SUP 16 Ann 11G: Guidance notes on completion of securities and futures firms' reporting forms

1. Standard reporting statement for securities and futures firms which are ISD firms

2. Consolidated reporting statement for securities and futures firms

3. Standard reporting statement for securities and futures firms which are not ISD firms

4. Large exposures monitoring quarterly returns

GUIDANCE NOTES:- STANDARD REPORTING STATEMENT FOR SECURITIES AND FUTURES FIRMS WHICH ARE ISD FIRMS

INTRODUCTION

This guidance has been prepared to assist firms in completing the monthly, quarterly and annual reporting statements in accordance with SUP 16.7.25R to SUP 16.7.27R and SUP 16 Ann10R. Guidance given does not override the rules themselves.

A firm must submit its reporting statement to the FSA by the due date in accordance SUP 16.7.25R to SUP 16.7.27R.

Self-generated computer statement

A firm which has obtained a waiver from electronic reporting may file this reporting statement using a self-generated computer form if such a form is identical in its layout to the standard reporting statement. Application for a waiver must be made in accordance with SUP 8.

Declaration

A valid submission of the standard reporting statement must be signed by two authorised signatories, except where the firm is a sole trader. (SUP 16.7.33R)A declaration should not be made lightly. The FSA will take a very serious view of a declaration that subsequently proves to be false or negligent and this may result in disciplinary action.

The FSA must be notified as soon as a firm has reason to believe that the standard reporting statement previously submitted was or has become misleading in any material respect (SUP 15.6.4R).

Categories of firms

Category D firms are required to complete all the sections of the standard reporting statement except the large exposures sections, and submit it on an annual and quarterly basis in accordance with SUP 16.7.27R. Category C firms are required to complete all the sections of the standard reporting statement and submit it on a quarterly basis in accordance with SUP 16.7.27R). Category A and B firms are required to complete all the sections of the standard reporting statement and submit it on an annual and monthly basis in accordance with SUP 16.7.25R.

Some pertinent rules and guidance

Keeping of records

A firm must be able to demonstrate compliance with the relevant financial resources requirements and should be able to prepare, within a reasonable time, this reporting statement as at the close of business of any date. The audit trail, records, working papers and schedules supporting the production of this reporting statement must be retained for six years, maintained and secured in an orderly manner so as to permit ready access to any particular record required under SUP 2.

IPRU(INV) 10-11R Reconciliation of balances

A firm must perform reconciliations as frequently as is necessary for the volume of transactions on the accounts, and in any event, not less than once a month for derivatives balances and positions, and once a year for securities balances and positions.

Notification

Inclusion or disclosure of an item in the standard reporting statement is not a substitute for notification required by IPRU(INV) 10-32R and SUP15. A firm must confirm in writing any verbal notification effected under these rules. A firm must be familiar with all the notification requirements, and the following are worthy of further mention:

SUP 15.6.4R Misleading information supplied to the FSA .

SUP 16.3.17R Changes in reporting dates.

SUP 3.7.2G Qualification of an audit report.

IPRU(INV) 10-32R(2) Defaults on repurchase type transactions and large exposure notifications.

SUP 16 Ann 10R Agreement with records

The reporting statement must agree with the books and records of the *firm*, and give a true and fair view of the result for the period and the financial position and state of affairs of the *firm*.

SUP 16 Ann 10R Offsetting and netting

Items representing assets or income must not be offset against items representing liabilities or expenditure except in the case of counterparties who have expressly agreed to settle on a net basis for the same value date.

SUP 16 Ann 10R Consolidation

A firm must not consolidate the accounts of separately incorporated group companies other than for the purposes of completing the consolidated reporting statement, but must include the assets, liabilities, income and expenditure of all branches of the firm.

SUP 16 Ann 10R Greater detail

A firm may show any item required in this reporting statement in greater detail than required by the appropriate format.

SUP 16 Ann 10R Reporting currency

A firm must use either sterling or the currency used for its UK statutory accounts as its reporting currency in its financial reporting statements. It may not change its reporting currency more than once in any 12 month period.

SUP 16 Ann10R Accounting policies

The accounting policies which are required to be used for the reporting statements are not necessarily the same as the accounting policies used in the audited annual financial statements (ie statutory accounts). A firm must give particulars of any departure from the requirements in SUP 16 Ann10R 10-41R. A firm must use the correct accounting policy for each case.

Reporting unit

Monetary amounts must be shown in thousands. Small rounding errors may occur and firms have a responsibility to ensure that these are kept to a minimum so that each item reported is as accurate as possible, within the overriding constraint that a reporting statement must cast correctly and balance within itself.

Certain amounts on the reporting statements are not monetary and should not be submitted in thousands.

Sign convention and totals

All items entered on this statement should normally be shown as a positive value. Where an item is required to be deducted, this will normally be indicated by the use of the word "Less" and should be entered as a positive figure. However, certain items may be either positive or negative values (e.g."Dealing profit/(loss)" on the Profit and Loss schedule). In this case, positive values will be added and negative values deducted from any previous item. Negative values on electronically reported statements should be indicated by the use of brackets around the figure eg £(5000) or preceded by a negative sign eg -£5000. Negative values on statements submitted on paper should be indicated by the use of brackets around the figure.

A box in the extreme right hand column is, unless otherwise indicated, the total of the boxes in the column immediately to its left.

Any departure from the methodology set out in this section will be clearly indicated on the form. It will be assumed that where an item on the statement is left blank, this is the same as entering a zero value.

Segregation
All client money (including free money) must be reported on-balance sheet for the purposes of the financial reporting statements.

BALANCE SHEET

A. FIXED ASSETS

1. Fixed assets is the net book value of all assets used by the firm in its activities on a continuing basis.

2. Intangible Assets

Intangible assets includes goodwill, capitalised development costs, patents, licences, exchange seats (such as seats on LIFFE), trademarks and similar rights. Exchange seats held for investment purposes may be treated as a fixed asset investment.

B. CURRENT ASSETS

3. Stock and Investments

This shall include positions valued on a prudent and consistent basis in accordance with IPRU(INV) 10-41R(9). Firms must ensure that investments arising from trading and non trading books are disclosed separately.

4. Trading Book Debtors

Amounts due from counterparties must be reflected at gross amounts less any provisions for bad and doubtful debts. Netting is only permitted to the extent that there is express agreement with the counterparty that balances may be settled on a net basis in accordance with SUP 16 Ann 10R 1.(3) and IPRU(INV) 10-170R(10). Firms must ensure that trading book debtors under and over 90 days, and debts with affiliates and non-affiliates are disclosed separately.

5. Non Trading Book Debtors

These include debtors not arising from trading book activities. Examples of these are corporate finance fees, commissions, interest and dividends not directly related to items in the trading book. Firms must ensure that non trading book debtors under and over 90 days and debts with affiliates and non-affiliates are disclosed separately.

6. Loans and other assets

Loans and other assets must also be split between affiliates and non-affiliates and those due within and after 90 days.

7. Cash at Bank and in Hand

Segregated client moneys on the balance sheet must be disclosed separately from other non segregated funds. Non segregated funds must be divided into qualifying and non qualifying deposits in accordance with the definition in IPRU(INV) 3 App 1.

C. CURRENT LIABILITIES

8. Bank Loans and Overdrafts

Comments on the inclusion of segregated deficits on the balance sheet made in Section 7 above are applicable here. Firms must ensure that bank loans and overdrafts under and over 1 year, and from affiliates and non-affiliates are disclosed separately.

9. Trading Book Creditors

The comments under Trading Book Debtors in Section 4 above are applicable as appropriate. Firms must ensure that trading book creditors under and over 1 year are disclosed separately and balances with affiliates are distinguished from balances with non-affiliates.

10. Non Trading Book Creditors

These include all other creditors not arising from trading book activities and also include amounts representing accruals, deferred income and provisions.

11. Subordinated Loans

Firms must classify and disclose subordinated loans firstly between short term and long term loans in accordance with IPRU(INV) 10-63R and secondly as amounts with residual maturity of under and over 1 year.

D. CAPITAL

12. Share Capital

Cumulative and non cumulative preference shares for fixed and non fixed terms must be disclosed separately. Preference share capital can only be included in financial resources, provided that there is an agreement in place, that redemption may not take place if it would take the firm into a deficit of financial resources.

Preference share capital may only be included in initial capital where the dividends are non-cumulative.

13. Profit and Loss

Incorporated firms must ensure that for both prior year brought forward and current year profit and loss, amounts representing externally audited balances and unaudited trading and non trading book balances are identified and disclosed separately in accordance with IPRU(INV) 10-61R(4). Interim profits may only be included in a firm's initial capital where they have been verified by an external auditor in accordance with IPRU(INV) 10 App 58.

