Chapter 9

Financial resources requirements for an exempt CAD firm

9.3 CALCULATING INITIAL CAPITAL

Initial capital

9.3.1 R A *firm's initial capital* consists of the sum of the following items:

(1) ordinary *share* capital which is fully paid;

(2) perpetual non-cumulative *preference share* capital which is fully paid;

(3) *share* premium account;

(4) reserves excluding revaluation reserves;

(5) audited retained earnings;

(6) externally *verified* interim net profits;

(7) partners' capital;

(8) *eligible LLP members' capital* (in accordance with the provisions of IPRU-INV Annex A); and

(9) *sole trader* capital.

Perpetual noncumulative preference share capital

9.3.2 R A *firm* may include *preference share* capital in *initial capital* only where any *coupon* on it is not cumulative, and the *firm* is under no obligation to pay a *coupon* in any circumstances.

Audited retained earnings

9.3.3 R When calculating *initial capital*, a *firm* may include its audited retained earnings only after making the following adjustments:

(1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;

(2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;

(3) a *firm* must not include any unrealised gains from investment property (these should be reported as part of revaluation reserves);

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

Externally verified interim net profits or current account

9.3.4 R A *firm* may include interim net profits or current account when calculating *initial capital* to the extent that they have been *verified* by the *firm's* external auditor and are net of any foreseeable tax, dividend and other appropriations.

9.3.5 R When calculating *initial capital*, a *firm* may includes its partners' capital only after making the following adjustments:

(1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;

(2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;

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

Defined benefit pension scheme: defined benefit liability

9.3.6 R For the calculation of *initial capital*, a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

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