and Lender hereunder shall be continuing obligations and shall be and remain fully effective until the repayment of the Loan in full in accordance with the provisions of this Agreement.
14.	Governing Law	This Agreement shall be governed by and construed in accordance with the laws of England and each of the parties hereby irrevocably submits to the non-exclusive jurisdiction of the Courts of England and Wales, Scotland and Northern Ireland.
15.	Rights of the FSA	Although not a party to the agreement, the FSA may in its own right enforce a term of the agreement to the extent that it purports to confer upon the FSA a benefit.
16.	Notices	Any notice of demand to be given or made hereunder may be delivered by hand or sent by first class registered or pre-paid post to the recipient at the address first above mentioned or such other address as it shall last notify to each of the other parties hereto. Such notice shall be deemed to have been received: (a) if delivered by hand, on the day of delivery; (b) if sent by first class registered or pre-paid post three days after the date of despatch (as to which the sender's certificate shall be conclusive).
17.	Counterparts	This Agreement may be executed in any number of counterparts and by the different parties hereto on separate counterparts, each of which when so executed and delivered shall be an original, but all the counterparts shall together constitute one and the same instrument. IN WITNESS whereof the parties hereto have executed this Agreement as a deed the day and date first above written.

Notes for Prescribed Subordinated Loan Agreement

These notes accompany the *prescribed subordinated loan agreement* and are intended to assist those who are or propose to be regulated by FSA. These notes relate solely to the mechanical drafting aspects of the prescribed agreement.

These notes refer to the Clauses in the order in which they appear in the prescribed agreement.

1.	Parties	Complete the name, registered number and registered office of the Lender and the Borrower.
2.	Loan	The Specimen Agreement provides for two alternative ways of advancing the Loan: (a) one advance on the date of the Agreement; or (b) one advance at a date other than the date of the Agreement. Firms are requested to specify clearly the date of the advance.
3.	Interest	The maximum rate of interest is 5 per cent above LIBOR. However, if a fixed rate of interest is charged, the Interest Rate must not exceed 5 per cent above LIBOR on the date the Loan is first taken out. If the Loan is to be free of interest: (a) Clause 3 should be deleted and replaced by the words "The Loan shall be interest-free"; and (b) the definitions of "Interest Amount", "Interest Payment Date", "Interest Period", LIBOR and "Rate of Interest" should be deleted and consequential changes should be made to Clauses 4(c), 6(a), 7(preamble), 7(b)(i), and 8(b) accordingly.
4.	Repayment	The specified date of repayment must not be less than two years after: (a) the date of the Agreement; or (b) where the principal amount was advanced after the date of the Agreement, the date the principal amount was advanced.

5.	Execution	The date of the Agreement is the date on which execution of the Agreement by all parties is completed. Execution must accord with the laws and regulations governing the execution of documents in the jurisdiction of the Firm's principal place of business (e.g. a company whose principal place of business is in the UK must observe the requirements of Section 130 of the Companies Act 1989).
6.	Number of copies of Agreements	Three copies of the Agreement should be executed by both the Lender and the Borrower and forwarded to FSA. FSA will retain one original Agreement and return the other two copies to the Firm.

PRESCRIBED QUALIFYING UNDERTAKING

THIS UNDERTAKING IS ENTERED INTO

THE DAY OF 20 BETWEEN

(I) [ ] of [ ] ("the Bank" or "Holding Company")

(2) FINANCIAL SERVICES AUTHORITY whose registered office is at 25 The North Colonnade, Canary Wharf, London E14 5HS ("FSA") and

(3) [ ] of [ ] ("the Principal")

WHEREAS

(A) The Principal is regulated by FSA

(B) The Principal is required to maintain financial resources to meet the provisions of Chapter 5 of the Interim Prudential Sourcebook as they apply to the Principal and FSA has agreed that the Financial Resources Requirement may in part be represented by one or more undertakings in the form hereof

(C) The Principal has requested the Bank or Holding Company to give an undertaking to FSA for the purposes of the Principal's Financial Resources Requirement which the Bank or Holding Company has agreed to do

NOW THESE PRESENT WITNESS and it is hereby agreed and declared as follows:

1. In this Undertaking:

"Business Day"
means a day on which the Bank or Holding Company is open for business;

"Excluded Liabilities"
means Liabilities which are expressed to be and in the opinion of the liquidator of the Principal, do, rank junior to the Subordinated Liabilities in such liquidation;

"Financial Resources Requirement"
means the amount of liquid capital which the Principal is, pursuant to the Rules, required to maintain at any particular time;

"Interim Prudential Sourcebook"
means the Interim Prudential Sourcebook for Investment Businesses made by the FSA;

"Liabilities"
means all present and future sums, liabilities and obligations payable or owing by the Principal (whether actual or contingent, jointly or severally or otherwise howsoever);

"Senior Liabilities"
means all Liabilities except all Liabilities in respect of any sums paid to the Principal under the terms of this Undertaking and Excluded Liabilities;

"Subordinated Liabilities"
means all Liabilities of the Principal to the Bank or Holding Company in respect of repayment of any sums paid to the Principal under the terms of this Undertaking;

"the Rules"
means the Rules of FSA from time to time;

the term "liquid capital"
has the meaning ascribed to it in the Rules;

any reference to an enactment is a reference to it as already amended and includes a reference to any repealed enactment which it may re-enact, with or without amendments, and to any future re-enactment and/or amendment of it.

2. (a) In consideration of FSA agreeing to take this Undertaking into account for the purpose of determining compliance by the Principal with its Financial Resources Requirement the Bank or Holding Company with intent to bind its successors and assigns and any body corporate with which it may amalgamate or merge HEREBY UNDERTAKES with and to FSA and the Principal that at any time after the occurrence of any Event of Default specified in paragraph 5 hereof ("Event of Default") and notwithstanding that any other Event of Default may have occurred prior thereto the Bank or Holding Company will on demand in writing made upon it by FSA accompanied by a certificate of FSA as referred to in paragraph 8 hereof ("the Certificate") pay to the Principal the sum of £[ ] ("the Specified Amount").

(b) The Bank or Holding Company shall pay the Specified Amount to such account of the Principal as FSA may specify.

3. The liability of the Bank or Holding Company hereunder shall not be affected or discharged and the Bank or Holding Company shall not be released from its obligations hereunder by any act, omission, matter or thing whatsoever whereby, if the Bank or Holding Company was treated as a surety or guarantor for the Principal, its liability would or might have been so affected or discharged or it might have been so released.

4. FSA may without notification to or the consent of the Bank or Holding Company and without affecting or discharging the Bank's or the Holding Company's liability hereunder or releasing the Bank or Holding Company from its obligations hereunder from time to time waive or omit or fail to exercise or delay exercising its rights hereunder in respect of any Event of Default and any such waiver, omission, failure or delay shall not prejudice or affect FSA's rights hereunder in respect of that Event of Default (except in the case of a waiver) or any other or further Event of Default (whether or not of the same kind).