14. Partnership/Sole trader current account

Unincorporated firms must ensure that for both prior year brought forward and current year current account, amounts representing externally audited balances and unaudited trading and non trading book balances are identified and disclosed separately in accordance with IPRU(INV) 10-61R(4). Interim current account may only be included in a firm's initial capital where they have been verified by an external auditor in accordance with IPRU(INV) 10 App 58.

14A. Limited liability partnerships

Firms that are limited liability partnerships may include members' capital that complies with the relevant IPRU(INV) or GENPRU rules

15. Total Capital

Total Capital should agree with Net Assets in Box 44.

PROFIT AND LOSS ACCOUNT

E. REVENUE

16. Dealing profit/(loss)

This shall be the total gross profit less loss which arises from market making and other dealings as principal for the period which the statement covers. Stamp duty, exchange fees, commissions and brokerage and any related interest paid or payable may be deducted. This box will drill down to 6 boxes for member firms to split out their 5 largest income centres/trading desks plus a balancing figure, which will total to the total dealing profit or loss. Firms should contact their teams if they are in any doubt as to how to complete these fields.

17. **Gross commission and brokerage**

This shall be the total commission and brokerage earned by the firm in the conduct of agency broking, before the deduction of commissions shared or paid to third parties. Commissions receivable on underwriting of international and domestic offerings are included in 18 below.

18. **Investment management fees**

This shall be the total of underwriting fees and commissions, fees from investment advice, valuations, management of investments and unit trusts, pension funds, discretionary management and collective investment schemes.

19. **Corporate Finance Fees**

This shall be the total of all income earned by the firm from corporate finance business.

20. **Other Revenue**

This shall be the total of all other revenue of the firm, including all interest and dividends receivable (except for that arising out of dealing as principal, which is included in a) above).

F. EXPENDITURE

21. This section should show the expenditure for the period reported on under each of the headings specified below. Expenditure should be split between those items included in relevant annual expenditure and those excluded from relevant annual expenditure (see G below).

22. **Commission and brokerage**

This shall be the total of commissions paid away and shared, plus fees, brokerage and other charges paid in relation to the execution, registration or clearing of transactions.

23. **Establishment costs**

This shall include marketing, communications, office services costs, rent, rates, heating, electricity, maintenance, depreciation, professional fees and other general overheads of the business.

24. **Staff Costs**

This shall be the aggregate of gross salary costs, including National Insurance contributions, pensions contributions, benefits in kind and bonuses or profit shares.

25. **Bad and Doubtful Debts**

This shall be the charge to the profit and loss account which the firm considers to be an adequate provision for all doubtful debts, even where there is no addition to CRR or deduction from financial resources.

26. **Intercompany charges**

This shall be charges made by affiliated companies whether for the recharge of costs incurred by the affiliate on behalf of the firm, or for management fees.

27. **Interest payable**

This shall be the total of any interest payable on borrowings of the firm and interest payable on client bank accounts.

28. **Foreign exchange losses**

This shall be the total of foreign exchange losses.

29. **Exceptional and other expenses**

Exceptional expenses shall be those arising from events within the ordinary course of business which are not expected to recur frequently or regularly.

G. ITEMS NOT INCLUDED IN RELEVANT ANNUAL EXPENDITURE

30. **Commission and brokerage**

A firm may exclude commission shared with third parties other than employees, directors, half commission men or appointed representatives. Fees, brokerage and other charges paid for the purposes of executing, registering or clearing transactions may also be excluded.

31. **Staff costs**

A firm may exclude bonuses or profit sharing where they are discretionary and paid out of current year profits.

32. **Interest payable**

A firm may exclude interest which is payable to counterparties or which relates to borrowings which finance the firm's regulated activities.

33. **Foreign Exchange Losses**

A firm may exclude losses arising from the translation of foreign currency balances.

34. Exceptional items

A firm may exclude exceptional items as defined in IPRU(INV) 3 App 1.

FINANCIAL RESOURCES

H. INITIAL CAPITAL

35. Initial capital includes ordinary share capital plus non cumulative preference shares, reserves other than revaluation reserves, share premium account and externally audited retained earnings. Interim profits can be included only if they have been verified by the firm's auditor and are net of any foreseeable charges or losses.

I. ORIGINAL OWN FUNDS

36. From initial capital any investments in own shares, intangible assets and any material current year losses (those arising from trading and non trading book, which exceed 10% of initial capital), must be deducted to arrive at original own funds.

J. SUBORDINATED LOANS

37. There are certain limits on subordinated loans and other items which may be taken into financial resources. The limits prescribed are –

a) for firms which calculate their financial resources in accordance with Table IPRU(INV) 10-62R(2)A, 200% of original own funds after the liquidity adjustment, charged assets, contingent liabilities and deficiencies in subsidiaries have been covered. A firm may use items listed in "D" in the table ie cumulative preference shares, long term subordinated loans and revaluation reserves, to cover the above adjustments, before using original own funds.

b) for firms which calculate their financial resources in accordance with Table

IPRU(INV) 10-62R(2)B, 250% of original own funds after the liquidity adjustment, charged assets, contingent liabilities and deficiencies in subsidiaries, and material holdings in credit and financial institutions, which would normally fall within the firm's group for consolidated supervision purposes, have been adjusted for. A firm may use items listed in "E" in the table, ie cumulative preference shares, long term subordinated loans and revaluation reserves, to cover the above adjustments, before using original own funds.

38. In addition, the total of fixed term long term subordinated loan and fixed term cumulative preference shares which may be taken into financial resources can not exceed 50% of original own funds; and the total of all long term subordinated loan, cumulative preference shares and revaluation reserves must not exceed 100% of original own funds.

K. LIQUIDITY ADJUSTMENT

39. The liquidity adjustment must be calculated in accordance with IPRU(INV) 10-64R to IPRU(INV) 10-66R and must be deducted in order to arrive at the financial resources.

L. MATERIAL HOLDINGS IN CREDIT AND FINANCIAL INSTITUTIONS

40. A firm must deduct the full value of its material holdings in credit or financial institutions (as defined in the rules) in arriving at financial resources, unless a firm has been granted a waiver from consolidated supervision. In that case, it must deduct in full those material holdings in credit or financial institutions which would normally have been included in the scope of consolidation, and deduct in full as an illiquid asset, those which would not normally be included in the scope of consolidation, unless these are trading book positions on which the firm calculates a PRR.

M. POSITION RISK REQUIREMENT

41. A firm which carries a house position must calculate a position risk requirement. The methods and position risk weightings (known as PRAs) to be used can be found in IPRU(INV) 10-80R to IPRU(INV) 10-133R, and IPRU(INV) 10-166R to IPRU(INV) 10-169R contain summary tables giving the methodology and PRAs can be found in IPRU(INV) 10 App 49 – IPRU(INV) 10 App 54.

42. **Equity method**

The valuation of equity and equity equivalent positions included in the equity methods should be included in boxes 301 to 307 and the PRRs for each method included in boxes 309 to 312. The equivalent values of each product type included in the equity method should then be analysed in the second section, boxes 314 to 330. The net balance sheet market value of the instruments should be included in the third column, boxes 332 to 339. The total balance sheet equity positions and PRR on equities will feed forward to the position risk statement.

43. **Equity derivative method**

Equity derivative positions not included in the equity method must be included in the next section of the form, split between the hedging, margin and basic methods. The balance sheet value of the derivative positions should be included in boxes 341 to 343A. The net balance sheet value of cash positions included in the hedging method should be inserted in box 345A. Balance sheet values of positions in approved risk assessment models, including cash positions should be included in boxes 351 to 353.

44. **Interest rate method**

The valuation of debt and debt equivalent positions included in the interest rate methods should be included in boxes 360 to 366 and the general market risk PRRs for each method included in boxes 368 to 370. The interest rate add-on for equity derivatives under the basic method IPRU(INV) 10-86R(4) should be included in box 371. Where the add-on is calculated under the alternative method by inclusion in the interest rate ladder, the charges will automatically go into the interest rate method. The interest rate specific risk charges should be split into the various categories in boxes 375 to 379, the total will feed into box 380. The equivalent values of each product type included in the interest rate method should then be analysed in the second section, boxes 400 to 420. The net balance sheet value of the instruments should be included in the third column, boxes 422 to 431. The total balance sheet interest rate positions and PRR thereon will feed forward to boxes 458 and 463.

45. **Interest rate derivative method**

Interest rate derivative positions not included in the interest rate method must be included in the next section of the form, split between the hedging, margin and basic methods. The balance sheet value of the derivative positions should be included in boxes 433 to 436. The net balance sheet value of cash positions included in the hedging method should be inserted in box 438. Values of positions in approved risk assessment models, including cash positions should be included in boxes 450 to 453.

46. **Other methods**

The net balance sheet value of positions included in the issuing market method, commodities positions and the PRR thereon should be included in the next section. Any other positions should be included in box 457 so that the position risk statement includes all trading book positions and the total PRR.

