Chapter 7

Prudential requirements and professional indemnity insurance

7

7.2 Prudential requirements

General solvency requirement

7.2.1 R A *firm* must ensure that it is able at all times to meet its liabilities as they fall due.

General prudential resources requirement

7.2.2 R A *firm* must ensure at all times that its prudential resources, calculated in accordance with CMCOB 7.3, are not less than its prudential resources requirement.

Prudential resources: general accounting principles

7.2.3 R A *firm* must recognise an asset or liability, and measure its amount, in accordance with the relevant accounting principles applicable to it for the purpose of preparing its *annual financial statements* unless a *rule* requires otherwise.

Prudential resources requirement: firms carrying on other regulated activities

7.2.4 R The prudential resources requirement for a firm carrying on a *regulated activity* in addition to those covered by this chapter, is the higher of:

(1) the requirement which is applied by this chapter; and

(2) the prudential resources requirement or *capital resources requirement* which is applied by another *rule* or requirement to the *firm*.

Classification of firms for prudential resources purposes

7.2.5 R (1) For the purposes of this chapter, a *firm* which carries on any *regulated claims management activities* other than *seeking out, referrals and identification of claims or potential claims* is:

(a) a "Class 1 firm" if its total income in the year ending on its most recent *accounting reference date* is not less than £1million; and

(b) a "Class 2 firm" if its total income in the year ending on its most recent *accounting reference date* is less than £1million.

(2) A *firm* which carries on no *regulated claims management activities* other than *seeking out, referrals and identification of claims or*

potential claims is neither a Class 1 firm nor a Class 2 firm, and its prudential resources requirement is specified in CMCOB 7.2.10R.

(3) For the purposes of this chapter, total income only includes income relating to the part of the business which is involved in carrying on *regulated claims management activities* and *ancillary activities*.

(4) Where the *firm* has not yet started to trade, total income is to be calculated based on forecast income included in the budget for the first twelve *months*' trading, as submitted with the *firm's* application for *authorisation*.

Prudential resources requirement for a Class 1 firm

7.2.6 R Subject to CMCOB 7.2.10R, the prudential resources requirement for a Class 1 firm is:

(1) the higher of:

£10,000; and

the *firm's* overheads requirement (see CMCOB 7.2.8R); plus

(2) if the *firm* has held *client money* at any time in the last 12 *months*, the client money requirement (see CMCOB 7.2.9R).

Prudential resources requirement for a Class 2 firm

7.2.7 R Subject to CMCOB 7.2.10R, the prudential resources requirement for a Class 2 firm is:

(1) the higher of:

(a) £5,000; and

(b) the *firm's* overheads requirement (see CMCOB 7.2.8R); plus

(2) if the *firm* has held *client money* at any time in the last 12 *months*, the client money requirement (see CMCOB 7.2.9R).

The overheads requirement

7.2.8 R (1) A *firm's* overheads requirement is an amount that is equal to one sixth of its overheads expenditure.

(2) For the purposes of (1), a *firm's* overheads expenditure is to be calculated as follows:

(a) the *firm's* total expenditure in the period of 12 *months* ending on its most recent *accounting reference date*; less

(b) the total of the following items (if they are included in such expenditure) in that period:

(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;

(ii) other appropriations of profits and other variable *remuneration*, except to the extent that they are guaranteed;

(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) 20% of total marketing expenditure; and

(viii) other variable expenditure.

(3) Where the *firm's* total expenditure in the year ending on its *accounting reference date* was incurred in a period of less than twelve *months*, the items in (2)(a) and (2)(b) are to be calculated on a pro-rated basis to produce an equivalent annual amount.

(4) Where the *firm* has not yet started to trade, the items in (2)(a) and (2)(b) are to be calculated based on forecast expenditure included in the budget for the first twelve *months'* trading, as submitted with the *firm's* application for *authorisation*.

(5) In (2)(b)(vii) total marketing expenditure means spending in the twelve *months* ending on the *firm's* most recent *accounting reference date* on, or relating to:

(a) advertising across different media channels;

(b) digital marketing;

(c) publicity expenses;

(d) advertising agency fees;

(e) public relations consultancy fees;

(f) expenses for promotions offered in connection with services provided by the *firm*;

(g) market research and customer surveys;

(h) publications including printed promotional material such as brochures and leaflets, and the *firm's annual report*;

(i) sponsorships; and

(j) gifts to *customers*.

(6) Where, during a period of six *months*, a *firm's* overheads expenditure, calculated according to (2), decreases by 20% or more relative to the overheads expenditure calculated at the last *accounting reference date*, the *firm* may recalculate its overheads requirement and therefore its prudential resources requirement accordingly.

(7) For the purpose of the recalculation in (6), the *firm's* overheads requirement shall be equal to one third of:

(a) the *firm's* total expenditure in the period of 6 *months* ending on the date it changes its prudential resources requirement; less

(b) the total of the items in (2)(b) (if they are included in such expenditure) in that six *month* period.

(9) A *firm* must notify the *FCA* of any change in its prudential resources requirement within 14 *days* of that change.

The client money requirement

7.2.9 R The *client money* requirement is £20,000.

Prudential requirement for lead generators

7.2.10 R If a *lead generator* holds *client money*, the prudential requirement for the *firm* is the client money requirement (see CMCOB 7.2.9R).