5. The following shall be Events of Default for the purposes hereof:

(a) the Principal is deemed to be unable to pay its debts in accordance with Section 123 of the Insolvency Act 1986;

(b) the Principal is unable or admits its inability to pay its debts as they fall due or makes a general assignment for the benefit of, or a composition with, its creditors;

(c) an encumbrancer takes possession, or a receiver, administrator or similar officer is appointed, of all or any part of the undertaking or assets of the Principal;

(d) the Principal shall in the opinion of FSA be in breach of its Financial Resources Requirement and in the opinion of FSA shall not have remedied such breach within 5 Business Days after being required by FSA to restore the deficiency.

6. This Undertaking shall be a continuing undertaking and shall apply irrespective of, and shall not be affected or discharged by, any matter relating to the compliance at any time by the Principal with its Financial Resources Requirement and in particular (but without limitation) the fact (if such be the case) that the Principal at any time complies or is able to comply with the Financial Resources Requirement without making use of this Undertaking or taking the same into account for the purposes of its Financial Resources Requirement.

7. This Undertaking shall apply in relation to any Event of Default occurring at or before the close of business on the earliest (if any) to occur of the following dates ("the Termination Date"):

(a) if the Bank or Holding Company gives FSA not less than six months' written notice of its desire to terminate this Undertaking with effect from the date (being a date falling on or after the second anniversary of the date hereof) specified therein, such specified date;

(b) if FSA and the Bank or Holding Company agree in writing to terminate this Undertaking with effect from the date specified in such agreement, such specified date; and

(c) if this Undertaking shall cease with effect from any day to be eligible to represent (in whole or in part) the Financial Resources Requirement to be maintained by the Principal pursuant to the Rules, the date falling two Business Days after such day.

Provided that no demand may be made upon the Bank or Holding Company hereunder later than midnight on the thirtieth Business Day after the Termination Date.

8. (a) In any demand proceedings or otherwise under this Undertaking the occurrence of any Event of Default shall be conclusively proved by a certificate signed by a duly authorised signatory of FSA which shall specify the Event of Default which has occurred and to which the certificate relates and shall give brief particulars thereof.

(b) If FSA requires the Principal to remedy a breach of its Financial Resources Requirement as referred to in paragraph 5(d) hereof, it shall notify the Bank or Holding Company thereof as soon as reasonably practicable thereafter.

9. A demand shall be duly made upon the Bank or Holding Company hereunder if it is signed by a duly authorised signatory of FSA (accompanied by evidence reasonably satisfactory to the Bank or Holding Company of the signatory's authority) and is addressed to the Bank or Holding Company at its registered office [principal place of business in the UK] and posted by first class mail and (if it has not been received prior thereto) the Bank or Holding Company shall be taken to have received such demand forty-eight hours after it is posted.

10. (a) The rights of the Bank or Holding Company to repayment of any sums paid to the Principal under the terms of this Undertaking are subordinated to the Senior Liabilities and accordingly repayment of any such sums is conditional upon:

(i) (if an order has not been made or an effective resolution passed for the winding up of the Principal) the Principal being in compliance with its Financial Resources Requirement prevailing at the time of payment by the Principal and no such payment which would otherwise fall due will fall so due except to the extent that, subject to sub-paragraph (b) below, the Principal could make such payment and still be in compliance with such Financial Resources Requirement immediately thereafter;

(ii) (if an order has been made or effective resolution passed for the winding up of the Principal) the Principal being solvent at the time of payment by the Principal and accordingly no such payment which would otherwise fall due for payment will fall due except to the extent that the Principal could make such payment and still be solvent immediately thereafter. For the purposes of this sub-paragraph, the Principal shall be solvent if it is able to pay its debts in full and in determining whether the Principal is solvent for the purposes of this sub-paragraph there shall be disregarded obligations which are not payable or capable of being established or determined in the winding up of the Principal and the Excluded Liabilities.

(b) No payment of the Subordinated Liabilities shall be made at any time pursuant to sub-paragraph (a)(i) above unless:

(i) the Principal has given to FSA prior written notification that it proposes to make such payment; and

(ii) FSA has notified the Principal in writing that it consents to such proposed payment.

The Principal shall give or procure that there are given to FSA such information and auditor's certificate in relation to such proposed payment as FSA may require.

(c) For the purposes of sub-paragraph (a)(ii) above a report given at any relevant time as to the solvency of the Principal by its liquidator, in form and substance acceptable to FSA, shall in the absence of proven error be treated and accepted by FSA, the Bank or Holding Company and the Principal as correct and sufficient evidence thereof.

(d) If the Bank or Holding Company shall receive from the Principal payment of any sum in respect of the Subordinated Liabilities when any of the terms and conditions referred to in sub-paragraphs (a) or (b) above is not satisfied the payment of such sum shall be void for all purposes and such sums shall be received by the Bank or Holding Company upon trust to return the same to the Principal and the Bank or Holding Company shall at any time thereafter be bound to return such sum to the Principal or, as the case may be, its liquidator (and any sums so returned shall then be treated for the purposes of the Principal's obligations hereunder as if they had not been paid by the Principal and its original payment shall be deemed not to have discharged any of the obligations of the Principal hereunder). A request to the Bank or Holding Company for return of any sum under the foregoing provisions of this sub-paragraph (d) shall be in writing and shall be made by or on behalf of the Principal or, as the case may be, its liquidator.

11. The Bank or Holding Company will not without the prior written consent of FSA:

(i) assign or purport to assign to any person the whole or any part of the Subordinated Liabilities;

(ii) purport to retain or set-off at any time any amount payable by it to the Principal against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Undertaking;

(iii) amend any document evidencing or providing for the Subordinated Liabilities;

(iv) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Undertaking;

(v) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected;

(vi) take any security from any person for all or any part of the Subordinated Liabilities, and the Bank or Holding Company shall, upon obtaining security in breach of this undertaking, hold the same on trust for the Principal.

12. The Bank or Holding Company acknowledges that FSA would seek to enforce any breach of the Undertaking of the Bank or Holding Company contained in Clause 2 hereof by seeking an order for specific performance thereof and the Bank or Holding Company acknowledges that an order for specific performance would be the remedy appropriate to be granted to FSA for such a breach.

13. This Undertaking forms the entire Agreement as to the agreement of the Bank or Holding Company to provide an undertaking in relation to the Principal's Financial Resources Requirement. If there are any other terms relating thereto existing at the date hereof and not comprised in this Undertaking such terms shall be of no further force and effect. No variation of or amendment to this Undertaking shall be of any effect unless it is in writing subscribed by all the parties hereto. Any amendment to this Undertaking made or purported to be made without the consent of FSA shall be void.