N. FOREIGN EXCHANGE REQUIREMENT

47. This section of the standard reporting statement captures the firm's foreign exchange requirement calculated in accordance with IPRU(INV) 10-150R to IPRU(INV) 10-153R. Box 242 will drill down into a screen detailing foreign exchange exposures and the resulting FER. The long and short positions in all the currencies must net to zero.

O. COUNTERPARTY RISK REQUIREMENT

48. This section is split into debtors and creditors arising on the trading book. The headings for assets and liabilities are designed to reflect the balance sheet values of transactions analysed by type.

49. **Cash Against Documents**

Where a firm expects to receive cash against the unsettled securities transactions (such as shares, gilts, bonds, etc.), it should enter the total value of all such amounts at their balance sheet value in the column headed "assets". Where a firm has a liability to pay cash in respect of unsettled securities transactions, it should enter the total value of all such liabilities at their balance sheet value in the column headed "liabilities". In the column headed "CRR", a firm should enter its total CRR in respect of unsettled securities transactions.

50. **Free Deliveries**

Where a firm has made a free delivery of either commodities or securities, it should enter the balance sheet value of the related amounts receivable in the column headed "assets". Where a firm has made a free delivery of cash in respect of the anticipated receipt of securities or commodities, it should not enter the balance sheet value of such payments in the section headed "liabilities", since this is no longer a creditor. In the column headed "CRR", a firm should enter its total CRR in respect of free deliveries.

51. Repos, Reverse Repos, Securities Borrowing and Lending, Sale and Buy Back and Buy and Sell Back Agreements etc.

Whilst these types of transactions all have their separate characteristics, , the FS*A* treats them in the same way for CRR purposes under IPRU(INV) 10-173R and for accounting purposes under IPRU(INV) 10-41R(7). The value of collateral provided to counterparties to cover reverse repurchase, securities borrowing and buy and sale backs, where this is shown on the firm's balance sheet, should be reported in the column headed "assets". The value of collateral received from counterparties to cover repurchase, securities lending and sale and buy back agreements, where this is shown on the firm's balance sheet, should be reported in the column headed "liabilities". In the column headed "CRR", a firm should report its total CRR calculated in accordance with IPRU(INV) 10-173R.

52. **Derivatives Transactions**

In the column headed "assets", a firm should report the value of all amounts due from counterparties, clearing banks and exchanges arising on derivatives, where these are shown on the firm's balance sheet. In the column headed "liabilities", a firm should report the value of all amounts due to counterparties, clearing houses and exchanges arising on derivatives, where these are shown on the firm's balance sheet. In the column headed "CRR", a firm should report its CRR calculated in accordance with IPRU(INV) 10-174R.

53. **Deposits and other amounts due arising from trading book activities**

A firm should report the remaining balance sheet debtors and creditors in its trading book (typically, these items would include commissions owed to the firm in respect of its trading book business or trading book qualifying deposits) not covered in 1-4 above as assets or liabilities, as appropriate, and enter the CRR arising from these activities in the column headed "CRR".

P. CREDIT EXPOSURES

54. The Credit Exposure form should be filled in by all firms regardless of whether they are subject to a large exposures requirement. It is designed to pick up all third party credit exposures ignoring the exemptions which would apply for the large exposures calculation. The form is designed to pick up the total exposure to a counterparty, ie trading book as well as non-trading book, including all transaction exposures between trading date and settlement date. Boxes 200 to 209C should be completed for intra group exposures, listing for each of the 10 group counterparties with the largest credit exposures, the gross exposure to the counterparty, and, if there is a netting agreement in place the net exposure to the counterparty. Boxes 210 to 219C should be completed giving the same information for the 10 non group counterparties with the largest credit exposures. Boxes 220 to 229B should include the 10 largest net credit exposures, where there is a netting agreement in place, which have not been reported in the two previous sections.

Q. LARGE EXPOSURE REQUIREMENT

55. In addition to any notifications of large exposures required by the rules, firms should provide details of the 10 greatest large exposures, analysed between trading and non-trading book in this section. The large exposures requirement for each exposure should be entered in the third column. The line detailed "others" should include the total of all other exposures giving rise to an LER where a firm has more than 10 such large exposures.

R. REPORTING REQUIREMENTS FOR FIRMS PERMITTED TO USE INTERNAL MODELS FOR CALCULATING REGULATORY CAPITAL

56. Firms' reporting requirements consist of two strands:
1. model derived capital requirements; and
2. back-testing exceptions.

These guidance notes address each of these in turn.

57. Model derived regulatory capital requirements

There are specific requirements for those firms which are permitted by the FSA to calculate some or all of their regulatory capital requirements using their internal risk assessment models in accordance with IPRU(INV) 10. This permission will be granted in the form of a waiver or modification of the relevant rules. As stated in SUP 8.3.6G, the FSA may impose conditions on a waiver, such as additional reporting requirements. The reporting requirements set out below are a condition for the granting of the relevant waiver(s) in this case. The proforma overleaf sets out the information which the FSA requires from firms in this regard. Firms should submit this information with the same frequency as they currently submit their regular financial reporting statements - the paper report will be regarded as forming a part of a firm's standard reporting statement. Frequency and timing of reporting should be in accordance with SUP 16.7.25R to SUP 16.7.27R.

58. Backtesting exceptions

<u>Further guidance on the review process for internal models can be obtained from the FSA</u>.Notifications of exceptions to the FSA and adjustments to capital requirements should be made in accordance with the timing of the following schedule:

t=-1: firm makes t=0 VaR prediction based upon its positions at close of business t=-1.

t=0: firm incurs profit or loss.

t=+1: firm calculates daily P&L for t=0 and compares to VaR prediction in accordance with the CAD backtesting requirements.

t=+2: firm should notify the FSA of an exception by close of business. All exceptions should be reported.

t=+3: firm should reflect increased capital requirement (if appropriate) in accordance the CAD backtesting requirements.

Firms should additionally be mindful of the following:

(a) An exception is considered to have occurred where the daily loss experienced by a firm exceeds its VaR prediction. For these purposes, the VaR prediction should be compared to daily 'cleaned actual P&L' at the whole-book level (or other level as appropriate to the scope of the model). 2. Firms should report all exceptions in accordance with the schedule above. This may be done by telephone to the firm's usual supervisory contact. An exception will automatically lead to the adjustment of a firm's capital on t=3 (if required in accordance with the CAD criteria) unless a firm has agreed with the FSA that the exception may be 'disregarded'. The FSA's agreement to 'disregard' an exception may additionally be granted retrospectively. A firm seeking to have an exception 'disregarded' should submit to the FSA a written explanation of why the exception occurred, and why it would be appropriate to 'disregard' it.

(b) All firms should submit to the FSA a written report of exceptions, with details of the amount of each exception, explanations for why each exception occurred and consequent action taken-on a monthly basis.(Category A and B firms and Broadscope firms should submit this in conjunction with their standard reporting statement. Category C and D firms and Arrangers should submit exception reports in accordance with the timing of the standard monthly reporting cycle.) There is no prescribed format for the reporting of exceptions.

59. <u>Calculation of Regulatory Capital based on Firm's Internal Assessment of Value-at Risk</u>

Firm Code:

Currency:

Statement date:

Date Submitted:

	Previous Day's VaR	60 Day Average VaR
Modelled Market Risk and FX Risk		
Specific Risk Surcharge		
Overall VaR		
Multiplication factor		
Reg. Cap. requirement		

*Number of instances in reporting period when previous day's VaR exceeded 60 day average VaR x multiplication factor.

Explanation of significant changes from previous report date

Notes: Value of positions should be shown in boxes 351-4 (equity). 450-462 (int.rate), and 456 (commodities) of the standard reporting statement for ISD firms.

* Where firms have reported instances, a supplementary written explanation of the causes should be submitted.

GUIDANCE NOTES:- CONSOLIDATED REPORTING STATEMENT FOR SECURITIES AND FUTURES FIRMS WHICH ARE ISD FIRMS

INTRODUCTION

This guidance has been prepared to assist firms in completing the consolidated reporting statements in accordance with SUP16.7.25R and SUP16.7.27R. Guidance given does not override the rules themselves.

A firm must submit its reporting statement to the FSA by the due date in accordance with SUP16.7.25R and SUP16.7.27R.

Self-generated computer statement

A firm which has obtained a waiver from electronic reporting may file this reporting statement using a self-generated computer form if such a form is identical in its layout to the standard reporting statement. Application for a waiver must be made in accordance with SUP 8.

Declaration

A valid submission of the standard reporting statement must be signed by two authorised signatories, except where the firm is a sole trader. An authorised signatory is a director for a body corporate; a registered partner for a partnership; and a proprietor for a sole trader(SUP16.7.33R).

