Chapter 10

Prudential rules for debt management firms

10.1 Application and purpose

Application

10.1.1 R This chapter applies to:

(1) a *debt management firm*; and

(2) a *not-for-profit debt advice body* that, at any point in the last 12 *months*, has held £1 million or more in *client money* or as the case may be, projects that it will hold £1 million or more in *client money* at any point in the next 12 *months*.

Application: professional firms

10.1.2 R (1) This chapter does not apply to an *authorised professional firm*:

(a) whose main business is the practice of its profession; and

(b) whose *regulated activities* covered by this chapter are incidental to its main business.

(2) A *firm's* main business is the practice of its profession if 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).

(3) Professional fees are fees, commissions and other receipts receivable in respect of legal, accountancy, conveyancing and surveying services provided to clients but excluding any items receivable in respect of *regulated activities*.

Purpose

10.1.3 G This chapter builds on the *threshold condition* referred to at COND 2.4 (Appropriate resources) by providing that a *firm* must meet, on a continuing basis, a basic solvency requirement. This chapter also builds on *Principle* 4 which requires a *firm* to maintain adequate financial resources by setting out prudential requirements for a *firm* according to what type of *firm* it is.

10.1.4 G Prudential standards have an important role in minimising the risk of harm to *customers* by ensuring that a *firm* behaves prudently in monitoring and managing business and financial risks.

10.1.5 G More generally, having adequate prudential resources gives the *firm* a degree of resilience and some indication to *customers* of creditworthiness, substance and the commitment of its owners. Prudential standards aim to ensure that a *firm* has prudential resources which can provide cover for operational and compliance failures and pay redress, as well as reducing the possibility of a shortfall in funds and providing a cushion against disruption if the *firm* ceases to trade.

10.1.6 R A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 138D of the *Act* (and each of those *rules* is specified under section 138D(3) of the *Act* as a provision giving rise to no such right of action).

10.2 Prudential resources requirements

General solvency requirement

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

General prudential resource requirement

10.2.2 R A *firm* must ensure that, at all times, its prudential resources are not less than its prudential resources requirement.

Prudential resources: relevant accounting principles

10.2.3 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

10.2.4 R The prudential resources requirement for a *firm* carrying on a *regulated activity* or activities 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 which is applied by another *rule* or requirement to the *firm*.

Prudential resources requirement

10.2.5 R On its *accounting reference date* in each year, a *firm* must calculate:

(1) the total value of its *relevant debts under management* outstanding on that date; and

(2) the sum of:

(a) 0.25% of the first £5 million of that total value;

(b) 0.15% of the next £95 million of that total value; and

(c) 0.05% of any remaining total value.

10.2.6 R The total value of a *firm's relevant debts under management* outstanding referred to in CONC 10.2.5 R (1) is the sum of all the *firm's customers' relevant debts under management*.

10.2.7 G The definition of *relevant debts under management* refers to a debt due under a *credit agreement* or a *consumer hire agreement* in relation to which the *firm* is carrying on *debt adjusting* or an activity connected to that activity. The reference to "debt due" covers not only amounts that are payable at the time the prudential resources requirement is calculated but also amounts the *borrower* or *hirer* is presently obliged to pay under the *credit agreement* or the *consumer hire agreement* in the future.

10.2.8 R The prudential resources requirement for a *firm* to which this chapter applies is the higher of:

(1) £5,000; or

(2) the sum calculated in accordance with CONC 10.2.5 R (2);

for the period until (subject to CONC 10.2.13 R) its next *accounting reference date*.

10.2.9 R To determine a *firm's* prudential resources requirement for the period beginning on the date on which it obtains *Part 4A permission* and ending on the day before its next *accounting reference date*, the *firm* must carry out the calculation in CONC 10.2.5 R (2) on the basis of the total value of *relevant debts under management* the *firm* projects will be outstanding on the day before its next *accounting reference date*.