14. This Undertaking is governed by English law [and for the benefit of FSA solely the Bank or Holding Company irrevocably submits to the jurisdiction of the Courts of England and Wales, Scotland and Northern Ireland and appoints [ ] as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that such non-exclusivity prejudices the submission to such jurisdiction].

(l) To be executed by the Bank or Holding Company under seal—other parties to execute either under seal or under hand.

(2) Words in brackets in 9 and 14 above are required only where either the Bank or Holding Company or the Principal (or both) are not incorporated in any part of the UK.

(3) Where the Principal is not a company, the provisions of the Undertaking shall (in agreement with FSA) be amended as appropriate to reflect the legal status of the Principal.

9 Exempt CAD Firms

9.1 Approved Form of Long-Term Subordinated Loan Agreement

A. Front Page

THIS AGREEMENT is made on the date set out in the Variable Terms (as set out in **Schedule 1** to this Agreement) and is to be effective on that date unless a different effective date is set out in those terms

BETWEEN -

(1) **the Lender** (as defined in the Standard Terms set out in **Schedule 2** to this Agreement), and

(2) **the Borrower** (as defined in the Standard Terms)

WHEREAS the Borrower wishes to use the Loan, or each Advance under the Facility (as those expressions are defined in the Standard Terms) in accordance with FSA rule IPRU(INV) 9.5 and has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective Subordination of the Loan and each Advance.

IT IS AGREED THAT this Agreement shall comprise the Variable Terms set out in **Schedule 1** to this Agreement and the Standard Terms set out in **Schedule 2** to this Agreement.

This Agreement is executed by the parties the day and year indicated in the Variable Terms.

Schedule 1

B. Variable Terms

1. **Date of Agreement**	
2. **Effective Date**	
3. **Lender**	
4. **Address of Lender**	
5. **Borrower**	
6. **Address of Borrower**	

7. **The Loan or Facility**

With reference to paragraph 2 of the Standard Terms,

8. **Interest**

With reference to paragraph 3 of the Standard Terms, interest shall be calculated and paid as follows -

9. **Repayment**

With reference to paragraph 4(2) of the Standard Terms and subject always to paragraphs 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms, the terms for repayment are -

Notes to paragraph 9 -

1. The repayment date for the Loan must be one or more of -
   - a date not less than five years from the date of drawdown,
   - a date not less than five years from the Borrower giving notice in writing to the Lender and the FSA, or
   - a date not less than five years from the Lender giving notice in writing to the Borrower and the FSA.
2. Where this Agreement is for a loan facility each Advance must be treated separately and have a repayment date not less than five years from the date of drawdown, or be subject to not less than five years' notice or have and be subject to both.

10. **Additional terms**
With reference to paragraph 11 of the Standard Terms, the additional terms to this Agreement are -

11. **Jurisdiction**
With reference to paragraph 16 of the Standard Terms, the person(s) indicated below is (are) appointed as agents for service of process -

(a) by the Lender -

of

(b) by the Borrower -

of

Schedule 2

C. Standard Terms

Interpretation

1 (1) In this Agreement -

"Advance" means, where this Agreement is for a loan facility, an amount drawn or to be drawn down by the Borrower or otherwise made available by the Lender under this Agreement as that amount may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

"Borrower" means the person identified as such in the Variable Terms and includes its permitted successors and assigns and, where the Borrower is a partnership, each Partner;

"Business Day" means any day except Saturday, Sunday or a bank or public holiday in England;

"Effective Date" means the date on which this Agreement is to take effect being the date of this Agreement unless otherwise stated in the Variable Terms;

"Excluded Liabilities" means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

"Facility" means the loan facility referred to in paragraph 2(2);

"Financial Resources" has the meaning given in the Financial Rules;

"Financial Resources Requirement" has the meaning given it in the Financial Rules;

"Financial Rules" means the rules in IPRU(INV) 9 in the FSA handbook;

"Insolvency" means and includes liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

"Insolvency Officer" means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower's Insolvency;

1 (1) **"Lender"** means the person identified as such in the Variable Terms and includes its permitted successors and assigns;

"Liabilities" means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);

"Loan" means the indebtedness of the Borrower to the Lender referred to in paragraph 2(1) as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

"Partner" means, where the Borrower is a partnership, each and every partner of the Borrower as a partner and as an individual (see also paragraph 8);

"Senior Liabilities" means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

"Subordinated Liabilities" means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon.

"the FSA" means The Financial Services Authority Limited whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS; and

(2) Any reference to any rules of the FSA is a reference to them as in force from time to time.

(3) Reference to any gender includes a reference to all other genders.

(4) Reference to a paragraph is to a paragraph of these Standard Terms, unless otherwise indicated.

The Loan or Facility

2 (1) Where as indicated in the Variable Terms this Agreement is for a loan, the Borrower hereby acknowledges its indebtedness to the Lender in the sum mentioned in the Variable Terms as an unsecured loan upon and subject to the terms and conditions of this Agreement.

(2) Where, as indicated in the Variable Terms this Agreement is for a loan facility -

(a) the maximum aggregate principal amount of each Advance outstanding at any time under the Facility shall not exceed the maximum amount specified in the Variable Terms or such other amount as may be agreed between the Borrower and the Lender from time to time;

(b) the Facility will be available until the last available date specified in the Variable Terms; and

2 (2) (c) any specific terms dealing with the mechanics of drawdown are contained in the Variable Terms.

(3) The Lender and the Borrower undertake to provide the FSA, immediately upon request, with details in writing of all principal and interest in respect of the Loan or each Advance outstanding for the time being and all payments of any amount made in the period specified by the FSA in the request.

Interest

3 Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan or each Advance in full, the Borrower will pay to the Lender interest on the Loan or each Advance (or on any part or parts of it or them for the time being outstanding under this Agreement) calculated and payable in the manner set out in the Variable Terms.

Repayment

4 (1) The provisions of this paragraph are subject in all respects to the provisions of paragraph 5(subordination).

(2) The terms concerning repayment are set out in the Variable Terms but are subject to paragraph 4(3).

(3) (a) Except where the FSA otherwise permits, no repayment or prepayment of the Loan or any Advance may be made, in whole or in part, before the relevant repayment date provided for in paragraph 9 of the Variable Terms.

(b) At the request of the Borrower, the FSA may permit the early repayment or prepayment of the Loan or any Advance, in whole or in part, only where, immediately after such repayment or prepayment, the Borrower's Financial Resources would be greater than 100% of its Financial Resources Requirement.

(c) Payments of interest at a rate not exceeding the rate provided for in paragraph 3 may be made without notice to or consent of the FSA, except that where -

(i) immediately after payment, the Borrower's Financial Resources would be less than or equal to 120% of its Financial Resources Requirement; or

(ii) before payment, the Insolvency of the Borrower commences,

no such payment may be made without the prior written consent of the FSA.