A declaration should not be made lightly. The FSA will take a very serious view of a declaration that subsequently proves to be false or negligent and this may result in disciplinary action.

The FSA must be notified as soon as a firm has reason to believe that the consolidated reporting statement previously submitted was or has become misleading in any material respect (SUP15.6.4R).

Some pertinent rules

Keeping of records

A firm must be able to demonstrate compliance with the relevant financial resources requirements and should be able to prepare, within a reasonable time, this reporting statement as at the close of business of any date. The audit trail, records, working papers and schedules supporting the production of this reporting statement must be retained for six years, maintained and secured in an orderly manner so as to permit ready access to any particular record required under SUP 2.

Notifications

Inclusion or disclosure of an item in the standard reporting statement is not a substitute for notification required by the notification requirements contained in SUP15. A firm must confirm in writing any verbal notification effected under these rules. A firm must be familiar with all the notification requirements, and the following are worthy of further mention:

SUP3.7.2G Qualification of an audit report.

SUP 15.6.4R Misleading information supplied to the FSA.

SUP 16.3.17R Changes in reporting dates.

IPRU(INV) 10-32R Large exposure notifications.

Form and content of financial reporting statements and accounting policies

SUP16 Ann10R Agreement with records

The reporting statement must agree with the books and records of the firm and its group.

SUP16 Ann10R Greater detail

A firm may show any item required in this reporting statement in greater detail than required by the appropriate format.

SUP16 Ann10R Reporting currency

A firm must report in sterling unless it completes its UK statutory accounts in another currency. The reporting currency must not be changed without notification to the FSA. Only one reporting currency may be used on all reporting statements.

SUP 16 Ann 10R and IPRU(INV) 10-41 Accounting policies

The accounting policies which are required to be used for the reporting statements are not necessarily the same as the accounting policies used in the audited annual financial statements (ie statutory accounts). A firm must give particulars of any departure from the requirements in SUP16 Ann10R or IPRU(INV) 10-41R. A firm must use the correct accounting policy for each case.

Reporting unit
Monetary amounts must be shown in thousands. Small rounding errors may occur and firms have a responsibility to ensure that these are kept to a minimum so that each item reported is as accurate as possible, within the overriding constraint that a reporting statement must cast correctly and balance within itself.

Certain amounts on the reporting statements are not monetary and should not be submitted in thousands.

Sign convention and totals

All items entered on this statement should normally be shown as a positive value. However, certain items may be either positive or negative values, e.g."Surplus/(deficit)" in column F. In this case, positive values will be added and negative values deducted from any previous item. Negative values on electronically reported statements should be indicated by the use of brackets around the figure e.g.£(5000) or preceded by a negative sign e.g.-£5000. Negative values on statements submitted on paper should be indicated by the use of brackets around the figure.

Any departure from the methodology set out in this section will be clearly indicated on the form. It will be assumed that where an item on the statement is left blank, this is the same as entering a zero value.

CONSOLIDATED FINANCIAL RESOURCES TEST

This form will have an unlimited number of rows, and the required information for each undertaking included in the firm's group for the purposes of consolidated supervision (under IPRU(INV) 10-200R to 10-203R) should be reported on a separate row.

Column C represents the book value of the investment in a firm's financial resources which its parent has made.

Box J should include the ultimate parent/holding company's financial resources requirement, excluding any large exposure requirement which that individual undertaking has suffered. The group's large exposure requirement should instead be included in Box J.

SUP 16 Ann 11G section 3

GUIDANCE NOTES: STANDARD REPORTING STATEMENT FOR SECURITIES AND FUTURES FIRMS WHICH ARE NOT ISD FIRMS

INTRODUCTION

This guidance has been prepared to assist firms in completing the monthly, quarterly and annual reporting statements in accordance with SUP 16.7.25R – SUP 16.7.27R. Guidance given does not override the rules themselves.

A firm must submit its reporting statement to the FSA by the due date in accordance with SUP 16.7.25R – SUP 16.7.27R.

Self-generated computer statement

A firm which has obtained a waiver from electronic reporting may file this reporting statement using a self-generated computer form if such a form is identical in its layout to the standard reporting statement. Application for a waiver must be made in accordance with SUP 8.

Declaration

A valid submission of the standard reporting statement must be signed by two authorised signatories, except where the firm is a sole trader. (SUP 16.7.33R) A declaration should not be made lightly. The FSA will take a very serious view of a declaration that subsequently proves to be false or negligent and this may result in disciplinary action.

The FSA must be notified as soon as a firm has reason to believe that the standard reporting statement previously submitted was or has become misleading in any material respect SUP 15.6.4R)

Categories of firms

Corporate finance advisory firms and derivative fund managers are only required to complete the balance sheet, profit & loss and the tangible net worth sections of the standard reporting statement and submit it on an annual and quarterly basis in accordance with SUP 16.7.27R. Venture capital firms not handling client money are required to complete the balance sheet, profit & loss, the financial resources and financial resources requirement sections (except for the PRR sections) of the standard reporting statement and submit it on an annual and quarterly basis in accordance with SUP 16.7.27R. Other arrangers are required to complete all the sections of the standard reporting statement and submit it on an annual and quarterly basis in accordance with SUP 16.7.27R. Broadscope firms are required to complete all the sections of the standard reporting statement and submit it on an annual and monthly basis in accordance with SUP 16.7.25R.

Some pertinent rules and guidance

IPRU(INV) 3-10R Keeping of records

A firm must be able to demonstrate compliance with the financial resources requirement and should be able to prepare, within a reasonable time, this reporting statement as at the close of business of any date. The audit trail, records, working papers and schedules supporting the production of this reporting statement must be retained for six years, maintained and secured in an orderly manner so as to permit ready access to any particular record required under SUP 2.

IPRU(INV) **3-11R Reconciliation of balances**

A firm must perform reconciliations as frequently as is necessary for the volume of transactions on the accounts, and in any event, not less than once a month for derivatives balances and positions, and once a year for securities balances and positions.

Notifications

Inclusion or disclosure of an item in the standard reporting statement is not a substitute for notification required by SUP 15. A firm must confirm in writing any verbal notification effected under these rules. A firm must be familiar with all the notification requirements, and the following are worthy of further mention:

SUP 15.6.4R Misleading information supplied to the FSA.

SUP 16.3.17R Changes in accounting reference dates.

SUP 3.7.2G Qualification of an audit report.

Form and content of financial reporting statements and accounting policies

SUP 16 Ann 10R Agreement with records

The reporting statement must agree with the books and records of the firm, and give a true and fair view of the result for the period and the financial position and state of affairs of the firm.

SUP 16 Ann 10R Offsetting and netting

Items representing assets or income must not be offset against items representing liabilities or expenditure except in the case of counterparties who have expressly agreed to settle on a net basis for the same value date.

SUP 16 Ann 10R Consolidation

A firm must not consolidate the accounts of separately incorporated group companies other than for the purposes of completing the consolidated reporting statement, but must include the assets, liabilities, income and expenditure of all branches of the firm.

SUP 16 Ann 10R Greater detail

A firm may show any item required in this reporting statement in greater detail than required by the appropriate format.

SUP 16 Ann 10R Reporting currency

A firm must use either sterling or the currency used for its UK statutory accounts as its reporting currency in its financial reporting statements. It may not change its reporting currency more than once in any 12 month period.

SUP 16 Ann 10R Accounting policies

The accounting policies which are required to be used for the reporting statements are not necessarily the same as the accounting policies used in the annual financial statements (ie statutory accounts). A firm must give particulars of any departure from the requirements in SUP 16 Ann 10R. A firm must use the correct accounting policy for each case.

Reporting unit

Monetary amounts must be shown in thousands. Small rounding errors may occur and firms have a responsibility to ensure that these are kept to a minimum so that each item reported is as accurate as possible, within the overriding constraint that a reporting statement must cast correctly and balance within itself.

Certain amounts on the reporting statements are not monetary and should not be submitted in thousands.

Sign convention and totals

All items entered on this statement should normally be shown as a positive value. Where an item is required to be deducted, this will normally be indicated by the use of the word "Less" and should be entered as a positive figure. However, certain items may be either positive or negative values (e.g."Dealing profit/(loss)" on the Profit and Loss schedule). In this case, positive values will be added and negative values deducted from any previous item. Negative values on electronically reported statements should be indicated by the use of brackets around the figure eg £(5000) or preceded by a negative sign eg -£5000. Negative values on statements submitted on paper should be indicated by the use of brackets around the figure.

A box in the extreme right hand column is, unless otherwise indicated, the total of the boxes in the column immediately to its left.

Any departure from the methodology set out in this section will be clearly indicated on the form. It will be assumed that where an item on the statement is left blank, this is the same as entering a zero value.