What is not included as relevant debts under management

10.2.10 G Activities carried on by a *person* acting as an insolvency practitioner (within section 388 of the Insolvency Act 1986 or, as the case may be, article 3 of the Insolvency (Northern Ireland) Order 1989) or by a *person* acting in reasonable contemplation of that *person's* appointment as an insolvency practitioner are excluded from the *regulated activity* of *debt adjusting*. A debt in relation to which a *person* is acting in such a capacity is, therefore, excluded from the calculation of its *relevant debts under management* (but a debt in relation to which the same *person* is not acting in such capacity and is carrying on *debt-adjusting* is included in the calculation).

Determining the prudential resources requirement

10.2.11 G If a *firm* has 1000 *relevant debts under management* and each of those debts is £10,000, the total value of the *firm's relevant debts under management* is £10,000,000. If the *firm* does not carry on any other *regulated activity* to which another higher prudential resources requirement applies, its prudential resources requirement is £20,000. This is calculated as follows:

(1) 0.25% x £5,000,000 = £12,500; and

(2) 0.15% x £5,000,000 = £7,500.

10.2.12 G If during the following year 20% (£200) of each *relevant debt under management* is paid off by the *borrower* or *hirer* leaving an outstanding balance of £800 on each *relevant debt under management*,and during that year the *firm* does not carry on *debt adjusting* in relation to any further debts due under *credit agreements* or *consumer hire agreements*, the total value of the *firm*'s *relevant debt under management* is £8,000,000. If the *firm* does not carry on any other *regulated activity* to which another higher prudential resources requirement applies, its prudential resources requirement is £17,000. This is calculated as follows:

(1) 0.25% x £5,000,000 = £12,500; and

(2) 0.15% x £3,000.000 = £4,500.

Recalculating the prudential resources requirement

10.2.13 R If a *firm* experiences a greater than 15% increase in the total value of its *relevant debts under management* compared to the value used in its last prudential resources requirement calculation, it must recalculate its prudential resources requirement using the new total value of its *relevant debts under management*.

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

10.3 Calculation of prudential resources

10.3.1 R

(1) A *firm* must calculate its prudential resources only from the items which are eligible to contribute to a *firm*'s prudential resources (see CONC 10.3.2 R).

(2) In arriving at its calculation of its prudential resources a *firm* must deduct certain items (see CONC 10.3.3 R).

10.3.2 R

Table: Items which are eligible to contribute to the prudential resources of a firm

	Item	Additional explanation
1	*Share* capital	This must be fully paid and may include: (1) ordinary *share* capital; or (2) preference *share* capital (excluding preference *shares* redeemable by shareholders within two years).
2	Capital other than *share* capital (for example, the capital of a *sole trader*, *partnership* or *limited liability partnership*)	The capital of a *sole trader* is the net balance on the *firm*'s capital account and current account. The capital of a *partnership* is the capital made up of the *partners*': (1) capital account, that is the account: (a) into which capital contributed by the *partners* is paid; and (b) from which, under the terms of the *partnership* agreement, an amount representing capital may be withdrawn by a *partner* only if: (i) he ceases to be a *partner* and an equal amount is transferred to another such account by his former *partners* or any *person* replacing him as their *partner*; or (ii) he ceases to be a partner and an equal amount is transferred to another such account by his former partners or any person replacing him as their partner; or (iii) the partnership is otherwise dissolved or wound up; and (2) current accounts according to the most recent financial statement. For the purpose of the calculation of capital resources in respect of a *defined benefit occupational pension scheme*:

		(1) a *firm* must derecognise any *defined benefit asset*; (2) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*, provided that the election is applied consistently in respect of any one financial year.
3	Reserves (Note 1)	These are, subject to Note 1, the audited accumulated profits retained by the *firm* (after deduction of tax, dividends and proprietors' or *partners*' drawings) and other reserves created by appropriations of share premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a *parent undertaking*. For the purposes of calculating capital resources, a *firm* must make the following adjustments to its reserves, where appropriate: (1) a *firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on debt instruments held, or formerly held, in the available-for-sale financial assets category; (2) 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; (3) in respect of a *defined benefit occupational pension scheme*: (a) a *firm* must derecognise any *defined benefit asset*; (b) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*, provided that the election is applied consistently in respect of any one financial year.
4	Interim net profits (Note 1)	If a *firm* seeks to include interim net profits in the calculation of its capital resources, the profits have, subject to Note 1, to be verified by the *firm's* external auditor, net of tax, anticipated dividends or proprietors' drawings and other appropriations.
5	Revaluation reserves	
6	Subordinated loans/debt	Subordinated loans/debts must be included in capital on the basis of the provisions in this chapter that apply to subordinated loans/debts.