(4) If in respect of the Loan or any Advance default is made for a period of -

(a) seven days or more in the payment of any principal due, or

(b) 14 days or more in the payment of any interest due,

4 (4) the Lender may, at its discretion and after taking such preliminary steps or actions as may be necessary, enforce payment by instituting proceedings for the Insolvency of the Borrower after giving seven Business Day's prior written notice to the FSA of its intention to do so.

(5) Subject to (6) below, the Lender may at its discretion, subject as provided in this Agreement, institute proceedings for the Insolvency of the Borrower to enforce any obligation, condition or provision binding on the Borrower under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan or any Advance) PROVIDED THAT the Borrower shall not by virtue of the institution of any such proceedings for the Insolvency of the Borrower be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

(6) The Lender may only institute proceedings for the Insolvency of the Borrower to enforce the obligations referred to in (5) above if -

(a) a default under those obligations is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender requiring such default to be remedied;

(b) the Lender has taken all preliminary steps or actions required to be taken by it prior to the institution of such proceedings; and

(c) the Lender has given seven Business Days' prior written notice to the FSA of its intention to institute such proceedings.

(7) No remedy against the Borrower other than as specifically provided by this paragraph 4 shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower of any of its obligations under this Agreement.

Subordination

5 (1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon -

(a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that -

(i) paragraph 4(3) has been complied with; and

5 (1) (a) (ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and

(b) the Borrower being "solvent" at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be "solvent".

(2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be "solvent" if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding -

(a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and

(b) the Excluded Liabilities.

(3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.

(4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower's solvency or Insolvency.

(5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities -

(a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or

(b) where such payment is prohibited under paragraph 4(3),

the payment of such sum shall be void for all purposes.

(6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.

(7) Any sum so returned shall then be treated for the purposes of the Borrower's obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.

(8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

Representations and undertakings of Borrower

6 From and after the date of this Agreement (or the Effective Date if earlier), the Borrower shall not without the prior written consent of the FSA -

(a) secure all or any part of the Subordinated Liabilities;

(b) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;

(c) amend any document evidencing or providing for the Subordinated Liabilities;

(d) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;

(e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part thereof to the Senior Liabilities might be terminated, impaired or adversely affected; or

(f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under this Agreement to be entered into, and

other than as disclosed in writing to the FSA, the Borrower represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Representations and undertakings of Lender

7 From and after the date of this Agreement (or the Effective Date if earlier), the Lender shall not without the prior written consent of the FSA -

(a) assign, transfer, dispose of or encumber the whole or any part of the Subordinated Liabilities or purport to do so in favour of any person;

(b) purport to retain or set off at any time any amount payable by it to the Borrower against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set off in breach of this provision to the Borrower and such retention or set off shall be deemed not to have occurred;

(c) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;

(d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;

(e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected; or

7 (f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower, and

other than as disclosed in writing to the FSA, the Lender represents that it has not done so before the date of this Agreement (or the Effective Date if earlier).

Borrower being a partnership

8 Where the Borrower is a partnership -

(a) this Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present Partners or any of them or the assumption of new Partners or by a change of name PROVIDED THAT -

(i) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligations in this Agreement until the Lender and the remaining Partner(s) shall agree in writing to release a retired Partner from those obligations and the FSA has agreed in writing to the release; and

(ii) in the event of a new Partner being assumed as a partner of the Borrower the other Partners shall procure that said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum hereto as the Lender and the FSA may consider necessary;

(b) the obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally.

Partial invalidity

9 If any of the provisions of this Agreement is or becomes invalid, illegal or unenforceable under any law, the validity, legality and enforceability of the remaining provisions shall not in any way be affected or impaired.

The FSA and indemnity

10 The FSA shall not, by virtue of having rights under this Agreement, be taken to be a trustee or other fiduciary for, or have any obligations to, any person to whom some or all of the Senior Liabilities are owed. Each of the Lender and Borrower shall on demand indemnify the FSA against all claims, losses, costs, expenses and other liabilities made against or incurred by the FSA as a consequence of it having rights, or taking action under this Agreement.

Additional terms

11 Any additional terms agreed between the parties are set out in the Variable Terms provided that, if there is any inconsistency between the Variable Terms and the Standard Terms, the Standard Terms shall prevail.

Entire agreement

12 This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date hereof and not comprised in this Agreement such terms shall be of no further force and effect.

Amendments

13 Any amendments to this Agreement must be made by the prescribed Deed of Variation and any amendments made or purported to be made without the consent of the FSA shall be void. For the avoidance of doubt, nothing in this paragraph requires the FSA to be a party to this Agreement.

Notices to the FSA

14 A notice given to the FSA under this Agreement shall have no effect, and time shall not start to run in connection with that notice, until the FSA has given to the sender written confirmation of its receipt.

Law

15 This Agreement is governed by English law.

Jurisdiction

16 For the benefit of the FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the English Courts and, to the extent that it does not have a place of business within the jurisdiction, appoints the process agent specified in the Variable Terms as agent for receipt of service of process in such courts. Such jurisdiction shall be non-exclusive except to the extent that non-exclusivity prejudices the submission to the jurisdiction.

Rights of the FSA

17 Although not a party to the Agreement, the FSA may in its own right enforce a term of the Agreement to the extent that it purports to confer upon the FSA a benefit

9.3 FORM OF DEED OF TERMINATION

THIS DEED OF TERMINATION is made on the .... day of .... 20....

BETWEEN -

(1) * [insert full name of Lender] (registered in [England] number *) whose registered office is at [*if an individual or partnership* of] * ("the **Lender**").

(2) * [insert full name of Borrower] (registered in [England] number *) whose registered office is at [*if an individual or partnership* of] * ("the **Borrower**").

(3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS ("**the FSA**").

WHEREAS -

A subordinated loan agreement was entered in between the Lender (1); the Borrower (2); and the FSA (3) on [date] ("the Agreement") pursuant to which the Lender agreed to make available to the Borrower a [Loan/Facility] of up to [£]. [insert brief details of any Variations] The parties to the Agreement now wish to terminate the Agreement.

IT IS AGREED THAT -

1. The Agreement shall be deemed terminated [in accordance with its terms] with effect from [the date of this Deed of Termination/insert relevant future date]. All obligations and liabilities arising before that date shall remain continuing.

2. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

....