Segregation

All client money (including free money) must be reported on-balance sheet for the purposes of the financial reporting statements.

BALANCE SHEET

A. FIXED ASSETS

1. Fixed assets is the net book value of all assets used by the firm in its activities on a continuing basis.

2. **Intangible Assets**

Intangible assets includes goodwill, capitalised development costs, patents, licences, exchange seats (such as seats on LIFFE), trademarks and similar rights. Exchange seats held for investment purposes may be treated as a fixed asset investment.

B. CURRENT ASSETS

3. **Stock and Investments**

This shall include positions valued on a prudent and consistent basis in accordance with IPRU(INV) 3-41R(9).

4. **Trade Debtors**

Amounts due from counterparties must be reflected at gross amounts less any provisions for bad and doubtful debts. Netting is only permitted to the extent that there is express agreement with the counterparty that balances may be settled on a net basis in accordance with SUP 16 Ann 10R. Firms must ensure that trade debtors under and over 90 days, and debts with affiliates and non-affiliates are disclosed separately.

5. **Non Trade Debtors**

These include debtors not arising from trading activities. Examples of these are corporate finance fees, commissions, interest and dividends not directly related to the firm's investment or associated business. Firms must ensure that non trade debtors under and over 90 days and debts with affiliates and non-affiliates are disclosed separately.

6. **Loans and other assets**

Loans and other assets must also be split between affiliates and non-affiliates and those due within and after 90 days.

7. **Cash at Bank and in Hand**

Segregated client moneys on the balance sheet must be disclosed separately from other non segregated funds. Non segregated funds must be divided into qualifying and non qualifying deposits with the definition in IPRU(INV) 3 App 1.

C. CURRENT LIABILITIES

8. **Bank Loans and Overdrafts**

Comments on the inclusion of segregated deficits on the balance sheet made in Section 7 above are applicable here. Firms must ensure that bank loans and overdrafts under and over 1 year, and from affiliates and non-affiliates are disclosed separately.

9. **Trade Creditors**

The comments under Trade Debtors in Section 4 above are applicable as appropriate. Firms must ensure that trade creditors under and over 1 year are disclosed separately and balances with affiliates are distinguished from balances with non-affiliates.

10. **Non Trade Creditors**

These include all other creditors not arising from trading activities and also include amounts representing accruals, deferred income and provisions.

D. CAPITAL

11. **Approved Share Capital**

Box 65 includes all ordinary share capital and redeemable share capital satisfying the criteria set out in IPRU(INV) 3-62R for inclusion in tangible net worth.

12. **Non-approved Share Capital**

Box 66 includes any share capital which may not contribute to the firm's tangible net worth.

13. **Profit and Loss**

Incorporated firms must ensure that for both prior year brought forward and current year profit and loss, amounts representing externally audited balances and unaudited balances are identified and disclosed separately.

14. **Partnership/Sole trader current account**

Unincorporated firms must ensure that for both prior year brought forward and current year current account, amounts representing externally audited balances and unaudited balances are identified and disclosed separately.

14A. **Limited liability partnerships**

Firms that are limited liability partnerships may include members' capital that complies with the relevant IPRU(INV) rules.

15. **Total Capital**

Total Capital should agree with Net Assets in Box 43.

PROFIT AND LOSS ACCOUNT

E. REVENUE

16. **Dealing profit/(loss)**

This shall be the total gross profit less loss which arises from market making and other dealings as principal for the period which the statement covers. Stamp duty, exchange fees, commissions and brokerage and any related interest paid or payable may be deducted.

17. **Gross commission and brokerage**

This shall be the total commission and brokerage earned by the firm, before the deduction of commissions shared or paid to third parties.

18. **Investment management fees**

This shall be the total of underwriting fees and commissions, fees from investment advice, valuations, management of investments and unit trusts, pension funds and collective investment schemes.

19. **Corporate Finance Fees**

This shall be the total of all income earned by the firm from corporate finance business.

20. **Other Revenue**

This shall be the total of all other revenue of the firm, including all interest and dividends receivable (except for that arising out of dealing as principal, which is included in 16 above).

F. EXPENDITURE

21. This section should show the expenditure for the period reported on under each of the headings specified below. Expenditure should be split between those items included in relevant annual expenditure and those excluded under IPRU(INV) 3-73R (see G below).

22. **Commission and brokerage**

This shall be the total of commissions paid away and shared, plus fees, brokerage and other charges paid in relation to the execution, registration or clearing of transactions.

23. **Establishment costs**

This shall include marketing, communications, office services costs, rent, rates, heating, electricity, maintenance, depreciation, professional fees and other general overheads of the business.

24. **Staff Costs**

This shall be the aggregate of gross salary costs, including National Insurance contributions, pensions contributions, benefits in kind and bonuses or profit shares.

25. **Bad and Doubtful Debts**

This shall be the charge to the profit and loss account which the firm considers to be an adequate provision for all doubtful debts, even where there is no addition to CRR or deduction from financial resources.

26. **Intercompany charges**

This shall be charges made by affiliated companies whether for the recharge of costs incurred by the affiliate on behalf of the firm, or for management fees.

27. **Interest payable**

This shall be the total of any interest payable on borrowings of the firm and interest payable on client bank accounts.

28. **Foreign exchange losses**

This shall be the total of foreign exchange losses.

29. **Exceptional and other expenses**

Exceptional expenses shall be those arising from events within the ordinary course of business which are not expected to recur frequently or regularly.

G. ITEMS NOT INCLUDED IN RELEVANT ANNUAL EXPENDITURE

30. **Commission and brokerage**

A firm may exclude commission shared with third parties other than employees, directors, half commission men or appointed representatives. Fees, brokerage and other charges paid for the purposes of executing, registering or clearing transactions may also be excluded.

31. **Staff costs**

A firm may exclude bonuses or profit sharing where they are discretionary and paid out of current year profits.

32. **Interest payable**

A firm may exclude interest which is payable to counterparties or which relates to borrowings which finance the firms regulated activities.

33. **Exceptional and extraordinary items**

A firm may exclude exceptional items and extraordinary items as defined in

IPRU(INV) 3 App 1.

FINANCIAL RESOURCES

H. TANGIBLE NET WORTH

34. For an incorporated firm, tangible net worth includes ordinary share capital plus redeemable preference shares, meeting the criteria set out in IPRU(INV) 3-62R, approved reserves as explained in IPRU(INV) 3-62R, share premium account and retained earnings, less any intangible assets.

35. For a partnership or sole trader, tangible net worth includes the capital account plus current account, less any intangible assets.

I. ELIGIBLE CAPITAL SUBSTITUTES

36. There are certain limits on subordinated loans, approved bank bonds and approved undertakings which may be taken into financial resources. The total of boxes 104 to 106 must not exceed four times tangible net worth. The other limits are detailed in IPRU(INV) 3-63R.

J. PRIMARY REQUIREMENT

37. This requirement is set out in IPRU(INV) 3-70R and is the sum of boxes 107 to 113.

38. **Base requirement**

The base requirement is the greater of–

- the absolute minimum requirement which is determined in accordance with IPRU(INV) 3-72R;
- the expenditure requirement which is determined in accordance with IPRU(INV) 3-73R; and

- the volume of business requirement which is 3.5% of the aggregate of the firm's counterparties' total initial margin requirement.

39. **Liquidity adjustment**

The liquidity adjustment must be calculated in accordance with IPRU(INV) 3-75R and must be deducted in order to arrive at the financial resources.

40. **Charged assets**

This is the balance sheet value of each asset charged to a third party (IPRU(INV)

3-76R) unless the related exposure has already been recorded as a liability or is subject to CRR.

41. **Contingent liabilities**

An amount must be added to primary requirement in accordance with IPRU(INV) 3-77R.

42. **Deficiency in subsidiaries**

Unless a provision has already been made (ie a reduction of the firm's financial resources), the amount is equal to the deficiency in shareholders' funds in the subsidiary of the firm (IPRU(INV) 3-78R).

POSITION RISK REQUIREMENT

43. A firm which carries a house position must calculate a position risk requirement. The methods and position risk weightings (known as PRAs) to be used can be found in IPRU(INV) 3-80R to 3-169R and IPRU(INV) 3 App 26.

44. **Foreign exchange requirement**

This section of the standard reporting statement captures the firm's position risk requirement arising from foreign exchange exposures, calculated in accordance with IPRU(INV) 3-150R to IPRU(INV) 3-154R. Box 149 will drill down into a screen detailing foreign exchange exposures and the resulting PRR. The long and short positions in all the currencies must net to zero.

45. **Physical commodities**

Boxes 128 and 138 include the balance sheet value of positions subject to the physical commodities method IPRU(INV) 3-166R to 3-169R. Box 151 should include the PRR calculated under these rules.

