Chapter 12

Financial resources requirements for operators of electronic systems in relation to lending.

12.1 APPLICATION AND PURPOSE

Application

12.1.1 R This chapter applies to an *operator of an electronic system in relation to lending*.

12.1.2 G This chapter amplifies the *threshold condition* 2D (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 appropriate requirements for a *firm* according to what type of *firm* it is.

12.1.3 G Prudential standards have an important role in minimising the risk of harm to consumers by requiring a *firm* to behave prudently in monitoring and managing business and financial risks.

12.1.4 G More generally, having adequate **financial resources** gives the *firm* a degree of resilience and some indication to consumers of creditworthiness, substance and the commitment of its owners. The *rules* in this chapter aim to ensure that a *firm* has **financial 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.

Relevant accounting principles

12.1.5 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.

Actions for damages

12.1.6 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).

Interpretation

12.1.7 R The definitions in the glossary at IPRU-INV 12 Appendix 1 apply to terms shown in **bold** type this chapter. Where the term is italicised, the *FCA Handbook Glossary* definition applies.

12.2 FINANCIAL RESOURCES REQUIREMENTS

General solvency requirement

12.2.1 R A *firm* must at all times be able to meet its liabilities as they fall due.

General financial resource requirement

12.2.2 R A *firm* must ensure that at all times its **financial resources** are not less than its **financial resources requirement**.

Financial resources requirement: firms carrying on other regulated activities

12.2.3 R The **financial resources requirement** for a *firm* carrying on one or more regulated activities in addition to operating an electronic system in relation to lending, is the higher of:

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

(2) the financial resources or own funds requirement which is applied by another *rule* or by directly applicable legislation of the *UK* to the *firm.*

Financial resources requirement

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

(1) the total value of *loaned funds* outstanding on that date; and

(2) the sum of:

(a) 0.2% of the first £50 million of that total value;

(b) 0.15% of the next £200 million of that total value;

(c) 0.1% of the next £250 million of that total value; and

(d) 0.05% of any remaining total value.

12.2.5 R The total value of *loaned funds* outstanding is the total amount of funds that are currently being provided to borrowers under *P2P agreements* through an *operator of an electronic system in relation to lending*.

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

(1) £50,000; and

(2) the sum calculated in accordance with IPRU-INV 12.2.4R(2) for the period until (subject to IPRU-INV 12.2.9R) its next *accounting reference date*.

12.2.7 R To determine a *firm's* **financial resources requirement** for the period beginning on the date on which it obtains a *Part 4A permission* and ending on the *day* before its next *accounting reference date*, the *firm* must carry out the calculation in IPRU-INV 12.2.4R(2) on the basis of the total value of *loaned funds* the *firm* projects will be outstanding on the *day* before its next *accounting reference date*.

Determining the financial resources requirement

12.2.8 G If the *firm* has 30,000 individuals each lending £100,000, the total value of the *firm's loaned funds* outstanding is £3,000,000,000. If the *firm* does not carry on any other *regulated activity* to which another higher financial resources or own funds requirement applies, its **financial resources requirement** is £1,900,000. This is calculated as follows:

(1) 0.2% x £50,000,000 = £100,000;

(2) 0.15% x £200,000,000 = £300,000;

(3) 0.1% x £250,000,000 = £250,000;

(4) 0.05% x £2,500,000,000 = £1,250,000.

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Recalculating the financial resources requirement

12.2.9 R If the firm experiences a greater than 25% increase in the total value of loaned funds outstanding compared to the value used in its last **financial resources requirement** calculation, it must recalculate its **financial resources requirement** using the higher total value of loaned funds outstanding.

12.2.10 R A firm must notify the FCA of any change, or any likely change, in its **financial resources requirement** within 14 days of that change, or it becoming aware that the change is likely, whichever is the earlier.

12.3 CALCULATION OF FINANCIAL RESOURCES

12.3.1 R

(1) A firm must at all times have available the amount and type of **financial resources** required by this chapter (see IPRU-INV 12.3.2R).

(2) In arriving at its calculation of its **financial resources**, a firm must deduct certain items (see IPRU-INV 12.3.3R).

12.3.2 R

Table: Items which are eligible to contribute to the financial 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

	Item	Additional explanation
		(ii) 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 **financial 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 **financial 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.

	Item	Additional explanation
4.	Interim net profits (Note 1)	If a *firm* seeks to include interim net profits in the calculation of its **financial 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/debt must be included in **financial resources** on the basis of the provisions in this chapter that apply to subordinated loans/debt.
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.	

12.3.3 R Table: Items which must be deducted in arriving at financial resources

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

Subordinated loans/debt

12.3.4 R A subordinated loan/debt must not form part of the **financial 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* and such event of default must not prejudice the subordination in (2);

(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.

12.3.5 R When calculating its **financial 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* **financial resources** (see IPRU-INV 12.3.2R)
b	=	Items 1- 5 in the table of items which must be deducted from a *firm's* **financial resources** (see IPRU-INV 12.3.3R)

12.3.6 G IPRU-INV 12.3.5R can be illustrated as follows:

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 IPRU-INV 12.3.5R. Therefore, total **financial resources** will be £50,000.

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 **financial resources**. Therefore, total **financial resources** will be £80,000.

12.4 NOTIFICATION REQUIREMENTS

12.4.1 G

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
IPRU-INV 12.2.10R	A change or likely change, in a *firm's* **financial resources requirement**	The **financial resources requirement** as re-calculated	A greater than 25% increase in the *firm's* total value of the amount of *loaned funds* outstanding compared to the value used in its last **financial resources requirement** calculation	Within 14 *days* of the trigger event