Signed ....
Director

Signed ....
Director/Secretary

or

Signed as a deed by
[full names of individual partners of Lender]
(as such partners and as individuals)

Signed..................................
Partner

Signed..................................
Partner/Witness

or

Signed as a deed by [full name of Lender]
(if an individual)

Signed..................................

in the presence of

Signed..................................
Witness

Executed as a deed by [full name of Borrower]

.... Signed ....
Director

Signed ....
Director/Secretary

or

Signed as a deed by [full names of individual partners of Borrower]
(as such partners and as individuals)

Signed..................................
Partner

Signed..................................
Partner/Witness

or

Signed as a deed by [full name of Borrower]
(if an individual)

Signed..................................

in the presence of

Signed...................................
Witness

The Common Seal of THE FINANCIAL SERVICES AUTHORITY LIMITED was hereunto affixed in the presence of

Signed ....
Authorised Signatory

Signed ....
Authorised Signatory

9.4 FORM OF DEED OF VARIATION

THIS DEED OF VARIATION is made on the .... day of .... 2…...

BETWEEN -

(1) * [insert full name of Lender] (registered in [England] number *) whose registered office is at [*if an individual or partnership* of] * ("the **Lender**");

(2) * [insert full name of Borrower] (registered in [England] number *) whose registered office is at [*if an individual or partnership* of] * ("the **Borrower**"); and

(3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS ("**the FSA**").

WHEREAS -

A subordinated loan agreement was entered into between the Lender (1); the Borrower (2); and the FSA (3) on [date] 199 ("the Agreement") pursuant to which the Lender agreed to make available to the Borrower a (Loan/Facility] of up to [£].

The parties to the Agreement now wish to vary the Agreement to [insert brief details].

IT IS AGREED THAT -

1. The Agreement shall be deemed varied [, in accordance with its terms,] from [the date of this Deed of Variation/insert relevant future date] so that the FSA is no longer a party to the Agreement. Any obligation owed to or by, and any requirement for any consent or permission to be given to or by, FSA shall be of no further effect. FSA is hereby released from each and every obligation owed by it under the Agreement. Although on the execution of this deed the FSA is no longer a party to the Agreement, it may in its own right enforce a term of the Agreement to the extent that it purports to confer upon the FSA a benefit.

   [insert additional clauses/details of amended clauses].

   to the extent that any term of the Agreement is inconsistent with their terms and conditions contained in the Approved Form, the terms and conditions in the Approved Form shall prevail (provided that for the purposes of this clause 1, in clauses 11 and 12 of the Approved Form, the expressions "Variable Terms" and "Agreement" shall be deemed to include references to the Agreement and this Deed.

2. All other terms and conditions of the Agreement remain unchanged.

3. This Deed is governed by English Law.

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

....

Signed ....
Director

Signed ....
Director/Secretary

or

Signed as a deed by
[full names of individual partners of Lender]
(as such partners and as individuals)

Signed...................................
Partner

Signed...................................
Partner/Witness

or

Signed as a deed by [full name of Lender]
(if an individual)

Signed...................................

in the presence of

Signed...................................
Witness

Executed as a deed by [full name of Borrower]

....

Signed ....
Director

Signed ....
Director/Secretary

or

Signed as a deed by [full names of individual

partners of Borrower]
(as such partners and as individuals)

Signed..................................
Partner

Signed..................................
Partner/Witness

or

Signed as a deed by [full name of Borrower]
(if an individual)

Signed..................................

in the presence of

Signed..................................
Witness

The Common Seal of THE FINANCIAL SERVICES AUTHORITY LIMITED was hereunto affixed in the presence of

Signed ....
Authorised Signatory

Signed ....
Authorised Signatory

9.5 FORM OF GUARANTOR UNDERTAKING

This undertaking is entered into the [ ] day of [ ] 20[ ] by

[ ] (the "Guarantor") of [ ] in favour of

The Financial Services Authority Limited ("the FSA") whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS.

WHEREAS:-

(A) By a subordinated loan agreement (the "Loan Agreement") made [of even date] between [ ] (the "Lender"), [ ] (the "Borrower") and the FSA, the Lender made available to the Borrower a loan [facility] on the terms and conditions contained in the Loan Agreement.

(B) By a guarantee (the "Guarantee") made [of even date] between the Guarantor and the Lender, the Guarantor guaranteed the obligations of the Borrower to the Lender under the Loan Agreement on the terms and conditions contained in the Guarantee.

IT IS HEREBY AGREED as follows:-

1 The Guarantor hereby undertakes to the FSA that all and any rights which the Guarantor may have against the Borrower in respect of the Guarantee (whether by subrogation or otherwise howsoever) shall be subordinated on the same terms and conditions (mutatis mutandis) set out in the Loan Agreement (as amended from time to time) and further undertakes and confirms that the Guarantor will be bound by the terms of the Loan Agreement as if the Guarantor were a party to it in place of the Lender.

2 This undertaking is governed by English law.

IN WITNESS whereof this deed has been executed by the Guarantor on the date first above written.

Executed as a Deed by
[ ]

Witness:.. ....

Witness's Name: ....

Witness's Address: ....

....

9.8 Guidance Notes on Completion of Agreements

A GENERAL

Introduction

1. These Notes are designed to accompany the Approved Forms of Subordinated Loan Agreement, each of which is in four parts: the front page, the Variable Terms in Schedule 1, the Standard Terms in Schedule 2 and the signature page. The parties will need to set out details of themselves and the transaction in the Variable Terms and complete the signature page. The front page and the Standard Terms should remain unaltered.

2. All communications with the FSA regarding the proposed Agreement should in the first instance be via the firm's inspector.

3. Firms are advised to ensure that the appropriate form of subordinated loan agreement is used (Chap 9/Chap 3). This is, of course, dependent on the firm's authorisation categorisation. Should the firm's categorisation change, this should be discussed with the firm's usual contact as it is likely that any subordinated loan agreement in place will have to be revised.

Preparation of the Agreement

4. (a) The form containing the Variable Terms may be completed or re-typed according to preference.

   (b) Rather than re-type the Standard Terms (Schedule 2), firms should simply **photocopy Schedule 2 of the FSA precedent or print it from the website and include it as part of the original Agreement**.

Financial Rules

6. Firms are referred to rule IPRU(INV) 9.5 on the use of subordinated loans, including restrictions on approved lenders, repayment provisions and gearing limits.

B NOTES ON VARIABLE TERMS

Dates

7. If the **Effective Date of the Agreement** is to be different from the Date of the Agreement, care should be taken to record this in paragraph 2. Where this is the case,

the Effective Date will normally be expected to be later than the Date of the Agreement. If the Effective Date is to be a date prior to the date of the Agreement (for example because the loan was drawn down before the Agreement was put in place), the firm will be expected to provide a reasonable explanation to the FSA as to why it was not possible to document the loan more promptly.

Addresses

8. Paragraphs 4 and 6: The address given should be the firm's registered office or equivalent.

Partnerships

9. Paragraph 5: Where the Borrower is a partnership, insert "See Additional Terms, paragraph 10( ) below" and in paragraph 10 of Schedule 1, insert the names and addresses of each of the partners.