46. **Other**

The balance sheet value of positions in interest rate instruments taken on to hedge interest rate risks in the commodities portfolio should be included in boxes 128A and 138A. Box 151A should include the PRR calculated on these positions.

COUNTERPARTY RISK REQUIREMENT

48. This section is split into debtors and creditors arising on the trading book. The headings for assets and liabilities are designed to reflect the balance sheet values of transactions analysed by type.

49. **Cash Against Documents and Free Deliveries**

Where a firm expects to receive cash against unsettled securities transactions, such as gilts, bonds, it should enter the total value of all such amounts at their balance sheet value in the column headed "assets". Where a firm has a liability to pay cash in respect of unsettled securities transactions, it should enter the total value of all such liabilities at their balance sheet value in the column headed "liabilities".

50. Where a firm has made a free delivery of either commodities or securities, it should enter the balance sheet value of the related amounts receivable in the column headed "assets". Where a firm has made a free delivery of cash in respect of the anticipated receipt of securities or commodities, it should not enter the balance sheet value of such payments in the section headed "liabilities", since this is no longer a creditor.

51. In the column headed "requirement", a firm should enter its total CRR in respect of unsettled securities transactions and free deliveries.

52. **Margined Transactions and Options**

In the column headed "assets", a firm should report the value of all amounts due from counterparties, clearing houses and exchanges arising on exchange-traded-margined transactions, where these are shown on the firm's balance sheet. In the column headed "liabilities", a firm should report the value of all amounts due to counterparties, clearing houses and exchanges arising on exchange-traded-margined transactions, where these are shown on the firm's balance sheet. In the column headed "requirement", a firm should report its CRR calculated in accordance with IPRU(INV) 3-173A.

53. **OTC**

In the column headed "assets", a firm should report the value of amounts due from counterparties on OTC transactions, where these are shown on the balance sheet. In the column headed "liabilities", a firm should report the value of all amounts due to counterparties on OTC transactions, where these are shown on the firm's balance sheet. In the column headed "requirement", a firm should report its CRR calculated in accordance with IPRU(INV) 3-173A.

54. **Other**

A firm should report its remaining balance sheet trade debtors and creditors not covered in 49 to 53 above as assets or liabilities, as appropriate, and enter the CRR arising from these activities in the column headed "requirement".

CREDIT EXPOSURES

55. The credit exposure section is designed to pick up all third party credit exposures. The form is designed to pick up the total exposure to a counterparty, ie trade debtors and non-trade debtors, including all transaction exposures between trading date and settlement date. Boxes 200 to 209C should be completed for intra group exposures, listing for each of the 10 group counterparties with the largest credit exposures, the gross exposure to the counterparty, and, if there is a netting agreement in place the net exposure to the counterparty. Boxes 210 to 219C should be completed giving the same information for the 10 non group counterparties with the largest credit exposures. Boxes 220 to 229B should include the 10 largest net credit exposures, where there is a netting agreement in place, which have not been reported in the two previous sections.

56. REPORTING REQUIREMENTS FOR FIRMS PERMITTED TO USE INTERNAL MODELS FOR CALCULATING REGULATORY CAPITAL

Firms' reporting requirements consist of two strands:

1. model derived capital requirements; and

2. back-testing exceptions.

These guidance notes address each of these in turn.

57. Model derived regulatory capital requirements

There are specific requirements for those firms which are permitted by the FSA to calculate some or all of their regulatory capital requirements using their internal risk assessment models in accordance with IPRU(INV) 3. This permission will be granted in the form of a waiver or modification of the relevant rules. As stated in SUP 8.3.6G, the FSA may impose conditions on a waiver, such as additional reporting requirements. The reporting requirements set out below are a condition for the granting of the relevant waiver(s) in this case. The proforma overleaf sets out the information which the FSA requires from firms in this regard. Firms should submit this information with the same frequency as they currently submit their regular financial reporting statements - the paper report will be regarded as forming a part of a firm's standard reporting statement. Frequency and timing of reporting should be in accordance with SUP 16.7.25R to SUP 16.7.27R.

58. Backtesting exceptions

Further guidance on the review process for internal models can be obtained from the FSA. Notifications of exceptions to the FSA and adjustments to capital requirements should be made in accordance with the timing of the following schedule:

t=-1: firm makes t=0 VaR prediction based upon its positions at close of business t=-1.

t=0: firm incurs profit or loss.

t=+1: firm calculates daily P&L for t=0 and compares to VaR prediction in accordance with the CAD backtesting requirements.

t=+2: firm should notify the FSA of an exception by close of business. All exceptions should be reported.

t=+3: firm should reflect increased capital requirement (if appropriate) in accordance the CAD backtesting requirements.

Firms should additionally be mindful of the following:

(a) An exception is considered to have occurred where the daily loss experienced by a firm exceeds its VaR prediction. For these purposes, the VaR prediction should be compared to daily 'cleaned actual P&L' at the whole-book level (or other level as appropriate to the scope of the model). 2. Firms should report all exceptions in accordance with the schedule above. This may be done by telephone to the firm's usual supervisory contact. An exception will automatically lead to the adjustment of a firm's capital on t=3 (if required in accordance with the CAD criteria) unless a firm has agreed with the FSA that the exception may be 'disregarded'. The FSA's agreement to 'disregard' an exception may additionally be granted retrospectively. A firm seeking to have an exception 'disregarded' should submit to the FSA a written explanation of why the exception occurred, and why it would be appropriate to 'disregard' it.

(b) All firms should submit to the FSA a written report of exceptions, with details of the amount of each exception, explanations for why each exception occurred and consequent action taken-on a monthly basis.(Category A and B firms and Broadscope firms should submit this in conjunction with their standard reporting statement. Category C and D firms and Arrangers should submit exception reports in accordance with the timing of the standard monthly reporting cycle.) There is no prescribed format for the reporting of exceptions.

59. <u>Calculation of Regulatory Capital based on Firm's Internal Assessment of Value-at Risk</u>

Firm Code:

Currency:

Statement date:

Date Submitted:

	Previous	60 Day Average

	Day’s VaR	VaR
Modelled Market Risk and FX Risk		
Specific Risk Surcharge		
Overall VaR		
Multiplication factor		
Reg. Cap. Requirement		

*Number of instances in reporting period when previous day’s VaR exceeded 60 day average VaR x multiplication factor.

Explanation of significant changes from previous report date

Notes: Value of positions should be shown in box 128 of the standard reporting statement for non-ISD firms.

* Where firms have reported instances, a supplementary written explanation of the causes should be submitted.

SUP 16 Ann 11G section 4

Guidance on the completion of LEM Forms for securities and futures firms which are ISD firms

I SUMMARY OF REPORTING REQUIREMENTS

(1) An exposure

The measurement of an exposure should reflect the maximum loss, which would occur should a counterparty fail, or the loss that may be experienced due to the realisation of assets or off-balance sheet positions. IPRU(INV) 10 provides details of the rules, which have been expanded upon below.

A large exposure forms the basis for the completion of Form LEM, as required under CAD. With regard to the compliance of quarterly reporting of large exposures up to and including 31 December 2006 only, FSA, with prior authorisation, will allow firms to measure whether a large exposure has occurred, based upon the firm's own funds rather than financial resources and own funds, on condition that financial resources are higher than own funds.

For the first reporting date after 31 December 2006 for firms reporting on a solo basis (or the first two reporting dates in the case of a report on a consolidated basis), firms should use the own funds figure that was used on their 31 December 2006 report, or the last report prior to the date if their reporting cycle is different. Thereafter, instead of the own funds figure (or financial resources and own funds figures), firms should use the figure of capital resources, calculated in accordance with *BIPRU* 10.5.2,

Exposures should be measured prior to any exemptions detailed in IPRU(INV) 10-192R(1),(2), and (3), unless otherwise detailed in IPRU(INV) 10-32R(3) to 10-32R(7).

Whether an exposure falls as a trading book or non trading book item will vary from firm to firm. For the purpose of this return, an exposure should be classified as trading book or non trading book in the same manner as it is for the capital calculation, as detailed in IPRU(INV) 10 and any further updates thereto.

Exposures entered into by a firm as trustee are excluded from the scope of the large exposures return. This covers all client assets, but excludes any buffer held by the firm within the segregated client account, which is reflected within the firm's balance sheet, and should be included in the large exposures return.

Non trading book issuer risk is the full market value of the underlying exposure.

If the firm has any doubt on whether a constituent of a large exposure should be reported, it should continue to report the exposure until it has received guidance to the contrary from FSA.