Note:

1 Reserves must be audited and interim net profits, general and collective provisions 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.

10.3.3 R Table: Items which must be deducted in arriving at prudential resources

1	*Investments* in own *shares*
2	*Investments* in *subsidiaries* (Note 1)
3	Intangible assets (Note 2)

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4	Interim net losses (Note 3)
5	Excess of drawings over profits for a *sole trader* or a *partnership* (Note 3)
Notes	1 *Investments* in *subsidiaries* are the full balance sheet value. 2 Intangible assets are the full balance sheet value of goodwill, capitalised development costs, brand names, trademarks and similar rights and licences. 3 The interim net losses in row 4, and the excess of drawings in row 5, are in relation to the period following the date as at which the capital resources are being computed.

[**Note:** Until 31 March 2017, transitional provisions apply to CONC 10.3.3 R: see CONC TP 5.1]

Subordinated loans/debt

10.3.4 R A subordinated loan/debt must not form part of the prudential resources of the *firm* unless it meets the following conditions:

(1) it has an original maturity of:

(a) at least five years; or

(b) it is subject to five years' notice of repayment;

(2) the claims of the subordinated creditors must rank behind those of all unsubordinated creditors;

(3) the only events of default must be non-payment of any interest or principal under the debt agreement or the winding up of the *firm*;

(4) the remedies available to the subordinated creditor in the event of non-payment or other default in respect of the subordinated loan/debt must be limited to petitioning for the winding up of the *firm* or proving the debt and claiming in the liquidation of the *firm*;

(5) the subordinated loan/debt must not become due and payable before its stated final maturity date, except on an event of default complying with (3);

(6) the agreement and the debt are governed by the law of England and Wales, or of Scotland or of Northern Ireland;

(7) to the fullest extent permitted under the rules of the relevant jurisdiction, creditors must waive their right to set off amounts they owe the *firm* against subordinated amounts owed to them by the *firm*;

(8) the terms of the subordinated loan/debt must be set out in a written agreement that contains terms that provide for the conditions set out in this *rule*; and

(9) the loan/debt must be unsecured and fully paid up.

10.3.5 R When calculating its prudential resources, the *firm* must exclude any amount by which the aggregate amount of its subordinated loans/debts exceeds the amount calculated as follows:

a - b

where:

a	=	Items 1 - 5 in the Table of items which are eligible to contribute to a *firm's* prudential resources (see CONC 10.3.2 R)
b	=	Items 1 - 5 in the Table of items which must be deducted in arriving at a *firm's* prudential resources (see CONC 10.3.3 R)

[**Note:** Until 31 March 2017, transitional provisions apply to CONC 10.3.5 R: see CONC TP 5.2]

10.3.6 G CONC 10.3.5 R can be illustrated by the examples set out below:

(1) Share Capital	£20,000
Reserves	£30,000
Subordinated loans/debts	£10,000
Intangible assets	£10,000

As subordinated loans/debts (£10,000) are less than the total of share capital + reserves - intangible assets (£40,000) the *firm* need not exclude any of its subordinated loans/debts pursuant to CONC 10.3.5 R. Therefore total prudential resources will be £50,000.

(2) Share Capital	£20,000
Reserves	£30,000
Subordinated loans/debts	£60,000
Intangible assets	£10,000

As subordinated loans/debts (£60,000) exceed the total of share capital + reserves - intangible assets (£40,000) by £20,000, the *firm* should exclude £20,000 of its subordinated loans/debts when calculating its prudential resources. Therefore total prudential resources will be £80,000.

[**Note:** Until 31 March 2017, transitional provisions apply to CONC 10.3.6 G: see CONC TP 5.3]