The Loan or Facility

10. Paragraph 7: Check that paragraph 2 of the Standard Terms accurately reflects the intentions of the parties.

11. Suggested wording for a loan is:

> "This is an agreement for the Loan of £[ ]."

12. Suggested wording for a facility is:

> "This is an agreement for a Facility under which the Lender is committed to make Advances in pounds sterling to the Borrower up to a maximum amount of £[ ] until the last available date of the Facility being [................(date)].
>
> The terms (if any) agreed between the parties on the mechanics of drawdown are as follows - ". *

* For example, the parties may wish to provide that:

"Advances may be drawndown in integral multiples of £100,000.".

Interest

13. Paragraph 8: the FSA will be concerned if an excessive rate of interest compared with the market rate is charged. Broadly speaking a rate of interest will be regarded by the FSA as excessive if it is not a commercial one. Compound interest is not acceptable.

Repayment

14. Irrespective of the form of agreement being used, the specified notice period runs from the date of drawdown and, therefore, where a loan is in the form of a facility, each advance must be for a minimum of the required period.

15. Repayment clauses have given rise to confusion in the past. The wording of such clauses will differ depending on which form is being used. Sample wordings for each of these forms of agreement are set out below.

Long-term form

16 Firms are advised that for a long-term form the repayment date must be a specified date not less than 5 years from one or more of:

- the date of drawdown;
- the borrower giving notice in writing to the lender and the FSA; or
- the lender giving notice in writing to the borrower and the FSA.

17. Paragraph 9: Examples of suggested wordings for either a fixed repayment date or repayment on notice for a long-term form are as follows:

(a) "The Borrower shall repay [the Loan/each Advance made to it] on the [date which falls five years after the date] [fifth anniversary]of drawdown of the [Loan/relevant Advance]."

(b) "The Borrower shall repay [the Loan/each Advance made to it] five years after the date on which:

(a) the Borrower gives written notice to the Lender and to the FSA; or

(b) the Lender gives written notice to the Borrower and to the FSA."

Note: either (a) or (b) above by itself is sufficient.

(c) "[The Loan / Each Advance made to the Borrower] shall be repayable on the date specified by notice in writing given by the Lender to the Borrower and to the FSA or notice in writing given by the Borrower to the Lender and to the FSA, in either case that date being not less than five years after the date on which the notice is given."

Additional terms

20. Paragraph 10: Additional terms may be agreed between the borrower and lender such as those relating to -

- representations and warranties
- provision of financial and other information
- covenants
- costs and expenses
- taxes and increased costs
- mechanics of payment
- notices
- termination provisions.

However, they should not be inconsistent with the Agreement or the FSA rules. For example, any terms dealing with additional payments by the borrower (eg to compensate for taxes or increased costs) should be subject to the FSA's prior written consent. Covenants and additional representations and warranties should not be inconsistent with the existing representations and warranties in paragraphs 6 and 7 of the Standard Terms. Similarly, any notices clause should take into account paragraph 14 of the Standard Terms (notices to the FSA of no effect until receipt confirmed). Any inconsistency between the Variable Terms and the Standard Terms is resolved in favour of the Standard Terms (paragraph 11 of the Standard Terms).

21. The lender and borrower should note that the action which can be taken by the lender in response to any breach of representation, warranty or covenant by the borrower is considerably constrained by paragraphs 4 and 5 of the Standard Terms. Therefore the value to the lender of including additional representations, warranties or covenants is very limited.

22. See also note 9 above for the situation where the borrower is a partnership and notes 24 -25 below for additional terms relating to law and jurisdiction.

Law and jurisdiction

23. If the borrower or lender is resident in another jurisdiction and does not have a branch office within the United Kingdom, paragraph 11 of the Variable Terms should be completed.

24. The borrower should not be appointed agent for service of process on the lender in case a dispute arises between them.

C NOTES ON STANDARD TERMS

Representations and undertakings

25. Paragraphs 6(f) and 7(f): The guarantor or other provider of security must waive its right of subrogation against the borrower until all Senior Liabilities of the borrower have been paid in full. A form of deed for this purpose is available from the FSA.

26. On the effect of other terms relating to the subordinated liabilities not contained in this Agreement, see also paragraph 12 of the Standard Terms.

27. Paragraphs 15 and 16: See Notes 24-25 above.

D SIGNATURE PAGE

Arrangements for execution

28. **Two identical original Agreements** (i.e. the front page, the two Schedules and the signature page, each copy stapled or otherwise bound together) should be prepared for signature. Firms and lenders may use any of the execution forms set out in Notes 34-35 below.

E DEEDS OF VARIATION/ DEEDS OF TERMINATION

30. Firms are advised to ensure that the appropriate standard the FSA form is used. These forms are available from the FSA on request.

31. The recitals to the deed should refer to the amount of the loan/ each advance and where applicable, briefly summarise the effect of any previous variation of the agreement and of variation of the original agreement which is currently proposed.

32. A variation or termination of a subordinated loan agreement can only be effected by the execution of a further deed. In particular, this means that the formalities for executing a deed (see note 34-36 below) must be observed for all deeds of variation or termination and that all parties to the original agreement must also be parties to the subsequent deed of variation or termination. Only the forms set out at Notes 35(1) and (2) or 36(2) below are appropriate for execution as a deed.

33. A deed of variation will be required where the parties wish to change the terms of a subordinated loan agreement eg. where the amount of the loan or advance is to be increased. A deed of termination is needed where the parties wish to bring to terminate an agreement that is in place before it would otherwise come to an end. This could occur, for example, where the firm wants to substitute a new lender. Please note that where a subordinated loan agreement is terminated in this way, all obligations and liabilities of the parties arising before the date of termination remain in effect.

F Execution

34. In the case of English companies, reference is made to sections 36 and 36A of the Companies Act 1985 under which a company may contract

    - under its common seal
    - through any person acting under its authority, express or implied,

    and a document signed by a director and the secretary of the company or by two directors and expressed to be executed by the company as a deed has the same effect as if executed under the common seal of the company.

35. Suggested wordings for English companies are:

(1) THE COMMON SEAL OF

[ ]
was hereunto affixed
in the presence of

....
Director Director/secretary

OR

(2) EXECUTED as a deed

by
....
Director Director/secretary

(3) SIGNED for and on behalf of
[ ]

by ....

....
Authorised signatory

(4) SIGNED for and on behalf of
[ ]
by

....
Director Director/secretary

36. Suggested wording for individuals is –

(1)	SIGNED by [ ] in the presence of -	....
	Signature of witness	....
	Name of witness	....
	Address of witness	....

OR

(2)	EXECUTED as a deed by [ ] in the presence of -	....
	Signature of witness	....
	Name of witness	....
	Address of witness	....

37. In the case of overseas companies or partnerships, appropriate wording should be used. If necessary, firms should obtain legal advice from lawyers qualified in the relevant jurisdiction.