Examples of exposures include, but are not limited to:–

(a) fees receivable/prepayments;

(b) stockborrowing/stocklending, repos/reverse repos; and their foreign equivalents; buy/sells, sell/buys - these should be recorded as for CRR but without any counterparty weighting factors;

(c) deposits, loans, current account credit balances, including those denominated in precious metals;

(d) discounted bills held;

(e) the net investment in finance leases;

(f) bonds, bond futures, and bond options;

(g) equity positions held as principal, equity options, equity warrants, equity futures, swaps, contracts for difference, and similar instruments;

(h) interest rate contracts, including single currency interest rate swaps, basis swaps, forward rate agreements, interest rate futures, and products with similar characteristics;

(i) foreign exchange rate contracts, cross currency swaps, cross currency interest rate swaps, outright forward foreign exchange contracts, currency futures, currency options purchased, outstanding currency option premia, and similar instruments;

(j) acceptances, promissory notes, loan stock, commercial paper, MTN`s, and other paper held;

(k) margin deposits with futures, options, commodities exchanges, and other clearing houses, brokers, investment exchanges;

(l) forwards, including buy/sells, sell/buys and similar transactions;

(m) free deliveries, failed trades, and any trade with extended settlement day;

(n) those claims arising from similar transactions entered into by the firm;

(o) all intra-group exposures which do not fall within any consolidation.

Exposures which are exempt from the quarterly report:–

(a) exposures and other assets which have already been deducted when calculating the firm's own funds for the purpose of monitoring large exposures. Such deductions can be found in IPRU(INV) 10-61R(1)B - these include the reporting firm's own shares and investments in subsidiaries and associated companies;

Material holdings in credit and financial institutions which have been deducted in full when calculating own funds. See IPRU(INV) 10-192R(1)(k);

(b) claims arising in the course of settlement of a foreign exchange transaction on a counterparty where the firm has settled its side of the transaction, but has not received the corresponding payment, for a period of up to two working days after payment was made. After this period such claims will constitute an exposure. See IPRU(INV) 10-190R(2)(a);

(c) exposures to Zone A governments, related government entities (e.g. Inland Revenue, Bank of England, government debt), and the EU/European Communities see - IPRU(INV) 10-32R(7). This does not extend to local government, unless a full legal guarantee exists, and complies where appropriate with EU legislation in respect of government support;

(d) in the case of securities, which are settled on a delivery versus payment basis, claims on the counterparty to the transaction which occur in the normal course of business up to and including the five business days (see IPRU(INV) 10-190R(2)(b)) following the due payment or delivery date;

(e) counterparty risk exposure on commodities, commodity derivatives, and other physical assets.

(2) The amount at risk

The amount at risk should, with certain exceptions detailed below (or otherwise advised to the firm) be reported as the exposure of the firm's actual or potential claim, contingent liability, or assets. IPRU(INV) 10 methodology takes precedence and should be followed in calculating all exposures, unless an alternative format is indicated within these reporting instructions.

Bank accounts

Credit balances should not be offset with debit balances with any credit institution, unless legal opinion has been obtained. This opinion should address the issue of set off for term versus demand deposits/loans, and cross border set off. Firms internally should monitor their exposure to the counterparty in this manner to utilise this form of set off.

Balances recorded within forms LEM 1 or LEM 2 should be the cashbook value rather than the bank statement value. It should be noted that this is different to the methodology applied for completing Form LE under the provisions set out in IPRU(BANK).

Free Deliveries/Failed Trades

Free deliveries are reportable from the business day when delivery took place, at full value. The exposure recorded should be the higher of the market value of the underlying or the cash side to the transaction, where the firm has made a payment. Where the firm has made a delivery of securities, then the cash value of the transaction should be reported.

For transactions which are deemed to be cross border, then a window of one working day is available before the transaction becomes reportable, in line with IPRU(INV) 10-172R(4).
Failed trades have occurred if a trade for the purchase/sale of a security, incurred in the ordinary course of settlement, fails to settle during the five business days following and including due payment or due delivery date, where neither cash nor securities have been delivered.

Other failed transactions are reportable under the large exposures regime, such as foreign exchange. An exposure should become a reportable item when a foreign exchange transaction remains outstanding for two business days following due payment date in the ordinary course of settlement.

Interest and dividends

The value of outstanding claims should include interest and dividends due. Once the underlying equity issue has gone ex-dividend, and the dividend will not be reflected in the underlying price of the equity, then there will be a receivable due to the firm until payment is received.

Interest Rate Contracts/Equity Derivatives/Foreign Exchange

The reportable exposure for derivatives should be calculated in line with IPRU(INV) 10-174R.

Where a netting agreement is held which complies with current FSA requirements, it may then be utilised if the firm calculates its exposure to the counterparty or counterparty group on a net basis.

Loans, advances etc denominated in gold, silver, and other precious Metals

Exposures in this form should be translated into the reporting currency at the closing spot price. Where the maximum exposure during a reporting period is required to be reported, the closing spot rate for the day on which the exposure occurred should be used. Precious metals should not be considered as a “cash equivalent”, but as a commodity.

Netting

In reporting large exposures, counterparty credit balances should not be offset against counterparty debit balances, unless a netting agreement is in place. At no time may issuer exposure to company “A” be netted with counterparty exposure to “A”.

Debt securities should not be netted against equity exposure for the same issuer. The **<u>netting of debt securities issued by the same legal entity together with underlying derivatives are allowable</u>.**

Firms should indicate, by way of a “*” against the relevant counterparty groups (next to column “a”) on forms LEM 1 & 2, where they have reported net amounts.

Firms should be aware that currently there is a difference between CRR and large exposures with regard to the measurement of exposure and the maturity of the net exposure. Large exposure calculates the exposure using the underlying positive exposure with the longest maturity.

Any netting agreements should comply with FSA requirements at all times.

Receivables

Receivables, which include prepayments, dividends receivable (see **Interest and dividends**), and other receivables not exempted under the large exposures guidance notes, are reportable within the quarterly return.

Replacement cost/mark to market for derivative transactions

In order to include exposures which fall within the trading book, a firm should aggregate:–

(a) the total replacement cost (obtained by marking to market) of all of its contracts with a positive value. The exception to this is if the firm has a netting agreement with the counterparty, which complies with FSA requirements.

(b) an amount for potential future credit exposure which reflects the residual maturity of the contract, calculated as a percentage of the underlying notional amount in accordance with IPRU(INV) 10-174R(3).

Where a firm has not received option premia or acceptable collateral, this shortfall should be recorded as 100% of the exposure to the counterparty.

Any acceptable or adequate collateral held by a firm, should be recorded in

column “c” of LEM 2.

Residual Maturity

The residual maturity of an option/swap, or any other derivative product falling within IPRU(INV) 10-174R, should be taken as the time from the reporting date until the final expiry date. Rollovers which are reset with a new contract, which details when the exposure will be cleared by either party to the contract, have maturity lengths equal to the total rollover period.

Underwriting Commitments - IPRU(INV) 130R to IPRU(INV) 133R

The firm's exposure (debt or equity), if using the Issuing Market Method, shall be its net exposure in line with IPRU(INV) 10-132R(1) and 10-132R(2). The net position can be reduced for new issues/tranches, using the discount percentages for the issuing market method (IPRU(INV) 10-133R(5)).

After “working day five”, the full market value of the remaining underwriting “stick” should be reported when taken in aggregation with other exposures to the counterparty/group.

(3) A counterparty

A counterparty is an individual, a legal entity, partnership/sole trader, or some other party to which the member firm is directly or indirectly exposed. Large exposures to the following types of counterparties should be reported as follows:–

A counterparty dealing as agent

Firms should treat the exposure as an exposure to the counterparty with whom it has contracted. This will mean the disclosed underlying clients where possible. If there are no disclosed underlying clients, then the deal should be deemed as being with the agent.

Connected parties

A pension fund or other trust fund of the group should not be classified as connected for the purposes of this return. Those counterparties which merge during the reporting period, should be included as connected counterparties from the date the offer goes unconditional. In such cases the *exposure* to these individual counterparties should be aggregated and considered as a single *exposure* to a group of closely related counterparties. *Exposures* to a number of public sector bodies, or local authorities are deemed not to constitute a single *exposure* to a group of connected counterparties. Where consolidated quarterly reporting on a sub-group basis has been requested, then all group *exposures* outside the sub-group should be included in Part 2.

Multilateral Development Banks

Multilateral development banks, as defined in IPRU(INV) 10 App 1, should be reported in Part 3(i) and 3(ii) of the return for those firms using Form LEM 2.

Parental or third party guarantees

The exposure should be recorded against the end counterparty, without any deduction for the amount provided for by the guarantor. The amount of guarantee utilised/drawn at the reporting date should be noted and recorded in column (i) of the return. The highest exposure to the "guarantor" during the reporting period should be included within column "g" of the return, and disclosed by way of memorandum below the details of the other exposure to the guarantor. Guarantees granted by firms should be disclosed separately. The disclosure should be in the standard format required under **Part 2** of Form LEM 2. Utilisation at the reporting date should show the exposure to the firm if the guarantee were to be drawn, in order to cover the value of guaranteed reportable exposure at the close of business.

Credit institutions/Investment firms/ Third Country Investment Firm/ Clearing Houses and Exchanges

Definitions are provided in the Handbook Glossary, with the exception of Exchanges which is defined in 9 App 1.

(4) Identity of counterparty

The identity of a counterparty will generally be the customer named in a contract note. Where an agent identifies the underlying client, then the underlying client is the counterparty. In the case of a security held, the exposure should be against the issuer. In an equity derivative transaction, the underlying security should be included as exposure to the issuer, and the firm should record counterparty exposure against the relevant counterparty to the transaction.

Exposures guaranteed by a parent or third party should be recorded as exposure to the original counterparty, with the amount of exposure guaranteed by the guarantor recorded in column "i". The overall utilisation of the guarantee should be recorded against the guarantor, with a memorandum indicating the amount of the guarantee included within the overall exposure.

II THE REPORTING FORM (LEM)- GENERAL, COVERAGE AND LAYOUT.

GENERAL

Forms LEM 1 or LEM 2 should be completed both on a solo and, where relevant a consolidated basis:

(a) Those firms who have been granted a waiver from consolidation (IPRU(INV) 10-204R) and hold a group wide ACMP (IPRU(INV) 10-196R), are exempt from reporting large exposures on a consolidated basis.

(b) Nil returns are required to be submitted.

(c) LEM 2 Forms are required to be submitted in line with SUP 16.7.25R and SUP 16.7.27R.

(d) Details of counterparty risk netting with counterparty groups during any part of the quarter, should be indicated by way of (*) against the counterparty group recorded in column “a” of Forms LEM 1 or 2.

Coverage and Layout of Forms LEM 1 and 2
All counterparties which have had a large exposure during the quarter should report that exposure. Firms should make further copies of the enclosed forms where required.

Large exposures should be reported in the same currency and format that the FSA requires for all other regulatory reporting.

Large exposures to individual counterparties and counterparty groups should be reported, in each category of counterparty, ranked in descending order using the “highest exposure during the reporting period”.

Details of own funds/financial resources as at the reporting date should be reported on the front cover of Forms LEM 1 and LEM 2.

Large exposures as at the reporting date (see Form LEM 2, columns “d”,“e”, and “f”), should be reported, and split between trading book and non trading book exposure.

An exposure which is not a large exposure as at the reporting date, but where there has been a large exposure since the previous reporting date should also be reported.

Any specific bad debt provisions raised but not yet passed through the accounting records should be indicated in column “b”. Any non performing assets held where no specific provision has been raised should also be recorded here.

A memorandum showing the breakdown of material holdings in credit institutions/investment firms at the reporting date should be reported in the space provided on Form LEM 2. Any exposures which have been deducted from own funds and detailed in the Material Holdings in Credit and Financial Institutions will not appear in any further part of the quarterly return.

There may be circumstances where it is possible to record the exposure more than once. When in doubt, the firm should either report the exposure twice as an exposure to each counterparty, or seek guidance from the FSA.

PART 1

Large exposures to Corporates (individual non-credit institutions/non investment firms and groups of closely related non-credit institutions/investment firms)

Part 1 of Form LEM 2 - exposures to Corporates, which include all counterparties which do not fall within **Parts 2, 3**, or **4** of Form LEM 2;

Exposures to individual counterparties which constitute a group of connected third parties should be reported as one exposure.

Exposures to individual non-credit institution/investment firm counterparties and groups of closely related counterparties which are connected to the firm should be reported in **Part 2**.

Exposures to a local authority, state or public sector body about which the FSA has given guidance stating that it may be considered as an exposure to a central government, should be reported in **Part 4.**

PART 2

Exposures to individual group members of closely related counterparties connected to the reporting firm

Part 2 of Form LEM 2 - exposures to each individual legal entity within the firm's group which constitute a large exposure. Any legal entity which comes within the firm's world-wide group, should be reported here, rather than Part 3(i) or 3(ii) of the return.

When completing a consolidated version of Form LEM 2, only exposures to group members outside the scope of the group for FSA consolidation need to be reported.

For those firms required to complete a full group consolidated quarterly return, this part of the return will be nil. Those firms subject to sub-consolidation, as advised by the FSA, will be required to include connected exposure falling outside the "advised" consolidated group.(This is likely to be connected companies falling outside the EEA).

PART 3(i)

Large exposures to credit institutions/investment firms/ third country investment firms/ clearing houses and exchanges

References to "investment firms" hereafter are intended to include credit institutions, third country investment firms, clearing houses and exchanges recognised for the purposes of IPRU(INV) 10.

Exposures to groups of closely related investment firms should be recorded by legal entity basis within **Part 2** of LEM 2. An aggregation of the exposure to the group falling within this sector should be provided,(though it should not include capital instruments) deducted in calculating own funds. A breakdown of those material holdings deducted from own funds must be provided within the Material Holdings in Credit and Financial Institutions section of your return.

Exposures to exchanges should be reported as a separate entity, rather than splitting the exposure to the “owners” of the exchange, unless one owner either has a majority holding or management control.

Where a counterparty group contains a legal entity to which the firm has exposure, and this legal entity would be classified as an “Investment Firm”, then all exposure to that counterparty group should be reported within **Part 3(i)/3(ii)**. All exposure to entities which fall within the title for inclusion in **Part 3**, should fall within **Part 3(i)**, and any part of that total large exposure over 1 year, which taken in aggregate, and is equal to being classified as a large exposure, should be reported in **Part 3(ii)**.

A list of clearing houses/ exchanges recognised for these purposes can be found in, IPRU(INV) 10 App 57.

PART 3(ii)

Large exposures appearing in **Part 3(ii)**, should also be included in **Part 3(i)**. This will provide a breakdown of all medium to long term exposure - this is defined as exposure of one year and over (including a further breakdown of derivatives over 1 year).

Most issuer risk to counterparties falling within **Part 3** of LEM 2, unless there is less than 1 year to redemption, will fall within this section. An exposure with optional redemption dates for exercise should be classified in accordance with the latest redemption/maturity date.

Derivative exposure which falls within this category, should be shown separately from the total exposure over 1 year, by way of memorandum,[ie a second entry below the individual total large exposure for the counterparty group].

PART 4

Large Exposures **to Zone B central governments and central banks**

List the highest large exposures which have occurred during the quarter to each Zone B counterparty group. Exposures to European Communities, and institutions which would fall under a formal guarantee issued by the above, should not be included.

For the purposes of this form of this report, exposure to the European Union (EU)/EEC should be considered to be equivalent to Zone A governments and not reportable for LEM.

General

The reporting forms only differ in the amount of data that needs to be completed. The standard form (LEM 1) only requires columns “a”,“f” and “g” to be completed.

Form LEM 1

There is no segregation between the type of counterparty within the standard form LEM 1. Exposures should simply be listed using the highest exposure during the quarter, in descending order.
See **Appendix 1** and **2** for copies of the quarterly reports (LEM 1 & 2). The column references referred to below are cross referenced accordingly.

Form LEM 2

Column reference

(a) This will be the counterparty, or where relevant the counterparty group - the exception to this is **Part 3i** and **3ii**, where a breakdown by legal entity to which the reporting firm has exposure is required.

##(b) This is any specific bad debt raised, which has already been deducted from own funds. This should also include any non-performing assets, where it is reasonable to determine that the counterparty to the transaction is outside the parameters set for the specific transaction, or the market norm. This is not aimed at failed trades, but at aged debt repayments which are unlikely to be repaid and for which no specific provision has been raised.

##(c) This should include any acceptable or adequate collateral at the reporting date which has not already been used to reduce an exposure [trading or non trading] at the reporting date. With regard repos/reverse repos and other similar instruments dealt with under IPRU(INV) 10-173R, adequate collateral may be included where appropriate.

Items that should be recorded here would be any *exposures* not exempted or discussed above, where acceptable/adequate collateral has been lodged, which could cover a number of transactions. Partial coverage by acceptable/adequate collateral is permissible.

##(d) “R”- non-trading book exposure as at the reporting date.

##(e) “S”- trading book exposure at the reporting date.

(f) “T”- is the aggregate of “R” and “S” for each respective counterparty or group of counterparties.

(g) This should be the highest large exposure that occurred during the reporting period.

If a limits based approach is used, then the aggregate of the limits marked, plus any excesses, will be the highest large exposure during the reporting period.

##(h) The figure in “g” as a percentage of financial resources, at the date the highest large exposure occurred.

##(i) This should record the amount of exposure guaranteed by a parent/third party.

The aggregate amount of guaranteed exposure by each guarantor should be recorded by the firm within the total exposure to the guarantor. A memorandum line beneath each guarantor, should break out the size of the guaranteed exposure from the total [guarantee + other reportable exposure] to the guarantor.