13 Personal Investment Firms (former PIA firms)

13.1 FORM OF SUBORDINATED LOAN AGREEMENT FOR PERSONAL INVESTMENT FIRMS (SEE IPRU (INV) 13)

NOTES FOR COMPLETION OF THIS DOCUMENT

This subordinated loan Agreement is to be used for injecting additional funds into a firm on a semi-permanent basis. This loan should normally be made in cash. You should speak to FSA before completing the Agreement if you intend to make the loan by a transfer or assignment of assets.

(1) *This is the standard form prescribed by FSA for long term or short term subordinated loans. A long term subordinated loan must have an original maturity of at least five years or, where it has no fixed term, be subject to five years' notice of repayment; a short term subordinated loan must have an original maturity of at least two years or, where it has no fixed term, be subject to two years' notice of repayment. Delete from the heading and from paragraph 4(2) (Repayment of the Loan) whichever period in brackets is not relevant.*

(2) In paragraph 2, you should insert the Effective Date of the Loan, that is, the date on which the Lender will make the advance, if this differs from the date of the Agreement.

*(3) Words in brackets marked with a double asterisk ** are for use where the Borrower is a partnership.*

Governing Law

Number of crosses	***Governing Law***
+	Scottish
++	Scottish or Northern Irish
+++	English or Northern Irish
++++	Northern Irish
+++++	English

*Example: Words marked ++** will be for use where the Borrower is a partnership and the Agreement is governed by either Scottish or Northern Irish law.*

(4) Words in round brackets in paragraph 10 are only required where either the Lender or Borrower (or both) is not incorporated in any part of the United Kingdom.

(5) You should speak to FSA before changing or amending this standard form (for example, by adding provisions relating to the terms of the Loan to be made to the Borrower by the Lender). FSA reserves the right to make a charge for considering any non-standard agreement.

THIS SUBORDINATED LOAN AGREEMENT IS MADE ON 20

BETWEEN:-

(1) [ ] of
[ ]
(the "Lender" which term includes its permitted successors and assigns); and

(2) [ ] of
[ ]
(the "Borrower" which term includes its permitted successors and assigns); [and
[ ] of
[ ],
[ ] of
[ ] and
[ ] of
[ ]
the individual partners of the Borrower as such partners and as individuals]

IT IS AGREED AS FOLLOWS:-

1. DEFINITIONS

In this agreement:-

"Effective Date" means the date on which this Agreement is to take effect being the date of the Agreement unless otherwise stated in paragraph 2;

"Excluded Liabilities" means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do rank junior to the Subordinated Liabilities in any Insolvency of the Borrower;

"Financial Resource Requirement" means 120 per cent. of the minimum amount of financial resources which the Borrower is required by FSA to maintain at any particular time in compliance with the Rules in chapter 13 of the Interim Prudential Sourcebook ("IPRU (INV)") and any provisions amending or replacing them;

"Insolvency" means and includes liquidation, winding up, bankruptcy, sequestration, administration or dissolution (whichever term may apply to the Borrower) or the equivalent in any other jurisdiction to which the Borrower may be subject;

"Insolvency Officer" means and includes any person duly appointed to administer and distribute assets of the Borrower in the course of the Borrower's Insolvency;

"Liabilities" means all present and future sums, liabilities and obligations payable or owing by the Borrower [or any Partner **] (whether actual or contingent, jointly or severally or otherwise howsoever);

"Loan" means the indebtedness of the Borrower to the Lender referred to in paragraph 2 as that indebtedness may be reduced from time to time by any repayment or prepayment permitted under this Agreement;

[**"Partner"** means an individual partner of the Borrower**];

"Rules" means the Rules of FSA from time to time in force;

"Senior Liabilities" means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;

"Subordinated Liabilities" means all Liabilities to the Lender in respect of the Loan and all interest payable thereon.

2. LOAN

The Borrower hereby acknowledges its indebtedness to the Lender in the sum of [ ] as an unsecured loan upon and subject to the terms and conditions of this Agreement.

> *[**Note:** This paragraph may be adapted to reflect the actual basis on which the unsecured Loan arises and, if applicable, how it is to be drawn down. **Members are requested to specify clearly the Effective Date of the Loan if it will differ from the date of the Agreement.]***

3. INTEREST

Subject to the provisions of paragraphs 4 and 5, until repayment of the Loan in full the Borrower will [the Borrower and the partners hereby bind and oblige themselves jointly and severally to +**] pay to the Lender interest on the Loan or on any part or parts of it for the time being remaining due under this Agreement such interest to be calculated and to be payable as provided below.

> *[**Enter details** of interest calculations and manner and time of payments. The rate of interest is not to exceed an annual rate of five per cent. above the London Inter-Bank Offered Rate for deposits of the currency in question for the relevant interest period or (where a fixed rate of interest is charged) give per cent. per annum above such rate at the date the Loan is first taken out.]*

4. REPAYMENT OF THE LOAN

(1) The provisions of this paragraph are subject to the provisions of paragraph 5.

(2) Except where the Borrower has obtained FSA's prior written consent and that consent has not been withdrawn, **no** repayment or prepayment of the Loan shall be made, in whole or in part, earlier than a date:

(a) not less than [five years] [two years] from the date on which the Loan was first made; or

(b) not less than [five years] [two years] from the date on which the Borrower gave notice in writing to the Lender and FSA, or

(c) not less than [five years] [two years] from the date on which the Lender gave notice in writing to the Borrower and FSA.

(3) If default is made for a period of 7 days or more in the payment of any principal due in respect of the Loan or for a period of 14 days or more in the payment of any interest due in respect of the Loan the Lender may, in order to enforce payment, at its discretion and after taking such preliminary steps as may be necessary and after notifying FSA, institute proceedings for the Insolvency of the Borrower [or the Insolvency of all or any Partners**]. If an order is made or an effective resolution is passed for the winding up of the Borrower, the Loan shall become repayable.

(4) The Lender may at its discretion, subject to the provisions which follow, institute proceedings for the Insolvency of the Borrower [or the Insolvency of all or any Partners**] to enforce any obligation, condition or provision binding on the Borrower [or on all or any Partners**+] under this Agreement (other than any obligation for the payment of principal moneys or interest in respect of the Loan) provided that the borrower [or any Partner**] shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it. The Lender may only institute such proceedings to enforce the obligations referred to above if (i) the default is not remedied to the satisfaction of the Lender within 60 days after notice of such default is not remedied to the satisfaction of the Lender within 60 days after notice of such default has been given to the Borrower by the Lender (with a copy to FSA) requiring the default to be remedied and (ii) the Lender has taken all preliminary steps required to be taken by it prior to the institution of such proceedings.

(5) No remedy against the Borrower [or any Partner**] other than as specifically provided by this paragraph shall be available to the Lender whether for the recovery of amounts owing under this Agreement or in respect of any breach by the Borrower [or any Partners**] of any of its obligations under this Agreement.

5. SUBORDINATION

(1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount whether principal (by way of repayment or prepayment), interest or otherwise, of the Subordinated Liabilities is conditional upon:-

(a) (if an order has **not** been made or an effective resolution passed for the Insolvency of the Borrower) the Borrower being in compliance with its Financial Resource Requirement prevailing at the time of payment by the Borrower; and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that repayment under paragraph 4(2) above is permitted and the Borrower could make such payment and still be in compliance with its Financial Resource Requirement immediately thereafter; and

(b) (if an order has been made or an effective resolution has been passed for the Insolvency of the Borrower [or if the Borrower shall be dissolved**]) the Borrower being solvent at the time of payment by the Borrower; and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be solvent immediately thereafter. For the purposes of this sub-paragraph, the Borrower shall be solvent if it is able to pay its debts in full and in determining whether the Borrower is solvent for the purposes of this sub-paragraph there shall be disregarded obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower.

(2) (a) No payment of the Subordinated Liabilities (other than in respect of interest) shall be made at any time under sub-paragraph (1) above unless the Borrower has obtained FSA's prior written consent to such payment and that consent has not been withdrawn.

(b) The Borrower shall give or ensure that there are given to FSA such information and auditor's certificate in relation to the proposed payment as FSA may require.

(3) Payments of interest at a rate not exceeding the rate provided in paragraph 3 may be made to the extent permitted by sub-paragraph (1) above without prior notification to FSA.

(4) For the purposes of sub-paragraph (1)(b) above a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to FSA, shall in the absence of proven error be treated and accepted by FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower's solvency.

(5) If the Lender shall receive from the Borrower [or any Partner**] payment of any sum in respect of the Subordinated Liabilities where repayment is prohibited under paragraph 4(2) or when any of the terms and conditions referred to in sub-paragraphs (1) or (2) above is not satisfied the payment of such sum shall be void for all purposes and [any such sum shall be received by the Lender upon trust to return the same to the Borrower+++] [the Lender shall at any time thereafter be bound to return such sum to the Borrower, or, as the case may be, its Insolvency Officer+] (and any sum so returned shall then be treated for the purposes of the Borrower's obligations under this Agreement as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower). A request to the Lender for return of any sum under the foregoing provisions of this sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.

6. UNDERTAKINGS OF BORROWER

From and after the date of this Agreement (or the Effective Date if earlier), the Borrower will not [and no Partner will**] without the prior written consent of FSA:-

(1) secure all or any part of the Subordinated Liabilities;

(2) redeem, purchase or otherwise acquire any of the Subordinated Liabilities;

(3) amend any document evidencing or providing for the Subordinated Liabilities;

(4) repay any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;

(5) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected.

7. DOCUMENTATION

This Agreement forms the entire agreement as to the Subordinated Liabilities. If there are any other terms relating to the Subordinated Liabilities existing at the date of this Agreement and not comprised in it such terms shall be of no further force and effect. No variation of or amendment to this Agreement shall be of any effect unless it is in writing signed by all the parties. Any amendment to this Agreement made or purported to be made without the consent of FSA shall be void. For the avoidance of doubt, nothing in this paragraph requires the FSA to be a party to this agreement.

8. UNDERTAKINGS OF LENDER

The Lender will not without the prior written consent of FSA:-

(1) assign or purport to assign to any person the whole or any part of the Subordinated Liabilities;

(2) purport to retain or set-off at any time any amount payable by it to the Borrower [or any Partner**] against any amount of the Subordinated Liabilities except to the extent that payment of such amount of the Subordinated Liabilities would be permitted at such time by this Agreement, and the Lender shall immediately pay an amount equal to any retention or set-off in breach of this provision to the Borrower and such retention or set-off shall be deemed not to have occurred;

(3) amend or waive the terms of any document evidencing or providing for the Subordinated Liabilities;

(4) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;

(5) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected;

(6) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities, and the Lender shall, upon obtaining security, guarantee or indemnity in breach of this undertaking, hold the same [on trust for +++] [as agent of and for the benefit of ++] the Borrower.

*[**Note:** Before giving its consent to a transaction falling under paragraph 8(6), FSA will need to be satisfied that the provider of security has waived his rights of subrogation against the Borrower until all Senior Liabilities of the Borrower have been paid in full.]*

9. **[**This Agreement shall subsist in full force and effect notwithstanding any change which may take place from time to time in the constitution or title of the Borrower by the retirement of the present partners or [either] [any] of them or the assumption of new Partners or by a change of name it being provided that:-

(a) a retired Partner shall continue to be liable for the payment of all sums due under this Agreement and implementation of all other obligation contained in it until such time as the Lender and the remaining Partner[s] shall agree in writing to release a retired Partner from such obligations and FSA has given its written consent to the release; and

(b) in the event of a new partner being assumed as a Partner of the Borrower the other partners shall procure that the said assumed Partner shall become bound to the Lender as a party to this Agreement and shall execute such addendum to it as the Lender and FSA may consider necessary.

The obligations and undertakings of the Borrower under this Agreement shall bind the Borrower and the Partners jointly and severally. **+]

10. LAW [AND JURISDICTION]

(1) This Agreement is governed by [English law +++++] [the law of Scotland +] [the law of Northern Ireland ++++] and, for the benefit of FSA solely, each of the Borrower and the Lender irrevocably submits to the jurisdiction of the [English Courts +++++] [Court of Session, Scotland +] [Northern Irish Courts ++++] (and, to the extent that it does not have a place of business within this jurisdiction, appoints [*name and address of agent for service]* as agent for receipt of service of process in such courts). Such jurisdiction shall be non-exclusive except to the extent that such non-exclusivity prejudices the submission to such jurisdiction.

(2) Although not a party to the agreement, the FSA may in its own right enforce a term of the agreement to the extent that it purports to confer upon the FSA a benefit.

IN WITNESS whereof the parties hereto have duly executed this Agreement as a Deed the day and year first above written.

(EXECUTED AS A DEED and DELIVERED by
(the Lender
(and signed by:

Director

Director/Secretary

or

(SIGNED and DELIVERED as a DEED
by the individual partners of the Lender
(as such partners and as individuals
(in the presence of:

or

SIGNED and DELIVERED as a DEED by
the Lender *(if an individual)*
in the presence of:

(EXECUTED AS A DEED and DELIVERED by
(the Borrower
(and signed by:

Director

Director/Secretary

or

(SIGNED and DELIVERED as a DEED
(by the individual partners or the Borrower
(as such partners and as individuals
(in the presence of:

or

SIGNED and DELIVERED as a DEED by
the Borrower *(if an individual)*
in the presence of:

Dated this day of 20

BETWEEN

the Lender

and

the Borrower

SUBORDINATED LOAN AGREEMENT